EAST WEST PETROLEUM CORP.

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED
DECEMBER 31, 2012 AND 2011

(Expressed in Canadian Dollars)

DAVIDSON & COMPANY LLP — Chartered Accountants — A Partnership of Incorporated Professionals

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
East West Petroleum Corp.

We have audited the accompanying consolidated financial statements of East West Petroleum Corp., which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011 and the consolidated statements of comprehensive (loss) income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of East West Petroleum Corp. as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

"DAVIDSON & COMPANY LLP"

Vancouver, Canada — Chartered Accountants

April 23, 2013

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EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in Canadian Dollars)

	Note	December 31, 2012 $	December 31, 2011 $
ASSETS			
Current assets			
Cash	4	21,208,781	25,601,140
Amounts receivable	5	148,300	62,794
Prepaid expenses		35,361	31,225
Total current assets		21,392,442	25,695,159
Non-current assets			
Investment	6	4,128,835	-
Deposit	7(a)	876,626	-
Restricted cash	7(d)	3,482,150	3,561,442
Exploration and evaluation assets	7	869,344	-
Property, plant and equipment	8	706,584	996,572
Total non-current assets		10,063,539	4,558,014
TOTAL ASSETS		31,455,981	30,253,173
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		137,815	222,778
Non-current liabilities			
Decommissioning liabilities	9	81,404	56,837
TOTAL LIABILITIES		219,219	279,615
SHAREHOLDERS' EQUITY			
Share capital	10	37,907,477	38,382,398
Share-based compensation reserve		4,335,556	3,620,539
Deficit		(14,186,606)	(12,029,379)
Accumulated other comprehensive income		3,180,335	-
TOTAL SHAREHOLDERS' EQUITY		31,236,762	29,973,558
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		31,455,981	30,253,173

Nature of Operations - see Note 1

Commitments - see Note 13

Events after the Reporting Period- see Note 17

These consolidated financial statements were approved for issue by the Board of Directors on April 23, 2013 and are signed on its behalf by:

/s/ ***Greg Renwick***	/s/ ***Nick DeMare***
Greg Renwick	Nick DeMare
Director	Director

The accompanying notes are an integral part of these consolidated financial statements.

EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(Expressed in Canadian Dollars)

	Note	Year Ended December 31, 2012 $	2011 $
Revenue			
Petroleum and natural gas sales		160,870	227,485
Royalties		(7,331)	(12,426)
		153,539	215,059
Expenses			
Production		71,020	70,136
Depletion and depreciation	8	144,928	170,440
Impairment of property, plant and equipment	8	168,000	-
Finance expense of decommissioning liabilities	9	1,627	927
General and administrative		2,050,554	2,504,277
Share-based compensation	10(d)	715,017	2,529,428
		3,151,146	5,275,208
Loss before other items		(2,997,607)	(5,060,149)
Other items			
Interest and other income		322,200	272,359
Write-off of deferred finance costs	7(f)	-	(727,399)
Gain on disposal of exploration and evaluation assets	7(b)	68,750	218,879
Foreign exchange		(79,089)	30,868
		311,861	(205,293)
Loss before deferred income taxes		(2,685,746)	(5,265,442)
Deferred income tax recovery		450,000	-
Net loss for the year		(2,235,746)	(5,265,442)
Other comprehensive income, net of deferred income taxes	6	3,180,335	-
Comprehensive income (loss) for the year		944,589	(5,265,442)
Basic and diluted (loss) per common share		$(0.03)	$(0.06)
Weighted average number of common shares outstanding		83,031,000	83,300,229

The accompanying notes are an integral part of these consolidated financial statements.

EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Expressed in Canadian Dollars)

	Year Ended December 31, 2012					
	Share Capital					
	Number of Shares	Amount $	Share-Based Compensation Reserve $	Deficit $	Accumulated Other Comprehensive Gain $	Total Equity $
Balance at December 31, 2011	83,700,648	38,382,398	3,620,539	(12,029,379)	-	29,973,558
Repurchase of common shares	(951,000)	(474,921)	-	78,519		(396,402)
Share-based compensation	-	-	715,017	-	-	715,017
Unrealized gain on available-for-sale investment	-	-	-	-	3,630,335	3,630,335
Deferred income tax on unrealized gain on available-for-sale investment	-	-	-	-	(450,000)	(450,000)
Net loss for the year	-	-	-	(2,235,746)	-	(2,235,746)
Balance at December 31, 2012	82,749,648	37,907,477	4,335,556	(14,186,606)	3,180,335	31,236,762

	Year Ended December 31, 2011				
	Share Capital				
	Number of Shares	Amount $	Share-Based Compensation Reserve $	Deficit $	Total Equity $
Balance at December 31, 2010	81,313,648	37,581,656	1,139,911	(6,766,027)	31,955,540
Common shares issued for:					
Cash - exercise of share options	45,000	10,250	-	-	10,250
Cash - exercise of warrants	2,215,000	753,100	-	-	753,100
Cash - exercise of compensation options	300,000	75,000	-	-	75,000
Repurchase of common shares	(173,000)	(86,408)	-	2,090	(84,318)
Share-based compensation	-	-	2,529,428	-	2,529,428
Transfer on exercise of share options	-	9,800	(9,800)	-	-
Transfer on exercise of compensation options	-	39,000	(39,000)	-	-
Net loss and comprehensive loss for the year	-	-	-	(5,265,442)	(5,265,442)
Balance at December 31, 2011	83,700,648	38,382,398	3,620,539	(12,029,379)	29,973,558

The accompanying notes are an integral part of these consolidated financial statements.

EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in Canadian Dollars)

	Year Ended December 31,	
	2012 $	2011 $
Operating activities		
Net loss for the year	(2,235,746)	(5,265,442)
Adjustments for:		
Depletion and depreciation	144,928	170,440
Impairment of property, plant and equipment	168,000	-
Finance expense of decommissioning liabilities	1,627	927
Share-based compensation	715,017	2,529,428
Gain on disposal of exploration and evaluation assets	-	(218,879)
Write-off of deferred finance costs	-	727,399
Deferred income taxes	(450,000)	-
Foreign exchange	79,292	-
	(1,576,882)	(2,056,127)
Changes in non-cash working capital items:		
Decrease (increase) in amounts receivable	(85,506)	78,546
Decrease (increase) in prepaid expenses	(4,136)	(17,823)
Decrease in accounts payable and accrued liabilities	(84,963)	(233,711)
	(174,605)	(172,988)
Net cash used in operating activities	(1,751,487)	(2,229,115)
Investing activities		
Restricted cash	-	(3,561,442)
Purchase of investment	(498,500)	-
Deposits (advanced) received	(876,626)	3,526,950
Expenditures on property, plant and equipment	-	(52,128)
Expenditures on exploration and evaluation assets	(869,344)	-
Proceeds on sale of exploration and evaluation assets	-	250,000
Net cash used in investing activities	(2,244,470)	163,380
Financing activities		
Issuance of share capital	-	838,350
Repurchase of common shares	(396,402)	(84,318)
Net cash (used in) provided by financing activities	(396,402)	754,032
Net change in cash	(4,392,359)	(1,311,703)
Cash at beginning of year	25,601,140	26,912,843
Cash at end of year	21,208,781	25,601,140

Supplemental cash flow information - See Note 15

The accompanying notes are an integral part of these consolidated financial statements.

1. Nature of Operations

East West Petroleum Corp. (the "Company") was incorporated on October 23, 1987 under the provisions of the Company Act (British Columbia). The Company is listed and trades on the TSX Venture Exchange ("TSXV") under the symbol "EW". The Company's principal office is located at #1210 - 1095 West Pender Street, Vancouver, British Columbia V6E 2M6 Canada.

The Company carries on business in one operating segment, being the acquisition of, exploration for and production from petroleum and natural gas properties. Management considers that the Company has adequate resources to maintain its core operations and planned exploration programs for the next twelve months. However, the Company recognizes that exploration expenditures may change with ongoing results and, as a result, it may be required to obtain additional financing. While the Company has been successful in securing financings in the past, there can be no assurance that it will be able to do so in the future.

2. Basis of Preparation

Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the IFRS Interpretations Committee ("IFRIC").

Basis of Presentation

These consolidated financial statements have been prepared on a historical cost basis except for certain financial instruments which are measured at fair value. The consolidated financial statements are presented in Canadian dollars unless otherwise stated.

Significant Accounting Estimates

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and the disclosure of contingencies. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements. Significant judgments, estimates and assumptions made by management in the preparation of these financial statements are described below:

(i) Fair values of petroleum and natural gas properties, depletion and depreciation and amounts used in impairment calculations are based on estimates of crude oil and natural gas reserves, oil and gas prices and future costs required to develop those reserves. By their nature, estimates of reserves and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

(ii) Petroleum and natural gas properties, exploration and evaluation assets and other corporate assets are aggregated into cash-generating-units ("CGUs") based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company's CGUs is subject to management's judgment.

(iii) The decision to transfer exploration and evaluation assets to property, plant and equipment is based on management's determination of an area's technical feasibility and commercial viability based partially on proved and probable reserves.

(iv) The calculation of decommissioning liabilities includes estimates of the future costs to settle the liability, the timing of the cash flows to settle the liability, the risk-free rate and the future inflation rates. The impact of differences between actual and estimated costs, timing and inflation on the consolidated financial statements of future periods may be material.

2. Basis of Preparation (continued)

(v) The estimated fair value of the Company's financial assets and liabilities, are by their nature, subject to measurement uncertainty.

(vi) The calculation of income taxes requires judgment in applying tax laws and regulations, estimating the timing of the reversals of temporary differences, and estimating the realizability of deferred tax assets. These estimates impact current and deferred income tax assets and liabilities, and current and deferred income tax expense (recovery).

(vii) The calculation of share-based compensation requires estimates of volatility, forfeiture rates and market prices surrounding the issuance of stock options. These estimates impact share-based compensation expense and contributed surplus.

(viii) Contingencies are resolved only when one or more events transpire. As a result, the assessment of contingencies inherently involves estimating the outcome of future events.

3. Summary of Significant Accounting Policies

Details of the Group

In addition to the Company, the consolidated financial statements include all subsidiaries. Subsidiaries are all corporations over which the Company is able, directly or indirectly, to control financial and operating policies, which is the authority usually connected with holding majority voting rights. Subsidiaries are fully consolidated from the date on which control is acquired by the Company. Inter-company transactions and balances are eliminated upon consolidation. They are de-consolidated from the date that control by the Company ceases.

Cash and Cash Equivalents

Cash includes cash on hand and demand deposits. Cash equivalents include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. The Company is not exposed to significant credit or interest rate risk although cash is held in excess of federally insured limits with a major financial institution. The Company did not have any cash equivalents as at December 31, 2012 and 2011.

Amounts Receivable

Receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. Receivables are classified as loans and receivable. A provision for impairment of receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables.

Accounts Payable and Accrued Liabilities

Payables are obligations to pay for materials or services that have been acquired in the ordinary course of business from suppliers. Payables are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Payables are classified as other financial liabilities initially at fair value and subsequently measured at amortized cost using the effective interest method.

3. Summary of Significant Accounting Policies (continued)

Exploration and Evaluation Expenditures

Pre-license costs are recognized in the statement of comprehensive loss as incurred. Exploration and evaluation expenditures directly attributable to the exploration for petroleum and natural gas reserves are capitalized as exploration and evaluation assets on a field-by-field basis. These costs include, but are not limited to: lease acquisition either directly or by business combination, lease rentals on undeveloped properties, acquisition of rights to explore, geological, and geophysical costs, exploratory drilling of both productive and unproductive wells and overhead charges. No depletion or amortization is charged during the exploration and evaluation phase.

Exploration and evaluation expenditures are capitalized until reserves are evaluated and determined to be commercially viable and technically feasible. If reserves are not identified, these costs are expensed. The balance of exploration and evaluation expenditures is carried forward as an exploration and evaluation asset in the statement of financial position where the resource rights are current and it is considered probable that costs will be recovered through the future development or sale of the property.

If it is determined that a commercial discovery of reserves will not be achieved, the capitalized exploration and evaluation assets are written down to their recoverable amounts. Where commercial discovery of reserves has been made, the exploration and evaluation assets are tested for impairment and transferred to property, plant and equipment as petroleum and natural gas properties.

Property, Plant and Equipment

Property, plant and equipment are carried at cost, less accumulated depreciation and accumulated impairment losses.

The cost of an item of property, plant and equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Where commercial production in an area has commenced, petroleum and natural gas properties are depreciated on a unit-of-production basis over the proved reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. The unit-of-production rate for the amortization of field development costs takes into account expenditures incurred to date, plus future development expenditures to develop the proved and probable reserves. Changes in factors such as estimates of proved reserves that affect unit-of-production calculations do not give rise to prior year financial period adjustments and are accounted for on a prospective basis.

Other equipment and leasehold improvements are depreciated annually on a straight-line basis over the estimated useful life of the assets, at a rate of between 20% and 30% commencing when the related asset is available for use.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss in the condensed consolidated interim statement of comprehensive income or loss.

Where an item of plant and equipment comprises major components with different useful lives, the components are accounted for as separate items of plant and equipment. Expenditures incurred to replace a component of an item of plant and equipment that is accounted for separately, including major inspection and overhaul expenditures are capitalized.

The Company compares the carrying value of property, plant and equipment to estimated net recoverable amounts, based on estimated future cash flows, to determine whether there is any indication of impairment whenever events or circumstances warrant.

3. Summary of Significant Accounting Policies (continued)

Joint Operations

A portion of the Company's operations are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Impairment of Assets

Non-Financial Assets

The Company reviews the carrying amounts of its non-financial assets, other than exploration and evaluation assets and deferred tax assets, at each reporting date to determine whether there is any indication of impairment. If such indication exists, then the asset's recoverable amount is estimated. For goodwill and other intangible assets that have indefinite lives or that are not yet available for use, an impairment test is completed annually. Exploration and evaluation assets are tested for impairment when reclassified to property, plant and equipment as petroleum and natural gas properties, and also if facts and circumstances suggest that the carrying value exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the lowest level at which there is identifiable cash flows that are largely independent of the cash flows of other groups of assets, known as a cash-generating unit ("CGU"). Exploration and evaluation assets are grouped on an area basis for impairment assessment purposes. The goodwill acquired in a business combination, for the purposes of impairment testing, is allocated to the CGU's that are expected to benefit from the synergies of the combination.

An impairment loss is recognized if the asset or CGU's carrying amount exceeds its recoverable amount determined as the higher of: its fair value less costs to sell, and its value in use. In assessing value in use, the estimated future after-tax cash flows are adjusted for the risks specific to the asset group and are discounted to present value using a discount rate that reflects current market assessments of the time value of money. Fair value less costs to sell is based on discounted cash flow forecasts using market assumptions, including market assessment of reserves, future prices and a risk-adjusted discount rate appropriate to the asset by reference to general market conditions, market expectations of current and future development, and the costs of future development. Impairment losses are recognized in the statement of operations and comprehensive loss.

For other assets, impairment losses recognized in prior years are assessed at each reporting date for indications that previously recognized impairment losses may no longer exist or may have decreased. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. The impairment loss is reversed only to the extent that the asset's or CGU's carrying amount does not exceed the carrying amount that would have been determined, net of depletion, had no impairment loss been recognized in prior years. An impairment loss in respect of goodwill is not reversed.

Financial Assets

Financial assets are assessed for impairment at each reporting date to determine whether there is any objective evidence that they are impaired. Objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of the asset and will not be realized. For loans and receivables, the amount of impairment is the difference between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

If there is impairment, the carrying amount of the financial asset is reduced by the impairment loss, except for trade receivables where the carrying amount is reduced through the use of an allowance account, and the loss is recognized in the statement of operations and comprehensive loss. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the statement of operations and comprehensive loss

3. Summary of Significant Accounting Policies (continued)

Decommissioning Liabilities

Liabilities for decommissioning costs are recognized when the Company has an obligation to dismantle or remove a facility and to restore the site on which it is located, and when a reliable estimate of that liability can be made. Cost is estimated upon current regulation and technology. Normally an obligation arises for a new facility or well during the construction or installation phase. Obligations may also be created through a change in legislation. The amount recognized is the fair value of the estimated future cost determined in accordance with local conditions and requirements.

Fair value is determined using the present value of the estimated future cash outflows to abandon the asset and restore the site, discounted using a pre-tax risk-free rate. Costs and the discount rate are updated at each reporting date to reflect current market assessments of the time value of money. The provision is reviewed regularly by the Company's management based on current regulations, costs, technologies and industry standards.

The corresponding amount is capitalized to petroleum and natural gas assets and is amortized on a unit-of-production basis as part of depletion and depreciation. Any adjustments arising from the reassessment of estimated costs or the current estimate of the discount rate used are reflected as an adjustment to the cost of petroleum and natural gas assets. The unwinding of the discount is recognized as a finance cost in income. Actual restoration expenditures are charged as reductions to the accumulated provision when incurred.

Provisions

Provisions are recognized when the Company has a present obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The provisions are measured at Management's best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect of time is material.

Financial Instruments

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held to maturity, available-for-sale, loans and receivables or at fair value through profit or loss ("FVTPL").

Financial assets classified as FVTPL are measured at fair value with unrealized gains and losses recognized through comprehensive loss. Cash and restricted cash are classified as FVTPL.

Financial assets classified as loans and receivables and held to maturity are measured at amortized cost. Amounts receivable are classified as loans and receivables.

Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) except for losses in value that are considered other than temporary. Investments in common shares are classified as available-for-sale.

Transaction costs associated with FVTPL are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

All financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or other financial liabilities.

Financial liabilities classified as other financial liabilities are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities.

Financial liabilities classified as FVTPL are measured at fair value with unrealized gains and losses recognized through comprehensive loss. At December 31, 2012 and 2011 the Company has not classified any financial liabilities as FVTPL.

3. Summary of Significant Accounting Policies (continued)

Share Capital

Common shares issued by the Company are classified as equity. Costs directly attributable to the issue of common shares, share purchase warrants and share options are recognized as a deduction from equity, net of any related income tax effects.

Share-Based Compensation Transactions

The share option plan allows Company employees and consultants to acquire shares of the Company. The fair value of share options granted is recognized as a share-based compensation expense with a corresponding increase in the equity settled share-based payments reserve in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee.

For employees the fair value is measured at grant date and each tranche is recognized separately on a straight line basis over the period during which the share options vest. The fair value of the share options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the share options were granted. At the end of each reporting period, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

Equity-settled share-based compensation transactions with non-employees are measured at the fair value of the goods or services received. However, if the fair value cannot be estimated reliably, the share-based compensation transaction is measured at the fair value of the equity instruments granted at the date the Company receives the goods or the services.

Current and Deferred Income Tax

Income tax expense comprises current and deferred tax. Income tax is recognized separately in the statement of comprehensive loss, except to the extent that it relates to items recognized in other comprehensive loss or directly in equity. In this case the income tax is also recognized in other comprehensive loss or directly in equity, respectively.

Current Income Tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Company's subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred Income Tax

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax relating to items recognized directly in equity or other comprehensive income ("OCI") is recognized in equity or OCI and not in the statement of comprehensive loss.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

3. Summary of Significant Accounting Policies (continued)

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Loss Per Share

Basic loss per share is computed by dividing loss attributable to common shareholders by the weighted average number of common shares outstanding during the period. The computation of diluted loss per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on loss per share. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the "if converted" method. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted loss per share, when diluted loss per share is presented.

Revenue Recognition

Revenue is recognized when it is probable that the economic benefits will flow to the Company and delivery has occurred, the sale price is fixed or determinable, and collectability is reasonably assured. These criteria are generally met at the time the product is shipped and delivered to the customer and, depending on the delivery conditions, title and risk have passed to the customer and acceptance of the product, when contractually required, has been obtained. Revenue is measured based on the sales contract.

Foreign Currency Translation

Functional and Presentation Currency

The financial statements of each of the Company's subsidiaries are prepared in the local currency of their home jurisdictions. Consolidation of each subsidiary includes re-measurement from the local currency to the subsidiary's functional currency. Each subsidiary's functional currency and the functional currency of the parent, being the currency of the primary economic environment in which the subsidiary and the parent operates, is the Canadian dollar. The consolidated financial statements are presented in Canadian dollars.

Exchange rates published by the Bank of Canada were used to translate subsidiary financial statements into the consolidated financial statements. Income and expenses for each statement of comprehensive loss presented are translated using the rates prevailing on the transaction dates. All resulting foreign exchange differences are recognized in comprehensive loss.

Foreign Currency Transactions

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in comprehensive loss.

3. Summary of Significant Accounting Policies (continued)

Accounting Standards and Interpretations Issued but Not Yet Adopted

The standards and interpretations that are issued but not yet effective up to the date of issuances of the Company's financial statements are listed below.

(i) IFRS 10 *Consolidated Financial Statements*: In 2011, the IASB issued IFRS 10 which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees, including special purpose entities. The standard is required to be adopted for periods beginning January 1, 2013. IFRS 10 will have minimal impact on the Company's financial statements on adoption as the current consolidation method adheres to this standard.

(ii) IFRS 11 *Joint Arrangements:* In 2011, the IASB issued IFRS 11 which presents a new model for determining whether an entity should account for joint arrangements using proportionate consolidation or the equity method. An entity will have to follow the substance rather than legal form of a joint arrangement and will no longer have a choice of accounting method. The standard is required to be adopted for periods beginning January 1, 2013. IFRS 11 will have minimal impact on the Company's financial statements on adoption as all the joint arrangements the Company has were determined to be joint operations and; therefore, use the proportionate consolidation method, which is already currently in use.

(iii) IFRS 12 *Disclosure of Interests in Other Entities*: In 2011, the IASB issued IFRS 12 which aggregates and amends disclosure requirements included within other standards. The standard requires a company to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard is required to be adopted for periods beginning January 1, 2013. IFRS 12 will require minimal disclosure changes in the Company's financial statements.

(iv) IFRS 13 *Fair Value Measurement*: In 2011, the IASB issued IFRS 13 to provide comprehensive guidance for instances where IFRS requires fair value to be used. The standard provides guidance on determining fair value and requires disclosures about those measurements. The standard is required to be adopted for periods beginning January 1, 2013. IFRS 13 will require minimal disclosure changes in the Company's financial statements.

(v) IAS 27 *Separate Financial Statements*: In 2011, the IASB issued amendments to IFRS 27 to conform to the changes made in IFRS 10 Consolidated Financial Statements, but the standard retains the current guidance for separate financial statements. These amendments are required to be adopted for periods beginning January 1, 2013. These amendments will require minimal disclosure changes in the Company's financial statements.

(vi) IAS 28 *Investments in Associates and Joint Ventures*: as a consequences of the new IFRS 11 *Joint Arrangements*, and IFRS 12 *Disclosure of Interest in Other Entities*, IAS 28 *Investments in Associates*, has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The revised standard is required to be adopted for periods beginning January 1, 2013. IFRS 28 will have minimal impact on the Company's financial statements on adoption as the Company has no associates or joint ventures that will be accounted for under the equity method.

(vii) IFRS 9 *Financial Instruments Classification and Measurement*: In 2011, the IASB issued an amended version of IFRS 9 which provides additional guidance to classification and measurement of the Company's financial assets, but will not have an impact on classification and measurements of financial liabilities. Due to the amendment in 2011, this standard is now required to be adopted for periods beginning January 1, 2015. The Company is currently analyzing the impact, if any, that the adoption of this standard will have on its financial statements.

3. Summary of Significant Accounting Policies (continued)

(viii) IFRS 7 *Financial Instruments Disclosures*: In 2011, the IASB issued amendments to IFRS 7 *Financial Instruments Disclosures* relating to disclosure requirements for the offsetting of financial assets and liabilities when offsetting is permitted under IFRS. The disclosure amendments are required to be adopted retrospectively for periods beginning January 1, 2013. These amendments will require minimal disclosure changes in the Company's financial statements.

The Company is currently analyzing the impact, if any, that the adoption of these standards will have on its consolidated financial statements.

4. Cash

	December 31, 2012 $	December 31, 2011 $
Cash on hand	2,286,414	7,883,527
Demand deposits	18,922,367	17,717,613
	21,208,781	25,601,140

5. Amounts Receivable

	December 31, 2012 $	December 31, 2011 $
Production receivable	20,924	19,079
Canadian harmonized sales tax	20,488	42,678
Other (Note 7(c))	106,888	1,037
	148,300	62,794

6. Investment

	As at December 31, 2012			
	Number of Common Shares	Cost $	Accumulated Unrealized Gain on Available-for-Sale Investment $	Carrying Value $
North American Oil and Gas Corp. ("NAMG")	5,000,000	498,500	3,630,335	4,128,835

During fiscal 2012 the Company purchased 5,000,000 common shares of NAMG at a cost of $498,500 (US $500,000). As at December 31, 2012 the quoted market value of the NAMG shares was $4,128,835 (US $4,150,000). See also Note 7(a).

During fiscal 2012 the Company recorded a net unrealized comprehensive gain of $3,180,335, net of deferred tax expense of $450,000.

The President of the Company was appointed as a director of NAMG in conjunction with the Company's purchase of the NAMG shares.

7. Exploration and Evaluation Assets

	San Joaquin Basin $	Romania $	Total $
Balance at December 31, 2010	-	31,121	31,121
Disposal	-	(31,121)	(31,121)
Balance at December 31, 2011	-	-	-
Leasehold costs	53,933	-	53,933
Intangible work in progress costs	776,630	-	776,630
Tangible work in progress costs	38,781	-	38,781
Balance at December 31, 2012	869,344	-	869,344

(a) On August 29, 2012 the Company entered into a letter of intent with Lani, LLC ("Lani") and subsequently, on November 13, 2012, the Company entered into a farm-in agreement (collectively the "Lani Agreement") whereby the Company was assigned certain participation interests in Lani's petroleum and gas leases covering exploration properties in the San Joaquin Basin of California. Under the terms of the Lani Agreement the Company was assigned:

(i) 25% working interest in the Tejon Ranch Extension. The Company is required to fund 100% of the working interest costs associated with the drilling and completing of one exploration well on the Tejon Ranch Extension leases, up to a maximum of US $1,300,000;

(ii) 21.25% working interest in the Tejon Main Area. The Company is required to fund 42.5% of the working interest costs associated with the drilling and completing one exploration well on the Tejon Main Area leases, up to a maximum of US $552,500; and

(iii) 50% working interest in leases in the White Wolf. The Company is required to pay US $347,500 to Lani to be used for lease delay rental payments and for leasing new acreage in White Wolf before July 1, 2013.

On November 20, 2012 Lani and NAMG (formerly known as Calendar Dragon Inc.) entered into an agreement and plan of merger whereby NAMG acquired 100% of Lani. In conjunction with terms of the Lani Agreement the Company made an investment of US $500,000 in NAMG as part of Lani's restructuring. See also Note 6.

During fiscal 2012 the Company advanced a total of US $1,700,000 to NAMG to fund exploration activities of which $816,932 (US $821,119) is included in deposits at December 31, 2012.

The Lani Agreement also requires the Company to advance up to US $300,000 to NAMG for working capital purposes. The advances are non-interest bearing and are repayable from production revenues or equity financing conducted by NAMG, whichever comes first. During fiscal 2012 the Company advanced a total of $59,694 (US $60,000), which has been included in deposits at December 31, 2012.

(b) On December 11, 2012 the Government of New Zealand awarded the Company and its partner, TAG Oil Ltd. ("TAG"), interests in three onshore exploration blocks located in the Taranaki Basin, New Zealand. Under the terms of the agreements, the Company will participate in the drilling of a minimum of nine exploration wells on Petroleum Exploration Permits ("PEP") 54876, 54877 and 54879 in fiscal 2013. The Company will earn a 50% participation interest in PEP 54876 and PEP 54879 and a 30% participation interest in PEP 54877 by funding 100% ($2,500,000 each - the "Initial Funding") of the initial well cost on PEP 54876, the first two wells on PEP 54877 and the initial well on PEP 54879. All subsequent costs on the wells will be funded based on each company's participation interest. The Company will be entitled to receive 100% of the oil and gas revenues to recover its Initial Funding. All additional net revenues will be shared according to each party's interest. TAG will operate the joint venture.

7. **Exploration and Evaluation Assets** (continued)

(c) During fiscal 2010 the Company was informed by the government of Romania that it had been awarded four exploration blocks located in the Pannonian Basin, in western Romania. In May 2011 the Company signed petroleum concession agreements with the National Agency for Minerals and Hydrocarbons ("NAMR") the government agency in Romania which regulates the oil and gas industry.

The four concessions have specific mandatory work programs (the "Romania Work Programs"), currently estimated at US $56,630,000 for all four programs, to be completed over two years. Production from the concessions is also subject to royalties of between 3.5% to 13.5% based on quarterly gross production payable to the government.

On May 20, 2011 the Company and Naftna Industrija Srbije j.s.c. Novi Sad ("NIS"), an arm's length corporation, signed a memorandum of understanding to jointly explore the four exploration blocks in Romania. On October 27, 2011 the Company and NIS signed a farm-out agreement (the "Farm-out"). Under the terms of the Farm-out, NIS paid the Company $250,000 and agreed to pay a further $275,000 upon final concession approvals by the government of Romania and assignment of an 85% participation interest and operatorship of the Romania Work Programs to NIS. NIS has the obligation to fund the Romania Work Programs, including environmental work, 2D and 3D seismic acquisition and processing, and the drilling of 12 wells. The Company retains a 15% carried interest in each block through the obligatory two year Phase I work program and the optional one year Phase II work program. If a commercial discovery is made, the Company is responsible for its 15% interest in development of the commercial discovery. During fiscal 2011 the Company recorded a gain of $218,879 resulting from the application of the $250,000 against capitalized costs. During fiscal 2012 the Company received final concession approval by the government of Romania for one exploration block (EX-2, Tria) and the Company transferred the 85% participation interest in EX-2, Tria to NIS Petrol S.R.L, a wholly-owned subsidiary of NIS. The Company has recorded a pro-rata amount of $68,750 as amounts receivable and as a gain on disposal of exploration of exploration and evaluation assets.

(d) Effective November 28, 2011 the Company and the Office National des Hydrocarbures et des Mines ("ONHYM"), an agency of the Moroccan government, entered into agreements whereby the Company was granted an exploration permit (the "Exploration Permit") for a 75% participation interest in a prospective exploration block (the "Doukkala Block") situated along the Atlantic coast southwest from Casablanca, Morocco. The Exploration Permit has an overall duration of eight years, comprising :

(i) Phase 1 program under which the Company is committed to carry out a specified exploration work program, estimated to cost approximately US $5,500,000, over three years;

(ii) on completion of the Phase 1 program, the Company can elect to enter into an extension for a Phase 2 program under which, amongst other things, the Company will be committed to drill two wells, estimated to cost approximately US $14,000,000 over a two year duration; and

(iii) on completion of the Phase 2 program the Company can elect to enter into an extension for a Phase 3 program under which, amongst other things, the Company will be committed to acquire 3D seismic and drilling of one well, estimated to cost approximately US $14,000,000 over a three year duration.

ONHYM retains a 25% carried interest to declaration of commerciality on the Doukkala Block.

The Company has provided a US $3,500,000 (Cdn $3,482,150) guarantee in favour of ONHYM as security for performance of the Phase 1 program. The amount is deposited in a savings account with a major Canadian bank.

There is a gross royalty of 10% on crude oil and 5% on natural gas on production in excess of certain thresholds from the Doukkala Block, which would be payable to the Moroccan government. In addition, the Moroccan government is also entitled to certain bonuses based on daily production targets to a total of US $9,000,000.

7. Exploration and Evaluation Assets (continued)

(e) Effective March 28, 2012 the Company (10% interest), Oil India Limited (40% interest), Oil and Natural Gas Corporation Limited (30% interest) and Gail (India) Limited (20% interest) (collectively the "Partners") and the government of India signed a production sharing contract (the "PSC") for Block AA-ONN-2010/2 (the "AA Block") located in the Assam-Arakan Basin of northeast India. Under the terms of the PSC work program commitment, the Partners will acquire certain 3D seismic data and drill two wells, at an estimated cost to the Company of US $2.8 million, over a five year period.

(f) In December 2010 the Company entered into a sale and purchase agreement whereby the Company agreed to acquire a 20% participation interest in the Burg El Arab field (the "BEA Field") in Egypt from Kuwait Energy Egypt Limited ("Kuwait Energy"), a private corporation, for US $17,500,000. Under the terms of the agreement the Company made a refundable deposit of US $3,500,000. The closing of the agreement was subject to a number of conditions precedent and regulatory approvals.

In fiscal 2010 the Company arranged bridge loan financings totalling US $3,500,000 to provide funding of the deposit. In December 2010 the Company repaid the bridge loans plus interest of $20,399. In addition the Company issued 669,508 common shares of the Company, at a fair value of $707,000, as a bonus to the lenders. As the bridge loans were incurred to provide funding for the participation in the BEA Field, the Company had capitalized $727,399 for interest and financing costs ("Finance Costs").

During fiscal 2011 the Company and Kuwait Energy mutually agreed to terminate the sale and purchase agreement on the BEA Field and Kuwait Energy refunded the US $3,500,000 (Cdn $3,526,950) deposit. Accordingly the Company has written off the Finance Costs.

8. Property, Plant and Equipment

Cost:	**Petroleum and Natural Gas Properties $**	**Office Furniture and Equipment $**	**Leasehold Improvements $**	**Total $**
Balance at December 31, 2010	1,292,682	-	-	1,292,682
Additions	-	28,460	23,668	52,128
Revision of estimate for decommissioning costs	(112,636)	-	-	(112,636)
Balance at December 31, 2011	1,180,046	28,460	23,668	1,232,174
Revision of estimate for decommissioning costs	22,940	-	-	22,940
Balance at December 31, 2012	1,202,986	28,460	23,668	1,255,114

Accumulated Depletion and Depreciation:	**Petroleum and Natural Gas Properties $**	**Office Furniture and Equipment $**	**Leasehold Improvements $**	**Total $**
Balance at December 31, 2010	(65,162)	-	-	(65,162)
Depletion and depreciation	(162,725)	(5,743)	(1,972)	(170,440)
Balance at December 31, 2011	(227,887)	(5,743)	(1,972)	(235,602)
Depletion and depreciation	(130,473)	(8,538)	(5,917)	(144,928)
Impairment	(168,000)	-	-	(168,000)
Balance at December 31, 2012	(526,360)	(14,281)	(7,889)	(548,530)

8. Property, Plant and Equipment (continued)

Carrying Value:	**Petroleum and Natural Gas Properties $**	**Office Furniture and Equipment $**	**Leasehold Improvements $**	**Total $**
Balance at December 31, 2011	952,159	22,717	21,696	996,572
Balance at December 31, 2012	676,626	14,179	15,779	706,584

Effective September 1, 2010 the Company executed a purchase and sale agreement with Sphere Energy Corp. ("Sphere"), a private company, whereby the Company paid $1,125,000 to acquire Sphere's working interests, ranging from 4.12% to 20%, in four producing oil wells and fourteen gas wells (the "Carbon Property") located northeast of Calgary, Alberta.

The Company performed impairment test calculations at December 31, 2012 and 2011 to assess whether the carrying value of the petroleum and natural gas properties were recoverable. As a result of lower oil prices and well operating performance, an impairment loss of $168,000 (2011 - $nil) was recognized.

9. Decommissioning Liabilities

	2012 $	**2011 $**
Balance, beginning of year	56,837	168,546
Finance cost	1,627	927
Revision of estimate	22,940	(112,636)
Balance, end of year	81,404	56,837

The total amount of estimated cash flows required to settle the Company's estimated obligation is $122,628 (2011 - $97,386) which has been discounted using pre-tax risk-free rates of between 1.06% to 2.45% (2011 - 1.08% to 2.88%). The decommissioning liabilities relate to the Carbon Property in Canada. The present value of the decommissioning liabilities may be subject to change based on management's current estimates, changes in remediation technology or changes to the applicable laws and regulations. Such changes will be recorded in the accounts of the Company as they occur.

The total future asset decommissioning obligations were estimated based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future years. These liabilities will be settled at the end of the useful lives of the underlying assets which are currently expected to extend up to 48 years. Settlement of the liabilities is expected to be funded from general corporate funds at the time of retirement.

10. Share Capital

(a) *Authorized Share Capital*

At December 31, 2012 the Company's authorized share capital consisted of an unlimited number of common shares without par value. All issued common shares are fully paid.

(b) *Reconciliation of Changes in Share Capital*

No equity financings were conducted by the Company in fiscal 2012 or 2011.

10. Share Capital (continued)

On October 11, 2011 the Company filed a normal course issuer bid (the "First Normal Course Issuer Bid"), which authorized the Company to repurchase for cancellation up to 7,995,189 common shares until October 13, 2012 or the date by which the Company has acquired the maximum number of common shares under the First Normal Course Issuer Bid.

On October 11, 2012 the Company renewed its normal course issuer bid (the "Second Normal Course Issuer Bid") to repurchase for cancellation up to 7,433,924 common shares until October 15, 2013 or the date by which the Company has acquired the maximum number of common shares under the Second Normal Course Issuer Bid.

As at December 31, 2012 the Company has repurchased a total of 951,000 (2011 - 173,000) common shares, of which 989,000 (2011 - nil) common shares have been cancelled and returned to treasury and the remaining 135,000 (2011 - 173,000) common shares have not yet been cancelled, for $396,403 (2011 - $84,318) cash consideration. The average carrying value of the common shares was $0.50 (2011 - $0.50) per share. The difference between the purchase price and the carrying value of the common shares was $78,519 (2011 - $2,090).

As at December 31, 2012 the Company may repurchase up to 7,315,924 common shares under the Second Normal Course Issuer Bid.

See also Note 17(a).

(c) *Warrants*

A summary of the number of common shares reserved pursuant to the Company's outstanding warrants at December 31, 2012 and 2011 and the changes for the years ended on those dates is as follows:

	2012		2011	
	Number	Weighted Average Exercise Price $	Number	Weighted Average Exercise Price $
Balance, beginning of year	26,105,595	1.12	28,020,595	1.07
Issued	-	-	300,000	0.34
Exercised	-	-	(2,215,000)	0.34
Expired	(14,420,595)	1.75	-	-
Balance, end of year	11,685,000	0.34	26,105,595	1.12

The following table summarizes information about the number of common shares reserved pursuant to the Company's warrants outstanding and exercisable at December 31, 2012:

Number	Exercise Price $	Expiry Date
11,685,000	0.34	September 29, 2013

(d) *Share Option Plan*

The Company has established a rolling share option plan (the "Plan"), in which the maximum number of common shares which can be reserved for issuance under the Plan is 10% of the issued and outstanding shares of the Company. The minimum exercise price of the share options is set at the Company's closing share price on the day before the grant date, less allowable discounts in accordance with the policies of the TSXV. Options granted may be subject to vesting provisions as determined by the Board of Directors and have a maximum term of ten years from the date of grant.

10. Share Capital (continued)

During fiscal 2012 the Company granted 300,000 (2011 - 3,351,000) share options and recorded compensation expense of $546,048 (2011 - $2,529,428) on the granting and vesting of share options.

The fair value of share options granted and vested during fiscal 2012 and 2011 is estimated using the Black-Scholes option pricing model using the following assumptions:

	2012	2011
Risk-free interest rate	0.96% - 1.34%	1.04% - 2.44%
Estimated volatility	109% - 131%	139% - 169%
Expected life	2 years - 4 years	2 years - 5 years
Expected dividend yield	0%	0%
Estimated forfeiture rate	0%	0%

The weighted average grant date fair value of all share options granted and vested during fiscal 2012 was $0.32 (2011 - $0.95) per share option.

During fiscal 2012 the Company repriced share options previously granted to purchase 1,726,000 common shares, from original exercise prices ranging from $0.87 to $1.16 per share to a revised exercise price of $0.40 per share. The fair values of the repriced share options have been estimated using the Black-Scholes option pricing model. The assumptions used were: risk-free interest rate 1.16% - 1.44%; estimated volatility 106% - 124%; expected life 2 years - 4 years; expected dividend yield 0%; and estimated forfeiture rate 0%. The value assigned to the re-pricing of the share options was $86,220, of which $79,721 was expensed in the current year.

During fiscal 2012 the Company extended the expiry dates:

(i) on 36,000 share options with an exercise price of $0.40 per share expiring on April 6, 2014 to a revised expiry date of April 6, 2016;
(ii) on 1,160,000 share options with an exercise price of $0.83 per share expiring on May 31, 2014 to a revised expiry date of May 31, 2016; and
(iii) on 225,000 share options with an exercise price of $0.45 per share expiring on September 14, 2014 to a revised expiry date of September 14, 2016.

All other terms of the options remained the same.

The fair values of the extension of the expiry dates on the share options have been estimated using the Black-Scholes option pricing model. The assumptions used were: risk-free interest rate 1.09% - 1.24%; estimated volatility 102% - 120%; expected life 3.5 years - 4 years; expected dividend yield 0%; and estimated forfeiture rate 0%. The value assigned to the extension of the expiry date on the share options was $99,955 of which $89,248 was expenses in the current year.

Option-pricing models require the use of estimates and assumptions including the expected volatility. Changes in the underlying assumptions can materially affect the fair value estimates and, therefore, existing models do not necessarily provide reliable measure of the fair value of the Company's share options.

10. Share Capital (continued)

A summary of the Company's share options at December 31, 2012 and 2011 and the changes for the year ended on those dates, is as follows:

	2012		2011	
	Number of Options Outstanding	Weighted Average Exercise Price $	Number of Options Outstanding	Weighted Average Exercise Price $
Balance, beginning of year	8,033,530	0.56	4,727,530	0.25
Granted	300,000	0.40	3,351,000	0.99
Exercised	-	-	(45,000)	0.23
Expired	(100,000)	0.50	-	-
Balance, end of year	8,233,530	0.40	8,033,530	0.56

The following table summarizes information about the share options outstanding and exercisable at December 31, 2012:

Number Outstanding	Number Exercisable	Exercise Price $	Expiry Date
300,000	300,000	0.26	January 7, 2015
300,000	100,000	0.40	April 11, 2015
1,700,000	1,700,000	0.16	June 11, 2015
720,000	720,000	0.20	July 19, 2015
1,252,530	1,252,530	0.25	October 1, 2015
610,000	610,000	0.50	October 1, 2015
240,000	160,000	1.16	February 2, 2016
1,610,000	1,073,333	0.40	February 2, 2016
80,000	80,000	0.90	March 14, 2016
36,000	36,000	0.87	April 6, 2016
1,160,000	773,334	0.83	May 31, 2016
225,000	150,000	0.45	September 14, 2016
8,233,530	6,955,197		

See also Notes 17(b) and 17(c).

(e) *Compensation Options*

During fiscal 2010 the Company granted 1,031,000 compensation options with each compensation option entitling the holder to purchase one unit for $0.25 per unit. Each unit will comprise of one common share and one warrant to purchase an additional common share at a price of $0.34 per share on or before September 29, 2013.

10. Share Capital (continued)

A summary of the Company's compensation options at December 31, 2012 and 2011 and the changes for the year ended on those dates, is as follows:

	2012		2011	
	Number Outstanding	Weighted Average Exercise Price $	Number Outstanding	Weighted Average Exercise Price $
Balance, beginning of year	731,000	0.25	1,031,000	0.25
Exercised	-	-	(300,000)	0.25
Balance, end of year	731,000	0.25	731,000	0.25

As at December 31, 2012, 731,000 compensation options were outstanding and exercisable at an exercise price of $0.25 expiring September 29, 2013.

(f) *Escrow Shares*

As at December 31, 2012 there are 1,997,023 common shares which remain held in escrow and will be released in accordance with the requirements of the TSXV over a remaining period ending October 4, 2013.

11. Related Party Disclosures

A number of key management personnel, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities. Certain of these entities transacted with the Company during the reporting period.

(a) *Transactions with Key Management Personnel*

During fiscal 2012 and 2011 the following amounts were incurred with respect to the President, Chairman, Chief Financial Officer and Vice-President of Engineering of the Company:

	2012 $	2011 $
Salaries	447,142	258,455
Professional fees	102,000	89,000
Health benefit premiums	13,898	6,399
Share-based compensation	457,613	923,096
	1,020,653	1,276,950

As at December 31, 2012, $41,138 (2011 - $37,748) remained unpaid and has been included in accounts payable and accrued liabilities.

See also Note 14(b).

11. Related Party Disclosures (continued)

(b) *Transactions with Other Related Parties*

During fiscal 2012 and 2011 the following amounts were incurred with respect to other officers and directors of the Company:

	2012 $	2011 $
Professional fees	444,000	457,000
Legal	14,456	24,420
Rent	-	6,750
Share-based compensation	327,954	985,135
	786,410	1,473,305

In addition during fiscal 2012 the Company incurred a total of $41,000 (2011 - $45,825) to Chase Management Ltd. ("Chase"), a private corporation owned by the CFO of the Company, for accounting and administration services provided by Chase personnel, excluding the CFO. The Company also paid $3,802 (2011 - $3,759) to the spouse of the President of the Company for professional services rendered.

As at December 31, 2012, $49,375 (2011 - $5,430) remained unpaid and has been included in accounts payable and accrued liabilities.

(c) See also Notes 6 and 14(a).

12. Income Tax

A reconciliation of taxes at statutory rates to the Company's effective tax expense is as follows:

	2012 $	2011 $
Loss before income taxes	2,776,350	5,265,442
Statutory tax rate	25%	26.5%
Expected income tax recovery	(694,000)	(1,395,000)
Permanent differences	213,000	638,000
Effect of change in tax rates	(55,000)	34,000
Unrealized gain on investments	(450,000)	-
Change in deductible temporary differences	536,000	723,000
Tax recovery	(450,000)	-

Unrecognized temporary differences:

	2012 $	Expiry Thru (Year)	2011 $
Share issuance costs	884,000	2014	1,325,000
Investments	(3,630,000)	N/A	-
Property, plant and equipment	373,000	N/A	-
Tax losses	8,171,000	2032	5,432,000
Other	271,000	N/A	318,000

Deferred income tax assets have not been recognized in respect of these items because it is not probable that the Company will be able to generate sufficient taxable income upon which these deferred tax assets can be realized. Tax attributes are subject to review and potential adjustment by tax authorities.

13. Financial Instruments and Risk Management

Categories of Financial Assets and Financial Liabilities

Financial instruments are classified into one of the following four categories: fair value through profit or loss ("FVTPL"); held-to-maturity investments; loans and receivables; and available-for-sale. The carrying values of the Company's financial instruments are classified into the following categories:

Financial Instrument	Category	December 31, 2012 $	December 31, 2011 $
Cash	FVTPL	21,208,781	25,601,140
Amounts receivable	Loans and receivables	148,300	62,794
Investments	Available-for-sale	4,128,835	-
Restricted cash	FVTPL	3,482,150	3,561,442
Accounts payable and accrued liabilities	Other liabilities	(137,815)	(222,778)

The Company's financial instruments recorded at fair value require disclosure about how the fair value was determined based on significant levels of inputs described in the following hierarchy:

Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and value to provide pricing information on an ongoing basis.

Level 2 - Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the market place.

Level 3 - Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The recorded amounts for amounts receivable and accounts payable and accrued liabilities approximate their fair value due to their short-term nature. The fair value of cash, investment and restricted cash under the fair value hierarchy is measured using Level 1 inputs.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

Credit Risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash, restricted cash and amounts receivable. Management believes that the credit risk concentration with respect to financial instruments included in cash and restricted cash is remote.

The Company is not the operator of certain petroleum and natural gas properties in which it has an ownership interest. The Company is dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the Company's activities may be impacted by the ability, expertise, judgement and financial capability of the operators.

Commodity Price Risk

Commodity prices for petroleum and natural gas are impacted by global economic events that dictate the levels of supply and demand, as well as the relationship between the Canadian dollar and the US dollar. Significant changes in commodity prices may materially impact the Company's ability to raise capital. The Company does not have any financial risk management contracts in place at December 31, 2012 to manage these risks.

13. Financial Instruments and Risk Management (continued)

Liquidity Risk

Liquidity risk is the risk that the Company will not have the resources to meet its obligations as they fall due. The Company manages this risk by closely monitoring cash forecasts and managing resources to ensure that it will have sufficient liquidity to meet its obligations. All of the Company's financial liabilities are classified as current and are anticipated to mature within the next fiscal period. The following table is based on the contractual maturity dates of financial assets and the earliest date on which the Company can be required to settle financial liabilities.

	Contractual Maturity Analysis at December 31, 2012				
	Less than 3 Months $	3 - 12 Months $	1 - 5 Years $	Over 5 Years $	Total $
Cash	21,208,781	-	-	-	21,208,781
Amounts receivable	148,300	-	-	-	148,300
Investment	-	-	4,128,835	-	4,128,835
Restricted cash	-	-	3,482,150	-	3,482,150
Accounts payable and accrued liabilities	(137,815)	-	-	-	(137,815)

Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices. These fluctuations may be significant.

(a) Interest Rate Risk

The Company is exposed to interest rate risk to the extent that the cash bears floating rates of interest. The interest rate risk on cash and on the Company's obligations are not considered significant.

(b) Foreign Currency Risk

The Company maintains cash deposits in US Dollars with its Canadian bank and conducts activities denominated in US dollars. As such, the fluctuation of the Canadian Dollar in relation to the US Dollar will have an impact upon the operations of the Company and may also affect the value of the Company's assets and the amount of shareholders' equity. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks. At December 31, 2012, 1 Canadian Dollar was equal to 1.01 US Dollar.

Balances are as follows:

	US Dollar	Canadian Dollar Equivalent
Cash	1,956,662	1,937,289
Amount receivable	21	21
Investment	4,150,000	4,128,835
Restricted cash	3,500,000	3,482,150
Accounts payable and accrued liabilities	(72,633)	(71,914)
	9,534,050	9,476,381

Based on the net exposures as of December 31, 2012 and assuming that all other variables remain constant, a 10% fluctuation on the Canadian Dollar against the US Dollar would result in the Company's net loss being approximately $900,000 higher (or lower).

13. Financial Instruments and Risk Management (continued)

Capital Management

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of petroleum and natural gas properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain development of the business. The Company defines capital that it manages as share capital. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

14. Commitments

(a) Effective August 1, 2011 the Company entered into an operating lease, expiring July 31, 2016, for the rental of an office in Vancouver, BC with a gross monthly lease payment of $5,511. The Company has entered into a sub-lease with a public company, which is related through a common director and officer, whereby the Company will be reimbursed $2,755 per month. During fiscal 2012 the Company received $33,060 (2011 - $5,510) from the public company for shared premises.

(b) The Company and Greg Renwick have entered into an executive agreement whereby Mr. Renwick provides his services as the President and Chief Executive Officer of the Company. Under the agreement the Company is currently paying Mr. Renwick a base salary of US $250,000 per annum. The agreement expires on September 30, 2013.

The agreement provides that, in the event Mr. Renwick's services are terminated, a severance payment of six months compensation is payable.

(c) See also Note 7.

15. Supplemental Cash Flow Information

During fiscal 2012 and 2011 non-cash activities were conducted by the Company as follows:

	2012 $	2011 $
Investing activity		
Expenditures on property, plant and equipment	(22,940)	112,636
Operating activity		
Provision for decommissioning liabilities	22,940	(112,636)
Financing activities		
Common shares issued for non-cash consideration	-	48,800
Share-based compensation reserve	-	(48,800)
	-	-

16. Segmented Information

The Company currently operates in one business segment, being the acquisition, exploration and production of oil and gas properties.

	As at December 31, 2012		
	Canada **$**	**United States** **$**	**Total** **$**
Current assets	21,299,697	92,745	21,392,442
Restricted cash	3,482,150	-	3,482,150
Investment	4,128,835	-	4,128,835
Property, plant and equipment	706,584	-	706,584
Deposit	-	876,626	876,626
Exploration and evaluation assets	-	869,344	869,344
	29,617,266	1,838,715	31,455,981

	As at December 31, 2011		
	Canada **$**	**United States** **$**	**Total** **$**
Current assets	25,589,167	105,992	25,695,159
Restricted cash	3,561,442	-	3,561,442
Property, plant and equipment	996,572	-	996,572
	30,147,181	105,992	30,253,173

17. Events after the Reporting Period

(a) Subsequent to December 31, 2012 the Company repurchased an additional 595,500 common shares under its Second Normal Course Issuer Bid for $170,211 cash consideration.

(b) On March 8, 2013 the Company amended, subject to disinterested shareholder approval, the terms of 1,400,000 share options previously granted to a director of the Company, whereby the exercise price of the share options was reduced from $0.83 per share on 1,160,000 share options and $1.16 per share on 240,000 share options to $0.40 per share. Other than the imposition of certain trading restrictions, all other terms of the options remain the same.

(c) On April 4, 2013 the Company agreed, subject to shareholder approval, to amend the Plan, from a rolling 10% share option plan to a fixed 15% share option plan (the “15% Plan”). The Company also granted share options to directors, officers and consultants of the Company to purchase 1,725,000 common shares at $0.37 per share for a period of five years. The grant of these options is conditional upon shareholders approving the 15% Plan.