

Vital Energy Inc.

Financial Statements

December 31, 2021 and 2020

(Expressed in Canadian Dollars)

Independent Auditor's Report

To the Shareholders of Vital Energy Inc.

Opinion

We have audited the financial statements of Vital Energy Inc. ("the Company"), which comprise the balance sheets as at December 31, 2021 and December 31, 2020 and the statements of net and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2021 and December 31, 2020, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained the other information prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

Independent Auditor's Report (continued)

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Independent Auditor's Report (continued)

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Todd Freer.

Calgary, Canada
April 27, 2022

Crowe MacKay LLP
Chartered Professional Accountants

Vital Energy Inc.

Balance Sheets

(Expressed in Canadian Dollars)

As at December 31,	Note	2021	2020
Assets			
Current			
Cash and cash equivalents		\$ 1,456,841	\$ 107,104
Short-term investments	5	205,022	606,359
Trade and other receivables		2,050,711	710,678
Prepaid expenses		17,146	32,887
		3,729,720	1,457,028
Deposits	13	564,101	561,288
Exploration and evaluation assets	6	66,273	224,085
Right-of-use asset	8	190,725	-
Property and equipment	7	11,731,118	8,650,888
		\$ 16,281,937	\$ 10,893,289
Liabilities			
Current			
Accounts payable and accrued liabilities		\$ 792,568	\$ 970,252
Contract liabilities	9	1,288,648	1,138,350
Current portion of lease liability	12	49,773	-
Current portion of decommissioning liabilities	13	258,574	117,498
		2,389,563	2,226,100
Bank loan	10	60,000	40,000
Loan payable	11	-	3,800,643
Lease liability	12	143,254	-
Decommissioning liabilities	13	1,552,428	1,635,624
		4,145,245	7,702,367
Shareholders' Equity			
Share capital	14	31,740,885	31,740,885
Contributed surplus		1,406,451	1,406,451
Deficit		(21,010,644)	(29,956,414)
		12,136,692	3,190,922
		\$ 16,281,937	\$ 10,893,289
General information and uncertainties	1		

Approved by the Board:

(Signed) "Ngai Ho", _____ Director

(Signed) "Yingchuan Wu", _____ Director

Vital Energy Inc.

Statements of Net and Comprehensive Income (Loss)

(Expressed in Canadian Dollars)

Year ended December 31,	Note	2021	2020
Revenue			
Oil and gas sales	15	\$ 15,066,687	\$ 4,940,701
Less: Crown royalties		(1,577,810)	(749,024)
Net revenue		13,488,877	4,191,677
Other income			
Interest		12,306	9,456
Government grant	13	228,850	80,935
		241,156	90,391
		13,730,033	4,282,068
Expenses			
Production operating costs		2,681,805	2,210,090
General and administrative	16	877,021	700,424
Finance charges	11,12	429,650	260,887
Accretion of decommissioning liabilities	13	39,836	24,920
Revision to decommissioning liabilities	13	234,093	22,932
Impairment (reversal)	7	(1,871,808)	6,564,780
Depletion, depreciation and amortization	7,8	2,393,666	2,062,589
		4,784,263	11,846,622
Income (loss) before income taxes		8,945,770	(7,564,554)
Income taxes			
Current	17	2,111,000	-
Deferred income tax recovery	17	(2,111,000)	-
		-	-
Net and comprehensive income (loss) for the year		\$ 8,945,770	\$ (7,564,554)
Basic income (loss) per share	14	\$ 0.11	\$ (0.09)

Vital Energy Inc.**Statements of Changes in Shareholders' Equity***(Expressed in Canadian Dollars)*

	Share capital	Contributed surplus	(Deficit)	Total equity
Balance, December 31, 2020	\$ 31,740,885	\$ 1,406,451	\$ (29,956,414)	\$ 3,190,922
Net and comprehensive income	-	-	8,945,770	8,945,770
Balance, December 31, 2021	\$ 31,740,885	\$ 1,406,451	\$ (21,010,644)	\$ 12,136,692
Balance, December 31, 2019	\$ 31,740,885	\$ 1,406,451	\$ (22,391,860)	\$ 10,755,476
Net and comprehensive loss	-	-	(7,564,554)	(7,564,554)
Balance, December 31, 2020	\$ 31,740,885	\$ 1,406,451	\$ (29,956,414)	\$ 3,190,922

Vital Energy Inc.**Statements of Cash Flows**
(Expressed in Canadian Dollars)

Years ended December 31,	2021	2020
Operating activities		
Net and comprehensive income (loss) for the period	\$ 8,945,770	\$ (7,564,554)
Non-cash items:		
Current income taxes	2,111,000	-
Deferred income tax recovery	(2,111,000)	-
Depletion, depreciation and amortization	2,393,666	2,062,589
Impairment (recovery)	(1,871,808)	6,564,780
Government grant	(228,850)	(80,935)
Finance charges - lease liability accretion	5,125	-
Revision to decommissioning liabilities	234,093	22,932
Accretion of decommissioning liabilities	39,836	24,920
Decommissioning liabilities settled	(77,209)	-
	9,440,623	1,029,732
Changes in non-cash working capital		
Trade and other receivables	(1,340,033)	289,077
Prepaid expenses	15,741	33,312
Accounts payable and accrued liabilities	(64,052)	190,008
Cash flows provided by operating activities	8,052,279	1,542,129
Investing activities		
Deposits paid	(2,813)	(5,261)
Purchase of short-term investments	-	(606,359)
Expenditures on property and equipment	(3,265,816)	(3,724,636)
Changes in accounts payable and accrued liabilities	(113,632)	(287,663)
Changes in contract liabilities	150,298	(841,327)
Expenditures on exploration and evaluation assets	(66,273)	(224,086)
Redemption of short-term investments	401,337	-
Cash flows used in investing activities	(2,896,899)	(5,689,331)
Financing activities		
Proceeds (repayment) of loan payable (note 11)	(3,800,643)	3,800,643
Lease liability payments	(25,000)	-
Bank loan proceeds (note 10)	20,000	40,000
Cash flows provided by (used in) financing activities	(3,805,643)	3,840,643
Increase (decrease) in cash and cash equivalents	1,349,737	(306,559)
Cash and cash equivalents, beginning of year	107,104	413,663
Cash and cash equivalents, end of year	\$ 1,456,841	\$ 107,104
Supplemental cash flow information:		
Interest paid	\$ 424,525	\$ 260,887
Non-cash transactions – (notes 6, 7, 12 and 13)		

Vital Energy Inc.

Notes to the Financial Statements

For the years ended December 31, 2021 and 2020

(Expressed in Canadian Dollars)

1. General information and uncertainties

Vital Energy Inc. (“the Company”) is an oil and gas exploration and development company incorporated in the province of Alberta on November 14, 2006 with its head and registered office at Suite 888, 940 - 6th Avenue SW, Calgary, Alberta, T2P 3T1. The Company is engaged in the acquisition of, exploration for and development of crude oil and natural gas in Western Canada.

COVID-19 and the war in Ukraine has contributed to significant volatility in financial and commodity markets. They have impacted global commercial activity, including causing significant fluctuations in worldwide demand and prices for certain commodities, including crude oil, natural gas and natural gas liquids. The Company has reacted to the pandemic by accessing available government subsidies (notes 13 and 16).

The pandemic and the war in Ukraine remain dynamic and the ultimate duration and magnitude of the impact on the economy and financial effect on the Company is not known at this time.

These market conditions increase the complexity of estimates and assumptions used to prepare financial statements for future periods. The most significant estimates and judgments impacted are the estimated recoverable amount of the Company’s petroleum and natural gas assets and the appropriateness of the going concern assumption.

2. Basis of preparation, significant estimates and judgments

The financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board as of December 31, 2021. The financial statements were authorized for issue by the Board of Directors on April 26, 2022.

The financial statements have been prepared on the historical cost basis except where otherwise noted.

The financial statements are presented in Canadian dollars which is also the Company’s functional currency.

Use of estimates and judgments

The preparation of the financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, shareholder’s equity, income and expenses. Actual amounts may differ from these estimates. Estimates and underlying assumptions are continually reviewed. Changes to accounting estimates are recognized in the period in which the estimates are revised.

Information about critical judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in these financial statements are outlined below:

a. Reserve estimate

Petroleum and natural gas assets are depleted on a unit-of-production basis at a rate calculated by reference to proven and probable reserves determined in accordance with National Instrument 51-101, Standards of disclosure for Oil and Gas Activities (“NI 51-101”) and incorporating the estimated future cost of developing and extracting those reserves. Proved and probable reserves are estimated using independent reservoir engineering reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids, which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible.

Vital Energy Inc.

Notes to the Financial Statements For the years ended December 31, 2021 and 2020 (Expressed in Canadian Dollars)

Reserves estimates, although not reported as part of the Company's financial statements, can have a significant effect on net income (loss), assets and liabilities as a result of their impact on depreciation and depletion, decommissioning liabilities, deferred taxes and asset impairments. Independent reservoir engineers perform evaluations of the Company's oil and gas reserves on an annual basis. The estimation of reserves is an inherently complex process requiring significant judgment. Estimates of economically recoverable oil and natural gas reserves are based upon a number of variables and assumptions such as geoscientific interpretation, production forecast, commodity prices and costs and related future cash flows, all of which may vary considerably from actual results. These estimates are expected to be revised upward or downward over time, as additional information such as reservoir performance becomes available or as economic conditions change.

b. Impairment indicators and discount rate

For purposes of impairment testing, petroleum and natural gas assets are grouped into cash generating units ("CGU's"), based on separately identifiable and largely independent cash flows. The determination of the Company's CGU's is subject to judgment.

The recoverable amounts of CGU's and individual assets are based on the higher of their value-in-use and fair values less costs to sell. These calculations require the use of estimates and assumptions. Unless indicated otherwise, the recoverable amount used in assessing impairment charges is fair value less costs to sell. The Company generally estimates fair value less costs to sell using a discounted cash flow model, which has a significant number of assumptions. The model uses expected cash flows from proved plus probable reserves. These estimates are subject to measurement uncertainty as discussed above and subject to variability to changes in forecasted commodity prices. The discount rate applied to the cash flows is also subject to management's judgment and will affect the recoverable amount calculated.

It is reasonably possible that the commodity price assumptions may change which may then impact the estimated life of the field and may then require a material adjustment to the carrying value of its tangible and intangible assets. The Company monitors internal and external indicators of impairment relating to its tangible assets. These indicators include changes in (a) commodity prices, (b) reserve volumes and (c) discount rates.

The future cash flows are adjusted for risks specific to the asset and discounted using a before-tax discount rate of 10%. As a result, changes in commodity prices, a reduction to reserve volumes or an increase in the discount rate may potentially lead to impairments.

c. Decommissioning costs

At the end of the operating life of the Company's facilities and properties and upon retirement of its oil and natural gas assets, decommissioning costs will be incurred by the Company. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities. These assumptions can be impacted by changes outside of the Company's control, such as technological advancements, legal and regulatory requirements and environmental laws and regulations. The liability, the related assets and the expenses are impacted by estimates with respect to the costs and timing of decommissioning.

d. Measurement of share-based compensation

The estimation of the fair value of stock options requires the use of assumptions, which include the estimated volatility of the issuer's stock price over the life of the options, future interest rates, dividend yield, forfeiture rates and the estimated life of the option. Changes in these estimates would alter the option's fair value and the related expense as determined by the valuation model.

Vital Energy Inc.

Notes to the Financial Statements For the years ended December 31, 2021 and 2020 (Expressed in Canadian Dollars)

e. Income taxes

Tax regulations and legislation and the interpretations thereof are subject to change. The Company recognized the net future tax benefit of deferred tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred tax assets requires the Company to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted. Additionally, future changes in tax laws in the jurisdictions in which the Company operates could limit the ability of the Company to obtain tax deductions in future periods.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements except as otherwise noted.

Jointly controlled operations and jointly controlled assets

Some of the Company's petroleum and natural gas properties are jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

Property and equipment

Property and equipment consist of oil and gas assets, computer equipment, office equipment, furniture and vehicles. Oil and gas properties are stated at cost, less any accumulated depletion, depreciation and accumulated impairment losses. These properties and equipment include oil and natural gas development and production assets, which represent costs incurred in developing oil and natural gas reserves and maintaining or enhancing production from such reserves. Future decommissioning liabilities related to producing assets are also capitalized to property and equipment.

Oil and gas properties are not depreciated until commercial production commences. The net carrying value of oil and gas assets is depleted using the unit-of-production method based on estimated proven and probable oil and gas reserves. The depletion calculation takes into account the estimated future development costs of the recognized proved plus probable reserves.

Proven and probable reserves are determined by independent engineers in accordance with Canadian National Instrument 51-101. Production and reserves of natural gas are converted to equivalent barrels of crude oil on the basis of six thousand cubic feet of gas to one barrel of oil. Changes in estimates of proved and probable reserves used in prior periods that affect the unit-of-production calculations do not give rise to prior year adjustments and are dealt with on a prospective basis.

Values of oil and gas properties are reviewed for impairment at the end of each reporting period for any indication that the carrying value of the asset may not be recoverable. If any such indication of impairment exists, an estimate of the recoverable amount is calculated. Individual assets are grouped, for the purposes of impairment testing, together into the smallest group of assets or groups of assets that generates cash flows that are largely independent of the cash flows of other assets or groups of assets (the cash generating unit or CGU). A CGU's recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down to its recoverable amount.

Vital Energy Inc.

Notes to the Financial Statements

For the years ended December 31, 2021 and 2020

(Expressed in Canadian Dollars)

The recoverable amount is the greater of the value in use or fair value less costs to sell. Fair value is the amount the asset could be sold for in an arm's length transaction. The value in use is the present value of the estimated future cash flows of the asset from its continued use. The fair value less costs to sell considers the continued development of a property and market transactions in a valuation model. The Company uses the present value of the cash generating unit's estimated future cash flows from both proved and probable reserves in its fair value model. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded entities or other available fair value indicators.

Computer equipment, office equipment, furniture and vehicles are recorded at cost. The declining balance method of depreciation is used to depreciate the cost of these assets over their estimated useful lives. Computer equipment is depreciated at 100% per annum, office equipment and furniture is depreciated at 20% per annum and vehicles are depreciated at 30% per annum.

Exploration and evaluation

Exploration and evaluation ("E&E") costs are capitalized for projects after the Company has acquired the legal right to explore but prior to their technical feasibility and commercial viability being confirmed, generally determined as the establishment of proved or probable reserves. These costs may include costs of license acquisition, technical services and studies, seismic acquisition, exploration drilling and testing, directly attributable overhead and administration expenses, including remuneration of production personnel and supervisory management, the projected costs of retiring the assets, and any activities in relation to evaluating the technical feasibility and commercial viability of extracting mineral resources.

Exploration and evaluation assets are subject to a separate impairment test at least annually or when facts and circumstances indicate that an impairment has occurred.

Once technical feasibility and commercial viability are confirmed, the E&E asset is then reclassified to property and equipment and tested for impairment.

Expired lease costs are expensed as part of impairment expense as they occur and costs incurred prior to the legal right to explore are charged to net income (loss).

Decommissioning liabilities

The Company provides for future decommissioning liabilities related to its oil and gas operating activities based on current legislation, constructive obligations and industry operating practices. Decommissioning liabilities are recognized as a liability in the period in which they are incurred. Decommissioning liabilities are measured as the present value of management's best estimate of the expenditure required to settle the asset retirement liability at the reporting date using a discount rate. When the liability is initially recognized, an amount equivalent to the provision is capitalized to the cost of the related oil and gas asset. This cost is amortized to expense through depletion and depreciation over the life of the related asset on a unit-of-production basis. Subsequent to initial measurement, the liability is adjusted at the end of each period to reflect the passage of time and changes in the estimated future costs underlying the liability. The increase in the balance due to the passage of time is charged to the statement of net and comprehensive income (loss) whereas increases or decreases due to changes in the estimated future costs are capitalized. Actual costs incurred upon settlement of the decommissioning liability are charged against the liability or expense if greater than the liability.

Cash and cash equivalents

Cash and cash equivalents include balances with banks and other highly liquid investments that have original maturity dates of 90 days or less.

Vital Energy Inc.

Notes to the Financial Statements For the years ended December 31, 2021 and 2020 (Expressed in Canadian Dollars)

Short-term investments

Short-term investments include term deposits and cashable Guaranteed Investment Certificates with original maturity dates greater than 90 days and less than one year.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Financial instruments

Financial instruments are comprised of cash and cash equivalents, short-term investments, trade and other receivables, accounts payable and accrued liabilities, bank loan, loan payable, contract liabilities and lease liability. Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or when the Company has transferred all risks and rewards of ownership.

a. Financial assets

Classification and Measurement of Financial Assets

The initial classification of a financial asset depends upon the Company's business model for managing its financial assets and the contractual terms of the cash flows. There are three measurement categories into which the Company classified its financial assets:

- Amortized Cost: Includes assets that are held within a business model whose objective is to hold assets to collect contractual cash flows and its contractual terms give rise on specified dates to cash flows that represent solely payments of principal and interest;
- Fair value through other comprehensive income ("FVOCI"): Includes assets that are held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets, where its contractual terms give rise on specified dates to cash flows that represent solely payments of principal and interest; or
- Fair Value through Profit and Loss ("FVTPL"): Includes assets that do not meet the criteria for amortized cost or FVOCI and are measured at fair value through profit or loss.

This includes all derivative financial assets. On initial recognition, the Company may irrevocably designate a financial asset that meets the amortized cost or FVOCI criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch. On initial recognition of an equity investment that is not held-for-trading, the Company may irrevocably elect to present subsequent changes in the investment's fair value in OCI. There is no subsequent reclassification of fair value changes to earnings following the derecognition of the investment. However, dividends that reflect a return on investment continue to be recognized in net earnings. This election is made on an investment-by-investment basis. At initial recognition, the Company measures a financial asset at its fair value and, in the case of a financial asset not at FVTPL, including transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are recorded as an expense in net earnings. Financial assets are reclassified subsequent to their initial recognition only if the business model for managing those financial assets changes. The affected financial assets will be reclassified on the first day of the first reporting period following the change in the business model. A financial asset is derecognized when the rights to receive cash flows from the asset have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

Vital Energy Inc.

Notes to the Financial Statements For the years ended December 31, 2021 and 2020 (Expressed in Canadian Dollars)

The company has classified its cash and cash equivalents, short-term investments and trade and other receivables as financial assets at amortized cost.

Impairment of Financial Assets

The Company recognizes loss allowances for expected credit losses (“ECLs”) on its financial assets measured at amortized cost. Due to the nature of its financial assets, the Company measures loss allowances at an amount equal to lifetime ECLs. Lifetime ECLs are the anticipated ECLs that result from all possible default events over the expected life of a financial asset. ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive). ECLs are discounted at the effective interest rate of the related financial asset. The Company does not have any financial assets that contain a financing component.

b. Financial liabilities

Financial liabilities include accounts payable and accrued liabilities, bank loan, loan payable, contract liabilities and lease liability. Financial liabilities are classified as current liabilities if payment is due within twelve months; otherwise, they are presented as non-current liabilities.

Classification and Measurement of Financial Liabilities

A financial liability is initially classified as measured at amortized cost or FVTPL. A financial liability is classified as measured at FVTPL if it is held-for-trading, a derivative, or designated as FVTPL on initial recognition. The classification of a financial liability is irrevocable. Financial liabilities at FVTPL (other than financial liabilities designated at FVTPL) are measured at fair value with changes in fair value, along with any interest expense, recognized in net earnings. Other financial liabilities are initially measured at fair value less directly attributable transaction costs and are subsequently measured at amortized cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognized in net earnings. Any gain or loss on derecognition is also recognized in net earnings. A financial liability is derecognized when the obligation is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same counterparty with substantially different terms, or the terms of an existing liability are substantially modified, it is treated as a derecognition of the original liability and the recognition of a new liability. When the terms of an existing financial liability are altered, but the changes are considered non-substantial, it is accounted for as a modification to the existing financial liability. Where a liability is substantially modified it is considered to be extinguished and a gain or loss is recognized in net earnings based on the difference between the carrying amount of the liability derecognized and the fair value of the revised liability. Where a liability is modified in a non-substantial way, the amortized cost of the liability is remeasured based on the new cash flows and a gain or loss is recorded in net earnings.

The Company has classified its accounts payable and accrued liabilities, contract liabilities, bank loan and loan payable at amortized cost.

Finance charges

Included in finance charges is interest on the loan payable and accretion of lease liability.

Revenue recognition

Revenue associated with the sale of the Company’s crude oil and natural gas is recognized when control passes from the Company to its customer. This generally occurs when product is physically transferred into a vessel, pipe or other delivery mechanism and it is probable that the economic benefits will flow to the Company.

Vital Energy Inc.

Notes to the Financial Statements For the years ended December 31, 2021 and 2020 (Expressed in Canadian Dollars)

The Company sells its production pursuant to variable price contracts. The transaction price for variable price contracts is based on the commodity price and then adjusted for quality, location or other factors whereby each component of the pricing formula can be either fixed or variable depending on the contract terms. Revenue is recognized when a unit of production is delivered to the counterparty. The amount of revenue recognized is based on the agreed transaction price, whereby any variability in revenue relates specifically to the Company's efforts to transfer production and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the variable revenue is considered constrained.

Crude oil and natural gas are sold under contracts of varying price and volume terms of up to one year. Revenues are typically collected on the 25th day of the month following production.

Interest income is recognized when earned.

Share-based compensation plan

The Company has issued options to acquire common shares to directors, officers and employees of the Company. These options are accounted for using the fair-value method which estimates the value of the options at the date of the grant using the Black Scholes option pricing model. The fair value thus established is recognized as compensation expense over the vesting period of the options using the graded method of amortization, with an equivalent increase to contributed surplus. A forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest. At the time the stock options are exercised, the fair value of the associated share-based compensation is reclassified from contributed surplus to share capital.

At each reporting date, the Company revises its estimates of the number of options expected to vest. It recognizes the impact of the revision of original estimates, if any, in the statement of net and comprehensive income (loss), with a corresponding adjustment to equity.

Income taxes

Deferred income tax is determined on a non-discounted basis using the liability method and tax rates and laws that have been enacted or substantially enacted at the reporting date. Provision is made for temporary differences at the reporting date between the tax basis of the assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets are recognized to the extent that it is probable that the future taxable profit will be available against which the deductible temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Earnings (loss) per share

Earnings (loss) per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments using the treasury stock method. The Company's potentially dilutive common shares include debentures convertible into common shares and stock options granted to employees and directors. It is assumed that any proceeds obtained on the exercise of any options or warrants would be used to purchase common shares at the average price during the period.

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Leases

The Company assesses whether a contract is a lease based on whether the contract conveys the right to control the use of an underlying asset for a period of time in exchange for consideration. The Company allocates the consideration in the contract to each lease component based on their relative stand-alone prices.

Leases are recognized as a Right-of Use ("ROU") asset and a corresponding lease liability at the date on which the leased asset is available for use by the Company. Assets and liabilities arising from a lease are initially measured on a present value basis. These payments are discounted using the Company's incremental borrowing rate when the rate implicit in the lease is not readily available. The Company uses a single discount rate for a portfolio of leases with reasonably similar characteristics. Lease payments are allocated between the liability and finance costs. The finance cost is charged to net earnings over the lease term. The lease liability is measured at amortized cost using the effective interest method. It is re-measured when there is a change in the future lease payments arising from a change in an index or rate, if there is a change in the amount expected to be payable under a residual value guarantee or if there is a change in the assessment of whether the Company will exercise a purchase, extension or termination option that is within the control of the Company.

When the lease liability is re-measured, a corresponding adjustment is made to the carrying amount of the ROU asset or is recorded in the Statements of Net and Comprehensive Income (Loss) if the carrying amount of the ROU asset has been reduced to zero.

The ROU asset is initially measured at cost, which comprises the initial amount of the lease liability, any initial direct costs incurred, and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or site on which it is located less any lease payments made at or before the commencement date. The ROU asset is depreciated, on a straight-line basis, over the shorter of the estimated useful life of the asset or the lease term. The ROU asset may be adjusted for certain re-measurements of the lease liability and impairment losses. Leases that have terms of less than twelve months or leases on which the underlying asset is of low value are recognized as an expense in the Statements of Net and Comprehensive Income (Loss) on a straight-line basis over the lease term. A lease modification will be accounted for as a separate lease if the modification increases the scope of the lease and if the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope. For a modification that is not a separate lease or where the increase in consideration is not commensurate, at the effective date of the lease modification, the Company will re-measure the lease liability using the Company's incremental borrowing rate, when the rate implicit to the lease is not readily available, with a corresponding adjustment to the ROU asset. A modification that decreases the scope of the lease will be accounted for by decreasing the carrying amount of the ROU asset, and recognizing a gain or loss in net income (loss) that reflects the proportionate decrease in scope.

ROU assets are assessed for impairment on initial recognition and subsequently on an annual basis, at a minimum. ROU assets subject to leases that have become onerous in nature are adjusted by the amount of any provision for onerous leases.

During the year ended December 31, 2021, the Company expensed \$20,382 (2020 - \$53,465) for short-term leases including operating costs.

Government grants and assistance

Government grants or assistance is recognized when there is reasonable assurance that the funds will be received and all conditions of the assistance will be met. Government assistance related to assets and liabilities are recorded as a reduction of the asset's or liability's carrying value. Claims under government assistance programs related to income are recorded as a reduction of the related expense in the period in which eligible expenses were incurred or when the services have been performed.

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The Company participated in the Government of Alberta's Site Rehabilitation Program ("SRP") and the Government of Saskatchewan's Accelerated Site Closure Program ("ASCP"), and has received approval for government funding to assist with abandonment and reclamation activities. The Company does not recognize any of the grant income until completion of the individual projects. During the year ended December 31, 2021, the Company recorded a reduction in the asset retirement obligation of \$228,850 (2020 - \$80,935) with the offset being recorded as government grant income in the Statements of Net and Comprehensive Income (Loss).

4. Newly adopted accounting standards and pronouncements

Future accounting standards and pronouncements

Onerous Contracts—Cost of Fulfilling a Contract (Amendments to IAS 37)

The amendments to IAS 37 specify which costs an entity includes in determining the cost of fulfilling a contract for the purpose of assessing whether the contract is onerous. Costs that relate directly to a contract can either be incremental costs of fulfilling that contract (examples would be direct labour, materials) or an allocation of other costs that relate directly to fulfilling contracts (an example would be the allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract).

These amendments are effective for reporting period beginning on or after January 1, 2022.

Classification of Liabilities as Current or Non-current (Amendments to IAS 1)

The amendments to IAS1 provide a more general approach to the classification of liabilities based on the contractual arrangements in place at the reporting date.

These amendments are effective for reporting periods beginning on or after January 1, 2023.

5. Short-term investments

Short-term investments consist primarily of a cashable guaranteed investment certificate issued by the Company's bank. The certificate matures in June 2023 and earns interest at 0.49% per annum.

6. Exploration and evaluation assets

Exploration and evaluation expenditures consist of the Company's exploration projects which are pending the determination of proven or probable reserves.

	2021	2020
Cost, beginning of year	\$ 224,085	\$ -
Additions	66,273	224,085
Reclassified to property and equipment (note 7)	(224,085)	-
Cost, end of year	\$ 66,273	\$ 224,085

As at December 31, 2021, the Company assessed its exploration and evaluation assets for indications of impairment and determined that no indications existed at this time as the Company plans on incurring further substantive expenditures on the assets.

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7. Property and equipment

Petroleum and natural gas ("PNG") properties are as follows:

	2021	2020
Cost, beginning of year	\$ 31,152,061	\$ 27,298,800
Additions	3,376,038	3,748,528
Reclassified from exploration & evaluation assets, (note 6)	224,085	-
Decommissioning liability revisions (note 13)	(20,212)	104,733
Cost, end of year	34,731,972	31,152,061
Accumulated depletion and impairment, beginning of year	22,501,173	13,831,696
Depreciation and depletion	2,371,489	2,062,589
Impairment (reversal)	(1,871,808)	6,606,888
Accumulated depletion and impairment, end of year	23,000,854	22,501,173
Carrying value, end of year	\$ 11,731,118	\$ 8,650,888

At December 31, 2021, future development costs of \$3,232,000 (December 31, 2020 - \$4,256,600) associated with proved and probable reserves are included in costs subject to depletion.

Recoverable amounts were determined using the fair value less costs to sell method and based on internally generated cash flow projections. In determining fair value less costs to sell, the Company considered recent transactions within the industry, long-term views of oil prices, externally evaluated reserve volumes, and discount rates specific to the asset. The estimated future cash flows were estimated as the proved plus probable reserve value for the property in each CGU discounted at 10% per annum and were based on the Company's external independent engineering report.

At December 31, 2021, commodity prices had improved as compared to the historically low commodity prices at December 31, 2020 when the Company determined that the fair value less costs to sell of certain petroleum and natural gas assets were less than the carrying values resulting in an impairment charge of \$6,564,780 being recorded. The 2021 financial statements reflect a reversal of previously recorded impairment charges. The impairments or (reversals) were in the following CGUs:

	2021	2020
Baxter Lake	\$ (844,704)	\$ 844,704
Pennant	443,195	1,687,543
Sullivan Lake	(1,470,299)	3,983,028
Other	-	49,505
	\$ (1,871,808)	\$ 6,564,780

During the year ended December 31, 2020, the Company settled a financial liability and recognized a gain on settlement of \$42,108, which has been accounted for as a recovery to impairment expense as the original expenditure was recognized in property and equipment and subsequently charged to impairment expense in a prior year.

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The benchmark prices used by the independent reserve evaluators in preparing the Company's reserve report at December 31, 2021 were also used in determining whether impairment of the carrying value of the CGU's existed at December 31, 2021. The prices are referenced for medium crude oil based on Western Canadian Select ("WCS") Crude Oil at Hardisty:

	2022	2023	2024	
Cdn\$/bbl	\$75.00	\$71.00	\$68.00	+2%/yr thereafter

8. Right-of use asset

	2021	2020
Balance, beginning of year	\$ -	\$ -
Addition (note 12)	212,902	-
Amortization	(22,177)	-
Balance, end of year	\$ 190,725	\$ -

The right-of-use asset relates to an office lease that commenced in 2021 and is being amortized on a straight-line basis over four years, being the term of the lease.

9. Contract liabilities

During 2018, the Company entered into an agreement with an exploration drilling contractor whereby the contractor agreed to drill and complete up to five wells (amended in 2019 for a further two wells) and finance the expenditures over a twelve (12) month period from date of invoice. In consideration of the financing terms, the Company is charged a 12% fee based on contract invoices. All the wells have been drilled pursuant to the contract and any further wells are drilled on a one-off basis under the same terms of the prior contract. The invoices shall be paid by the Company within twelve months of issuance in equal monthly payments starting the month following the invoice date. The balance owing is non-interest bearing if all payments are made on schedule. Interest accrues at a rate of 18% per annum on all invoiced amounts not paid by the Company pursuant to the above terms.

10. Bank loan

In the first quarter of 2021, the Corporation received an additional \$20,000 bank loan that is guaranteed by the Canadian government under the Canada Emergency Business Account program in response to the Covid-19 pandemic. The bank loan is interest-free and 25% of the initial tranche of \$40,000 and 50% of the second tranche of \$20,000 are eligible for loan forgiveness if fully repaid on or before December 31, 2022. No principal payments are required during this period.

If the bank loan is not repaid by December 31, 2022, the bank loan may be converted into a three-year term loan at an interest rate of 5% per annum payable monthly with no principal payments until December 31, 2025. Subsequent to year end, the Government of Canada has amended the repayment terms of the loans such that the principal must be fully repaid on or before December 31, 2023 for forgiveness as noted above and will convert to a two year term loan at the same interest rate.

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The amount initially attributed to the debt should equal the discounted cash flows using a market rate of interest that would be payable on a similar debt instrument. The difference between the cash flows discounted using a market rate of interest and the cash flows discounted using the coupon rate would be accreted to the Statement of Net and Comprehensive Income (Loss) over the term of the debt. This non-interest bearing bank loan was compared to a similar loan based on a market rate of interest and it was determined that the principal amounts were not materially different.

11. Loan Payable

On May 22, 2020, the Corporation entered into a loan agreement with a company controlled by a director that provided for a \$4,000,000 credit facility (the "Credit Facility") that was unsecured and was to mature on May 22, 2022. Funds advanced under the Credit Facility incurred interest at a rate of 12% per annum, payable annually. In May 2020, \$1,800,643 was received pursuant to the credit facility and was used to pay down the contract liabilities (note 9) and a further \$2,000,000 was received and used for general working capital purposes. The balance of \$3,800,643 was repaid in full in 2021.

Interest expense of \$424,525 (2020 - \$260,887) was recorded as finance charges in the Statement of Net and Comprehensive Income (Loss).

12. Lease liability

	2021	2020
Balance, beginning of year	\$ -	\$ -
Addition (note 8)	212,902	-
Payments	(25,000)	-
Amortization	5,125	-
	193,027	-
Less: current portion	(49,773)	-
Balance, end of year	\$ 143,254	\$ -

The Company is committed under an office lease that expires on July 31, 2025. The minimum monthly payment is \$5,000 and has been discounted at a rate of 6%.

The accretion expense of \$5,125 was recorded as finance charges in the Statement of Net and Comprehensive Income (Loss).

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Notes to the Financial Statements For the years ended December 31, 2021 and 2020 (Expressed in Canadian Dollars)

13. Decommissioning liabilities

The Company's total decommissioning liability is estimated based on the Company's net ownership in wells and facilities and management's estimate of costs to abandon and reclaim those wells and facilities, as well as an estimate of the future timing of the costs to be incurred.

By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements could be significant. The total undiscounted amount of the estimated cash flows required to settle its decommissioning liabilities are approximately \$1,744,812 (2020 - \$1,570,887) which will be settled over the operating lives of the underlying assets, estimated to occur between 2021 and 2031. A risk-free interest rate of 1.47% (2020 - 0.71%) and an inflation rate of 2% (2020 - 2%) were used to calculate the decommissioning liability.

Settlement of the liability will be funded from general corporate funds at the time of retirement or removal. As at December 31, 2021, \$564,101 (December 31, 2020 - \$561,288) has been paid as deposits to the applicable regulatory bodies for settlement of these obligations.

	2021	2020
Balance, beginning of year	\$ 1,753,122	\$ 1,657,580
Additions	110,222	23,893
Government grants	(228,850)	(80,935)
Revisions	213,881	127,664
Accretion	39,836	24,920
Liabilities settled	(77,209)	-
	1,811,002	1,753,122
Less: current portion	258,574	117,498
Balance, end of year	\$ 1,552,428	\$ 1,635,624

During 2021, there was a revision to the decommissioning liabilities of \$213,881 (2020 - \$127,664) as a result of changes in estimates. Property and equipment was decreased \$20,212 (note 7) (2020 - increased by \$104,732) and \$234,093 (2020 - \$22,932) was charged to the Statements of Net and Comprehensive Income (Loss) representing the impact of the revisions on previously impaired properties.

In May 2020, the Government of Alberta announced the Site Rehabilitation Program ("SRP") whereby qualified contractors (the "Contractors") could apply for grants to assist with the abandonment and reclamation activities of upstream oil and gas wells, pipelines and associated facilities. The Government of Saskatchewan announced a similar program called the Accelerated Site Closure Program ("ASCP").

These government programs are designed to provide grant funding to successful Contractors in the oil field services sector who have entered into, and comply with, an oil field service contract with a qualifying energy company. The funding is provided directly to the Contractors by the provincial governments.

In 2021, under the SRP and ASCP, the Company has continued abandonment of five wells and recognized the corresponding government grant income of \$228,850 (2020 - \$80,935).

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14. Share capital

a. Authorized

Unlimited number of voting Class A, B and C common shares
Unlimited number of non-voting Class D, E and F common shares
Unlimited number of non-voting, non-cumulative, redeemable Class A preferred shares
Unlimited number of non-voting, cumulative, redeemable Class B preferred shares

b. Issued and outstanding - Class A common shares

	# of shares	Amount
Balance, December 31, 2021, 2020 and 2019	82,249,971	\$ 31,740,885

c. Share-based compensation

The Company has established a stock option plan (the "Plan") which is administered by the Board of Directors, allowing the Board of Directors to grant stock options. The Company adopted a 10% Rolling Stock Option Plan, which allows for the granting of stock options for the purchase of up to 10% of the outstanding shares of the Company.

Additionally, options may not be granted to any one person, any one consultant or any persons performing investor relations duties in any twelve-month period which could, when exercised, result in the issuance of shares exceeding 5%, 2% or 2%, respectively, of the issued and outstanding shares of the Company. All options granted under the Plan shall expire no later than the tenth anniversary of the date the options were granted.

The exercise price of the options is to be determined by the Board of Directors, subject to any applicable Exchange approval, at the time any option is granted. In no event shall such exercise price be lower than the exercise price permitted by any applicable Exchange. Vesting of the options is at the discretion of the Board of Directors.

A summary of the status of the stock option plan and changes during the year is presented below:

	#	2021 Weighted average exercise price	#	2020 Weighted average exercise price
Outstanding, beginning of year	1,200,000	\$ 0.25	1,200,000	\$ 0.25
Outstanding, end of year	1,200,000	\$ 0.25	1,200,000	\$ 0.25
Exercisable, end of year	1,200,000	\$ 0.25	1,200,000	\$ 0.25

The details of the options outstanding at December 31, 2021 are as follows:

Options outstanding	Weighted average exercise price	Options exercisable	Weighted average years to expiry
1,200,000	0.25	1,200,000	2.5

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c. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares issued during the year excluding ordinary shares purchased by the Company and held as treasury shares. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares.

	2021	2020
Weighted average number of common shares –basic and diluted	82,249,971	82,249,971

The Company has dilutive instruments outstanding, which consist of stock options. The dilutive impact of these instruments using the treasury stock method results in anti-dilution. As a result, diluted income (loss) per share and the impact of these instruments on the weighted average number of shares outstanding is not presented in the financial statements.

15. Revenue

The following table presents the Company's oil and gas revenues disaggregated by revenue source. All of the Company's revenues are earned in Canada.

	2021	2020
Oil	\$ 14,693,669	\$ 4,817,564
Natural gas	373,018	123,137
	\$ 15,066,687	\$ 4,940,701

16. Expenses by nature

	2021	2020
Wages and employee benefits	\$ 343,334	\$ 231,691
Professional fees	62,069	41,409
Consulting fees	297,011	277,370
User fees	67,553	69,990
Rent	17,158	38,064
Office	89,896	41,900
Total general and administrative expenses	\$ 877,021	\$ 700,424

Finance costs, which consist of interest expense on the loan payable and accretion of the lease liability, were \$429,650 for 2021 (2020 - \$260,887).

During fiscal 2020 and 2021, the Company was entitled to government assistance in the form of the Canada Emergency Wage Subsidy ("CEWS"), the Canada Emergency Commercial Rent Assistance ("CECRA") and the Canada Emergency Rent Subsidy ("CERS"). The subsidies received and receivable were recorded as a reduction of the related expenses as follows:

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	2021	2020
CEWS – reduction in wages and employee benefits	\$ 6,960	\$ 48,616
CERS – reduction in rent	3,224	2,356
CECRA – reduction in rent	-	13,044
Total subsidies	\$ 10,184	\$ 64,016

At December 31, 2021, \$nil (2020 - \$16,191) of government assistance receivable is included in trade and other receivables.

17. Deferred income taxes

Deferred income taxes are based on the differences between the accounting amounts and the related tax bases of the Company's assets and liabilities. The income tax rate used to calculate deferred income taxes is 23% (2020 - 23%).

	2021	2020
Temporary differences related to:		
Property and equipment	\$ 6,549,000	\$ 8,315,000
Decommissioning liabilities	417,000	403,000
Tax loss carry forwards	2,538,000	2,894,000
Other	-	3,000
Deferred tax assets not recognized, net	(9,504,000)	(11,615,000)
Deferred income tax asset	\$ -	\$ -

At December 31, 2021, the Company has tax pools and non-capital losses as described below totaling approximately \$51,308,000 (2020 - \$57,622,000) that are available to shelter future taxable income. The Company's non-capital losses expire between the years 2028 and 2040.

Non-capital losses	\$ 11,036,000
Undepreciated capital cost	5,787,000
Canadian exploration expenses	12,867,000
Canadian development expenses	11,352,000
Canadian oil and gas property expenses	10,266,000
	\$ 51,308,000

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The income tax provision recorded differs from the income tax obtained by applying the statutory income tax rate to the income for the year and is reconciled as follows:

	2021	2020
Income (loss) before income taxes	\$ 8,945,770	\$ (7,564,554)
Statutory rate	23.0%	24.0%
Anticipated income tax recovery at the combined basic federal and provincial tax rate	\$ 2,058,000	\$ (1,815,000)
Increase (decrease) in taxes resulting from:		
Change in substantively enacted tax rates	-	76,000
Other	53,000	8,000
Change in deferred tax assets not recognized	(2,111,000)	1,731,000
Tax expense	\$ -	\$ -

18. Key management compensation

Key management includes directors involved with the daily operations of the Company. The compensation paid or payable to key management for services is shown below:

	2021	2020
Salaries and other short-term employee benefits	\$ 245,760	\$ 192,000
Consulting fees	212,929	210,929
	\$ 458,689	\$ 402,929

19. Related party transactions

Transactions with related parties are incurred in the normal course of business and are measured at the exchange amount which is the amount of consideration established and approved by the related parties. Related party transactions are disclosed below, unless they have been disclosed elsewhere in the financial statements.

For the year ended December 31, 2021, the Company incurred \$212,929 (2020 - \$210,929) in consulting fees billed from officers and companies controlled by officers and directors.

Interest of \$424,525 (2020 - \$260,887) on the loan payable to a company controlled by a director (note 10) is included in finance charges in the Statements of Net and Comprehensive Income (Loss) related to this debt.

20. Financial instruments

The Company's financial instruments recognized on the balance sheet includes cash and cash equivalents, short-term investments, trade and other receivables, accounts payable and accrued liabilities, bank loan, loan payable, contract liabilities and lease liability.

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Fair value

The fair value of these financial instruments approximates their carrying value due to their short-term nature.

Risks associated with financial assets and liabilities

The Company's activities are exposed to a variety of financial risks such as credit risk, market risk and liquidity risk that arise as a result of its exploration, development and production activities. Management has primary responsibility for monitoring and managing financial instrument risks under the direction of the Board of Directors, which has overall responsibility for establishing the Company's risk management framework.

a. Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company limits its exposure to credit risk related to cash and cash equivalents by only investing in liquid securities and only with counterparties that have an acceptable credit rating. Given these factors, management does not expect any counterparty to fail to meet its obligations.

Credit risk is primarily related to the Company's trade receivables from petroleum and natural gas marketers and the risk of financial loss if a marketer fails to meet its contractual obligation. The Company's policy to mitigate credit risk associated with these receivables is to establish marketing relationships with large, credit worthy purchasers. The Company has not experienced any collection issues with its petroleum and natural gas marketers. As at December 31, 2021 and 2020, the majority of the Company's trade receivable are all current. No default on outstanding receivables is anticipated and, as such, no provision for expected credit losses has been recorded. The aging of the Company's trade and other receivables at December 31 is as follows:

	Total	0 - 30 days	31 - 60 days	61 - 90 days	Over 90 days
2021	\$ 2,050,711	\$ 1,843,390	\$ 202,717	\$ -	\$ 4,604
2020	\$ 710,678	\$ 540,486	\$ 170,192	\$ -	\$ -

b. Liquidity risk

Liquidity risk relates to the risk the Company will encounter should it have difficulty in meeting obligations associated with the financial liabilities which are due within one year. The financial liabilities on its balance sheet consist of accounts payable and accrued liabilities, bank loan, loan payable and contract liabilities, which are due within one year, and a lease liability which is due over the next three years. The Company manages its liquidity through continuously monitoring its cash flows from operating activities and review of its actual capital expenditure program against budget. Liquidity difficulties would emerge if the Company was unable to establish a profitable production base to generate sufficient cash flow to cover both operating and capital requirements and service debt financing arrangements. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities through its future funds from operations and issuance of debt or equity instruments.

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The following are the contractual maturities of financial liabilities including expected interest payments at December 31:

2021	Contractual cash flows	Less than one year	1 - 3 years
Bank loan	\$ 60,000	\$ -	\$ 60,000
Accounts payable and accrued liabilities	792,568	792,568	-
Lease liability	215,000	60,000	155,000
Contract liabilities	1,288,648	1,288,648	-
	\$ 2,356,216	\$ 2,141,216	\$ 215,000

2020	Contractual cash flows	Less than one year	1 - 3 years
Bank loan	\$ 40,000	\$ -	\$ 40,000
Accounts payable and accrued liabilities	970,252	970,252	-
Loan payable	4,434,153	456,077	3,978,076
Contract liabilities	1,138,350	1,138,350	-
	\$ 6,582,755	\$ 2,564,679	\$ 4,018,076

c. Market risk

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

d. Commodity price risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by global economic and other events that dictate the level of supply and demand. The Company has no commodity hedges in place as at December 31, 2021 and 2020.

e. Foreign currency risk

Foreign currency risk is the risk that future cash flow will fluctuate as a result of changes in foreign exchange rates. Although all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market price in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian dollar and the United States dollar. The Company has no forward exchange rate contracts in place as at December 31, 2021 and 2020.

f. Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent the changes in market interest rates will impact the Company's cash and cash equivalents and short-term investments that are at a floating or short-term rates of interest. The Company does not have any floating interest rate contracts in place as at December 31, 2021 and 2020.

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21. Capital risk management

The Company's policy is to maintain a strong capital base for the objectives of maintaining financial flexibility in order to preserve its ability to meet financial obligations, to execute on strategic acquisitions, and to provide an appropriate return on investment to its shareholders.

The Company manages its capital structure and makes adjustments to respond to changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholders' equity. In order to maintain or adjust its capital structure, the Company may from time-to-time issue new shares and adjust its capital spending.

In order to facilitate the management of capital expenditures, the Company prepares annual budgets which are updated as necessary depending upon varying factors including current and forecast crude oil and natural gas prices, capital expenditures and general industry conditions.

The Company's share capital is not subject to external restrictions. The Company has not declared or paid any dividends since inception and does not contemplate doing so in the foreseeable future.

There have been no changes in the composition of capital or how the Company manages these risks.