MANAGEMENT'S DISCUSSION & ANALYSIS

For the three months ended March 31, 2007

This report is dated May 14, 2007

The following Management's Discussion and Analysis ("MD&A") of the financial condition and results of our operations should be read in conjunction with the consolidated financial statements of Arawak Energy Corporation ("Arawak" or the "Company") and Notes relating thereto as at and for the three months ended March 31, 2007 (unaudited) and for the year ended December 31, 2006. Our financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and presented in US dollars, unless otherwise indicated.

This MD&A contains certain "forward-looking statements". Forward-looking statements are not based on historical facts but rather on management's expectations regarding the Company's future growth, results of operations, production, future capital and other expenditure, competitive advantages, plans for and results of drilling activity, environmental matters, business prospects and opportunities. Forward-looking statements are based on the opinions and estimates of management at the date the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These risks and uncertainties include, but are not limited to, risks associated with the oil and gas industry (for example operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditure; the uncertainty of reserve estimates; the uncertainty of estimates and projections in relation to production, costs and expenses and health, safety and environmental risks), the risk of commodity price and foreign exchange rate fluctuations, the uncertainty associated with negotiating with foreign governments and risk associated with international activity. Due to the risks, uncertainties and assumptions inherent in forward-looking statements, prospective investors in the Company's securities should not place undue reliance on these forward-looking statements.

Certain financial measures referred to in this MD&A are not prescribed by Canadian GAAP. These non-GAAP financial measures do not have any standardised meaning and therefore may not be comparable to similar measures presented by other companies. Funds from Operations (dollars and per share amounts) are included because some investors use this information to analyse operating performance and liquidity. The additional information should not be considered in isolation or as a substitute for measures of performance prepared in accordance with Canadian GAAP. Funds from operations per share and funds from operations are expressed before changes in non-cash working capital. A reconciliation of funds from operations to cash flow from operating activities is provided within the statement of cash flows.

This MD&A uses certain terms which are specific to the oil and gas industry. These are non-GAAP terms and are defined within our document. Except as otherwise required by the context, reference in this MD&A to "our", "we" or "us" refer to the combined business of Arawak and all subsidiaries and associated companies.

Additional information relating to the Company is available on SEDAR at www.sedar.com and the Company's website at www.arawakenergy.com.

OVERALL PERFORMANCE AND OPERATIONS REVIEW

Arawak Energy Corporation (“Arawak” or the “Company”) made a good start to 2007 with an average production from Kazakhstan and Russia reaching 9,088 barrels of oil per day (“bopd”) in the first three months of 2007, up 43% from 6,369 bopd in the first quarter of 2006 and up 2% from 8,872 bopd in the fourth quarter of 2006.

Sales rose 31% to 826,973 barrels from 631,805 in the first quarter of 2006 and 10% from 749,064 barrels in the last quarter of 2006.

Production would have risen further had it not been for extraordinary weather conditions in Kazakhstan, where snowfall in the Aktobe region reached record levels in February and March. Extreme snow storms caused a temporary halt in production at the Akzhar field in February and the subsequent thaw left the steppe roads to and from Akzhar and Besbolek in very poor condition throughout March. The thaw was exacerbated by heavy rainfall in mid-April which further impeded the Company’s ability to evacuate oil by truck to the KazTransOil pipeline system. These roads are only just starting to dry out. As a result, Kazakh production dropped to an average 4,767 bopd in the first quarter of 2007 from 4,838 bopd in the final quarter of 2006, while average Russian output of 4,322 bopd in the first three months of the year rose from 4,034 bopd in the fourth quarter of 2006.

Arawak has completed an engineering study into the proposed pipeline from Akzhar to the KazTransOil system and this project has moved into the project design phase. Once completed , this pipeline will eliminate the need to truck oil from the Akzhar field and significantly reduce the impact of adverse weather on production from Akzhar, Arawak’s largest producing field in Kazakhstan.

Prospects for increased production in Kazakhstan were, however, boosted by the completion of a new Central Processing Facility at Arawak’s second biggest producing field in Kazakhstan, Besbolek. At a cost of around $700,000 and with a planned capacity to handle up to 5,000 bopd, the CPF came online to produce sales quality crude oil in the first quarter of 2007 and is currently able to process 3,000 bopd.

Meanwhile, to alleviate a potential bottleneck in access to the main KazTransOil export pipeline system for Besbolek and Karakaityz, the construction of a Company-owned custody point at the KazTransOil station is underway and scheduled for completion in the third quarter of 2007.

Also, in the first quarter, the Company has commenced the interpretation of the 3D seismic survey over the southern part of the Besbolek field and as a result has identified 4 entirely new leads and 2 possible extensions to existing structures, as well as numerous new drilling locations. In addition, early results of the 3D survey over the entire Akzhar block are very encouraging and the company aims to identify locations for at least 4 exploration wells by the end of the second quarter, to be drilled in the second half of the year.

Turning to drilling, two rigs are now active in Kazakhstan and the first two new wells of 2007 have been drilled in Akzhar during April. Further wells are being drilled in Akzhar and drilling has just commenced in Besbolek. The company remains on target to drill approximately 30 wells in Kazakhstan in 2007.

In Russia, Arawak continued drilling at the Sotchemyu-Talyu fields, following the re-interpretation in 2006 of existing seismic data. Two new wells were successfully drilled there in the first quarter of this year and are being put on production. Three rigs are currently active in our Russian fields.

At North Irael, difficulties in obtaining permits have meant 3D seismic must be postponed until the winter but the Company intends to drill two new wells in the block based on 2D seismic. The first of these will be in the new structure discovered in 2006, but the second will be exploratory and attempt to prove up oil in a further identified and as yet un-drilled structure.

In Azerbaijan, 3D seismic over the Coastal block has been completed and 2D over the Central and Northern blocks is under way.

FINANCIAL HIGHLIGHTS

(In thousands, except per share amounts)

For the three months ended March 31	2007	2006
Crude oil sales	$35,804	$27,719
Net income	$1,268	$5,292
Per share - basic	$0.007	$0.031
Per share - diluted	$0.007	$0.030
Funds from operations*	$8,636	$10,971
Per share - basic	$0.050	$0.063
Per share - diluted	$0.050	$0.063
Capital expenditure	$7,700	$9,627
Shareholders' equity	$130,042	$115,543
Shares outstanding - basic	173,392	173,175
Shares outstanding - diluted	174,476	174,622
Weighted average shares - basic	173,392	173,039
Weighted average shares - diluted	174,476	174,486

*** Funds from operations is a non-GAAP measure that represents cash generated from operating activities before changes in non-cash working capital.**

OPERATIONAL HIGHLIGHTS

For the three months ended March 31	2007	2006
Production - barrels	817,983	573,223
Average daily production - barrels	9,088	6,369
Sales - barrels	826,973	631,805
<u>Revenue and expenses per barrel sold</u>		
Crude oil sales	$43.30	$43.87
Interest and other income	$0.36	$0.25
Royalties and taxes	($10.29)	($7.76)
Production costs	($4.87)	($2.84)
Transportation and selling expenses	($4.98)	($4.79)
Net operating income	$23.52	$28.73

NETBACK TABLE

The following table presents the operations and earnings netbacks on a per barrel basis calculated by dividing total Company revenues and costs by total sales volumes.

For the three months ended March 31

Per barrel	2007	2006
Crude oil sales	43.30	43.87
Interest and other income	0.36	0.25
Total revenue	43.66	44.12
Royalties and taxes	(10.29)	(7.76)
Production costs	(4.87)	(2.84)
Transportation and selling expenses	(4.98)	(4.79)
Net operating income	23.52	28.73
General and administrative expenses	(3.78)	(3.82)
Realised foreign exchange gain	0.03	1.40
Interest expense	(2.23)	(0.95)
Current income tax expense	(7.09)	(7.99)
Funds from operations	10.45	17.37
Depletion, depreciation and amortisation	(9.59)	(8.41)
Stock option compensation	(1.02)	(0.98)
Accretion expense	(0.09)	(0.09)
Unrealised foreign exchange gain (loss)	0.15	(0.60)
Future income tax recovery	1.65	1.09
Net income	1.55	8.38

PRODUCTION

Overall, the Company's production increased 43% in the first quarter of 2007 versus the first quarter of 2006 to 817,983 barrels or the equivalent of 9,088 bopd from 573,223 barrels or 6,369 bopd.

Production from our Kazakhstan operations increased 59% to 429,044 barrels or the equivalent of 4,767 bopd in the first three months of 2007 versus 269,306 barrels or 2,992 bopd for the same period in 2006.

In Russia, production increased 28% in the first quarter of 2007 to 388,939 barrels or the equivalent of 4,322 bopd versus 303,917 barrels or 3,377 bopd for the first quarter of 2006.

For the three months ended March 31

	2007	2006	Increase	Percentage increase
Production - barrels				
Kazakhstan	429,044	269,306	159,738	59%
Russia	388,939	303,917	85,022	28%
Total	817,983	573,223	244,760	43%
Average daily production - barrels				
Kazakhstan	4,767	2,992	1,775	59%
Russia	4,322	3,377	945	28%
Total	9,088	6,369	2,720	43%

SALES

For the three months ended March 31

	2007	2006	Change	Percentage change
Sales - barrels				
Kazakhstan	457,195	333,246	123,949	37%
Russia	369,778	298,559	71,219	24%
Total	826,973	631,805	195,168	31%
Average sales price per barrel				
Kazakhstan	$47.67	$51.84	$(4.17)	(8%)
Russia	$37.88	$34.98	$2.90	8%
Total	$43.30	$43.87	$(0.57)	(1%)

Sales volume increased 31% to 826,973 barrels in the three months ended March 31, 2007 from 631,805 barrels in the same period in 2006 reflecting our production growth. The average sales price received in the first quarter decreased slightly to $43.30 per barrel in 2007 from $43.87 in the first quarter of 2006. The average selling price per barrel is dependent upon world benchmark and domestic prices, and is impacted by the mix between export and domestic sales as well as between Kazakhstan and Russia as detailed in the marketing section below.

For the three months ended March 31

Sales composition by volume	2007	2006
Kazakhstan export	47%	49%
Russian domestic	24%	38%
Russian export	21%	9%
Kazakhstan domestic	8%	4%
Total	100%	100%

MARKETING

The majority of Kazakhstan crude is exported by pipeline and sold as Urals Export Blend, FOB (free on board) Odessa, Ukraine while the alternative route is by train and sold as Brent Export Blend, FCA (free carrier) Poland. Russian crude is exported by pipeline and sold as Urals Export Blend FOB Primorsk, Russia. In Kazakhstan, domestic oil sales are sold either ex-field or delivered to the local refinery. In Russia, domestic sales are sold ex-field.

For the three months ended March 31, 2007

Export oil sales	Kazakhstan	Russia	Total
Volume - barrels	394,135	172,557	566,692
Percentage of total sales by country	86%	47%	69%
Revenue (thousands)	$20,492	$9,662	$30,154
Average export price per barrel	$51.99	$55.99	$53.21
Domestic oil sales			
Volume - barrels	63,060	197,221	260,281
Percentage of total sales by country	14%	53%	31%
Revenue (thousands)	$1,303	$4,347	$5,650
Average domestic price per barrel	$20.66	$22.04	$21.71

For the three months ended March 31, 2006

Export oil sales	**Kazakhstan**	**Russia**	**Total**
Volume – barrels	305,351	59,805	365,156
Percentage of total sales by country	92%	20%	58%
Revenue (thousands)	$16,726	$3,577	$20,303
Average export price per barrel	$54.78	$59.81	$55.60
Domestic oil sales			
Volume – barrels	27,895	238,754	266,649
Percentage of total sales by country	8%	80%	42%
Revenue (thousands)	$548	$6,868	$7,416
Average domestic price per barrel	$19.65	$28.77	$27.81

Kazakhstan
Total sales volume in Kazakhstan increased 37% in the first quarter of 2007 versus the same period in 2006 as a result of a 59% production increase. Export sales volume increased 29% while domestic sales volume increased 126%.

Revenues from Kazakhstan export sales increased 23% to $20.5 million from $16.7 million due to a 29% sales volume increase to 394,135 barrels from 305,351 barrels despite a 5% decrease in the average export price per barrel to $51.99 from $54.78.

Domestic sales revenues in Kazakhstan increased 138% due to a 126% increase in sales volume to 63,060 barrels from 27,895 barrels and a 5% increase in the average domestic price per barrel to $20.66 from $19.65.

Russia
Total sales volume in Russia increased 24% in the three months ended March 31, 2007 versus the same period in 2006 as a result of a 28% increase in production. The sales mix in Russia during the first quarter of 2007 was 53% domestic and 47% export versus 80% domestic and 20% export in the first quarter of 2006.

Revenues from Russian export sales increased 170% to $9.7 million from $3.6 million due to a 189% sales volume increase to 172,557 barrels from 59,805 barrels despite a decrease in the average export price per barrel of 6% to $55.99 from $59.81.

Domestic sales revenues in Russia decreased 37% to $4.3 million from $6.9 million due to a 23% decrease in the average domestic price per barrel to $22.04 from $28.77 and a 17% decrease in sales volume to 197,221 barrels from 238,754 barrels.

CRUDE OIL INVENTORY
Crude oil inventory consists of amounts produced and in storage tanks at the end of each period and is recorded at the lower of cost, determined on a weighted average basis, and net realisable value. The table below summarises the current period oil movement and inventory balances.

For the three months ended March 31

In barrels	**2007**	**2006**
Crude oil inventory - beginning	99,353	101,309
Production	817,983	573,223
Sales	(826,973)	(631,805)
Field usage and losses	(10,227)	(6,863)
Crude oil inventory - ending	80,136	35,864

ROYALTIES AND TAXES

For the three months ended March 31

In thousands of US dollars	2007	2006
Mineral resource extraction tax	3,732	3,223
Export duties	4,245	1,310
Royalties	533	371
Total	8,510	4,904

Underlying a relatively stable average sales price per barrel between the first quarter of 2007 and the first quarter 2006 has been a decline in the average export price by $2.39 per barrel and a decline by $6.10 per barrel in respect of domestic sales. The impact on overall Company revenues of these price decreases has been largely offset by a shift in Russian sales to a higher proportion of volumes being sold to export markets. Russian export sales, which have increased to 21% of total sales volumes in the first quarter 2007 from 9% in the first quarter 2006, have significantly higher sales prices per barrel than domestic sales. Russian export sales are however subject to export duties whereas domestic sales are exempt. The increased volume of sales subject to export duties along with a rate increase to $24.60 per barrel in the first quarter 2007 from $21.90 in the first quarter 2006 together has led to an overall increase in the amount of royalties and taxes per barrel to $10.29 in the first quarter 2007 from $7.76 in the first quarter 2006.

Mineral resource extraction tax
The Company is subject to production taxes in Russia at a rate established monthly by the state based on current world oil prices. The tax decreased 6% to $10.09 per barrel sold in the first three months in 2007 from $10.80 per barrel in the same period in 2006.

Export duties
Export sales in Russia are subject to export duties with rates established by the state two months in advance based on prevailing world oil prices. Export duties are not levied on domestic sales. The export duties increased 12% to $24.60 per barrel of Russian export sales in the first quarter of 2007 compared to $21.90 in the first quarter in 2006.

Royalties
For its producing fields in Kazakhstan, Arawak pays royalties monthly to the Government using stabilised rates that are graduated and increase with cumulative annual production. The Company was also paying over-riding royalties on two of its properties in Kazakhstan at fixed rates per barrel sold until the Company acquired the over-riding royalty interests in December 2006. The increase in royalties in the first quarter of 2007 reflects the increased sales. Royalties are 2.4% of Kazakhstan sales revenues in 2007 and 2.1% in 2006.

PRODUCTION COSTS

Production costs increased to $4.87 per barrel sold in the quarter ended March 31, 2007 compared to $3.96 for the year 2006 and $2.84 in first quarter of 2006. This increase in production costs on a per barrel basis was due to a combination of factors including the inclusion of higher cost production from Recher, local currency cost inflation in both Russia and Kazakhstan, and the effect of a weak US dollar pushing up local currency costs in US dollar terms. There was in addition some catch-up of costs that were under-accrued in Kazakhstan in 2006.

TRANSPORTATION AND SELLING COSTS

Transportation and selling expenses include pipeline, trucking and other selling costs associated with marketing and delivering crude oil to markets. On a per barrel basis, these costs increased to $4.98 in the first quarter of 2007 from $4.79 in the first quarter of 2006 due mainly to the devaluation of the US dollar as a significant portion of these costs are denominated in local currency.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses increased to $3.1 million in the first quarter of 2007 from $2.4 million in the first quarter of 2006, reflecting the Company's increased activity level but decreased on a per barrel basis to $3.78 in 2007 from $3.82 in 2006.

INTEREST EXPENSE

Interest expense increased to $1.8 million in the first quarter of 2007 from $0.6 million in the same period in 2006 due mainly to the increases in the crude oil sales prepayment facility.

CURRENT INCOME TAX EXPENSE

Current income tax expense decreased to $7.09 per barrel in the first quarter of 2007 versus $7.99 per barrel for the first quarter of 2006 reflecting higher costs and lower profitability in the current period.

Arawak is subject to Excess Profit Tax ("EPT") on the Akzhar, Besbolek and Karataikyz hydrocarbon contracts in Kazakhstan at incremental tiered rates based on each contract's cumulative internal rate of return in excess of 20%. The EPT rates for these fields range from 0 to 30%. For the Alimbai field and East Zharkamys III block in Kazakhstan, EPT rates range from 0 to 60% and are calculated based on the ratio of net income to deductions in excess of 20%. The Company accrued $1.0 million EPT in the first quarter of 2007 versus $1.1 million for the year in 2006.

DEPLETION, DEPRECIATION AND AMORTISATION

Depletion, depreciation and amortisation expense increased to $9.59 per barrel in the first three months of 2007 from $8.41 per barrel in the first three months of 2006 due mainly to increased future development cost estimates and the June 2006 oilfield acquisition in Russia which recognised sales in the first quarter of 2007 equal to 8.5% of proved reserves compared to 3.7% for our other fields.

CAPITAL EXPENDITURE

In the first quarter of 2007 a total of $7.7 million was spent on capital expenditure compared to $9.6 million in the previous year, excluding acquisitions. Capital expenditure included purchases of property, plant and equipment of $4.7 million in Kazakhstan, $2.0 million in Russia and $0.9 million in Azerbaijan.

OPERATIONS IN AZERBAIJAN

Pilot oil production continued in the South West Gobustan fields in 2006 from the first development well, Dashgil 91, with small amounts also produced from the Adzhiveli wells in the Central block and Donguzdyg 101 in the Northern block. Production in the first quarter of 2007 was 1,810 barrels of oil and 14 million scf of gas net to Arawak, versus 1,774 barrels of oil and 11 million scf of gas in the same period of 2006.

Sales from pilot production of 1,603 barrels of oil net to Arawak for $0.08 million during the first quarter of 2007 have been offset against capitalised costs and not recognised as revenue compared to sales of 1,366 barrels of oil for $0.07 million for the same period in the previous year.

OUTSTANDING SHARE DATA

The table below sets out the Company's outstanding shares.

As at:	May 14, 2007	March 31, 2007	December 31, 2006
Common Shares	173,180,907	173,180,907	171,181,702
Exchangeable Shares	210,958	210,958	2,210,163
Total outstanding	173,391,865	173,391,865	173,391,865
Stock Options	10,785,000	10,785,000	10,785,000

LIQUIDITY AND CAPITAL RESOURCES

The levels of cash, current assets and current liabilities are as set out below and expressed in thousands of US dollars.

As at December 31	**2007**	**2006**
Cash and cash equivalents	8,353	9,663
Current assets	41,933	33,595
Current liabilities	(65,486)	(57,063)
Net current assets	(23,553)	(23,468)

The Company's cash deposits are held principally in US dollars and are centrally managed. Surplus funds are placed on short term deposit. Operational funds are kept in Azerbaijan, Russia and Kazakhstan.

The Company has a crude oil sales prepayment facility which allows Arawak to draw prepayments on future oil sales up to a maximum of $45.0 million. The amount drawn as at March 31, 2007 was $38.0 million and at December 31, 2006 was $30.0 million.

Arawak's 50% owned joint venture in Russia has a bank borrowing base facility agreement with a $60.0 million limit (Arawak share – $30.0 million). The facility carries interest at LIBOR plus 4.4% and is repayable via quarterly repayments of $3.5 million. The balance outstanding as at March 31, 2007 is $43.6 million (Arawak share – $21.8 million) and at December 31, 2006 is $47.1 million (Arawak share – $23.55 million). There are no penalties for early repayment and in certain circumstances accelerated repayments are required. The borrowing is secured by Russian export crude oil sales and by proportionate partner guarantees.

The Company continues to seek additional business opportunities in Kazakhstan, Russia, Azerbaijan and potentially elsewhere in the Former Soviet Union. Funding of any such further transactions will be considered on a case-by-case basis, depending on materiality and the expected cash flow profile of the opportunity.

SUMMARY OF QUARTERLY RESULTS

The following financial data is derived from the Company's consolidated financial statements for each of the eight most recently completed quarters.

(In thousands of US dollars except for per share amounts)

				Net income (loss) per share	
Quarter ended		**Crude oil sales**	**Net income (loss)**	**Basic**	**Diluted**
2007	March 31	35,804	1,268	0.007	0.007
2006	December 31	29,123	(3,720)	(0.021)	(0.021)
	September 30	39,638	5,841	0.034	0.034
	June 30	33,975	5,026	0.029	0.029
	March 31	27,719	5,292	0.031	0.030
2005	December 31	20,323	(317)	(0.002)	(0.002)
	September 30	27,575	7,355	0.043	0.041
	June 30	13,756	566	0.003	0.003

RELATED PARTY TRANSACTIONS

Crude oil sales
Export crude oil sales from Russia and Kazakhstan to Vitol S.A. during the three months ended March 31, 2007 were $29.6 million (three months ended March 31, 2006 – $20.0 million). Related accounts receivable at March 31, 2007 include $15.5 million and at December 31, 2006 include $6.7 million.

Crude oil sales prepayment facility
The balance of the crude oil sales prepayment facility provided by Vitol S.A. at March 31, 2007 is $38.0 million (December 31, 2006 – $30.0 million) with related interest expense for the three months ended March 31, 2007 of $1.0 million (three months ended March 31, 2006 – $0.1 million).

These transactions were, to the knowledge of management, at terms and rates no more and no less favourable than those with unrelated parties.

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

Principles of consolidation
Arawak is an international oil and gas exploration, development and production company with activities in Kazakhstan, Russia and Azerbaijan. The consolidated financial statements have been prepared in US dollars following Canadian GAAP and include the financial statements of Arawak and its wholly owned subsidiaries, which are registered under the laws of Anguilla (British West Indies), Netherlands, Kazakhstan, Alberta (Canada), Cyprus and England & Wales. The Company's shares are listed on the Toronto Stock Exchange (TSX Venture Exchange until October 30, 2006) under the symbol "ABG".

Substantially all of the Company's operations in Russia and Azerbaijan are conducted through joint ventures and accordingly these financial statements reflect only the Company's proportionate interest.

Foreign currency translation
In Kazakhstan and Azerbaijan, operations are financially and operationally integrated and the functional currency is the US dollar. Arawak translates foreign currency denominated transactions using the temporal method whereby monetary assets and liabilities are translated at year end rates; non-monetary assets and liabilities are translated at rates in effect on the date of the transactions; revenue and expenses are translated at rates in effect on the date of the transaction with the exception of depreciation and amortisation, which are translated at historic rates. Foreign exchange gains and losses are included in earnings.

The functional currency of the Russian operations is the Russian rouble as it reflects the economic substance of the underlying events and circumstances of the self sufficient Russian activities. Transactions and amounts are translated using the current rate method whereby assets and liabilities are translated at the rate in effect on the balance sheet date; revenues and expenses are translated at the rate in effect on the transaction date. Foreign exchange gains or losses are recorded as cumulative translation adjustments which are a separate component in shareholders' equity.

Oil and gas properties
Arawak follows the full cost method of accounting, whereby all costs incurred in exploring for and developing oil and gas reserves are capitalised. Such costs include land acquisition, geological and geophysical, drilling of both productive and unproductive wells, plant and equipment and administration costs that are reasonably allocated to these activities. Proceeds from disposals are recorded as a reduction of the related expenditure without recognition of a gain or loss unless the disposal would result in a change of 20% or more in the depletion rate.

Capitalised costs are accumulated on a country by country basis and are depreciated and depleted using the unit of production method based upon estimated proved reserves. The carrying values of unproved properties are excluded from the depreciation and depletion calculation.

The Company applies a ceiling test to capitalised costs to ensure that such costs do not exceed estimated future net revenues from production of proved reserves using forecasted sales prices less expected future capital, production, royalties and asset retirement obligation, together with the cost of unproved properties. An impairment loss is recognised when the carrying amount is not recoverable and exceeds its fair value.

Asset retirement obligation
The Company recognises a liability for the fair value of legal obligations associated with the retirement of long-lived tangible assets in the period incurred with a corresponding increase in the carrying amount of the related asset, which is depleted as a component of oil and gas properties. The liability is adjusted each reporting period to reflect revisions to the estimated future cash flows and for the passage of time. The liability accretes until the date of expected settlement of the retirement obligations. The related accretion expense is charged to earnings. Actual expenditure incurred for site reclamation and abandonment is charged against the liability to the extent it exists on the balance sheet with the difference recognised as a gain or loss in the period in which settlement occurs.

Use of estimates
The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of commitments and contingent liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting periods. Amounts recorded for the depletion of oil and gas properties and asset retirement obligations are based on estimates of proved reserves and future development costs. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices and future costs. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be material.

Income tax
The Company follows the liability method of accounting for future income taxes. Under this method, income tax assets and liabilities are recognised based on the estimated tax effects of temporary differences in the carrying values of assets and liabilities in the financial statements and their respective tax bases, using income tax rates enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognised in income or loss in the period of the change.

Stock-based compensation costs
The Company has a stock-based compensation plan. Compensation expense is based on the fair value at the grant date and recognised over the vesting periods of the respective options with a corresponding increase to contributed surplus. Any consideration received upon exercise of the options, together with the amount previously recognised in contributed surplus, is recorded as an increase to share capital.

ADOPTION OF NEW ACCOUNTING POLICIES AND SIGNIFICANT ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2007 the Company adopted the Canadian Institute of Chartered Accountants Handbook Section 1530 “Comprehensive income”, Section 3251 “Equity”, Section 3865 “Hedges” and Section 3855 “Financial instruments – recognition and measurement”. As required by the new standards, prior periods have not been restated, except to reclassify the foreign currency translation balance as described under “comprehensive income”. The adoption of these Handbook sections had no impact on opening retained earnings or accumulated other comprehensive income.

Comprehensive income
This standard introduces a new “Statement of comprehensive income” and establishes accumulated other comprehensive income as a separate component of shareholders’ equity. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources and includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Other comprehensive income comprises revenues, expenses, gains and losses that, in accordance with GAAP, are recognised in comprehensive income but excluded from net income. Amounts included in accumulated other comprehensive income are reclassified to net income when realised. Upon adoption of Section 1530, cumulative translation adjustments relating to self-sustaining foreign operations were reclassified to accumulated other comprehensive income and comparative amounts have been restated.

Equity
The equity section establishes standards for the presentation of equity and changes in equity during the reporting period.

Hedges
This section prescribes new hedge accounting standards. Hedge accounting continues to be optional. At the inception of the hedge, the Company must formally document the designation of the hedge, the risk management objectives, the hedging relationships between the hedged items and the hedging instruments and the methods for testing the hedge’s effectiveness. The Company assesses at inception and throughout its term whether the hedging instruments are highly effective in offsetting changes in fair values or cash flows of hedged items.

Financial instruments
The accounting standard on financial instruments establishes the recognition and measurement criteria for financial assets, liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition while measurement in subsequent periods depends on its classification as “held-for-trading”, “available-for-sale”, “held-to-maturity”, “loans and receivables” or “other financial liabilities” as defined by the standard.

Financial instruments “held-for-trading” are measured at fair value with changes to fair value recognised in net income, “available-for-sale” are measured at fair value with changes to fair value recognised in other comprehensive income and “held-to-maturity” , “loans and receivables” and “other financial liabilities” are measured at amortised cost using the effective interest rate method of amortisation.

Cash and cash equivalents are classified as “held-for-trading” and are measured at carrying value, which approximates fair value due to their short term nature. Accounts receivable and other current assets are classified as “loans and receivables”. Accounts payable and accrued liabilities, corporate income taxes payable, crude oil sales prepayment facility, long term debt and other long term liabilities are classified as “other liabilities”.

Upon adoption of this standard and its transition provisions, with respect to the amortised cost using the effective interest rate method of long term debt, deferred financing costs of $0.9 million previously included in deferred charges have been reclassified as unamortised debt issue costs which reduce the carrying value of the long term debt.

COMMITMENTS AND CONTINGENT LIABILITIES

Work commitments
Pursuant to its contracts, Arawak has minimum spending commitments for each oilfield in Kazakhstan. For the contract years ended in 2006, cumulative spending commitments were $41.7 million comprising $34.7 million for Akzhar, $2.9 million for Besbolek, $3.5 for Karataikyz and $0.6 million for Alimbai. As of December 31, 2006 the Company believes these commitments have been satisfied. Non-fulfilment of contractual work commitments could result in punitive actions by the Government, including suspending or revoking the licenses for which the work commitment was not fulfilled.

The work commitments for each of the next five years and in total are as follows (in thousands of US dollars):

	2007	2008	2009	2010	2011	Thereafter	Total
Akzhar	1,351	934	-	-	-	-	2,285
Besbolek	1,864	95	-	-	-	-	1,959
Karataikyz	700	700	-	-	-	-	1,400
Alimbai	928	1,163	980	643	643	7,900	12,257
East Zharkamys III	1,616	9,039	15,605	36,865	-	-	63,125
Total	6,459	11,931	16,585	37,508	643	7,900	81,026

BUSINESS RISKS

As a junior oil and gas exploration, development and production company, Arawak is subject to risks and uncertainties inherent in the oil and gas industry and to risks inherent to a company of its size and stage of development. Due to the international nature of the Company's operations, it is subject to additional risks, including currency fluctuations, political risk, price controls and varying forms of fiscal regimes.

Oil and gas industry risks

Risks in the oil and gas industry include price fluctuations for commodity prices, operational risks and environmental concerns. Oil and natural gas prices have fluctuated widely during recent years and are determined by supply and demand factors. Arawak manages its operations in order to keep exposure to these risks to reasonable levels, including the use of hedging instruments and forward sale, fixed price contracts to hedge its exposure.

Operational risks in the oil and gas industry include exploration and reserve estimate risks, costs and availability of services and materials, premature reservoir declines, blowouts, well bore collapse, equipment failure and other accidents and adverse weather conditions. Arawak attempts to mitigate these risks by employing experienced field personnel, consultants and contractors.

The oil and gas industry is subject to extensive environmental and other regulation imposed by governmental authorities. Arawak has existing policies and practices that ensure its operations conform to the standards and government regulations required for each jurisdiction in which it operates.

Foreign currency exchange risk

Due to our operations in Russia, Kazakhstan and Azerbaijan, the Company is exposed to foreign currency fluctuations as domestic oil sales in Russia and Kazakhstan and a large portion of local expenses are denominated in local currencies.

Credit risk

A substantial portion of accounts receivable is related to export oil sales from Russia and Kazakhstan with one major customer. This customer also provides a crude oil prepayment facility allowing the Company to draw prepayments on future oil sales and diminishing the risk of collection. The Company's credit risk is mitigated on domestic sales by receiving full or majority payment in advance of each sale.

Interest rate risk

The Company is exposed to interest rate cash flow risk related to the variable interest rates on the crude oil sales prepayment facility, long term debt and interest-bearing other long term liabilities.

Political and economic conditions in Russia, Kazakhstan and Azerbaijan

Whilst there have been improvements in the economic situation in Russia, Kazakhstan and Azerbaijan in recent years, their economies continue to display some characteristics of emerging markets. These characteristics include, but are not limited to, the existence of currencies that are not freely convertible outside of the respective countries, a low level of liquidity of debt and equity securities in the markets and relatively high inflation.

Additionally, the oil and gas sectors in Russia, Kazakhstan and Azerbaijan are impacted by political, legislative, fiscal and regulatory developments. The prospects for future economic stability are largely dependent upon the effectiveness of economic measures undertaken by the respective Governments, together with legal, regulatory and political developments, which are beyond the Company's control.

The financial condition and future operations of the Company may be adversely affected by continued uncertainties in the business environment of Russia, Kazakhstan and Azerbaijan. Management is unable to predict the extent and duration of these uncertainties, nor quantify the impact, if any, on the financial statements.

Tax legislation and practice in Russia, Kazakhstan and Azerbaijan are in the developmental stage and therefore are subject to varying interpretations and frequent changes, which may be retroactive. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activities of the Company may not coincide with that of management. As a result, transactions may be challenged by tax authorities and the Company may be charged additional taxes, penalties and interest. Tax periods remain open to review by the tax authorities for three to five years, however under certain circumstances a tax year may remain open longer.

Need for capital

Arawak must rely on access to debt and capital markets to supplement internally generated cash flow to fund its capital commitments and to finance its growth plans. There can be no assurance that Arawak will be successful in obtaining the funds required to meet its capital needs on a timely basis or, if successful, that the terms will be advantageous to Arawak.