FORTRESS ENERGY INC.

Management's Discussion and Analysis

For the year ended December 31, 2011

HIGHLIGHTS

Financial				
Operations				

MANAGEMENT'S DISCUSSION AND ANALYSIS

ADVISORIES

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Forward-Looking Information

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Non-IFRS Measures

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Natural Gas, Crude Oil and Natural Gas Liquids ("NGL") Conversions

[illegible]

Description of the Business

[illegible]

CORPORATE HIGHLIGHTS

[illegible]

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2011 FINANCIAL RESULTS

Production

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Revenue

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Royalties

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Commodity Contracts

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Operating Expenses

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Transportation Expenses

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Impairment of Exploration and Evaluation Assets

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Depletion, Depreciation and Amortization Expense

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General and Administrative Expenses

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Finance Expenses

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Other Expenses

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Net Loss

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Funds from Operations

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Liquidity and Capital Resources

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Capital Expenditures

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Commitments and Contingencies

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Subsequent Events

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Indemnification of Flow-Through Share Subscribers

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Financial Risk Management

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Off-Balance Sheet Arrangements

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Outstanding Securities

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SELECTED QUARTERLY INFORMATION

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CRITICAL ACCOUNTING ESTIMATES

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New Accounting Standards and Interpretations Not Yet Adopted

[illegible] *Financial Instruments* [illegible]

[illegible] *Consolidated Financial Statements* [illegible]

[illegible] *Joint Arrangements* [illegible]

[illegible] *Disclosure of Interests in Other Entities* [illegible]

[illegible] *Fair Value Measurement* [illegible]

[illegible] *Presentation of Items of Other Comprehensive Income* [illegible] *Presentation of Financial Statements* [illegible]

[illegible] *Separate Financial Statements* [illegible]

[illegible] *Investment in Associations and Joint Ventures* [illegible]

[illegible]

RISK FACTORS

Going Concern Issues

[illegible]

Delisting

[illegible]

Substantial Capital Requirements

[illegible]

Volatility of Oil and Natural Gas Prices

[illegible]

Capital Markets

[illegible]

[illegible]

[illegible]

Need to Replace Reserves

[illegible]

Acquisition Risks

[illegible]

Failure to Realize Anticipated Benefits of Acquisition

[illegible]

Operating Hazards and Other Uncertainties

[illegible]

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TRANSITION TO IFRS

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CORPORATE INFORMATION

Head Office

Auditors

Bankers

Legal Counsel

Reserve Engineers

Transfer Agent

Abbreviations

Board of Directors

Officers

Corporate Manager

FORTRESS

ENERGY

The accompanying consolidated financial statements are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS"") as issued by the International Accounting Standards Board ("IASB"). Financial statements are not precise since they include certain amounts based upon estimates and judgments. When alternative accounting methods exist, management has chosen those it deems to be the most appropriate to ensure fair and consistent presentation. The financial information presented elsewhere in this financial report is consistent with that in the consolidated financial statements.

Management maintains financial and operating systems that include appropriate and effective internal controls. These systems are designed to provide reasonable assurance that the financial information is reliable and relevant, and the Company's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board of Directors carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board of Directors and reviews the financial statements and Management's Discussion and Analysis; assesses the adequacy of the internal controls of the Company; considers the report of the external auditors; examines the fees and expenses for audit services; and recommends to the Board of Directors the independent auditors for appointment by the shareholders. The Audit Committee reports its findings to the Board of Directors for consideration when approving the annual financial statements for issuance to the shareholders.

KPMG LLP, an independent firm of Chartered Accountants, has been engaged, as approved by a vote of the shareholders at the Company's Annual General Meeting, to audit and provide their independent audit opinion on the Company's consolidated financial statements as at and for the year ended December 31, 2011. Their report, contained herein, outlines the nature of their audit and expresses their opinion on the consolidated financial statements.

(signed)
J. Cameron Bailey
President & CEO
Fortress Energy Inc.

(signed)
Jamie Jeffs, C.A.
Chief Financial Officer
Fortress Energy Inc.

Calgary, Canada

April 20, 2012

KPMG LLP
Chartered Accountants
2700 205 - 5th Avenue SW
Calgary AB T2P 4B9

Telephone (403) 691-8000
Telefax (403) 691-8008
Internet www.kpmg.ca

To the Shareholders of Fortress Energy Inc.

We have audited the accompanying consolidated financial statements of Fortress Energy Inc. (the "Company") which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Fortress Energy Inc. as at December 31, 2011, December 31, 2010 and January 1, 2010, and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.
KPMG Canada provides services to KPMG LLP.

Emphasis of Matter – Going Concern

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which indicates that the Company has a history of operating losses and as at December 31, 2011 has a working capital deficiency of $1,383,000. These conditions, along with the other matters explained in Note 2 to the financial statements, indicate the existence of a material uncertainty that may cast significant doubt about Fortress Energy Inc.'s ability to continue as a going concern.

(signed)

"KPMG LLP"

Chartered Accountants
April 20, 2012

Calgary, Canada

(in thousands of Canadian dollars)

	Note	December 31, 2011	December 31, 2010	January 1, 2010
			(note 20)	(note 20)
Cash and cash equivalents		$ 1,008	$ 2,433	$ 64
Trade and other receivables		357	1,750	5,576
Prepaid expenses and deposits		284	338	470
Marketable securities	10	850	4,544	-
Commodity contracts		-	-	1,321
		2,499	9,065	7,431
Exploration and evaluation assets	11	1,000	1,000	3,900
Property, plant and equipment, net	12	3,519	3,418	61,319
		4,519	4,418	65,219
		$ 7,018	$ 13,483	$ 72,650
Bank loans		$ -	$ -	$ 23,044
Trade and other payables		1,069	1,914	8,182
Indemnification of flow-through share subscribers payable	13	2,587	1,656	-
Income taxes payable		226	164	164
		3,882	3,734	31,390
Decommissioning liabilities	14	1,741	1,250	5,686
		5,623	4,984	37,076
Share capital	15	139,447	139,447	139,447
Warrants	15	-	5,406	5,406
Contributed surplus	15	21,659	16,253	15,694
Accumulated losses		(159,711)	(152,607)	(124,973)
		1,395	8,499	35,574
		$ 7,018	$ 13,483	$ 72,650

The notes are an integral part of these consolidated financial statements.

Approved by the Board

(signed)
J. Cameron Bailey
Director

(signed)
George Watson
Director

For the year ended December 31, 2011, with comparative figures for 2010
(in thousands of Canadian dollars, except per share amounts)

	Note	2011	2010
Natural gas sales		$ 855	$ 11,387
Royalties		(82)	(473)
Gain on commodity contracts		-	3,948
		773	14,862
Operating		289	5,924
Transportation		199	987
Impairment of exploration and evaluation assets	11	74	2,404
Depletion, depreciation and amortization	12	838	26,123
General and administrative		2,513	4,850
Finance expenses	6	3,166	1,780
Other expenses	7	564	784
		7,643	42,852
Loss before income tax		(6,870)	(27,990)
Income tax expense (reduction):			
Current	9	234	106
Deferred	9	-	(462)
		$ 234	(356)
Net loss and comprehensive loss		$ (7,104)	$ (27,634)
Net loss per share			
Basic	15	$ (0.13)	$ (0.50)
Diluted	15	$ (0.13)	$ (0.50)

The notes are an integral part of these consolidated financial statements.

(in thousands of Canadian dollars)

	Note	Share capital	Warrants	Contributed surplus	Accumulated losses	Total shareholders' equity
Balance at January 1, 2010	15	$139,447	$5,406	$15,694	$(124,973)	$ 35,574
Share-based compensation		-	-	559	-	559
Net loss for the year		-	-	-	(27,634)	(27,634)
Balance at December 31, 2010		$139,447	$5,406	$16,253	$(152,607)	$ 8,499
Balance at January 1, 2011		$139,447	$5,406	$16,253	$(152,607)	$ 8,499
Net loss for the year		-	-	-	(7,104)	(7,104)
Expiry of warrants		-	(5,406)	5,406	-	-
Balance at December 31, 2011		$139,447	$ -	$21,659	$(159,711)	$ 1,395

The notes are an integral part of these consolidated financial statements.

For the year ended December 31, 2011, with comparative figures for 2010
(in thousands of Canadian dollars)

	Note	2011	2010
Net loss		$ (7,104)	$ (27,634)
Unrealized loss on commodity contracts		-	1,321
Impairment of exploration and evaluation assets		74	2,404
Depletion, depreciation and amortization		838	26,123
Share-based compensation		-	522
Finance expenses		3,166	1,780
Gain on sale of oil and gas assets		-	(530)
Deferred income taxes		-	(462)
Interest		(402)	(1,318)
Change in non-cash working capital	17	545	(650)
Net cash from (used in) operating activities		(2,883)	1,556
Exploration and evaluation expenditures		(64)	(63)
Property, plant and equipment expenditures		(500)	(1,684)
Property divestitures		-	25,146
Proceeds on sale of marketable securities		972	-
Change in non-cash working capital	17	161	(856)
Net cash from investing activities		569	22,543
Repayment of bank loans		-	(23,044)
Change in non-cash working capital	17	889	1,314
Net cash from (used in) financing activities		889	(21,730)
Change in cash and cash equivalents		(1,425)	2,369
Cash and cash equivalents at beginning of year		2,433	64
Cash and cash equivalents at end of year		$ 1,008	$ 2,433

The notes are an integral part of these consolidated financial statements.

Fortress Energy Inc. ("Fortress" or the "Company") was incorporated on January 15, 2007 under the Business Corporations Act (Alberta). Fortress is a Calgary-based junior oil and natural gas exploration and development company operating in the Western Canadian Sedimentary Basin ("WCSB"), which comprises a single operating segment.

The consolidated financial statements of the Company as at and for the year ended December 31, 2011 comprise the Company and its wholly-owned subsidiary. The Company conducts many of its activities jointly with others; these financial statements reflect only the Company's proportionate interest in such activities.

(a) Going concern uncertainty:

The Company's consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has experienced consecutive losses and has accumulated losses of $159,711,000 to December 31, 2011.

As at December 31, 2011, the Company has cash on hand of $1,008,000 and 1,574,244 common shares of a publicly listed entity with a carrying value of $850,000. The Company sold a portion of its shares in this publicly listed entity in 2011 and subsequently sold the remaining shares to allow it to continue to operate and to provide the initial US$1,000,000 deposit to secure the acquisition of a Brazilian oil and gas company (note 19). The Company is currently negotiating an equity financing to fund the remainder of the purchase price of this acquisition. The Company expects that the closing of this acquisition and financing will allow the Company to continue to operate for the foreseeable future.

The Company requires additional working capital to fund operations until the acquisition is complete. The Company has issued $245,000 of principal amount of convertible debentures in the first tranche of an interim financing for the required capital and is anticipating to raise a total of $1,500,000.

There is significant uncertainty regarding the Company's ability to continue as a going concern, which is dependent upon achieving on-going cash flow from operating activities and receiving additional support from its creditors and investors.

The Company is experiencing negative cash flow from operating activities. There is no certainty as to when the Company will have positive cash flow. The Company is solely dependent upon outside sources and third party financings to obtain the necessary capital to fund operations until the acquisition closes as well as to complete the acquisition and fund a proposed drilling program on the acquired oil and gas assets and to explore and develop its properties and the Brazilian properties or acquire further properties or pursue other business opportunities or restructure the Company and continue as a going concern. If the Company is unable to secure sufficient financing, delays or postponement of future business opportunities or development or production of the Company's properties will result. There can be no assurance that the additional capital required or other types of financing will be available if needed or even if available, the terms of such financing will be acceptable to the Company. Therefore, failure to obtain suitable financing would, in all likelihood, lead to the liquidation of the Company's assets. There is no assurance that even if the acquisition is completed the Company will be successful in developing the acquired properties. In the event the Company cannot develop its properties at will, in all likelihood, this will lead to a liquidation of the Company's assets.

The financial statements for the year ended December 31, 2011 do not contain any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

(b) CCAA proceedings:

On March 2, 2011, Fortress applied to the Court of Queen's Bench of Alberta for an Order under the Companies' Creditors Arrangement Act (Canada)("CCAA") staying all claims and actions against the Company and its assets. Fortress had taken this action to enable it to challenge a reassessment issued by the Canada Revenue Agency ("CRA") which reassessment was in the amount of $18,000,000. In addition, the Company received provincial reassessments of approximately $6,200,000 as a result of the CRA reassessments.

(b) CCAA proceedings (continued):

On October 26, 2011, the Company received revised notices of reassessment from the CRA indicating that CRA was vacating its claim, reversing the previous assessments resulting in no federal income taxes or penalties payable. The Company later received revised provincial reassessments indicating that its previous reassessments were also being vacated. As a result, Fortress no longer requires the protection of the Order under the CCAA and on October 28, 2011, the Company applied to the Court of Queen's Bench of Alberta to discharge the Company from the CCAA proceedings.

(c) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). A summary of significant accounting policies and methods of computation is presented in note 3. The Company's accounting policies have been applied retrospectively and consistently to all years presented with the exception of certain IFRS 1, *First-time Adoption of International Financial Reporting Standards* ("IFRS 1"), transition elections and exemptions the Company applied in its transition from Canadian generally accepted accounting principles ("previous GAAP") to IFRS as discussed in note 20. The impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's previous GAAP consolidated financial statements for the year ended December 31, 2010 is included in note 20.

After applying the transition exemptions of IFRS 1, these consolidated financial statements have been prepared on a historical cost basis, except as detailed in the Company's accounting policies disclosed in note 3.

These consolidated financial statements were authorized for issuance by the Board of Directors on April 20, 2011.

(d) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

(e) Use of estimates and judgments:

The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and income and expenses. Accordingly, actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Significant estimates and judgments made by management in the preparation of these financial statements are outlined below.

Critical judgments in applying accounting policies:

The following are the critical judgments, apart from those involving estimations (see below), that management has made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in these interim condensed financial statements:

(i) Reserves

Estimation of reported recoverable quantities of proved and probable reserves include judgmental assumptions regarding production profile, commodity prices, exchange rates, remediation costs, timing and amount of future development costs, and production, transportation and marketing costs for future cash flows. It also requires interpretation of geological and geophysical models in anticipated recoveries.

(e) Use of estimates and judgments (continued):

(i) Reserves (continued)

The economical, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact the carrying values of the Company's petroleum and natural gas properties and equipment, the calculation of depletion and depreciation, the provision for decommissioning liabilities, and the recognition of deferred tax assets due to changes in expected future cash flows. The recoverable quantities of reserves and estimated cash flows from the Company's petroleum and natural gas interests are independently evaluated by reserve engineers at least annually.

The Company's petroleum and natural gas reserves represent the estimated quantities of petroleum, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be economically recoverable in future years from known reservoirs and which are considered commercially producible. Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon (i) a reasonable assessment of the future economics of such production; (ii) a reasonable expectation that there is a market for all or substantially all the expected petroleum and natural gas production; and (iii) evidence that the necessary production, transmission and transportation facilities are available or can be made available. Reserves may only be considered proven and probable if producibility is supported by either production or conclusive formation tests. The Company's petroleum and natural gas reserves are determined pursuant to National Instrument 51-101, *Standard of Disclosures for Oil and Gas Activities*.

(ii) Identification of cash-generating units

Fortress' assets are aggregated into cash-generating units, for the purpose of calculating impairment, based on their ability to generate largely independent cash flows. By their nature, these estimates and assumptions are subject to measurement uncertainty and may impact the carrying value of the Company's assets in future periods.

(iii) Share-based payments

All equity-settled, share-based awards issued by the Company are recorded at fair value using the Black-Scholes option-pricing model. In assessing the fair value of equity-based compensation, estimates have to be made regarding the expected volatility in share price, option life, dividend yield, risk-free rate and estimated forfeitures at the initial grant date.

Key sources of estimation uncertainty:

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

(i) Decommissioning liabilities

The Company estimates future remediation costs of production facilities, wells and pipelines at different stages of development and construction of assets or facilities. In most instances, removal of assets occurs many years into the future. This requires judgment regarding abandonment date, future environmental and regulatory legislation, the extent of reclamation activities, the engineering methodology for estimating cost, future removal technologies in determining the removal cost and liability-specific discount rates to determine the present value of these cash flows.

(e) Use of estimates and judgments (continued):

(ii) Impairment of petroleum and natural gas assets

For the purposes of determining whether impairment of petroleum and natural gas assets has occurred, and the extent of any impairment or its reversal, the key assumptions the Company uses in estimating future cash flows are future petroleum and natural gas prices, expected production volumes and anticipated recoverable quantities of proved and probable reserves. These assumptions are subject to change as new information becomes available. Changes in economic conditions can also affect the rate used to discount future cash flow estimates. Changes in the aforementioned assumptions could affect the carrying amounts of assets, and impairment charges and reversal will affect profit or loss.

(iii) Income taxes

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in profit or loss both in the period of change, which would include any impact on cumulative provisions, and in future periods. Deferred tax assets are recognized only to the extent it is considered probable that those assets will be recoverable. This involves an assessment of when those deferred tax assets are likely to reverse and a judgment as to whether or not there will be sufficient taxable profits available to offset the tax assets when they do reverse. This requires assumptions regarding future profitability and is therefore inherently uncertain. To the extent assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in respect of deferred tax assets as well as the amounts recognized in profit or loss in the period in which the change occurs.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

(a) Basis of consolidation:

(i) Subsidiaries:

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded 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 immediately in the statement of income.

(ii) Jointly controlled operations and jointly controlled assets:

Many of the Company's oil and natural gas activities involve jointly controlled assets. The consolidated financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

(iii) Transactions eliminated on consolidation:

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(b) Financial instruments:

(i) Non-derivative financial instruments:

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, marketable securities, bank loans, and trade and other payables. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition all non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash on hand, term deposits held with banks, other short-term highly liquid investments with original maturities of three months or less.

Other non-derivative financial instruments, such as trade and other receivables, bank loans, and trade and other payables, are measured at amortized cost using the effective interest method, less any impairment losses.

Marketable securities are recorded at fair value through profit and loss.

(ii) Derivative financial instruments:

The Company enters into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the balance sheet at fair value. Transaction costs are recognized in profit or loss when incurred.

(iii) Share capital:

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

(c) Property, plant and equipment and exploration and evaluation assets:

(i) Recognition and measurement.

Pre-licence costs are recognized in the consolidated statement of loss as incurred.

Exploration and evaluation expenditures:

Exploration and evaluation ("E&E") costs, including the costs of acquiring licences and directly attributable general and administrative costs, initially are capitalized as either tangible or intangible E&E assets according to the nature of the assets acquired. The costs are accumulated in cost centres by well, field or exploration area pending determination of technical feasibility and commercial viability.

E&E assets are assessed for impairment if: (i) sufficient data exists to determine technical feasibility and commercial viability; and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, E&E assets are allocated to a cash generating unit ("CGU").

The technical feasibility and commercial viability of extracting a mineral resource is generally considered to be determinable when proven reserves are determined to exist. A review of each exploration licence or field is carried out, at least annually, to ascertain whether proven reserves have been discovered. Upon determination of technical feasibility and commercial viability, intangible E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to a separate category within tangible assets referred to as oil and natural gas interests.

Development and production costs:

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into CGU's for impairment testing. The Company has only one CGU for development and production assets being its Buick Creek property. When significant parts of an item of property, plant and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized net within "other income" or "other expenses" in profit or loss.

(ii) 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 interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

(c) Property, plant and equipment and exploration and evaluation assets (continued):

(iii) Depletion and depreciation:

The net carrying value of development or production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable and a 50 percent statistical probability that it will be less. The equivalent statistical probabilities for the proven component of proven and probable reserves are 90 percent and 10 percent, respectively.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered proven and probable if producibility is supported by either actual production or a conclusive formation test. The area of reservoir considered proven includes (a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, or both, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geophysical, geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of oil and natural gas controls the lower proved limit of the reservoir.

Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are only included in the proven and probable classification when successful testing by a pilot project, the operation of an installed program in the reservoir, or other reasonable evidence (such as, experience of the same techniques on similar reservoirs or reservoir simulation studies) provides support for the engineering analysis on which the project or program was based.

The estimated useful lives for certain production assets for the current and comparative periods are as follows:

Gas processing plant and pipelines	Unit of production
Turnaround costs	1 year

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment.

(c) Property, plant and equipment and exploration and evaluation assets (continued):

(iii) Depletion and depreciation (continued):

The estimated useful lives for other assets for the current and comparative periods are as follows:

Office equipment, furniture and fixtures	5 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(d) Leased assets:

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Company's statement of financial position.

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(e) 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 objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows 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.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss.

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 profit or loss.

(e) Impairment (continued):

(ii) Non-financial assets:

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and other intangible assets that have indefinite lives or that are not yet available for use an impairment test is completed each year. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to the CGU's or groups of CGU's that are expected to benefit from the synergies of the combination. E&E assets are allocated to related CGU's or groups of CGU's when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (oil and natural gas interests in property, plant and equipment).

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (Company of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

(f) Share-based payments:

The grant date fair value of options granted to employees is recognized as compensation expense, within general and administrative expenses, with a corresponding increase in contributed surplus over the vesting period.

(g) Provisions:

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

(h) Decommissioning liabilities:

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

Decommissioning liabilities are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning liabilities are charged against the provision to the extent the provision was established.

(i) Revenue:

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time product enters the pipeline.

(j) Finance expenses:

Finance expense comprises interest expense on borrowings, interest on unspent flow-through share obligations, accretion of the discount on provisions, impairment losses recognized on financial assets, and corporate acquisition costs. Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Company's outstanding borrowings during the period.

(k) Income tax:

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. 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. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference 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.

(l) Earnings per share:

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

(m) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. On issuance the premium received on flow-through shares being the difference in price over a common share with no tax attributes, is recognized on the statement of financial position. As expenditures are incurred the deferred tax liability associated with the renounced tax deductions are recognized through profit or loss along with a pro-rata portion of the deferred premium.

(n) New standards and interpretations not yet adopted:

IFRS 9 *Financial Instruments* – in November 2009, the IASB issued IFRS 9 to address classification and measurement of financial assets. In October 2010, the IASB revised the standard to include financial liabilities. The standard is required to be adopted for periods beginning January 1, 2015. Portions of the standard remain in development and the full impact of the standard will not be known until the project is complete.

IFRS 10 *Consolidated Financial Statements* – in May 2011, the IASB issued IFRS 10 which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees, including special purpose entities. The standard is required to be adopted for periods beginning January 1, 2013.

IFRS 11 *Joint Arrangements* – in May 2011, the IASB issued IFRS 11 which presents a new model for determining whether an entity should account for joint arrangements using proportionate consolidation or the equity method. An entity will have to follow the substance rather than legal form of a joint arrangement and will no longer have a choice of accounting method. The standard is required to be adopted for periods beginning January 1, 2013.

IFRS 12 *Disclosure of Interests in Other Entities* – in May 2011, the IASB issued IFRS 12 which aggregates and amends disclosure requirements included within other standards. The standard requires a company to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard is required to be adopted for periods beginning January 1, 2013.

IFRS 13 *Fair Value Measurement* – in May 2011, the IASB issued IFRS 13 to provide comprehensive guidance for instances where IFRS requires fair value to be used. The standard provides guidance on determining fair value and requires disclosures about those measurements. The standard is required to be adopted for periods beginning January 1, 2013.

IAS 1 *Presentation of Items of Other Comprehensive Income* – in June 2011, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* to split items of other comprehensive income (OCI) between those that are reclassed to income and those that do not. The standard is required to be adopted for periods beginning on or after July 1, 2012.

IAS 27 *Separate Financial Statements* – the IASB issued amendments to IAS 27 to coincide with changes made to IFRS 10, but retains the current guidance for separate financial statements.

IAS 28 *Investment in Associations and Joint Ventures* – the IASB issued amendments to IAS 28 to coincide with changes made to IFRS 10 and IFRS 11, but retains the current guidance for separate financial statements.

The Company is currently analyzing the impact, if any, that the adoption of these standards will have on its consolidated financial statements.

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(i) Property, plant and equipment and exploration and evaluation assets:

The fair value of property, plant and equipment recognized in a business combination or used in impairment tests, is based on market values. The market value of property, plant and equipment is the estimated amount for which property, plant and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in property, plant and equipment) is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

The market value of exploration and evaluation assets and other items of property, plant and equipment is based on the quoted market prices for similar items.

(ii) Cash and cash equivalents, trade and other receivables, and trade and other payables:

The fair value of cash and cash equivalents, trade and other receivables, and trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2011, the fair value of these balances approximated their carrying value due to their short term to maturity.

(iii) Share options:

The fair value of employee share options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). There were no stock options outstanding at December 31, 2011 (or 2010).

(iv) Marketable securities:

The fair value of marketable securities is based on unadjusted quoted market prices (level 1 fair values).

(a) Overview:

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as:

- credit risk;
- liquidity risk; and
- market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors oversees managements' establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and oil and natural gas marketers. All of the Company's operations are conducted in Canada. The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

Credit risk is primarily related to the Company's receivables from joint venture partners and petroleum and natural gas marketers and the risk of financial loss if a customer, partner or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable is with partners in the energy industry and is subject to normal industry credit risk. The Company generally grants unsecured credit but routinely assesses the financial strength of its partners.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company sells the majority of its production to a single petroleum and natural gas marketer and, therefore, is subject to concentration risk which is mitigated by management's policies and practices related to credit risk, as discussed above. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs, the risk of unsuccessful drilling and occasional disagreements between parties. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure.

The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however in certain circumstances, it may cash call a partner in advance of the work. As well, the Company does have the ability, in most cases, to withhold production from joint venture partners in the event of non-payment.

The Company establishes an allowance for doubtful accounts as determined by management based on their assessment of collection and, therefore the carrying amount of accounts receivable generally represents the maximum credit exposure.

The maximum exposure to credit risk for trade and other receivables at December 31, 2011 and 2010 was $357,000 and $1,750,000, respectively.

(b) Credit risk (continued):

At December 31, 2011 and 2010, the Company's receivables consisted of:

	2011 $	2010 $
Natural gas marketing companies	88	59
Joint venture partners	147	1,511
Other	122	180
Total trade and other receivables	357	1,750

As at December 31, 2011 and 2010, the Company's trade and other receivables are aged as follows:

	2011 $	2010 $
Current (less than 90 days)	133	125
Past due (more than 90 days)	224	1,625
	357	1,750

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due (see note 2). The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non operated projects to further manage capital expenditure. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month. To facilitate the capital expenditure program, the Company relies on working capital and cash flows from operations (see note 2).

The contractual maturities of the Company's trade and other payables balance of $1,069,000 (2010 - $1,914,000) is less than 6 months.

(d) Market risk:

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

(d) Market risk (continued):

Currency risk

Prices for oil are determined in global markets and generally denominated in United States dollars. Natural gas prices obtained by the Company are influenced by both US and Canadian demand and the corresponding North American supply, and recently, by imports of liquefied natural gas. The exchange rate effect cannot be quantified but generally an increase in the value of the $CDN as compared to the $US will reduce the prices received by the Company for its petroleum and natural gas sales.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company has no outstanding loans or borrowings at December 31, 2011 and 2010 and, accordingly, is not subject to interest rate risk.

Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar and also world economic events that dictate the levels of supply and demand.

The Company does not enter into commodity contracts other than to meet the Company's expected sale requirements. There are no commodity contracts outstanding at December 31, 2011 (2010 – nil).

(e) Capital management:

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying oil and natural gas assets. The Company considers its capital structure to include shareholders' equity and working capital. In order to maintain or adjust the capital structure, the Company may issue shares and adjust its capital spending to manage current and projected debt levels.

The Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

To assess capital and operating efficiency and financial strength, the Company continually monitors its working capital (deficiency) which is a non-IFRS measure and is calculated as follows:

	2011 $	2010 $
Current assets	2,499	9,065
Current liabilities	(3,882)	(3,734)
Working capital (deficiency)	(1,383)	5,331

	2011 $	2010 $
Unrealized loss on marketable securities	935	293
Realized loss on marketable securities	1,787	-
Interest on bank loans	-	976
Interest on unspent flow-through funds	384	341
Interest – other	18	1
Accretion of decommissioning liabilities	42	169
Finance expenses	3,166	1,780

	2011 $	2010 $
Gain on sale of oil and gas assets	-	(530)
Refund of gas cost allowance and custom processing credits	(325)	-
Indemnification of flow-through shareholders	889	1,314
Other expenses	564	784

The Company received a refund of $325,000 in 2011 for royalties that it had paid in prior periods related to oil and gas assets that it sold in August 2010. Specifically, this refund related to adjustments to gas cost allowance and custom processing credits that are used in the determination of Alberta crown royalties.

The aggregate payroll expense of employees and executive officers was as follows:

	2011 $	2010 $
Wages and salaries	372	875
Benefits and other personnel costs	27	158
Termination benefits	-	895
Share-based payments	-	586
Total employee remuneration	399	2,514
Capitalized portion of total remuneration	-	(292)
	399	2,222

The Company did not capitalize any personnel expenses in 2011 (2010 - $292,000).

In addition to their salaries, the Company also provides non-cash benefits to executive officers. Executive officers also participate in the Company's option program. Key management personnel compensation is comprise of the following:

	2011 $	2010 $
Wages and salaries	255	440
Benefits and other personnel costs	18	80
Termination benefits	-	600
Share-based payments (i)	-	405
	273	1,525

(i) Represents the amortization of share-based compensation associated with options and restricted stock units granted to executive officers as recorded in the consolidated financial statements.

(a) The provision for income taxes reflects an effective tax rate which differs from the Federal and Provincial statutory tax rates. The main differences are as follows:

	2011 $	2010 $
Loss before income tax	(6,870)	(27,990)
Combined federal and provincial income tax rate	26.5%	28.25%
Expected income tax reduction	(1,821)	(7,907)
Increase (decrease) in income taxes resulting from:		
Share-based compensation	-	148
Tax payable on prior year assessments, interest and penalties	234	106
Portion of capital losses not deductible	237	41
Indemnification of flow-through share subscribers	236	371
Reinstatement of resource pools	(466)	-
Rate adjustments and other	(75)	494
Unrecognized tax benefits	1,889	6,853
	234	106
Flow-through share premium	-	(462)
Income tax expense (reduction)	234	(356)

The current tax provision reflects reassessments of income taxes for prior years of acquired companies. The income tax rate change is due to a change in the statutory Federal and provincial income tax rates.

(b) Unrecognized deferred tax assets:

The components of the Company's unrecognized deferred tax assets are as follows:

	2011 $	2010 $
Property, plant and equipment	59,812	56,733
Marketable securities	1,228	293
Non-capital losses	5,167	2,235
Capital losses	1,001	107
Decommissioning liabilities	1,741	1,250
Share issue costs	789	1,560
Unrecognized deferred tax assets	69,738	62,178

The Company has not recognized these deferred tax assets because it is uncertain that future taxable profits will be available against which the Company can utilize these benefits due to the going concern uncertainty that exists at December 31, 2011 (note 2).

The following table summarizes the tax pools:

	2011 $	2010 $
Cumulative Canadian Exploration Expense	14,904	12,988
Cumulative Canadian Development Expense	22,077	21,578
Cumulative Canadian Oil and Gas Property Expense	34	384
Undepreciated Capital Costs	25,201	24,299
Share issue costs	789	1,560
Non-capital losses	5,167	2,235
Capital losses	1,001	107
Cumulative eligible capital	22	22
Total	69,195	63,173

Non-capital loss carry forwards of $5,167,000 (December 31, 2010 - $2,235,000) expire between 2026 and 2031.

(b) Unrecognized deferred tax assets (continued):

The following table provides a continuity of the unrecognized deferred tax asset:

	January 1, 2010 $	Recognized in profit or loss $	December 31, 2010 $
Property, plant and equipment	6,359	7,824	14,183
Commodity contracts	(373)	373	-
Marketable securities	-	73	73
Non-capital losses	635	(76)	559
Capital losses	26	1	27
Decommissioning liabilities	1,422	(1,109)	313
Share issue costs	623	(233)	390
Unrecognized deferred tax asset	(8,692)	(6,853)	(15,545)
Deferred tax asset	-	-	-

	January 1, 2011 $	Recognized in profit or loss $	December 31, 2011 $
Property, plant and equipment	14,183	770	14,953
Marketable securities	73	234	307
Non-capital losses	559	733	1,292
Capital losses	27	223	250
Decommissioning liabilities	313	122	435
Share issue costs	390	(193)	197
Unrecognized deferred tax asset	(15,545)	(1,889)	(17,434)
Deferred tax asset	-	-	-

Marketable securities reflect the Company's investment in 1,574,244 common shares of Terra Energy Corp. ("Terra") which had a quoted market value on December 31, 2011 of $850,000 or $0.54 per share. The Terra shares trade on the Toronto Stock Exchange ("TSX") under the symbol "TT".

During 2011, the Company sold 2,090,200 shares of Terra Energy at an average price of $0.46 per share for proceeds of $972,000. This resulted in a recognized loss on the sale of $1,787,000. The Company also recorded an unrecognized loss in 2011 reflecting the decrease in the quoted market value of the remaining shares of $935,000 (2010 - $293,000).

Subsequent to 2011, the Company sold the remaining shares of Terra Energy for $590,000, recognizing an additional loss of $260,000 in 2012.

	$
Cost:	
At January 1, 2010	3,900
Additions	62
Impairments	(2,404)
Divestitures	(583)
Change in decommissioning liabilities	25
Balance, December 31, 2010	1,000
Additions	64
Impairments	(74)
Change in decommissioning liabilities	10
Balance, December 31, 2011	1,000

Exploration and evaluation (E&E) assets consist of the Company's exploration projects which are pending the determination of proven or probable reserves. As at December 31, 2011, an amount of $1,000,000 (December 31, 2010 - $1,000,000) remains in exploration and evaluation assets.

The Company evaluated its exploration and evaluation CGU for impairment. As a result, the Company recorded an impairment loss of $74,000 on its E&E assets for the year ended December 31, 2011 due to declining natural gas prices. The amount of the impairment loss was determined using the fair value less costs to sell.

The Company recorded impairment losses of $2,404,000 in 2010 on exploration and evaluation assets. The Elmworth property was sold on August 31, 2010 and the sale price effectively determined the fair value less costs to sell for that property. The Company also recorded an impairment loss on its remaining exploration and evaluation asset based on its fair value less costs to sell resulting from declining natural gas prices.

	$
Cost:	
Balance, January 1, 2010	61,319
Additions	1,667
Divestitures	(33,366)
Change in decommissioning liabilities	(79)
Balance, December 31, 2010	29,541
Additions	500
Change in decommissioning liabilities	439
Balance, December 31, 2011	30,480
Accumulated depletion, depreciation and impairment losses:	
Balance, January 1, 2010	-
Depletion, depreciation and amortization expense	(4,309)
Impairment losses	(21,814)
Balance, December 31, 2010	(26,123)
Depletion, depreciation and amortization expense	(320)
Impairment losses	(518)
Balance, December 31, 2011	(26,961)
Carrying amount:	
Balance, January 1, 2010	$ 61,319
Balance, December 31, 2010	$ 3,418
Balance, December 31, 2011	$ 3,519

The depletion, depreciation and impairment of property, plant and equipment, and any eventual reversal thereof, are recognized in depletion, depreciation and amortization in the statement of loss and comprehensive loss.

The calculation of depletion expense for the year ended December 31, 2011 included estimated future development costs of $955,000 (December 31, 2010 - $875,000) associated with the development of the Company's proved plus probable reserves.

In 2011, the Company did not capitalize any general and administrative expenses or share-based compensation expenses (December 31, 2010 - $292,000).

In 2010, the Company disposed of its oil and gas assets in the Square Creek and Ladyfern areas for proceeds of $30,437,000, consisting of cash of $25,600,000 and 3,664,444 shares of Terra Energy Corp. (TSX: "TT") valued at $1.32 per share. These assets had a net book value of $33,366,000 and associated decommissioning liabilities of $4,682,000.

At December 31, 2011, due to declining natural gas prices, reserves revisions and adjustments to future costs, the Company tested its Buick Creek property for impairment. The recoverable amount of the property was estimated as the fair value less costs to sell based on its net present value of the before tax cash flows from proved plus probable reserves estimated by the Company's independent reserves evaluator discounted at 10%. In determining the appropriate discount rate the Company considered the acquisition metrics of recent transactions completed on similar assets. At December 31, 2011, the Company determined that the net book value of the Buick Creek CGU exceeded the recoverable amount and Fortress recognized an impairment charge of $518,000.

The following estimates were used in determining whether impairment to the carrying value of the CGU existed at December 31, 2011:

	BC West Coast Station 2 $Cdn/MMBtu
2012	3.10
2013	3.72
2014	4.07
2015	5.47
2016	5.59
2017	5.71
2018	5.83
2019	5.95
2020	6.08
2021	6.21
Thereafter	Escalation rate of 2% per year

During 2010, the Company recorded an impairment loss on oil and gas assets of $21,814,000 on certain CGU's due to declining natural gas prices and the eventual sale on August 31, 2010 which established the fair value less cost to sell for these properties.

(a) In March 2009, the CRA conducted an audit of the 2004 flow-through expenditures of a company that was acquired by the Fortress in 2006. As a result of the audit, the Company was reassessed by the CRA for flow-through taxes of approximately $384,000 on expenditures not qualifying for renunciation under the flow-through share program in the amount of $1,916,000. The Company filed a Notice of Objection on July 31, 2009 after consultation with its tax advisors and legal counsel to appeal this reassessment. The Company also indemnified the subscribers from income taxes related to the offering. The amount of the potential indemnification is approximately $889,000.

As a result of recent discussions with the CRA and additional arguments put forward by the CRA, the Company has determined that the continued appeal of this reassessment is unlikely to be successful. Accordingly, the Company has recorded the estimated flow-through taxes and indemnification of flow-through subscribers as liabilities at December 31, 2011.

(b) On September 30, 2009 the Company closed a public offering of 6,594,000 flow-through common shares. The expenditure commitment resulting from the issuance of flow-through common shares was $3,000,270; however, the Company incurred expenditures of only $104,000 by the December 31, 2010 deadline. Accordingly, the Company has recorded a liability of $1,314,000 at December 31, 2011 (December 31, 2010 - $1,314,000) which represents the anticipated payments to investors required under indemnification agreements.

The Company's decommissioning liabilities result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning liabilities are estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the cash flows to be incurred in future years. The Company has estimated the net present value of the decommissioning liabilities to be $1,741,000 as at December 31, 2011 (December 31, 2010 - $1,250,000) based on an undiscounted total future liability of $2,966,000 (December 31, 2010 - $2,966,000). These payments are expected to be made over the next 25 years. A risk-free rate of 2.49 percent (December 31, 2010: 4.1 %) and an inflation rate of 2.0 percent were used to calculate the net present value of decommissioning liabilities.

Decommissioning liabilities	$
Balance, January 1, 2010	5,686
Adjustments to assumptions	51
Liabilities incurred and acquired	25
Accretion expense	170
Disposition of abandonment liability	(4,682)
Balance, December 31, 2010	1,250
Adjustments to assumptions	449
Accretion expense	42
Balance, December 31, 2011	1,741

(a) Authorized:

Fortress is authorized to issue an unlimited number of voting common shares and an unlimited number of preferred shares.

(b) Common shares issued and outstanding:

	Number of Common Shares	$
Balance, January 1, 2010	55,294,617	139,447
Balance, December 31, 2010	55,294,617	139,447
Balance, December 31, 2011	55,294,617	139,447

(c) Warrants issued and outstanding:

	Number of warrants	$
Balance, January 1, 2010	27,295,700	5,406
Balance, December 31, 2010	27,295,700	5,406
Expired	(27,295,700)	(5,406)
Balance, December 31, 2011	-	-

(d) Contributed surplus:

	$
Balance, January 1, 2010	15,694
Share-based compensation expense	559
Balance, December 31, 2010	16,253
Expiry of warrants (note 15 (c))	5,406
Balance, December 31, 2011	21,659

(e) Stock option plan:

The Company grants stock options to employees, officers, directors and consultants of the Company pursuant to an incentive plan. Under this plan, the exercise price of options granted cannot be less than the closing market price for the Company's common shares on the date of grant. Options vest over a three-year period and expire five years from the date of grant.

The following table summarizes stock option transactions:

	Number of options	Weighted average exercise price $
Balance, January 1, 2010	4,774,579	0.50
Cancelled or expired	(4,773,779)	0.50
Balance, December 31, 2010	800	50.00
Expired	(800)	50.00
Balance, December 31, 2011	-	-

(f) Share-based compensation expense:

The following table summarizes the share-based compensation expense recorded for all plans within general and administrative expenses in the consolidated statements of loss and comprehensive loss:

	2011	2010
Stock options	-	496
Restricted stock units	-	26
Total share-based compensation expense	-	522

(g) Loss per share:

	2011	2010
Loss for the year	$ 7,104	$ 27,634
Weighted average shares outstanding - basic and diluted	55,294,617	55,294,617
Loss per share – basic and diluted	$ 0.13	$ 0.50

(a) Letter of guarantee:

The Company has a letter of guarantee of $107,000 outstanding as at December 31, 2011 ($107,000 as at December 31, 2010) which is secured by a cash deposit. This amount has been included in cash and cash equivalents in the consolidated statement of financial position.

(b) Office premises:

The Company is committed to minimum annual lease payments under an operating lease for office premises to January 2013, as follows:

	$
2012	162
2013	14
	176

Changes in non-cash working capital balances are comprised of the following:

	2011 $	2010 $
Trade and other receivables	1,393	3,826
Prepaid expenses and deposits	54	132
Trade and other payables	(845)	(5,806)
Indemnification of flow-through share subscribers payable	931	1,656
Income taxes payable	62	-
	1,595	(192)
Attributable to operating activities	545	(650)
Attributable to investing activities	161	(856)
Attributable to financing activities	889	1,314
	1,595	(192)

In 2011 the Company was charged $387,000 (2010 - $242,000) by a law firm of which a director of the Company is a partner. All related party transactions are in the normal course of business and have been measured at the agreed to exchange amounts, which are the amounts of consideration established and agreed to by the related parties and which are similar to those negotiated with third parties.

(a) On March 1, 2012, Fortress signed a formal purchase and sale agreement to acquire 100 percent of the shares of a Brazilian private oil and gas company for an acquisition price of up to US$37,000,000. The oil and gas interests to be acquired include a 100 percent working interest in 7 exploration blocks located in the Reconcavo Basin, covering an area of approximately 200 sq km and a 100 percent working interest in three onshore producing oil fields: Bom Lugar, located in the Reconcavo Basin, Jiribatuba, located in the Camamu Basin and Aracaju, located in the Sergipe Basin.

Closing of the acquisition is subject to receipt of all necessary regulatory approvals including the approval of ANP (Agência Nacional do Petróleo, Gás Natural e Biocombustíveis) in Brazil to permit the Brazilian private company to complete a reorganization prior to the sale of the shares to Fortress, to permit Fortress to purchase and own the shares and to otherwise consummate the transaction. Closing is also subject to the satisfaction of the other conditions set out in the purchase and sale agreement.

To finance the acquisition, the Company entered into a letter of intent with a private equity syndicate to raise $55,000,000 to fund the acquisition price and a portion of the planned capital program. The Company expects to close this financing in May 2012, the funds of which will be held in trust pending the closing of the acquisition which is expected in June 2012. The Company had also entered into discussions with various investment banks to raise an additional $20,000,000 that will be directed to the capital program.

(b) On February 27, 2012, the Company granted stock options to officers, directors and consultants to the Company to acquire 5,500,000 common shares of the Company at an exercise price of $0.25 per share, expiring February 27, 2017. The options vest over a three year period on the anniversary dates. Also on February 27, 2012, the Company granted performance warrants to officers, directors and consultants to the Company to acquire 5,500,000 common shares at an exercise price of $0.25 per share, expiring February 27, 2017.

(c) On April 9, 2012, the Company closed the first round of a convertible debenture financing for $245,000. The Company expects to have additional closings in April and May to raise a total of $1,500,000 to provide working capital to fund the Company's operations until it can close the acquisition of the Brazilian oil and gas company.

The adoption of IFRS requires the application of IFRS 1. IFRS 1 generally requires that an entity retrospectively apply all IFRS effective at the end of its first IFRS reporting period; however IFRS 1 provides certain mandatory exceptions and permits limited optional exemptions. Certain IFRS 1 optional exemptions have been applied including:

- Deemed cost exemption for full cost oil and gas entities whereby exploration and evaluation assets were classified from the full cost pool to intangible exploration assets at the amount that was recorded under previous GAAP and the remaining full cost pool was allocated to the development assets and components pro rata using reserve values.
- Decommissioning liabilities exemption that allows any changes in decommissioning liabilities on transition to IFRS to be adjusted through opening accumulated losses.
- Share-based compensation exemption that allows a company to only have to evaluate share-based compensation awards that were unvested as of the date of transition and that were issued subsequent to November 7, 2002.
- Business combinations exemption that allows a company to not have to restate any business combinations that occurred prior to the date of transition.

The accounting policies in note 3 have been applied in preparing the consolidated financial statements for the year ended December 31, 2011 and the comparative information for the year ended December 31, 2010, the financial statements for the year ended December 31, 2010, and the preparation of the opening IFRS statement of financial position at January 1, 2010, the Company's date of transition to IFRS.

In preparing its opening IFRS statement of financial position, comparative information for the year ended December 31, 2010, the Company adjusted amounts previously reported in financial statements prepared in accordance with previous GAAP. An explanation of how the transition from previous GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes accompanying the tables.

(a) Reconciliation of statement of financial position from previous GAAP to IFRS:

At the date of IFRS transition – January 1, 2010:

	Note 20 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
Cash and cash equivalents		$ 64	$ -	$ 64
Trade and other receivables		5,576	-	5,576
Prepaid expenses and deposits		470	-	470
Commodity contracts		1,321	-	1,321
		7,431	-	7,431
Exploration and evaluation assets	(i)	-	3,900	3,900
Property, plant and equipment, net	(ii)	90,017	(28,698)	61,319
		90,017	(24,798)	65,219
		$ 97,448	$ (24,798)	$ 72,650
Bank loans		$ 23,044	$ -	$ 23,044
Trade and other payables		7,884	-	7,884
Flow-through share premium	(vii)	-	462	462
		30,928	462	31,390
Decommissioning liabilities	(iii)	4,324	1,362	5,686
		4,324	1,362	5,686
		35,252	1,824	37,076
Share capital	(viii)	140,094	(647)	139,447
Warrants		5,406	-	5,406
Contributed surplus	(vii)	15,435	259	15,694
Accumulated losses	(vii)	(98,739)	(26,234)	(124,973)
		62,196	(26,622)	35,574

(b) Reconciliation of consolidated statement of loss and comprehensive loss from previous GAAP to IFRS (continued):

For the year ended December 31, 2010:

	Note 20 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
Natural gas sales		$ 11,387	$ -	$ 11,387
Royalties		(473)		(473)
Gain on commodity contracts		3,948	-	3,948
		14,862	-	14,862
Operating		5,924	-	5,924
Transportation		987	-	987
Impairment of exploration and evaluation	(i)	-	2,404	2,404
Depletion, depreciation and amortization	(iv)	54,874	(28,751)	26,123
General and administrative	(v)	5,095	(245)	4,850
Finance expenses	(iii), (vi)	4,156	(1,592)	2,564
		71,036	(28,184)	42,852
Loss before income tax		(56,174)	28,184	(27,990)
Income tax expense (reduction):				
Current		106	-	106
Deferred	(vii)	(26)	(436)	(462)
		80	(436)	(356)
Net loss and comprehensive loss for the period		$ (56,254)	$ 28,620	$ (27,634)
Net loss per share				
Basic		$ (1.02)	$ 0.52	$ (0.50)
Diluted		$ (1.02)	$ 0.52	$ (0.50)

(c) Reconciliation of consolidated cash flow statement from previous GAAP to IFRS (continued):

For the year ended December 31, 2010:

	Note 20 (d)	Previous GAAP	Effect of transition to IFRS	IFRS
Net loss		$(56,254)	$28,620	$(27,634)
Adjustments for:				
Unrealized gain on commodity contracts		1,321	-	1,321
Impairment of exploration and evaluation assets	(i)	-	2,404	2,404
Depletion, depreciation and amortization	(iv)	54,874	(28,751)	26,123
Share-based compensation	(v)	767	(245)	522
Finance expenses	(iii)	2,842	(1,592)	1,250
Deferred income tax	(vii)	(26)	(436)	(462)
Interest paid		(1,318)	-	(1,318)
Change in non-cash working capital		(650)	-	(650)
Net cash from operating activities		1,556	-	1,556
Exploration and evaluation expenditures	(i)	-	(63)	(63)
Property, plant and equipment expenditures	(i), (ii)	(1,747)	63	(1,684)
Proceeds on sale of property, plant and equipment		25,146		25,146
Change in non-cash working capital		(856)	-	(856)
Net cash from investing activities		22,543	-	22,543
Repayment of bank loans		(23,044)	-	(23,044)
Indemnification of flow-through share subscribers		1,314	-	1,314
Net cash used in financing activities		(21,730)	-	(21,730)
Change in cash and cash equivalents		2,369	-	2,369
Cash and cash equivalents at beginning of period		64	-	64
Cash and cash equivalents at end of period		$ 2,433	$ -	$ 2,433

(d) Impact of transition to IFRS on 2010 results:

(i) Exploration and Evaluation assets ("E&E") – As required under IFRS 6, upon transition to IFRS, Fortress reclassified $4,491,000 from Property, Plant and Equipment ("PP&E") to E&E, which primarily consisted of undeveloped exploration lands. The Company reclassified $4,578,000 at December 31, 2010.

On transition to IFRS, the Company recorded an impairment loss on E&E assets of $591,000 which resulted in a reduction in E&E assets with the offset to accumulated losses. For the year ended December 31, 2010, the Company recorded additional impairment losses on E&E assets of $2,404,000. The Elmworth property was sold on August 31, 2010 and the sale price effectively determined the fair value less costs to sell for that property. The Company recorded an impairment loss on its remaining exploration and evaluation asset based on its fair value less costs to sell resulting from declining natural gas prices.

The following table summarizes the changes to E&E assets resulting from the transition to IFRS:

E&E assets	January 1, 2010 $	December 31, 2010 $
Transferred from PP&E assets	4,491	4,578
Impairment losses	(591)	(2,995)
Change in allocation of sales proceeds	-	(583)
E&E assets as reported under IFRS	3,900	1,000

(ii) Property, Plant and Equipment ("PP&E") – The Company's PP&E assets were allocated to CGU's unlike under previous GAAP where all oil and natural gas assets are accumulated into one cost centre. Under IFRS 1, the deemed cost of the Company's oil and natural gas assets were allocated to CGU's based on total proved plus probable reserve values as at January 1, 2010.

Under IFRS, impairment tests for PP&E are performed at a CGU level as opposed to the entire Company's PP&E balance being subjected to a full cost ceiling test under previous GAAP. Impairment is recognized if the carrying value exceeds the recoverable amount for a CGU. The recoverable amount is determined using the greater of the fair value less costs to sell based on discounted future cash flows of proved plus probable reserves using forecast prices and costs, and the value in use. As a result of decreased natural gas prices and the sale of oil and gas assets on August 31, 2010 which impacted the fair value less costs to sell, the Company recognized impairment losses for the year ended December 31, 2010 of $21,814,000. This resulted in a reduction of PP&E with the offset charged to depletion, depreciation and amortization expense. The Company also recorded an impairment loss of $24,207,000 on January 1, 2010, on transition to IFRS due to declining natural gas prices.

(d) Impact of transition to IFRS on 2010 results (continued):

(ii) Property, Plant and Equipment ("PP&E") (continued):

The following table summarizes the changes to PP&E assets resulting from the transition to IFRS:

PP&E assets	January 1, 2010 $	December 31, 2010 $
PP&E assets as reported under previous GAAP	90,017	2,178
Transferred to E&E assets	(4,491)	(4,578)
Change in depletion, depreciation and amortization	-	3,089
Change in impairment losses	(24,207)	1,455
Change in decommissioning liabilities	-	(256)
Change in loss on sale of oil and gas properties	-	1,530
PP&E assets as reported under IFRS	61,319	3,418

(iii) Decommissioning liabilities – Under previous GAAP, Fortress's decommissioning liabilities were discounted based on a credit adjusted risk-free rate which was 9 percent at December 31, 2009. Under IFRS, the Company is required to revalue its obligation at each balance sheet date using a current liability-specific discount rate. At transition, Fortress revalued the obligation based on a risk-free rate of 4.1% resulting in a $1,362,000 increase to the liability with the offset charged to accumulated losses. As a result of the change in the discount rate applied, accretion of decommissioning liabilities expense decreased by $62,000 for the year ended December 31, 2010. The accretion of decommissioning liabilities expense has been included in finance expenses.

The following table summarizes the changes to decommissioning liabilities resulting from the transition to IFRS:

Decommissioning liabilities	January 1, 2010 $	December 31, 2010 $
Decommissioning liabilities as reported under previous GAAP	4,324	789
Increase resulting from change in discount rate	1,362	1,362
Change in accretion expense	-	(62)
Change in net additions/(disposals)	-	(839)
Decommissioning liabilities as reported under IFRS	5,686	1,250

(iv) Depletion, depreciation and amortization expense – Under IFRS, Fortress has chosen to calculate depletion expense based on proved plus probable reserves as opposed to proved reserves under previous GAAP. This has resulted in a reduction of depletion, depreciation and amortization expense for the year ended December 31, 2010 of $3,089,000.

(d) Impact of transition to IFRS on 2010 results (continued):

The following table summarizes the changes to depletion, depreciation and amortization expense resulting from the transition to IFRS:

	Year ended December 31, 2010 $
Depletion, depreciation and amortization expense as reported under previous GAAP	54,874
Decrease in depletion, depreciation and amortization expense	(3,089)
Decrease in impairment losses on PP&E	(25,662)
Depletion, depreciation and amortization expense as reported under IFRS	26,123

(v) Under previous GAAP, Fortress expensed share-based compensation on a straight-line basis. Under IFRS, share-based payments are expensed based on a graded vesting schedule. Fortress also incorporated a forfeiture multiplier rather than accounting for forfeitures as they occur as currently practiced under previous GAAP. This resulted in an increase to contributed surplus and accumulated losses of $259,000 on transition to IFRS. Share-based compensation expense for the year ended December 31, 2010 decreased by $245,000. This decrease in share-based compensation expense resulted in no change in amounts previously capitalized to PP&E for the year ended December 31, 2010. Share-based compensation expense has been included in general and administrative expenses on the statement of loss and comprehensive loss.

(vi) Divestitures – Under previous GAAP, proceeds from divestitures were deducted from the full cost pool without recognition of a gain or loss unless the divestiture resulted in a change in the depletion rate of 20% or greater in which case, a gain or loss was recorded. Under IFRS, gains and losses are recorded on divestitures and are calculated as the difference between the proceeds and the net book value of the asset disposed of.

The Company sold substantially all of its oil and gas properties on August 31, 2010. Under previous GAAP the Company recorded a loss on sale of oil and gas assets of $1,000,000 for the year ended December 31, 2010. Under IFRS, the Company has recorded a gain on the sale of oil and gas assets of $530,000 as a result of an increase in decommissioning liabilities and a change in the allocation of the sale proceeds to specific CGU's.

(vii) Flow-through shares are a Canadian income tax incentive which is the subject of specific guidance under previous GAAP, however there is no specific guidance under IFRS. Under previous GAAP, when flow-through shares were issued they were recorded at face value. The related deferred income tax liability was established for the tax effect of the difference between the tax basis and the book basis of the assets when renounced and was recorded as a reduction of share capital. The reduction to share capital under previous GAAP was based on the corporate tax rates in effect at that time. There was no income statement effect associated with the issuance of these shares, however upon renunciation to the flow-through subscriber, a deferred tax liability was recorded. In the Company's case, since its tax basis was larger than its book basis, a deferred tax liability was reversed and taken into income as a deferred income tax reduction.

(d) Impact of transition to IFRS on 2010 results (continued):

Under IFRS the proceeds from the offering are to be allocated between the sale of the shares and the sale of the income tax benefit. The allocation is made based on the difference between the quoted market price of the existing shares and the amount an investor pays for the flow-through shares. This flow-through premium is recorded as a liability that is reduced when qualifying flow-through expenditures are incurred. The reduction of the flow-through liability is offset by an increase in the deferred tax liability and due to the valuation allowance recognized in the Company's case it is treated as a deferred income tax reduction. On transition to IFRS on January 1, 2010, the Company recorded a flow-through share liability of $462,000 which has been included with trade and other payables, a decrease in share capital of $647,000 and a decrease in accumulated losses of $185,000.

For the year ended December 31, 2010, the effects of these changes resulted in a decrease in share capital of $621,000 and an offsetting increase in accumulated losses.

(viii) The following table summarizes the changes to share capital resulting from the transition to IFRS:

	January 1, 2010 $	December 31, 2010 $
Share capital as reported under previous GAAP	140,094	140,068
Flow-through shares	(647)	(621)
Share capital as reported under IFRS	139,447	139,447

(ix) The following table summarizes the changes to contributed surplus resulting from the transition to IFRS:

	January 1, 2010 $	December 31, 2010 $
Contributed surplus as reported under previous GAAP	15,435	16,239
Change in share-based compensation	259	14
Contributed surplus as reported under IFRS	15,694	16,253

(x) The following table summarizes the changes to accumulated losses resulting from the transition to IFRS:

	January 1, 2010 $	December 31, 2010 $
Accumulated losses as reported under previous GAAP	(98,739)	(154,993)
Change in decommissioning liabilities	(1,362)	(1,300)
Change in depletion, depreciation and amortization	(24,207)	4,544
Change in loss on sale of oil and gas properties	-	1,530
Change in impairment of E&E assets	(591)	(2,995)
Change in share-based compensation	(259)	(14)
Flow-through shares	185	621
Accumulated losses as reported under IFRS	(124,973)	(152,607)

(d) Impact of transition to IFRS on 2010 results (continued):

(xi) The following table summarizes the changes to net loss and comprehensive loss resulting from the transition to IFRS:

	Year ended December 31, 2010 $
Net loss and comprehensive loss as reported under previous GAAP	(56,254)
Change in exploration and evaluation expenses	(2,404)
Change in depletion, depreciation and amortization expense	3,089
Change in impairment losses included in depletion, depreciation and amortization expense	25,662
Change in share-based compensation	245
Change in accretion expense included in finance expenses	62
Change in loss on sale of oil and gas properties	1,530
Change in deferred income tax expense	436
Net loss and comprehensive loss as reported under IFRS	(27,634)