



**NXT ENERGY SOLUTIONS INC**  
**(Formerly Energy Exploration Technologies Inc)**  
**As at and for the year ended December 31, 2009**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following management's discussion and analysis ("MD&A") was prepared by management based on information available as at April 29, 2010. It should be reviewed in conjunction with the audited year end Consolidated Financial Statements for the year ended December 31, 2009.

As used in this MD&A, the terms "we", "us", "our", "NXT" and "company" mean NXT Energy Solutions Inc.

Our reporting currency is the Canadian dollar. All references to "dollars" in this MD&A refer to Canadian or Cdn. dollars unless specific reference is made to United States or U.S. dollars.

**Forward-Looking Statements**

Certain statements in this document may constitute "forward-looking statements". These forward-looking statements can generally be identified as such because of the context of the statements including words such as "believes", "anticipates", "expects", "plans", "estimates" or words of a similar nature.

These forward-looking statements are based on current expectations and are subject to known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Except as required by law, the company assumes no obligation to update forward-looking statements should circumstances or the company's estimates or opinions change.

**Description of Business**

NXT is a Calgary based company providing airborne hydrocarbon detection solutions that enable our clients to focus their exploration decisions concerning land commitments, data acquisition expenditures or prospect prioritization onto the areas with the greatest hydrocarbon potential. Utilizing its proprietary airborne Stress Field Detection ("SFD<sup>®</sup>") survey system, NXT provides a unique survey method that is environmentally noninvasive and unaffected by ground security issues or difficult terrain. Additionally, surveys can generally be conducted year round and are effective both onshore and offshore. The advantage to NXT's clients is an efficient and reliable method to explore for hydrocarbons.

On September 22, 2008 the company changed its name from Energy Exploration Technologies Inc to NXT Energy Solutions Inc. This change was approved by shareholders at the November 29, 2007 Annual General Meeting. The name change was implemented to better reflect our principal activities and now aligns with the NXT trademark. SFD<sup>®</sup> and NXT<sup>®</sup> in Canada are the registered trademarks of NXT Energy Solutions Inc.

**Overall Performance**

**Discussion of business**

Our airborne Stress Field Detector (SFD<sup>®</sup>) technology, we believe, defines prospective areas for the oil and gas ("O&G") industry in frontier areas more cost effectively than conventional exploration methods. This advantage reduces risk and assists oil companies plan their seismic programs more economically.

The challenge is how to best exploit this advantage and in what market. Widespread adoption of any new technology by the O&G industry is never easy. Barriers to adoption are particularly acute when the fundamental science related to the technology is complex and not easily understood. Prior to 2009 we relied primarily upon technical and business relationships in Canada and upon endorsements from previous customers. This approach resulted in initial sales in the Canadian market in 2006 through 2008. When exploration activity was seriously diminished in Canada, as a result of the international financial crisis and falling commodity prices, the company adopted an international strategy.

By mid 2008 we took a number of steps towards this new strategy and began a process of building up our core team competency, strengthening our technical explanations and searching for appropriate new markets. After a careful study of the international market, we made the strategic decision to focus on Colombia because it offered immediate sales opportunities to a large number of clients. Our objective was to become an industry leader in Colombia and then use Colombia as a “springboard” to pursue other international markets.

Colombia has many characteristics desirable for achieving market success for our SFD<sup>®</sup> survey system. Colombia was recently described as a “magnet for exploration and production companies” by the Wall Street Journal. With a business friendly approach and practical resource policies Colombia attracts a large number of exploration & production companies from around the world. Each of these companies is confronted with significant challenges in acquiring the geological and geophysical data required to evaluate unexplored land. Obstacles include rain forests, environmental and community restrictions, security concerns and the high cost of seismic. SFD<sup>®</sup> is a very effective tool to help overcome these problems.

These operational SFD<sup>®</sup> advantages were recognized in Colombia resulting in early commercial and technical successes.

- Our first contract for U.S. \$2.3 million was conducted in the second quarter of 2009. Our SFD<sup>®</sup> survey of 1,800 kilometers replaced, at no extra cost to our client, a 100 kilometers seismic survey commitment. Notably, permits for a seismic program may take 6 months with the actual seismic survey taking potentially another year. By contrast the SFD<sup>®</sup> survey was completed in only 2 months. The interpreted SFD<sup>®</sup> report provided our client with data to evaluate the block, focus future seismic programs and support a decision to relinquish un-prospective lands back to the government.
- Later in 2009 we completed a U.S. \$1.0 million survey with an independent operating subsidiary of a large Colombian oil company. This client is currently planning and conducting seismic and drilling programs in the surveyed areas on targets identified by SFD<sup>®</sup>.
- In the first quarter of 2010 a national oil company, controlling large unexplored blocks in Colombia, contracted NXT for a pilot program to evaluate SFD<sup>®</sup> in both their on-shore and off-shore concession areas. We completed flying the surveys in early March and delivered the final report to the client mid April.

In less than a year, we have been contracted to provide nearly Cdn. \$4.0 million of surveys by three large Colombian operators. Jointly, these three companies with their partners control approximately 43% of the large blocks available for survey in Colombia and are also active in other Latin American markets.

In the same period, we developed a Colombian team and set up a branch office in Bogota. NXT is currently very active in marketing its SFD<sup>®</sup> survey services to other Colombian based companies as well as offering previously obtained SFD<sup>®</sup> survey data to companies for their evaluation of Colombia 2010 bid round lands. We have now contacted over 30 companies operating in Colombia and are diligently pursuing these leads.

In addition to conducting revenue surveys for our three current clients, we have been active in conducting non-revenue blind tests for these clients as well as for another large international company. The purpose of these tests is to demonstrate SFD<sup>®</sup> survey effectiveness in a number of geological formations, both onshore and offshore. The tests involve conducting an SFD<sup>®</sup> survey over an area where the client possesses non-public geological data. NXT then works with the client to integrate and compare the SFD<sup>®</sup> interpreted results with their existing data. Clients have advised that we have satisfied these initial tests to evaluate SFD<sup>®</sup>.

Penetrating the Colombian market has resulted in additional costs being incurred by the company which we believe are important for the development of our business plan. These costs included the devotion of management and technical resources in country, the conducting of the blind tests and other expenses that might be reduced in the future. Management will continue to evaluate our overall business plan including cost structure, management and technical resources, our marketing plan for Colombia and elsewhere with the objective of achieving revenue growth and profitability. However we must caution that we are in an early stage of market adoption of SFD<sup>®</sup> (particularly given the size of the market potential) and our revenue could still be uneven as clients assess how best to apply SFD<sup>®</sup> within their exploration programs.

We believe the strength of our technology, the continued build-out of our team and the endorsements we are earning from our customers will position us for growing success over the coming years. We plan to build on our current success in Colombia and use this success to open up other new markets opportunities.

## Selected Annual Information

	For the year ended December 31,		
	2009	2008	2007
Survey revenue	\$ 3,683,326	\$ 2,944,470	\$ 5,608,432
Oil and natural gas revenue	997	10,592	33,260
Net comprehensive income (loss)	(2,405,125)	(1,141,291)	350,431
Net income (loss) per share unit; basic	(0.08)	(0.04)	0.01
Net income (loss) per share unit; diluted	(0.08)	(0.04)	0.01
Net cash generated (used) in operating activities	(2,580,308)	(1,816,150)	3,851,850
Cash and short term investments	4,174,145	6,894,170	7,640,962
Total assets	6,005,640	7,600,609	9,142,535
Long term liabilities	232,546	53,808	32,140

### Highlights of 2009

- We completed SFD<sup>®</sup> surveys for two new clients earning \$3,683,326 of revenue in the year and incurred a net loss of \$2,435,125.
- \$2,580,308 in cash was used for operating activities in the year.
- Our cash and investments held on account as at the end of the year are \$4,174,145; a decrease of \$2,720,025 from the beginning of the year. Working capital ended the year at \$4,600,036 as compared with \$6,325,055 at the end of 2008.

## Results of Operations

The company reported a loss of \$2,435,125 for the year ended December 31, 2009.

### Revenue

	For the year ended December 31,		
	2009	2008	2007
SFD <sup>®</sup> survey revenue	\$ 3,683,326	\$ 2,944,470	\$ 5,608,432
Oil and gas revenue	997	10,592	33,260
Total revenue	\$ 3,684,323	\$ 2,955,062	\$ 5,641,692

### SFD<sup>®</sup> Survey Revenue

In 2009, NXT expanded its market to include South America. SFD<sup>®</sup> survey revenue for the year ended December 31, 2009 is \$3,683,326 and is related to two SFD<sup>®</sup> survey contracts in South America that were completed for new NXT clients. This compares to 2008 survey revenue of \$2,944,470 for two surveys completed for existing NXT clients (2007 - \$5,608,432 for five contracts). NXT believes that the decline in 2008 as compared to 2007 is a result of downward market conditions in North America that have caused a delay or cancellation of surveys planned by two junior oil and gas clients as they attempted to secure financing or re-evaluated their capital programs.

## Income from Operations

We had an operating loss of \$2,358,184 in 2009 (2008 - operating loss of \$1,114,922 and 2007 - operating income of \$591,464), representing an overall decrease in earnings of \$1,243,262 in the year. The decrease is primarily the result of the increase in expenses associated with operating internationally in 2009 as compared to performing only domestic operations in 2008.

## Expenses

	For the year ended December 31,		
	2009	2008	2007
SFD <sup>®</sup> survey cost	\$ 1,587,120	\$ 211,237	\$ 814,343
Oil and natural gas operating expenses	8,348	3,959	3,753
Administrative	4,241,139	3,678,803	4,016,662
Depletion and impairment of oil and natural gas properties	2,315	4,372	87,291
Amortization and depreciation	173,585	171,613	128,179
	<u>\$ 6,012,507</u>	<u>\$ 4,069,984</u>	<u>\$ 5,050,228</u>

Expenses for the years ended December 31, 2009, 2008 and 2007

- **SFD<sup>®</sup> survey costs** - in 2009 all of our surveys were performed in Colombia and in 2008 and 2007 our surveys were conducted in Canada. In 2009 we incurred survey costs of \$1,587,120 (\$211,237 - 2008 and \$814,343 - 2007) which include commissions on sales of \$160,891 (2008 - nil and 2007 - \$339,545), flight costs of \$956,836 (2008 - 223,946 and 2007 - 425,131) and meal, hotel and transportation costs of \$334,717 (2008 - \$7,145 and 2007 - \$21,969).

The higher survey costs incurred in 2009 as compared with 2008 and 2007 (as measured as a percentage of revenue) is largely due to two factors. The first is the extra market development costs required to become established and gain a market profile in a new country. The second is the inherent cost differences associated with operating in Colombia as compared with Canada.

The market development costs include mainly non-revenue survey flights designed to showcase SFD<sup>®</sup> capabilities in a new geological and market setting. These non-revenue survey costs represented over 20% of our total survey costs in the year. In addition, NXT performed SFD<sup>®</sup> data interpretation in Colombia rather than in Canada for our first Colombian survey. This location decision was entirely marketing driven despite the higher travel, accommodation and out of country premiums. We won added client respect for our survey system by providing them with an opportunity to directly observe the SFD<sup>®</sup> interpretation process and interact with our interpretation staff.

The extra Colombian survey costs as compared with a Canadian survey is due to the time required to conduct a survey as well as the higher cost to mobilize and demobilize the survey aircraft and crews to a non-Canadian location. In Colombia NXT does incur many delays related to obtaining permits and approvals not required in Canada that can result in surveys taking several weeks to complete that may take only a few days in Canada. These delays result in extra aircraft, crew and accommodation costs.

- **Oil and natural gas operating expenses and impairment of oil and natural gas properties** - the company sold the last of its working interest in wells in 2008 and therefore will no longer have depletion of oil and natural gas properties. In 2009 we reflected the impairment of remaining undeveloped land.
- **Administration** - the administrative cost increase of \$592,336 for the year in comparison to 2008 related to hiring of additional staff and increased costs associated with symposiums, conferences and travel for marketing and sales in international markets. The administrative cost decrease of \$337,859 for 2008 to 2007 related mainly to employee bonuses and TSX-V sponsorship and listing costs being incurred in 2007 (nil - 2008). These were offset somewhat by increased consultant expenses in 2008 that included fees for electronic design and development, investor relations, an executive compensation study, geosciences advisory services and sales and marketing strategy development.
- **Amortization and Depreciation** - in 2009 depreciation increased slightly in correlation to continuing computer and software upgrades necessary for our operations. In 2008, the company expanded its office space in its existing building incurring costs to update and furnish the facilities. We also invested in additional equipment required to develop sensors. This has resulted in an increase in amortization and depreciation costs.

## Other Expense (Income)

	For the year ended December 31,		
	2009	2008	2007
Interest on convertible debenture including registration penalty	\$ -	\$ -	\$ 100,980
Gain on sale of properties	(1,037)	(20,325)	-
Interest income	(80,633)	(234,007)	(109,374)
Loss (gain) on foreign exchange	150,958	(20,242)	249,427
Other	-	90,000	-
Abandonment	7,653	210,943	-
Other expense	\$ 76,941	\$ 26,369	\$ 241,033

**Interest on convertible debenture** - the registration penalty obligation was incurred through a registration rights agreement provided to all investors in the 2005 convertible debenture. Pursuant to this rights agreement the company was obliged to pay a 2% per month registration penalty for month four and beyond following the close of the convertible debenture private placement. The penalty continued to accrue until the shares became free trading concurrent with the company's TSX Venture Exchange listing on December 3, 2007. For the year ended December 31, 2007, penalties of \$343,824 were paid out and the remaining \$178,540 in penalty payments were released in the first quarter of 2008.

**Interest income** - interest income, generated by short term investments, was offset by interest expense resulting in \$80,633 net income in 2009 as compared to \$234,007 net income in 2008 and \$109,374 net income in 2007. Due to the downturn in the market there has been a reduction in interest rates which is having an impact on this area.

**Loss (gain) on foreign exchange** - loss or gain on foreign exchange is caused by changes in the relative exchange values of the U.S. and Canadian dollars. For example, when the Canadian dollar trades higher relative to the U.S. dollar, cash held in U.S. dollars will decline in value and this decline will be reflected as a foreign exchange loss in the period. The company holds nearly all cash and investments in Canadian dollars to reduce the impact caused by market volatility.

The equivalent Canadian dollars for a U.S. dollar changed from \$1.2107 on January 1, 2009 to \$1.0466 as at December 31, 2009 resulting in a loss of \$150,958 in 2009; the change was from \$0.9928 as at January 1, 2008 to \$1.218 as at December 31, 2008 resulting in a 2008 gain of \$20,242; the change was from \$1.1636 as at January 1, 2007 to \$0.9913 as at December 31, 2007 resulting in a loss of \$249,427 for 2007.

**Other** - in the third quarter of 2008 the company paid out \$90,000 to settle a Statement of Claim that was outstanding since 2002. The plaintive was a past president and director of NXT.

**Abandonment** - management conducted a review in 2008 of all wells for which NXT had a historical participation and determined that there is an obligation related to 8 gross (1.1 net) wells drilled in the years 2000 through 2004 that still require abandonment. Management has determined the asset retirement obligation based upon estimates of the costs to remediate, reclaim and abandon the wells and the estimated timing of the costs to be incurred. At December 31, 2009, the asset retirement obligation is estimated to be \$31,897 (December 31, 2008 – \$28,997), based on a total future liability of \$42,454. These obligations are estimated to be settled in four years. This amount has been calculated using an inflation rate of 3.4% and discounted using a credit-adjusted risk-free interest rate of 10.0%.

## Summary of Quarterly Results (Unaudited)

	Dec 31, 2009	Sep 30, 2009	Jun 30, 2009	Mar 31, 2009
Revenue	\$ 1,044,889	\$ 447	\$ 2,638,759	\$ 228
Net income (loss) from continuing operations	(671,458)	(969,591)	283,005	(1,047,081)
Basic earnings (loss) per share	(0.02)	(0.03)	0.01	(0.03)
Diluted earnings (loss) per share	(0.02)	(0.03)	\$ 0.01	\$ (0.03)
	Dec 31, 2008	Sep 30, 2008	Jun 30, 2008	Mar 31, 2008
Revenue	\$ 6,153	\$ 1,193,250	\$ 1,749,076	\$ 6,583
Net income (loss) from continuing operations	(945,394)	(290,639)	806,619	(711,877)
Basic earnings (loss) per share	(0.04)	(0.01)	0.03	(0.02)
Diluted earnings (loss) per share	\$ (0.04)	\$ (0.01)	\$ 0.02	\$ (0.02)

In comparing Q4 2009 to Q3 2009; the company recognized \$1,044,766 in survey revenue in Q4 (nil - Q3) and recognized \$187,343 in stock-based compensation expense (\$112,254 - Q3).

In comparing Q3 2009 to Q2 2009; the net loss in Q3 is due to the company recognizing no survey revenue in Q3 (\$2,638,560 - Q2).

In comparing Q2 2009 to Q1 2009; the company recognized \$2,638,560 in survey revenue in Q2 (nil - Q1) for one completed international survey contract resulting in net income. Our expenses in the second quarter are higher due to the ramp up required for executing an international survey contract as well as increased costs as we pursue marketing to foreign markets.

In comparing Q1 2009 to Q4 2008; the increased net loss in Q1 2009 over Q4 2008 of \$115,744 is due to additional salary costs incurred with the hiring of a Chief Operating Office to augment our senior management staff, fees for a geosciences consultant, higher stock-based compensation costs and costs incurred for the NAPE conference in Houston, Texas.

In comparing Q4 2008 to Q3 2008; the company recognized nil in survey revenue in Q4 (\$1,200,000 in Q3 from one completed survey contract) and recognized \$207,457 in stock-based compensation expense (\$144,843 - Q3).

In comparing Q3 2008 to Q2 2008; the company recognized \$1,200,000 in SFD<sup>®</sup> survey revenue for one completed survey contract in the third quarter (\$1,744,470 in Q2) resulting in net income. We settled a Statement of Claim from 2002 for \$90,000 wherein the plaintiff was a past president and director. Management conducted a review in 2008 of all wells for which NXT had a historical participation and determined a net 1.1 (8 actual) wells drilled from 2000 through 2004 that still require abandonment. The asset retirement obligation is based upon estimates of the costs to remediate, reclaim and abandon the wells and the estimated timing of the costs to be incurred. The abandonment expense recorded in Q3 2008 is \$28,338. In addition, the company recorded an obligation of \$160,148 in respect to a well drilled in 2000 and abandoned in 2008 for which no previous abandonment obligation had been anticipated.

In comparing Q2 2008 to Q1 2008; the company recognized \$1,744,470 in SFD<sup>®</sup> survey revenue for one completed survey contract in the second quarter (nil in Q1) resulting in net income. We sold our producing well for net proceeds of \$47,400 which generated a gain on disposal of \$20,325.

In comparing Q1 2008 to Q4 2007; there is no survey revenue recognized in the first quarter of 2008 (Q4 2007 - \$2,344,812 for two surveys). \$1,220,940 of invoiced services was recorded as unearned revenue at March 31, 2008 and was recognized as revenue in Q2 2008 in addition to the final invoice of \$523,530 that was billed in Q2 2008.

## Liquidity and Capital Resources

The company's cash position at December 31, 2009 continues to be healthy. Our cash and equivalents and short term investments held on account as of April 29, 2010 is \$3,395,323.

With cash and short term investments and the proceeds of U.S. \$986,000 for two SFD<sup>®</sup> survey contracts that completed in the fourth quarter of 2009, we forecast having the required cash to operate for over one year without any additional sources of cash. However, our ability to continue as a going concern will ultimately be dependent upon our ability to sustain positive cash flow from operations and/or obtain additional financing. The outcome of these matters cannot be predicted with certainty at this time.

The following table summarizes the change in cash flow for the year ended December 31, 2009, 2008 and 2007:

	For the year ended December 31,		
	2009	2008	2007
Cash generated (used) in operating activities	\$ (2,580,308)	\$ (1,816,150)	\$ 3,851,850
Cash generated by financing activities	42,262	1,313,984	1,731,993
Cash used in investing activities	6,566,126	(1,340,065)	(4,588,163)
Effect of foreign exchange translation	-	-	-
	<u>\$ 4,028,080</u>	<u>\$ (1,842,231)</u>	<u>\$ 995,680</u>

#### Operating Activities

- 2009 - the \$2,580,308 of cash used in operating activities reflects our net loss of \$2,435,125 adjusted for \$854,576 of non-cash additions and a \$994,363 net decrease in non-cash working capital.
- 2008 - the \$1,816,150 of cash used in operating activities reflects our net loss of \$1,141,291 adjusted for \$1,019,645 of non-cash additions and a \$1,532,558 net decrease in non-cash working capital.
- 2007 - the \$3,851,850 cash generated in operating activities reflects our net income of \$350,431 adjusted for \$1,517,365 of non-cash additions and a \$1,984,054 net increase in non-cash working capital.

#### Financing Activities

- 2009 - NXT raised \$50,239 through the issuance of shares and reduced our capital lease by \$7,977.
- 2008 - we raised \$1,499,853 through the exercise of options and warrants and reduced our capital lease by \$7,329. We also paid out the final amount of \$178,540 in registration penalty against a convertible debenture from 2005.
- 2007 - we raised \$2,319,433 through the exercise of options and warrants and paid off the note payable of \$239,618. We also paid out \$343,824 in registration penalty against a convertible debenture from 2005.

#### Investing Activities

- 2009 - due to the low interest rates offered in the current market, maturing short term investments were moved to more liquid investments as we wait for an upturn in rates, \$184,035 was invested in capital assets and \$2,056 was generated through the sale of property.
- 2008 - \$1,095,439 was invested in short-term investments, \$288,849 in capital assets and \$47,400 was generated through the sale of oil and gas properties in the Entice area of Alberta.
- 2007 - \$4,279,380 was invested in short-term investments, \$337,829 in capital assets and \$35,000 was generated through the sale of oil and gas properties in the Ladyfern/Drake area of British Columbia.

#### Contractual Commitments

The company has an office lease until October 31, 2012 which requires minimum monthly lease payments of \$31,871.

Contractual obligations as of December 31, 2009:

	Total (\$)	Payments Due by Period		
		Less Than 1 Year	1-3 Years	4-5 Years
Copier/scanner lease-to-own agreement	27,518	8,681	18,837	-
Rent or operating lease	1,061,480	374,640	686,840	-

#### Transactions with Related Parties

In the second quarter of 2009 a private placement for 25,000 common shares was issued to an officer of the company to fulfill an obligation.

	For the year ended December 31,		
	2009	2008	2007
Interest expense recognized or paid to related parties and officers	\$ -	\$ -	13,371

In 2007 the company repaid a loan to one of its officers. Prior to payout the company incurred \$13,371 in interest.

A Director of NXT is also an officer for one of our SFD<sup>®</sup> survey clients. We recorded revenue from this client for the years ended December 31, 2009, 2008 and 2007 of nil, \$1,200,000 and nil respectively.

## Additional Disclosures

### Outstanding share data

Outstanding securities:	April 29, 2010	December 31, 2009
Common shares	30,751,796	30,751,796
Preferred shares	10,000,000	10,000,000
Options	2,757,204	2,757,204
Warrants	-	-
Total	43,509,000	43,509,000

### Critical Accounting Estimates

The preparation of these consolidated financial statements is in accordance with accounting principles generally accepted in the United States of America and requires our management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities including the disclosure of contingent assets and liabilities at the date of these consolidated financial statements as well they affect revenues and expenses recorded during the reporting periods. Estimates include allowances for doubtful accounts, valuation of the note receivable, estimated useful lives of assets, provisions for contingent liabilities, and measurement of stock-based compensation, valuation of future tax assets, valuations of convertible debentures and estimates for asset retirement obligations. All estimates and assumptions reflect management's best estimate. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period that they are determined necessary. Actual results may differ from those estimates.

Changes in the accounting estimates or assumptions could have a significant impact on the reported Consolidated Statement of Income (Loss).

The key elements and assumptions that we have made under these principles and their impact on the amounts reported in the consolidated financial statements remain substantially unchanged from those described in our 2008 audited consolidated financial statements.

### Revenue Recognition

We recognize revenue on SFD<sup>®</sup> survey contracts on a completed contract basis, net of government sales tax. All money received or invoiced in advance of completion of the contract is reflected as unearned revenue and treated as a current liability on our balance sheet. All survey expenditures and obligations related to SFD<sup>®</sup> survey contracts are reflected as work-in-progress and treated as a current asset on our balance sheet. Upon completion of the related contract, unearned revenue and the work-in-progress is moved as appropriate to the statement of earnings (loss) as either revenue or survey cost. Sales commissions are included in survey costs. Survey cost does not include any amortization or depreciation of property and equipment.

### Income tax accounting

The determination of the company's income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### Stock-based compensation

The company follows the fair value method of accounting for stock options. Under this method, an estimate of the fair value of the cost of all stock options granted to employees, directors and consultants is calculated using the Black Scholes option pricing model and charged to income over the vesting period of the option, with a corresponding increase recorded in contributed surplus. Upon exercise of the stock option, the consideration received by the company and the amount previously recorded in contributed surplus, is recorded as an increase to the share capital of the company.

Stock-based compensation for non-employees is periodically re-measured until the non-employees' performance is complete, or the amortization period is complete. Changes to the re-measured compensation are recognized in the period of change and amortized over the remaining life of the vesting period in the same manner as the original option.

## **Change in Accounting Policies Including Initial Adoption**

Effective for the company's year end commencing January 1, 2009, the FASB issued new standards relating to business combinations and non-controlling interest. The requirements of these standards will be applied to business combinations subsequent to December 31, 2008.

The FASB issued new guidance on accounting for derivative instruments and hedging activities which requires companies with derivative instruments to disclose information about how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect a company's financial position, financial performance, and cash flows. The required disclosures under this new guidance include the fair value of derivative instruments and their gains or losses in tabular format, information about credit-risk-related contingent features in derivative agreements, counterparty credit risk, and the company's strategies and objectives for using derivative instruments. This standard is effective prospectively for periods beginning on or after November 15, 2008. It does not impact our financial statements as we do not have any derivative instruments or hedging activities except discussed below.

In June 2008, the FASB issued new guidance in assessing whether an equity-linked financial instrument (or embedded feature) is indexed to an entity's own stock for purposes of determining whether the instrument falls outside the scope of the FASB's standard for accounting for derivative instruments. This EITF became effective for all fiscal year ends beginning after December 15, 2008 and required the cumulative effect in the account principle to be recognized as an adjustment to the opening balance of retained earnings.

The adoption of this policy resulted in the company reducing contributed capital by \$108,779, representing the historical value attributed to certain derivative instruments and then recording these instruments as a derivative liability at their fair market value of \$41,415. The cumulative effect of this change in accounting principle of \$67,364 was recognized as a reduction to the opening balance of Accumulated Loss for the year ended December 31, 2008. These options will be revalued to market at each reporting period and the change in the liability value will be charged or credited to the Statement of Income (Loss).

In May 2009, the FASB issued a new standard, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This new standard became effective for the company's interim reporting at June 30, 2009 and did not have a material impact on the company's disclosures.

In June 2009, the FASB issued a revised hierarchy of generally accepted accounting principles which became the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities effective for the company's interim reporting period ending September 30, 2009. The adoption of this standard had no material impact on disclosures or amounts recorded in the company's financial statements.

### **Risk Factors**

#### **Estimates and assumptions**

The preparation of financial statements requires our management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities including the disclosure of contingent assets and liabilities as well as revenues and expenses recorded in our financial statements. Estimates include allowances for doubtful accounts, estimated useful lives of assets, provisions for contingent liabilities, measurement of stock-based compensation, valuation of future tax assets, determination of proved reserves, valuation of undeveloped land, valuation of preferred shares including the likelihood that the conversion feature of the preferred shares will be achieved.

The estimates and assumptions are based upon the best information available to management, however, we cannot provide assurance that future events will not prove that these estimates and assumptions are inaccurate. Any revisions to our estimates and assumptions may have a material impact on our future reported net income or loss, assets or liabilities.

#### **Future Operations**

The company is in the early stage of commercializing its SFD<sup>®</sup> technology. Its ability to generate cash flow from operations will depend on its ability to service its existing clients and develop new clients for its SFD<sup>®</sup> services. Management recognizes that this early commercialization phase can last for several years. Consistent with this early stage of commercialization the company has a significant economic dependency on a few clients. While the company is in this early stage of commercialization, the company's financial position is materially impacted by the loss or gain of any one client.

The company anticipates generating both net income and cash from operations in future years with this business model; however this outcome cannot be predicted with certainty at this time. The company has an extensive prior history of generating net losses. These consolidated financial statements do not include any adjustments to amounts and classifications of assets and liabilities that may be necessary should we be unable to generate sufficient net income and cash from operations in future years in order to continue as a going concern.

#### **Related party transactions**

We have related party transactions between NXT and its officers and directors. The most significant transaction was the Technical Transfer Agreement executed on December 31, 2006 between NXT and its CEO, President and Director wherein the NXT issued 10,000,000 preferred shares in exchange for the acquisition of the SFD<sup>®</sup> technology. All related party transactions have the potential for conflicts of interest that may undermine the board's fiduciary responsibility to NXT shareholders.

NXT manages this conflict of interest risk through maintenance of a strong independent board of directors. Four of the five directors are independent. All transactions between officers and or directors of the company are negotiated on behalf of NXT and voted upon by disinterested directors to protect the best interest of shareholders.

#### **Oil and gas price fluctuations**

We incur a risk of market changes in oil and natural gas prices. Prospective revenues from the sale of products or properties will be impacted by oil and natural gas prices. The impact of price changes on any potential sale of the our existing oil and natural gas property or our ability to enter into SFD<sup>®</sup> survey contracts cannot be readily determined, however, in general if commodity prices decline our opportunity to execute SFD<sup>®</sup> survey contracts will also decline.

#### **Currency fluctuations**

We currently hold our cash in Canadian as well as in U.S. dollars. At December 31, 2009 we are exposed to foreign exchange fluctuation on approximately \$26,383 of U.S. dollar cash. Additionally, most of our operating expenses are incurred in Canadian dollars. We do not engage in currency hedging activities.

#### **Interest rate fluctuations**

As at December 31, 2009 we had \$3,736,947 of our available cash in liquid investments that generate interest income that can be adversely affected by any material changes in interest rates.

#### **Management**

Our success is currently largely dependent on the performance of our directors and officers. The loss of the services of any of these persons could have an adverse effect on our business and prospects. There is no assurance we can maintain the services of our directors, officers or other qualified personnel required to operate our business.

#### **Charter aircraft availability**

NXT, since the sale of its aircraft in 2003, has relied upon the availability of aircraft from charter operators. Charter operators provide the required aircraft for SFD<sup>®</sup> survey operations on an as required basis for an hourly charter fee. NXT is not required to make a capital investment in a chartered aircraft. The only potential prepayment is the purchase of blocks of aircraft time.

#### **Disclosure Controls, Procedures and Internal Controls over Financial Reporting**

The company's Chief Executive Officer and Chief Financial Officer (the "Responsible Officers") are responsible for establishing and maintaining disclosure controls and procedures, or causing them to be designed under their supervision, for the company to provide reasonable assurance that material information relating to the company is made known to the Responsible Officers by others within the organization, particularly during the period in which the company's quarterly and year-end financial statements and MD&A are being prepared. However, any internal control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Disclosure controls and other procedures are designed to ensure that information required to be disclosed in reports filed or submitted is recorded, processed, summarized and reported within the time periods specified by the relevant security authority in either Canada or the United States of America. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in our reports is accumulated and communicated to management, including our Responsible Officers, to allow timely decisions regarding required disclosure.

As of December 31, 2009 an evaluation was carried out under the supervision of, and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the company's disclosure controls and procedures as defined under the rules adopted by the Canadian securities regulatory authorities and by the SEC. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the company's disclosure controls and procedures were effective as at December 31, 2009.

During the year ended December 31, 2009 there have been no changes in the company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting.

We continue to monitor the following areas that we believe are most susceptible to control weaknesses common to many companies of our size:

- Due to the limited number of staff at the company it is not feasible to achieve complete segregation of incompatible duties. The company has mitigated this concern in controls by adding management review procedures of the areas where segregation is an issue; and
- The company does not retain staff with specialized expertise in current income tax accounting, financial reporting and complex accounting matters. The company prepares their best estimate of complex accounting calculations and relies on reviews by management, external consultants and the audit committee for quality assurance.

Notwithstanding the foregoing, all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

For additional information on NXT Energy Solutions Inc. please consult our web page at [www.nxtenergy.com](http://www.nxtenergy.com), or the SEDAR webpage at <http://www.sedar.com>.