



**VECTA ENERGY CORPORATION**

**Audited Financial Statements**

**For the Year Ended**

**December 31, 2010**

# Contents

	Page
Management Report	1
Auditors' Report	2
Balance Sheets	3
Statements of Operations, Comprehensive Loss and Deficit	4
Statements of Cash Flows	5
Notes to the Financial Statements	6

# Vecta Energy Corporation

## Management's Report

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### Management's Responsibility for Financial Statements

The accompanying financial statements of Vecta Energy Corporation ("the Company") are the responsibility of management. The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles and include certain estimates that reflect management's best judgements. The financial information contained in management's discussion and analysis is consistent with the financial statements.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the financial statements.

The Company's Board of Directors, through its Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control systems. The Audit Committee is composed of independent directors who are not employees of the Company. The Audit Committee is responsible for reviewing the financial statements and recommending them to the Board of Directors for approval. To discharge its duties, the Audit Committee meets regularly with management and Meyers Norris Penny LLP to discuss internal controls, accounting and financial reporting processes, audit plans and financial matters. The Audit Committee reports its findings to the Board of Directors for its consideration in approving the financial statements for issuance to the shareholders.

Meyers Norris Penny LLP, an independent firm of Chartered Accountants, is responsible for auditing the financial statements and expressing an opinion thereon and their report is presented separately. The external auditors have full and free access to, and meet regularly with, management and the Audit Committee.

April 20, 2011

*"signed"*

Thomas D. Coffman

President & CEO

*"signed"*

Diane Zuber

Vice President Finance & CFO

# Independent Auditors' Report

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To the Shareholders of Vecta Energy Corporation:

We have audited the accompanying financial statements of Vecta Energy Corporation, which comprise the balance sheet as at December 31, 2010, and the statements of operations, comprehensive loss and deficit, and cash flows for the year then ended, and 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 Canadian generally accepted accounting principles, 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 audit. We conducted our audit 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 the auditors' 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, the auditor considers 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 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 Vecta Energy Corporation as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

## *Other Matter*

The financial statements of Vecta Energy Corporation as at December 31, 2009 and for the year then ended were audited by another firm who expressed an opinion without reservation on those financial statements in its report dated April 17, 2010.

## *Emphasis of Matter – Going Concern and Financing*

We draw attention to Note 1 in the financial statements which indicates that Vecta Energy Corporation has a net loss from continuing operations of \$1,953,419, accumulated losses of \$10,394,327, a negative cash flow from operations of \$420,581 and working capital deficiency of \$779,938. Management has assessed that additional financing to execute operating and capital commitments is required but, there is no assurance that efforts to obtain financing will be successful. These conditions indicate the existence of a material uncertainty which may cast significant doubt on the Corporation's ability to continue as a going concern. Our opinion is not qualified in respect of this matter.

May 2, 2011  
Calgary, Alberta

*Mayer Norris Penny LLP*

Chartered Accountants







## Statements of Operations, Comprehensive Loss and Deficit

Years Ended December 31	2010	2009
Revenue		
Oil and natural gas sales	\$ 474,159	\$ 890,007
Royalties	<u>(67,742)</u>	<u>(148,558)</u>
	<u>406,417</u>	<u>741,449</u>
Expenses		
Operating	144,981	323,856
Transportation	27,600	57,861
Depletion, depreciation and accretion	430,205	3,324,752
Foreign exchange loss	-	808
General and administrative	671,442	600,399
Interest	81,228	23,780
Stock based compensation	<u>39,450</u>	<u>84,285</u>
	<u>1,394,906</u>	<u>4,415,741</u>
Loss before other items and income taxes	<u>(988,489)</u>	<u>(3,674,292)</u>
Other items		
Interest and other earnings	886	-
Loss on disposition of assets (Note 3)	<u>(965,816)</u>	<u>-</u>
	<u>(964,930)</u>	<u>-</u>
Loss before the income taxes	<u>(1,953,419)</u>	<u>(3,674,292)</u>
Future tax recovery	-	<u>(364,983)</u>
Loss from continuing operations	<u>(1,953,419)</u>	<u>(3,309,309)</u>
Net loss from discontinued operations (Note 9)	-	<u>(1,694)</u>
Net loss, and comprehensive loss	\$ <u>(1,953,419)</u>	\$ <u>(3,311,003)</u>
Net loss per share from continuing operations		
Basic and diluted (Note 7)	\$ <u>(0.027)</u>	\$ <u>(0.046)</u>
Net loss per share from discontinued operations		
Basic and diluted (Note 9)	\$ <u>(0.000)</u>	\$ <u>(0.000)</u>
Net loss per share		
Basic and diluted (Note 7)	\$ <u>(0.027)</u>	\$ <u>(0.046)</u>
Deficit, beginning of year	\$ (8,440,908)	\$ (5,129,905)
Net loss	<u>(1,953,419)</u>	<u>(3,311,003)</u>
Deficit, end of year	\$ <u>(10,394,327)</u>	\$ <u>(8,440,908)</u>



## Statements of Cash Flow

Years Ended December 31	2010	2009
<b>Operating</b>		
Net loss from continuing operations	\$ (1,953,419)	\$ (3,309,309)
Items not affecting cash		
Depletion, depreciation and accretion	430,205	3,324,752
Stock based compensation	39,450	84,285
Asset retirement obligation expenditures	(58,228)	(22,986)
Loss on disposition of assets	965,816	-
Non-cash administrative expenses	21,000	-
Future tax recovery	-	(364,983)
	<u>(555,176)</u>	<u>(288,241)</u>
Change in non-cash operating working capital (Note 13)	<u>134,595</u>	<u>337,080</u>
	<u>(420,581)</u>	<u>48,839</u>
<b>Financing</b>		
Proceeds from operating loan	-	425,000
Repayments to operating loan	-	(425,000)
Proceeds from secured loans	-	500,000
	<u>-</u>	<u>500,000</u>
<b>Investing</b>		
Additions to property and equipment	(19,156)	(81,641)
Proceeds on disposal of property and equipment	650,000	174,100
Change in non-cash working capital (Note 13)	(25,027)	(649,469)
	<u>605,817</u>	<u>(557,010)</u>
Net change in cash and cash equivalents	185,236	(8,171)
Net cash flows of discontinued operations	-	9,831
Cash and cash equivalents		
Beginning of year	175,958	174,298
End of year	\$ <u>361,194</u>	\$ <u>175,958</u>

See accompanying notes to the financial statements.



## 1. Nature of operations and going concern

The Corporation was incorporated under the Business Corporations Act of Alberta under the name Kroes Energy Inc. ("Kroes") on December 20, 1995. In 2008, Kroes acquired 97% of Vecta Energy Corporation's ("Vecta") issued and outstanding common shares and debentures. Both entities were amalgamated on September 30, 2008. On June 22, 2009, the amalgamated entity changed its name from Kroes to Vecta Energy Corporation ("the Company"). The Company's operations relate to the exploration for and production of petroleum and natural gas reserves in Canada.

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles applicable to a going concern which assumes that the Company will realize the carrying value of its assets and satisfy its obligations as they become due in the normal course of operations. For the year ended December 31, 2010, the Company has a net loss from continuing operations of \$1,953,419 (2009 - \$3,309,309) and negative cash flows from operating activities of \$420,581 (2009 - a positive \$48,839). At December 31, 2010, the Company had a working capital deficiency of \$779,938 (2009 - \$855,605) and a deficit of \$10,394,327 (2009 - \$8,440,908).

The ability of the Company to continue as a going concern depends on raising additional financing and achieving profitable operations sufficient to meet all obligations. Management has assessed its credit facilities and capital requirements in the first quarter 2011 and is considering additional equity financings as well as partnership opportunities in order to execute its operating and capital commitments in 2011. Although, in the opinion of management, the use of going concern assumption is appropriate, there can be no assurance that any steps management is taking will be successful.

These financial statements do not reflect adjustments in the carrying values of the assets and liabilities, expenses and the balance sheet classifications that would be used if the going concern assumption were not appropriate. Such adjustments could be material.

## 2. Summary of significant accounting policies

### Basis of presentation

The financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles within the framework of the accounting policies summarized below.

#### Cash and cash equivalents

Cash and cash equivalents are comprised of cash on hand, balances with banks and short-term deposits with a duration of three months or less from the date of acquisition. Bank borrowings are considered to be financing activities.

## 2. Summary of significant accounting policies (Continued)

### Petroleum and natural gas properties

#### i) Capitalized costs

The Company follows the full cost method of accounting for its petroleum and natural gas operations. Under this method all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, and costs of drilling both producing and non-producing wells and overhead directly related to exploration and development activities. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion and depreciation in the cost centre by 20%.

#### ii) Depletion and depreciation

Depletion of exploration and development costs and depreciation of production equipment and processing facilities is provided for using the unit-of-production method based upon estimated proved petroleum and natural gas reserves, before royalties, as estimated by independent petroleum engineers. The costs of significant undeveloped properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment has occurred. Estimated future costs to be incurred in developing proved reserves are included in costs subject to depletion. For depletion and depreciation purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Office equipment is provided for on a declining balance method at 20% per annum which is designed to depreciate the cost of the assets over their estimated useful lives.

#### iii) Impairment test

At each reporting period the Company performs an impairment test to determine the recoverability of capitalized costs associated with reserves for each cost centre. An impairment loss is recognized in operations when the carrying amount of a cost centre exceeds its fair value. The carrying amount of the cost centre is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves plus the costs of unproved properties and royalties. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited to the amount by which the carrying amount exceeds the sum of the fair value of proved and probable reserves and the costs of unproved properties that have been subject to a separate impairment test and contain no probable reserves. Any impairment loss is recognized as an adjustment to depletion and depreciation in the period in which the impairment occurs.

## 2. Summary of significant accounting policies (Continued)

### iv) Asset retirement obligations

The Company recognizes the fair value of estimated asset retirement obligations on the balance sheet when a reasonable estimate of fair value can be made. Asset retirement obligations include those for which a company faces a legal obligation to retire tangible long-lived assets such as well sites, pipelines and facilities. The asset retirement cost, equal to the initially estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long lived asset. Changes in the estimated obligation resulting from revisions to estimated timing or amount of undiscounted cash flows are recognized as a change in the asset retirement obligation and the related asset retirement cost.

Asset retirement costs are depleted using the unit-of-production method and are included in depletion and depreciation in the statement of operations. Increases in the asset retirement obligations resulting from the passage of time are recorded as accretion to the asset retirement obligations in the statement of operations. Actual expenditures incurred are charged against the accumulated obligations and are shown as a deduction from operating activities.

### Measurement uncertainty

The preparation of the financial statements in accordance with Canadian generally accepted accounting principles requires management to make certain assumptions and estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from and affect the results reported in these financial statements as future confirming events occur.

Amounts recorded for depletion and depreciation, asset retirement obligations and amounts used in impairment test calculations are based upon estimates of petroleum and natural gas reserves and future costs to develop those reserves. By their nature, these estimates of reserves, costs and related future cash flows are subject to uncertainty, and the impact on the financial statements of future periods could be material.

The amounts attributable to the fair value of stock options issued are based on estimates of the future volatility of the Company's share price, expected lives of the options, expected dividends and other relevant assumptions.

### Joint operations

The majority of the Company's oil and gas exploration, development and production activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

## 2. Summary of significant accounting policies (Continued)

### Foreign currency translation

Monetary items are translated at the rate of exchange at the balance sheet date; non-monetary items are translated at historical exchange rates and income and expense items are translated at the average exchange rate for the period. Translation gains and losses are reflected in the statement of operations for the period.

### Revenue recognition

Oil and natural gas sales are recognized in earnings when title passes to the customer, collection is reasonably assured and delivery has taken place.

### Income taxes

Income taxes are recorded using the asset and liability method of tax allocation. Future income taxes are calculated based on temporary differences arising from the difference between the tax basis of an asset or liability and its carrying value using substantively enacted tax rates anticipated to apply in the periods when the temporary differences are expected to reverse. Future income tax assets are recognized when it is more likely than not the tax deductions and loss carry-forwards will be utilized. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized. Changes in income tax rates that are substantively enacted are reflected in the accumulated future income tax balances in the period the change occurs.

### Per share amounts

The basic loss per share is calculated using the net loss divided by the weighted-average number of common shares outstanding. The treasury stock method is used to determine the dilutive effect of stock options and warrants. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock instruments are used to repurchase common shares at the average market price for the year.

### Flow through shares

Resources 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 income tax legislation. The liability for future income taxes is increased and capital stock is reduced by the estimated tax benefits transferred to shareholders at the time the resource exploration deductions are renounced.

## 2. Summary of significant accounting policies (Continued)

### Stock-based compensation

The Company uses the fair value based method to account for all stock-based payments. Under this method, the compensation cost is charged directly to earnings. Direct awards of stock granted to directors, officers and consultants are recorded at fair value on the date of grant and the associated expense is amortized over the vesting period with a corresponding credit to contributed surplus. When stock options are exercised, the proceeds, together with the amount recorded in contributed surplus, are recorded as share capital. The fair value of stock options granted is estimated using the Black-Scholes option pricing model, taking into account amounts that are believed to approximate the volatility of the trading price of the Company's shares, the expected lives of the awards of stock-based compensation, the fair value of the Company's stock and the risk-free rate, as determined at the grant date.

### Financial instruments

Financial instruments are measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial

instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the accounting standards.

Financial assets and financial liabilities "held-for-trading" are measured at fair value with changes in those fair values recognized in the statement of operations. Financial assets "available-for-sale" are measured at fair value, with changes in those fair values recognized in other comprehensive loss. Financial assets "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method. All transaction costs related to the issuance of the instruments are expensed as incurred.

Cash and cash equivalents are classified as "held-for-trading". Receivables and other are classified as "loans and receivables". Payables and accruals and secured loans are classified as "other-financial-liabilities".

### Future accounting pronouncements

The Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have an impact on the Company:

The Canadian Accounting Standards Board ("AcSB") has confirmed January 1, 2011 as the date that IFRS will replace Canadian GAAP for publicly accountable enterprises. As a result, the Company will report under IFRS for interim and annual periods beginning January 1, 2011 with comparative information for 2010 restated under IFRS. Adoption of IFRS as Canadian GAAP will require the Company to make certain accounting policy choices and could materially impact its reported financial position and results of operations.



**3. Property and equipment**

		<u>2010</u>	
	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>
Exploration and development costs	2,263,056	\$ 1,603,845	\$ 659,211
Production equipment and processing facilities	164,607	115,354	49,253
Office equipment	48,580	32,573	16,007
Asset retirement costs	<u>121,244</u>	<u>42,829</u>	<u>78,415</u>
	<u>\$ 2,597,487</u>	<u>\$ 1,794,601</u>	<u>\$ 802,886</u>
			<u>2009</u>
	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>
Exploration and development costs	\$ 7,032,106	\$ 4,512,593	\$ 2,519,513
Production equipment and processing facilities	512,350	303,941	208,409
Office equipment	47,072	29,302	17,770
Asset retirement costs	<u>113,926</u>	<u>63,514</u>	<u>50,412</u>
	<u>\$ 7,705,454</u>	<u>\$ 4,909,350</u>	<u>\$ 2,796,104</u>

Future capital expenditures of \$Nil (2009 - \$59,000), as estimated by independent engineers, relating to the development of proved reserves have been included in costs subject to depletion. As of December 31, 2010, undeveloped properties of \$235,426 (2009 - \$736,154) included in exploration and development costs, have not been subject to depletion.

Included in exploration and development costs is a technical license agreement related to the use of Shear Wave Technology. This license agreement was acquired as a result of the Vecta transaction and was allocated a nominal value. As such, it is presented within exploration and development costs.

Effective June 1, 2010, the Company disposed of its interest in the shallow gas area of Alberta effective June 1, 2010 for cash proceeds of \$650,000. This transaction resulted in an accounting loss of \$965,816 and resulted in the reduction of a significant portion of Vecta's property and equipment as well as production. In December 2009 Vecta sold a lease to a third party and retained a 2.5% gross overriding royalty. The third party drilled a successful well with significant production and Vecta began earning royalties in December 2010.

The Company performed an impairment test as at December 31, 2010, which indicated that no impairment had occurred during the year. In 2009 an impairment of \$2,299,430 was recorded as part of depletion, depreciation and accretion.

### 3. Property and equipment (Continued)

The prices used in the impairment test evaluation of the Company's petroleum properties were as follows:

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>Increase Thereafter</u>
Oil per BBL (\$CDN)						
(Edmonton Par Price 40 <sup>0</sup> API)	\$93.08	\$93.85	\$93.43	\$93.54	\$94.95	1.5%
Natural gas per Mcf (\$CDN)						
(Alberta AECO – C Spot)	\$4.04	\$4.66	\$4.99	\$6.58	\$6.69	1.5%

### 4. Secured loan/Credit facilities

As at March 31, 2009, the Company had arranged a \$1,000,000 revolving operating bank loan with the National Bank of Canada. The terms of the loan repayment provided for interest only, but were subject to availability, review and the lender's right of demand. By June 2009 there was \$400,000 drawn down on the credit facility and due to the low natural gas environment the bank reduced the credit facility to \$500,000 and the Company became non-compliant with its loan agreement.

To remedy this, in October 2009, the Company entered into nine Secured Loan Agreements with Directors of the Company and other related parties for \$500,000. The proceeds were used to retire the Company's bank loan and for other corporate purposes. The secured loans mature on April 30, 2011 and have an interest rate of 15% payable on maturity. The loans are secured by all of the Company's interest in petroleum and natural gas assets and all other assets of the Company. At December 31, 2010, the Company owed \$583,916 (2009 - \$513,973) in principal and interest to the loan holders. The \$83,916 (2009 - \$13,973) in accrued interest has been recorded as part of payables and accruals. During the year the Company paid \$11,176 (2009 – \$Nil) of accrued interest to secured loan holders.

The Company was not in violation of its covenant at year end (see Note 12).

During the year ended December 31, 2010, the revolving operating bank loan with the National Bank of Canada was cancelled. The only credit facility remaining is a MasterCard credit facility for \$5,000 which is secured by a \$5,000 guaranteed investment certificate included in cash and cash equivalents. At December 31, 2010, the Company has utilized \$Nil (2009 - \$Nil) on its MasterCard facility.



## 5. Asset retirement obligations

The following table represents the reconciliation of the beginning and ending aggregate carrying amount of the obligations associated with the retirement of oil and gas assets:

	<u>2010</u>	<u>2009</u>
Asset retirement obligations, beginning of year	\$ 109,295	\$ 92,570
Liabilities incurred	-	586
Revision of estimates	84,810	28,602
Disposition of assets	(58,122)	-
Settlement of liability	(58,228)	(27,524)
Accretion expense	<u>6,958</u>	<u>15,061</u>
Asset retirement obligations, end of year	\$ <u>84,713</u>	\$ <u>109,295</u>

The total undiscounted amount of estimated cash flows required to settle the obligation is \$117,898 (2009 - \$182,072), which has been discounted using a credit-adjusted risk free rate of 8%. The majority of these obligations are not expected to be settled for several years in the future and will be funded from general Company resources at the time of retirement and removal.

## 6. Capital stock

### a) Authorized

Unlimited number of voting common shares

Unlimited number of preferred shares issuable in series

### b) Issued and outstanding

	<u>Shares</u>	<u>2010</u> Number of Amount	<u>Shares</u>	<u>2009</u> Number of Amount
<b>Common shares</b>				
Balance, beginning of year	72,220,009	\$ 9,107,951	72,220,009	\$ 9,107,951
Shares issued in payment of services	<u>1,400,000</u>	<u>21,000</u>	-	-
Balance, end of year	<u>73,620,009</u>	\$ <u>9,128,951</u>	<u>72,220,009</u>	\$ <u>9,107,951</u>

In November 2010, 1.4 million shares were issued to a private company controlled by an officer of the Company in satisfaction of accounting services. The shares were valued using the trading price of the Company's shares on November 2, 2010.



6. Capital stock (Continued)

c) Share purchase warrants

	<u>2010</u>		<u>2009</u>	
	<u>Number of Warrants</u>	<u>Amount</u>	<u>Number of Warrants</u>	<u>Amount</u>
Balance, beginning of year	-	\$ -	2,434,538	\$ 8,784
Issued on acquisition of Vecta	-	-		
Expired	-	-	(2,434,538)	(8,784)
Balance, end of year	-	\$ -	-	\$ -

As part of the Vecta acquisition, Kroes assumed 2,434,538 outstanding Vecta share purchase warrants, exercisable at \$0.61 for a six months period determined from a period after the common shares of Vecta are listed and posted for trading on the TSX Stock Exchange. These warrants were issued through a private placement of \$8.2 million by Vecta in November 2005. The fair value of these warrants approximated \$8,784 or \$0.0036 per warrant. The fair value of these warrants were estimated using the Black-Scholes option pricing model with an average risk-free interest rate of 3.3%, expected life of 0.6 years, volatility in the price of the Kroes's common shares of 165% and a dividend yield of 0.00%. These warrants expired unexercised in March 2009.

d) Agents warrants

	<u>2010</u>		<u>2009</u>	
	<u>Number of Warrants</u>	<u>Amount</u>	<u>Number of Warrants</u>	<u>Amount</u>
Balance, beginning of year	-	\$ -	1,392,911	\$ 8,618
Expired	-	-	(1,392,911)	(8,618)
Balance, end of year	-	\$ -	-	\$ -



**6. Capital stock (Continued)**

As part of the Vecta acquisition, Kroes assumed Vecta agent's warrants issued as a result of a private placement by Vecta in November 2005. Kroes issued 1,392,911 agent warrants to the agent, exercisable at \$0.41 per warrant for a six months period determined from a period after the common shares of Vecta are listed and posted for trading on the TSX Stock Exchange. The number of warrants and exercise price has been factored by the rate of Kroes shares issued on the Vecta transaction. The fair value of these agent warrants approximated \$8,618 or \$0.0061 per warrant. The fair value of these warrants was estimated using the Black-Scholes option pricing model with an average risk-free interest rate of 3.3%, expected life of 0.6 years, volatility in the price of the Kroes's common shares of 165% and a dividend yield of 0.00%. These warrants expired unexercised in March 2009.

**e) Contributed surplus**

	<u>2010</u>	<u>2009</u>
Balance, beginning of year	\$ 1,164,161	\$ 1,062,475
Fair value attributed to stock options granted	39,450	111,120
Transfer of carrying value of warrants expired	-	17,402
Fair value of unvested options cancelled	<u>-</u>	<u>(26,836)</u>
Balance, end of year	\$ <u>1,203,611</u>	\$ <u>1,164,161</u>

**7. Per share information**

Basic net loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding for the year. Diluted net earnings per common share are computed by dividing net loss by the diluted weighted average number of common shares outstanding for the year. In the calculation of diluted per share amounts, options under the stock option plan and purchase warrants are assumed to have been converted or exercised on the later of the beginning of the year or the date granted. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. In net loss per share situations, the diluted per share amount is the same as basic, as all factors are anti-dilutive.

	<u>2010</u>	<u>2009</u>
Weighted average shares outstanding:		
Basic and diluted	<u>72,540,146</u>	<u>72,220,009</u>

## 8. Stock-based compensation plan

The Company grants stock options to its directors, officers and consultants. The Company has a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. At December 31, 2010, there were 7,362,001 (2009 – 7,222,001) common shares reserved for this purpose. All options issued prior to January 1, 2005 vested immediately upon being granted while the options granted after January 1, 2005 vest equally over three years on the anniversary date of issuance. The exercise price of each option granted was equal to or higher than the closing market price of the Company's common shares on the day prior to the issuing of the option. In 2010, the 600,000 stock options issued in June 2005 expired unexercised (2009 – 723,334).

The following tables summarize the information about the stock options:

	<u>2010</u>		<u>2009</u>	
	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding, beginning of year	4,475,000	\$ 0.16	5,760,000	\$ 0.19
Granted	-	-	-	-
Cancelled	-	-	(561,666)	0.39
Expired	<u>(600,000)</u>	<u>0.56</u>	<u>(723,334)</u>	<u>0.16</u>
Outstanding, end of year	<u>3,875,000</u>	<u>\$ 0.10</u>	<u>4,475,000</u>	<u>\$ 0.16</u>
Options exercisable, end of year	<u>3,008,334</u>	<u>\$ 0.10</u>	<u>2,316,667</u>	<u>\$ 0.22</u>

Range of Exercise Prices	<u>Outstanding Options</u>			<u>Exercisable Options</u>	
	<u>Number of Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Years to Expiry</u>	<u>Number of Options Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$0.10	3,775,000	\$ 0.10	3.3	2,908,334	\$ 0.10
\$0.16	<u>100,000</u>	<u>0.16</u>	<u>2.2</u>	<u>100,000</u>	<u>0.16</u>
	<u>3,875,000</u>	\$ 0.10	<u>2.9</u>	<u>3,008,334</u>	<u>\$ 0.10</u>



**9. Discontinued operations**

On January 12, 2008, the Company sold its interest in its Trinidad properties for US \$250,000 and as a result, the assets were written down in 2007 to the net proceeds received. For financial purposes, the cost centre operations and assets are treated as discontinued operations. The remaining results of the discontinued operations of the Trinidad assets were as follows:

	<u>2010</u>	<u>2009</u>
General and administrative	\$ _____ -	\$ (1,694)
Net (loss) earnings from discontinued operations	\$ _____ -	\$ (1,694)
Net earnings from discontinued operations per common share:		
Basic and diluted	\$ <u>0.00</u>	\$ <u>0.00</u>

**10. Income taxes**

**a) Provision for income taxes**

Loss before income taxes before discontinued operations

	<u>\$ (1,953,419)</u>	<u>\$ (3,309,309)</u>
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Expected tax recovery at combined federal and provincial rate of 28% (2009 – 29%)

Increase (decrease) resulting from:

Stock based compensation	11,046	24,443
Rate change and other	74,366	130,163
Valuation allowance	<u>461,545</u>	<u>440,111</u>

Provision for income taxes	\$ _____ -	\$ (364,983)
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**10. Income taxes (Continued)**

**b) Future income tax liability**

Due to the uncertainty of realizing the future income tax assets it was determined that more likely than not did not exist. Therefore, no future income tax asset has been recognized on the balance sheet. Future income tax assets consist of the following temporary differences:

	<u>2010</u>	<u>2009</u>
Property and equipment	\$ 811,109	\$ 600,919
Non-capital losses	1,631,959	1,359,031
Share issue costs	-	15,428
Asset retirement obligations	<u>21,179</u>	<u>27,324</u>
	<b>2,464,247</b>	2,002,702
Valuation allowance	<u>(2,464,247)</u>	<u>(2,002,702)</u>
Future income tax liability	\$ <u>-</u>	\$ <u>-</u>

**c) Tax losses available**

The Company has incurred losses for Canadian income tax purposes of \$6,527,838 (2009 - \$5,436,124), the related benefit of these losses has not been recognized in the financial statements. Unless sufficient taxable income is earned these losses will expire as follows:

2014	\$ 283,951
2015	1,008,850
2026	1,803,777
2027	857,050
2028	1,125,992
2029	660,579
2030	<u>787,639</u>
	<b>\$ <u>6,527,838</u></b>

## 11. Financial instruments

### Fair value of financial instruments

The Company's financial instruments as at December 31, 2010 include cash and cash equivalents, receivables and other, payables and accruals and secured loans. The Company records its financial instruments at their carrying amounts which approximates fair value, unless otherwise disclosed in the financial statements. The carrying amounts approximate fair values due to the short term maturities of these financial instruments.

The Company adopted the amendments to CICA Section 3862, Financial Instruments – Disclosure in 2009. The amendments require the Company to present certain information about financial instruments measured at fair value on the balance sheet. In the first year of application, comparative information need not be presented for the disclosures required by the amendment. Accordingly, the disclosure of the fair value hierarchy is only presented for the December 31, 2010 year end.

The standard establishes a three level hierarchy that ranks the quality and reliability of information used in developing fair value estimates. The hierarchy gives the highest priority to quoted prices in an active market and the lowest to unobservable data. In cases where two or more levels of inputs are used to determine fair value, a financial instrument's level is determined based on the lowest level input that is considered significant to the fair value measurement in its entirety.

#### Level 1

This category includes assets and liabilities measured at fair value based on unadjusted quoted prices for identical assets and liabilities in active markets. An active market for an asset or liability is considered to be a market where transactions occur with sufficient frequency and volume to provide information on an ongoing basis. As at December 31, 2010, the Company has cash and cash equivalents which are measured at Level 1.

#### Level 2

This category includes valuations determined using directly or indirectly observable inputs other than quoted prices included within Level 1. Derivative instruments in this category are valued using models or other industry standard valuation techniques derived from observable market data. Such valuation techniques include inputs such as quoted forward prices, time value, volatility factors and broker quoted that can be observed or corroborated in the market for the entire duration of the derivative instrument. As at December 31, 2010, the Company does not have any assets which qualify as Level 2.

#### Level 3

This category of financial instruments is those with inputs for the asset that are not based on observable market data (unobservable inputs). As at December 31, 2010, the Company does not have any assets which qualify as level 3.



**11. Financial instruments (Continued)**

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. At December 31, 2010, the Company was holding cash and cash equivalents of \$361,194 and has secured loans outstanding of \$500,000 which are due April 30, 2011. There is no guarantee that the Company can raise the cash to pay the secured loans on April 30, 2011 which is secured by the assets of the Company.

The contractual maturities of financial liabilities as of December 31, 2010 are as follows:

	<u>Total</u>	<u>2011</u>	<u>2012</u>	<u>Thereafter</u>
Payables and accruals	\$ 762,683	\$ 762,683	\$ -	\$ -
Secured loans	500,000	500,000	-	-
Asset retirement obligations	<u>84,713</u>	<u>51,132</u>	<u>-</u>	<u>33,581</u>
	<u>\$ 1,347,396</u>	<u>\$ 1,313,815</u>	<u>\$ -</u>	<u>\$ 33,581</u>

*Commodity price risk*

The Company is exposed to risks from fluctuations in the natural gas sales prices. During the year, the Company did not have any derivative financial instruments in place to manage this risk. When appropriate, the Company will enter into forward sale commitments, in limited quantities and at fixed prices, with the Board of Director's approval. The Company does not use derivative financial instruments for speculative purposes.

If natural gas prices had increased or decreased by 10%, natural gas revenue would have increased by \$36,472 from \$364,720 to \$401,192 and decreased to \$328,248 for the period ended December 31, 2010.

**Credit risk management**

Receivables and other include amounts receivable for oil and natural gas sales which are generally made to large credit worthy purchasers and accounts receivable from joint venture partners which are generally recoverable from production. Accordingly, the Company views credit risks on these amounts as low. The maximum credit risk exposure associated with the Company's financial assets is the carrying value.

The cash equivalents consist mainly of amounts held with reputable financial institutions. None of the cash equivalents are in asset backed commercial paper products. Management believes the risk of loss is minimal.



## **11. Financial instruments (Continued)**

### **Foreign currency risk**

Foreign currency risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company has no foreign currency nor any foreign currency related receivables or payables. The Company does not use derivative instruments to reduce its exposure to foreign currency risk. The Company believes their exposure is minimal given the minimal amount of foreign currency at risk.

### ***Interest rate risk***

The Company's secured loans are for a fixed interest rate until maturity so there is no interest rate risk exposure.

## **12. Capital management**

The Company's capital structure consists of shareholders' equity plus debt, defined as long term debt including the current portion. Management's objective when managing capital is to provide an adequate return to its shareholders and to safeguard the Company's ability to obtain financing and have access to capital markets.

To facilitate the management of its capital structure, the Company prepares annual expenditure and operating budgets that are updated as necessary depending on success factors, industry conditions and operating cash flow. These annual and updated budgets are approved by the Board of Directors. Vecta has the ability to adjust its capital structure by making modifications to its capital expenditure program or by issuing new equity.

Under the conditions of the secured loan agreement, the Company is required to maintain a working capital deficiency below \$1.1 million and it cannot sell, transfer, convey or dispose of its right, title or interest in any of its property nor create a lien or other encumbrances upon its properties without the written consent of the lenders. At December 31, 2010, the Company was not in violation of any of these covenants.



**13. Supplemental cash flow information**

	<u>2010</u>	<u>2009</u>
<b>Change in non-cash working capital:</b>		
Receivables and other	\$ 43,035	\$ 257,430
Prepays and deposits	(12,244)	(8,715)
Payables and accruals	<u>78,777</u>	<u>(561,104)</u>
	<u>\$ 109,568</u>	<u>\$ (312,389)</u>
Changes in non-cash working capital related to:		
Operating activities	\$ 134,595	\$ 337,080
Investing activities	<u>(25,027)</u>	<u>(649,469)</u>
	<u>\$ 109,568</u>	<u>\$ (312,389)</u>
Interest paid (Note 4)	<u>\$ 11,176</u>	<u>\$ -</u>

**14. Commitments and contingencies**

a) The Company is a defendant in legal claims associated with normal operations. These claims, although unresolved at the current time, in management's opinion are not expected to have a material impact on the financial position or results of operations of the Company and accordingly, no amount has been accrued in the financial statements for potential settlements.

b) The Company has implemented a plan to sustain operations during the current economic recession, caused by low natural gas prices, that has negatively impacted its financial position. The Company has rolled back officers and management salaries by more than fifty percent with the expectation to reimburse these cuts as well as a 25% risk premium at a later date once natural gas prices have rebounded and if the Company's operations are more sustainable. Specifically, when the Company's working capital becomes positive and payments of these contingent liabilities will not return the Company to deficit working capital position, then the contingent liabilities for salaries and other items can be paid subject to approval of the Directors. There is no legal obligation or certainty that this will happen and as such, these costs have not been recognized in the financial statements and are disclosed as a contingent liability. As of December 31, 2010, none of the conditions for payment of contingent liabilities in the amount of \$305,313 have been met.



## 15. Related parties

The Company has undertaken joint ventures with Vecta Resources LLC ("Vecta Resources"), a related party to the Company. Vecta Resources owns approximately 16.51% of the issued and outstanding shares of the Company. In 2010, Vecta Resources continued to participated in three projects, the Company's share of capital expenditures being \$8,830 (2009 - \$7,117) and Vecta Resources share being \$2,943 (2009 - \$2,372). During the year ended December 31, 2010, the Company received \$51,979 (2009 - \$77,055) in petroleum products revenue and paid \$34,917 (2009 - \$67,725) in operating expenses on behalf of Vecta Resources. Vecta Resources pays its full share of project costs in the normal course of operations on a comparable basis to similar transactions conducted between arm's length parties on standard commercial terms for the oil and gas industry. As at December 31, 2010, the amounts owing to Vecta Resources of \$6,094 (2009 - \$4,370) are included in payables and accruals.

In October 2009, the Company entered into nine Secured Loan Agreements with Directors of the Company and related and non-related parties that raised \$500,000. These proceeds were used to retire the Company's bank loan and for other corporate purposes. The secured loans mature on April 30, 2011 and have an interest rate of 15% payable on maturity. The secured loan holders receive the security equivalent to the security held by the bank, being all of the Company's interests in petroleum and natural gas rights and the other assets of the Company. As at December 31, 2010, the directors and related parties were owed \$506,081 (2009 - \$462,513).

The Company paid personal expenses on behalf of its President and CEO in the amount of \$2,833 (2009 - Nil) which has been charged to accounts receivable and offsets \$54,810 (2009 - \$54,810) which the Company owes for services prior to May 2009.

## 16. Subsequent events

a) On March 8, 2011, Vecta entered into a Joint Venture Agreement (the "JV Agreement") with Vecta Oil & Gas, Ltd. ("VOG"), of Dallas, Texas to participate in an Exshaw/Bakken light oil resource play in north central Montana.

Under the terms of the JV Agreement, Vecta will make a capital contribution of US\$27.0 million to initially evaluate the play (the "Evaluation Phase") and VOG will assign more than 112,000 net acres (approximately 175 sections) of leasehold and other development rights to the JV within Pondera, Glacier and Toole Counties of Montana (the "Project Area").

Vecta also entered into an engagement letter with Wellington West Capital Markets Inc. ("Wellington"), pursuant to which Vecta will issue subscription receipts, by way of a short form prospectus offering, for gross proceeds of at least \$32 million to participate in and to meet work commitments associated with the joint venture and for general corporate purposes.

b) On March 24, 2011, Vecta Energy Corporation announced that the secured loan holders have agreed to extend the maturity date of the secured loans to April 30, 2011. This extension is to allow additional time for Vecta to complete the financing and other requirements pertaining to the joint venture agreement, entered into on March 8, 2011.