

PetroFalcon Corporation

Amended Consolidated Financial Statements
December 31, 2005 and 2004
(expressed in U.S. dollars)

March 10, 2006, except for note 15, which is dated March 21, 2006

AUDITORS' REPORT

To the Shareholders of
PetroFalcon Corporation.

We have audited the consolidated balance sheets of PetroFalcon Corporation as at December 31, 2005 and December 31, 2004 and the consolidated statements of operations and retained earnings (accumulated deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and December 31, 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

PetroFalcon Corporation
 Amended Consolidated Balance Sheets
 As of December 31, 2005 and 2004

(expressed in U.S. dollars)

	2005 \$	2004 \$
Assets		
Current assets		
Cash	9,297,444	20,445,802
Restricted cash (note 7)	-	3,600,000
Accounts receivable (note 3)	14,378,285	4,310,634
Income tax recoverable	412,423	61,092
Future Income Tax (note 10)	1,082,375	-
	<hr/> 25,170,527	<hr/> 28,417,528
Property and equipment (note 5)	<hr/> 46,004,470	<hr/> 16,413,226
	<hr/> 71,174,997	<hr/> 44,830,754
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	4,801,490	1,963,706
Income tax payable (note 10)	-	58,314
Current portion of long term debt and due to shareholder (note 7)	10,081,395	2,825,521
	<hr/> 14,882,885	<hr/> 4,847,541
Future Income Tax Liability (note 10)	769,833	-
Long-term debt (note 7)	8,000,000	-
Provision for asset retirement obligation (note 8)	522,557	347,720
	<hr/> 24,175,275	<hr/> 5,195,261
Shareholders' Equity		
Capital stock (note 6)	40,797,542	36,513,195
Warrants (note 6)	118,571	-
Contributed surplus (note 6)	3,268,067	1,316,359
Retained earnings	<hr/> 2,815,542	<hr/> 1,805,939
	<hr/> 46,999,722	<hr/> 39,635,493
	<hr/> 71,174,997	<hr/> 44,830,754

Approved by the Board of Directors


 _____ Director
 William Gumma


 _____ Director
 Clarence Cottman III

PetroFalcon Corporation

Amended Consolidated Statements of Operations and Retained Earnings (Accumulated Deficit) For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

	2005 \$	2004 \$
Revenue	11,325,144	7,996,259
Expenses		
Operating, maintenance and transportation	3,096,612	2,546,642
General and administrative	3,729,895	2,394,561
Amortization, depletion and accretion	1,719,861	1,284,939
Stock-based compensation (note 6)	1,995,000	978,450
	<u>10,541,368</u>	<u>7,204,592</u>
Income before other income (expenses) and income taxes	<u>783,776</u>	<u>791,667</u>
Other income (expenses)		
Interest on long-term debt	(1,392,568)	(401,194)
Interest on bank deposits	260,324	292,580
Gain on financing transactions (note 4)	2,443,876	1,354,167
Gain on foreign exchange	116,731	304,905
Other income	-	36,398
	<u>1,428,363</u>	<u>1,586,856</u>
Income before income taxes	2,212,139	2,378,523
Income taxes (note 10)		
– current	1,515,078	265,473
– future	(312,542)	-
	<u>1,202,536</u>	<u>265,473</u>
Net income	1,009,603	2,113,050
Retained earnings (deficit) – Beginning of year	<u>1,805,939</u>	<u>(307,111)</u>
Retained earnings – End of year	<u>2,815,542</u>	<u>1,805,939</u>
Weighted average number of common shares outstanding	<u>76,404,818</u>	<u>68,377,996</u>
Basic and diluted earnings per share (note 14)	0.01	0.03

PetroFalcon Corporation

Amended Consolidated Statements of Cash Flows For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

	2005 \$	2004 \$
Cash provided by (used in)		
Operating activities		
Net income	1,009,603	2,113,050
Items not affecting cash		
Amortization, depletion and accretion	1,719,861	1,284,939
Future Income Tax	(312,542)	-
Stock-based compensation	1,995,000	978,450
	<u>4,411,922</u>	<u>4,376,439</u>
Net change in non-cash working capital items		
Accounts receivable	(10,067,651)	(1,792,568)
Accounts payable and accrued liabilities	1,050,565	55,849
Income taxes (payable) recoverable – net	(409,645)	39,606
	<u>(5,014,809)</u>	<u>2,679,326</u>
Financing activities		
Proceeds from private placement	-	15,859,165
Warrants	118,571	9,974,077
Restricted cash	3,600,000	(3,600,000)
Issuance (repayment) of long-term debt	19,255,874	(1,374,092)
Proceeds received on exercise of share options	241,055	483,997
	<u>23,215,500</u>	<u>21,343,147</u>
Investing activities		
Acquisition of property and equipment	(31,136,268)	(9,251,768)
Movement in non-cash working capital from investing activities	1,787,219	1,169,440
	<u>(29,349,049)</u>	<u>(8,082,328)</u>
Net (decrease) increase in cash during year	(11,148,358)	15,940,145
Cash – Beginning of year	<u>20,445,802</u>	<u>4,505,657</u>
Cash – End of year	<u>9,297,444</u>	<u>20,445,802</u>
Supplementary information		
Interest paid	1,367,232	392,489
Income taxes paid	1,743,897	190,315

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

1 Description of business

The principal business of PetroFalcon Corporation (“PetroFalcon” or the “Corporation”) is conducted through its indirect wholly owned subsidiary, Vinccler Oil and Gas C.A. (“Vinccler Venezuela”) which provides oil and gas operating services in Venezuela. All of the revenues of Vinccler Venezuela are generated through an Operating Service Agreement (“OSA”) with Petroleos de Venezuela, S.A. (“PDVSA”), the state oil company of Venezuela.

Business with PDVSA

All of PetroFalcon’s production and operating revenues are derived from Vinccler Venezuela through its operations at the East Falcon Block pursuant to the terms of the OSA with PDVSA. During 2005, Vinccler Venezuela executed a gas addendum (the “Gas Addendum”) to the OSA to produce up to 249 Bcf of natural gas and 11 mmbbl of oil from the Cumarebo and La Vela fields. The Gas Addendum allows Vinccler Venezuela to deliver the natural gas produced by Vinccler Venezuela to PDVSA for a price of \$1.33 per Mcf. On August 4, 2005, Vinccler Venezuela signed a transitory agreement (the “Transitory Agreement”) under which Vinccler Venezuela agreed to convert the rights granted pursuant to the OSA to an Empresa Mixta. The terms and conditions of the Empresa Mixta are currently under negotiation. In addition to the Transitory Agreement, Vinccler and PDVSA entered in a confidentiality agreement to facilitate the exchange of information during the negotiations.

The terms and conditions, including the equity ownership, of the Empresa Mixta to be entered between Vinccler Venezuela and PDVSA is the subject of negotiations which are presently ongoing. While the ultimate contractual arrangement that will result from negotiations remain, at present, uncertain, PDVSA has advised Vinccler Venezuela that PDVSA will own a majority, controlling interest in the Empresa Mixta, Vinccler Venezuela will hold a minority interest, the Empresa Mixta will be subject to a royalty on production of oil and natural gas at a rate of 30% and will be taxed at a rate of 50%. Vinccler Venezuela will be required to pay its proportionate share of the applicable royalties and taxes charged to the Empresa Mixta. The term of the Empresa Mixta is expected to be 20 years.

2 Significant accounting policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) and include the following significant accounting policies:

Cash

Cash includes short-term and demand deposits with a term to maturity of three months or less when purchased and are recorded at cost.

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported years. Balances that are significantly affected by estimates include amortization, depletion and accretion, as well as provision for asset retirement obligations. Actual results could differ from these estimates.

Amounts used for cost recovery calculation for the annual assessment of oil and gas properties are based on estimates of oil and natural gas reserves in the area covered by the operating service contract. The reserve estimates are reviewed annually by an independent engineering firm. By their nature, these estimates of reserves and future cash flows are subject to measurement uncertainty and the impact on the financial statements of future periods could be material.

Property and equipment

The Corporation follows the full cost method of accounting for oil and gas properties and related expenditures, whereby all costs relating to the exploration for and development of petroleum and natural gas reserves are capitalized and accumulated. Such costs include geological and geophysical studies, drilling, equipment and facilities, carrying charges on non-producing properties and related overhead. General and administrative expenses and interest are expensed as incurred. Unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion. Proceeds from the sale of oil and gas properties and equipment are applied against capitalized costs.

The costs are depleted on the unit-of-production method based on the estimated proven reserves that Vincler Venezuela is able to produce by the end of the operating service contract period. The ratio of production to proved reserves determines the proportion of depletable costs to be expensed. Undeveloped properties are excluded from the depletion calculation until quantities of proved reserves are found or if impairment occurs. Other property and equipment is amortized using the straight-line method over their estimated useful lives of three years.

Gains and losses are not recognized upon disposition of oil and natural gas properties unless such disposition would alter the rate of depletion by 20% or more.

The AcG-16 "Oil and Gas Accounting – Full Cost", Accounting Guideline issued by the Canadian Institute of Chartered Accountants requires that a ceiling test be performed at least annually to assess the carrying value of oil and gas assets. The assets are tested for recoverability using undiscounted future cash flows from proved reserves and forward indexed commodity prices, adjusted for contractual obligations and product quality differentials. The assets are written down to their fair value when the carrying value, less the cost of unproved properties, is in excess of the related undiscounted cash flows. Fair value is estimated using techniques that incorporate risk and uncertainty when determining expected future cash flows. Unproved properties are excluded from the ceiling test calculation and subject to a separate impairment test.

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

The fair value of estimated asset retirement obligations is recognized in the Consolidated Balance Sheet when identified and a reasonable estimate of fair value can be made. Asset retirement obligations include those legal obligations where the Corporation will be required to retire tangible long lived assets. 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 amortized using the unit-of production method. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion of asset retirement obligation in the Consolidated Statement of Operations. Actual expenditures incurred are charged against the accumulated obligation.

Translation of foreign currencies

These consolidated financial statements are presented and measured in U.S. dollars, as substantially all of the Corporation's operations are located in Venezuela where the Corporation uses the U.S. dollar as its functional currency. Transactions and balances using the Venezuelan Bolivar ("Bs") are translated into U.S. dollars using the temporal method at the official exchange rate. Under this method, monetary assets and liabilities are translated at the period-end exchange rate. Non-monetary assets and liabilities are translated at historical exchange rates. Revenue and expenses are translated at the weighted average exchange rate for the period. Exchange gains and losses from the translation of monetary items are included in the consolidated statements of operations and retained earnings (deficit).

Revenue

Oil and gas revenue is recognized at the time production is delivered to PDVSA with the remuneration in accordance with a formula set forth in the OSA and its addendum approved on May 27, 2005.

Income taxes

Vinccler Venezuela files its Venezuelan income tax return using the Venezuelan Bolivar as the reporting currency in accordance with the Venezuelan income tax law which also provides regular adjustments for inflation. Vinccler Venezuela recognizes the effects of the inflation in non-monetary assets and liabilities through the application of the Consumer General Price Index, based on procedures established in the Venezuelan tax legislation. This adjustment for inflation is considered to be a taxable gain or, in the case of deflation, a deductible loss in determining the taxable income. As the majority of Vinccler Venezuela's net assets are held in US dollars but the tax return is filed in Venezuelan Bolivars, foreign currency exchange adjustments will produce either a taxable gain or a deductible loss. The variation between the Venezuelan statutory tax rate of 50% and the income tax rate presented in these financial statements is due to the adjustments required for inflation and foreign currency translation.

In November 1993, the Venezuelan Corporate Assets Tax Law was enacted. Companies are exempt from this tax for their first two years of activity. The first declaration and payment of this tax for Vinccler Venezuela was due in the fiscal year ended December 31, 2002. The tax is determined on the basis of the simple average value of tangible and intangible assets generating revenue. The annual tax rate applicable is 1% and is determined by the cost of the assets less any devaluation due to inflation, plus the updated value of non-monetary assets and liabilities after adjusting for inflation. The tax can be credited against income

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

tax payable for the next three years. In August 2004, the tax was eliminated and all credited amounts due to this tax was used against 2004 income tax.

Future income taxes

Income taxes are calculated using the liability method of tax allocation accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using the substantively enacted tax rates and laws that are expected to be in effect in the periods that the temporary differences are expected to reverse. The effect of changes in rates is included in earnings in the period which includes the substantive enactment of the rate changes. Temporary differences also arise due to fluctuations in the exchange rate between the US dollar and the Venezuelan Bolivar that are not matched by corresponding rates of inflation in the same period. Historically, the inflation rate in Venezuela has mirrored the rate of devaluation of the Venezuelan Bolivar against the US dollar.

Stock-based compensation

The Corporation records compensation cost in the consolidated financial statements for stock options granted using the Black-Scholes option-pricing model to determine its fair value. Compensation costs are recognized over the vesting period.

Reclassification

Certain information provided for prior years has been reclassified to conform to the current year presentation.

3 Accounts Receivable

At December 31, 2005, PetroFalcon had \$14.4 million (2004 - \$4.3 million) in accounts receivable of which \$3 million represents credit for IVA (Value Added Taxes) incurred as a result of the Corporation's capital expenditures during the year, and \$7.4 million which represent the return of the bid to the Castilletes Block made by VOG (see note 15) on November 15, 2005.

4 Gain on financing transactions

During the year ended December 31, 2005, Vinccler Venezuela recorded a gain of \$2,443,876 as a result of the acquisition and disposal of US dollar denominated Venezuelan government bonds (2004-\$1,354,167).

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

Issued	Number of Shares	Amount \$
As at December 31, 2003	52,853,379	10,195,314
Exercise of Canadian warrants	6,840,000	6,431,407
Exercise of U.S. warrants	4,551,600	3,542,670
Exercise of agents' options	588,249	442,490
Exercise of special warrants	10,240,000	15,859,165
Exercise of share options	105,000	42,149
As at December 31, 2004	75,178,228	36,513,195
Conversion of long term debt	2,078,273	4,000,000
Exercise of stock options	374,906	241,055
Transfer from contributed surplus related to exercise of stock options	-	43,292
As at December 31, 2005	77,631,407	40,797,542

Common stock

The common shares of PetroFalcon are all of the same class, are voting and entitle shareholders to receive dividends as and when declared by the Board of Directors. In the event of a liquidation, dissolution or winding up, the shareholders are entitled to receive equal distributions of net assets or any dividends which may be declared.

Stock option plan

A summary of the status of the PetroFalcon's stock option plan and changes during the periods is presented below:

	2005		2004	
	Share Options	Weighted- average exercise price CDN\$	Share Options	Weighted- average exercise price CDN\$
Outstanding – beginning of year	7,420,000	1.67	4,365,000	0.93
Granted	1,931,500	2.38	3,250,000	2.62
Exercised	(374,906)	0.78	(105,000)	0.52
Cancelled	(80,400)	2.00	(90,000)	1.23
Outstanding – end of year	8,896,194	1.86	7,420,000	1.67
Options exercisable – December 31	4,515,029	1.34	2,205,000	0.89

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

A summary of stock options outstanding at December 31, 2005 is set out below:

Exercise price	Outstanding stock options		Exercisable stock options
	Number	Weighted average remaining contractual life	Number
\$0.50	250,000	2.70 years	250,000
\$0.72	100,000	1.40 years	100,000
\$1.00	3,438,354	7.70 years	3,100,022
\$1.30	13,340	8.00 years	6,674
\$2.05	30,000	9.83 years	-
\$2.20	290,000	8.50 years	96,667
\$2.35	1,885,000	8.70 years	628,333
\$2.38	300,000	9.75 years	-
\$2.39	1,589,500	9.45 years	-
\$3.28	1,000,000	8.90 years	333,333
	<u>8,896,194</u>		<u>4,515,029</u>

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

Risk free interest rate	3.33%
Expected volatility	60%
Dividends yield rate	0.00%
Weighted average expected life of options	5 years

Issue of warrants

On June 28, 2005, PetroFalcon issued 100,000 warrants with an exercise price of CDN\$2.17 per warrant in connection with the IFC financing. There were no proceeds received by the Corporation from the issue of warrants. Each warrant is exercisable into one common share of PetroFalcon until June 30, 2007. As of December 31, 2005, these warrants remained outstanding.

Private Placement

On June 26, 2005, PetroFalcon issued 2,078,273 common shares at a price of CDN\$2.37 per share as a result of the conversion of \$4,000,000 of long term debt (see note 7).

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

7 Long-term debt

The Corporation's debt consists of the following:

	2005	2004
	\$	\$
Due to shareholder with no specific terms for repayment, unsecured and non-interest bearing	3,000,000	-
Bank loans bearing interest at 17%, with maturity of 90 day basis	7,081,395	2,825,521
Due to International Finance Corporation bearing interest at "(), with maturity in 2011	8,000,000	-
	<u>18,081,395</u>	<u>2,825,521</u>
Short Term	10,081,395	2,825,521
Long term	<u>8,000,000</u>	-

The Bank Loans consisted of Vinccler Venezuela's lines of credit with Venezuelan banks to meet its short term working capital and local currency financing.

During the year ended December 31, 2004, Vinccler Venezuela secured a line of credit of five billion Bolivar (\$2.6 million) from Banco Occidental de Descuento ("BOD"). This line of credit was secured by an irrevocable Letter of Credit ("LC") issued by HSBC Bank in favour of BOD which was 100% cash collateralized. Vinccler Venezuela also arranged a five billion Bolivar (\$2.6 million) line of credit with Banco Exterior ("BE") which required that Vinccler Venezuela maintained a balance of \$1 million with BE. As of December 31, 2004, the \$2.6 million LC and the \$1 million deposit with BE were considered restricted cash. On August 1, 2005, Vinccler Venezuela realized its secured deposit of \$1 million and extended an unsecured line of credit with BE for 10 billion Bolivars (\$4.66 million). On August 10, 2005, Vinccler Venezuela repaid BOD its existing line of credit and had the related LC for \$2.6 million released. On August 31, 2005, Vinccler Venezuela renewed an unsecured line of credit of Bs.5 billion (\$2.33 million) with BOD.

The Corporation reached an agreement with the International Finance Corporation ("IFC"), the private sector arm of the World Bank, pursuant to which the IFC will provide up to \$36 million in loans to Vinccler Venezuela for the development of oil and gas properties. During the second quarter of 2005, the IFC disbursed \$12 million from the "C" Loan. Principal repayments on the "C" Loan are due in 2011. Interest will be payable semi-annually on May 15 and November 15 and will accrue at the London Inter Bank Offered Rate ("Libor") plus 1% for the "C" Loan from June 27, 2005, the date of the full disbursement of the "C" loan. IFC is also entitled to receive three percent of Vinccler Venezuela's cash flow so long it does not exceed 10% per annum of the principal amount of the "C" loan on an aggregate accumulated basis. At December 31, 2005, the outstanding principal due to IFC was \$8 million as a result of IFC's conversion of \$4 million of debt into 2,078,273 common shares of PetroFalcon based on a price of CDN\$2.37, which was determined by the average closing price of the last 20 trading days to the date of the "C" Loan Agreement. During the year ended December 31, 2005, the effective interest rate on the "C" loan was 5.44%. IFC has

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

the option, from January 1, 2006, until December 27, 2008, to convert all or portion of the remaining \$8 million "C" loan into common shares of PetroFalcon at the market price of PetroFalcon's common shares at the time of conversion. The facility contains a number of covenants that Vinccler Venezuela must fulfill including the satisfaction of minimum financial tests, compliance with IFC and World Bank environmental and social policies and compliance with restrictions on the use and application of the proceeds.

8 Asset retirement obligations

The following table presents the reconciliation of the beginning and ending aggregate asset retirement obligation associated with the retirement of oil and gas properties:

(\$000's)	2005	2004
Asset retirement obligation, beginning of year	347,720	321,964
Liabilities recorded during the period	139,943	-
Accretion expense	34,894	25,756
Asset retirement obligation, end of year	522,557	347,720

The total undiscounted amount of the estimated cash flows required to settle the obligations is \$570,000 (2004 - \$510,000), which has been discounted using a credit-adjusted risk free rate of 8 %. Payments to settle the obligations will occur on an ongoing basis over the next 10 years.

9 Related party transactions and balances

Pacific Oil and Gas, LLC and Venezolana de Inversiones y Construcciones Clerico, C.A. are controlled by officers of PetroFalcon. For the year ended December 31, 2005, the Corporation paid to Pacific Oil and Gas, LLC, controlled by PetroFalcon's Chief Financial Officer, Clarence Cottman and the Corporation's President, William Gumma, \$840,000 for professional services (\$680,000, for the year ended December 31, 2004). During the year ended December 31, 2005, PetroFalcon was also invoiced \$1.84 million for construction services provided by Venezolana de Inversiones y Construcciones Clerico, C.A. an independent operating construction company controlled by the Company's Chairman of the Board and Chief Executive Officer, Juan Francisco Clerico.

These related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

On November, 26, 2005, Vinccler Venezuela received a short term loan for the amount of \$3,000,000 from its Chief Executive Officer. The purpose of the facility was to finance the bid for the Castilletes Noreste II Block in the Rafael Urdaneta Phase B lease sale in the Gulf of Venezuela (the "Block"). On February 15, 2006, the short term loan received by Vinccler Venezuela from its Chief Executive Officer was fully repaid.

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

10 Income Tax

During 2005 the Corporation recorded a current income tax expense of \$1,515,078 (2004-\$265,473) and a future income tax benefit of \$312,542 (2004-\$Nil).

Current income tax expense was recognized in Vinccler Venezuela due to additional tax assessments received from the National Integrated Customs and Tax Administration Service of Venezuela (“SENIAT”) with respect to the income tax returns for the years ended December 31, 2001 to 2004, inclusive, for a total of \$3,288,000 (Bs. 7,071,000,000) payable in nominal Bolivars. The revised tax assessment was mainly due to the SENIAT’s reinterpretation of Vinccler Venezuela’s business purpose. The SENIAT stresses that under its income tax laws, Vinccler Venezuela is an oil and natural gas producing company instead of an operating service company. Thus, the income tax expense for the audited years had to be recalculated at the rate of 50% (rather than the previous rate of 34%). Vinccler Venezuela filed amended tax returns on December 22, 2005, and partially accepted SENIAT’s objections, which represents the current income tax expense of \$1,515,078 (Bs. 3,257,000,000) and includes additional income tax of \$1,365,000 (Bs. 2,936,000,000). On January 26, 2006, Vinccler Venezuela filed a discharge claim with SENIAT and SENIAT is expected to issue an acceptance resolution within one year from the filing date of the discharge claim. There are technical arguments to support the inadmissibility of objections by the SENIAT tax authorities in the tax assessments and the Corporation has not, therefor, set aside any provision to cover additional liabilities, however, there are no assurances that the SENIAT will accept the technical arguments made.

A future income tax expense of \$770,000 was recognized in Vinccler Venezuela based on a timing difference in the financial and fiscal treatment of fixed assets. In addition, Vinccler Venezuela recorded a future income tax benefit of \$150,000 related to carry forward tax losses for the years ended December 31, 2005 to 2008, inclusive. Future income tax benefits were also recognized in the two Canadian entities Vinccler Oil and Gas Corporation and PetroFalcon. These benefits arose due to an exchange loss of \$2.4 million from the fluctuation of each company’s currency for Canadian tax filing purposes.

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

A reconciliation of the consolidated income tax expense for 2005 and 2004 is set forth below:

	2005 \$	2004 \$
Earnings before tax	2,212,139	2,378,523
Combined statutory income tax rate	34%	34%
	<u>752,127</u>	<u>808,698</u>
Income taxes at statutory rate		
Increase (decrease) resulting from		
Benefit of tax losses not recognized	465,868	628,364
Non-taxable transactions	(1662,059)	(460,417)
Inflation adjustments (Venezuela)	(283,041)	(376,601)
Benefit of recognizing previous years' losses	(709,212)	(186,422)
Increase resulting from taxation in Venezuela	353,942	-
Venezuelan capital tax expense (benefit)	-	(141,718)
Property and Equipment	769,833	
Additional income tax from tax assessment	1,515,078	(6,431)
Other	-	(6,431)
	<u>1,202,536</u>	<u>265,473</u>

The Corporation's future income tax asset (liability) is comprised of the following tax-affected temporary differences:

	2005 \$	2004 \$
Foreign exchange losses	820,372	-
Operating loss carryforwards	365,119	-
Provisions	373,162	-
Valuation allowance	(476,279)	-
Difference in property basis	(769,832)	-
	<u>312,542</u>	<u>-</u>

11 Financial instruments

The Corporation is exposed to fluctuations in commodity prices, interest rates and Canada/U.S. dollars and Venezuelan Bolivar/U.S. dollars exchange rates. The Corporation, where appropriate, utilizes financial instruments to manage its exposure to these risks. During the year, the Company did not hold or issue any derivative financial instruments. The Company's financial assets and liabilities as at December 31, 2005 included cash, accounts receivable and accounts payable. Fair values approximate carrying values unless otherwise stated.

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

Additionally, the Company's financial instruments include long-term debt that bears interest at market-related rates, which approximates fair value.

12 Economic dependence

Payments to the Corporation from PDVSA under the OSA and its Gas Addendum are the primary source of revenues. Any material failure of PDVSA to fulfill its obligations under the OSA would have a material adverse effect on the Corporation's business, financial condition and results of operations.

13 Commitments

At December 31, 2005, the Corporation had outstanding commitments for the purchase of capital equipment of \$0.84 million (2004-\$2.7 million).

14 Earnings per share

	2005	2004
Net income	\$1,009,603	\$2,113,050
Weighted average number of common shares	76,404,818	68,377,996
Stock Options and Warrants*	7,996,194	6,420,000
Basic earnings per share	\$0.01	\$0.03
Diluted earnings per share*	\$0.01	\$0.03

* The calculation of diluted earnings per common share excludes 1,000,000 options in both 2004 and 2005 as these would have been anti-dilutive to the calculation.

15 Subsequent Events

On January 12, 2006, Vinccler Venezuela opened a line of credit with Banco Mercantil for Bs. 2 billion (equivalent to \$1 million).

On November 15, 2005, Vinccler Venezuela was declared the winning bidder for the Castilletes Noreste II Block in the Rafael Urdaneta Phase B lease sale in the Gulf of Venezuela (the "Castilletes Block"). Due to circumstances beyond Vinccler Venezuela's control, exploration and exploitation activities may not be commenced in the Castilletes Block. On February 1, 2005, Vinccler Venezuela signed an agreement with MENPET defining Vinccler Venezuela future rights and obligations regarding the Castilletes Block. The agreement states that, in consideration of Vinccler Venezuela waiving all claims for damages that may flow from the postponement of the start of exploration and exploitation activities in the Castilletes Block, MENPET agreed to initiate all procedures with the Venezuelan national treasury to return the \$7,388,000

PetroFalcon Corporation

Notes to Amended Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

(expressed in U.S. dollars)

bid paid for the Castilletes Block and granted Vinccler Venezuela the exclusive right to exercise the option of commencing exploration and exploitation activities when circumstances permit by re-posting the bid amount. On February 14, 2006 Vinccler Venezuela was returned the full amount of the bid from MENPET and on February 15, 2006 the \$3 million short term loan received by Vinccler Venezuela from its Chief Executive Officer in respect of the Castilletes Block bid was fully re-paid.

On March 21, 2006 Vinccler Venezuela completed the acquisition of West Falcon Samson Hydrocarbons, S.R.L. ("WFSH"), which is permitted pursuant to the terms of an operating service agreement entered into on November 17, 1994 with a predecessor of PDVSA, to produce oil and natural gas on the West Falcon Block which is immediately adjacent to the East Falcon Block and covers approximately 2 million acres. The acquisition was effective October 1, 2005 and the purchase price was \$2 million in cash and the issuance of 1.75 million common shares of PetroFalcon. Current production is approximately 450 boe/d. Vinccler Venezuela anticipates that the West Falcon operating service agreement will become a part of the Empresa Mixta which is presently being negotiated with PDVSA.