



**CONSOLIDATED FINANCIAL STATEMENTS  
AS AT DECEMBER 31, 2009 AND 2008  
AND FOR THE YEARS THEN ENDED**



## MANAGEMENT'S REPORT

The accompanying consolidated financial statements of Trilogy Energy Trust ("Trilogy") are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include certain estimates that reflect management's best judgments. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. The relevant financial information contained elsewhere in this annual report is consistent with the consolidated financial statements.

Management has the overall responsibility for internal controls and maintains a system of internal controls that provides reasonable assurance that all transactions are accurately recorded, that the financial statements realistically report Trilogy's operating and financial results and that Trilogy's assets are safeguarded.

The Board of Directors has approved the information contained in the consolidated financial statements. The Board of Directors fulfills its responsibility regarding the consolidated financial statements through its Audit Committee, which is comprised of independent directors. The Audit Committee meets at least quarterly with management and the external auditors to ensure that management's responsibilities are properly discharged and to review the consolidated financial statements. The Audit Committee reports its findings to the Board of Directors for consideration when approving the annual consolidated financial statements for issuance to the Unitholders. The Audit Committee also considers, for review by the Board of Directors and approval by the Unitholders, the engagement or re-appointment of external auditors.

PricewaterhouseCoopers LLP, an independent firm of chartered accountants, was appointed by a vote of Unitholders at Trilogy's last annual meeting to audit the consolidated financial statements and provide an independent opinion. PricewaterhouseCoopers LLP have full and free access to the Audit Committee and management.

*/s/ J. H. T. Riddell*

**J. H. T. Riddell**

President and Chief Executive Officer

*/s/ M. G. Kohut*

**M. G. Kohut**

Chief Financial Officer

March 2, 2010

## **AUDITORS' REPORT**

March 2, 2010

### **To the Shareholders of Trilogy Energy Corp.**

We have audited the consolidated balance sheet of **Trilogy Energy Trust** as at December 31, 2009 and 2008 and the consolidated statements of (loss) / earnings and other comprehensive (loss) / income, unitholders' equity, and cash flows for each of the years in the two year period ended December 31, 2009. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2009 in accordance with Canadian generally accepted accounting principles.

*/s/ PricewaterhouseCoopers LLP*  
**Chartered Accountants**  
**Calgary, Alberta**

**TRILOGY ENERGY TRUST**  
**Consolidated Balance Sheets**

(In thousand dollars)

	As at December 31,	
	2009	2008
<b>ASSETS</b>		
<b>Current Assets</b>		
Accounts receivable (notes 10, 11 and 13)	\$ 50,797	\$ 55,149
Financial instruments (notes 10 and 11)	2,803	22,187
Prepaid expenses	546	826
	<b>54,146</b>	<b>78,162</b>
<b>Property, plant and equipment</b> (note 4)	<b>686,736</b>	<b>728,207</b>
<b>Future income taxes</b> (note 15)	<b>11,840</b>	<b>10,749</b>
<b>Goodwill</b>	<b>140,471</b>	<b>140,471</b>
	<b>\$ 893,193</b>	<b>\$ 957,589</b>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (notes 10, 11 and 13)	\$ 58,257	\$ 61,138
Distributions payable (notes 8, 10, 11 and 13)	5,525	9,600
	<b>63,782</b>	<b>70,738</b>
<b>Long-term debt</b> (notes 5, 10 and 11)	<b>236,791</b>	<b>307,405</b>
<b>Asset retirement obligations</b> (note 6)	<b>75,355</b>	<b>75,213</b>
<b>Future income taxes</b> (note 15)	<b>82,653</b>	<b>88,136</b>
	<b>394,799</b>	<b>470,754</b>
<b>Unitholders' equity</b>		
Unitholders' capital (note 7)	825,758	714,950
Contributed surplus (note 9)	10,251	8,977
Accumulated deficit after distributions	(401,397)	(307,830)
	<b>434,612</b>	<b>416,097</b>
	<b>\$ 893,193</b>	<b>\$ 957,589</b>

**Commitments and contingencies** (notes 5, 10 and 14)

See accompanying notes to consolidated financial statements.

On behalf of the Board

/s/ R. M. MacDonald  
**R. M. MacDonald**  
 Director

/s/ M. H. Dilger  
**M. H. Dilger**  
 Director

# TRILOGY ENERGY TRUST

## Consolidated Statements of (Loss) Earnings and Other Comprehensive (Loss) Income

(In thousand dollars except as otherwise indicated)

	Years Ended December 31,	
	2009	2008
<b>Revenue</b>		
Petroleum and natural gas sales	\$ 236,079	\$ 465,297
Realized gain on financial instruments <i>(notes 10 and 11)</i>	31,489	16,020
Unrealized gain (loss) on financial instruments <i>(notes 10 and 11)</i>	(19,405)	29,150
Royalties	(26,903)	(92,372)
Other (expense) income	(414)	7,664
	<b>220,846</b>	<b>425,759</b>
<b>Expenses</b>		
Operating	81,146	88,879
Transportation	11,933	14,139
General and administrative <i>(notes 9 and 13)</i>	18,559	18,848
Bad debt expense <i>(note 10)</i>	4,000	—
Exploration expenditures	2,058	10,615
Loss (gain) on disposition of property, plant and equipment	(228)	(441)
Accretion on asset retirement obligations <i>(note 6)</i>	5,802	5,372
Depletion and depreciation <i>(note 4)</i>	124,964	141,660
Interest and financing charges	11,866	15,003
	<b>260,100</b>	<b>294,075</b>
<b>(Loss) earnings before taxes</b>	<b>(39,254)</b>	<b>131,684</b>
<b>Future income taxes</b> <i>(note 15)</i>	<b>(5,892)</b>	<b>8,331</b>
<b>Net (loss) earnings / Total comprehensive (loss) income</b>	<b>\$ (33,362)</b>	<b>\$ 123,353</b>
<b>Earnings (loss) per Trust Unit</b> (in full amounts)		
— Basic	\$ (0.33)	\$ 1.29
— Diluted	\$ (0.33)	\$ 1.28
<b>Weighted average Trust Units outstanding</b> (in thousands)		
— Basic	100,060	95,715
— Diluted <i>(note 7)</i>	100,060	96,089

See accompanying notes to consolidated financial statements.

## TRILOGY ENERGY TRUST

### Consolidated Statements of Unitholders' Equity

(In thousand dollars except Trust Unit information)

	Year Ended December 31, 2009				
	Outstanding Trust Units	Paid-in Capital	Accumulated Deficit	Contributed Surplus	Unitholders' Equity
Opening balance	95,996,646	\$ 714,950	\$ (307,830)	\$ 8,977	\$ 416,097
Net loss for the year	—	—	(33,362)	—	(33,362)
Distribution reinvestment plan and other equity issuances <i>(notes 7 and 8)</i>	14,493,688	110,808	—	—	110,808
Distributions declared <i>(note 8)</i>	—	—	(60,205)	—	(60,205)
Normal course issuer bid <i>(note 7)</i>	—	—	—	—	—
Unit/stock option recognition <i>(note 9)</i>	—	—	—	1,274	1,274
Closing balance	110,490,334	\$ 825,758	\$ (401,397)	\$ 10,251	\$ 434,612

	Year Ended December 31, 2008				
	Outstanding Trust Units	Paid-in Capital	Accumulated Deficit	Contributed Surplus	Unitholders' Equity
Opening balance	94,608,704	\$ 704,100	\$ (327,653)	\$ 5,558	\$ 382,005
Net earnings for the year	—	—	123,353	—	123,353
Distribution reinvestment plan <i>(notes 7 and 8)</i>	6,159,521	46,597	—	—	46,597
Distributions declared <i>(note 8)</i>	—	—	(103,530)	—	(103,530)
Normal course issuer bid <i>(note 7)</i>	(4,771,579)	(35,747)	—	762	(34,985)
Unit/stock option recognition <i>(note 9)</i>	—	—	—	2,657	2,657
Closing balance	95,996,646	\$ 714,950	\$ (307,830)	\$ 8,977	\$ 416,097

See accompanying notes to consolidated financial statements.

**TRILOGY ENERGY TRUST**  
**Consolidated Statements of Cash Flows**  
(In thousand dollars)

	Years Ended December 31	
	2009	2008
<b>Operating activities</b>		
Net (loss) earnings	\$ (33,362)	\$ 123,353
Add (deduct) non-cash and other items:		
Depletion and depreciation	124,964	141,660
Gain on disposition of property, plant and equipment	(228)	(441)
Exploration expenditures	2,058	10,615
Asset retirement obligation expenditures <i>(note 6)</i>	(1,515)	(5,441)
Accretion on asset retirement obligations <i>(note 6)</i>	5,802	5,372
Future income tax expense <i>(note 15)</i>	(5,892)	8,331
Non-cash general and administrative expense (recovery)	1,290	(433)
Unrealized loss (gain) on financial instruments <i>(note 11)</i>	19,405	(29,150)
Other	(45)	—
Net changes in operating working capital	7,992	(10,346)
<b>Cash flow from operating activities</b>	<b>120,469</b>	<b>243,520</b>
<b>Financing activities</b>		
Credit facilities – draws	301,441	505,530
Credit facilities – repayments	(372,251)	(524,398)
Distributions to unitholders <i>(note 8)</i>	(36,092)	(53,956)
Trust Units issued	81,920	—
Purchase and cancellation of Trust Units under normal course issuer bid	—	(34,985)
<b>Cash flow provided by (used in) financing activities</b>	<b>(24,982)</b>	<b>(107,809)</b>
<b>Investing activities</b>		
Property, plant and equipment expenditures	(89,509)	(123,721)
Property acquisitions	(406)	(20,594)
Proceeds on disposition of property, plant and equipment	448	561
Change in investing working capital	(6,020)	8,043
<b>Cash flow used in investing activities</b>	<b>(95,487)</b>	<b>(135,711)</b>
<b>Change in cash / cash, end of year</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Cash interest and financing charges paid</b>	<b>\$ 11,976</b>	<b>\$ 15,226</b>

See accompanying notes to consolidated financial statements.

# TRILOGY ENERGY TRUST

## Notes to Consolidated Financial Statements

December 31, 2009 and 2008

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

### 1. GENERAL

Prior to February 5, 2010, Trilogy Energy Trust ("Trilogy" or the "Trust") was an open-ended unincorporated investment trust governed by the laws of the Province of Alberta and created pursuant to its Trust Indenture dated February 25, 2005, as amended and restated from time to time. The Trust was managed by Trilogy Energy Ltd., the administrator of the Trust. The beneficiaries of the Trust were the holders of Trust Units (the "Unitholders").

On December 23, 2009, Trilogy announced that it had entered into an arrangement agreement with a private corporation providing for an arrangement under the Business Corporations Act (Alberta) and related transactions (collectively, the "Conversion") pursuant to which Trilogy will convert from an income trust to a corporation to be named Trilogy Energy Corp. (the "Company"). On February 5, 2010, the Trust completed the Conversion and Unitholders became shareholders of the Company, owning approximately 96 percent of the equity with the residual equity owned by the private corporation's sole shareholder as more particularly described in Trilogy's information circular dated January 6, 2010.

The consolidated financial statements of Trilogy have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are expressed in Canadian Dollars.

### 2. ACCOUNTING CHANGES

#### Change in Accounting Policies

In conjunction with the transition to IFRS (as discussed below), the CICA has issued several new standards that harmonize Canadian GAAP to IFRS, including Handbook Section 3064 (*Goodwill and Intangible Assets*). CICA HB 3064 replaces CICA HB 3062 and establishes new standards for the recognition, measurement and disclosure of goodwill and intangible assets. CICA HB 3064's provisions relating to the definition and initial recognition of intangible assets are equivalent to the corresponding provisions of International Accounting Standards ("IAS") 38, *Intangible Assets*. A number of CICA handbook and EIC Abstracts were amended and/or replaced as a consequence of this new standard. CICA HB 3064 was effective January 1, 2009 for Trilogy, however did not impact its financial statements.

#### Future Accounting Changes

CICA 1582 (*Business Combinations*) and CICA 1601 (*Consolidated Financial Statements*) replace former sections CICA 1581 (*Business Combinations*) and CICA 1600 (*Consolidated Financial Statements*), respectively. CICA 1602 (*Non-controlling Interests*) establishes a new section for accounting for a non-controlling interest in a subsidiary. These sections provide the Canadian equivalent to IFRS 3, Business Combinations (January 2008) and IAS 27, Consolidated and Separate Financial Statements (January 2008). CICA 1582 is effective for business combinations for which the acquisition date is on/after the beginning of the first annual reporting period beginning on/after January 1, 2011. CICA 1601 and CICA 1602 apply to interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011.

# **TRILOGY ENERGY TRUST**

## **Notes to Consolidated Financial Statements**

**December 31, 2009 and 2008**

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

### **International Financial Reporting Standards**

On February 13, 2008, the Canadian Accounting Standards Board ("AcSB") confirmed the mandatory changeover date to International Financial Reporting Standards ("IFRS") for Canadian profit-oriented publicly accountable entities ("PAEs") such as Trilogy. The AcSB requires that IFRS compliant financial statements be prepared for annual and interim financial statements commencing on or after January 1, 2011. For PAEs with a December 31 year-end, the first unaudited interim financial statements under IFRS will be for the quarter ending March 31, 2011, with comparative financial information for the quarter ending March 31, 2010. The first audited annual financial statements will be for the year ending December 31, 2011, with comparative financial information for the year ending December 31, 2010. This also means that all opening balance sheet adjustments relating to the adoption of IFRS must be reflected in the January 1, 2010 opening balance sheet which will be issued as part of the comparative financial information in the March 31, 2011 unaudited interim financial statements.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Consolidation**

These consolidated financial statements include the accounts of the Trust and its wholly-owned subsidiaries. The Trust obtains all of the economic benefits of the operations of its operating subsidiaries.

#### **Property, Plant and Equipment**

The Trust follows the successful efforts method of accounting for petroleum and natural gas operations. Under this method, acquisition costs of oil and gas properties and the costs of drilling and equipping development wells and successful exploratory wells are capitalized. Exploration expenses, including geological and geophysical costs, lease rentals on properties and exploratory dry hole costs, are charged to earnings as incurred. The net costs of abandoned exploratory wells and surrendered leases are charged to earnings in the year of abandonment or surrender. Gains or losses are recognized on the disposition of property, plant and equipment.

Other property, plant and equipment are recorded at cost.

The net amount at which petroleum and natural gas costs on a property or project are carried is subject to an annual cost recovery test or as economic events dictate. An impairment loss is recognized when the carrying amount of the asset is less than the sum of the expected cash flows on an undiscounted basis. The amount of the impairment loss is then calculated as the difference between the carrying amount and the fair value of the asset. Fair value is calculated as the present value of estimated future cash flows.

#### **Depletion and Depreciation**

Capitalized costs of proved oil and gas properties are depleted using the unit-of-production method. For purposes of these calculations, production and reserves of natural gas are converted to barrels on an energy equivalent basis. Successful exploratory wells and development costs are depleted over proved developed reserves while acquired resource properties with proved reserves

## **TRILOGY ENERGY TRUST**

### **Notes to Consolidated Financial Statements**

**December 31, 2009 and 2008**

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves.

Depreciation of production equipment, gas plants and gathering systems is calculated using the straight-line method over their estimated useful life of 12 years. Depreciation of other property, plant and equipment is provided on a straight-line basis over the assets' estimated useful lives varying from three to 10 years.

#### **Joint Operations**

Certain exploration, development and production activities are conducted jointly with others. These financial statements reflect only the Trust's proportionate interest in such activities.

#### **Asset Retirement Obligations**

The fair value of an asset retirement obligation is recognized in the period in which it is incurred or when a reasonable estimate of the fair value can be made. The asset retirement costs equal to the fair value of the retirement obligations are capitalized as part of the cost of the related long-lived asset and allocated to earnings on a basis consistent with depreciation and depletion. The liability associated with the asset retirement costs which is recorded initially at its present value is subsequently adjusted for the passage of time which is recognized as accretion expense in the statement of earnings. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Actual costs incurred upon settlement of the asset retirement obligations reduce the asset retirement liability to the extent of the liability recorded. Differences between the actual costs incurred upon settlement of the asset retirement obligations and the liability recorded are recognized in earnings in the period in which the settlement occurs.

#### **Goodwill**

Goodwill, which represents the excess of the purchase price over the fair value of net assets acquired, is not amortized and is assessed for impairment at least annually. Impairment is assessed by comparison of the fair value of the reporting unit, as to which goodwill is attributable, to the carrying value of the reporting unit's net assets, including goodwill. If the carrying value of the reporting unit's net assets exceeds the fair value of the reporting unit, the excess of the carrying value of goodwill over its fair value is the impairment amount, and is charged to earnings in the period the impairment is identified.

When a portion of a reporting unit that constitutes a business is disposed of, the goodwill associated with such business is included in the carrying amount of the disposed business in determining the gain or loss on disposal.

#### **Revenue Recognition**

Revenues associated with the sale of natural gas, crude oil, and natural gas liquids are recognized when title passes to the customer in accordance with the terms of the sales contracts. Revenues from oil and natural gas production from properties in which there is an interest with other producers are recognized on a net working interest basis.

## **TRILOGY ENERGY TRUST**

### **Notes to Consolidated Financial Statements**

**December 31, 2009 and 2008**

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

#### **Derivative Financial Instruments**

Trilogy recognizes a financial asset or liability when it becomes a party to the contractual provisions of a financial instrument. Financial assets and financial liabilities are initially measured at fair value. After initial recognition, financial assets and liabilities held for trading are measured at fair value with the unrealized gains and losses recorded in income, loans and receivables are carried at amortized cost, while all other financial liabilities are subsequently measured at amortized cost using the effective interest method. Transaction costs on financial instruments are included in the fair value assessment of each financial asset and financial liability. Trilogy does not designate derivative instruments as hedges and does not have available-for-sale financial assets or held-to-maturity investments.

#### **Income Taxes**

Trilogy follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized for the effect of any difference between the carrying amount of an asset or liability reported in the financial statements and its respective tax basis, using substantively enacted income tax rates. Future income tax balances are adjusted to reflect changes in substantively enacted income tax rates, with adjustments being recognized in net earnings in the period in which the change occurs.

#### **Unit-based Compensation**

The Trust accounts for its unit option plan using the 'fair value method'. Fair values of options are determined using the Binomial model at the grant date and are amortized as compensation cost over the life of the option with a credit to contributed surplus.

Non-reciprocal awards of stock options to Trust employees made by a significant unitholder are fair valued using the Black Scholes model and are amortized to compensation expense over their contractual life of two to four years, with a credit to contributed surplus.

The Trust measured compensation cost under the unit appreciation plan (that expired on December 15, 2008) as the amount by which the quoted market value of Trust Units covered by the grants exceeded the exercise price and adjusted by unit distributions. Compensation cost under the unit appreciation plan was recognized over the appreciation units' vesting period.

#### **Foreign Currency Translation**

Transactions denominated in U.S. Dollars are translated to Canadian Dollars at the exchange rate on the transaction date. U.S. Dollar denominated monetary assets and liabilities are translated to Canadian Dollar at exchange rates in effect on the balance sheet date. The resulting exchange rate differentials arising from these items are included in net earnings.

#### **Per Trust Unit Information**

The Trust uses the treasury stock method whereby only "in the money" dilutive instruments impact the dilution calculations.

#### **Measurement Uncertainty**

The timely preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles requires that management make estimates and assumptions and use judgment that affect the reported amounts of assets, liabilities, revenues and

## TRILOGY ENERGY TRUST

### Notes to Consolidated Financial Statements

December 31, 2009 and 2008

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Actual results could materially differ from these estimates.

The amounts recorded for depletion and depreciation, purchase accounting, asset retirement obligations and related accretion, future income taxes and amortization of fair value of options are based on estimates of reserves, future costs, petroleum and natural gas prices and other relevant assumptions. By their nature, these estimates and those related to the discounted cash flow used to assess impairment are subject to measurement uncertainty, and the impact on the financial statements of future periods could be material.

#### 4. PROPERTY, PLANT AND EQUIPMENT

	2009			2008		
	Cost	Accumulated Depletion and Depreciation	Net Book Value	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	1,551,630	(869,322)	682,308	1,477,303	(754,669)	722,634
Other	9,412	(4,984)	4,428	9,038	(3,465)	5,573
	<b>1,561,042</b>	<b>(874,306)</b>	<b>686,736</b>	<b>1,486,341</b>	<b>(758,134)</b>	<b>728,207</b>

Capital costs associated with non-producing petroleum and natural gas properties totaling approximately \$92.5 million as at December 31, 2009 (2008 - \$112.5 million) were not subject to depletion. No interest costs were capitalized for the years ended December 31, 2009 and 2008.

The costs of exploratory dry holes and uneconomic wells, amounting to \$0.7 million for the year ended December 31, 2009 (2008 - \$9.6 million), were written off and included in exploration expenditures. A property impairment loss of \$13.1 million was also recognized for the year ended December 31, 2009 (2008 - \$24.1 million) and was included as part of depletion and depreciation expense. The reduction in the expected recoverable reserves attributable to certain petroleum and natural gas wells and the decline in forecast prices used in the estimation of future cash flows resulted in the asset impairment. The fair value of these assets was determined using discounted future cash flows.

#### 5. LONG-TERM DEBT

	2009	2008
Revolving credit and working capital facility	236,977	307,787
Less unamortized discount	(186)	(382)
Carrying value of long-term debt	<b>236,791</b>	<b>307,405</b>
Weighted average interest rate for the year	<b>3.81%</b>	4.46%

The Trust has a \$315 million revolving credit facility and a \$35 million working capital facility with a syndicate of mostly Canadian banks. Borrowing under the facility bears interest at the lenders' prime rate, bankers' acceptance rate or LIBOR, plus an applicable margin dependent on certain conditions. The facilities are available on a revolving basis for a period of at least 364 days and can be extended a further 364 days upon request. The revolving phase of this credit facility expires on

## TRILOGY ENERGY TRUST

### Notes to Consolidated Financial Statements

December 31, 2009 and 2008

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

March 26, 2010, if not extended. In the event the revolving period is not extended, the revolving facility would be available for a one year term on a non-revolving basis, at the end of which time amounts drawn down under the facility would be due and payable. The working capital facility would continue on a revolving basis for a one year term. Advances drawn on the Trust's facility are secured by a fixed and floating charge debenture over the assets of the Trust. The \$350 million borrowing base is subject to semi-annual review by the banks.

The Trust also has a \$40 million committed, non-revolving construction facility with the above lenders. Borrowing under this facility bears interest at a premium relative to the above revolving and working capital facilities. The ability to draw from the construction facility is contingent on the receipt of certain regulatory approvals. Borrowings from the construction facility are to be used to construct a specific proposed pipeline and plant upgrade project. Expiry of this construction facility occurs on the earlier of construction project completion and April 30, 2010.

The Trust has undrawn letters of credit totaling \$8.9 million as at December 31, 2009. These letters of credit reduce the amount available for draw under the Trust's working capital facility.

#### 6. ASSET RETIREMENT OBLIGATIONS

	2009	2008
Asset retirement obligations, beginning of year	75,213	60,752
Liabilities incurred	1,095	2,370
Revisions in estimate	(5,177)	12,353
Liabilities settled	(1,515)	(5,441)
Accretion expense	5,802	5,372
Liabilities relating to assets sold	(63)	(193)
Asset retirement obligations, end of year	75,355	75,213

The undiscounted asset retirement obligations at December 31, 2009 are estimated to be \$183.3 million (2008 - \$182.6 million). The credit-adjusted risk-free rates used to estimate asset retirement obligation liabilities range from 7.875 to 8.5 percent. These obligations will be settled based on the expected life of the underlying assets, the majority of which are expected to be paid after 10 to 30 years and will be funded from the general resources of the Trust at the time of removal.

#### 7. UNITHOLDERS' CAPITAL

##### Authorized

The authorized capital of the Trust prior to the Conversion was comprised of an unlimited number of Trust Units and an unlimited number of Special Voting Rights. Compared to the holders of the Trust Units, holders of Special Voting Rights were not entitled to any distributions of any nature from the Trust nor have any beneficial interest in any property or assets of the Trust on termination or winding-up of the Trust.

##### Issued and Outstanding

Trilogy had 110,490,334 Trust Units and 95,996,646 Trust Units outstanding at December 31, 2009 and 2008, respectively. No Special Voting Rights have been issued to date.

## **TRILOGY ENERGY TRUST**

### **Notes to Consolidated Financial Statements**

**December 31, 2009 and 2008**

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

For the year ended December 31, 2009, 4,486,188 Trust Units (2008 – 6,159,521 Trust Units) were issued for proceeds of \$28.2 million under Trilogy's Distribution Reinvestment Plan ("DRIP") (see note 8); 10,000,000 Trust Units were issued for gross proceeds of \$86.5 million (net proceeds of \$81.9 million after commissions and related expenses) pursuant to an equity offering of the Trust; and 7,500 Trust Units were issued pursuant to Trilogy's unit option plan, as more fully described below.

In calculating Trilogy's 2009 weighted average diluted number of units, 3,003,500 unit options were considered in the calculation. Accordingly, 1,621,500 options were excluded from the diluted calculation. Options excluded include those where the option exercise price is less than the unit price as at the balance sheet date.

#### **Redemption Right**

Prior to the Conversion, Unitholders could redeem their Trust Units by delivering their Trust Unit Certificates to Trilogy's transfer agent together with a duly completed and properly executed notice. The redemption price per Trust Unit was equal to the lesser of 95 percent of the market price of the Trust Units on the principal market on which the Trust Units were quoted for trading during the 10-trading day period commencing immediately after the date on which the Trust Units were tendered for redemption, and the closing market price on the principal market on which the Trust Units are quoted for trading on the date that the Trust Units were tendered for redemption. Cash payments for Trust Units tendered for redemption were limited, subject to the administrator's sole discretion, to \$50,000 per month with redemption requests in excess of this amount eligible to receive notes from the holding trust or other assets held by the Trust. In addition, cash redemption did not apply if the outstanding Trust Units tendered for redemption were not listed for trading, the normal trading of the Trust Units were suspended or halted on any stock exchange or the redemption of Trust Units would have resulted in the delisting of the Trust Units. In such cases, the fair market value of the Trust Units would have been determined by the administrator and be paid and satisfied by way of asset distribution.

#### **Normal Course Issuer Bid**

Pursuant to a normal course issuer bid program ("NCIB") and prior to the Conversion, Trilogy was able to purchase and cancel up to 4,912,483 Trust Units during the period March 24, 2009 through March 23, 2010. No Trust Units were purchased through this NCIB for the year-ended December 31, 2009 (refer to note 16 for NCIB activity subsequent to December 31, 2009). Trilogy purchased and cancelled 4,771,579 Trust Units (the maximum allowable number) through the facilities of the Toronto Stock Exchange in 2008 for a total cost of approximately \$35.0 million in conjunction with Trilogy's previous NCIB.

## TRILOGY ENERGY TRUST

### Notes to Consolidated Financial Statements

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#### 8. ACCUMULATED DISTRIBUTIONS

	2009				2008			
	Cash	DRIP	Payable	Total	Cash	DRIP	Payable	Total
Balance, beginning of year	538,355	76,857	9,600	624,812	484,399	30,260	6,623	521,282
Distributions paid and/or reinvested	36,092	28,188	—	64,280	53,956	46,597	—	100,553
Change in year end accrual	—	—	(4,075)	(4,075)	—	—	2,977	2,977
Distributions declared	36,092	28,188	(4,075)	60,205	53,956	46,597	2,977	103,530
Balance, end of year	574,447	105,045	5,525	685,017	538,355	76,857	9,600	624,812

Cumulative distributions amounted to \$0.60 per Trust Unit and \$1.08 per Trust Unit for the year ended December 31, 2009 and 2008, respectively.

The Trust intends to make cash distributions to Unitholders at a level that supports the sustainability of the Trust. Such distributions are at the sole discretion of the Trust and subject to numerous factors including, but not limited to, the financial performance of the Trust, debt covenants and obligations including credit availability, and the working capital and future capital requirements of the Trust.

Trilogy's DRIP program provides eligible Unitholders with the opportunity to reinvest their cash distributions, on each distribution payment date, for additional Trust Units at a price equal to 95 percent of the average market price as defined by the plan. Refer to note 16 for subsequent event information.

#### 9. UNIT BASED COMPENSATION

##### Unit Option Plan

The Trust has a long-term incentive plan that allows management to award unit options to eligible directors, officers and employees. Under this plan, holders of vested unit options are able to subscribe for the equivalent number of Trust Units at the exercise price within the contractual period prescribed in the governing option agreement. A continuity of the unit option plan for the years ended December 31, 2009 and 2008 is as follows:

	2009			2008		
	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value per Option	No. of Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value per Option	No. of Options
Balance, beginning of year	\$ 10.18	\$ 1.41	4,765,500	\$ 11.52	\$ 1.64	4,106,500
Granted	8.35	1.70	927,500	5.90	0.66	1,131,000
Exercised	6.05	0.85	(7,500)	10.54	1.59	(7,500)
Cancelled	17.47	2.13	(1,058,000)	11.61	1.66	(464,500)
Balance, end of year	\$8.16	\$1.30	4,627,500	\$ 10.18	\$ 1.41	4,765,500
Exercisable, end of year	\$8.76	\$1.33	1,075,750	\$ 11.97	\$ 1.65	434,500

The Trust recorded a compensation expense of \$0.9 million for the year ended December 31, 2009 (2008 - \$2.0 million) representing the recognition of the grant date fair value of outstanding unit

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options, with a corresponding credit to contributed surplus. The fair value of options granted was determined under the binomial model using the following key assumptions:

	Options Granted in	2009	2008
Risk-free interest rate		1.60% to 3.10%	2.07% to 3.08%
Expected life		4.5 to 5.5 years	4.5 to 5.6 years
Expected volatility		45%	35%
Expected distributions		7.0% to 23.4%	9.5% to 23.4%

Additional information about Trilogy's unit options outstanding as at December 31, 2009 is as follows:

Exercise Price Range	Weighted Average Contractual Life Remaining	Outstanding Options		Exercisable Options	
		Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$4.85 to \$6.98	3.9	2,074,500	\$ 5.89	456,500	\$5.97
\$8.24 to \$10.72	3.2	1,955,500	9.58	562,250	10.68
\$11.11 to \$12.88	2.4	597,500	11.37	57,000	12.28
Total	3.4	4,627,500	\$8.16	1,075,750	\$8.76

#### Unit Appreciation Rights Plan

In 2005, the Trust offered certain employees, officers and directors a unit appreciation arrangement whereby such employees, officers and directors were granted unit appreciation rights entitling the right holders to receive cash payments calculated as the excess of the market price over the exercise price per unit on the exercise date. The exercise price per unit appreciation right was reduced by the aggregate unit distributions paid or payable on the Trust Units to Unitholders of record from the grant date to the exercise date. The Unit Option Plan replaced the Unit Appreciation Plan in 2006. All remaining unit appreciation rights were paid as at the expiry date of December 15, 2008 and no further amounts will be recorded under this plan. In respect of the 2008 prior year, a compensation expense was recorded of \$2.8 million and cash paid for the exercise of unit rights amounted to \$5.9 million.

#### Non-reciprocal Awards to Trust Employees

The Trust also recognized compensation expense of \$0.4 million for the year ended December 31, 2009 (2008 - \$0.7 million) with respect to the non-reciprocal awards of stock options to Trust employees made by Paramount Resources Ltd. ("Paramount"), a related party. This amount was credited to contributed surplus. No further costs will be recorded with respect to these awards after 2009.

## 10. FINANCIAL RISK MANAGEMENT AND OBJECTIVES

Trilogy's principal financial instruments, other than financial derivatives, are its outstanding amounts drawn from its credit facilities. The credit facilities are the main source of Trilogy's finances after cash flow from operations. Trilogy has other financial assets and liabilities arising directly from its operations and trust activities, including accounts receivable, accounts payable and accrued

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liabilities, and distributions payable. Trilogy also enters into financial derivative transactions, the purpose of which is to mitigate the impact of market volatility.

The main risks arising from Trilogy's financial instruments are credit risk, liquidity risk, commodity price risk, interest rate risk and foreign exchange risk.

#### Credit Risk

Under the Services Agreement described in note 13, Paramount carries out marketing functions on behalf of the Trust. The Trust is exposed to credit risk from financial instruments to the extent of non-performance by third parties. Credit risks associated with the possible non-performance by financial instrument counterparties are minimized by entering into contracts with only highly rated counterparties. Third party credit risk is mitigated with credit approvals, limits on exposures to any one counterparty, and monitoring procedures.

Trilogy's production is sold to a variety of purchasers under normal industry sale and payment terms. Accounts receivable are from customers and joint venture partners in the Canadian petroleum and natural gas industry and are subject to normal credit risk. As at December 31, 2009, \$2.9 million or 5.7 percent of the outstanding accounts receivable are outstanding for 90 days or more. Trilogy recorded in 2009 a bad debt expense for a receivable in the amount of \$4 million in respect of a customer that filed for protection under the Companies' Creditors Arrangement Act. Trilogy originally set off certain amounts payable to this customer in sufficiency to offset the original receivable amount. Trilogy unsuccessfully appealed the initial ruling denying its ability to set off receivable amounts owing to it by the customer and has now written off the related receivable amount.

#### Liquidity Risk

Trilogy's principal sources of liquidity are its cash flow from operations and existing or new credit facilities. Trilogy mitigates liquidity risk by using forward commodity price contracts, maintaining adequate reserves and banking facilities, continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. Furthermore, Trilogy may adjust the levels of distribution to Unitholders and capital spending to maintain its liquidity (see notes 11 and 12).

A contractual maturity analysis for Trilogy's financial liabilities as at December 31, 2009 is as follows:

	Within 1 Year	After 1 Year	Total
Accounts payable and accrued liabilities	58,257	—	58,257
Distributions payable	5,525	—	5,525
Long-term debt and estimated interest <sup>(1)</sup>	9,022	245,813	254,835
<b>Total</b>	<b>72,804</b>	<b>245,813</b>	<b>318,617</b>

<sup>(1)</sup> Estimated interest for future periods was calculated using the weighted average interest rate for the year ended December 31, 2009 applied to the debt principal balance outstanding as at that date. Principal repayment is assumed one year after the expiry of the current revolving phase of the credit facility.

#### Commodity Price Risk

Inherent to Trilogy's business of producing petroleum and natural gas is the commodity price risk where fluctuations in the market price of oil and natural gas could significantly impact the Trust's ability to generate cash flow from operations. Given that numerous items, including but not limited

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to, the amounts of distributions to Unitholders, capital expenditures and debt repayments or draw-downs, are dependent upon the level of cash flow generated from operations, fluctuations in petroleum and natural gas prices (in addition to normal operational and external risks) impact Trilogy's liquidity.

To protect cash flow against commodity price volatility, Trilogy uses from time to time forward commodity price contracts that require financial settlement between counterparties. This financial instruments program is generally for periods of up to one year and would not exceed 50 percent of Trilogy's annual production (see note 11 for details of outstanding financial instruments as at December 31, 2009). As at December 31, 2009, assuming all other variables are held constant, a 10 percent increase or decrease in the applicable forward market prices would have the following impact on Trilogy's net earnings from changes in the fair value of its financial commodity contracts:

	10 % increase	10 % decrease
Natural gas	(6,434)	6,434

#### Interest Rate Risk

As described in note 5, Trilogy's credit facilities are subject to floating interest rates at the lenders' prime rate, bankers' acceptance rate or LIBOR, plus an applicable margin. The interest rate margin is determined by the lenders based on their periodic review of the Trust's results and is generally dependent upon Trilogy's debt to cash flow ratio, which may also be impacted by commodity price risk.

Draw-downs from Trilogy's credit facilities are generally in the form of bankers' acceptances with fixed terms ranging from 10 to 180 days which are then rolled-over if not repaid on their due dates. Trilogy may enter into interest rate swap contracts to mitigate the impact of interest rate fluctuations. There are no interest rate swap contracts outstanding as at December 31, 2009.

#### Foreign Exchange Risk

Foreign exchange rate exposure may impact the Trust mainly to the extent Trilogy has outstanding U.S. Dollar denominated financial instrument contracts, in addition to normal conversions of U.S. Dollar denominated revenues into Canadian Dollars. Approximately 13 percent of Trilogy's petroleum and natural gas sales for the year ended December 31, 2009 was denominated in U.S. Dollars. Trilogy may enter into foreign currency contracts to mitigate the impact of foreign exchange rate exposure. Trilogy had the following foreign Canadian Dollar / U.S. Dollar exchange option contracts outstanding as at December 31, 2009:

Option Payout Range CAD/US Dollar	Weekly premium receipt (CAD)	Weekly U.S. dollar commitment above upper range	Term
\$0.97 to \$1.12	\$10	\$1,000	January - May 2010
\$0.95 to \$1.10	\$10	\$1,000	January - May 2010
\$0.965 to \$1.115	\$10	\$1,000	January - May 2010

Where the weekly average spot foreign exchange rate exceeds the payout range, the weekly premium is forfeited and Trilogy is committed to selling the above listed U.S. Dollars at the upper payout range value for such week. To the extent the weekly average spot foreign exchange rate is

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below the payout range, the weekly premium is forfeited, however Trilogy is not committed to sell the above listed U.S. Dollars. Trilogy recorded premium receipts of \$0.2 million for 2009 in respect of the above contracts.

## 11. FINANCIAL INSTRUMENTS

### Carrying Values

Set out below are the carrying amounts by category of Trilogy's financial assets and liabilities that are reflected in the financial statements.

	2009	2008
<b>Financial assets</b>		
Receivables <sup>(1)</sup>	50,797	55,149
Financial instruments held-for-trading <sup>(3)</sup>	2,803	22,187
<b>Financial liabilities</b>		
Non-trading liabilities <sup>(1) (2)</sup>	(63,782)	(70,738)
Financial instruments held-for-trading <sup>(3)</sup>	—	—
Indebtedness <sup>(4)</sup>	(236,791)	(307,405)

<sup>(1)</sup> Carried at cost which approximates the fair value of the assets or liabilities due to the short-term nature of the accounts.

<sup>(2)</sup> Consists of accounts payable and accrued liabilities and distributions payable.

<sup>(3)</sup> Carried at the estimated fair value of the related financial instruments based on third party quotations. See Forward Contracts below.

<sup>(4)</sup> Carried at amortized cost.

During 2009, CICA Handbook section, 3862 - *Financial Instruments - Disclosures*, was amended to require disclosures regarding the inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and

Level 3 - Inputs that are not based on observable market data.

The following provides a classification summary of Trilogy's financial instruments within the fair value hierarchy as at December 31, 2009:

	Financial assts - fair value as at December 31, 2009			
	Level 1	Level 2	Level 3	Total
Natural gas forward sale contracts	—	2,782	—	2,782
Foreign exchange option contracts	—	21	—	21
	—	2,803	—	2,803

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#### Forward Contracts

At December 31, 2009, the Trust had the following outstanding financial forward commodity sales contracts:

Description	Total Quantity	Average Price	Remaining Term
<i>Sales Contracts</i>			
AECO Fixed Price	40,000 GJ/d	\$5.52/GJ	January 2010 – October 2010

The Trust classified these financial instruments as held-for-trading and therefore has recognized the fair value of such financial instruments on the balance sheet. The estimated fair values of these financial instruments are based on quoted prices or, in their absence, third-party market indicators and forecasts.

The changes in the fair value associated with the above financial contracts are recorded as an unrealized gain or loss on financial instruments in the statement of earnings. Gains or losses arising from monthly settlements with counterparties are recognized as a realized gain or loss in the statement of earnings.

#### 12. CAPITAL DISCLOSURE

The Trust's capital structure currently consists of (a) revolving long-term debt pursuant to a credit facility, (b) working capital facility pursuant to a credit facility, (c) non-revolving short-term debt pursuant to a construction facility (d) letters of credit issued as financial security to third parties, and (e) unitholders' equity.

The objectives in managing the capital structure are to:

- utilize an appropriate amount of leverage to maximize return on unitholders' equity; and
- provide for borrowing capacity and financial flexibility to maintain the petroleum and natural gas reserve base by replacing production at competitive finding and development costs.

Management and the Board of Directors review and assess the Trust's capital structure and distribution policy at each regularly scheduled board meeting and at other meetings called for that purpose. The financial strategy may be adjusted based on the current outlook of the underlying business, the capital required to fund the reserves program and the state of the debt and equity capital markets. In order to maintain or adjust the capital structure, the Trust may (1) issue new Trust Units, (2) issue new debt securities, (3) amend, revise, renew or extend the terms of the existing long-term debt and working capital facilities, (4) enter into new agreements establishing new credit facilities, (5) adjust the amount of distributions to unitholders, (6) adjust capital spending, and/or (7) sell non-core and/or non-strategic assets.

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A comparison of Trilogy's debt structure against the committed amount on existing credit facilities at the balance sheet dates is as follows:

	2009	2008
Committed amount that can be drawn from credit facilities	390,000	378,000
Outstanding undrawn letters of credit	(8,886)	(9,373)
Portion of credit facilities subject to draw restrictions as at the balance sheet date	(40,000)	—
<b>Amount that can be drawn after letters of credit</b>	<b>341,114</b>	<b>368,627</b>
Long-term debt	(236,791)	(307,405)
Net current assets (liabilities)	(9,636)	7,424
Net debt <sup>(1)</sup>	(246,427)	(299,981)
Mark-to-market valuation of financial instruments	(2,803)	(22,187)
<b>Adjusted net debt<sup>(1)</sup></b>	<b>(249,230)</b>	<b>(322,168)</b>
Remaining available credit	91,884	46,459

<sup>(1)</sup> Net debt and adjusted net debt as calculated above are not standard terms/measures used by others.

The decrease in adjusted net debt from \$322.2 million at December 31, 2008 to \$249.2 million at December 31, 2009 is attributable primarily to equity proceeds received pursuant to Trilogy's DRIP and the November 4<sup>th</sup> issuance of 10,000,000 units pursuant to Trilogy's equity offering, lower capital expenditures incurred in the year, partially offset by lower cash flow from operations generated in the year in conjunction with lower average realized gas commodity prices.

### 13. RELATED PARTY TRANSACTIONS

Trilogy had the following transactions with Paramount, a significant Unitholder of the Trust.

- Pursuant to a Services Agreement dated April 1, 2005, as amended, a Paramount subsidiary provides administrative and operating services to the Trust and its subsidiaries to assist a Trust subsidiary in carrying out its duties and obligations as general partner of Trilogy's main operating entity and as the administrator of the Trust and its holding trust. Under this agreement, Paramount is reimbursed at cost for all expenses it incurs in providing the services to the Trust and its subsidiaries. The agreement is in effect until March 31, 2011 however may be terminated by either party with at least six months written notice. The amount of expenses billed and accrued as management fees under this agreement was \$0.3 million for the year ended December 31, 2009 (2008 - \$0.3 million). This amount is included as part of the general and administrative expenses in the Trust's consolidated statement of earnings. Refer to note 16 for subsequent event information as it relates to the Services Agreement.
- The Trust and Paramount also had transactions with each other arising from the normal course of business. These transactions were recorded at exchange amounts.

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The amounts due from (to) Paramount as at the balance sheet dates are as follows:

Presented in the Balance Sheet as	2009			2008		
	Normal Business	Services Agreement	Trust Distribution	Normal Business	Services Agreement	Trust Distribution
Accounts receivable	219	—	—	222	—	—
Accounts payable and accrued liabilities	(615)	(60)	—	(159)	(120)	—
Distributions payable	—	—	(1,200)	—	—	(2,234)

#### 14. OFF BALANCE SHEET COMMITMENTS

In addition to items disclosed elsewhere in these financial statements, Trilogy had the following off balance sheet commitments as at December 31, 2009:

	2014					
	2010	2011	2012	2013	and after	Total
Pipeline transportation <sup>(1)</sup>	10,263	9,932	8,945	8,448	15,977	53,565
Office premises operating lease <sup>(2)</sup>	2,375	2,883	2,883	3,221	12,150	23,512
Vehicle and energy service commitments	3,509	2,724	2,044	—	—	8,277
Total	16,147	15,539	13,872	11,669	28,127	85,354

<sup>(1)</sup> Before Trilogy's undrawn letters of credit (see note 5) issued to cover some pipeline transportation commitments.

<sup>(2)</sup> Net of committed rental reimbursements through sub-lease arrangements.

Trilogy entered into the following significant physical fixed price power purchase contracts in the year:

Quantity	Price (per MWh)	Remaining Term
6 MW/h	\$50.82	January 2010 - December 2010
4 MW/h	\$53.80	January 2011 - December 2011
4 MW/h	\$58.19	January 2012 - December 2012

The amount of power purchased under the above contracts is below Trilogy's total ongoing power requirements. Trilogy does not record changes in fair value of the above contracts. Rather, the above contracts are factored in determining Trilogy's total power operating costs in the normal course of its business. The contracts will be settled upon delivery of the contracted power.

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#### 15. INCOME TAXES

The following table reconciles the income tax expense calculated using the statutory tax rates to the income tax expense per the statement of earnings (loss):

	2009	2008
Expected income tax expense (recovery) at statutory tax rate of 39 percent	(15,309)	51,357
Income of the Trust not subject to current tax	13,360	(42,324)
Non-deductible expenses	511	1,083
Benefit of statutory rate changes in year	(8,616)	—
Change in estimate of future reversals of temporary differences and other	4,162	(1,785)
<b>Income tax expense (recovery) per statement of earnings (loss)</b>	<b>(5,892)</b>	<b>8,331</b>

The nature and tax effect of temporary differences and unused carryforwards that give rise to future income tax assets and liabilities as at December 31, 2009 and 2008 are as follows:

Description of Temporary Differences and Carryforwards	2009	2008
Property, plant and equipment	(92,653)	(101,150)
Asset retirement obligation	18,408	20,536
Loss carryforwards and other	3,432	3,227
<b>Net future income tax liability</b>	<b>(70,813)</b>	<b>(77,387)</b>

In conjunction with its issuance of 10,000,000 units in 2009, Trilogy recorded a future tax asset and corresponding increase to unitholder capital of \$0.7 million in respect of the issuance costs associated with the offering.

On October 31, 2006, the Department of Finance (Canada) announced changes to Canadian federal income tax legislation relating to specified investment flow-through ("SIFT") entities (the "SIFT Rules"), including SIFT trusts and partnerships. Such changes were enacted into legislation by the Government of Canada in June 2007 (as amended). In the case of a SIFT trust, the SIFT Rules impose a tax at the trust level on distributions of certain income from the SIFT trust at rates of tax comparable to the combined federal and provincial corporate tax rate and treat such distributions as dividends to the unitholders of the SIFT trust.

SIFT trusts that were publicly traded at the time of the announcement by the Department of Finance (Canada), such as the Trust, are generally entitled to a four year transition period and are not subject to the SIFT Rules until 2011, provided such SIFT trust experiences only "normal growth" and no "undue expansion" before that time. As a result of the enactment of this legislation, the Trust recorded an initial net future income tax liability in 2007. As at December 31, 2009, the Trust's net future tax liability is \$70.8 million (2008 - \$77.4 million). The future income tax adjustment represents management's estimate of the differences between the book and tax basis of trust entity assets and liabilities ("temporary differences") anticipated to exist in 2011 under current legislation, tax-effected at 26.5 per cent, which is the rate that is currently anticipated to be applicable beginning 2011, and 25 percent thereafter. It also includes the differences between current book and tax basis of Trilogy corporate entities, tax effected at 25 percent.

Future changes in tax rates and technical interpretations of the new legislation could materially affect management's estimate of the Trust's future income tax liability. The amount and timing of

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reversals of temporary differences will be dependent upon, among other things, the Trust's future operating results, acquisitions and dispositions of assets and liabilities, and its distribution policy. A change in the assumptions on the preceding items could materially affect the Trust's estimated future income tax liability.

#### **16. SUBSEQUENT EVENTS**

On January 13, 2010, Trilogy purchased for cancellation under its NCIB 144,400 Trust Units at a cost of approximately \$1.2 million.

Holders of 64,661,077 Trust Units have reinvested their December distributions totaling \$3.2 million through Trilogy's DRIP resulting in the issuance of additional 403,385 Trust Units on January 15, 2010.

On January 15, 2010, the Trust announced that it has mailed to holders of Trust Units and filed on SEDAR a Notice of Special Meeting of Unitholders, Notice of Joint Petition and Information Circular dated January 6, 2010 with respect to the Trust's announced proposed Conversion. In addition to Unitholder approval, the Conversion was subject to the approval of the Court of Queen's Bench of Alberta, the approval of the Toronto Stock Exchange, competition bureau approval and the consent of Trilogy's lenders. On February 4, 2010, Trust unitholders voted in favor of the Conversion. Accordingly, on February 5, 2010, the Trust completed the Conversion and Unitholders became shareholders of Trilogy Energy Corp., owning approximately 96 percent of the equity of the Company with the residual equity owned by the private corporation's sole shareholder as more particularly described in Trilogy's information circular dated January 6, 2010.

On January 15, 2010, Trilogy announced its cash distribution for January 2010 of \$0.05 per Trust Unit. The distribution was paid on February 16, 2010 to Unitholders of record on February 1, 2010. In this same announcement, the Trust also suspended its DRIP. Accordingly, no further participation in the DRIP occurred after the December 2009 distribution month. Trilogy also terminated the DRIP concurrent with the completion of the Conversion.

On February 5, 2010, Trilogy Energy Corp. and Paramount Resources entered into an Amended and Restated Services Agreement to reflect Trilogy's post-Conversion structure. The services agreement is in effect until March 31, 2011 unless terminated prior thereto by either party upon six months' notice.

On February 18, 2010, Trilogy Energy Corp. declared a dividend of 3.5 cents per share to shareholders of record on March 1, 2010.