

ZARGON



O I L & G A S L T D.

**Audit and Reserves Committee
Mandate and Terms of Reference**

Approved by the Board of Directors

May 14, 2012

ZARGON OIL & GAS LTD.

AUDIT AND RESERVES COMMITTEE

MANDATE AND TERMS OF REFERENCE

Role and Objective

The Audit and Reserves Committee (the "**Committee**") is appointed by the Board of Directors (the "**Board**") of Zargon Oil & Gas Ltd. ("**Zargon**" or the "**Corporation**"), to which the Board has delegated its responsibility for oversight of the nature and scope of the annual audit, management's reporting on internal accounting standards and practices, financial information and accounting systems and procedures, financial reporting and statements, the audited financial statements and other mandatory disclosure releases containing financial information, and reviewing the annual independent report of the Corporation's petroleum and natural gas reserves and recommending all, for board of director approval.

Membership of the Committee

1. The Committee shall be comprised of at least three (3) directors of Zargon, none of whom are members of management of Zargon and all of whom are "independent" (as such term is used in Multilateral Instrument 52-110 - Audit Committees "MI 52-110" and National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities "NI 51-101"). Committee members shall also meet the independence requirements of the regulatory bodies to which the Corporation may be subject to.
2. All of the members of the Committee shall be "financially literate". The Board has adopted the definition for "financial literacy" used in MI 52-110.
3. The Board may from time to time designate one of the members of the Committee to be the Chair of the Committee.

Mandate and Responsibilities of the Committee

1. The Committee shall, in addition to any other duties and responsibilities specifically delegated to it by the Board, generally assume responsibility for developing the approach of the Corporation to matters concerning all financial information and disclosure and all petroleum and natural gas reserves information and disclosure and, from time to time, shall review and make recommendations to the Board as to such matters. Specifically, the Committee will have the authority and responsibility for:
 - a) Audit Matters:
 - (i) To assist directors meet their responsibilities (especially for accountability) in respect of the preparation and disclosure of the financial statements of Zargon and related matters;

- (ii) To provide better communication between directors and external auditors;
- (iii) To enhance the external auditor's independence;
- (iv) To increase the credibility and objectivity of financial reports;
- (v) To strengthen the role of the outside directors by facilitating in depth discussions between directors on the Committee, management and external auditors;
- (vi) It is the responsibility of the Committee to oversee the work of the external auditors, including resolution of disagreements between management and the external auditors regarding financial reporting;
- (vii) It is the responsibility of the Committee to satisfy itself on behalf of the board with respect to Zargon's Internal Control Systems:
 - A. Identifying, monitoring and mitigating business risks; and
 - B. Ensuring compliance with legal, ethical and regulatory requirements.
- (viii) It is a primary responsibility of the Committee to review the annual financial statements of Zargon prior to their submission to the board of directors for approval. The process should include but not be limited to:
 - A. Reviewing changes in accounting principles, or in their application, which may have a material impact on the current or future years' financial statements;
 - B. Reviewing significant accruals, reserves or other estimates such as the impairment test calculation;
 - C. Reviewing accounting treatment of unusual or non-recurring transactions;
 - D. Ascertaining compliance with covenants under loan agreements;
 - E. Reviewing disclosure requirements for commitments and contingencies;
 - F. Reviewing adjustments raised by the external auditors, whether or not included in the financial statements;
 - G. Reviewing unresolved differences between management and the external auditors; and

- H. Obtain explanations of significant variances with comparative reporting periods.
- (ix) The Committee is to review the financial statements, prospectuses, management discussion and analysis (“MD&A”), annual information forms (“AIF”) and all public disclosure containing audited or unaudited financial information before release and prior to board approval. The Committee must be satisfied that adequate procedures are in place for the review of Zargon's disclosure of all other financial information and shall periodically access the accuracy of those procedures.
- (x) With respect to the appointment of external auditors by the board, the Committee shall:
 - A. Recommend to the board the appointment of the external auditors;
 - B. Recommend to the board the terms of engagement of the external auditor, including the compensation of the auditors and a confirmation that the external auditors shall report directly to the Committee;
 - C. When there is to be a change in auditors, review the issues related to the change and the information to be included in the required notice to securities regulators of such change; and
 - D. Review and approve any non-audit services to be provided by the external auditors' firm and consider the impact on the independence of the auditors.
- (xi) Review with external auditors (and internal auditor if one is appointed by Zargon) their assessment of the internal controls of Zargon, their written reports containing recommendations for improvement, and management's response and follow-up to any identified weaknesses. The Committee shall also review annually with the external auditors their plan for their audit and, upon completion of the audit, their reports upon the financial statements of Zargon and its subsidiaries.
- (xii) The Committee must pre-approve all non-audit services to be provided to Zargon or its subsidiaries by the external auditors. The Committee may delegate to one or more members the authority to pre-approve non-audit services, provided that the member report to the Committee at the next scheduled meeting such pre-approval and the member comply with such other procedures as may be established by the Committee from time to time.
- (xiii) The Committee shall review risk management policies and procedures of Zargon (i.e. hedging, litigation and insurance).

- (xiv) The Committee shall establish a procedure for:
 - A. The receipt, retention and treatment of complaints received by Zargon regarding accounting, internal accounting controls or auditing matters; and
 - B. The confidential, anonymous submission by employees of Zargon of concerns regarding questionable accounting or auditing matters.
- (xv) The Committee shall review and approve Zargon's hiring policies regarding employees and former employees of the present and former external auditors of Zargon.
- (xvi) The Committee shall have the authority to investigate any financial activity of Zargon. All employees of Zargon are to cooperate as requested by the Committee.
- (xvii) The Committee may retain persons having special expertise and/or obtain independent professional advise to assist in filling their responsibilities at the expense of Zargon without any further approval of the board.

b) Reserves Matters:

- (i) In conjunction with the Corporation's senior engineering management, meet with the independent evaluating engineers being considered for appointment to review their qualifications and independence to ensure the independent evaluating engineers being considered for appointment are technically qualified and competent, are independent of management and to establish the terms of their engagement;
- (ii) After consultation with the Corporation's senior engineering management recommend to the Board the appointment of the independent evaluating engineers to assist the Corporation in the annual review of its petroleum and natural gas reserves;
- (iii) In consultation with the Corporation's senior engineering management determine the scope of the annual review of the petroleum and natural gas reserves by the independent evaluating engineers, having regard to regulatory reporting requirements;
- (iv) Review both the procedures for providing petroleum and natural gas reserves information to the independent evaluating engineers and the information used by the independent evaluating engineers to enable the independent evaluating engineers to provide a report that will meet regulatory reporting requirements;

- (v) In consultation with the Corporation's senior engineering management and the independent evaluating engineers:
 - A. Determine whether any restrictions affect the ability of the independent evaluating engineers to report on reserves data without reservations; and
 - B. Review the reserves data and the report of the independent evaluating engineers.
- (vi) Recommend to the Board for filing, the report from the independent evaluating engineers and/or senior engineering management on the Corporation's petroleum and natural gas reserves data;
- (vii) Ensure the disclosure to the public on the Corporation's petroleum and natural gas reserves is in compliance with regulatory requirements;
- (viii) Review any proposals to change the independent evaluating engineers and/or resolve any differences between the independent evaluating engineers and management;
- (ix) Meet on an annual basis with the Corporation's senior engineering management and/or the independent evaluating engineers of the Corporation to review and consider the evaluation of the Corporation's petroleum and natural gas reserves;
- (x) Meet separately with the independent evaluating engineers and/or senior engineering management when the Committee deems it desirable and advise the Board on the results of such meeting;
- (xi) Co-ordinate meetings with the Corporation's senior engineering management, independent evaluating engineers and auditors as required to address matters of mutual concern in respect of the Corporation's evaluation of petroleum and natural gas reserves;

Meeting and Administrative Matters

1. Meetings of the Committee should be scheduled to take place at least four (4) times per year. Special meetings may be convened as required upon the request of the Committee Chairman or the CEO. The President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer shall attend meetings of the Committee, unless otherwise excused from all or part of any such meeting by the Chairman.
2. A majority of the members of the Committee shall constitute a quorum. No business may be transacted by the Committee except at a meeting of its members at which a quorum of the Committee is present or by a resolution in writing signed by all the members of the Committee. Meetings may occur via telephone or teleconference.

3. Any members of the Committee may be removed or replaced at any time by the Board and shall cease to be a member of the Committee as soon as such member ceases to be a director. The Board of directors may fill vacancies on the Committee by appointment from among its members. If and whenever a vacancy shall exist on the Committee, the remaining members may exercise all its powers so long as a quorum remains. Subject to the foregoing, each member of the Committee shall hold such office until the close of the next annual meeting of shareholders following appointment as a member of the Committee.
4. The Committee may invite such officers, directors and employees of the Corporation as it may see fit from time to time to attend at meetings of the Committee and assist thereat in the discussion and consideration of the matters being considered by the Committee.
5. The time at which and place where the meetings of the Committee shall be held and the calling of meetings and the procedure in all respects at such meetings shall be determined by the Committee, unless otherwise determined by the by-laws of the Corporation or by resolution of the Board.
6. Unless otherwise designated by the Board, the members of the Committee shall elect a Chairman from among the members and the Chairman shall preside at all meetings of the Committee. The Chairman of the Committee shall have a second and deciding vote in the event of a tie. In the absence of the Chairman, the members of the Committee shall appoint one of their members to act as Chairman. Notwithstanding the foregoing, in all circumstances the Chairman must be an outside director, unrelated to the Corporation.
7. Minutes of the Committee will be recorded and maintained and circulated to directors who are not members of the Committee or otherwise made available at a subsequent meeting of the Board.
8. Agendas, approved by the Chair, will be circulated to Committee members along with background information on a timely basis prior to the Committee meetings.
9. The Committee may obtain information from any employee of the Corporation and the Corporation's agents that it may require to carry out this mandate. The Committee may retain persons having special expertise and may obtain independent professional advice to assist in fulfilling its responsibilities at the expense of the Corporation, as determined by the Committee.
10. Any issues arising from these meetings that bear on the relationship between the Board and management should be communicated to the Chairman of the Board by the Committee Chair.
11. The Committee shall meet with the external auditor at least once per year (in connection with the preparation of the year end financial statements) and at such other times as the external auditor and the Committee consider appropriate.

12. Review annually the Committee mandate and terms of reference and recommend any changes to the Board.