Madalena Ventures Inc.

December 31, 2006

Management's Discussion and Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management Discussion and Analysis ("MD&A") is provided by the management of Madalena Ventures Inc. ("Madalena" or the "Company"), and should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2006. The Company's audited financial statements and other public disclosure documents are filed on SEDAR at www.sedar.com. The commentary in this MD&A is based on information available to April 27, 2007. Unless otherwise stated, all dollar amounts are expressed in Canadian dollars.

In this MD&A, all calculations converting natural gas to barrels of oil equivalent ("boe") have been made using a conversion ratio of six thousand cubic feet (six "mcf") of natural gas to one barrel of oil, unless otherwise stated. The use of boe may be misleading, particularly if used in isolation, as the conversion ratio of six mcf of natural gas to one barrel of oil, is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Forward-looking Statements

This MD&A contains forward-looking statements within the meaning of applicable securities legislation. Forward-looking statements are based on current expectations, estimates, and projections that involve numerous risks and uncertainties, many of which are beyond the Company's and management's control. These risks and uncertainties could cause actual results to differ materially from those anticipated by the Company and described in this MD&A. These risks and uncertainties include, but are not limited to, the impact of general economic conditions, industry conditions, fluctuation of commodity prices, fluctuation of foreign exchange rates, imperfection of reserve estimates, environmental risks, industry competition, availability of qualified personnel and management, stock market volatility, and timely and cost-effective access to sufficient capital from internal and external sources. The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change except as required by law.

Non-GAAP Measurements

This MD&A contains the term operating netback, which has been calculated as total revenue less royalties, operating expenses, and transportation expenses.

Disclosure Controls and Procedures

Disclosure controls and procedures ("DC&P") are designed to provide reasonable assurance, that information required to be disclosed by the Company in its annual and interim filings or other reports filed or submitted under various securities legislation, are recorded, processed, summarized, and reported within the time limits specified by the particular securities legislation, and include controls and procedures designed to ensure that information to be disclosed by the Company is accumulated and communicated to management to allow timely decisions regarding the required disclosure. The Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of the Company are responsible for designing DC&P, or causing them to be designed under their supervision, to provide reasonable assurance that material information related to the Company is made known to them by others within the organization.

The CEO and CFO have evaluated the effectiveness of the Company's DC&P as of December 31, 2006 and have concluded that the DC&P provide a reasonable level of assurance that material information related to the Company is recorded, processed, summarized, and reported in a timely fashion and that material information is made known to them by others within the organization except as described below.

Internal Controls over Financial Reporting

Internal controls over financial reporting ("ICFR") is a process designed by, or under the supervision of, the CEO and CFO, and effected by the Company's board of directors, management and other personnel, to provide

reasonable assurance regarding the reliability of financial reporting and the preparation of financials statements for external purposes in accordance with Canadian GAAP, and includes those policies and procedures that:

(a) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and disposition of the assets of the Company;

(b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Canadian GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors; and

(c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets, that could have a material affect on the annual or interim financial statements.

ICFR have been designed under the supervision of the CEO and CFO of Madalena to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP, however in designing the ICFR, management has identified the following significant weaknesses inherent in the system:

- A lack of segregation of incompatible duties within the accounting and reporting function.
- The lack of sufficient financial reporting personnel with enough technical accounting knowledge in all areas to address all complex and non-routine accounting transactions that may arise.
- A lack of sufficient information system controls with respect to access and documentation of spreadsheet information.

Management is of the view that the size of the Company and cost of correcting these inherent weaknesses does not justify the additional assurance re-mediation will provide, and therefore does not plan to re-mediate these weaknesses. Management believes that the small size of the Company, allows the board of directors and management to possess significant knowledge of all events occurring in the Company which mitigates the possibility of a material error from taking place.

There were no changes in the Company's ICFR during the fourth quarter of 2006 that have materially affected, or are reasonable likely to materially affect the Company's ICFR.

OVERVIEW

2006 was a year of transition for Madalena. From the date of its formation in September of 2001, until the end of 2005, Madalena had pursued mining exploration and development opportunities and considered itself *"a development stage company"*. In 2006 Madalena focused its attention on the development of an International oil and gas exploration and development Company.

During 2006 Madalena made significant changes to its board of directors by adding and replacing the previous board with experienced oil and gas directors. In January and March of 2006 Madalena negotiated two non-operated, domestic oil and gas development joint ventures in the Edson and Brazeau areas of Alberta in order to generate a stable cash flow to fund general and administrative expenses while it pursued international opportunities. Cash flow has been generated from the joint ventures however the results of the domestic joint ventures did not meet the Company's expectations. Due to development drilling issues beyond its control, the Company spent more on the drilling programs than anticipated, and was required to write down the carrying cost of its Canadian properties following its full cost accounting policy.

In April of 2006 the Company hired a new management team with significant international oil and gas experience and moved its head office from Vancouver, BC, to Calgary, Alberta. The Company shifted its focus to concentrate on the evaluation of opportunities in North Africa and South America and in May and June of 2006 the Company announced two exploration programs in Tunisia which are currently ongoing. In August of 2006 the Company disposed of its mineral exploration business as part of a plan of arrangement approved by the BC Supreme Court and the shareholders of the Company. In November of 2006 the Company announced the completion of a private placement of common shares which raised a net $18,869,758 to allow the Company to take advantage of its international opportunities. In September of 2006 the Company applied to have its common shares traded on the TSX Venture exchange and began trading on the exchange in February of 2007.

Madalena is confident that the corporate changes undertaken during 2006 will place the Company in a good position to take advantage of its international opportunities in 2007.

SELECTED ANNUAL INFORMATION

(Cdn $'s except boe/d)	2006	2005	2004
Revenues			
Interest Income	286,533	26,396	1,171
Gain on disposal of marketable securities	45,016	890,033	340,952
Petroleum and natural gas	290,348		
Income (loss) from continuing operations	(4,647,850)	679,284	342,123
Basic and diluted per share	(0.07)	0.02	0.07
Net income (loss)	(4,661,496)	467,374	174,378
Basic and diluted per share	(0.07)	0.01	0.04
Total assets	26,426,093	2,457,393	1,929,496
Total liabilities	1,132,761	97,755	203,821
Dividends declared per share	0.00	0.03	0.00
Total daily production (boe/d)	24		

SUMMARY OF QUARTERLY RESULTS *

	Year Ended December 31, 2006			
	Q4	Q3	Q2	Q1
Sales Volumes:				
Natural gas (mcf/d)	198	109	68	
Oil and natural gas liquids (bbl/d)	7	2	2	
Barrels of oil equivalent (boe/d)	40	20	13	
Per unit information:				
Natural gas price ($/mcf)	7.54	5.75	6.57	
Oil and natural gas liquids price ($/bbl)	51.65	62.47	65.66	
Oil equivalent price ($/boe)	46.39	37.01	43.02	
Operating net back ($/boe)	25.11	32.57	27.81	
Financial:				
Revenue:				
Interest Income	$ 147,948	$ 94,762	$ 17,303	$ 26,520
Gain on disposal of marketable securities		17,429		27,588
Petroleum and natural gas revenues	171,532	67,475	51,341	
Income (loss) from continuing operations	(2,793,574)	(352,724)	(421,722)	(1,034,814)
Basic and diluted per share	(0.03)	(0.00)	(0.01)	(0.06)
Net income (loss)	(2,796,248)	(405,633)	(424,801)	(1,034,814)
Basic and diluted per share	(0.03)	(0.01)	(0.01)	(0.06)
Capital expenditures	1,471,112	5,398,608	1,718,484	1,181,058
Shares outstanding (000's)	106,391	71,586	71,471	66,521
Working capital	18,309,436	274,561	5,874,256	6,490,488

(*)The comparative quarterly information for June 30, 2006 and March 31, 2006 has been re-stated to reflect an adjustment to stock based compensation calculated in those periods, as well as a movement of oil and gas revenues, royalties, operating costs, and depletion from Q3 to Q2. Stock based compensation for Q1 and Q2 was overstated by $1,744,247, and $2,927 respectively. The result of these adjustments is to reduce the net loss for Q1 by $1,744,246 and to increase the net loss for Q2 by $7,593. Comparative information for Sales Volume and Per unit information, has not been provided for 2005, as no production occurred in 2005.

	Year Ended December 31, 2005			
	Q4	Q3	Q2	Q1
Financial:				
Revenue:				
Interest Income	$ 18,225	$ 0	$ 1,937	$ 6,234
Gain on disposal of marketable securities	4,839	20,869	69,784	794,541
Petroleum and natural gas	0	0	0	0
Income (loss) from continuing operations	(214,081)	20,869	71,721	800,775
Basic and diluted per share	(0.01)	0.00	0.00	0.02
Net income (loss)	(280,045)	(35,160)	23,021	759,558
Basic and diluted per share	(0.01)	(0.00)	0.00	0.02
Capital expenditures	133,108	56,782	0	4,899
Shares outstanding (000's)	51,421	35,471	35,471	35,471
Working capital	1,769,182	1,067,411	1,182,369	1,235,275

RESULTS OF OPERATIONS

Production

Madalena's daily production rates increased each quarter of 2006 as the Edson and Brazeau area wells were drilled, completed and tied in. Production volume averaged 24.4 boe/d in 2006. Fourth quarter production volumes averaged 40.2 boe/d as four Brazeau area wells were tied in and started producing during the quarter. The Company had no production in 2005. Natural gas and natural gas liquids accounted for 100 percent of the Company's production in 2006.

Production Revenue

Madalena received an average of $6.84 per mcf for natural gas and $55.74 per bbl for its natural gas liquids during 2006, resulting in gross revenues of $234,958 (81%) and $55,390 (19%) respectively for 2006. The Company had no production during 2005. The Company averaged $43.24 per boe during 2006.

In the fourth quarter the Company received an average of $7.54 per mcf of natural gas and $51.65 per bbl for natural gas liquids or an average of $46.39 per boe.

The Company did not have any natural gas pricing contracts in place at December 31, 2006.

Interest Income

Interest income for the fourth quarter of 2006 amounted to $147,948 compared to $18,225 in 2005. Interest income for the year ended 2006 amounted to $286,533 compared to $26,396 in 2005. The increase in interest income in the fourth quarter and the year reflects the Company's investment of funds it received from its private placement in November in short term asset backed securities which are purchased at a discount and mature at face value providing interest income for the company.

Operating netbacks

Madalena realized the following operating netbacks from oil and gas operations:

Quarterly operating netbacks ($'s per boe)	Year Ended December 31, 2006 Q4	Q3	Q2	Q1
Gross revenue	46.39	37.01	43.02	
Less:				
Royalties	9.64	0	8.01	
Production Expenses	10.86	4.14	6.72	
Transportation	0.78	0.30	0.48	
Operating net back	25.11	32.57	27.81	

For 2006 total average operating netbacks were $27.62 per boe consisting of gross revenue of $43.24 per boe, less royalties of 10.17 per boe, production expenses of $8.29 per boe, and transportation costs of $0.60 per boe. Madalena does not operate any of its properties.

Royalties

Crown royalties net of accrued ARTC amounted to $45,184 for 2006 for an average of $10.17 per boe or 15.6% of production revenues. The somewhat low royalty rates reflect reduced rates for low productivity wells. On September 21, 2006 the Alberta government announced the elimination of the ARTC for royalties paid in respect of production after January 1, 2007. The Company will apply for ARTC on eligible 2006 production prior to the elimination of the program.

Production expenses and transportation

Total production expenses for 2006 amounted to $55,704 or $8.29 per boe, and transportation expenses amounted to $4,011 or $0.60 per boe for 2006.

General and administrative costs

General and administrative ("G&A") costs were $291,146 in the fourth quarter of 2006 compared to $65,964 in the fourth quarter of 2005. For 2006 G&A costs totaled 1,013,873 compared to $211,910 in 2005. The Company capitalized $470,961 of G&A in the Argentina cost centre in 2006 and $31,692 of G&A in the Tunisia cost center in 2006. The capitalized G&A reflects costs directly attributable to exploration activities in these cost centers.

The Company incurred significantly more G&A costs in 2006 and the fourth quarter of 2006 than in 2005 for the following reasons:

- Office expenses – the Company moved its head office out of Vancouver to a location in downtown Calgary and incurred additional costs for rent, supplies, etc.
- Shareholder communications – the Company announced numerous changes to its board of directors and management team, had three significant financings, and numerous announcements with respect to the plan of arrangement, and its exploration and development activities which did not occur in 2005.
- Consulting services – the Company utilized the services of computer consultants, corporate media consultants, and consultants to assist in the development of business in Argentina during 2006.
- Salaries and benefits – in 2006 the Company hired four full time senior people to develop the oil and gas business internationally. In 2005 the only costs incurred was a management fee paid to a company owned by the President.
- Travel and entertainment – in 2006 significantly more was spent to travel to international locations such as Argentina, Chile, Colombia, and Tunisia, to evaluate oil and gas exploration opportunities in those areas.

- Geological consulting – in 2006 the Company incurred geological consulting fees to evaluate oil and gas opportunities which were not incurred in 2005. These costs have been expensed in relation to areas where a cost center has not been established. $83,850 of geological fees was capitalized into two cost centers in Argentina and Tunisia.
- Legal and accounting fees – considerably more money was spent on legal and accounting fees in 2006 than in 2005. Legal fees increased because: legal responsibilities were transitioned from a Vancouver firm to a Calgary firm, the Company made an application to get listed on the TSX Venture exchange, additional legal fees were spent on dealing with issues related to the plan of arrangement transferring out the mining properties, and assisting with the additional reporting requirements mentioned above. Accounting fees increased in 2006 because: the size of the company increased substantially resulting in additional audit work, the company had its third quarter reviewed by external auditors for the first time, the company addressed specific reporting issues which required the assistance of its auditors on the plan of arrangement and disclosures for oil and gas companies.

The increase in general and administrative costs is consistent with transitioning the Company from a mining company to an oil and gas exploration, development and production, company.

Stock-based compensation

Stock-based compensation ("SBC") in the fourth quarter of 2006 amounted to $31,860 compared to $237,145 in 2005. The costs recorded in the fourth quarter reflect revisions to the calculation of SBC for the correct vesting period associated with the SBC. The amount recorded in the fourth quarter of 2005 reflects stock options which were granted in the last quarter. The Company capitalized $19,189 of SBC to the Argentina cost center, and $9,594 to the Tunisia cost center in 2006. The SBC capitalized reflects the estimated cost of options granted to the Company's geological consultant for evaluating exploration opportunities in these cost centers.

The Company recorded SBC in 2006 of $1,312,249 compared to $237,145 in 2005. SBC is a measure of the estimated cost of options granted during the year. At December 31, 2006, the Company has $1,568,862 of unamortized stock-based compensation costs that will be charged to income over the remaining vesting period of the options outstanding.

Depletion depreciation and accretion

Depletion for petroleum and natural gas assets is calculated using the unit-of-production method based on total estimated proved reserves. Depreciation on office furniture and fixtures and on leasehold improvements is calculated on a declining balance basis or on a straight line basis at rates designed to amortize the cost of the asset over its estimated useful life. Depletion expense for the fourth quarter of 2006 was $222,000 compared to nil for 2005 and depletion for the year ended 2006 was $288,000 compared to nil in 2005. The substantial increase in depletion for the last quarter of 2006 reflects revised reserve values at December 31, 2006 compared to the estimated reserves used in the first three quarters of 2006 to calculate the initial depletion. Depletion for the year ended 2006 amounted to $42.88 per boe.

Depletion was not recorded in Argentina or Tunisia. These cost centers are considered to be in the development stage where all costs reasonably attributable to exploring for oil and gas in these areas are capitalized to the cost center. Management feels that the costs capitalized to date will be recoverable from future business activities in the area.

Depreciation for the fourth quarter amounted to $6,237 compared to nil in 2005 and was $19,431 for the year ended 2006 compared to nil in 2005.

The provision for accretion of asset retirement costs was $3,604 for the fourth quarter and $5,945 for the year ended December 31, 2006.

Ceiling test write down

At December 31, 2006 the Company compared the estimated fair value of its Canadian oil and gas properties (as determined by an independent group of petroleum engineers based on the proven properties of the Company using a 0% discount rate) to the carrying cost of those properties, and determined that the carrying amount exceeded the estimated fair value. The Company prepared a ceiling test calculation in which the net present value of the proved plus probable reserves using a 5% discount rate was determined by the same group of independent engineers. The 5% discount rate was estimated to be the Company's risk free rate of return. As a result of this calculation, the Company determined that the carrying cost of the Canadian oil and gas properties had to be written down to their estimated value of $6,455,000 and expensed $2,480,341 in the fourth quarter of 2006.

Loss from discontinued operations, distribution of assets, dividends, and gain on sale of marketable securities

In 2006 the Company decided to focus on International oil and gas exploration and development opportunities. In August of 2006 the Company received final approval to complete a plan of arrangement to distribute the mining exploration business, and marketable securities related to that business, to its shareholders. The company identified $58,662 of legal costs relating to the plan of arrangement that were removed from G&A and shown separately as a loss from discontinued operations. All expenses incurred in 2005 with the exception of SBC were considered to be related to the discontinued operations and the comparative numbers for the year ended 2005 and for the quarterly information shown in this MD&A were separated and shown as a loss from discontinued operations. For 2005 the total loss from discontinued operations amounted to $211,910.

As part of the plan of arrangement the carrying cost of the mineral exploration properties and the marketable securities associated with the mineral exploration business were transferred to Great Bear Resources Ltd. In accordance with the CICA handbook the carrying cost of the mineral resource assets and the marketable securities at the time of completion of the plan of arrangement in the amount of $653,386 were charged to retained earnings.

On November 15, 2004 the Company declared a dividend in specie with respect to shares of Planet Exploration Inc. ("Planet"). Each shareholder of the Company at November 15, 2004 became entitled to receive 0.675 Planet shares for each Madalena share owned at November 15, 2004, subject to the shareholder fulfilling certain conditions. During 2006, and prior to the completion of the plan of arrangement, the Company distributed 96,963 Planet shares to shareholders that had fulfilled the conditions. In 2005 1,898,498 Planet shares were distributed. The fair market value of the shares at the date of the distribution (determined from the trading value of the shares on the TSX Venture exchange) is recorded as dividends paid in kind, and any gain or loss on the disposition of the Planet shares is recorded as a gain on sale of marketable securities. In 2006 the Company recorded $51,716 of dividends in kind and $45,016 of gain on sale of marketable securities. In 2005, $953,784 of dividends in kind and $890,033 of gain on sale of marketable securities were recorded. At August 22, 2006 any Planet shares that had not been distributed by the Company were transferred to Great Bear Resources Ltd. who assumed the obligation to distribute the shares if the shareholders fulfilled the commitment specified in the dividend in specie.

Net income (loss)

The net loss for the fourth quarter of 2006 was $2,796,248, compared to net loss of $280,045 in the fourth quarter of 2005. The net loss for 2006 was $4,661,496 compared to a net income of $467,374 for 2005. The increase in net loss for the fourth quarter and the year reflects the write down and depletion taken on the Canadian petroleum and natural gas properties, higher G&A and SBC offset by increases in production revenues and higher interest income. In 2005 net income was generated from the distribution of Planet shares as described above.

Income taxes

The Company has no provision for current income taxes in 2006 or 2005 and does not expect to have a current income tax expense for 2007 based on its available tax pool deductions. At December 31, 2006 the Company has tax pools available to deduct against income as follows:

Non capital loss carryforwards	3,567,983
Share issue costs	1,399,715
Asset retirement obligations	80,262
Property and equipment	7,596,680
ACRI	45,354

Future income tax assets and liabilities arise due to the difference between the tax basis of assets and their respective accounting carrying cost. The Company's tax basis of its assets exceeds its accounting carrying costs which results in a net future tax asset. The benefit of the future tax assets of the Company have not been recognized in the Company as it is not more likely than not that the benefit of the assets will be realized in the carry forward period.

Capital Expenditures

Madalena spent $9,845,506 on petroleum and natural gas properties and office furniture and fixtures in 2006 and $1,471,112 in the fourth quarter. In 2005 no capital expenditures made except for expenditures on mining properties which have been shown separately as discontinued operations assets. The total expenditures on the mining properties in 2005 amounted to $194,789. The expenditures incurred in 2005 are summarized in the following table:

Canada	
Drilling and intangible completions	8,158,008
Tangible completion and facilities	936,209
Land	54,807
Asset retirement obligations	67,893
Office furniture and equipment	97,153
	9,314,070
Argentina - prospecting costs	490,149
Tunisia - prospecting costs	41,286
Total capital expenditures	9,845,506

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2006 Madalena had working capital of $18,309,436 compared to $1,769,182 in 2005. Working capital increased significantly in 2006 as a result of the issuance of common stock from private placements in March, May and November of 2006 for gross proceeds of $27,124,200, stock options exercised for gross proceeds of $262,000, and warrants exercised for gross proceeds of $1,257,626. The funds received from the issuance of common stock amounted to $26,959,262 in 2006. The Company has no debt at December 31, 2006. Capital expenditures in 2006 were funded entirely from working capital.

The Company is committed to a seismic exploration program in Tunisia in which it expects to incur $4,700,000 during 2007. In Canada, the Company expects to spend $1,208,000 on follow up wells, completions and tie-ins in the Edson and Brazeau areas in 2007. All expected expenditures will be funded from the Companies existing working capital.

TRANSACTIONS WITH RELATED PARTIES

Two directors of the Company are also directors of a public exploration company with which Madalena is in engaged in joint venture operations. All of the Company's oil and gas revenues, royalties and operating expenses are derived from this joint venture. At December 31, 2006 the Company has accounts payable due to this joint venture partner of $858,625.

The Company utilizes the services of a law firm in which one of the directors is a partner. During the year ended December 31, 2006 the Company expended $108,883 on services obtained from this firm.

SHARE INFORMATION

The Company has 106,391,449 common shares, 8,400,000 stock options and 15,071,690 warrants to purchase common shares outstanding at December 31, 2006. During 2006 the Company issued 38,155,250 shares pursuant to private placements, 1,700,000 shares pursuant to the exercise of stock options, and 15,115,250 shares pursuant to the exercise of warrants. At April 27, 2007 the company had 107,368,697 common shares, 7,900,000 stock options and 14,586,940 warrants outstanding.

BUSINESS RISKS

The oil and gas industry involves inherent risks which include but are not limited to the uncertainty of the exploration process and finding new reserves, securing markets for production from existing reserves, commodity price fluctuations, exchange rate fluctuations, interest rate changes, and changes in government regulations related to pricing, royalties, taxes, land fees, allowable production volumes, and environmental requirements. The oil and natural gas industry is intensely competitive and the Company competes with a number of Companies that may have better access to capital.

The Company's ability to increase reserves in the future will depend on its ability to select and acquire suitable prospects and the funds required to develop those prospects in a timely fashion. The ability of equity or debt financing is affected by many factors, some of which are not controllable by the Company.

The Company is focused on the international oil and gas exploration market. Conducting oil and gas exploration and development activities in foreign jurisdictions creates inherent risks in addition to oil and gas exploration risks which include but are not limited to currency instability, potential civil disturbances, currency and funds movement controls, price controls, political instability, changes in foreign ownership restrictions, and potential expropriation of property.

For addition detail regarding the Company's risks and uncertainties, refer to the Company's most recent AIF on SEDAR at www.sedar.com.

CONTRACTUAL OBLIGATIONS

The Company has committed to a lease for office premises terminating on June 15, 2010. The estimated obligation at December 31, 2006, including operating costs at current levels, is $393,289. The Company is also committed to a lease for its photocopier until December 15, 2010. The estimated obligation at December 31, 2006 is $14,888.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

Significant accounting policies used by Madalena are disclosed in note 2 to the December 31, 2006 audited financial statements. Preparing financial statements in accordance with Canadian GAAP requires management to make judgments and estimates with respect to the critical accounting policies. Changes to these judgments and estimates could have a material effect on the Company's financial statements and financial position.

In 2006 the Company adopted new accounting policies applicable to the oil and gas exploration and development industry. These policies were not applicable to Madalena in 2005 when it was considered to be a

development stage company in the mineral exploration business. The following is a summary of the significant accounting policies adopted and the estimates used by the Company in adopting these policies:

Full cost accounting

The Company has chosen to follow the full cost method of accounting exploration and development costs in accordance with the Canadian Institute of Chartered Accountants guideline AcG-16. The Company chose the full cost method of accounting, over the successful efforts method of accounting because it feels the full cost method of accounting is more widely utilized in the industry, Note 2 to the audited financial statements at December 31, 2006 describes' the full cost method of accounting in detail. The following is brief summary of the two methods:

Full cost method

In accordance with the full cost method of accounting, all costs associated with the exploration for and the development of oil and gas reserves in cost centers that are no longer in the preproduction stage, are capitalized. Proceeds on sale or disposition of oil and gas properties are credited to the full cost pool unless this results in a change in the depletion and depreciation rate by 20 percent or more, in which case a gain or loss is recognized. Capitalized costs, including estimated future costs to develop proved reserves, accumulated within a cost center are depleted and depreciated using the unit of production method, based on estimated gross proved reserves of petroleum and natural gas as determined by independent engineers. For purposes of this calculation, reserves and production are converted to equivalent units of petroleum based on relative energy content of six thousand cubic feet of natural gas to one barrel of petroleum. Costs of acquiring and evaluating significant unproved petroleum and natural gas interests are excluded from the depletion calculation until it is determined that proved reserves are attributable to such interests, or until impairment occurs.

Successful efforts method

Under the successful efforts method of accounting costs associated with the development wells are capitalized and costs associated with exploration well are initially capitalized. Exploration wells are then evaluated to determine if economically recoverable reserves have been found, if reserves are not found the costs are expensed. All other exploration costs including geological and geophysical costs are expensed. Each year the capitalized wells are evaluated and reduced to estimated fair value of proved plus probable reserves as applicable. Depletion of capitalized costs is calculated following the unit of production method.

There are a number of estimates inherent in the full cost method of accounting for oil and gas expenditures including but not limited to the following:

(a) The proved and probable reserves available to be produced from the reservoir;
(b) The future pricing expected to be received;
(c) The decline rates applicable to the reserve;
(d) The estimated future costs to be used in the calculation of depletion;
(e) The discount rate associated with calculating net present value; and
(f) In cost centers in the development stage the ability to recover recorded costs from future activities.

Asset Retirement Obligations

The Company recognizes an asset retirement obligation ("ARO") in the period in which a well is drilled and a reasonable estimate of the fair value of the future costs associated with removal, site restoration and asset retirement, can be made. The fair value of the estimated ARO is recorded as a long-term liability with a corresponding increase in the carrying amount of property and equipment. Asset retirement costs recorded in property plant and equipment are amortized using the unit of production method and included in depreciation and depletion and accretion. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the

obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized in the Company's earnings in the period in which the settlement occurs.

RECENT CANADIAN ACCOUNTING PRONOUNCEMENTS

Financial instruments:

Effective January 1, 2007, the Company will adopt the recommendations of the Canadian Institute of Chartered Accountants ("CICA") contained in an number of new Handbook Sections relating to financial instruments. These new accounting standards are effective for fiscal years beginning on or after October 1, 2006 and are described in new Handbook Sections1530 – "Comprehensive Income"; 3855 – "Financial Instruments – Recognition and Measurement";3862 – "Financial Instruments – Disclosures"; 3863 – "Financial Instruments – Presentation"; and 3865 – "Hedges".

The new standards determine how reporting entities recognize and measure financial assets, financial liabilities, and non-financial derivatives. All financial assets are to be measured at fair market value with the exception of loans, receivables and investments that are "held to maturity", and certain equity investments, which are to be measured at cost. All financial liabilities are to be measured at fair market value when they are "held for trading" or if they are derivatives.

Gains and losses on financial instruments measured at fair market value will be included in net income in the period in which they arise, except for gains and losses from financial assets held for sale, and gains and losses from financial instruments which qualify for hedge accounting. Gains and losses from financial assets held for sale will be deferred and accumulated in other comprehensive income, disclosed separately from net income, and reclassified to net income when they are realized or impaired.

The Company has determined that a number of its asset backed securities which are usually held to maturity would be considered under this new standard to be available for sale assets which would require comprehensive accounting treatment. The Company believes that separate comprehensive accounting treatment provides no additional value, and therefore has designated to treat these financial instruments as held for trading assets, which require the recognition of an income or loss in net income in the period in which it arises.

Accounting changes:

The CICA has issued revisions to Handbook Section – 1506 – "Accounting Changes", which will apply to interim and annual financial statements issued after January 1, 2007. The revisions in this section address changes in accounting policies, accounting estimates and the correction of errors. The Company will adopt the requirements of this section for any future changes to accounting policies and estimates and any identification of errors.