

MANAGEMENT'S DISCUSSION & ANALYSIS

For the three months ended September 30th, 2005.

This report is dated November 18th, 2005.

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 unaudited consolidated financial statements of Arawak Energy Corporation ("Arawak" or the "Company") and Notes relating thereto as at and for the three and nine months ended September 30th, 2005 and the audited consolidated financial statements of Arawak as at and for the year ended December 31st, 2004. Our financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in US dollars.

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 expenditures, competitive advantages, plans for and results of drilling activity, political and regulatory matters 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 expenditures; 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.

This MD&A contains disclosure in respect of crude oil and natural gas production expressed as barrels of oil equivalent per day ("boepd"). All crude oil and natural gas equivalency volumes have been derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of crude oil. Equivalency measures may be misleading, particularly if used in isolation. This conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

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" refers to the combined business of Arawak and all of its subsidiaries.

All dollar amounts in this report are in US dollars unless otherwise indicated.

Additional information relating to the Company is available on SEDAR at www.sedar.com.

OVERALL PERFORMANCE AND OPERATIONS REVIEW

The Company announced record net income of \$7.4 million in the third quarter, compared to \$1.5 million for the first half of 2005, reflecting further improvements in net backs as a result of high international oil prices, higher production and the reduction of inventory levels which were unusually high at the end of second quarter 2005. The Company was able to finance its substantial capital investment program of \$9.0 million in Russia, Kazakhstan and Azerbaijan entirely from cash flow of \$10.7 million.

This progress continues to build on the two significant events of the first quarter of 2005 which materially improved the outlook and development potential of the Company. The first of these was the acquisition of 100% of Altius Energy Corporation ("Altius") in Kazakhstan and 50% of RF Energy Investments Limited ("RF Energy"), the holding company of ZAO PechoraNefteGas ("PNG"), in Russia. The second significant event was the raising of Cdn. \$58.8 million (before fees and expenses) through the placing of 28 million shares at Cdn. \$2.10 per share.

Average production for the quarter increased by 9% on a quarter on quarter basis, with third quarter average production of 6,265 barrels of oil per day ("bopd"). New wells were drilled in the Sotchemyu - Talyu fields in Russia and the Akzhar field in Kazakhstan, and the Company is preparing a new 3D seismic survey of the Besbolek field in Kazakhstan. A new deep gas well was drilled in Azerbaijan which will be put on test in mid November.

In Kazakhstan, average production in the third quarter of 2005 increased by 20% to 3,233 bopd from 2,685 bopd in the second quarter. This increase in the production rate was due to the successful results of drilling operations in the Akzhar field, and would have been substantially higher but for the shutting-in of the Besbolek and Karataiky fields on 1st September 2005. The Company is continuing to work with the relevant authorities to obtain permission to recommence Trial Production. It has also started the procedure to move to the Production Phase early in first quarter 2006, which would in any case lead to the resumption of full production.

In Russia, where Arawak operates via its 50% owned affiliate PNG, production in the third quarter averaged 3,032 bopd net to Arawak, and was virtually unchanged compared to the previous quarter. Since August, PNG has drilled three horizontal or directional wells, and so far has put the first on production, achieving a rate of around 115 bopd. However, the net pay in the two subsequent wells is much larger, and the results on completion and after clean-up are expected to be correspondingly better and provide the key to PNG achieving its year end production target.

In Azerbaijan, Arawak's non-operated associate Gobustan Operating Company Ltd. ("GOCL") drilled the Duvanny 108 well in the Coastal block of the South West Gobustan fields to a depth of 3,800 meters, and encountered strong gas and oil shows. This well is expected to be put on test by the end of November. The installation and commissioning of gas facilities in Azerbaijan is continuing to progress, albeit with some delays, and first gas is expected in mid December 2005.

Pilot oil production continued in the third quarter from the South West Gobustan fields and, together with crude oil inventory at the beginning of the period, two sales totalling approximately 5,400 barrels were made via SOCAR's pipeline for export to Novorossiysk.

RESULTS OF OPERATIONS

Prior to the acquisition of the Kazakhstan and Russian assets on January 7th, 2005, the Company did not have any sales or production. Accordingly, sales and production data for the comparative three and nine months ended September 30th, 2004 are not presented below:

Summary of netbacks

For the	3 months ended Sept. 30 th , 2005		9 months ended Sept. 30 th , 2005	
	US Dollars (thousands)	Per Barrel	US Dollars (thousands)	Per Barrel
Crude oil sales	\$27,575	\$44.32	\$54,750	\$37.63
Interest and other income	\$323	\$0.52	\$867	\$0.60
Total revenue	\$27,898	\$44.84	\$55,617	\$38.23
Royalties and taxes	\$(5,300)	\$(8.52)	\$(12,439)	\$(8.55)
Production costs	\$(1,738)	\$(2.79)	\$(4,170)	\$(2.87)
Transportation and other selling costs	\$(2,539)	\$(4.08)	\$(5,490)	\$(3.77)
Net operating income	\$18,321	\$29.45	\$33,518	\$23.04
General and administrative expenses	\$(2,250)	\$(3.62)	\$(6,733)	\$(4.63)
Realized foreign exchange gain (loss)	\$43	\$0.07	\$(328)	\$(0.23)
Interest expense	\$(327)	\$(0.53)	\$(1,467)	\$(1.01)
Current income tax expense	\$(5,039)	\$(8.10)	\$(7,919)	\$(5.44)
Cash flow from operations	\$10,748	\$17.27	\$17,071	\$11.73
Depletion, depreciation and amortization	\$(3,797)	\$(6.10)	\$(9,549)	\$(6.56)
Stock based compensation costs	\$(931)	\$(1.50)	\$(1,400)	\$(0.96)
Accretion expense	\$94	\$0.15	\$(143)	\$(0.10)
Loss on disposal of office equipment	-	-	\$(7)	-
Unrealized foreign exchange gain (loss)	\$(24)	\$(0.04)	\$66	\$0.05
Future income tax recovery	\$1,265	\$2.03	\$2,777	\$1.91
Net income	\$7,355	\$11.81	\$8,815	\$6.07

Production

The Company's production from its Kazakhstan and Russian operations amounted to 576,301 barrels for the three months ended September 30th, 2005, 6,265 bopd on average, compared to 521,472 barrels, 5,730 bopd on average for the previous quarter. The increase is due to the results of the drilling programs in Kazakhstan and Russia.

Production for the three months ended Sept. 30 th , 2005	Kazakhstan	Russia	Total
Production - barrels	297,368	278,933	576,301
Average daily production - barrels	3,233	3,032	6,265

Sales

Sales for the three months ended September 30th, 2005 totalled 622,207 barrels, 6,763 bopd on average, compared to 400,984 barrels, 4,406 bopd on average, for the previous quarter. The average price received in the third quarter was \$44.32 per barrel versus \$34.31 per barrel in the second quarter. Sales volumes in the third quarter were positively impacted by the reduction in inventory, which was unusually high at the end of the second quarter 2005.

Sales for the three months ended Sept. 30th, 2005	Kazakhstan	Russia	Total
Sales - barrels	357,538	264,669	622,207
Average daily sales - barrels	3,886	2,877	6,763
Average sales price per barrel	\$47.64	\$39.83	\$44.32

The Company sells oil to export, near abroad and domestic markets. PNG's export oil sales are made by pipeline and sold as Urals Export Blend free on board ("FOB") Butinge, Lithuania. Altius crude is exported by pipeline and sold as Urals Export Blend, FOB Odessa, Ukraine or Butinge, Lithuania. Near-abroad oil sales refer to sales by PNG to Belarus, which is party to customs union arrangements with Russia and exempted from export duty, while also being zero-rated for VAT purposes. The basis of domestic sales is ex-field in Russia and delivered to the local refinery in Kazakhstan.

Legislation in both Kazakhstan and Russia obliges all producers to sell a proportion of their production in the domestic markets, where prices are significantly below those for export sales. Prices achieved in respect of export sales by producers in Kazakhstan and Russia are linked to international prices for crude oil (e.g. Brent), but at a discount due to location and quality differentials.

Sales for the three months ended Sept. 30th, 2005			
Export oil sales	Kazakhstan	Russia	Total
Volume - barrels	285,840	115,356	401,196
Percentage of total sales	80%	43%	64%
Revenue (thousands)	\$15,714	\$6,018	\$21,732
Average price per barrel	\$54.97	\$52.17	\$54.17
Near-abroad oil sales			
Volume - barrels	-	23,042	23,042
Percentage of total sales	-	9%	4%
Revenue (thousands)	-	\$801	\$801
Average price per barrel	-	\$34.75	\$34.75
Domestic oil sales			
Volume - barrels	71,697	126,272	197,969
Percentage of total sales	20%	48%	32%
Revenue (thousands)	\$1,320	\$3,722	\$5,042
Average price per barrel	\$18.42	\$29.48	\$25.47

General and administrative expenses

The Company's general and administrative expenses, including non-cash stock based compensation costs, were \$3.2 million for the three months ended September 30th, 2005 versus \$0.7 million for the same period in 2004. The increase is due to the current year acquisitions and the related increase in activity. During the three months ended September 30th, 2005, the Company capitalized \$0.3 million of general and administrative costs (9

months ended September 30th: \$0.7 million). Capitalized costs of \$1.5 million relating to unproved properties have been excluded from the depletion calculation. Future development costs on proved undeveloped reserves of \$43.5 million are included in the base for the current quarter's depletion and depreciation calculation.

Interest expense

Interest expense includes interest on the loan facility put in place to fund the acquisition of RF Energy, on the crude oil sales prepayment facility and on the BNP Paribas loan put in place in September to replace the original acquisition facility. Interest expense was \$0.3 million for the three months ended September 30th, 2005 (2004: nil) and \$1.5 million for the nine months ended September 30th, 2005 (2004: nil).

Depletion, depreciation and amortization expense

Depletion, depreciation and amortization expense for the three months ended September 30th, 2005 has increased to \$3.8 million from \$1,845 for the same period of 2004 as a result of the acquisitions of operations in Kazakhstan and Russia.

Depletion expense has been calculated in accordance with the Company's accounting policies set out herein. The base for the country-by-country depletion calculations include amounts resulting from the respective acquisition purchase price allocations.

Future development costs and proved reserve estimates are derived from the respective independent reserve reports for Kazakhstan and Russia. Future development costs on proved undeveloped reserves of \$32.0 million for Kazakhstan and \$11.5 million for Russia are included in the depletion calculation.

Capital expenditures

The major investments made by the Company during 2005 were the acquisition of a 50% share in RF Energy and 100% of Altius. Significant development programs continued in the third quarter in both Russia and Kazakhstan with capital expenditures of \$1.1 million and \$5.4 million respectively.

SHARE CAPITAL

As of September 30th, 2005 and as of the date of this report the Company had the following securities outstanding:

As at:	Sept. 30 th , 2005	Nov. 18 th , 2005
Common Shares	170,040,502	170,640,502
Exchangeable Shares of Arawak Acquisition Inc.	2,384,696	2,384,696
Stock Options	6,325,000	5,725,000
Total	178,750,198	178,750,198

Of the 6,325,000 stock options outstanding as of September 30th, 2005, 2,625,000 were vested and fully exercisable. As of November 18th, 2005, a total of 5,725,000 stock options were outstanding, of which 2,025,000 were vested and fully exercisable.

LIQUIDITY AND CAPITAL RESOURCES

The levels of cash, current assets and current liabilities as at September 30th, 2005 and December 31st, 2004 are as set out below:

(In thousands of US dollars)	Sept. 30th, 2005	Dec. 31st, 2004
As at:		
Cash and cash equivalents	25,177	1,345
Total current assets	38,407	1,393
Total current liabilities	10,928	1,616
Net current assets	27,479	(223)

The Company had working capital of \$27.5 million at September 30th, 2005 and negative working capital of \$0.2 million at December 31st, 2004.

The Company's cash deposits are held principally in US dollars and are managed centrally. Surplus funds are placed on time deposit. Limited funds are kept in the Azerbaijan Republic or, subsequent to the acquisitions of RF Energy and Altius, in Russia or Kazakhstan respectively.

A share placement of 28 million shares at Cdn. \$2.10 per share was completed on March 18th, 2005, resulting in net proceeds after underwriters' fees of \$45.8 million (Cdn. \$55.2 million). From this amount, \$29 million was used to reduce group indebtedness and the balance has been retained to fund, in part, the 2005 capital expenditures program, of which the Company's share is expected to be \$32 million in total (\$18.2 million in Kazakhstan, \$7.3 million in Russia and \$6.5 million in Azerbaijan). The balance of the 2005 capital expenditures program will be funded from operating cash flow.

On September 1st, 2005, Arawak's associated company PNG, which is owned via the Company's 50% interest in RF Energy, entered into a \$51.0 million borrowing base facility agreement with BNP Paribas ("BNP Facility"). The funds borrowed by PNG have been remitted to the shareholders of RF Energy, and Arawak has used its portion to repay the borrowings from Vitol Holding B.V. that Arawak incurred to finance the acquisition of its interest in RF Energy, and to supplement the Company's cash balances. The facility carries interest at LIBOR plus 4.4% and is repayable by September 1st, 2010, with the first repayment due on July 1st, 2006. There are no penalties for early repayment and in certain circumstances PNG is required to accelerate repayment. PNG, RF Energy and Arawak have granted certain security as part of this borrowing, including a guarantee of 50% of PNG's obligations by Arawak.

The Company incurred certain costs and expenses on behalf of PNG in negotiating and establishing the BNP Facility, including a structuring fee of \$0.5 million and fees and expenses incurred on behalf of PNG and BNP Paribas totalling \$0.6 million. These amounts have been capitalised and will be amortised over the life of the loan.

The Company continues to seek additional business opportunities in Kazakhstan, Russia and 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)						
Quarter ended	Total Revenues	Income (loss) before extraordinary items	Net income (loss)	Net Income (loss) Per Common Share		
				Basic	Fully Diluted	
2005 September 30th	27,575	7,355	7,355	0.043	0.041	
June 30 th	13,756	566	566	0.003	0.003	
March 31 st	13,419	894	894	0.006	0.006	
2004 December 31 st	-	(198)	(198)	(0.002)	(0.002)	
September 30 th	-	(596)	(596)	(0.006)	(0.006)	
June 30 th	-	(328)	(328)	(0.004)	(0.004)	
March 31 st	-	(363)	(363)	(0.004)	(0.004)	
2003 December 31 st	-	667	667	0.007	0.007	

RELATED PARTY TRANSACTIONS

Business transactions

On January 7th, 2005, the Company completed two business transactions which are considered related party transactions.

The first was the acquisition of 50% of the shares of RF Energy, the holding company of PNG. The 50% stake was acquired from an affiliate of Rosco S.A. (the Company's largest shareholder). The consideration paid by Arawak was \$40.3 million in cash. The consideration and transaction costs were satisfied by drawing from a loan facility with Vitol Holding B.V. (also an affiliate of Rosco S.A.), as described below.

The second transaction, also completed on January 7th, 2005, was the acquisition of all of the outstanding shares of Altius in consideration for the issuance by Arawak of 37,374,480 common shares and the issuance by Arawak Acquisition Inc. (a wholly-owned subsidiary of Arawak incorporated for the purposes of the Altius transaction) of 13,873,971 exchangeable shares. These exchangeable shares are exchangeable for Arawak common shares on a one-for-one basis on or before January 7th, 2007. The Altius transaction will result in the issuance by Arawak of an aggregate of 51,248,451 shares, including 27,555,986 common shares issued to Rosco S.A., which owned 45.3% of Altius prior to the transaction.

Loan from Vitol Holding B.V. - Tranche A

Interest expense for the three months ended September 30th, 2005 includes \$0.181 million related to Tranche A of the loan provided by Vitol Holding B.V. The loan and accrued interest was repaid in full during the third quarter and there is a nil balance at September 30th, 2005.

Loan from Vitol Holding B.V. - Tranche B

Interest expense for the three months ended September 30th, 2005 includes \$0.112 million related to Tranche B of the loan provided by Vitol Holding B.V. The loan and accrued interest was repaid in full during the third quarter and there is a nil balance at September 30th, 2005.

Crude oil sales

Revenues from Russian and Kazakhstan export crude oil sales during the three months ended September 30th, 2005 received from Vitol S.A. (an affiliate of Rosco S.A.) were \$21.7 million. Accounts receivable at September 30th, 2005 includes revenues from export crude oil sales to Vitol S.A. of \$4.3 million.

Crude oil sales prepayment facility

There were no drawdowns in the crude oil sales prepayment facility provided by Vitol S.A. and the outstanding balance at September 30th, 2005 is nil. Related interest expense for the current quarter is nil and there are no related accounts payable and accrued liabilities outstanding at September 30th, 2005.

Price insurance

Put options were purchased from Vitol S.A. for \$0.12 million during the first quarter of 2005 for price insurance for the period from March through to December 2005. An amount of \$0.036 million was charged to earnings in the third quarter of 2005. Prepaid expenses at September 30th, 2005 include \$0.036 million related to the put options.

Legal fees

During the three months ended September 30th, 2005, the Company incurred legal fees totalling \$0.067 million (three months ended September 30th, 2004: \$0.257 million) from a legal firm of which a director of the Company is a partner. Legal fees included in accounts payable and accrued liabilities are \$0.016 million as at September 30th, 2005 and \$0.2 million as at December 31st, 2004.

Loan One to associate

Interest revenue on Loan One to Commonwealth Gobustan Limited ("CGL"), during the three months ended September 30th, 2005 was \$0.041 million (three months ended September 30th, 2004: \$0.060 million). There were no repayments or drawdowns during the three months ended September 30th, 2005 (repayments for three months ended September 30th, 2004: \$0.068 million, drawdowns for three months ended September 30th, 2004: nil).

Loan Two to associate

Interest revenue on Loan Two to CGL during the three months ended September 30th, 2005 was \$0.153 million (three months ended September 30th, 2004: nil). There were no repayments during the three months ended September 30th, 2005 (three months ended September 30th, 2004: nil). An amount of \$1.950 million was drawn down during the three months ended September 30th, 2005 (drawdowns for three months ended September 30th, 2004: \$0.836 million).

Transactions with shareholder

During the three months ended September 30th, 2005, the Company reimbursed the Vitol group, of which Rosco S.A. is an affiliate, for transactions with a value of \$0.785 million (three months ended September 30th, 2004: \$0.075 million) which were all charged at cost. The balance owed to the Vitol group at September 30th, 2005 was \$0.136 million (December 31st, 2004: \$0.076 million).

Standby facility

Included in the current liabilities acquired from Altius in 2005 was a \$3.6 million standby financing facility provided by Vitol S.A. which charged 7% interest per annum. The standby facility and related accrued interest was repaid in full in January 2005.

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

INVESTMENT IN AZERBAIJAN

Pilot oil production continued in the third quarter from the South West Gobustan fields and, together with crude oil inventory at the beginning of the period, two sales totalling approximately 5,400 barrels were made via SOCAR's pipeline for export to Novorossiysk. An additional 5,250 barrels were in inventory as of the quarter end and will be sold in the fourth quarter 2005.

Revenue from test production for the three months ended September 30th, 2005 of \$0.335 million (three months ended September 30th, 2004: \$0.166 million) has been offset against capitalized costs and not recognized as turnover.

In the third quarter, Arawak's non-operated associate GOCL drilled the Duvanny 108 well in the Coastal block of the South West Gobustan fields to a depth of 3,800 meters, and encountered strong gas and oil shows. This well is expected to be put on test by the end of November. Following the completion of this well, the rig is being moved back to Kyanizadag to sidetrack Kyanizadag 101 and to drill to the original target depth, so that the exploration section can be fully appraised. Once this operation is complete, the well will be logged and tested, with results expected towards the end of 2005.

The installation and commissioning of gas facilities in Azerbaijan is continuing to progress, albeit with some delays, and first gas is expected in mid-December 2005.

CRITICAL ACCOUNTING ESTIMATES AND ADOPTION OF NEW ACCOUNTING POLICIES

Principles of consolidation

The Company's unaudited consolidated financial statements have been prepared in US dollars following Canadian generally accepted accounting principles and include the financial statements of Arawak and its wholly owned subsidiaries, which are registered under the laws of Anguilla (British West Indies), the Netherlands, Kazakhstan, British Columbia, Alberta & Ontario (Canada) and England & Wales.

Operations in Russia are conducted through a joint venture and accordingly, these financial statements reflect only the Company's proportionate interest.

The Company's operations in Azerbaijan are recognized as an equity investment and accordingly, these financial statements reflect the Arawak share of the net results and net assets.

Foreign currency translation

In Kazakhstan, 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 amortization, which are translated at historic rates; and 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 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; and exchange gains or losses are recorded directly as 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 capitalized. Such costs include land acquisition, geological and geophysical, drilling of both productive and unproductive wells, plant and equipment and administration costs reasonably allocable to these activities. Proceeds from disposals are recorded as a reduction of the related expenditures without recognition of a gain or loss unless the disposal would result in a change of 20 percent or more in the depletion rate.

Capitalized 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 capitalized 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 value of unproved properties at the lower of cost and net realizable value. An impairment loss is recognized when the carrying amount is not recoverable and exceeds its fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected from the proved reserves.

Asset retirement obligation

The Company recognizes 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 on a unit-of-production basis over the life of the proved reserves. 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 expenditures incurred for site reclamation and abandonment are charged against the liability to the extent it exists on the balance sheet with the difference recognized as a gain or loss in the period in which settlement occurs.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles 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 income taxes. Under this method, income tax assets and liabilities are recognized 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 recognized in income in the period of the change.

Stock based compensation costs

Compensation expense is based on the fair value at the grant date and recognized in income over the vesting periods of the respective options for options granted on or after January 1, 2003 with a corresponding increase to contributed surplus. Any consideration received upon exercise of the options, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

Financial instruments and financial risk

The fair value of cash, accounts receivable, other current assets, accounts payable and accrued liabilities and the crude oil prepayment facility approximate their carrying values due to the short term nature of these instruments. The fair value of the funding of associate and long term debt approximate their carrying amounts as applicable interest rates approximate market interest rates. The other long-term liabilities are non-interest bearing and therefore do not approximate fair value, however the fair value cannot be practically estimated.

The Company uses various financial instruments to manage its crude oil price exposure. The instruments are not used for trading purposes. The Company hedges its exposure to petroleum commodity prices by entering into crude oil options when deemed appropriate. These derivative contracts are not accounted for as hedges and are recorded at fair value on the balance sheet with changes in fair value recognized in earnings. Premiums paid are deferred and amortized to earnings over the term of the contract.

COMMITMENTS AND CONTINGENT LIABILITIES

Work commitments

Arawak has contractual work commitments for each of its three oilfields in Kazakhstan as summarized below:

	2000-2005	2006	2007	2008	Total
Besbolek	2.9	1.0	1.0	1.0	5.9
Karataikyz	2.8	0.7	0.7	0.6	4.8
Akzhar	32.5	-	-	-	32.5
Total commitments	38.2	1.7	1.7	1.6	43.2
Expenditures to date	37.3	-	-	-	37.3
Outstanding commitments	0.9	1.7	1.7	1.6	5.9

Work programs for 2005

The 2005 work programs have been approved by the Government for each field and contain any work commitment shortfalls from prior years. Although management expects that meeting these earlier work commitment shortfalls will rectify the breaches, management cannot say with certainty that there will not be any further ramifications which might affect these financial statements. Non-fulfilment of contractual work commitments could result in other actions by the Government, including suspending or revoking licenses.

Carried working interest

Arawak has 100% of the Besbolek and Karataikyz Licenses and Contracts in Kazakhstan subject to a minority interest partner receiving a 10% interest in the project net cash flow after payout of capital invested. The Company is to provide 100% of the start-up capital for the project.

BUSINESS RISKS

As a junior oil and gas exploration, development and production company, Arawak is subject to risks and uncertainties inherent to the oil and gas industry and to risks inherent to a company of its size and at its 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.

Political and economic conditions in Russia and Kazakhstan

Whilst there have been improvements in the economic situation in Russia and Kazakhstan 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 and Kazakhstan 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 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. Management is unable to predict the extent and duration of these uncertainties, nor quantify the impact, if any, on these financial statements.

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 it is successful, that the terms on which such funds are obtained will be advantageous to Arawak.