



Annual Report
2005

HIGHLIGHTS

	Year ended December 31,	
	2005	2004
Production:		
Gas (thousand cubic feet per day)	71	68
Oil and NGLs (barrels per day)	11	12
Boe (barrels oil equivalent per day)	23	23
Revenue (\$)	493,616	389,524
Funds flow from operations (\$)	200,319	130,281
Net income (\$)	335,476	3,684
Per diluted share amounts:		
Funds flow from operations (\$/share)	\$0.02	\$0.01
Net income (\$/share)	\$0.03	-
Number of shares outstanding:		
Basic weighted average	11,912,654	8,871,558
Diluted weighted average	12,556,186	8,939,742
End of Period	14,871,558	8,871,558

MANAGEMENT DISCUSSION AND ANALYSIS

Management discussion and analysis of the financial condition and results of operations of the Company should be read in conjunction with the Company's audited financial statements and related notes for the year ended December 31, 2005, and the year ended December 31, 2004. Additional information about the Company, its operations and history including the Company's Annual Information Form may be found as filed on the System for Electronic Data Analysis and Retrieval at www.sedar.com. The calculation of barrels of oil equivalent ("boe") is based on a relative energy content conversion ratio of six thousand cubic feet ("mcf") of natural gas to one barrel of oil. Production volumes reported are the Company's interest before royalties. All amounts are expressed in Canadian dollars unless otherwise stated.

This discussion and analysis may contain forward-looking information that is subject to known and unknown risks, uncertainties and other factors. Readers are cautioned that actual future results, performance or achievements may be different from those expressed or implied and the difference may be material.

Non-GAAP Measures

The financial data presented has been prepared in accordance with Canadian generally accepted accounting principles (GAAP) except for the term "funds flow from operations". Funds flow from operations has been presented for information purposes only and should not be considered an alternative to, or more meaningful than cash flow from operating activities as determined in accordance with GAAP. The determination of the Company's funds flow from operations may not be comparable to the same reported by other companies. Funds flow from operations refers to net income before non-cash charges from the statement of operations plus non-cash expenses and excluding the change in non-cash operating working capital and abandonment costs incurred for the period. Funds flow from operations per share was calculated using the same weighted average shares outstanding used in calculating net income per share.

Internal Controls

The Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure and procedures and concluded that these disclosure controls and procedures were effective as of December 31, 2005 and in respect of the year then ended.

Business Environment and Risks

In addition to being impacted by operational risks normally associated with oil and gas operations, the Company has not hedged its production and is directly affected by commodity price fluctuations. World and Canadian crude oil prices and Canadian natural gas prices strengthened significantly in 2005 over 2004 levels. Both commodities are at historically high price levels.

	Q4 '05	Q3 '05	Q2 '05	Q1 '05	Q4 '04	Q3 '04	Q2 '04	Q1 '04
West Texas Intermediate for crude oil (US\$/bbl)	\$60.14	\$63.18	\$53.18	\$49.44	\$48.35	\$43.93	\$38.74	\$35.12
Edmonton posted reference for crude oil (C\$/bbl)	71.74	76.81	66.09	61.58	58.52	56.04	50.85	45.67
AECO-C for natural gas (C\$/mcf)	11.68	9.38	7.37	6.90	6.73	6.22	7.00	6.43

Operations

The Company produced petroleum and natural gas from Boundary Lake and Lochend in Alberta since June 27, 2003 and began accounting for production of petroleum and natural gas in the third quarter of 2003.

Selected Annual Operating Data

	Year ended December 31, 2005	Year ended December 31, 2004	Six months ended December 31, 2003
Crude oil and natural gas liquids production (barrels)	3,921	4,304	2,191
Natural gas production (mcf)	25,907	24,941	12,690
Barrels of oil equivalent (boe)	8,239	8,461	4,306
Per day (boe per day)	23	23	23
Price per barrel (\$/barrel)	\$62.72	\$49.42	\$36.70
Price per mcf (\$/mcf)	9.56	7.09	6.30
Price per boe (\$/boe)	59.91	46.04	37.25
Royalty rate	24.8%	23.8%	25.0%
Operating costs per boe	\$10.79	\$7.32	\$4.75
General and admin per boe	16.85	12.90	13.23
Revenue	\$493,616	\$389,524	\$160,413
Operating netback	282,252	234,905	99,866
Funds flow from operations	200,319	130,281	42,889
Net income (loss)	335,476	3,684	(4,975)
Basic and diluted net income (loss) per share	0.03	—	—
Basic weighted average shares	11,912,654	8,871,558	8,871,558
Diluted weighted average shares	12,556,186	8,939,742	8,947,941
Total assets as at period end	7,524,256	768,630	689,998

Operations (continued)

The Company's production base has been very stable since 2003. The Company recorded a strong operating netback (revenue less royalties and operating costs) throughout 2005, amounting to \$282,252 from its properties for the year. This improvement of 20% over 2004 was primarily due to a 30.1% increase in prices in 2005 over the 2004 levels, partially offset by an increase in operating expense rates to \$10.79 per boe from \$7.32 per boe, a 2.6% decline in production, and an increase in the royalty rate to 24.8% from 23.8%. Prices in 2005 reflect a 60.8% increase over 2003 levels.

During 2005, operating expenses rose by 52.2% over 2004 levels. Approximately half of this increase is considered to be non-recurring with the balance reflecting increased service costs in the Company's operating areas at Boundary Lake and Lochend.

With stable production and increased prices, the Company achieved record revenue, operating netback and funds flow from operations in 2005. Net income in 2005 increased significantly as the Company recorded a future tax recovery in the fourth quarter of 2005 to recognize previously unrecognized income tax assets held by the Company available to offset taxable income in future periods.

Selected Quarterly Operating Data								
	Q4 '05	Q3 '05	Q2 '05	Q1 '05	Q4 '04	Q3 '04	Q2 '04	Q1 '04
Crude oil and natural gas liquids production (barrels)	922	969	1,024	1,006	992	1,182	1,147	983
Natural gas production (mcf)	6,272	6,460	6,630	6,545	6,097	7,036	5,363	6,445
Barrels of oil equivalent (boe)	1,967	2,046	2,129	2,097	2,008	2,355	2,041	2,057
Per day (boe per day)	21	22	23	23	22	26	22	23
Price per barrel (\$/barrel)	\$62.14	\$69.36	\$62.25	\$57.32	\$54.00	\$53.25	\$45.08	\$45.26
Price per mcf (\$/mcf)	12.79	9.86	8.23	7.53	7.05	7.11	7.03	7.15
Price per boe (\$/boe)	69.89	63.98	55.56	51.00	48.09	47.98	43.82	44.02
Royalty rate	23.3%	23.3%	26.3%	27.0%	22.9%	20.1%	26.2%	27.0%
Operating costs per boe	\$12.39	\$13.98	\$9.43	\$7.54	\$7.79	\$8.19	\$6.04	\$7.13
General and admin per boe	35.27	9.14	15.70	8.25	13.57	5.17	17.42	16.60
Revenue	\$137,480	\$130,896	\$118,293	\$106,947	\$96,573	\$112,989	\$89,396	\$90,566
Operating netback	81,112	71,757	67,133	62,250	58,852	71,036	53,604	51,413
Funds flow from operations	38,535	78,614	36,403	46,767	33,200	59,907	18,856	18,318
Net income (loss)	291,045	4,841	14,325	25,265	13,452	21,529	(14,989)	(16,308)
Basic and diluted net income (loss) per share	0.02	-	-	-	-	-	-	-
Basic weighted avg. shares (000s)	14,872	14,872	8,937	8,872	8,872	8,872	8,872	8,872
Diluted weighted avg. shares (000s)	15,723	15,709	9,430	9,017	8,984	8,987	8,937	8,970
Total assets as at period end (000s)	7,524	7,339	7,181	835	769	741	700	707

Production from the Company's properties at Boundary Lake and Lochend has been very stable. Year-over-year declines as measured from the fourth quarter of 2005 versus the fourth quarter of 2004 approximate 2.0%. The Company has not drilled or tied-in any new wells on these properties since the properties were acquired in 2003.

Operations (continued)

In the fourth quarter of 2005, high prices for natural gas sparked the Company's revenue to rise by 42.4% over the fourth quarter of 2004 and reach a record quarterly revenue and operating netback. Funds flow from operations in the fourth quarter of 2005 was 16% higher than the fourth quarter of 2004 and net income, primarily due to a future income tax benefit recorded in the fourth quarter of 2005, reached its highest quarterly level in the Company's history.

In the second quarter of 2005, the Company issued 6,000,000 common shares for gross proceeds of \$6,400,000 raising the number of outstanding shares to 14,871,558. This significantly increased the Company's total assets in the second quarter of 2005. No further shares were issued in the remainder of the year.

Overhead

General and administration costs in the fourth quarter increased from the Company's third quarter due to year-end professional fees and an increase in fees charged to the Company via its management and technical services contract with Grizzly Resources Ltd., a related company by virtue of common management. The Company is charged fees for services related to capital and operating activities. The higher fee component reflects the increased capital expenditure activity in the Company's Pembina field. General and administration charges for 2005 are higher than 2004 due to these higher fees and is also related to the increased capital expenditure activity at Pembina. These fees were \$24,734 in the fourth quarter and \$40,910 for the entire 2005 year, compared to \$9,746 in the third quarter of 2005 and \$15,921 for all of 2004.

Stock-based compensation charges in 2005 are higher than in 2004 due to the higher number of stock options outstanding in 2005 versus 2004.

Depletion, Depreciation and Amortization

	Q4 '05	Q3 '05	Q2 '05	Q1 '05	Q4 '04	Q3 '04	Q2 '04	Q1 '04
Depletion and depreciation	8,240	10,836	11,410	11,237	10,790	23,608	18,900	20,800
Asset retirement expense	1,759	1,764	(707)	2,224	1,534	2,942	3,117	3,832
Depletion and depreciation per boe	4.19	5.30	5.36	5.36	5.37	10.02	9.26	10.11
Actual abandonment costs incurred	2	1,613	22	4,929	839	-	-	-

The Company's depletion and depreciation rate declined in the fourth quarter of 2005 to \$4.19 per boe from \$5.30 per boe in the third quarter due to positive revisions of reserve estimates, particularly in the Company's Lochend producing area. The Company's average rate in 2005 was \$5.06 per boe, a 42% drop from 2004 due to this positive reserve revision plus other positive reserve revisions primarily attributed to the Company's Boundary Lake producing area in the fourth quarter of 2004.

Commencing in 2004 and finishing in 2005, the Company reclaimed a non-producing well at Boundary Lake. The well had ceased production prior to the Company's acquisition of the area in 2003.

Capital Expenditures

(\$000s)	Q4 '05	Q3 '05	Q2 '05	Q1 '05	Q4 '04	Q3 '04	Q2 '04	Q1 '04
Acquisition	\$ -	\$104	\$2,527	-	-	-	-	-
Drilling	701	102	-	-	-	-	-	-
Facilities	-	-	1	-	-	-	-	-
Total	\$701	\$206	\$2,528	-	-	-	-	-

Capital Expenditures (continued)

At the end of the second quarter, the Company acquired a significant land position in the prolific Pembina Nisku trend from Grizzly Resources Ltd., a related company by virtue of common management. This acquisition approximated \$2.5 million for land and seismic. Just over \$800,000 was spent on drilling in the Pembina field in the third and fourth quarters. This new area dominated the Company's capital expenditures for the year. At the end of 2005, the Company holds working interests of 6.94% to 18.75% on 8,000 acres of acreage at Pembina.

Subsequent to the year ended December 31, 2005, the Company entered into a second joint venture with Grizzly Resources Ltd., a related company by virtue of common management, to acquire and develop 6,560 acres in southwest Saskatchewan. The Company holds a 50% interest in the new area and will have a 50% working interest in the construction of a gas plant with a capacity of 14 million cubic feet per day. The plant is anticipated to be completed in the second quarter of 2006. The Company successfully drilled eight wells on the acreage in the first quarter of 2006 and anticipates production from this new area to be on stream in the second quarter of 2006. In addition, the Company expects to drill an additional 30 wells in the winter of 2006/07.

Also subsequent to the year ended December 31, 2005, the Company shot three dimensional seismic over a second phase of the Pembina development and pursued and acquired an 18.75% interest in 640 acres of additional acreage.

Taxation

In the fourth quarter of 2005, the Company recognized the tax assets associated with its unused non-capital losses and unused resource tax pools that are available for deduction in calculating taxable income in future periods. As a result, the Company recorded a \$460,890 future tax recovery in the fourth quarter of 2005.

The Company, pursuant to the flow-through share component of its equity issue in the second quarter of 2005, committed to renouncing qualifying expenditures of \$2,400,000 to be incurred prior to December 31, 2006. At December 31, 2005, expenditures of \$802,255 had been incurred with the balance of this commitment scheduled for 2006.

At December 31, 2005, the Company has unused non-capital losses of approximately \$550,000, with expiries spanning from 2006 to 2009, plus resource tax pools, net of future renunciation commitments, of approximately \$2.0 million.

Liquidity and Capital Resources

The Company raised gross proceeds of \$6.4 million through the issuance of 6 million shares in a private placement that closed on June 29, 2005. Proceeds from the issue are being used to finance the acquisition and development of the Company's interest in acreage in the Nisku trend at Pembina in Alberta. The project is anticipated to continue into 2008. The increased cash reserves have resulted in \$56,890 of interest income earned in 2005, up from \$4,506 earned in 2004.

The Company has been generating positive net income and consistently generating positive funds flow from its operations. At December 31, 2005, it has \$3.5 million of positive working capital with no long or short term debt outstanding. In addition, the Company negotiated a revolving production loan facility with a financial institution in 2005. The Company has not borrowed any of the \$0.4 million debt facility and has not incurred interest expenses for the past two years.

Liquidity and Capital Resources (continued)

Subsequent to the year ended December 31, 2005, the Company entered into a joint venture with Grizzly Resources Ltd., a company related by virtue of common management, to acquire and develop 6,560 acres in southwest Saskatchewan. The Company has a 50% working interest on the acreage. The Company successfully drilled eight of eight wells in the area in the first quarter of 2006 and anticipates a significant increase in funds flow from operations as these wells commence production in the second quarter of 2006.

The Company will require financial resources to complete its 50% working interest in the additional 30 wells and 14 million cubic feet per day capacity gas plant construction planned for the area and the Company anticipates having a working capital deficiency by the end of the first quarter of 2006. The Company may also pursue expansion opportunities in its operating areas. Management is confident that debt and equity financing will be available on satisfactory terms to meet the objectives of the Company in this area.

Petroleum and Natural Gas Reserves

	Year Ended December 31, 2005			Year Ended December 31, 2004		
	Oil & Liquids (mbbls)	Natural Gas (mmcf)	Barrels Equivalent (mboe)	Oil & Liquids (mbbls)	Natural Gas (mmcf)	Barrels Equivalent (mboe)
Proven reserves						
Opening balance	30	191	62	22	122	42
Production	(4)	(26)	(8)	(4)	(25)	(8)
Revisions	2	78	15	12	94	28
Closing balance	28	243	69	30	191	62
Probable reserves						
Opening balance	7	54	16	6	35	12
Revisions	(3)	(14)	(6)	1	19	4
Closing balance	4	40	10	7	54	16
Proven plus probable reserves						
Opening balance	37	245	78	28	157	54
Production	(4)	(26)	(8)	(4)	(25)	(8)
Revisions	(1)	64	9	13	113	32
Closing balance	32	283	79	37	245	78

Reserve estimates reflect only the Company's interests at Boundary Lake and Lochend. No amounts are included in this report for the Company's interests at Pembina or for its acreage in southwest Saskatchewan that was acquired and commenced development subsequent to the year-end.

Reserve estimates, primarily on the Company's Lochend property were positively revised in the fourth quarter of 2005 following an external reserve evaluation effective December 31, 2005. Reserve estimates on the Company's property at Boundary Lake and to a lesser extent Lochend were also positively revised in the fourth quarter of 2004 following an external reserve evaluation performed effective December 31, 2004. Both external reserve evaluations were performed by GLJ Petroleum Consultants.

Present Value Continuity of Petroleum and Natural Gas Reserves

The Company's estimates of future cash flows were also positively impacted by the positive revision in reserve estimates and to a lesser extent by increased estimates of petroleum and natural gas prices anticipated in future periods.

The value of the Company's petroleum and natural gas reserve estimates from the Company's external reserve evaluation performed by GLJ Petroleum Consultants, effective December 31, 2005 and as measured by the estimates of future cash flows of proved reserves and discounted by 10%, based on forecast prices, was measured at \$1,028,000, up from \$815,000 at December 31, 2004. Technical revisions raised this measure by 34% and accounted for \$277,000 of the increase with price revisions of a positive 17% adding an additional \$136,000. Cash flow earned from the properties and changes in present value account for the remaining amounts.

The value of the Company's petroleum and natural gas reserve estimates measured by the estimates of future cash flows of proved plus probable reserves and discounted by 10%, based on forecast prices, amounted to \$1,095,000, up from \$946,000 at December 31, 2004. Technical revisions as noted above had the most significant impact on this total, improving this measure by 23% or \$213,000 of the increase. Price revisions of a positive 13% added an additional \$123,000. Cash flow earned from the properties and changes in present value account for the remaining amounts.

	Year ended December 31, 2005 ⁽¹⁾		Year Ended December 31, 2004	
	PV 0%	PV 10%	PV 0%	PV 10%
	(\$000s)	(\$000s)	(\$000s)	(\$000s)
Proven reserves				
Opening balance	1,206	815	668	494
Cash flow	(282)	(282)	(235)	(235)
Changes in present value	–	82	–	49
Price revisions	150	136	168	67
Technical revisions	376	277	605	440
Closing balance	1,450	1,028	1,206	815
Probable reserves				
Opening balance	353	131	203	98
Changes in present value	–	13	–	10
Price revisions	(69)	(13)	48	(5)
Technical revisions	(79)	(64)	102	28
Closing balance	205	67	353	131
Proven plus probable reserves				
Opening balance	1,559	946	871	592
Cash flow	(282)	(282)	(235)	(235)
Changes in present value	–	95	–	59
Price revisions	81	123	216	62
Technical revisions	297	213	707	468
Closing balance	1,655	1,095	1,559	946

⁽¹⁾ Based on forecast prices prepared by GLJ Petroleum Consultants, effective January 1, 2006.

Outlook

The Company is in the first phase of a three-phase exploration and development project at Pembina in Alberta, where the Company is targeting oil along the prolific Pembina Nisku fairway. The Company has between 6.9% and 12.5% working interests in the first phase and 18.75% working interests throughout the second and third phases of the currently undeveloped project. Successful wells along the prolific fairway have produced in excess of 1,000 boes per day of oil and associated natural gas.

Increasing regulatory requirements prior to obtaining licenses to drill at Pembina has extended certain timelines for the Company's anticipated drilling program. As a result, the Company sought new areas to deploy existing cash resources and increase its investment returns.

Subsequent to the end of the year, the Company acquired a 50% working interest in a new area in southwest Saskatchewan. On this new acreage, the Company successfully drilled eight of eight wells in the first quarter of 2006 achieving a 100% success rate. Production from these wells is anticipated to commence in the second quarter of 2006 and is expected to significantly increase the Company's production base. Production will flow through a 14 million cubic feet per day gas plant currently under construction. The Company's working interest in the plant is 50%. In addition, the Company intends to drill a minimum of 30 wells in this area in the winter of 2006/07.

The Company's management continues to pursue expansion opportunities to create shareholder value.

Dated: April 7, 2006



**KENWAY
MACK
SLUSARCHUK
STEWART_{LLP}**
Chartered Accountants
www.kmss.ca

Auditors' Report

To: The Shareholders of
Ironhorse Oil & Gas Inc.

We have audited the balance sheets of **Ironhorse Oil & Gas Inc.** as at **December 31, 2005 and 2004** and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
March 13, 2006

Kennway Mack Slusarchuk Stewart LLP

Chartered Accountants

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IRONHORSE OIL & GAS INC.

Balance Sheets

	December 31 2005	December 31 2004
ASSETS		
Current Assets:		
Cash	\$ 3,719,903	\$ 396,871
Accounts receivable	47,323	34,541
Prepaid expenses	26,048	4,969
	3,793,274	436,381
Property and equipment (note 3)	3,730,982	332,249
	\$ 7,524,256	\$ 768,630

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities:		
Accounts payable and accrued liabilities	\$ 317,957	\$ 45,286
Asset retirement obligation (note 4)	113,140	109,151
Future income taxes (note 5)	413,929	-
	845,026	154,437
Shareholders' equity:		
Share capital (note 6)	9,620,765	4,170,174
Contributed surplus (note 6)	320,044	41,074
Deficit	(3,261,579)	(3,597,055)
	6,679,230	614,193
	\$ 7,524,256	\$ 768,630

Commitments (note 5)

See accompanying notes to the financial statements.

Approved on behalf of the board:

(signed) "Larry J. Parks"

Director

(signed) "James K. Wilson"

Director

IRONHORSE OIL & GAS INC.

Statements of Operations and Deficit

	Year ended December 31 2005	Year ended December 31 2004
Revenue	\$ 493,616	\$ 389,524
Royalties	(122,488)	(92,690)
	371,128	296,834
Other income	56,890	4,506
	428,018	301,340
Expenses		
Operations	88,876	61,929
General and administration	138,823	109,130
Stock-based compensation	278,970	41,074
Depletion, depreciation and amortization	46,763	85,523
	553,432	297,656
Income (loss) before income taxes	(125,414)	3,684
Future income tax recovery (note 5)	460,890	-
Net income	335,476	3,684
Deficit, beginning of the year	(3,597,055)	(3,600,739)
Deficit, end of the year	\$ (3,261,579)	\$ (3,597,055)
Net income per share (note 7)		
Basic	\$ 0.03	\$ -
Diluted	\$ 0.03	\$ -

See accompanying notes to the financial statements.

IRONHORSE OIL & GAS INC.

Statements of Cash Flows

	Year ended December 31 2005	Year ended December 31 2004
Cash flows from operations		
Net income	\$ 335,476	\$ 3,684
Add (deduct) items not affecting cash		
Depletion, depreciation and amortization	46,763	85,523
Future income tax recovery	(460,890)	-
Stock-based compensation	278,970	41,074
Funds flow from operations	200,319	130,281
Abandonment costs incurred	(6,566)	(839)
Changes in non-cash working capital (note 12)	50,638	24,133
	244,391	153,575
Cash flows from financing activities		
Issuance of common shares	6,325,410	-
Cash flows from investing activities		
Expenditures on property and equipment	(3,434,941)	-
Changes in non-cash working capital (note 12)	188,172	-
	(3,246,769)	-
Net increase in cash during the year	3,323,032	153,575
Cash, beginning of the year	396,871	243,296
Cash, end of the year	\$ 3,719,903	\$ 396,871

See accompanying notes to the financial statements.

IRONHORSE OIL & GAS INC.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

1. NATURE OF OPERATIONS

The Company was incorporated on September 18, 1972 in the Province of British Columbia and was continued under the Alberta Business Corporations Act on November 26, 2002. The Company is in the business of exploration for and production of petroleum and natural gas properties.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Petroleum and natural gas properties

Capitalized costs

The Company follows the full cost method of accounting, whereby all costs associated with the exploration for and development of petroleum and natural gas reserves are capitalized in a single Canadian cost centre. Such amounts include land acquisition costs, geological and geophysical expenditures, carrying charges of non-producing properties, costs of drilling productive and non-productive wells, site restoration and abandonment costs and administrative costs related to exploration and development activities.

Proceeds from the sale of properties are applied against capitalized costs and gains or losses are not recognized in the statement of operations unless the depletion and depreciation rate would be changed by 20% or more.

Impairment test

The Company calculates a ceiling test whereby the carrying value of its property and equipment is compared at each reporting period end to an estimate of undiscounted future net cash flow from the production of gross proved reserves plus the cost of unproven properties and major development projects excluded from depletion. Net cash flow is estimated using forecasted prices, less estimated costs directly associated with the development, production and sale of reserves. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess is recorded as a permanent impairment.

Depletion, depreciation and amortization

The capitalized costs of petroleum and natural gas properties plus future development costs, if any, are depleted and amortized using the unit-of-production method based on the Company's interest in proved reserves of petroleum and natural gas calculated before royalties. Estimated proved reserves are based on reports prepared by independent engineering consultants. Petroleum substances are converted to volumes of energy equivalent barrels of oil at a conversion rate of six thousand cubic feet ("mcf") of natural gas to one barrel of crude oil.

Costs associated with the acquisition and evaluation of significant unproved properties where there is no commercial production are excluded from amounts subject to depletion until such time as the properties are proved or become impaired.

IRONHORSE OIL & GAS INC.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Asset retirement obligation

The Company recognizes and measures the liabilities for obligations associated with the retirement of petroleum and natural gas properties when those obligations result from the acquisition, construction, development or normal operation of the asset. The obligation is measured at fair value and the related costs recorded as part of the carrying value of the related asset. In subsequent periods, the liability is adjusted for the change in present value and any changes in the amount or timing of the underlying future cash flows required for settlement of the obligation. The asset retirement costs included in petroleum and natural gas costs are depleted or amortized into income in accordance with the Company's policies pertaining to those assets.

(c) Interests in joint ventures

Substantially all of the Company's oil and gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(d) Future income taxes

The Company uses the liability method for accounting for future income taxes. Under the liability method, future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted tax rates and laws expected to apply when those differences reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

(e) Flow-through shares

Resource expenditure deductions funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. To recognize the foregone tax benefits to the Company, the future income tax liability and the carrying value of the shares issued are adjusted by the effect of the tax benefits renounced to subscribers in the period when the corresponding exploration and development expenditures are renounced.

(f) Stock based compensation

The Company uses the fair value method using the Black-Scholes option pricing model to account for stock options granted under its stock option plan. For options granted in respect of future services, compensation expense is recorded over the vesting period.

(g) Revenue recognition

Revenue from the production of petroleum and natural gas is recognized when deliveries of products are made to third parties.

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
For the Years Ended December 31, 2005 and 2004

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Use of estimates

Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. The amounts recorded for depletion and amortization of petroleum and natural gas properties and the provision for the asset retirement obligation and the ceiling test are based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. The fair value of stock options and the related stock-based compensation expense is based on estimates using the Black-Scholes option pricing model. 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 significant.

(i) Net income per share

Diluted per share amounts are calculated using the treasury stock method. Diluted calculations reflect the incremental common shares that would be issued upon exercise of dilutive options, warrants and equivalents assuming the proceeds would be used to repurchase shares at average market prices for the period. Anti-dilutive items are not included in the calculation.

3. PROPERTY AND EQUIPMENT

	December 31, 2005		
	Cost	Accumulated Depletion and Amortization	Net
Petroleum and natural gas properties	\$ 3,888,784	\$ 157,802	\$ 3,730,982

	December 31, 2004		
	Cost	Accumulated Depletion and Amortization	Net
Petroleum and natural gas properties	\$ 448,328	\$ 116,079	\$ 332,249

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
For the Years Ended December 31, 2005 and 2004

3. PROPERTY AND EQUIPMENT (continued)

In conducting the ceiling test as at December 31, 2005, the Company's estimated future cash flows exceeded the carrying value of the related petroleum and natural gas properties, after using certain assumptions pertaining to future commodity prices. Assumptions for crude oil refinery postings at Edmonton and for spot natural gas postings at AECO-C storage hub are consistent with the Company's December 31, 2005 reserve report as provided by GLJ Petroleum Consultants:

	Oil (\$/barrel)	Gas (\$/mcf)
2006	\$ 66.25	\$ 10.60
2007	64.00	9.25
2008	59.25	8.00
2009	55.75	7.50
2010	54.00	7.20
Thereafter	52.25 – 56.50	6.90 – 7.55

The Company's price forecasts at the wellhead reflect quality adjustments from these posted prices on a well by well basis.

During the year ended December 31, 2005, the Company has capitalized interest in the amount of \$27,730 (December 31, 2004 – nil) and no general and administrative costs (December 31, 2004 – nil).

The cost of unproved properties excluded from depletion in the year ended December 31, 2005 was \$3,446,145 (year ended December 31, 2004 – nil).

4. ASSET RETIREMENT OBLIGATION

	Year ended December 31 2005	Year ended December 31 2004
Asset retirement obligation, beginning of the year	\$ 109,151	\$ 98,565
Incurred in the year	5,515	–
Expenditures made on asset retirements	(6,566)	(839)
Change in present value during period	5,040	11,425
Asset retirement obligation, end of the year	\$ 113,140	\$ 109,151

The total undiscounted amount of cash flows required to settle the obligations as measured at December 31, 2005 is estimated to be \$163,921 (December 31, 2004 - \$160,310). These obligations are expected to be settled at various times over the 13 years subsequent to December 31, 2005. The credit-adjusted risk free rate at which the estimated cash flows were discounted was 8% during the year ended December 31, 2005 (December 31, 2004 – 8%) and the estimated inflation rate used to project future costs was 1.5% (December 31, 2004 – 1.5%).

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
For the Years Ended December 31, 2005 and 2004

5. INCOME TAXES

	Year ended December 31 2005	Year ended December 31 2004
Statutory tax rate	37.62%	37.87%
Anticipated tax expense (recovery)	\$ (47,181)	\$ 1,395
Increase (decrease) resulting from:		
Non-deductible crown royalties	26,008	23,539
Non-deductible stock-based compensation	104,949	15,555
Resource allowance	(14,630)	(10,428)
Tax rate changes	3,522	40,333
Valuation allowance	(533,558)	(70,394)
Future tax expense (recovery)	\$ (460,890)	\$ -

During the year ended December 31, 2005, the Company recorded a reversal of the remaining valuation allowance as the Company's remaining tax pools will more likely than not be utilized in future periods.

The components of the net future tax liability are as follows:

	December 31 2005	December 31 2004
Future income tax assets related to:		
Non-capital losses	\$ 206,657	\$ 276,708
Property and equipment	-	215,515
Asset retirement obligations	42,563	41,335
Share issue costs	22,449	-
Total future income tax assets	271,669	533,558
Future income tax liabilities related to:		
Property and equipment	(685,598)	-
Total future income tax asset (liability)	(413,929)	533,558
Valuation allowance	-	(533,558)
Future income tax asset (liability)	\$ (413,929)	\$ -

Pursuant to the Company's share issue in the year ended December 31, 2005, the Company has committed to renounce to investors qualifying expenditures incurred prior to December 31, 2006 of \$2,400,000. As at December 31, 2005, the Company has remaining commitments to renounce \$1,597,745 of qualifying expenditures prior to December 31, 2006.

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
For the Years Ended December 31, 2005 and 2004

6. SHARE CAPITAL

The Company has authorized unlimited common shares and unlimited first preferred shares. The outstanding share capital is as follows:

(a) Common Shares

	Year ended December 31, 2005	
	Number	Amount
Balance, beginning of the year	8,871,558	\$ 4,170,174
Issued during the year	4,000,000	4,000,000
Issued on a flow-through basis during the year	2,000,000	2,400,000
Share issue costs	—	(74,590)
Tax effect of flow-through shares issued	—	(902,880)
Tax effect of share issue costs	—	28,061
Balance, end of the year	14,871,558	\$ 9,620,765

	Year ended December 31, 2004	
	Number	Amount
Balance, beginning and end of the year	8,871,558	\$ 4,170,174

The Company is holding 679,049 common shares in escrow (December 31, 2004 – 1,351,049 shares) arising from two escrow agreements of 672,000 and 7,049 shares (December 31, 2004 – 1,344,000 and 7,049 shares). The former agreement provided for the escrow of the 2,240,000 shares issued pursuant to an asset purchase and sale closed June 27, 2003. The terms of the escrow agreement include a release of the shares from escrow over a three year period ending August 5, 2006. The latter agreement provides for the escrow of 7,049 shares subject to release upon approval by regulatory authorities.

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
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6. SHARE CAPITAL (continued)

(b) Stock Options

Under the Company's stock option plan, common share purchase options may be granted to directors, officers, staff and consultants. The Company may grant options to purchase common shares up to a maximum of 10% of the number of issued and outstanding common shares. The granted common share purchase options are subject to vesting requirements as determined upon granting and are subject to expiry five years following the date granted.

	Year ended December 31, 2005	
	Number Outstanding	Weighted Avg Price Per Share
Balance, beginning of the year	580,000	\$ 0.275
Granted during the year	903,500	1.274
Balance, end of the year	1,483,500	\$ 0.884
Exercisable, end of the year	320,000	\$ 0.257
	Year ended December 31, 2004	
	Number Outstanding	Weighted Avg Price Per Share
Balance, beginning of the year	460,000	\$ 0.225
Granted during the year	200,000	0.370
Cancelled during the year	(80,000)	0.225
Balance, end of the year	580,000	\$ 0.275
Exercisable, end of the year	126,667	\$ 0.225

(c) Contributed Surplus

	Year ended December 31 2005	Year ended December 31 2004
Contributed surplus, beginning of the year	\$ 41,074	\$ —
Stock-based compensation charged during the year	278,970	41,074
Contributed surplus, end of the year	\$ 320,044	\$ 41,074

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
For the Years Ended December 31, 2005 and 2004

6. SHARE CAPITAL (continued)

(c) Contributed Surplus (continued)

The following assumptions were used in the calculation of the weighted average fair value of the options granted:

	Year ended December 31 2005	Year ended December 31 2004
Options granted during the year	903,500	200,000
Risk-free interest rate	4.0%	5.0%
Expected life	5 years	5 years
Average volatility	98%	48%
Anticipated dividends	none	none
Weighted-average fair value per option	\$ 0.89	\$ 0.18

7. PER SHARE AMOUNTS

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the year ended December 31, 2005 of 11,912,654 (year ended December 31, 2004 – 8,871,558).

Options to purchase 1,483,500 common shares were outstanding at December 31, 2005 (580,000 – December 31, 2004), 863,500 of which were dilutive (year ended December 31, 2004 – 380,000).

The following table sets forth the details of the denominator used for the computation of basic and diluted earnings per share:

	Year ended December 31 2005	Year ended December 31 2004
Basic weighted average number of common shares	11,912,654	8,871,558
Net effect of dilutive securities		
Stock options	643,532	68,184
Diluted weighted average number of common shares	12,556,186	8,939,742

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
For the Years Ended December 31, 2005 and 2004

8. RELATED PARTY TRANSACTIONS

(a) Administrative Services Contract

The Company is subject to an administrative services contract with Grizzly Resources Ltd., a company related by virtue of common management. These services are in the normal course of business and are recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

	Year ended December 31 2005	Year ended December 31 2004
Administrative services contract	\$ 40,910	\$ 15,921

As at December 31, 2005, \$24,734 (December 31, 2004 – \$4,000) related to these services was included in accounts payable and accrued liabilities.

(b) Acquisition

Grizzly Resources Ltd. was also the vendor of certain undeveloped oil and gas properties acquired during the year. Grizzly Resources Ltd. is a significant joint venture partner on those lands. This acquisition is not in the normal course of business and is recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

	Year ended December 31 2005	Year ended December 31 2004
Acquisition of property and equipment	\$ 2,525,524	\$ –

No amounts related to this acquisition are included in accounts payable and accrued liabilities as at December 31, 2005 (December 31, 2004 – nil).

9. NON-MONETARY TRANSACTION

During the year, the Company exchanged certain working interests in undeveloped acreage with a third party for new working interests in additional acreage in one of the Company's operating fields. The exchange was recorded at the carrying value of the assets and no gain or loss on the exchange was recorded.

10. DEBT FACILITY

The Company has a revolving production loan facility to a maximum of \$400,000 with a financial institution of which no amounts have been drawn as at December 31, 2005 (December 31, 2004 – nil). The amount outstanding bears interest at the financial institution's prime rate. The facility is secured by a general security agreement providing coverage over all present and after acquired property of the Company.

IRONHORSE OIL & GAS INC.
Notes to the Financial Statements
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11. FINANCIAL INSTRUMENTS

Fair value

The Company's carrying values of cash, accounts receivable and accounts payable and accrued liabilities approximates their fair values due to the immediate or short-term maturity of these instruments.

Credit risk

The majority of the accounts receivable are in respect of oil and natural gas operations. The Company generally extends unsecured credit to these customers, and therefore, the collection of accounts receivables may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company has not experienced any credit loss in the collection of receivables to date.

Interest rate risk

The Company has not drawn on its debt facility and does not have any bank indebtedness and is currently not exposed to the risk of interest rate fluctuations.

Commodity prices and exchange rate risk

The nature of the company's operations results in exposure to fluctuation in commodity prices and exchange rates. The Company does not currently hedge these risks.

12. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	Year ended December 31 2005	Year ended December 31 2004
Changes in non-cash working capital		
Accounts receivable	\$ (12,782)	\$ 5,814
Prepaid expenses	(21,079)	(4,969)
Accounts payable and accrued liabilities	272,671	23,288
Total changes in non-cash working capital	238,810	24,133
Less changes in non-cash working capital from investing	(188,172)	-
Changes in non-cash working capital from operations	\$ 50,638	\$ 24,133

13. SUBSEQUENT EVENTS

In February of 2006, the Company entered into a joint venture with Grizzly Resources Ltd. to develop a new field in southwest Saskatchewan. Through the joint venture, the Company obtained a 50% working interest in 6,560 acres where the Company is targeting shallow natural gas production. In February and March of 2006, the Company successfully drilled and cased eight wells on the lands.

BOARD AND MANAGEMENT

Directors

Larry J. Parks, Chairman
Blaine C. Favel
Jeff Lawson
Gerry C. Quinn
James K. Wilson

Officers

Larry J. Parks, President & Chief Executive Officer
Alan G. Withey, VP Finance & CFO
D. Craig Boland, VP Exploration
William G. Manley, VP Engineering & Operations
James K. Wilson, Corporate Secretary

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