



**VERMILION ENERGY INC.**

**FINANCIAL STATEMENTS**

**FOR THE THREE MONTHS ENDED MARCH 31, 2011**

## DISCLAIMER

Certain statements included or incorporated by reference in this document may constitute forward-looking statements under applicable securities legislation. Forward-looking statements or information typically contain statements with words such as "anticipate", "believe", "expect", "plan", "intend", "estimate", "propose", or similar words suggesting future outcomes or statements regarding an outlook. Forward looking statements or information in this document may include, but are not limited to:

- capital expenditures;
- business strategy and objectives;
- reserve quantities and the discounted present value of future net cash flows from such reserves;
- net revenue;
- future production levels and rates of average annual production growth;
- exploration plans;
- development plans;
- acquisition and disposition plans and the timing thereof;
- operating and other costs;
- royalty rates;
- Vermilion's additional future payment in connection with the Corrib acquisition;
- the timing of regulatory proceedings and approvals;
- the timing of first commercial gas from the Corrib field; and
- estimate of Vermilion's share of the expected gas rates from the Corrib field.

Such forward-looking statements or information are based on a number of assumptions all or any of which may prove to be incorrect. In addition to any other assumptions identified in this document, assumptions have been made regarding, among other things:

- the ability of Vermilion to obtain equipment, services and supplies in a timely manner to carry out its activities in Canada and internationally;
- the ability of Vermilion to market oil and natural gas successfully to current and new customers;
- the timing and costs of pipeline and storage facility construction and expansion and the ability to secure adequate product transportation;
- the timely receipt of required regulatory approvals;
- the ability of Vermilion to obtain financing on acceptable terms;
- currency, exchange and interest rates;
- future oil and natural gas prices; and
- Management's expectations relating to the timing and results of development activities.

Although Vermilion believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward looking statements because Vermilion can give no assurance that such expectations will prove to be correct. Forward-looking statements or information are based on current expectations, estimates and projections that involve a number of risks and uncertainties which could cause actual results to differ materially from those anticipated by Vermilion and described in the forward looking statements or information. These risks and uncertainties include but are not limited to:

- the ability of management to execute its business plan;
- the risks of the oil and gas industry, both domestically and internationally, such as operational risks in exploring for, developing and producing crude oil and natural gas and market demand;
- risks and uncertainties involving geology of oil and natural gas deposits;
- risks inherent in Vermilion's marketing operations, including credit risk;
- the uncertainty of reserves estimates and reserves life;
- the uncertainty of estimates and projections relating to production, costs and expenses;
- potential delays or changes in plans with respect to exploration or development projects or capital expenditures;
- Vermilion's ability to enter into or renew leases;
- fluctuations in oil and natural gas prices, foreign currency exchange rates and interest rates;
- health, safety and environmental risks;
- uncertainties as to the availability and cost of financing;
- the ability of Vermilion to add production and reserves through development and exploration activities;
- general economic and business conditions;
- the possibility that government policies or laws may change or governmental approvals may be delayed or withheld;
- uncertainty in amounts and timing of royalty payments;
- risks associated with existing and potential future law suits and regulatory actions against Vermilion; and
- other risks and uncertainties described elsewhere in this document or in Vermilion's other filings with Canadian securities authorities.

The forward-looking statements or information contained in this document are made as of the date hereof and Vermilion undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless required by applicable securities laws.

Natural gas volumes have been converted on the basis of six thousand cubic feet of natural gas to one barrel equivalent of oil. Barrels of oil equivalent (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet to one barrel of oil is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

**CONSOLIDATED BALANCE SHEETS**  
(THOUSANDS OF CANADIAN DOLLARS, UNAUDITED)

	Note	March 31, 2011	December 31, 2010	January 1, 2010
<b>ASSETS</b>				
<b>Current</b>				
Cash and cash equivalents	17	\$ 182,426	\$ 145,623	\$ 99,066
Short-term investments		14,520	15,132	15,895
Accounts receivable		169,554	147,329	117,051
Crude oil inventory		13,371	10,707	5,235
Derivative instruments	13	10,552	10,249	8,217
Prepaid expenses and other		9,137	11,157	11,422
		<b>399,560</b>	<b>340,197</b>	<b>256,886</b>
Derivative instruments	13	-	942	7,896
Deferred taxes		167,302	147,949	124,707
Long-term investments		2,717	3,108	4,342
Exploration and evaluation assets	5	18,424	17,157	-
Goodwill	5	-	-	19,840
Reclamation fund	6	-	-	69,003
Capital assets	4	1,940,715	1,816,444	1,610,567
		<b>\$ 2,528,718</b>	<b>\$ 2,325,797</b>	<b>\$ 2,093,241</b>
<b>LIABILITIES</b>				
<b>Current</b>				
Accounts payable and accrued liabilities		\$ 291,473	\$ 252,319	195,909
Dividends or distributions payable		17,073	16,910	15,109
Derivative instruments	13	54,662	12,143	6,544
Income taxes payable		101,617	59,562	4,090
		<b>464,825</b>	<b>340,934</b>	<b>221,652</b>
Derivative instruments	13	11,962	8,157	4,563
Long-term debt	8	376,053	302,558	159,723
Amount due pursuant to acquisition	7	113,951	114,349	111,402
Asset retirement obligations	6	267,360	267,389	224,005
Equity based compensation liability	11	-	-	30,307
Deferred taxes		240,615	246,508	255,598
		<b>1,474,766</b>	<b>1,279,895</b>	<b>1,007,250</b>
Liability associated with exchangeable shares	10	-	-	217,992
<b>SHAREHOLDERS' OR UNITHOLDERS' EQUITY</b>				
Shareholders' capital	9	1,060,930	1,025,770	-
Unitholders' capital	9	-	-	711,667
Contributed surplus		31,759	40,726	-
Accumulated other comprehensive loss		(20,980)	(31,577)	-
Retained earnings (deficit)		(17,757)	10,983	156,332
		<b>1,053,952</b>	<b>1,045,902</b>	<b>867,999</b>
		<b>\$ 2,528,718</b>	<b>\$ 2,325,797</b>	<b>\$ 2,093,241</b>

**APPROVED BY THE BOARD**

(Signed "Kenneth Davidson")

W. Kenneth Davidson, Director

(Signed "Lorenzo Donadeo")

Lorenzo Donadeo, Director

**CONSOLIDATED STATEMENTS OF NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS)**  
(THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE OR UNIT AND PER SHARE OR UNIT AMOUNTS, UNAUDITED)

	Note	Three Months Ended	
		March 31, 2011	March 31, 2010
Petroleum and natural gas sales		\$ 229,740	\$ 169,581
Royalties		(13,207)	(13,147)
Petroleum and natural gas revenue		216,533	156,434
<b>EXPENSES</b>			
Operating		37,848	36,335
Transportation		6,084	6,949
Equity based compensation	11	8,226	12,273
Loss (gain) on derivative instruments	13	50,918	(4,086)
Interest expense		5,374	3,033
General and administration		12,107	10,153
Foreign exchange (gain) loss		(13,284)	22,328
Other expense		352	1,534
Accretion	6	6,315	4,519
Depletion and depreciation		51,714	39,214
		165,654	132,252
<b>EARNINGS BEFORE INCOME TAXES AND OTHER ITEM</b>		<b>50,879</b>	<b>24,182</b>
<b>INCOME TAXES</b>			
Deferred		(25,913)	(10,931)
Current		49,599	24,923
		23,686	13,992
<b>OTHER ITEM</b>			
Remeasurement loss on liability associated with exchangeable shares	10	-	18,373
		-	18,373
<b>NET EARNINGS (LOSS)</b>		<b>27,193</b>	<b>(8,183)</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>			
Currency translation adjustments		10,597	(33,606)
		10,597	(33,606)
<b>COMPREHENSIVE INCOME (LOSS)</b>		<b>\$ 37,790</b>	<b>\$ (41,789)</b>
<b>NET EARNINGS (LOSS) PER SHARE OR UNIT</b>			
Basic	12	\$ 0.30	\$ (0.10)
Diluted		\$ 0.30	\$ (0.10)
<b>WEIGHTED AVERAGE SHARES OR UNITS OUTSTANDING</b>			
Basic	12	89,224,446	79,710,068
Diluted		90,513,768	79,710,068

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(THOUSANDS OF CANADIAN DOLLARS, UNAUDITED)

	Note	Three Months Ended	
		March 31, 2011	March 31, 2010
<b>OPERATING</b>			
Net earnings (loss)		\$ 27,193	\$ (8,183)
Adjustments:			
Accretion		6,315	4,519
Depletion and depreciation		51,714	39,214
Change in unrealized gains and losses and accruals relating to derivative contracts	13	46,963	(4,333)
Equity based compensation		8,226	12,273
Unrealized foreign exchange (gain) loss		(13,104)	24,426
Remeasurement loss on liability associated with exchangeable shares		-	18,373
Change in unrealized gains and losses and accruals included in other expense relating to investments		391	1,537
Deferred taxes		(25,913)	(10,931)
		<b>101,785</b>	<b>76,895</b>
Asset retirement obligations settled	6	(1,631)	-
Changes in non-cash operating working capital	14	26,463	3,342
Cash flows from operating activities		<b>126,617</b>	<b>80,237</b>
<b>INVESTING</b>			
Drilling and development of petroleum and natural gas properties		(118,414)	(119,896)
Acquisition of petroleum and natural gas properties		(38,291)	(954)
Proceeds from purchase of short-term investments		612	80
Changes in non-cash investing working capital	14	29,320	(6,172)
Cash flows used in investing activities		<b>(126,773)</b>	<b>(126,942)</b>
<b>FINANCING</b>			
Increase in long-term debt		72,593	44,999
Issue of common shares or trust units pursuant to the dividend or distribution reinvestment plans		12,976	7,380
Cash dividends		(50,779)	-
Cash distributions		-	(45,359)
Cash flows from financing activities		<b>34,790</b>	<b>7,020</b>
Foreign exchange gain (loss) on cash held in foreign currencies		2,169	(5,945)
Net change in cash and cash equivalents		<b>36,803</b>	<b>(45,630)</b>
Cash and cash equivalents, beginning of period		145,623	99,066
Cash and cash equivalents, end of period	17	\$ 182,426	\$ 53,436
Supplementary information for operating activities - cash payments			
Interest paid		\$ 2,366	\$ 2,679
Income taxes paid		\$ 7,544	\$ 1,924

**STATEMENT OF CHANGES IN SHAREHOLDERS' (UNITHOLDERS') EQUITY**  
(THOUSANDS OF CANADIAN DOLLARS, UNAUDITED)

	Note	Shareholders' or Unitholders' Capital	Contributed Surplus	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total Shareholders' or Unitholders' Equity
Balances as at January 1, 2010		\$ 711,667	\$ -	\$ 156,332	\$ -	\$ 867,999
Currency translation adjustments		-	-	-	(31,577)	(31,577)
Vesting of equity based compensation awards	11	23,149	-	-	-	23,149
Issuance of shares or units pursuant to distribution or dividend reinvestment plans		40,824	-	-	-	40,824
Modification of equity based compensation from liability to equity		-	7,159	-	-	7,159
Equity based compensation expense		-	33,567	-	-	33,567
Issued on conversion of exchangeable shares	10	249,121	-	-	-	249,121
Units issued for bonus plan		1,009	-	-	-	1,009
Net earnings		-	-	44,395	-	44,395
Distributions declared		-	-	(122,236)	-	(122,236)
Dividends declared		-	-	(67,508)	-	(67,508)
Balances as at December 31, 2010		\$ 1,025,770	\$ 40,726	\$ 10,983	\$ (31,577)	\$ 1,045,902
Currency translation adjustments		-	-	-	10,597	10,597
Vesting of equity based compensation awards	11	16,407	(16,407)	-	-	-
Equity based compensation expense		-	7,440	-	-	7,440
Issuance of shares pursuant to the dividend reinvestment plan		12,976	-	-	-	12,976
Shares issued for bonus plan		786	-	-	-	786
Net earnings		-	-	27,193	-	27,193
Dividends declared		-	-	(50,942)	-	(50,942)
Equity-settled dividends on vested equity based awards	9	4,991	-	(4,991)	-	-
Balances as at March 31, 2011		\$ 1,060,930	\$ 31,759	\$ (17,757)	\$ (20,980)	\$ 1,053,952

**Description of equity reserves**

*Shareholders' (Unitholders') capital*

Represents the initially recognized amount for common shares or trust units issued and outstanding including share issuance costs associated with past issuances. Prior to September 1, 2010 the equity instruments issued and outstanding were trust units.

*Contributed surplus*

Represents the recognized value of employee awards which are settled in shares. Once vested the value of the awards is transferred to shareholders' capital.

*Retained earnings (deficit)*

Represents the consolidated undistributed earnings or accumulated losses of Vermilion.

*Accumulated other comprehensive income (loss)*

Includes income and expenses which are not recorded immediately in earnings and are accumulated until an event triggers recognition in earnings and results in a change to both accumulated other comprehensive income (loss) and retained earnings (deficit). The current balance consists of currency translation adjustments resulting from translating financial statements of subsidiaries with a foreign functional currency to Canadian dollars at period end rates.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2011 AND 2010**

(TABULAR AMOUNTS IN THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE OR UNIT AND PER SHARE OR UNIT AMOUNTS, UNAUDITED)

**1. BASIS OF PRESENTATION**

Vermilion Energy Inc. (the "Company" or "Vermilion") is a corporation governed by the laws of the Province of Alberta and is actively engaged in the business of oil and natural gas development, acquisition and production. The Company is the successor entity to Vermilion Energy Trust (the "Trust") following a corporate conversion completed on September 1, 2010 pursuant to an arrangement under the *Business Corporations Act (Alberta)*.

As a result of the conversion, units of the Trust were converted to common shares of Vermilion on a one-for-one basis and holders of exchangeable shares in Vermilion Resources Ltd., a wholly owned subsidiary of Vermilion, received 1.89344 common shares of the Company for each exchangeable share held (see Note 10). There were no exchangeable shares outstanding subsequent to the corporate conversion.

The conversion was accounted for on a continuity of interests basis, which recognizes Vermilion as the successor entity and accordingly, all comparative information presented for the pre-conversion period is that of the Trust. All transaction costs associated with the conversion were expensed as incurred as general and administration expense.

These consolidated financial statements were approved and authorized for issuance by the Board of Directors of Vermilion on May 4, 2011.

**2. SIGNIFICANT ACCOUNTING POLICIES**

***Accounting Framework***

The consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles for publicly accountable entities ("Canadian GAAP" or "GAAP") (alternatively, International Financial Reporting Standards ("IFRS")) which includes International Accounting Standard ("IAS") 34 "Interim Financial Reporting" as issued by the International Accounting Standards Board ("IASB"). These condensed consolidated financial statements do not include all the necessary annual disclosures in accordance with IFRS.

***Principles of Consolidation***

Subsidiaries that are directly controlled by the parent company or indirectly controlled by other consolidated subsidiaries are fully consolidated. Vermilion accounts for jointly controlled operations and jointly-controlled assets by recognizing its share of assets, liabilities, income and expenses. All significant intercompany balances, transactions and income are eliminated.

Vermilion currently has no special purpose entities of which it retains control and accordingly the consolidated financial statements do not include the accounts of any such entities.

***Exploration and Evaluation Assets***

Vermilion accounts for exploration and evaluation ("E&E") costs in accordance with IFRS 6 "Exploration for and Evaluation of Mineral Resources". Costs incurred are classified as E&E costs when they relate to exploring and evaluating a property for which the Company has the licence or right to extract resources.

E&E costs related to each license or prospect area are initially capitalized within E&E assets. E&E costs capitalized may include costs of licence acquisition, technical services and studies, seismic acquisition, exploration drilling and testing, directly attributable overhead and administration expenses and, if applicable, the estimated costs of retiring the assets. Any costs incurred prior to the acquisition of the legal rights to explore an area are expensed as incurred.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

E&E assets are not depleted pending evaluation and are carried at cost until technical feasibility and commercial viability of the area can be determined. The technical feasibility and commercial viability of extracting the reserves is considered to be determined when proven and/or probable reserves are determined to exist. If proven and/or probable reserves are identified the costs are capitalized as part of a new or existing depletion unit within petroleum and natural gas properties and equipment. If reserves are not found within the license area or the area is abandoned the E&E costs are amortized over a period no longer than five years and subject to an impairment test at least annually, as part of the group of cash generating units attributable to the jurisdiction in which the exploration area resides.

### ***Petroleum and Natural Gas Operations***

Vermilion recognizes petroleum and natural gas ("PNG") properties and equipment at cost less accumulated depletion, depreciation and impairment losses. The cost of PNG properties and equipment as at January 1, 2010 was determined in accordance with the IFRS 1 "Deemed Cost for Oil and Gas Assets" exemption through the allocation of the pre-transition Canadian GAAP carrying value to depletion units based upon relative reserve values at that date (Note 21). Directly attributable costs incurred for the drilling of development wells and for the construction of production facilities are capitalized together with the discounted value of estimated future costs of asset retirement obligations. When components of PNG properties are replaced, disposed of or no longer in use they are derecognized.

Gains and losses on disposal of a component of PNG properties and equipment, including oil and gas interests, are determined by comparing the proceeds of disposal with the carrying amount of the component and are recognized net within depletion and depreciation.

### ***Depletion and Depreciation***

Vermilion classifies its assets into depletion units which are groups of assets or properties which are within a specific production area and have a similar production life. The depletion units represent the lowest level of disaggregation for which Vermilion accumulates costs for the purposes of calculating and recording depletion and depreciation.

The net carrying value of each PNG depletion unit is depleted using the unit of production method by reference to the ratio of production in the period to the total proven and probable reserves, taking into account the future development costs necessary to bring those reserves into production. The reserve estimates are reviewed annually by management or when material changes occur to the underlying assumptions.

For the purposes of the depletion and depreciation calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content based on a conversion ratio of six thousand cubic feet of natural gas to one barrel of oil.

Furniture and equipment are recorded at cost and are depreciated on a declining-balance basis at rates of 10% to 50% per year.

### ***Impairment of Long-Lived Assets***

E&E assets are tested for impairment when reclassified to petroleum and natural gas properties or when indicators of impairment are identified. An impairment loss is recognized for the amount by which the exploration and evaluation assets carrying value exceeds its recoverable amount. The recoverable amount is the higher of the exploration and evaluation assets fair value less costs to sell and their value in use.

PNG depletion units are aggregated into groups known as cash generating units ("CGUs") for impairment testing. A cash generating unit represents the lowest level at which there is identifiable cash inflows that are largely independent of the cash inflows of other groups of assets or properties. CGUs are reviewed for indicators that the carrying value of the CGU may exceed its recoverable amount. If an indication of impairment exists, the CGU's recoverable amount is then estimated. A CGU's recoverable amount is defined as the higher of the fair value less costs to sell and its value in use. If the carrying amount exceeds its recoverable amount an impairment loss is recorded to earnings in the period to reduce the carrying value of the CGU to its recoverable amount.



## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

For assets excluding goodwill, when there has been an impairment loss recognized, each period end an assessment is performed as to whether the circumstances which led to the impairment loss have reversed. If the change in circumstances leads to the recoverable amount being higher than the net book value after recognition of an impairment that impairment loss is reversed. The reversal of the impairment loss cannot exceed the depreciated value of the asset had no impairment loss been previously recognized.

### ***Cash and Cash Equivalents***

Cash and cash equivalents include monies on deposit and guaranteed investments that have an original maturity date of not more than 90 days.

### ***Short-Term Investments***

Short-term investments are comprised of guaranteed investment certificates with an original maturity date of greater than 90 days.

### ***Crude Oil Inventory***

Inventories of crude oil, consisting of production for which title has not yet transferred to the buyer are valued at the lower of cost or net realizable value. Cost is determined on a weighted-average basis.

### ***Long-Term Investments***

Long-term investments over which Vermilion does not have significant influence are carried at fair value. Dividends received or receivable from the investments are included in Vermilion's earnings, with no adjustment to the carrying amount of the investment.

### ***Goodwill***

Goodwill is tested for impairment at least annually by comparing the fair value of the cash generating units to the carrying amount attributable to the goodwill. If the carrying amount exceeds the fair value, an impairment loss is recognized for the excess.

### ***Provisions and Asset Retirement Obligations***

Vermilion recognizes a provision or asset retirement obligation in the consolidated financial statements at the time an event gives rise to an obligation of uncertain timing or amount. The estimated present value of the asset retirement obligation is recorded as a long term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted and allocated to a CGU for impairment testing as part of the assigned depletion unit. The liability recorded is increased each reporting period due to the passage of time and this accretion is charged to earnings in the period. The asset retirement obligation can also increase or decrease due to changes in the estimated timing of cash flows, changes in the discount rate or changes in the original estimated undiscounted costs. The offset to the increase or decrease in the change in an estimated asset retirement obligation is recorded to property plant and equipment. Actual costs incurred upon settlement of the asset retirement obligation are charged against the asset retirement obligation to the extent of the liability recorded. Vermilion discounts the costs related to asset retirement obligations using the pre-tax discount rate that reflects current market assessment of time value of money and risks specific to the liabilities that have not been reflected in the cash flow estimates and applies rates applicable to each of the jurisdictions in which it has future asset retirement costs.

A provision for onerous contracts is recognized when the expected benefits to be derived by Vermilion from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, Vermilion recognizes any impairment loss on associated assets. For the periods presented in the consolidated financial statement there were no onerous contracts recognized.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### ***Revenue Recognition***

Revenues associated with the sale of crude oil, natural gas and natural gas liquids are recorded when title passes to the customer. For Canadian natural gas production, legal title transfer occurs at the intersection of major pipelines (referred to as the "Hub") whereas the majority of Vermilion's Canadian oil production is sold at the well head. In Australia, oil is sold at the Wandoo B Platform, in the Netherlands natural gas is sold at the plant gate and in France oil is sold when delivered to the pipeline or when delivered to the refinery via tanker.

### ***Financial Instruments***

Cash and cash equivalents and short-term investments are classified as held for trading and are measured at fair value. A gain or loss arising from a change in the fair value is recognized in net earnings in the current period.

Accounts receivable are classified as loans and receivables and are initially measured at fair value and are then subsequently measured at amortized cost. The carrying value approximates the fair value due to the short-term nature of these instruments.

Accounts payable and accrued liabilities, dividends or distributions payable, long-term debt and amount due pursuant to acquisition, have been classified as other financial liabilities and are initially recognized at fair value and are subsequently measured at amortized cost. Transaction costs and discounts are recorded against the fair value of long-term debt on initial recognition.

All derivative, debt and equity security investments not subject to consolidation have been classified as held for trading and are measured at fair value. Accordingly, gains and losses are reflected in earnings in the period in which they arise. Gains and losses associated with Vermilion's investments in debt and equity securities are included in other expense in the consolidated statements of net earnings.

### ***Equity Based Compensation***

Vermilion has equity based long-term compensation plans for directors, officers and employees of Vermilion and its subsidiaries. The expense recognized for equity based compensation awards is measured as the grant date fair value of the award adjusted for the ultimate number of awards that actually vest as determined by the Company's achievement of a number of performance conditions. Equity based compensation expense is recognized in earnings over the vesting period of the awards with a corresponding adjustment to contributed surplus. Prior to September 1, 2010 Vermilion's equity based compensation plans were accounted for as liabilities (see Note 11).

Upon vesting, the amount previously recognized in contributed surplus is reclassified to shareholders' capital. Vermilion has incorporated an estimated forfeiture rate based on historical vesting data.

### ***Per Share or Unit Amounts***

Net earnings per share or unit are calculated using the weighted-average number of shares or units outstanding during the period. Diluted net earnings per share are calculated using the treasury stock method to determine the dilutive effect of equity based compensation plans. The treasury stock method assumes that the deemed proceeds related to unrecognized equity based compensation expense are used to repurchase shares or units at the average market price during the period. Equity based compensation awards outstanding are included in the calculation of diluted net earnings per share or unit based on estimated performance factors.

### ***Foreign Currency Translation***

The consolidated financial statements are presented in Canadian dollars which is Vermilion's reporting currency. Several of Vermilion's subsidiaries transact in currencies other than the Canadian dollar and accordingly have functional currencies other than the Canadian Dollar. The functional currency of a subsidiary is the currency of the primary economic environment in which the subsidiary operates. Transactions denominated in a currency other than the functional currency are translated at the prevailing rates on the date of the transaction. Any monetary items held in a currency which is not the functional currency of the subsidiary are translated to the functional currency at the prevailing rate as at the date of the balance sheet. All exchange differences arising as a result of the translation to the functional currency of the subsidiary are recorded in net earnings.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Translation of all assets and liabilities from the respective functional currencies to the reporting currency are performed using the rates prevailing at the balance sheet date. The differences arising upon translation from the functional currency to the reporting currency are recorded as currency translation adjustments in other comprehensive income and are held within accumulated other comprehensive income until a disposal or partial disposal of a subsidiary. A disposal or partial disposal will then give rise to a realized foreign exchange (gain) loss which is recorded in net earnings.

Within the consolidated group there are outstanding intercompany loans which in substance represent an investment in certain subsidiaries. When these loans are identified as being a part of the net investment in the foreign subsidiary, any exchange difference arising on those loans are recorded to currency translation adjustments within other comprehensive income until a disposal or partial disposal of the subsidiary.

### **Taxation**

Deferred taxes are calculated using the liability method whereby income tax liabilities and assets are recognized for the estimated tax consequences attributable to temporary differences between the amounts reported in the consolidated balance sheets of Vermilion and the respective tax bases using substantively enacted income tax rates in the respective jurisdictions that will be in effect when the differences are expected to reverse. The effect of a change in income tax rates on deferred tax liabilities and assets is recognized in income in the period in which the related legislation is substantively enacted.

Vermilion currently incurs cash income taxes in France, the Netherlands and Australia based on the tax legislation of each respective country.

### **Liability Associated with Exchangeable Shares**

Outstanding exchangeable shares were recorded as a liability until exchanged for trust units. The liability was measured at the redemption value of the instruments and remeasured at each reporting date with the gain or loss associated with the remeasurement recorded within earnings. When the exchangeable shares were converted into trust units, the conversions were recorded as an extinguishment of the liability and accordingly the remeasured amount at the date of conversion was then reclassified to equity.

### **Borrowing Costs**

Borrowing costs that are directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use are capitalized as part of the cost of that asset. Borrowing costs are capitalized by applying interest rates attributable to the project being financed and includes both general and specific borrowings. Interest rates applied from general borrowings are computed using the weighted average borrowing rate for the period.

### **Measurement Uncertainty**

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses for the periods presented.

Key areas where management has made complex or subjective judgements include asset retirement obligations, assessment of impairments and deferred taxes. Actual results could differ from these and other estimates.

### **Asset Retirement Obligations**

Vermilion's asset retirement obligations are based on environmental regulations and estimates of future costs and the timing of expenditures. Changes in environmental regulations, the estimated costs associated with reclamation activities, the discount rate applied and the timing of expenditures impact Vermilion's measurement of the obligation. Changes related to any of these assumptions, including the discount rate, could have a material impact on the financial position and net earnings of Vermilion.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### *Assessment of Impairments*

Goodwill impairment tests involve estimates of Vermilion's recoverable amount of cash generating units on an annual basis or when events are identified which may be indicators of impairment. If the recoverable amount is less than the carrying value, an impairment loss would be recognized. The recoverable amount of the associated cash generating units is based on external market value, reserve estimates and the related future cash flows which are subject to measurement uncertainty.

Impairment tests of Petroleum and Natural gas properties and equipment are performed at the level of the cash generating unit when an indicator of impairment is identified. The calculation of the recoverable amount of the assets are based on market factors as well as estimates of petroleum and natural gas reserves and future costs required to develop those reserves. Vermilion's reserves estimates and the related future cash flows are subject to measurement uncertainty, and the impact on the consolidated financial statements of future periods could be material.

### *Deferred Taxes*

Tax interpretations, regulations, and legislation in the various jurisdictions in which Vermilion and its subsidiaries operate are subject to change. As such, income taxes are subject to measurement uncertainty.

## 3. CHANGES TO ACCOUNTING PRONOUNCEMENTS

### *New accounting pronouncements adopted*

March 31, 2011 is Vermilion's first reporting period under IFRS. Accounting standards effective for periods ending on December 31, 2011 have been adopted as part of the transition to IFRS.

### *Recent pronouncements issued*

As of January 1, 2013, Vermilion will be required to adopt IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The adoption of this standard should not have a material impact on Vermilion's consolidated financial statements.

## 4. CAPITAL ASSETS

	Petroleum and Natural Gas Properties and Equipment	Furniture and Equipment	Total
<b>Balance at January 1, 2010</b>	\$ 1,604,615	\$ 5,952	\$ 1,610,567
Additions	400,182	13,911	414,093
Borrowing costs capitalized	8,772	-	8,772
Changes in estimate for asset retirement obligations	43,621	-	43,621
Depletion and depreciation	(180,350)	(2,343)	(182,693)
Effect of movements in exchange rates	(77,526)	(390)	(77,916)
<b>Balance at December 31, 2010</b>	1,799,314	17,130	1,816,444
Additions	154,503	632	155,135
Borrowing costs capitalized	2,267	-	2,267
Changes in estimate for asset retirement obligations	(9,481)	-	(9,481)
Depletion and depreciation	(48,902)	(1,898)	(50,800)
Effect of movements in exchange rates	27,071	79	27,150
<b>Balance at March 31, 2011</b>	\$ 1,924,772	\$ 15,943	\$ 1,940,715
Cost	1,604,615	15,150	1,619,765
Accumulated depletion and depreciation	-	(9,198)	(9,198)
<b>Net book value as at January 1, 2010</b>	\$ 1,604,615	\$ 5,952	\$ 1,610,567

#### 4. CAPITAL ASSETS (Continued)

Cost	1,981,855	27,986	2,009,841
Accumulated depletion and depreciation	(182,541)	(10,856)	(193,397)
<b>Net book value as at December 31, 2010</b>	<b>\$ 1,799,314</b>	<b>\$ 17,130</b>	<b>\$ 1,816,444</b>

Cost	2,156,290	29,043	2,185,333
Accumulated depletion and depreciation	(231,518)	(13,100)	(244,618)
<b>Net book value as at March 31, 2011</b>	<b>\$ 1,924,772</b>	<b>\$ 15,943</b>	<b>\$ 1,940,715</b>

#### Depletion and depreciation rates

Petroleum and natural gas properties and equipment (unit of production method)

Furniture and equipment (declining balance at rates of 10% to 50%)

During the three months ended March 31, 2011, Vermilion capitalized \$0.9 million (for the year ended 2010 - \$1.3 million) of overhead costs directly attributable to PNG activities.

Vermilion performed an assessment as to whether any cash generating units had indicators of impairment. Based on the calculations and analysis performed, the estimated fair value less cost to sell or the value in use calculated using a discount rate of 8% exceeded the carrying values of Vermilion's petroleum and natural gas properties and equipment at March 31, 2011 and December 31, 2010 and therefore, the carrying values are not impaired.

The benchmark prices used in the December 31, 2010 calculations are as follows:

CDN\$/BOE	Canada	France	Netherlands	Australia	Ireland
2011	\$ 49.36	\$ 81.01	\$ 61.21	\$ 90.31	\$ -
2012	\$ 52.72	\$ 81.21	\$ 58.36	\$ 90.05	\$ -
2013	\$ 55.48	\$ 81.89	\$ 56.92	\$ 90.31	\$ 57.13
2014	\$ 58.52	\$ 85.39	\$ 58.21	\$ 92.35	\$ 58.36
2015	\$ 60.86	\$ 88.21	\$ 60.25	\$ 95.58	\$ 60.32
2016	\$ 62.77	\$ 90.34	\$ 61.78	\$ 98.01	\$ 61.79
2017	\$ 64.85	\$ 92.73	\$ 63.52	\$ 100.78	\$ 63.47
2018	\$ 66.85	\$ 94.95	\$ 65.11	\$ 103.31	\$ 65.00
2019	\$ 69.28	\$ 97.36	\$ 66.86	\$ 106.07	\$ 66.68
2020	\$ 71.55	\$ 99.28	\$ 68.22	\$ 108.23	\$ 67.99
Average increase thereafter	2.0%	2.0%	2.0%	2.0%	2.0%

## 5. INTANGIBLE ASSETS

	<b>Exploration and Evaluation Assets</b>
<b>Balance at January 1, 2010</b>	\$ -
Additions	18,537
Depletion and depreciation	(927)
Effect of movements in exchange rates	(453)
<b>Balance at December 31, 2010</b>	\$ 17,157
Additions	1,570
Depletion and depreciation	(914)
Effect of movements in exchange rates	611
<b>Balance at March 31, 2011</b>	\$ 18,424
Cost	18,060
Accumulated depletion and depreciation	(903)
<b>Net book value as at December 31, 2010</b>	\$ 17,157
Cost	20,292
Accumulated depletion and depreciation	(1,868)
<b>Net book value as at March 31, 2011</b>	\$ 18,424
	<b>Goodwill</b>
<b>Balance at January 1, 2010</b>	\$ 19,840
Goodwill impairment	(19,840)
<b>Balance at December 31, 2010</b>	\$ -

### Goodwill

The goodwill as at January 1, 2010 resulting from a previous business combination was written off during the year ended December 31, 2010 as a result of declines in Canadian natural gas prices.

### Exploration and Evaluation Assets

Exploration and evaluation assets are held at cost less accumulated depletion and impairment losses. Depletion is only recognized if the costs are attributable to a project which was determined to not contain economic reserves. When depleted the useful life used is between one to five years and is assessed based upon the prospect or area and is recognized within depletion and depreciation expense of the statement of comprehensive income.

## 6. ASSET RETIREMENT OBLIGATIONS

The asset retirement obligations were determined based on the estimated future costs and timing to reclaim Vermilion's net interest in all wells and facilities. Vermilion has estimated the net present value of its asset retirement obligations to be \$267.4 million as at March 31, 2011 (December 31, 2010 - \$267.4 million) based on a total undiscounted future liability after inflation adjustment of \$976.9 million (December 31, 2010 - \$967.5 million). These payments are expected to be made over the next 46 years with the majority of the costs being incurred between 2011 and 2041. Vermilion calculated the present value of the obligations using discount rates between 7.6% and 9.4% (2010 - between 7.4% and 9.4%) to reflect the market assessment of the time value of money as well as risks specific to the liabilities that have not been included in the cash flow estimates. Inflation rates used in determining the cash flow estimates were between 1.4% and 2.6% for the periods ended March 31, 2011 and December 31, 2010.

## 6. ASSET RETIREMENT OBLIGATIONS (Continued)

The following table reconciles the change in Vermilion's asset retirement obligations:

	<b>Asset Retirement Obligations</b>
<b>Balance at January 1, 2010</b>	\$ 224,005
Additional obligations recognized	851
Changes in estimates for existing obligations	39,352
Obligations settled	(6,861)
Accretion	17,903
Changes in discount rates	3,418
Movements in exchange rates	(11,279)
<b>Balance at December 31, 2010</b>	\$ 267,389
Additional obligations recognized	2,138
Changes in estimates for existing obligations	(2,135)
Obligations settled	(1,631)
Accretion	6,315
Changes in discount rates	(9,484)
Movements in exchange rates	4,768
<b>Balance at March 31, 2011</b>	\$ 267,360

At least once annually, Vermilion reviews its estimates of the expected costs to reclaim the net interest in its wells and facilities. Accordingly, Vermilion adjusted its asset retirement obligations to reflect these revised estimates and the resulting change is categorized as changes in estimates for existing obligations in the table above. The changes in estimates for the year ended December 31, 2010 related primarily to the Netherlands operations and resulted from the availability of better data associated with the abandonment obligations.

Vermilion had previously established a reclamation fund to provide for the ultimate payout of the environmental and site restoration costs on its asset base. After an extensive review, Vermilion concluded that the reclamation fund assets would be more effectively employed supporting Vermilion's operations and in July 2010, the reclamation fund assets were liquidated.

## 7. AMOUNT DUE PURSUANT TO ACQUISITION

On July 30, 2009, Vermilion completed the acquisition of an 18.5% non-operated interest in the Corrib gas field located off the northwest coast of Ireland. Pursuant to the terms of the acquisition agreement, Vermilion will make an additional future payment to the vendor of US \$135 million based on the current estimate as to when first commercial gas will be achieved. To reflect the future payment due to the vendor, Vermilion has recognized a non-current liability which was determined by discounting the expected future payment of US \$135 million. The discount rate used to present value this obligation was 8%, which is Vermilion's best estimate of the interest rate that would result from an arm's length borrowing transaction associated with the purchase of these assets.

## 8. LONG-TERM DEBT

### Revolving Credit Facility

As at March 31, 2011, Vermilion had a syndicated revolving credit facility allowing for maximum borrowings of \$635 million. The revolving period under the revolving credit facility is expected to expire in June 2011 and may be extended for an additional period of up to 364 days at the option of the lenders. If the lenders convert the revolving credit facility to a non-revolving credit facility, the amounts outstanding under the facility become repayable 24 months after the end of the revolving period. Various borrowing options are available under the facilities including prime rate based advances and bankers' acceptance loans.

The credit facilities are secured by various fixed and floating charges against subsidiaries of Vermilion. Under the terms of the revolving credit facility, Vermilion must maintain a ratio of total borrowings under the facility to consolidated earnings before interest, income taxes, depreciation, accretion and other certain non-cash items of not greater than 3.0.

The amount available to Vermilion under these facilities is reduced by outstanding letters of credit associated with Vermilion's operations totalling \$1.9 million as at March 31, 2011.

### Senior Unsecured Notes

On February 10, 2011, Vermilion issued \$225.0 million of senior unsecured notes at par. The notes bear interest at a rate of 6.5% per annum and will mature on February 10, 2016. As direct senior unsecured obligations of Vermilion, the notes rank pari passu with all other present and future unsecured and unsubordinated indebtedness of the Company.

Vermilion may, at its option, prior to February 10, 2014, redeem up to 35% of the notes with net proceeds of equity offerings by the Company at a redemption price equal to 106.5% of the principal amount of the notes to be redeemed, plus accrued and unpaid interest, if any, to the applicable redemption date. Subsequently, Vermilion may on or after February 10, 2014, redeem all or part of the notes at fixed redemption prices, plus, in each case, accrued and unpaid interest, if any, to the applicable redemption date. The notes were recognized at amortized cost and include the transaction costs directly related to the issuance.

	March 31, 2011	December 31, 2010	January 1, 2010
Revolving credit facility	\$ 155,369	\$ 302,558	\$ 159,723
Senior unsecured notes	\$ 220,684	\$ -	\$ -
Total long-term debt	\$ 376,053	\$ 302,558	\$ 159,723

## 9. SHAREHOLDERS' CAPITAL AND CONTRIBUTED SURPLUS

As a result of the conversion from an income trust to a corporation on September 1, 2010, (see Note 1), all of the outstanding units of the Trust were exchanged on a one-for-one basis for common shares of Vermilion. Exchangeable shares of Vermilion Resources Ltd., a wholly owned subsidiary of Vermilion, were converted to common shares of Vermilion at the prevailing exchange ratio of 1.89344.

Vermilion is authorized to issue an unlimited number of common shares with no par value.

Unitholders' Capital	Number of Units	Amount
Balance as at January 1, 2010	79,523,028	\$ 711,667
Distribution reinvestment plan	718,424	23,185
Issued on conversion of exchangeable shares (Note 10)	4,547	135
Vesting of equity based compensation awards	668,986	23,149
Trust units issued for bonus plan	28,624	1,009
Trust units exchanged pursuant to corporate conversion	(80,943,609)	(759,145)
Balance as at August 31, 2010	-	\$ -



## 9. SHAREHOLDERS' CAPITAL AND CONTRIBUTED SURPLUS (Continued)

<b>Shareholders' Capital</b>	<b>Number of Shares</b>	<b>Amount</b>
<b>Balance as at August 31, 2010</b>	-	\$ -
Issuance of common shares for trust units pursuant to corporate conversion	80,943,609	759,145
Issuance of common shares for exchangeable shares pursuant to corporate conversion (Note 10)	7,586,546	248,986
Dividend reinvestment plan	468,087	17,639
<b>Balance as at December 31, 2010</b>	<b>88,998,242</b>	<b>\$ 1,025,770</b>
Vesting of equity based compensation awards	449,952	16,407
Share settled dividends on vested equity based awards	102,625	4,991
Dividend reinvestment plan	289,719	12,976
Shares issued for bonus plan	15,851	786
<b>Balance as at March 31, 2011</b>	<b>89,856,389</b>	<b>\$ 1,060,930</b>

### Dividends and Distributions

Cash dividends declared to shareholders for the three months ended March 31, 2011 were \$50.9 million (three months ended March 31, 2010 - \$45.5 million) or \$0.19 per share (three months ended March 31, 2010 - \$0.19 per share or unit). Dividends are determined by the Board of Directors and are paid monthly. Vermilion has a dividend reinvestment plan which allows eligible holders of common shares to purchase additional common shares at a 5% discount to market by reinvesting their cash dividends. Subsequent to the end of the period and prior to the financial statements being authorized for issue on May 4, 2011, Vermilion declared dividends of \$17.1 million or \$0.19 per share.

### Prior to Corporate Conversion

Prior to the corporate conversion which occurred on September 1, 2010, Vermilion's outstanding equity instruments consisted of publically traded trust units. Pursuant to applicable legislation, those trust units included a redemption feature which required Vermilion to assess the appropriate presentation of those units under IFRS.

In general, IFRS requires that financial instruments which include a redemption feature making the instruments puttable be presented as a liability rather than as equity. However, an exception to that requirement is available if the financial instrument meets certain criteria. Vermilion determined that its trust units met the requirements for this exception and accordingly the trust units are presented as equity for the periods prior to the corporate conversion.

The trust units were redeemable at the option of the trust unit holders. The redemption price was calculated as the lower of the closing price on the day the units were tendered for redemption and 90% of the market price of the units for the ten days after redemption. The Trust had no redemptions for the period for which the trust units were outstanding.

### Subsequent to Corporate Conversion

On September 1, 2010 Vermilion issued common shares in exchange for the outstanding trust units and exchangeable shares (Note 10). The conversion of the trust units was accounted for as an exchange of equity instruments at carrying value. The exchange of exchangeable shares for common shares was accounted for an extinguishment of the exchangeable share liability at the redemption value measured on the date of the exchange (see Note 10).

## 10. LIABILITY ASSOCIATED WITH EXCHANGEABLE SHARES

Since 2003 and up to and including September 1, 2010 Vermilion had a number of exchangeable shares outstanding. These shares did not meet the definition of an equity instrument in accordance with IAS 32 "Financial Instruments: Presentation" and accordingly, were classified as financial liabilities. The exchangeable shares were recorded upon transition to IFRS at redemption value and subsequent to transition were adjusted to reflect the redemption value at each reporting date. The resulting change from carrying value to redemption value was recorded at transition and at each reporting period to retained earnings and earnings respectively. All dividends attributable to exchangeable share holders were recorded within remeasurement loss on exchangeable share liability in the reporting period for which the dividends were declared.

As a result of the corporate conversion (see Note 1), Vermilion issued 7,586,546 common shares in exchange for all remaining 4,006,753 exchangeable shares based on an exchange ratio of 1.89344. There were no exchangeable shares outstanding following the conversion.

The following table summarizes the changes in the liability associated with exchangeable shares:

	Number of Exchangeable Shares	Amount
<b>Liability Associated with Exchangeable Shares</b>		
<b>Balance as at January 1, 2010</b>	4,009,253	\$ 217,992
Exchanged for trust units	(2,500)	(135)
Remeasurement loss on liability associated with exchangeable shares	-	31,129
Extinguishment of exchangeable share liability pursuant to corporate conversion	(4,006,753)	(248,986)
<b>Balance as at December 31, 2010</b>	-	\$ -

## 11. EQUITY BASED COMPENSATION PLANS

### *Trust Unit Award Incentive Plan*

Prior to corporate conversion on September 1, 2010 Vermilion established and issued unvested trust units under the Trust Unit Award Incentive Plan (the "TAP Plan"). The plan which was established in 2005, allowed for the issuance of unvested trust units of the Trust to directors, officers and employees of the Trust and its Affiliates.

Upon vesting, the grantee received unrestricted trust units of the Trust, adjusted for cumulative dividends during the vesting period. The number of trust units issued upon vesting was dependent upon the performance of the Trust compared to its peers based on a performance factor that may range from zero to two times the number of awards originally granted. Original awards to new employees vest in equal tranches over three years and subsequent grants vest after three years.

As the award holders were entitled to receive trust units which under IFRS were considered puttable financial instruments, the awards were classified as liability based awards. The fair value of awards was estimated at each reporting period using a Monte Carlo simulation and the fair market value of the trust units as at the reporting date. Volatility was determined using historical market data for Vermilion and its peers. The resulting remeasurements of the liability were recorded as equity based compensation expense.

### *Vermilion Incentive Plan*

The Vermilion Incentive Plan (the "VIP Plan"), replaced the TAP Plan pursuant to the corporate conversion on September 1, 2010. At that date, all TAP Plan awards were exchanged on a one-for-one basis for VIP Plan awards. At vesting, the ultimate number of unrestricted shares received by the grantee is adjusted for the cumulative dividends which notionally accrue to the awards during the vesting period and the resulting total is multiplied by a performance factor which ranges from zero to two times the number of awards originally granted.

The performance factor is determined by the Board of Directors after consideration of a number of key corporate performance measures including, but not limited to, shareholder return, capital efficiency metrics, production and reserves growth as well as safety performance. The total expense recognized over the vesting period for a VIP Plan award is based on the fair value of the unvested share at the date of grant adjusted for the performance factor ultimately achieved.

## 11. EQUITY BASED COMPENSATION PLANS (Continued)

As a result of the corporate conversion, Vermilion's equity based compensation plan awards are now settled in non-redeemable common shares resulting in equity plan accounting under IFRS. Accordingly, at the date of conversion, the fair value of the vested portion of outstanding awards was reclassified from liability to contributed surplus.

The following table summarizes the number of awards outstanding under the TAP Plan and the VIP Plan. The table does not reflect the exchange of TAP plan awards for VIP plan awards as the exchange was completed on a one-for-one basis.

<b>Number of Awards</b>	<b>2011</b>	<b>2010</b>
Opening balance	1,683,776	1,417,314
Granted	553	845,199
Vested	(345,830)	(447,714)
Forfeited	(15,303)	(131,023)
Closing balance	1,323,196	1,683,776

Equity based compensation expense of \$7.4 million was recorded during the period ended March 31, 2011 (2010 - \$11.3 million) related to the VIP Plan and TAP Plan awards.

## 12. PER SHARE OR UNIT AMOUNTS

Basic and diluted net earnings (loss) per share or unit have been determined based on the following:

	<b>Three Months Ended</b>	
	<b>March 31, 2011</b>	<b>March 31, 2010</b>
Net earnings (loss) for diluted net earnings (loss) per share or unit calculation	\$ 27,193	\$ (8,183)
Basic weighted average shares or units outstanding	89,224,446	79,710,068
Dilutive impact of unit rights incentive and equity based or trust unit award plans	1,289,322	-
Diluted weighted average shares or units outstanding	90,513,768	79,710,068

Basic net earnings (loss) per share or unit has been calculated based on net earnings (loss) divided by the basic weighted average shares or units outstanding. For the three months ended March 31, 2010 the exchangeable shares were anti-dilutive and accordingly they were excluded from the number of units outstanding for the calculation of diluted loss per share. The equity based compensation awards were only dilutive in the current period therefore were only included in the calculations of diluted net earnings per share in that period.

## 13. DERIVATIVE INSTRUMENTS

### ***Risk Management Activities***

The nature of Vermilion's operations results in exposure to fluctuations in commodity prices, interest rates and foreign currency exchange rates. Vermilion monitors and, when appropriate, uses derivative financial instruments to manage its exposure to these risks. All transactions of this nature entered into by Vermilion are related to an underlying financial position or to future petroleum and natural gas production. Vermilion does not use derivative financial instruments for speculative purposes. Vermilion has elected not to designate any of its price risk management activities as accounting hedges and thus accounts for changes to fair value in net earnings for the period. During the normal course of business, Vermilion may enter into fixed price arrangements to sell a portion of its production. Vermilion has elected to exempt these contracts from fair value accounting through the use of the normal purchase and sales exemption. Vermilion does not obtain collateral or other security to support its financial derivatives as management reviews the creditworthiness of the counterparty prior to entering into a derivative contract.

### 13. DERIVATIVE INSTRUMENTS (Continued)

The following table summarizes Vermilion's outstanding financial derivative positions as at March 31, 2011.

<b>Risk Management: Oil</b>	<b>Funded Cost</b>	<b>bbls/d</b>	<b>US \$/bbl</b>
<b>Collar - WTI</b>			
January 2011 to June 2011	US \$1.00/bbl	2,400	\$ 80.00 - \$107.60
January 2011 to June 2011	US \$1.00/bbl	2,400	\$ 75.00 - \$ 97.85
January 2011 to December 2011	US \$1.00/bbl	500	\$ 78.00 - \$ 96.20
January 2011 to December 2011	US \$1.00/bbl	500	\$ 78.00 - \$ 96.25
July 2011 to December 2011	US \$1.00/bbl	2,400	\$ 80.00 - \$110.00
July 2011 to December 2011	US \$1.00/bbl	2,400	\$ 77.25 - \$ 98.50
<b>Collar - BRENT</b>			
January 2011 to December 2011	US \$1.00/bbl	1,000	\$ 77.75 - \$ 96.00
January 2011 to December 2011	US \$1.00/bbl	1,000	\$ 77.50 - \$ 96.00
January 2011 to December 2011	US \$0.00/bbl	750	\$ 77.00 - \$ 95.40
January 2011 to December 2011	US \$1.00/bbl	750	\$ 78.00 - \$ 98.10
January 2011 to December 2011	US \$1.00/bbl	500	\$ 78.00 - \$100.00
January 2011 to December 2011	US \$1.00/bbl	500	\$ 78.00 - \$100.05
January 2011 to December 2011	US \$1.00/bbl	500	\$ 78.00 - \$100.00
January 2012 to June 2012	US \$1.00/bbl	750	\$ 82.00 - \$105.60
January 2012 to June 2012	US \$1.00/bbl	750	\$ 82.00 - \$104.80
January 2012 to June 2012	US \$1.00/bbl	750	\$ 82.00 - \$106.10
January 2012 to December 2012	US \$1.00/bbl	1,000	\$ 82.00 - \$113.40
January 2012 to December 2012	US \$1.00/bbl	500	\$ 82.00 - \$115.50
January 2012 to December 2012	US \$1.00/bbl	500	\$ 82.00 - \$130.75
July 2012 to December 2012	US \$1.00/bbl	1,000	\$ 82.00 - \$126.55
July 2012 to December 2012	US \$1.00/bbl	1,000	\$ 82.00 - \$126.05
<b>Call Spread - BRENT</b>			
January 2011 to December 2011	US \$6.08/bbl <sup>1</sup>	960	\$ 65.00 - \$ 85.00
January 2011 to December 2011	US \$5.15/bbl <sup>1</sup>	600	\$ 65.00 - \$ 85.00
<b>Put - BRENT</b>			
January 2012 to December 2012	US \$4.46/bbl	600	\$ 83.00
January 2012 to December 2012	US \$4.90/bbl	600	\$ 83.00
January 2012 to December 2012	US \$4.49/bbl	600	\$ 83.00
January 2012 to December 2012	US \$4.39/bbl	600	\$ 83.00
<b>Risk Management: Natural Gas</b>			
	<b>Funded Cost</b>	<b>GJ/d</b>	<b>\$/GJ</b>
<b>SWAP - AECO</b>			
January 2011 to October 2011	\$0.00/GJ	700	\$5.13
<b>Risk Management: Foreign Exchange</b>			
	<b>Principal (\$US) / Month</b>	<b>Notional</b>	<b>Fixed rate (\$CDN / \$US)</b>
<b>US Dollar Forward Sale</b>			
January 2011 to December 2011		\$750,000	\$1.07
January 2011 to December 2011		\$750,000	\$1.07

<sup>1</sup> The funded amounts for these instruments were paid in a prior period.

### 13. DERIVATIVE INSTRUMENTS (Continued)

The following table reconciles the change in the fair value of Vermilion's derivative contracts:

	March 31, 2011	December 31, 2010
Fair value of contracts, beginning of period	\$ (9,109)	\$ 5,006
Reversal of opening unrealized loss (gain) on contracts settled during the period	2,367	(2,070)
Realized (loss) gain on contracts settled during the period	(3,955)	7,196
Unrealized (loss) during the period on contracts outstanding at the end of the period	(49,330)	(12,045)
Net payment to (receipt from) counterparties on contract settlements during the period	3,955	(7,196)
Fair value of contracts, end of period	(56,072)	(9,109)
Comprised of:		
Current derivative asset	10,552	10,249
Current derivative liability	(54,662)	(12,143)
Non-current derivative asset	-	942
Non-current derivative liability	(11,962)	(8,157)
Fair value of contracts, end of period	\$ (56,072)	\$ (9,109)

The loss (gain) on derivative instruments for the periods is comprised of the following:

	Three Months Ended	
	March 31, 2011	March 31, 2010
Realized loss on contracts settled during the period	\$ 3,955	\$ 247
Reversal of opening unrealized (loss) on contracts settled during the period	(2,367)	(53)
Unrealized loss (gain) during the period on contracts outstanding at the end of the period	49,330	(4,280)
Loss (gain) on derivative instruments	\$ 50,918	\$ (4,086)

### 14. CASH FLOW INFORMATION

The following details the changes in non-cash working capital:

	Three Months Ended	
	March 31, 2011	March 31, 2010
Accounts receivable	\$ (22,225)	\$ (5,830)
Crude oil inventory	(2,664)	(215)
Prepaid expenses and other	2,922	1,856
Accounts payable and accrued liabilities and income taxes payable	81,209	(911)
Movements in exchange rates	(3,459)	2,270
Changes in non-cash working capital	\$ 55,783	\$ (2,830)
Changes in non-cash operating working capital	\$ 26,463	\$ 3,342
Changes in non-cash investing working capital	29,320	(6,172)
Changes in non-cash working capital	\$ 55,783	\$ (2,830)

### 15. SEGMENTED INFORMATION

Vermilion has operations principally in Canada, France, the Netherlands, Australia and Ireland. Vermilion's entire operating activities are related to exploration, development and production of petroleum and natural gas. As each of the operating activities is undertaken in each of the countries in which Vermilion's operates the following segment information has been prepared by segregating the results into the geographic areas in which Vermilion operates. The segregation by country is consistent with how the financial performance of the business is measured internally by Vermilion's chief operating decision maker.

## 15. SEGMENTED INFORMATION (Continued)

All amounts below include transactions between segments which are recorded at fair value at the date of recognition.

<b>For the period ended March 31, 2011</b>						
	<b>Canada</b>	<b>France</b>	<b>Netherlands</b>	<b>Australia</b>	<b>Ireland</b>	<b>Total</b>
Total Assets	\$ 1,170,767	\$ 532,978	\$ 119,725	\$ 267,344	\$ 437,904	\$ 2,528,718
Capital expenditures	\$ 82,037	\$ 18,430	\$ 5,538	\$ 2,426	\$ 9,983	\$ 118,414
Oil and gas sales to external customers	\$ 54,499	\$ 77,874	\$ 23,165	\$ 74,202	\$ -	\$ 229,740
Royalties	(8,675)	(4,532)	-	-	-	(13,207)
Revenue from external customers	45,824	73,342	23,165	74,202	-	216,533
Realized (loss) on derivative instruments	(311)	(1,528)	-	(2,116)	-	(3,955)
Transportation	(1,515)	(2,371)	-	-	(2,198)	(6,084)
Operating expense	(12,582)	(9,724)	(4,401)	(11,141)	-	(37,848)
Operating income (loss)	\$ 31,416	\$ 59,719	\$ 18,764	\$ 60,945	\$ (2,198)	\$ 168,646

<b>Reconciliation of operating income to net earnings</b>	
Equity based compensation	\$ (8,226)
Unrealized (loss) on derivative instruments	(46,963)
Interest expense	(5,374)
General and administration	(12,107)
Foreign exchange gain	13,284
Other expense	(352)
Accretion	(6,315)
Depletion and depreciation	(51,714)
Earnings before income taxes	50,879
Income taxes	(23,686)
Net earnings	\$ 27,193

	<b>Canada</b>	<b>France</b>	<b>Netherlands</b>	<b>Australia</b>	<b>Ireland</b>	<b>Total</b>
Current income taxes	\$ 329	\$ 15,982	\$ 2,757	\$ 30,531	\$ -	\$ 49,599

<b>Three months ended March 31, 2010</b>						
	<b>Canada</b>	<b>France</b>	<b>Netherlands</b>	<b>Australia</b>	<b>Ireland</b>	<b>Total</b>
Total Assets	\$ 892,771	\$ 513,199	\$ 99,466	\$ 214,438	\$ 350,020	\$ 2,069,894
Capital expenditures	\$ 86,735	\$ 11,984	\$ 3,409	\$ 1,895	\$ 15,873	\$ 119,896
Oil and gas sales to external customers	\$ 47,929	\$ 56,269	\$ 12,302	\$ 53,081	\$ -	\$ 169,581
Royalties	(9,367)	(3,780)	-	-	-	(13,147)
Revenue from external customers	38,562	52,489	12,302	53,081	-	156,434
Realized (loss) on derivative instruments	(197)	(50)	-	-	-	(247)
Transportation	(1,541)	(2,743)	-	-	(2,665)	(6,949)
Operating expense	(9,822)	(10,855)	(4,266)	(11,392)	-	(36,335)
Operating income (loss)	\$ 27,002	\$ 38,841	\$ 8,036	\$ 41,689	\$ (2,665)	\$ 112,903

## 15. SEGMENTED INFORMATION (Continued)

### Reconciliation of operating income to net earnings

Unit based compensation	\$	(12,273)
Unrealized gain on derivative instruments		4,333
Interest expense		(3,033)
General and administration		(10,153)
Foreign exchange loss		(22,328)
Other (expense)		(1,534)
Accretion		(4,519)
Depletion and depreciation		(39,214)
Earnings before income taxes and other item		24,182
Income taxes		(13,992)
Remeasurement loss on liability associated with exchangeable shares		(18,373)
Net loss	\$	(8,183)

	Canada	France	Netherlands	Australia	Ireland	Total
Current income taxes	\$ 173	\$ 4,532	\$ 1,221	\$ 18,997	\$ -	\$ 24,923

Vermilion has two major customers which account for sales of \$53.8 million and \$23.1 million (2010 - \$37.1 million and \$12.3 million) respectively and are included in the above results within the France and Netherlands segments.

## 16. COMMITMENTS

Vermilion had the following future commitments associated with its operating leases as at March 31, 2011:

	2011	2012	2013	2014	2015	Thereafter	Total
Payments by period	\$ 4,398	\$ 6,845	\$ 6,845	\$ 6,845	\$ 6,845	\$ 45,521	\$ 77,299

In addition, Vermilion has various other commitments associated with its business operations, none of which, in management's view, are significant in relation to Vermilion's financial position.

## 17. COMPONENTS OF CASH AND CASH EQUIVALENTS

Cash and cash equivalents as at March 31, 2011 and December 31, 2010 was comprised solely of monies on deposit with banks.

## 18. CAPITAL DISCLOSURES

In managing capital, Vermilion reviews whether fund flows from operations, (a non-GAAP measure, defined as cash flows from operating activities before changes in non-cash operating working capital and asset retirement obligations settled) is sufficient to pay for all capital expenditures, dividends and abandonment and reclamation expenditures. To the extent that the forecasted fund flows from operations is not expected to be sufficient in relation to these expenditures, Vermilion will evaluate its ability to finance any excess with debt, an issuance of equity or by reducing some or all categories of expenditures to ensure that total expenditures do not exceed available funds.

As a part of the management of capital which Vermilion defines as net debt and shareholders' capital, Vermilion monitors the ratio of net debt (a non-GAAP measure, which is defined as long-term debt as shown on the consolidated balance sheets plus working capital) to fund flows from operations).

## 18. CAPITAL DISCLOSURES (Continued)

Vermilion typically strives to maintain a ratio of net debt to fund flows from operations near 1.0. In a commodity price environment where prices trend higher, Vermilion may target a lower ratio and conversely, in a lower commodity price environment, the acceptable ratio may be higher. At times, Vermilion will use its balance sheet to finance acquisitions and, in these situations, Vermilion is prepared to accept a higher ratio in the short term but will implement a plan to reduce the ratio to acceptable levels within a reasonable period of time, usually considered to be no more than 12 to 18 months. This plan could potentially include an increase in hedging activities, a reduction in capital expenditures, an issuance of equity and the utilization of excess fund flows from operations to reduce outstanding indebtedness.

The following table calculates Vermilion's ratio of net debt to fund flows from operations:

	Three Months Ended	
	March 31, 2011	March 31, 2010
Long-term debt	\$ 376,053	\$ 205,277
Current liabilities	464,825	220,425
Current assets	(399,560)	(221,360)
Net debt [1]	\$ 441,318	\$ 204,342
Cash flows from operating activities	\$ 126,617	\$ 80,237
Changes in non-cash operating working capital	(26,463)	(3,342)
Asset retirement obligations settled	1,631	-
Fund flows from operations [2]	\$ 101,785	\$ 76,895
Annualized fund flows from operation [2]	\$ 407,140	\$ 307,580
Ratio of net debt to fund flows from operations ([1] ÷ [2])	1.1	0.7

For the periods presented here, the ratio of net debt to fund flows from operations was 1.1 and 0.7, respectively. The increase in the figure year over year reflects lower debt levels at March 31, 2010 resulting from the 2009 sale of Verenex Energy Inc. and the equity offering which closed in the fourth quarter of 2009.

In relation to its long-term debt, Vermilion is subject to a debt to EBITDA ratio test (where debt is defined as long-term debt as presented on the consolidated balance sheet and EBITDA is defined as earnings before interest, taxes, depreciation, accretion and other certain non-cash items). During the periods covered by these consolidated financial statements, Vermilion continued to comply with this externally imposed capital requirement.



## 19. FINANCIAL INSTRUMENTS

The following table summarizes information relating to Vermilion's financial instruments as at March 31, 2011 and December 31, 2010:

### Classification of Financial Instruments

Class of Financial Instruments	Location on Consolidated Balance Sheet	Accounting Designation	Related Income or Expense Account on Statement of Earnings	As at March 31, 2011		As at December 31, 2010		Fair Value Measurement Hierarchy
				Carrying Value	Fair Value	Carrying Value	Fair Value	
Cash	Cash and cash equivalents	HFT-B	Gains and losses on foreign exchange are included in foreign exchange loss (gain)	\$ 182,426	\$ 182,426	\$ 145,623	\$ 145,623	Level 1
Short-term investments	Short-term investments	HFT-A	Gains and losses on foreign exchange are included in foreign exchange loss (gain)	\$ 14,520	\$ 14,520	\$ 15,132	\$ 15,132	Level 1
Receivables	Accounts receivable	LAR	Gains and losses on foreign exchange are included in foreign exchange loss (gain). Impairments are recognized as general and administration expense	\$ 169,554	\$ 169,554	\$ 147,329	\$ 147,329	Not applicable
Derivative assets	Derivative instruments	HFT-B	Loss (gain) on derivative instruments	\$ 10,552	\$ 10,552	\$ 11,191	\$ 11,191	Level 2
Derivative liabilities	Derivative instruments	HFT-B	Loss (gain) on derivative instruments	\$ (66,624)	\$ (66,624)	\$ (20,300)	\$ (20,300)	Level 2
Portfolio investments	Long-term investments	HFT-A	Other income or expense	\$ 2,717	\$ 2,717	\$ 3,108	\$ 3,108	Level 1
Payables	Accounts payable and accrued liabilities. Dividends or distributions payable	OTH	Gains and losses on foreign exchange are included in foreign exchange loss (gain)	\$ (308,546)	\$ (308,546)	\$ (269,229)	\$ (269,229)	Not applicable
Long-term debt	Long-term debt	OTH	Interest	\$ (376,053)	\$ (385,432)	\$ (302,558)	\$ (302,558)	Level 1
Long-term debt	Amount due pursuant to acquisition	OTH	None	\$ (113,951)	\$ (113,951)	\$ (114,349)	\$ (114,349)	Not applicable

Accounting designations used in the above table:

HFT-A – Designated by Vermilion as “Held for trading” upon initial recognition. Financial assets and liabilities designated as “Held for trading” are carried at fair value on the consolidated balance sheets with gains and losses associated with fair value adjustments recognized in net earnings. The designation as held for trading for these instruments is appropriate as this is consistent with Vermilion's risk management policies and investment strategies.

HFT-B – Classified as “Held for trading” in accordance with International Accounting Standard 39 “Financial Instruments: Recognition and Measurement”. As with HFT-A instruments, these financial assets and liabilities are carried at fair value on the consolidated balance sheets with associated gains and losses reflected in net earnings.

LAR – “Loans and receivables” are initially recognized at fair value and subsequently are measured at amortized cost. Impairments and foreign exchange gains and losses are recognized in net earnings.

## 19. FINANCIAL INSTRUMENTS (Continued)

OTH – “Other financial liabilities” are initially recognized at fair value and subsequently are measured at amortized cost. Interest is recognized in net earnings using the effective interest method. Foreign exchange gains and losses are recognized in net earnings.

Level 1 – Fair value measurement is determined by reference to unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Fair value measurement is determined based on inputs other than unadjusted quoted prices that are observable, either directly or indirectly.

Level 3 – Fair value measurement is based on inputs for the asset or liability that are not based on observable market data.

### **Determination of Fair Values**

The level in the fair value hierarchy into which the fair value measurements are categorized is determined on the basis of the lowest level input that is significant to the fair value measurement. Fair values for derivative assets and derivative liabilities are determined using option pricing models incorporating future prices that are based on assumptions which are supported by prices from observable market transactions and are adjusted for credit risk. Fair values for portfolio investments are determined by reference to published price quotations in active markets. The carrying value of receivables and payables approximate their fair value due to their short maturities. The carrying value of long-term debt outstanding on the revolving credit facility approximates its fair value due to the use of short-term borrowing instruments at market rates of interest. The amount due pursuant to acquisition was determined by calculating the expected value of the future payment due to the vendor based on management's best estimates associated with the timing of first commercial gas and discounting the resulting amount. The discount rate which would be used to present value this obligation as at March 31, 2011 would not differ significantly from the discount rate originally used. The fair value of the senior unsecured notes changes in response to changes in the market rates of interest payable on similar instruments and was determined with reference to prevailing market rates for such instruments.

### **Nature and Extent of Risks Arising From Financial Instruments**

Vermilion is exposed to the following types of risks in relation to its financial instruments:

#### **Credit risk:**

Vermilion extends credit to customers and it may, from time-to-time, be due amounts from counterparties in relation to derivative instruments. Accordingly, there is a risk of financial loss in the event that a counterparty fails to discharge its obligation. For transactions that are financially significant, Vermilion reviews third-party credit ratings and may require additional forms of security. Cash held on behalf of the Company by financial institutions is also subject to credit risk related to the credit profile of those institutions.

#### **Currency risk:**

Vermilion conducts business in currencies other than Canadian dollars and accordingly is subject to currency risk associated with changes in foreign exchange rates in relation to cash, receivables, payables and derivative assets and liabilities. The impact related to working capital is somewhat mitigated as a result of the offsetting effects of foreign exchange fluctuations on assets and liabilities. Vermilion monitors its exposure to currency risk and reviews whether the use of derivative financial instruments is appropriate to manage potential fluctuations in foreign exchange rates.

#### **Commodity price risk:**

Vermilion uses financial derivatives as part of its risk management program associated with the effects of changes in commodity prices on future cash flows. Changes in the underlying commodity prices impact the fair value and future cash flows related to these derivatives.

## 19. FINANCIAL INSTRUMENTS (Continued)

### Equity price risk:

At March 31, 2011, Vermilion held portfolio investments in equity securities with a fair value of \$2.7 million (December 31, 2010 - \$3.1 million). The fair value of these instruments is exposed to changes in the prices of the underlying equities.

### Interest rate risk:

Vermilion's debt is comprised of short-term bankers acceptances that bear interest at market rates and senior unsecured notes with a fixed interest rate. Accordingly, Vermilion's exposure to interest rate risk in relation to its long-term debt at the balance sheet date is not material.

### Liquidity risk:

Liquidity risk is the risk that Vermilion will encounter difficulty in meeting obligations associated with its financial liabilities. Vermilion does not consider this to be a significant risk as its financial position and available committed borrowing facility provide significant financial flexibility and allow Vermilion to meet its obligations as they come due.

The nature of these risks and Vermilion's strategy for managing these risks has not changed significantly from the prior period.

### **Summarized Quantitative Data Associated with the Risks Arising from Financial Instruments**

#### Credit risk:

As at March 31, 2011 Vermilion's maximum exposure to receivable credit risk was \$180.1 million (December 31, 2010 - \$158.5 million) which is the aggregate value of receivables and derivative assets at the balance sheet date. Vermilion's receivables are due from counterparties that have investment grade third party credit ratings or, in the absence of the availability of such ratings, Vermilion has satisfactorily reviewed the counterparty for creditworthiness.

As at the balance sheet date the amount of financial assets that were past due or impaired was not material.

#### Liquidity risk:

The following table summarizes Vermilion's undiscounted non-derivative financial liabilities and their contractual maturities as at March 31, 2011 and December 31, 2010:

<u>Due in (from balance sheet date)</u>	<u>Not later than one month</u>	<u>Later than one month and not later than three months</u>	<u>Later than three months and not later than one year</u>	<u>Later than one year and not later than five years</u>
March 31, 2011	80,417	217,329	10,890	512,293
December 31, 2010	89,063	163,110	17,823	438,371

Vermilion's derivative financial liabilities settle on a monthly basis.

#### Market risk:

Vermilion is exposed to currency risk related to changes in foreign currency denominated financial instruments and commodity price risk related to outstanding derivative positions. The following table summarizes what the impact on net earnings before tax would be for the three month period ended March 31, 2011 and 2010 given changes in the relevant risk variables that Vermilion considers were reasonably possible at the balance sheet date. The impact on net earnings before tax associated with changes in these risk variables for liabilities that are not considered financial instruments is excluded from this analysis. This analysis does not attempt to reflect any interdependencies between the relevant risk variables.

## 19. FINANCIAL INSTRUMENTS (Continued)

Three months ended March 31, 2011:

Risk	Description of change in risk variable	Before tax effect on comprehensive income increase (decrease)
Currency risk – Euro to Canadian	<b>Increase</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on March 31, 2011	\$ (4,175)
	<b>Decrease</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on March 31, 2011	\$ 4,175
Currency risk – US\$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on March 31, 2011	\$ 3,823
	<b>Decrease</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on March 31, 2011	\$ (3,823)
Currency risk – AUD\$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on March 31, 2011	\$ 568
	<b>Decrease</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on March 31, 2011	\$ (568)
Commodity price risk	<b>Increase</b> in relevant oil reference price at March 31, 2011 by US\$5.00/bbl within option pricing models used to determine the fair value of derivative positions	\$ (18,255)
	<b>Decrease</b> in relevant oil reference price at March 31, 2011 by US\$5.00/bbl within option pricing models used to determine the fair value of derivative positions	\$ 17,231

Three months ended March 31, 2010:

Risk	Description of change in risk variable	Before tax effect on comprehensive income increase (decrease)
Currency risk – Euro to Canadian	<b>Increase</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on March 31, 2010	\$ (1,215)
	<b>Decrease</b> in strength of the Canadian dollar against the Euro by 5% over the relevant closing rates on March 31, 2010	\$ 1,215
Currency risk – US\$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on March 31, 2010	\$ (394)
	<b>Decrease</b> in strength of the Canadian dollar against the US\$ by 5% over the relevant closing rates on March 31, 2010	\$ 394
Currency risk – AUD\$ to Canadian	<b>Increase</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on March 31, 2010	\$ (532)
	<b>Decrease</b> in strength of the Canadian dollar against the AUD\$ by 5% over the relevant closing rates on March 31, 2010	\$ 532
Commodity price risk	<b>Increase</b> in relevant oil reference price at March 31, 2010 by US\$5.00/bbl within option pricing models used to determine the fair value of derivative positions	\$ 1,444
	<b>Decrease</b> in relevant oil reference price at March 31, 2010 by US\$5.00/bbl within option pricing models used to determine the fair value of derivative positions	\$ (2,022)

Reasonably possible changes in interest rates and natural gas prices would not have had a material impact on comprehensive income for the periods ended March 31, 2011 or 2010.

## 20. TRANSITION TO IFRS

For all periods up to and including the year ended December 31, 2010, Vermilion prepared its financial statements in accordance with generally accepted accounting principles as issued by the Canadian Accounting Standards Board ("Previous GAAP"). The consolidated financial statements for the interim period March 31, 2011, are the first financial statements presented under IFRS. IFRS 1 "First-time Adoption of International Financial Reporting Standards" requires an entity to issue an explicit and unreserved statement of compliance with its first annual financial statements prepared under IFRS. Vermilion will issue a statement of compliance in its 2011 annual financial statements.

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which Vermilion began applying IFRS was January 1, 2010 (the "transition date"). IFRS 1 requires that a first time adopter use the same accounting policies in its opening IFRS balance sheet and for all subsequent periods presented in its first IFRS financial statements. The adoption of IFRS includes full retrospective application of all IFRS standards which are effective at the end of its first IFRS reporting period, which for Vermilion will be December 31, 2011. In order to facilitate an effective adoption of IFRS there are a number of discretionary exemptions as well as mandatory exceptions from retrospective application of a number of IFRS standards.

### **Exceptions to restatement under IFRS 1**

Vermilion is subject to the following mandatory exceptions to restatement under IFRS.

#### 1) Estimates

The estimates made under Previous GAAP are required to be applied to the balances in accordance with IFRS unless there is evidence that the estimates were in error or to reflect any adjustments made to accounting policies to comply with IFRS. The only significant change in estimate as at the date of transition related to the calculation of the present value of Vermilion's asset retirement obligations due to differing requirements between Previous GAAP and IFRS.

#### 2) Derecognition of financial instruments

A first-time adopter shall apply the requirements within IAS 39 "Financial Instruments" prospectively from the transition date unless it chooses to apply the derecognition guidance retrospectively from a date of its election. Vermilion has elected to apply derecognition of financial instruments prospectively from January 1, 2010, the date of transition. Based on the election there were no significant adjustments required as a result of derecognition.

#### 3) Non-controlling interests

At the date of transition IFRS, prescribes that certain requirements of IAS 27 "Consolidated and Separate Financial Statements" be applied prospectively. As Vermilion had no outstanding instruments which were accounted for as a non-controlling interest there was no impact of this exception under IFRS.

### **Exemptions from restatement**

#### 1) Business Combinations

A first-time adopter may elect not to apply IFRS 3 "Business Combinations" retrospectively to past business combinations. Vermilion is electing not to apply IFRS 3 retrospectively to business combinations that occurred prior to January 1, 2010, its date of transition. The exemption for past business combinations also applies to past acquisitions of investments in associates and of interests in joint ventures. Furthermore, the date selected for transition applies equally for all such acquisitions. As such, Vermilion is electing not to apply IFRS 3 to past investments in associates and joint ventures prior to January 1, 2010, its date of transition.

## 20. TRANSITION TO IFRS (Continued)

### 2) Foreign currency translation

A first-time adopter may elect to not retrospectively apply IAS 21 "The Effects of Changes in Foreign Exchange Rates". Under this exemption the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition, and any resulting gains or losses on a subsequent disposal of a foreign operation will then exclude translation differences that arose before the date of transition to IFRS and include only translation differences arising subsequent to the transition date.

Vermilion has elected to utilize the exemption pertaining to the cumulative translation differences and as a result there is a nil balance in cumulative translation adjustments upon the date of transition to IFRS.

### 3) Oil & gas deemed cost exemption

Under Previous GAAP, exploration and development costs for oil and gas properties in the development or production phases are accounted for in cost centres that include all properties in a country. A first-time adopter using full cost accounting may elect to measure oil and gas assets at the date of transition to IFRS on the following basis:

- a) Exploration and evaluation assets at the amount determined under the entity's previous GAAP; and
- b) Assets in the development or production phases at the amount determined for the cost centre under the entity's previous GAAP. The entity shall allocate this amount to the cost centre's underlying assets pro rata using reserve volumes or reserve values as of that date.

In addition, the entity shall test exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to IFRS in accordance with IFRS 6 "Exploration for and Evaluation of Mineral Resources" or IAS 36 "Impairment of Assets" respectively and, if necessary, reduce the amount determined in accordance with (a) or (b) above. Oil and Gas assets comprise only those assets used in the exploration, evaluation, development or production of oil and gas.

Vermilion elected to measure oil and gas assets using the exception permitted by IFRS 1 and therefore allocated the development and production phase assets based on reserve values as at January 1, 2010, its date of transition. There was no identified impacts as at the date of transition.

### 4) Asset retirement obligations

A first-time adopter that utilizes the Oil and Gas exemption above shall measure asset retirement obligations as at the date of transition to IFRS in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets". Any difference between the remeasured amount in accordance with IFRS and the carrying amount of those liabilities at the date of transition to IFRS determined under the entity's previous GAAP is recognized directly in retained earnings. The impact of the remeasurement of asset retirement obligations is disclosed in Note 21 (f).

### 5) Borrowing costs

A first-time adopter may apply the transitional provisions set out in IAS 23 "Borrowing Costs", as revised in 2007. IAS 23 "Borrowing Costs" transitional provisions should be interpreted to be January 1, 2009 or the date of transition to IFRS, whichever is later. Vermilion elected to apply the transitional provisions set out in IAS 23 and elected January 1, 2010, its date of transition, to be its date of application of IAS 23. There was no impact pursuant to the application of this exemption.

## 20. TRANSITION TO IFRS (Continued)

### 6) Share-based payment transactions

A first-time adopter is encouraged, but not required, to apply IFRS 2 "Share-based Payments" to liability instruments that were granted after November 7, 2002 and vested or settled at the later of the date of transition to IFRS and January 1, 2005. Vermilion elected to apply IFRS 2 as at January 1, 2010, its date of transition and applied IFRS 2 for all liabilities arising from share-based payment transactions that existed at that date.

#### EFFECT OF TRANSITION ON BALANCE SHEET

	PREVIOUS GAAP		IFRS		PREVIOUS GAAP		IFRS	
	As At March 31, 2010	Effect of Transition to IFRS	As At March 31, 2010	As At December 31, 2010	Effect of Transition to IFRS	As At December 31, 2010		
<b>ASSETS</b>								
<b>Current</b>								
Cash and cash equivalents	\$ 53,436	\$ -	\$ 53,436	\$ 145,623	\$ -	\$ 145,623		
Short term investments	15,815	-	15,815	15,132	-	15,132		
Accounts receivable	122,881	-	122,881	147,329	-	147,329		
Crude oil inventory	5,450	-	5,450	10,707	-	10,707		
Derivative instruments	13,657	-	13,657	10,249	-	10,249		
Prepaid expenses and other	10,121	-	10,121	11,157	-	11,157		
Deferred taxes	a	-	-	2,902	(2,902)	-		
			221,360	343,099	(2,902)	340,197		
Derivative instruments			6,381	942	-	942		
Deferred taxes	a	2,819	128,681	151,477	(3,528)	147,949		
Long-term investments			3,611	3,108	-	3,108		
Goodwill	j	-	19,840	51,589	(51,589)	-		
Reclamation fund			65,977	-	-	-		
E&E Assets			-	-	17,157	17,157		
Capital assets	b,c	(57,160)	1,624,044	2,031,501	(215,057)	1,816,444		
		\$ (54,341)	\$ 2,069,894	\$ 2,581,716	\$ (255,919)	\$ 2,325,797		
<b>LIABILITIES</b>								
<b>Current</b>								
Accounts payable	a	\$ (15,345)	\$ 171,999	\$ 253,086	\$ (767)	\$ 252,319		
Dividends or distributions payable			15,278	16,910	-	16,910		
Derivative instruments	i	4,353	6,059	12,143	-	12,143		
Income taxes payable	a	14,950	27,089	58,795	767	59,562		
Deferred taxes	a	(593)	-	-	-	-		
		3,365	220,425	340,934	-	340,934		
Long-term debt			205,277	302,558	-	302,558		
Amount due on acquisition			110,267	114,349	-	114,349		
Asset retirement obligation	f	(9,624)	221,448	274,560	(7,171)	267,389		
Unit compensation liability	d	19,973	19,973	-	-	-		
Derivative instruments	i	4,640	4,640	1,767	6,390	8,157		
Deferred taxes	a	34,022	240,832	246,982	(474)	246,508		
		52,376	1,022,862	1,281,150	(1,255)	1,279,895		
Liability associated with exchangeable shares	c	236,230	236,230	-	-	-		
Non-controlling interest – exchangeable shares	c	(104,643)	-	-	-	-		
<b>SHAREHOLDERS' EQUITY</b>								
Unitholders' capital		1,536	741,787	-	-	-		
Shareholders' capital		-	-	1,045,930	(20,160)	1,025,770		
Contributed surplus	d	(18,493)	-	39,841	885	40,726		
Accumulated other comprehensive income		(33,606)	(33,606)	-	(31,577)	(31,577)		
Retained earnings		(187,741)	102,621	214,795	(203,812)	10,983		
		(238,304)	810,802	1,300,566	(254,664)	1,045,902		
		\$ (54,341)	\$ 2,069,894	\$ 2,581,716	\$ (255,919)	\$ 2,325,797		

## 20. TRANSITION TO IFRS (Continued)

### EFFECT OF ADOPTION ON STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME (LOSS)

	PREVIOUS GAAP		IFRS		PREVIOUS GAAP		IFRS
	Three months ended March 31, 2010	Effect of Transition to IFRS	Three months ended March 31, 2010	Year ended December 31, 2010	Effect of Transition to IFRS	Year ended December 31, 2010	
<b>REVENUE</b>							
Petroleum and natural gas sales	\$ 169,581	\$ -	\$ 169,581	\$ 727,805	\$ -	\$ 727,805	
Royalties	(28,097)	14,950	(13,147)	(83,509)	39,537	(43,972)	
Revenue	141,484	14,950	156,434	644,296	39,537	683,833	
<b>EXPENSES</b>							
Operating	36,335	-	36,335	144,595	-	144,595	
Transportation	6,949	-	6,949	26,698	-	26,698	
Equity based compensation	5,307	6,966	12,273	28,170	6,406	34,576	
Loss (gain) on derivative instruments	(5,209)	1,123	(4,086)	3,906	3,013	6,919	
Interest	3,033	-	3,033	13,370	-	13,370	
General and administration	10,153	-	10,153	42,842	-	42,842	
Foreign exchange (gain) loss	(19,645)	41,973	22,328	(26,132)	61,091	34,959	
Other expense	1,534	-	1,534	2,469	-	2,469	
Accretion	-	4,519	4,519	-	17,903	17,903	
Depletion and depreciation	57,063	(17,849)	39,214	271,556	(87,936)	183,620	
	\$ 95,520	\$ 36,732	\$ 132,252	\$ 507,474	\$ 477	\$ 507,951	
<b>EARNINGS BEFORE INCOME TAXES AND OTHER ITEMS</b>							
	45,964	(21,782)	24,182	136,822	39,060	175,882	
<b>INCOME TAXES</b>							
Deferred	(10,400)	(531)	(10,931)	(55,383)	23,663	(31,720)	
Current	9,973	14,950	24,923	72,701	39,537	112,238	
	(427)	14,419	13,992	17,318	63,200	80,518	
<b>OTHER ITEMS</b>							
Goodwill impairment	-	-	-	-	19,840	19,840	
Non-controlling interest - exchangeable shares	3,883	(3,883)	-	8,241	(8,241)	-	
Remeasurement loss on exchangeable share liability	-	18,373	18,373	-	31,129	31,129	
<b>NET EARNINGS (LOSS)</b>	42,508	(50,691)	(8,183)	111,263	(66,868)	44,395	
Cumulative translation adjustments	-	(33,606)	(33,606)	-	(31,577)	(31,577)	
<b>TOTAL COMPREHENSIVE INCOME (LOSS)</b>	\$ 42,508	\$ (84,297)	\$ (41,789)	\$ 111,263	\$ (98,445)	\$ 12,818	
<b>NET EARNINGS (LOSS) PER SHARE OR UNIT</b>							
Basic	\$ 0.53	\$ (0.63)	\$ (0.10)	\$ 1.34	\$ (0.81)	\$ 0.53	
Diluted	\$ 0.53	\$ (0.63)	\$ (0.10)	\$ 1.32	\$ (0.79)	\$ 0.53	



## 20. TRANSITION TO IFRS (Continued)

### EFFECT OF ADOPTION ON STATEMENT OF CASH FLOWS

	PREVIOUS GAAP		IFRS		PREVIOUS GAAP		IFRS	
	Three months ended March 31, 2010	Effect of Transition to IFRS	Three months ended March 31, 2010	Year ended December 31, 2010	Effect of Transition to IFRS	Year ended December 31, 2010		
<b>OPERATING</b>								
Net earnings (loss)	\$ 42,508	\$ (50,691)	\$ (8,183)	\$ 111,263	\$ (66,868)	\$ 44,395		
<b>Adjustments:</b>								
Accretion	f -	4,519	4,519	-	17,903	17,903		
Depletion and depreciation	e 57,063	(17,849)	39,214	271,556	(87,936)	183,620		
Change in unrealized gains and losses and accruals relating to derivative contracts	i (3,991)	(342)	(4,333)	17,060	(2,945)	14,115		
Equity based compensation	d 5,307	6,966	12,273	28,170	6,406	34,576		
Unrealized foreign exchange (gain) loss	b (17,546)	41,972	24,426	(20,509)	61,091	40,582		
Goodwill impairment	j -	-	-	-	19,840	19,840		
Non-controlling interest exchangeables	c 3,883	(3,883)	-	8,241	(8,241)	-		
Remeasurement loss on liability associated with exchangeable shares	c -	18,373	18,373	-	31,129	31,129		
Change in unrealized gains and losses and accruals included in other (income) expense relating to investments	1,537	-	1,537	3,089	-	3,089		
Deferred taxes	a (10,400)	(531)	(10,931)	(55,383)	23,663	(31,720)		
	78,361	(1,466)	76,895	363,487	(5,958)	357,529		
Asset retirement obligations settled	-	-	-	(6,861)	-	(6,861)		
Changes in non-cash operating working capital	1,876	1,466	3,342	64,656	5,958	70,614		
<b>Cash flows from operating activities</b>	<b>80,237</b>	<b>-</b>	<b>80,237</b>	<b>421,282</b>	<b>-</b>	<b>421,282</b>		
<b>INVESTING</b>								
Drilling and development of petroleum and natural gas properties	(119,896)	-	(119,896)	(432,182)	-	(432,182)		
Acquisition of petroleum and natural gas properties	(2,897)	1,943	(954)	(6,655)	6,207	(448)		
Purchase of short-term investments	80	-	80	64,889	-	64,889		
Withdrawals from the reclamation fund	-	-	-	812	-	812		
Changes in non-cash investing working capital	(4,229)	(1,943)	(6,172)	14,073	(6,207)	7,866		
<b>Cash flows used in investing activities</b>	<b>(126,942)</b>	<b>-</b>	<b>(126,942)</b>	<b>(359,063)</b>	<b>-</b>	<b>(359,063)</b>		
<b>FINANCING</b>								
Increase (decrease) in long-term debt	44,999	-	44,999	142,700	-	142,700		
Issue of common shares or trust units pursuant to the dividend or distribution reinvestment plan	7,380	-	7,380	40,824	-	40,824		
Cash distributions	(45,359)	-	(45,359)	(121,966)	-	(121,966)		
Cash dividends	-	-	-	(65,977)	-	(65,977)		
<b>Cash flows (used in) from financing activities</b>	<b>7,020</b>	<b>-</b>	<b>7,020</b>	<b>(4,419)</b>	<b>-</b>	<b>(4,419)</b>		
Foreign exchange (loss) gain on cash held in foreign currencies	(5,945)	-	(5,945)	(11,243)	-	(11,243)		
<b>Net change in cash and cash equivalents</b>	<b>(45,630)</b>	<b>-</b>	<b>(45,630)</b>	<b>46,557</b>	<b>-</b>	<b>46,557</b>		
Cash and cash equivalents, beginning of period	99,066	-	99,066	99,066	-	99,066		
<b>Cash and cash equivalents, end of period</b>	<b>\$ 53,436</b>	<b>\$ -</b>	<b>\$ 53,436</b>	<b>\$ 145,623</b>	<b>\$ -</b>	<b>\$ 145,623</b>		

## 20. TRANSITION TO IFRS (Continued)

Supplementary information - cash payments												
Interest paid	\$	2,679	\$	-	\$	2,679	\$	13,585	\$	-	\$	13,585
Income taxes paid	\$	200	\$	1,724	\$	1,924	\$	16,272	\$	40,494	\$	56,766

### EFFECT OF TRANSACTION ON STATEMENT OF CHANGES IN SHAREHOLDERS' (UNITHOLDERS') EQUITY

		Shareholders' (Unitholders') Capital	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive loss	Total Shareholders' (Unitholders') Equity
<b>Balance per Previous GAAP as at January 1, 2010</b>		\$ 711,667	\$ 30,413	\$ 297,210	\$ -	\$ 1,039,290
<b>Transition adjustments:</b>						
Deferred tax adjustments	a	-	-	(31,159)	-	(31,159)
Retranslation of capital assets	b	-	-	3,573	-	3,573
Remeasurement of exchangeable shares	c	-	-	(117,168)	-	(117,168)
Differences in equity based compensation	d	-	(30,413)	106	-	(30,307)
Remeasurement of asset retirement obligation	f	-	-	13,105	-	13,105
Initial recognition of derivative instrument	i	-	-	(9,335)	-	(9,335)
<b>Balance per IFRS as at January 1, 2010</b>		711,667	-	156,332	-	867,999
<b>Balance per Previous GAAP as at March 31, 2010</b>		\$ 740,251	\$ 18,493	\$ 290,362	\$ -	\$ 1,049,106
<b>Transition adjustments (see above):</b>		-	(30,413)	(140,878)	-	(171,291)
<b>Comparative period adjustments:</b>						
Remeasurement of common shares issued for exchangeable shares	c	(16)	-	-	-	(16)
Differences in equity based compensation	d	1,552	11,920	3,828	-	17,300
Difference in net earnings for the period		-	-	(50,691)	-	(52,181)
Cumulative translation adjustment	b	-	-	-	(33,606)	(32,116)
<b>Balance per IFRS as at March 31, 2010</b>		\$ 741,787	\$ -	\$ 102,621	\$ (33,606)	\$ 810,802
<b>Balance per Previous GAAP as at December 31, 2010</b>		\$ 1,045,930	\$ 39,841	\$ 214,795	\$ -	\$ 1,300,566
<b>Transition adjustments (see above):</b>		-	(30,413)	(140,878)	-	(171,291)
<b>Comparative period adjustments:</b>						
Remeasurement of common shares issued for exchangeable shares	c	(21,642)	-	-	-	(21,642)
Differences in equity based compensation	d	1,482	31,298	3,934	-	36,714
Difference in net earnings for the year		-	-	(66,868)	-	(66,868)
Cumulative translation adjustment	b	-	-	-	(31,577)	(31,577)
<b>Balance per IFRS as at December 31, 2010</b>		\$ 1,025,770	\$ 40,726	\$ 10,983	\$ (31,577)	\$ 1,045,902

		Three months ended March 31, 2010	Year ended Dec 31, 2010
<b>NET EARNINGS UNDER PREVIOUS GAAP</b>		\$ 42,508	\$ 111,263
Increase in equity based compensation expense	d	(6,966)	(6,406)
Increase in loss on derivative instruments	i	(1,123)	(3,013)
Increase in foreign exchange loss	b	(41,973)	(61,091)
Decrease in accretion expense	f	143	250
Decrease in depletion and depreciation	e	13,187	69,783
Increase in deferred income tax expense	a	531	(23,663)
Goodwill impairment	j	-	(19,840)
Reversal of non-controlling interest - exchangeable shares	c	3,883	8,241
Remeasurement loss associated with exchangeable share liability	c	(18,373)	(31,129)
<b>NET (LOSS) EARNINGS UNDER IFRS</b>		<b>(8,183)</b>	<b>44,395</b>
Cumulative translation adjustments	b	(33,606)	(31,577)
<b>TOTAL COMPREHENSIVE (LOSS) INCOME UNDER IFRS</b>		<b>\$ (41,789)</b>	<b>\$ 12,818</b>

## 21. EXPLANATION OF TRANSITION TO IFRS

### a. Deferred Taxes

Under Previous GAAP deferred tax assets and liabilities were classified between current and non-current portions based on the nature of the balances upon which the temporary differences are related. IAS 12 "Income Taxes" requires that all recorded deferred taxes be classified as non-current.

Deferred tax adjustments also resulted from changes in the carrying values of capital assets and asset retirement obligations which resulted in changes to the temporary differences associated with those balances. The adjustments in the temporary differences to comply with IFRS resulted in adjustments to retained earnings and net earnings for the opening balance sheet and subsequent period balance sheets, respectively.

In addition, Australian Petroleum Resource Rent Tax ("PRRT") was classified as a royalty expense under Previous GAAP. Under IFRS this item is considered a component of current taxes and has been reclassified in the balance sheet and income statement to reflect this change. As there are timing differences in the deductibility of certain expenditures for PRRT purposes as compared to the IFRS accounting there were additional deferred tax adjustments which resulted from the change to account for PRRT as an income tax. The adjustments to deferred taxes required to record PRRT as an income tax were recorded to retained earnings and net earnings for the opening balance sheet and subsequent period balance sheets, respectively.

### b. Foreign Currency Translation

Under Previous GAAP, Vermilion concluded that the functional currency of its foreign operating subsidiaries is the Canadian dollar. As a result of differences in the guidance for functional currency determination, Vermilion has concluded that under IFRS the functional currency of its foreign operating subsidiaries will be their respective local currencies. As a consequence of this change, gains and losses related to the translation of the financial statements of these subsidiaries are recorded through other comprehensive income and do not impact net income until a disposal or partial disposal of a foreign operation. In addition, the capital asset accounts of Vermilion's foreign operating subsidiaries are translated to Canadian dollars at the foreign exchange rates in effect at the balance sheet date whereas under Previous GAAP, these capital asset accounts were translated at historical rates of exchange. Due to the election to not retrospectively apply IAS 21 "The Effects of Changes in Foreign Exchange Rates" the results of the restatement of capital assets to the period end rate was recorded as an adjustment to retained earnings. The translation of all balances denominated in foreign currencies resulted in adjustment at each period from net earnings to other comprehensive income.

### c. Exchangeable shares

Under Previous GAAP, pursuant to EIC 151 "Exchangeable Shares Issued by Subsidiaries of Income Trusts" Vermilion classified the outstanding exchangeable shares as non-controlling interest. Under Previous GAAP the balance in non-controlling interest was adjusted for the conversion of exchangeable shares for trust units and the portion of net earnings attributable to holders of exchangeable shares.

Under IFRS, pursuant to IAS 32 "Financial Instruments: Presentation" exchangeable shares outstanding were classified as financial liabilities and recorded based on the redemption value of the underlying trust units. The adjustment to recognize the liability associated with exchangeable shares in accordance with IFRS resulted in the elimination of the non-controlling interest balance and an adjustment to retained earnings. Subsequent to the transition date adjustments to reflect the remeasurement of the liability associated with exchangeable shares at each reporting period to the redemption amount were recorded in earnings in the respective periods. Upon conversion to a corporation the liability was extinguished at the corporate conversion date redemption value by reclassifying the carrying value to shareholders' capital.

## 21. EXPLANATION OF TRANSITION TO IFRS (Continued)

### d. Equity based compensation

Under Previous GAAP, Vermilion's TAP Plan was accounted for as an equity settled plan with the value of the awards accumulating in contributed surplus until vested. The awards vested based on the fair value upon issuance and were amortized based on the vesting period of the awards. Under IFRS, the TAP Plan was reclassified to a liability settled plan due to the redemption features which are implicit in the underlying trust units. The balance under Previous GAAP which had been accumulated in contributed surplus was reclassified to equity based compensation liability with the difference between the value of the awards upon the date of transition and the amount in contributed surplus being recorded to retained earnings. Subsequent to the date of transition the awards outstanding were remeasured with the gains and losses recorded to equity based compensation expense. Upon conversion to a corporation the underlying awards were no longer tied to the redeemable trust units and, accordingly, the awards were reclassified to contributed surplus.

### e. Property, plant and equipment

Under Previous GAAP, PNG properties and equipment were held at cost using the full cost method of accounting. The costs were accumulated and depleted at a country level using proven reserves. Under IFRS the initially recognized cost on adoption was the balance under Previous GAAP allocated based upon reserve value to depletion units as at January 1, 2010. Costs associated with PNG properties from January 1, 2010 onward are accumulated at the level of a depletion unit and depleted based on the attributed proven and probable reserves. Based on the use of proven and probable reserves the depletion recorded under IFRS is lower than the amount recorded for the same period under Previous GAAP.

### f. Asset retirement obligations

The basic fundamental premise underlying the accounting for asset retirement obligations is consistent between Previous GAAP and IFRS, however under the latter, the liability is remeasured at each reporting date using the pre-tax discount rate that reflects current market assessment of time value of money and risks specific to the liabilities that have not been reflected in the cash flow estimates. As Vermilion elected to use the IFRS 1 deemed cost accounting exemption noted above, upon transition Vermilion recognized its asset retirement obligations based on the measurement in accordance with IFRS and recorded the differences against retained earnings. Subsequent to the transition date the asset retirement obligation was remeasured to reflect changes in the discount rate at each reporting period and the revised accretion under IFRS. The adjustments for the discount rate and accretion differences were recorded to PNG properties and equipment and net earnings, respectively.

### g. Revenue

Under Previous GAAP royalties on production were included as royalty expense on the income statement. Under IFRS revenue is presented net of royalties when the royalty relates directly to the produced volume and does not relate to a net profit interest by the governing body. This change in presentation did not have an impact on the opening balance sheet presented in accordance with IFRS. All periods presented subsequent to the date of transition to IFRS reflect this change in the statement of net earnings.

### h. Cash flow statements

Cash flow statements prepared under IAS 7 "Statement of Cash Flows" present cash flows in the same manner as under Previous GAAP. Other than reclassifications between net earnings and the adjustments to compute cash flows from operating activities there were no material changes to the statement of cash flows.

## 21. EXPLANATION OF TRANSITION TO IFRS (Continued)

### i. Derivative instruments

Prior to the transition date, Vermilion completed a business combination that included a contingent consideration arrangement dependant upon the price of oil. Under Previous GAAP, payments made under this arrangement were accounted for as additional consideration. Although Vermilion has elected to not restate past business combinations, the contingent payment, outstanding at the date of transition, is subject to remeasurement under IFRS 3 "Business Combinations" and accordingly the contingent payment is accounted for as a derivative liability with changes in the estimated fair value recorded at each period end through earnings. Upon transition to IFRS the initial recognition of the contingent payment was recorded to derivative liability and retained earnings, respectively.

### j. Goodwill

Under Previous GAAP Vermilion tested for impairment at the level of a reporting unit, which for the year ended December 31, 2010 and prior periods related to assets in Canada. Under IFRS the testing of goodwill is performed by allocating the goodwill where possible to the CGU's upon which the goodwill value is attributable. As a result of the impairment testing under IFRS for the year ended December 31, 2010 the balance of goodwill was identified as being impaired and was charged to earnings in that year. The transition to IFRS therefore resulted in an adjustment to goodwill and a decrease in net earnings of \$19.8 million.

The remaining adjustment to the 2010 comparable period results from the reversal of the exchangeable share conversion under Previous GAAP. Under Previous GAAP the conversion of exchangeable shares was recorded as an acquisition of non-controlling interest at fair value. Under Previous GAAP the fair value of the common shares issued in consideration for the non-controlling interest represented by the exchangeable shares was \$270.6 million. The difference between that amount and the carrying value of the non-controlling interest of \$109.0 million resulted in increases to capital assets of \$189.9 million, goodwill of \$31.7 million and future income tax liability of \$60.0 million. Under IFRS the accounting for the exchangeable shares pursuant to IAS 32 resulted in a difference which is reflected in the above reconciliations for the year ended December 31, 2010.

## DIRECTORS

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William F. Madison <sup>2, 4, 5</sup>  
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Timothy R. Marchant <sup>3, 4, 5</sup>  
Calgary, Alberta

<sup>1</sup> Chairman of the Board

<sup>2</sup> Audit Committee

<sup>3</sup> Governance and Human Resources Committee

<sup>4</sup> Health, Safety and Environment Committee

<sup>5</sup> Independent Reserves Committee

## ABBREVIATIONS

bbl(s)	barrel(s)
mbbls	thousand barrels
bbls/d	barrels per day
mcf	thousand cubic feet
mmcf	million cubic feet
bcf	billion cubic feet
mcf/d	thousand cubic feet per day
mmcf/d	million cubic feet per day
boe	barrels of oil equivalent of natural gas and crude oil on the basis of one boe for six mcf of natural gas
mboe	thousand barrels of oil equivalent
mmboe	million barrels of oil equivalent
boe/d	barrels of oil equivalent per day
CBM	coalbed methane
NGLs	natural gas liquids
GJ/d	Gigajoules per day
WTI	West Texas Intermediate, the reference price paid in U.S. dollars at Cushing, Oklahoma for crude oil of standard grade
\$M	thousand dollars
\$MM	million dollars

## OFFICERS AND KEY PERSONNEL

### CANADA

Lorenzo Donadeo, P.Eng.  
President & Chief Executive Officer

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Executive Vice President Business Development

Curtis W. Hicks, C.A.  
Executive Vice President & CFO

G. R. (Bob) Mac Dougall, P.Eng.  
Executive Vice President & COO

Paul L. Beique  
Vice President Capital Markets

Mona Jasinski, M.B.A., C.H.R.P.  
Vice President People

Raj C. Patel, P.Eng.  
Vice President Marketing

Daniel Goulet, P.Eng.  
Director Production and Operations

Cameron A. Hercus, MSc  
Director Exploitation and New Growth

Dean N. Morrison, CFA  
Director Investor Relations

Gerardo Rivera  
Director Commercial

Robert (Bob) J. Engbloom, LL.B.  
Corporate Secretary

### EUROPE

Peter Sider, P.Eng.  
Vice President European Operations

David Burghardt, P.Eng.  
Director Exploitation

Scott Ferguson, P.Eng.  
Director European Operations

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Bruce D. Lake, P.Eng.  
Managing Director  
Vermilion Oil & Gas Australia Pty Ltd.

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The Bank of Nova Scotia  
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Alberta Treasury Branches  
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Computershare Trust Company of Canada

## STOCK EXCHANGE LISTING

The Toronto Stock Exchange  
Symbol: VET  
US OTC  
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