

MANAGEMENT'S REPORT

The consolidated financial statements of Zargon Energy Trust were prepared by management in accordance with Canadian generally accepted accounting principles. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

Management has designed and maintains a system of internal accounting controls that provide reasonable assurance that all transactions are accurately recorded, that the financial statements reliably report the Trust's operations and that the Trust's assets are safeguarded. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. Such estimates are based on careful judgments made by management.

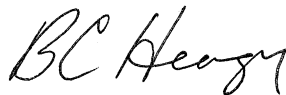
Ernst & Young LLP, an independent chartered accountant firm, was appointed by a resolution of the unitholders to audit the consolidated financial statements of the Trust and provide an independent opinion. They have conducted an independent examination of the Trust's accounting records in order to express their opinion on the consolidated financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through its Audit Committee. The Audit Committee, which consists of non-management directors, has met with Ernst & Young LLP and management in order to determine that management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The Audit Committee has reported its findings to the Board of Directors, who have approved the consolidated financial statements.



C.H. Hansen
President and Chief Executive Officer

Calgary, Canada
March 9, 2009



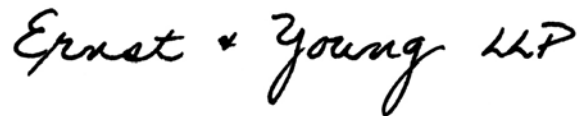
B.C. Heagy
Executive Vice President and
Chief Financial Officer

To the Unitholders of **Zargon Energy Trust**

We have audited the consolidated balance sheets of Zargon Energy Trust as at December 31, 2008 and 2007 and the consolidated statements of earnings and comprehensive income and accumulated earnings and cash flows for the years then ended. 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, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The image shows a handwritten signature in black ink that reads "Ernst & Young LLP". The signature is written in a cursive, flowing style.

Calgary, Canada
March 9, 2009

Chartered Accountants

CONSOLIDATED BALANCE SHEETS

As at December 31 (\$ thousands)

2008

2007

ASSETS [note 6]

Current

Accounts receivable	20,725	21,668
Prepaid expenses and deposits	1,162	1,690
Unrealized risk management asset [note 12]	29,641	1,432
Future income taxes [note 13]	-	2,919

51,528 27,709

Long term deposit

1,612 1,455

Unrealized risk management asset [note 12]

4,745 -

Goodwill

2,969 -

Property and equipment, net [note 5]

386,746 313,949

447,600 343,113

LIABILITIES

Current

Accounts payable and accrued liabilities	28,687	27,172
Cash distributions payable [note 19]	3,326	3,074
Unrealized risk management liability [note 12]	724	11,127
Future income taxes [note 13]	8,553	-

41,290 41,373

Long term debt [note 6]

77,581 56,868

Unrealized risk management liability [note 12]

281 1,303

Asset retirement obligations [note 7]

28,592 21,184

Future income taxes [note 13]

49,704 40,177

197,448 160,905

Commitments and contingencies [notes 6, 8, 12, 14 and 15]

NON-CONTROLLING INTEREST

Exchangeable shares [note 9]	27,610	20,730
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UNITHOLDERS' EQUITY

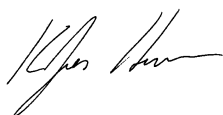
Unitholders' capital [note 8]	120,650	89,688
Contributed surplus [note 8]	4,617	3,714
Accumulated earnings	257,104	188,819
Accumulated cash distributions [note 19]	(159,829)	(120,743)

222,542 161,478

447,600 343,113

See accompanying notes to the consolidated financial statements.

On behalf of the Board:



K.J. Harrison, Director



K.D. Kitagawa, Director

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME AND ACCUMULATED EARNINGS

For the years ended December 31

(\$ thousands, except per unit amounts)

	2008	2007
REVENUE		
Petroleum and natural gas revenue	229,494	155,512
Unrealized risk management gain/(loss) [note 12]	44,378	(16,796)
Realized risk management gain/(loss) [note 12]	(15,722)	4,255
Royalties	(46,644)	(32,746)
	211,506	110,225
EXPENSES		
Production	39,913	32,620
General and administrative	10,447	8,209
Unit-based compensation [note 8]	1,185	1,705
Interest and financing charges [note 6]	4,911	3,071
Unrealized foreign exchange gain	(1,958)	(226)
Accretion of asset retirement obligations [note 7]	2,183	1,406
Depletion and depreciation	59,638	48,410
	116,319	95,195
EARNINGS BEFORE INCOME TAXES	95,187	15,030
INCOME TAXES [note 13]		
Current	4,051	2,143
Future (recovery)	12,751	(15,470)
	16,802	(13,327)
EARNINGS BEFORE NON-CONTROLLING INTEREST	78,385	28,357
Non-controlling interest – exchangeable shares [note 9]	(10,100)	(3,805)
NET EARNINGS AND COMPREHENSIVE INCOME	68,285	24,552
ACCUMULATED EARNINGS, BEGINNING OF YEAR	188,819	164,267
ACCUMULATED EARNINGS, END OF YEAR	257,104	188,819
NET EARNINGS PER UNIT [note 10]		
Basic	3.79	1.45
Diluted	3.80	1.45

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31 (\$ thousands)	2008	2007
OPERATING ACTIVITIES		
Net earnings for the year	68,285	24,552
Add (deduct) non-cash items:		
Non-controlling interest – exchangeable shares	10,100	3,805
Unrealized risk management (gain)/loss	(44,378)	16,796
Depletion and depreciation	59,638	48,410
Accretion of asset retirement obligations	2,183	1,406
Unit-based compensation	1,185	1,705
Unrealized foreign exchange gain	(1,958)	(226)
Future income taxes (recovery)	12,751	(15,470)
Asset retirement expenditures	(897)	(1,140)
	106,909	79,838
Changes in non-cash operating working capital [note 16]	3,215	(3,535)
	110,124	76,303
FINANCING ACTIVITIES		
Advances of bank debt	3,799	26,831
Cash distributions to unitholders	(39,086)	(36,695)
Exercise of unit rights	1,166	2,127
Changes in non-cash financing working capital [note 16]	252	52
	(33,869)	(7,685)
INVESTING ACTIVITIES		
Additions to property and equipment	(58,944)	(67,850)
Proceeds on disposal of property and equipment	220	1,181
Corporate acquisitions (cash portion)	(16,835)	-
Long term deposit	(157)	-
Changes in non-cash investing working capital [note 16]	(539)	(1,949)
	(76,255)	(68,618)
NET CHANGE IN CASH DURING THE YEAR AND CASH, END OF YEAR	-	-

See supplemental cash flow information contained in note 17.

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2008 and 2007

All amounts are stated in Canadian dollars unless otherwise noted.

1. STRUCTURE OF THE TRUST

On July 15, 2004, Zargon Oil & Gas Ltd. (the "Company") was reorganized into Zargon Energy Trust (the "Trust" or "Zargon") as part of a Plan of Arrangement (the "Arrangement"). Shareholders of the Company received one trust unit or one exchangeable share for each common share held. The unitholders of the Trust are entitled to receive cash distributions paid by the Trust. Holders of exchangeable shares are not eligible to receive cash distributions paid, but rather, on each payment of a distribution, the number of trust units into which each exchangeable share is exchangeable is increased on a cumulative basis in respect of the distribution. The Trust is an unincorporated open-end investment trust established under the laws of the Province of Alberta and was created pursuant to a trust indenture ("Trust Indenture").

The Trust's principal business activity is the exploration for and development and production of petroleum and natural gas in Canada and the United States ("US").

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Accordingly, actual results could differ materially from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the Trust's accounting policies summarized below.

The consolidated financial statements include the accounts of Zargon Energy Trust, all of its subsidiaries and a partnership. All subsidiaries and the partnership are directly or indirectly owned and their operations are fully reflected in the consolidated financial statements.

Revenue Recognition

Revenue associated with the sale of crude oil, natural gas, and natural gas liquids is recognized when title and risks pass to the purchaser, normally at the plant gate which is the pipeline delivery point for natural gas and at the contracted delivery point for crude oil.

Joint Operations

The majority of the petroleum and natural gas operations of the Trust are conducted jointly with others, and accordingly, these consolidated financial statements reflect only the proportionate interests of the Trust in such activities.

Property and Equipment

The Trust follows the full cost method of accounting for its oil and natural gas operations whereby all costs relating to the acquisition, exploration and development of oil and natural gas reserves are capitalized and accumulated in separate cost centres for Canada and the United States. Such costs include land acquisition costs, annual carrying charges of non-producing properties, geological and geophysical costs and costs of drilling and equipping wells.

Depletion and depreciation of petroleum, natural gas properties and equipment is computed using the unit of production method based on the estimated proved reserves of petroleum and natural gas before royalties determined by independent consultants. For purposes of this calculation, reserves are converted to common units on the basis that six thousand cubic feet of natural gas is equivalent to one barrel of oil. A portion of the cost of petroleum and natural gas rights relating to undeveloped properties is excluded from the depletion calculation. Twenty percent of the year end balance of these costs is added to the depletion base each year. Proceeds on the disposal of petroleum and natural gas properties are applied against capitalized costs, with gains or losses not ordinarily recognized, unless such a disposal would result in a change in the depletion rate of 20 percent or more.

Depreciation of office equipment is provided using the declining balance method at an annual rate of 20 percent. Leasehold improvements are depreciated over the term of the lease.

Impairment Test

The Trust applies an impairment test to petroleum, natural gas properties and equipment costs on a quarterly basis or more frequently as events or circumstances dictate. This impairment test is performed on both the Canadian and US cost centres. An impairment loss exists when the carrying amount of the Trust's petroleum, natural gas properties and equipment exceeds the estimated undiscounted future net cash flows associated with the Trust's proved reserves (before royalties). If an impairment loss is determined to exist, the costs carried on the consolidated balance sheets in excess of the fair value of the Trust's proved and probable reserves plus the cost of unproved properties are charged to earnings. Reserves are determined pursuant to evaluation by independent engineers as dictated by National Instrument 51-101.

Goodwill

The Trust must record goodwill relating to a corporate acquisition when the total purchase price exceeds the fair value for accounting purposes of the net identifiable assets and liabilities of the acquired company. The goodwill balance is assessed for impairment annually at year end or as events occur that could result in an indication of impairment. Impairment is recognized based on the fair value of the reporting entity (consolidated Trust) compared to the book value of the reporting entity. If the fair value of the consolidated Trust is less than the book value, impairment is measured by allocating the fair value of the consolidated Trust to the identifiable assets and liabilities as if the Trust had been acquired in a business combination for a purchase price equal to its fair value. The excess of the fair value of the consolidated Trust over the amounts assigned to the identifiable assets and liabilities is the fair value of the goodwill. Any excess of the book value of goodwill over this implied fair value of goodwill is the impairment amount. Impairment is charged to earnings in the period in which it occurs.

Goodwill is stated at cost less impairment and is not amortized.

At December 31, 2008 an impairment test was performed and it was determined that there was no impairment to the goodwill balance.

Asset Retirement Obligations

Zargon recognizes the fair value of an Asset Retirement Obligation ("ARO") in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit of production method based on proved reserves (before royalties). The liability amount is increased each reporting period due to the passage of time and the amount of accretion is expensed in the period. Actual costs incurred upon the settlement of the ARO are charged against the liability.

Financial Instruments

Effective January 1, 2007, the Trust adopted the accounting requirements for CICA Handbook Sections 3855 "Financial Instruments – Recognition and Measurement" and 3865 "Hedges". Adjustments to the consolidated financial statements for 2007 were made on a prospective basis.

Derivative financial instruments are utilized to reduce commodity price risk associated with the Trust's production of oil and natural gas. The base prices for the commodities are sometimes denominated in US dollars and the Trust may also use such financial instruments to reduce the related foreign currency risk. Financial instruments may also be used from time to time to reduce interest rate risk on outstanding debt. The Trust does not enter into financial instruments for trading or speculative purposes.

The Trust follows a policy of using risk management instruments such as fixed price swaps, forward sales, puts and costless collars. The objective is to partially offset or mitigate the wide price swings commonly encountered in oil and natural gas commodities and in so doing protect a minimum level of cash flow in periods of low commodity prices.

The Trust considers these financial risk management contracts to be effective on an economic basis but has decided not to designate these contracts as hedges for accounting purposes and, accordingly, for outstanding contracts not designated as hedges, an unrealized gain or loss is recorded based on the change in fair value ("mark-to-market") of the contracts at each reporting period end. These instruments have been recorded as unrealized risk management assets/liabilities in the consolidated balance sheets.

In the case of forward sales, the instrument can sometimes be satisfied by physical delivery. In the case of physical delivery, the payment/receipt is recorded as part of the normal revenue stream.

Foreign currency collar and swap agreements are utilized to manage the risk inherent in producing commodities whose price is based directly or indirectly on US dollars, using notional principal amounts equal to the projected monthly revenue from their sale. Payments or charges are calculated and paid according to the terms of the agreement, usually with monthly settlement.

The Trust had no interest rate financial instruments at December 31, 2008 and 2007.

Income Taxes

The Trust follows the liability method of tax allocation in accounting for income taxes. Under this method, the Trust records future income taxes for the effect of any differences between the accounting and income tax basis of an asset or liability using income tax rates expected to apply in the periods in which these temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in earnings in the period in which the change is substantively enacted.

Foreign Currency Translation

The Trust uses the temporal method of foreign currency translation whereby the monetary assets and liabilities recorded in a foreign currency are translated into Canadian dollars at year end exchange rates, and non-monetary assets and liabilities at the exchange rates prevailing when the assets were acquired or liability incurred. Revenues and expenses are translated at the average rate of exchange prevailing during the year. Gains and losses on translation are included in the consolidated statements of earnings and comprehensive income and accumulated earnings.

Trust Unit Rights and Unit-Based Compensation

Under the Trust's unit rights incentive plan (the "Plan"), rights to purchase trust units are allowed to be granted to directors, officers, employees and other service providers at current market prices. The Plan allows for the exercise price of rights to be reduced in future periods by an amount that distributions exceed a stated return on assets. Under the fair value method of accounting for unit-based compensation the cost of the option is charged to earnings with an offsetting amount recorded in contributed surplus, based on an estimate from the fair value model. Forfeiture of rights are recorded as a reduction in expense in the period in which they occur.

Per Unit Amounts

Per unit amounts are calculated using the weighted average number of trust units outstanding during the year. Diluted per unit amounts are calculated using the treasury stock method to determine the dilutive effect of unit-based compensation. The Trust follows the treasury stock method, which assumes that the proceeds received from "in-the-money" trust unit rights and unrecognized future unit-based compensation expense are used to repurchase units at the average market rate during the year. Diluted per unit amounts also include exchangeable shares using the "if-converted" method, whereby it is assumed the conversion of the exchangeable shares occurs at the beginning of the reporting period (or at the time of issuance if later).

Measurement Uncertainty

The amounts recorded for depletion and depreciation of property and equipment and the assessment of these assets for impairment are based on estimates of proved reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the consolidated financial statements of changes in such estimates in future periods could be material.

Inherent in the fair value calculation of asset retirement obligations are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement and changes in the legal and regulatory environments. To the extent future revisions to these assumptions impact the fair value of the existing asset retirement obligation liability, a corresponding adjustment is made to the property and equipment balance.

Cash Distributions

The Trust declares monthly distributions of cash to unitholders of record on the last day of each calendar month. Pursuant to the Trust's policy, it will pay distributions to its unitholders subject to satisfying its financing covenants. Such distributions are recorded as distributions of equity upon declaration of the distribution.

3. CHANGES IN ACCOUNTING POLICIES

On January 1, 2008, the Trust adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3862 "Financial Instruments – Disclosures"; Section 3863 "Financial Instruments – Presentation" and Section 1535 "Capital Disclosures". As required by the new standards, prior periods have not been restated.

The adoption of these standards has had no material impact on the Trust's net earnings or cash flows. The other effects of the implementation of the new standards are discussed below.

Capital Disclosures

This new guidance requires disclosure about the Trust's objectives, policies and processes for managing capital. These disclosures include a description of what the Trust manages as capital, the nature of externally imposed capital requirements, how the requirements are incorporated into the Trust's management of capital, whether the requirements have been complied with, or consequence of non-compliance and an explanation of how the Trust is meeting its objectives for managing capital. In addition, quantitative disclosures regarding capital are required. Refer to note 11 "Capital Disclosures".

Financial Instruments – Disclosure and Presentation

Sections 3862 and 3863 establish standards for the disclosure and presentation of financial instruments during the reporting period.

Section 3862 outlines the disclosure requirements for financial instruments and non-financial derivatives. This guidance prescribes an increased importance on risk disclosures associated with recognized and unrecognized financial instruments and how such risks are managed. This Section requires disclosure of the significance of financial instruments on the Trust's financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments.

The presentation requirements under 3863 are relatively unchanged from Section 3861. Refer to note 12, "Financial Instruments and Risk Management Contracts"; for the additional disclosures under Section 3862.

Future Accounting Pronouncements

The Trust has identified new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have a significant impact to the Trust:

In February 2008, the CICA issued Section 3064 "Goodwill and Intangible Assets," replacing Section 3062 "Goodwill and Other Intangible Assets." The new Section will be effective on January 1, 2009. This new guidance requires recognizing all goodwill and intangible assets in accordance with CICA Section 1000, "Financial Statement Concepts." Section 3064 will eliminate the current practice of recognizing items as assets that do not meet the Section 1000 definition and recognition criteria. Under this new guidance, fewer items meet the criteria for capitalization. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets subsequent to its initial recognition. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062, as the new Section was only amended for intangible assets. The Trust is currently evaluating the impact of the adoption of this new Section, however does not expect a material impact on its consolidated financial statements.

In December 2008, the CICA issued Section 1582 "Business Combinations," which will replace CICA Section 1581 of the same name. Under this guidance, the purchase price used in a business combination is based on the fair value of shares exchanged at the market price at the date of the exchange. Currently the purchase price used is based on the market price of the shares for a reasonable period before and after the date the acquisition is agreed upon and announced. This new guidance generally requires all acquisition costs to be expensed, which currently are capitalized as part of the purchase price. Contingent liabilities are to be recognized at fair value at the acquisition date and remeasured at fair value through earnings each period until settled. Currently only contingent liabilities that are resolved and payable are included in the cost to acquire the business. In addition, negative goodwill is required to be recognized immediately in earnings, unlike the current requirement to eliminate it by deducting it from the non-current assets in the purchase price allocation. Section 1582 will be effective for the Trust on January 1, 2011, with prospective application. The Trust is currently evaluating the impact of the adoption of the new Section on its consolidated financial statements.

In December 2008, the CICA issued Sections 1601 "Consolidated Financial Statements," and 1602 "Non-controlling Interests," which replaces existing guidance under Section 1600 "Consolidated Financial Statements." Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards will be effective for the Trust on January 1, 2011. The Trust is currently evaluating the impact of the adoption of these new Sections on its consolidated financial statements.

In January 2006, the CICA Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, the AcSB confirmed in February 2008 that International Financial Reporting Standards (“IFRS”) will replace Canadian GAAP in 2011 for profit-oriented Canadian publicly accountable enterprises. The Trust is currently reviewing the standards to determine the potential impact on its consolidated financial statements. The Trust, with the assistance of an independent consulting firm, has performed a diagnostic analysis that identifies differences between the Trust’s current accounting policies and IFRS. At this time, the Trust is evaluating the impact of these differences and assessing the need for amendments to existing accounting policies in order to comply with IFRS.

4. ACQUISITIONS

Rival Energy Ltd.

On January 23, 2008, a subsidiary of the Trust acquired all of the outstanding shares of Rival Energy Ltd. (“Rival”), a public oil and gas company, for consideration of \$30.06 million. Consideration consisted of \$16.40 million cash, the issuance of 573,300 Zargon trust units valued at \$23.32 per unit and acquisition costs of \$0.29 million.

The results of operations for Rival have been included in the consolidated financial statements since January 23, 2008.

The acquisition was accounted for by the purchase method and the purchase price allocation is as follows:

Net Assets Acquired

(\$ thousands)

Property and equipment	54,065
Goodwill	2,969
Working capital deficiency	(854)
Long term debt	(16,914)
Future income tax liability	(5,443)
Asset retirement obligations	(3,767)
Total net assets acquired	30,056

Consideration

(\$ thousands)

Cash	16,400
Trust units issued	13,369
Acquisition costs	287
Total purchase price	30,056

Newpact Energy Corp.

On May 16, 2008, a subsidiary of the Trust acquired all of the outstanding shares of Newpact Energy Corp. (“Newpact”), a private oil and gas company, for consideration of \$9.54 million. Consideration consisted of the issuance of 425,940 Zargon trust units valued at \$22.04 per unit and acquisition costs of \$0.15 million.

The results of operations for Newpact have been included in the consolidated financial statements since May 16, 2008.

The acquisition was accounted for by the purchase method and the purchase price allocation is as follows:

Net Assets Acquired

(\$ thousands)

Property and equipment	13,925
Working capital deficiency	(2,491)
Future income tax liability	(922)
Asset retirement obligations	(976)
Total net assets acquired	9,536

Consideration

(\$ thousands)

Trust units issued	9,388
Acquisition costs	148
Total purchase price	9,536

5. PROPERTY AND EQUIPMENT

(\$ thousands)	December 31, 2008		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum, natural gas properties and other equipment ⁽¹⁾	667,944	282,949	384,995
Leasehold improvements and office equipment	3,380	1,629	1,751
	671,324	284,578	386,746

(\$ thousands)	December 31, 2007		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum, natural gas properties and other equipment ⁽¹⁾	535,850	223,780	312,070
Leasehold improvements and office equipment	3,107	1,228	1,879
	538,957	225,008	313,949

(1) As a result of shareholders redeeming exchangeable shares, property and equipment has cumulatively increased \$55.15 million, \$3.39 million relating to 2008, \$8.82 million relating to 2007 and \$42.94 million relating to prior years. The effect of these increases has resulted in additional depletion and depreciation expense of approximately \$22.31 million, \$5.59 million relating to 2008, \$6.16 million relating to 2007 and \$10.56 million relating to prior years.

At December 31, 2008, petroleum, natural gas properties and equipment include \$24.73 million (2007 – \$22.78 million) relating to undeveloped properties that have been excluded from the depletion calculation.

An impairment test calculation was performed on the Trust's petroleum, natural gas properties and equipment at December 31, 2008 in which the estimated undiscounted future net cash flows associated with the proved reserves exceeded the carrying amount of the Trust's petroleum, natural gas properties and equipment; consequently an impairment provision was not recorded. This impairment calculation was performed separately on both the Canadian and US cost centres.

The following table outlines benchmark prices used in the impairment test at December 31, 2008:

Year	WTI Crude Oil (\$US/bbl)	Exchange Rate (\$US/\$Cdn)	WTI Crude Oil (\$Cdn/bbl)	AECO Gas (\$Cdn/gj)
2009	55.57	0.84	66.15	6.31
2010	64.77	0.84	77.11	7.28
2011	69.16	0.84	82.33	7.50
2012	70.62	0.84	84.07	7.39
2013	72.04	0.84	85.76	7.27
Thereafter (inflation %)	2.0%	0.84	2.0%	2.0%

Actual prices used in the impairment test were adjusted for commodity price differentials specific to Zargon.

6. LONG TERM DEBT

On July 28, 2008, Zargon amended and renewed its syndicated committed credit facilities, the result of which is an increase in the available facilities and borrowing base to \$180 million. These facilities consist of a \$170 million tranche available to the Canadian borrower and a US \$8 million tranche available to the US borrower. A \$300 million demand debenture on the assets of the subsidiaries of the Trust has been provided as security for these facilities. The facilities are fully revolving for a 364-day period with the provision for an annual extension at the option of the lenders and upon notice from Zargon's management. The next renewal date is July 28, 2009. Should the facilities not be renewed, they convert to one-year non-revolving term facilities at the end of the revolving 364-day period. Repayment would not be required until the end of the non-revolving term, and as such, these facilities have been classified as long term debt.

Interest rates fluctuate under the syndicated facilities with Canadian prime, US prime, and US base rates plus an applicable margin between zero basis points and 32.5 basis points, as well as with Canadian banker's acceptance and LIBOR rates plus an applicable margin between 97.5 basis points and 157.5 basis points. At December 31, 2008, \$77.58 million (2007 – \$56.87 million) had been drawn on the syndicated committed credit facilities bearing interest at Canadian prime (December 31, 2008 – 3.5 percent; December 31, 2007 – 6.0 percent) with any unused amounts subject to standby fees. In the normal course of operations Zargon enters into various letters of credit. At December 31, 2008, the approximate value of outstanding letters of credit totalled \$0.52 million (2007 – \$0.44 million). The letters of credit reduce the amount of Zargon's available credit facilities to \$101.90 million at December 31, 2008 (2007 - \$62.69 million).

7. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligation was estimated by management based on Zargon's net working interest in all wells and facilities, estimated costs to reclaim and abandon wells and facilities and the estimated timing of the costs to be incurred in future periods. Zargon has estimated the net present value of its total asset retirement obligations to be \$28.59 million as at December 31, 2008 (2007 – \$21.18 million), based on a total future liability of \$142.52 million (2007 – \$101.88 million). These payments are expected to be made over the next 40 years with the majority of the costs being incurred after 2018. Commencing July 1, 2005, incremental asset retirement obligations are calculated using a revised credit adjusted risk-free rate of 7.5 percent. Asset retirement obligations prior to this period were calculated using a credit adjusted risk-free rate of 8.5 percent. An inflation rate of two percent used in the calculation of the present value of the asset retirement obligation remains unchanged.

The following table reconciles Zargon's asset retirement obligations:

(\$ thousands)	Year Ended December 31,	
	2008	2007
Balance, beginning of year	21,184	17,307
Adjustment to asset retirement obligations	-	2,911
Net liabilities incurred/acquired	5,920	851
Liabilities settled	(897)	(1,140)
Accretion expense	2,183	1,406
Foreign exchange	202	(151)
Balance, end of year	28,592	21,184

8. UNITHOLDERS' EQUITY

Pursuant to the Plan of Arrangement on July 15, 2004, 14.87 million units of the Trust and 3.66 million exchangeable shares (see note 9) of the Company were issued in exchange for all of the outstanding shares of the Company on a one-for-one basis.

The Trust is authorized to issue an unlimited number of voting trust units.

Trust Units

(thousands)	December 31, 2008		December 31, 2007	
	Number of Units	Amount (\$)	Number of Units	Amount (\$)
Balance, beginning of year	17,076	89,688	16,789	82,868
Unit rights exercised for cash	69	1,166	120	2,127
Unit-based compensation recognized on exercise of unit rights	-	246	-	466
Issued on corporate and property acquisitions	1,045	23,910	-	-
Issued on conversion of exchangeable shares	289	5,640	167	4,227
Balance, end of year	18,479	120,650	17,076	89,688

Trust Unit Rights Incentive Plan

The Trust has a unit rights incentive plan (the "Plan") that allows the Trust to issue rights to acquire trust units to directors, officers, employees and other service providers. The Trust is authorized to issue up to 2.36 million unit rights; however, the number of trust units reserved for issuance upon exercise of the rights shall not at any time exceed 10 percent of the aggregate number of the total outstanding units, including units issuable upon exchange of exchangeable shares of Zargon and other fully paid securities of Zargon entities exchangeable into units, which are the economic equivalent of units including full voting rights. At the time of grant, unit right exercise prices approximate the market price for the trust units. At the time of exercise, the rights holder has the option of exercising at the original grant price or the exercise price as calculated under the Plan (the "modified price"). The modified price is calculated by deducting from the grant price the amount by which monthly distributions, on a per unit basis, made by the Trust after the grant date exceed a monthly return of 0.833 percent of the Trust's recorded net book value of oil and natural gas properties. Rights granted under the Plan generally vest over a three-year period and expire approximately five years from the grant date. Zargon uses a fair value methodology to value the unit rights grants.

The following table summarizes information about the Trust's unit rights:

	December 31, 2008		December 31, 2007	
	Number of Unit Rights (thousands)	Weighted Average Exercise Price Initial and Modified (\$/unit right)	Number of Unit Rights (thousands)	Weighted Average Exercise Price Initial and Modified (\$/unit right)
Outstanding at beginning of year	1,488	26.41 / 24.60	1,208	26.32 / 24.73
Unit rights granted	445	22.65	522	25.36
Unit rights exercised	(69)	16.92	(120)	17.73
Unit rights cancelled	(210)	27.22	(122)	28.75
Outstanding at end of year	1,654	25.57 / 23.63	1,488	26.41 / 24.60
Unit rights exercisable at year end	839	26.51 / 23.57	559	25.51 / 22.66

The following tables summarize information about unit rights outstanding and exercisable at December 31, 2008:

At the initial grant price:

Range of Exercise Prices (\$/unit right)	Unit Rights Outstanding			Unit Rights Exercisable	
	Number Outstanding (thousands)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price (\$/unit right)	Number Exercisable (thousands)	Weighted Average Exercise Price (\$/unit right)
13.00–19.25	118	0.9 years	17.07	93	17.82
21.10–25.06	686	3.0 years	22.81	247	23.21
26.00–27.40	358	2.8 years	26.68	158	27.22
27.91–33.05	492	2.0 years	30.65	341	30.96
	1,654		25.57	839	26.51

At the modified price:

Range of Exercise Prices (\$/unit right)	Unit Rights Outstanding			Unit Rights Exercisable	
	Number Outstanding (thousands)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price (\$/unit right)	Number Exercisable (thousands)	Weighted Average Exercise Price (\$/unit right)
12.94–14.72	118	0.9 years	13.39	93	13.17
18.03–23.11	686	3.0 years	21.42	247	20.59
23.65–25.78	358	2.8 years	24.96	158	24.13
26.63–30.97	492	2.0 years	28.22	341	28.31
	1,654		23.63	839	23.57

Unit-Based Compensation

The weighted average assumptions used for unit rights granted in 2008 include a volatility factor of expected market price of 26.9 percent, a risk-free interest rate of 3.2 percent, a dividend yield of 9.7 percent and an expected life of the unit rights of four years. These unit rights, together with the continued vesting of unit rights granted in prior years, resulted in unit-based compensation expense in 2008 of \$1.19 million (2007 – \$1.71 million).

Compensation expense associated with unit rights granted under the Plan is recognized in earnings over the vesting period of the Plan with a corresponding increase in contributed surplus. The exercise of trust unit rights is recorded as an increase in trust units with a corresponding reduction in contributed surplus. Forfeiture of rights are recorded as a reduction in expenses in the period in which they occur.

The following table summarizes information about the Trust's contributed surplus account:

Contributed Surplus

(\$ thousands)

Balance, December 31, 2006	2,475
Unit-based compensation expense	1,705
Unit-based compensation recognized on exercise of unit rights	(466)
Balance, December 31, 2007	3,714
Unit-based compensation expense ⁽¹⁾	1,149
Unit-based compensation recognized on exercise of unit rights	(246)
Balance, December 31, 2008	4,617

(1) During the fourth quarter of 2008, the Trust issued 10,000 unit appreciation rights ("UARS") with an intrinsic value of \$0.04 million at December 31, 2008. These UARS are awards entitling the recipients to receive cash in an amount equivalent to any excess of the market value of a stated number of units over a stated price. UARS are included in unit-based compensation expense; however rewards settled in cash are liabilities and therefore are not included in contributed surplus.

Trust Unit Redemption

Under the terms of the Trust Indenture, unitholders may require the Trust to redeem all or any part of the trust units at a price and under certain terms and conditions as specified in the Trust Indenture. The redemption price per trust unit will be equal to the lesser of: (i) 90 percent of the "market price" of the trust units on the principal market on which the trust units are quoted for trading during the 10 trading day period commencing immediately after the date on which the trust units are tendered to Zargon for redemption; and (ii) the closing market price on the principal market on which the trust units are quoted for trading on the date that the trust units are so tendered for redemption. Trust units tendered for redemption in any calendar month shall be paid on the last day of the third following month by, at the Trust's option: (i) a cash payment; or (ii) a distribution of notes and/or redemption notes. It is anticipated that this redemption right will not be the primary mechanism for holders of trust units to dispose of their trust units. Notes or redemption notes which may be distributed in specie to unitholders in connection with a redemption will not be listed on any stock exchange and no market is expected to develop for such notes or redemption notes. Notes or redemption notes may not be qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans. To date, no trust units have been tendered for redemption.

9. NON-CONTROLLING INTEREST – EXCHANGEABLE SHARES

Zargon Oil & Gas Ltd. is authorized to issue an unlimited number of exchangeable shares. The exchangeable shares are convertible into trust units at the option of the shareholder, based on the exchange ratio, which is adjusted monthly to reflect the distribution paid on the trust units. Cash distributions are not paid on the exchangeable shares. During the year, a total of 0.21 million (2007 – 0.14 million) exchangeable shares were converted into 0.29 million (2007 – 0.17 million) trust units based on the exchange ratio at the time of conversion. At December 31, 2008, the exchange ratio was 1.43643 (December 31, 2007 – 1.29611) trust units per exchangeable share. As set out in the Arrangement, the exchangeable shares are entitled to vote equally to the number of trust units for which each exchangeable share is convertible into a trust unit on the record date. The Board of Directors of Zargon Oil & Gas Ltd. hold the option to redeem all outstanding exchangeable shares for trust units on or before July 15, 2014. At such time, should the Board of Directors not extend the term of the exchangeable shares, there would be no remaining non-controlling interest.

Pursuant to EIC-151 "Exchangeable Securities Issued by a Subsidiary of an Income Trust," if certain conditions are met, the exchangeable shares issued by a subsidiary must be reflected as non-controlling interest on the consolidated balance sheets and in turn, net earnings must be reduced by the amount of net earnings attributed to the non-controlling interest.

The non-controlling interest on the consolidated balance sheets consists of the book value of exchangeable shares at the time of the Plan of Arrangement, plus net earnings attributable to the exchangeable shareholders, less exchangeable shares (and related cumulative earnings) redeemed. The net earnings attributable to the non-controlling interest on the consolidated statements of earnings and comprehensive income represents the cumulative share of net earnings attributable to the non-controlling interest based on the trust units issuable for exchangeable shares in proportion to total trust units issued and issuable each year end.

Non-Controlling Interest – Exchangeable Shares

(thousands, except exchange ratio)	December 31, 2008		December 31, 2007	
	Number of Shares	Amount (\$)	Number of Shares	Amount (\$)
Balance, beginning of year	2,071	20,730	2,207	18,319
Exchanged for trust units at book value and including earnings attributed during the period	(209)	(3,220)	(136)	(1,394)
Earnings attributable to non-controlling interest	-	10,100	-	3,805
Balance, end of year	1,862	27,610	2,071	20,730
Exchange ratio, end of period	1.43643		1.29611	
Trust units issuable upon conversion of exchangeable shares, end of year	2,675		2,684	

The proforma total units outstanding at December 31, 2008, including trust units outstanding, and trust units issuable upon conversion of exchangeable shares and after giving rise to the exchange ratio at the end of the year, is 21.15 million units (2007 – 19.76 million units).

The effect of EIC-151 on Zargon's unitholders' capital and exchangeable shares is as follows:

(\$ thousands)	Zargon Energy Trust Units	Zargon Oil & Gas Ltd. Exchangeable Shares	Total
Balance at December 31, 2006	82,868	18,319	101,187
Issued on redemption of exchangeable shares at book value	330	(330)	-
Effect of EIC-151	3,897	2,741	6,638
Unit-based compensation recognized on exercise of unit rights	466	-	466
Unit rights exercised for cash	2,127	-	2,127
Balance at December 31, 2007	89,688	20,730	110,418
Issued on redemption of exchangeable shares at book value	508	(508)	-
Effect of EIC-151	5,132	7,388	12,520
Unit-based compensation recognized on exercise of unit rights	246	-	246
Issued on corporate and property acquisitions	23,910	-	23,910
Unit rights exercised for cash	1,166	-	1,166
Balance at December 31, 2008	120,650	27,610	148,260

EIC-151 "Exchangeable Securities Issued by Subsidiaries of Income Trusts" states that exchangeable securities issued by a subsidiary of an Income Trust should be reflected as either a non-controlling interest or debt on the consolidated balance sheets unless they meet certain criteria. The exchangeable shares issued by Zargon Oil & Gas Ltd., a corporate subsidiary of the Trust, are publicly traded and have an expiry term, which could be extended at the option of the Board of Directors. Therefore, these securities are considered, by EIC-151, to be transferable to third parties and to have an indefinite life. EIC-151 states that if these criteria are met, the exchangeable shares should be reflected as a non-controlling interest.

As a result of EIC-151, the Trust has increased its unitholders' equity and non-controlling interest for 2008 by \$12.52 million (2007 – \$6.64 million) on the Trust's consolidated balance sheets. Consolidated net earnings for 2008 have been reduced for net earnings attributable to the non-controlling interest by \$10.10 million (2007 – \$3.81 million). In accordance with EIC-151 and given the circumstances in Zargon's case, each redemption is accounted for as a step-purchase, which for 2008 additionally resulted in an increase in property and equipment of \$3.39 million (2007 – \$8.82 million), and an increase in future income tax liability of \$0.97 million (2007 – \$5.99 million). Funds flow from operating activities were not impacted by this change.

The cumulative impact to date of the application of EIC-151 has been to increase gross property and equipment by \$55.15 million (for depletion impact see note 5), unitholders' equity and non-controlling interest by \$65.87 million, future income tax liability by \$18.19 million and an allocation of net earnings to exchangeable shareholders of \$28.91 million.

10. WEIGHTED AVERAGE NUMBER OF TOTAL UNITS

(thousands of units)	2008	2007
Basic	18,021	16,975
Diluted	20,632	19,551

Dilution amounts of 2.61 million units (2007 – 2.58 million) were added to the weighted average number of units outstanding during the year in the calculation of diluted per unit amounts. These unit additions represent the dilutive effect of unit rights according to the treasury stock method and also include exchangeable shares using the "if-converted" method. Due to the fact that at the time of exercise, the rights holder has the option of exercising at the original grant price or a modified price as calculated under the Plan, the prices used in the treasury stock calculation are the lower prices calculated under the Plan. An adjustment to the numerator amount was required in the diluted calculation to provide for the earnings of \$10.10 million (2007 – \$3.81 million) attributable to the non-controlling interest pertaining to the exchangeable shareholders.

11. CAPITAL DISCLOSURES

The Trust's capital structure is comprised of unitholders' equity plus long term debt. The Trust's objectives when managing its capital structure are to:

- i) maintain financial flexibility so as to preserve Zargon's access to capital markets and its ability to meet its financial obligations; and
- ii) finance internally generated growth as well as acquisitions.

The Trust monitors its capital structure and short term financing requirements using the non-GAAP financial metric of debt net of working capital ("net debt") to funds flow from operating activities. Net debt, as used by the Trust, is calculated as bank debt and any working capital deficit excluding the current portion of unrealized risk management assets and liabilities and future income taxes. Funds flow from operating activities represents net earnings/losses and asset retirement expenditures except for non-cash items. The metric is used to steward the Trust's overall debt position as a measure of the Trust's overall financial strength and is calculated as follows:

(\$ thousands, except ratio)	December 31, 2008	December 31, 2007
Net debt	87,707	63,756
Funds flow from operating activities	106,909	79,838
Net debt to funds flow from operating activities ratio	0.8	0.8

Zargon's net debt to funds flow from operating activities ratio was 0.8, unchanged from the 0.8 at December 31, 2007, primarily due to the strong funds flow from operating activities being offset by cash consideration and net debt assumed related to the acquisitions of Rival and Newpact.

To manage its capital structure, the Trust may adjust capital spending, adjust distributions paid to unitholders, issue new units, issue new debt or repay existing debt.

The Trust's capital management objectives, evaluation measures, definitions and targets have remained unchanged over the periods presented. Zargon is subject to certain financial covenants in its credit facility agreements and is in compliance with all financial covenants.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT CONTRACTS

All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading," "available-for-sale," "held-to-maturity," "loans and receivables," or "other financial liabilities" as defined by CICA Section 3855.

Financial assets and financial liabilities classified as “held-for-trading” are measured at fair value with changes in fair value recognized in earnings. Financial assets classified as “available-for-sale” are measured at fair value, with changes in fair value recognized in other comprehensive income (“OCI”) until the asset is removed from the consolidated balance sheets. Financial assets classified as “held-to-maturity,” “loans and receivables” and “other financial liabilities” are measured at amortized cost using the effective interest method of amortization.

Fair Value of Financial Assets and Liabilities

Zargon’s financial assets and liabilities are comprised of accounts receivable, deposits, accounts payable, cash distributions payable, unrealized risk management assets and liabilities and long term debt. Fair values of financial assets and liabilities, summarized information related to risk management positions and discussion of risks associated with financial assets and liabilities are presented as follows:

A) Fair Value of Financial Assets and Liabilities

Accounts receivable are designated as “loans and receivables.” Accounts payable and accrued liabilities, cash distributions payable and long term debt are designated as “other liabilities.” The fair values of these accounts approximate their carrying amounts.

Risk management assets and liabilities are derivative financial instruments classified as “held-for-trading.” These accounts are recorded at their estimated fair value based on the current mark-to-market method of accounting, using quoted market prices.

B) Risk Management Assets and Liabilities

The Trust is a party to certain financial instruments that have fixed the price of a portion of its oil and natural gas production and foreign exchange conversion rates. The Trust enters into these contracts for risk management purposes only, in order to protect a portion of its future cash flow from the volatility of oil and natural gas commodity prices and foreign exchange rates. For financial risk management contracts, the Trust considers these contracts to be effective on an economic basis but has decided not to designate these contracts as hedges for accounting purposes and accordingly, any unrealized gains or losses are recorded based on the fair value (mark-to-market) of the contracts at year end. The unrealized gain on the statement of earnings for 2008 was \$44.38 million and the unrealized loss for 2007 was \$16.80 million. As at December 31, 2008, the Trust had the following outstanding commodity and foreign currency risk management contracts:

Commodity Financial Risk Management Contracts:

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Gain (\$ thousands)
Oil swaps	500 bbl/d	\$72.74 US/bbl	Jan. 1/09 – Mar. 31/09	1,321
	500 bbl/d	\$87.58 US/bbl	Jan. 1/09 – Jun. 30/09	4,039
	300 bbl/d	\$107.40 US/bbl	Jan. 1/09 – Sep. 30/09	5,462
	500 bbl/d	\$114.97 US/bbl	Apr. 1/09 – Dec. 31/09	9,873
	500 bbl/d	\$85.30 US/bbl	Jul. 1/09 – Dec. 31/09	3,103
	300 bbl/d	\$132.98 US/bbl	Oct. 1/09 – Jun. 30/10	7,157
Natural gas swaps	4,000 gj/d	\$9.71/gj	Jan. 1/09 – Mar. 31/09	1,396
	2,000 gj/d	\$9.60/gj	Apr. 1/09 – Oct. 31/09	1,471
Total Fair Market Value, Commodity Price Financial Contracts				33,822

Oil swaps are settled against the NYMEX WTI pricing index, whereas natural gas swaps are settled against the AECO pricing index.

Foreign Exchange Financial Risk Management Contracts:

	Average Monthly US Dollar Volume	Foreign Exchange Rate (\$Cdn/\$US)	Range of Terms	Fair Market Value Gain/(Loss) (\$ thousands)
Foreign exchange forwards	\$1,517,000	1.1760	Jan. 1/09 – Dec. 31/09	(724)
	\$1,213,000	1.2550	Jan. 1/09 – Dec. 31/09	564
	\$1,203,000	1.1715	Jan. 1/10 – Jun. 30/10	(281)
Total Fair Market Value, Foreign Exchange Financial Contracts				(441)

The contracts are settled based on the average daily noon close rate for US dollars converted to Canadian dollars as published by the Bank of Canada.

Physical Risk Management Contracts:

	Rate	Weighted Average Price	Range of Terms	Fair Market Value Gain (\$ thousands)
Natural gas fixed price	5,000 gj/d	\$8.99/gj	Jan. 1/09 – Mar. 31/09	1,307
	3,000 gj/d	\$8.47/gj	Apr. 1/09 – Oct. 31/09	1,481
Total Fair Market Value, Physical Contracts				2,788

Contracts settled by way of physical delivery are recognized as part of the normal revenue stream. These instruments have no book values recorded in the consolidated financial statements.

Commodity Price Sensitivities

The following table summarizes the sensitivity of the fair value of the Trust's risk management positions to fluctuations in commodity prices, with all other variables held constant. When assessing the potential impact of these commodity price changes, the Trust believes 10 percent volatility is a reasonable long term measure.

Fluctuations in commodity prices could have resulted in unrealized gains/(losses) on risk management contracts impacting net earnings as follows:

(\$ thousands)	Year Ended December 31, 2008	
	10% Increase	10% Decrease
Natural gas price	(474)	474
Crude oil price	(3,584)	3,584

C) Risks Associated with Financial Assets and Liabilities

The Trust is exposed to financial risks arising from its financial assets and liabilities. The financial risks include market risk (commodity prices, interest rates and foreign exchange rates) credit risk and liquidity risk.

- Market Risk

Market risk is the risk that the fair value or future cash flows of financial assets or liabilities will fluctuate due to movements in market prices, is comprised of the following:

- Commodity Price Risk

As a means of mitigating exposure to commodity price risk volatility, the Trust has entered into various derivative agreements. The use of derivative instruments is governed under formal policies and is subject to limits established by the Board of Directors. The Trust's policy is to not use derivative financial instruments for speculative purposes.

Natural Gas – To partially mitigate the natural gas commodity price risk, the Trust enters into swaps, which fix the Canadian dollar AECO prices.

Crude Oil – The Trust has partially mitigated its exposure to the WTI NYMEX price with fixed price swaps.

- Interest Rate Risk

Borrowings under bank credit facilities are market rate based (variable interest rates); thus, carrying values approximate fair values.

At December 31, 2008, and at existing debt pricing levels, the increase or decrease in net earnings for each one percent change in interest rates would amount to \$0.83 million for the year ended December 31, 2008.

- Foreign Exchange Risk

As Zargon operates in North America, fluctuations in the exchange rate between the US/Canadian dollar can have a significant effect on the Trust's reported results. A \$0.01 change in the US to Canadian dollar exchange rate would have resulted in a \$1.16 million increase or decrease in net earnings for the year ended December 31, 2008. In order to mitigate the Trust's exposure to foreign exchange fluctuations, the Trust entered into foreign exchange derivative agreements in the fourth quarter of 2008.

• Credit Risk

Credit risk is the risk that the counterparty to a financial asset will default, resulting in the Trust incurring a financial loss. This credit exposure is mitigated with credit practices that limit transactions according to counterparties' credit quality. A substantial portion of the Trust's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

The maximum credit risk exposure associated with accounts receivable, accrued revenues and risk management assets is the total carrying value. The Trust monitors these balances monthly to limit the risk associated with collection. Of Zargon's accounts receivable at December 31, 2008, approximately 37 percent was owing from two companies and Zargon anticipates full collection.

• Liquidity Risk

Liquidity risk is the risk the Trust will encounter difficulties in meeting its financial liability obligations. The Trust manages its liquidity risk through cash and debt management. See note 11 for a more detailed discussion.

As at December 31, 2008, Zargon had available unused committed bank credit facilities of approximately \$101.90 million. The Trust believes it has sufficient funding through the use of these facilities to meet foreseeable borrowing requirements.

The timing of cash outflows relating to financial liabilities are outlined in the table below:

(\$ thousands)	1 year	2-3 years	Total
Accounts payable and accrued liabilities	28,687	-	28,687
Cash distributions payable	3,326	-	3,326
Risk management liabilities ⁽¹⁾	724	281	1,005
Long term debt ⁽²⁾	-	77,581	77,581

(1) See the section titled "Foreign Exchange Risk" in this note for a better understanding of the volatility around these amounts.

(2) See note 6 for the details on the credit facilities.

13. INCOME TAXES

The Trust is a taxable entity under the Income Tax Act (Canada) and, until 2011, is taxable only on income that is not distributed or distributable to the unitholders. As the Trust allocates all of its Canadian taxable income to the unitholders in accordance with the Trust Indenture, and meets the requirements of the Income Tax Act (Canada) applicable to the Trust, no current tax provision for Canadian income tax expense has been incurred by the Trust. Withholding taxes, provincial capital taxes and US income taxes are provided for under current income tax expense.

In the Trust's structure, payments are made between the Company and the Trust that result in the transferring of taxable income from the Company to individual unitholders. These payments may reduce future income tax liabilities previously recorded by the Company that would be recognized as a recovery of income tax in the period incurred.

On October 31, 2006, the Federal Government announced tax proposals pertaining to taxation of distributions paid by trusts and the personal tax treatment of trust distributions. Currently, the Trust does not pay tax on distributions as tax is paid by the unitholders. On June 12, 2007, the Federal Government enacted these tax proposals, which will result in taxation of distributions at the Trust level at a rate of 31.5 percent effective January 1, 2011. Subsequent 2007 fourth quarter legislation has lowered this tax rate to 29.5 percent in 2011 and 28.0 percent beyond 2011 to assimilate recent corporate tax rate changes. Prior to June 2007, the Trust

estimated the future income tax on certain temporary differences between amounts recorded on its consolidated balance sheets for book and tax purposes to have a nil effective tax rate. Under the legislation, the Trust now estimates the effective tax rate on the post 2010 reversal of these temporary differences to be approximately 28.0 percent. Until 2011, Zargon's future tax obligations are reduced as distributions are made from the Trust and, consequently, it is anticipated that Zargon's effective tax rate will continue to be low until that time.

Based on its assets and liabilities as at June 30, 2007, the quarter in which the tax proposals were substantively enacted, the Trust had estimated the amount of its temporary differences, which were previously not subject to tax and had estimated the periods in which these differences will reverse. The Trust estimated that \$7.05 million of net tax deductible temporary differences will reverse after January 1, 2011, which resulted in a reduction of the future tax liability of \$2.22 million in the 2007 second quarter. The taxable temporary differences relate principally to the remaining tax pools attributed to the oil and gas properties being greater than their net book value. The year-over-year increase in the future tax recovery reflects these legislated adjustments.

On February 26, 2008, the Federal Government, in its Federal Budget, announced changes to the Specified Investment Flow-Through ("SIFT") tax rules. The provincial component of the SIFT tax will be based on the provincial rates where the SIFT has a permanent establishment rather than using a 13.0 percent flat rate. For Zargon, the SIFT tax rate applicable in 2012 is expected to fall from 28.0 percent to 25.0 percent. As the tax rate change has not been substantively enacted, no future income tax rate benefit has been recorded in the financial statements.

The amount and timing of reversals of temporary differences will also depend on the Trust's future operating results, acquisitions and dispositions of assets and liabilities, and distributions. A significant change in any of the preceding assumptions could materially affect management's estimate of the future tax liability.

Income taxes differ from the amounts which would be obtained by applying the statutory income tax rates to earnings before income taxes as follows:

(\$ thousands)	2008	2007
Statutory income tax rates	30.08%	33.03%
Expected income taxes	28,632	4,964
Add (deduct) income tax effect of:		
Rate adjustments	(1,225)	(5,775)
Impact of changes in tax rates relating to income trusts after 2010	-	(2,220)
Cash distributions	(11,757)	(12,120)
Capital taxes and withholding taxes	969	2,143
Other	183	(319)
	16,802	(13,327)

The 2008 and 2007 years include recoveries relating to reductions in future federal and provincial income tax rates substantively enacted during the respective years.

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The components of Zargon's net future income tax liability are as follows:

(\$ thousands)	2008	2007
Net book value of property and equipment in excess of tax pools	49,829	43,469
Deferred partnership earnings	7,494	4,762
Asset retirement obligations	(7,525)	(7,051)
Current unrealized risk management (asset)/liability	8,553	(2,919)
Long-term unrealized risk management (asset)/liability	1,321	(714)
Non-capital losses	(1,046)	-
Share issue costs	(31)	(57)
Other	(338)	(232)
	58,257	37,258

As at December 31, 2008, Zargon's estimated tax pools are as follows:

(\$ thousands)	December 31, 2008	December 31, 2007
Canadian oil and gas property expenses in the Trust	33,992	37,772
Canadian oil and gas property expenses in other entities	29,846	7,821
Canadian development expenses	36,224	27,224
Canadian exploration expenses	39,332	45,125
Capital cost allowance	51,218	40,441
US tax pools	3,185	4,440
Partnership deferral	(8,312)	(15,815)
Other	2,474	1,248
	187,959	148,256

14. COMMITMENTS

The Trust is committed to future minimum payments for natural gas transportation sales commitments in addition to operating leases for office space, office equipment, vehicles and field equipment. Payments required under these commitments for each of the next five years are: 2009 – \$2.19 million; 2010 – \$1.73 million; 2011 – \$1.31 million; 2012 – \$0.76 million; 2013 – \$nil; thereafter – \$nil.

15. CONTINGENCIES AND GUARANTEES

In the normal course of operations, Zargon executes agreements that provide for indemnification and guarantees to counterparties in transactions such as the sale of assets and operating leases.

These indemnifications and guarantees may require compensation to counterparties for costs and losses incurred as a result of various events, including breaches of representations and warranties, loss of or damages to property, environmental liabilities or as a result of litigation that may be suffered by counterparties.

Certain indemnifications can extend for an unlimited period and generally do not provide for any limit on the maximum potential amount. The nature of substantially all of the indemnifications prevents the Trust from making a reasonable estimate of the maximum potential amount that might be required to pay counterparties as the agreements do not specify a maximum amount, and the amounts depend on the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time.

The Trust indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their services to the Trust to the extent permitted by law. The Trust has acquired and maintains liability insurance for its directors and officers. The Trust is party to various legal claims associated with the ordinary conduct of business. The Trust does not anticipate that these claims will have a material impact on its financial position.

16. CHANGES IN NON-CASH WORKING CAPITAL

(\$ thousands)	Year Ended December 31,	
	2008	2007
Changes in non-cash working capital items:		
Accounts receivable	943	(3,306)
Prepaid expenses and deposits	528	136
Accounts payable and accrued liabilities	1,515	(1,238)
Cash distributions payable	252	52
Working capital acquired from corporate acquisitions	(3,345)	-
Foreign exchange and other	3,035	(1,076)
	2,928	(5,432)
Changes relating to operating activities	3,215	(3,535)
Changes relating to financing activities	252	52
Changes relating to investing activities	(539)	(1,949)
	2,928	(5,432)

17. SUPPLEMENTAL CASH FLOW INFORMATION

(\$ thousands)	2008	2007
Cash interest paid	4,121	3,259
Cash taxes paid	4,973	2,972

18. SEGMENTED INFORMATION

Zargon's entire operating activities are related to exploration, development and production of oil and natural gas in the geographic regions of Canada and the US.

(\$ thousands)	2008		
	Canada	United States	Combined
Petroleum and natural gas revenue	202,146	27,348	229,494
Earnings before income taxes	82,647	12,540	95,187
Property and equipment, net	353,174	33,572	386,746
Total assets	428,968	18,632	447,600
Goodwill	2,969	-	2,969
Net capital expenditures	57,744	980	58,724

(\$ thousands)	2007		
	Canada	United States	Combined
Petroleum and natural gas revenue	133,473	22,039	155,512
Earnings before income taxes	5,703	9,327	15,030
Property and equipment, net	278,444	35,505	313,949
Total assets	304,562	38,551	343,113
Goodwill	-	-	-
Net capital expenditures	63,591	3,078	66,669

19. CASH DISTRIBUTIONS

During the year, the Trust declared distributions to the unitholders in the aggregate amount of \$39.09 million (2007 – \$36.70 million) in accordance with the following schedule:

2008 Distributions	Record Date	Distribution Date	Per Trust Unit
January	January 31, 2008	February 15, 2008	\$0.18
February	February 29, 2008	March 17, 2008	\$0.18
March	March 31, 2008	April 15, 2008	\$0.18
April	April 30, 2008	May 15, 2008	\$0.18
May	May 31, 2008	June 16, 2008	\$0.18
June	June 30, 2008	July 15, 2008	\$0.18
July	July 31, 2008	August 15, 2008	\$0.18
August	August 31, 2008	September 15, 2008	\$0.18
September	September 30, 2008	October 15, 2008	\$0.18
October	October 31, 2008	November 17, 2008	\$0.18
November	November 30, 2008	December 15, 2008	\$0.18
December	December 31, 2008	January 15, 2009	\$0.18

2007 Distributions	Record Date	Distribution Date	Per Trust Unit
January	January 31, 2007	February 15, 2007	\$0.18
February	February 28, 2007	March 15, 2007	\$0.18
March	March 31, 2007	April 16, 2007	\$0.18
April	April 30, 2007	May 15, 2007	\$0.18
May	May 31, 2007	June 15, 2007	\$0.18
June	June 30, 2007	July 16, 2007	\$0.18
July	July 31, 2007	August 15, 2007	\$0.18
August	August 31, 2007	September 17, 2007	\$0.18
September	September 30, 2007	October 15, 2007	\$0.18
October	October 31, 2007	November 15, 2007	\$0.18
November	November 30, 2007	December 17, 2007	\$0.18
December	December 31, 2007	January 15, 2008	\$0.18

20. RELATED PARTY TRANSACTIONS

Zargon paid \$0.05 million (2007 – \$0.05 million) for vehicle leases to a company owned by a Board member and \$0.23 million (2007 – \$0.07 million) for legal services to a law firm of which a Board member is a partner. These payments were in the normal course of operations, were made on commercial terms, and therefore were recorded at their exchange amounts.

21. SUBSEQUENT EVENTS

On February 27, 2009, Zargon entered into an Arrangement Agreement pursuant to which Zargon has agreed to make an offer to acquire all the issued and outstanding common shares of Masters Energy Inc. ("Masters") and assume approximately \$13.20 million of net debt (including transaction costs) subject to a number of conditions. Pursuant to the Arrangement Agreement, Masters shareholders will have the option of receiving 0.120 Zargon trust units, up to a maximum of 1.49 million trust units, or \$1.83 for each Masters common share, up to an aggregate maximum of \$5.70 million in cash.

22. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's financial statement presentation.