# KULCZYK OIL VENTURES INC.

**CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

(Unaudited)

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## Independent Auditors' Report on Review of Interim Financial Statements

To the shareholders of Kulczyk Oil Ventures Inc.

*Introduction*

We have reviewed the accompanying consolidated statement of financial position of Kulczyk Oil Ventures Inc. ("the Company") as at September 30, 2010, December 31, 2009 and January 1, 2009, the consolidated statements of operations and comprehensive loss and cash flows for the three and nine-month periods ended September 30, 2010 and 2009, the consolidated statement of changes in equity for the nine month periods ended September 30, 2010 and 2009 and the year ended December 31, 2009, and notes, comprising a summary of significant accounting policies and other explanatory information (the consolidated interim financial statements). Management is responsible for the preparation and fair presentation of these consolidated interim financial statements in accordance with IAS 34, 'Interim Financial Reporting'. Our responsibility is to express a conclusion on these consolidated interim financial statements based on our review.

*Scope of Review*

We conducted our review in accordance with the International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

*Conclusion*

Based on our review, nothing has come to our attention that causes us to believe that the accompanying consolidated interim financial statements do not present fairly, in all material respects the financial position of the entity as at September 30, 2010, December 31, 2009 and January 1, 2009, and of its financial performance and its cash flows for the three and nine-month periods ended September 30, 2010 and 2009 in accordance with IAS 34, 'Interim Financial Reporting'.

*Emphasis of Matter*

Without qualifying our opinion, we draw attention to Note 2(b) to the consolidated interim financial statements which describes that the Company is an oil and gas exploration and development entity whose operating cash flow is not sufficient to fund future development and exploration activities. This condition, as described in Note 2(b), indicates the existence of a material uncertainty which may cast significant doubt on the Company's ability to continue as a going concern.

KPMG LLP

Chartered Accountants
Calgary, Canada
November 10, 2010

# KULCZYK OIL VENTURES INC.

Consolidated Statements of Financial Position

US$

(Unaudited)

| | September 30, 2010 | December 31, 2009 | January 1, 2009 |
|---|---|---|---|
| **Assets** | | | |
| Current | | | |
| Cash and cash equivalents | $ 24,556,830 | $ 784,810 | $ 9,322,225 |
| Accounts receivable | 6,050,332 | 659,899 | 289,696 |
| Inventory and other current assets | 111,444 | - | - |
| Prepaid expenses | 382,627 | 367,280 | 165,526 |
| | 31,101,233 | 1,811,989 | 9,777,447 |
| Deposit on acquisition (note 6) | - | 1,350,000 | - |
| Restricted cash (note 7) | 4,749,995 | 6,758,241 | 7,500,000 |
| Investments (note 8) | 391,634 | 578,649 | 610,764 |
| Investment in associates (note 9) | 1,431,873 | 100,000 | - |
| Other assets (note 10) | - | 1,699,903 | - |
| Property and equipment (note 11) | 63,550,850 | 257,989 | 224,723 |
| Exploration and evaluation (note 12) | 99,274,854 | 72,679,678 | 3,692,304 |
| | $ 200,500,439 | $ 85,236,449 | $ 21,805,238 |
| **Liabilities** | | | |
| Current | | | |
| Accounts payable and accrued liabilities | $ 5,208,324 | $ 4,538,627 | $ 1,936,112 |
| Income taxes payable | 130,260 | - | 3,563 |
| Convertible debentures (note 16) | 8,645,582 | 7,272,229 | - |
| | 13,984,166 | 11,810,856 | 1,939,675 |
| Decommissioning provision (note 15) | 404,051 | 16,247 | 15,372 |
| Convertible debentures (note 16) | - | 7,471,208 | - |
| Deferred tax liability (note 23) | 5,672,252 | - | - |
| | 20,060,469 | 19,298,311 | 1,955,047 |
| **Shareholders' Equity** | | | |
| Share capital (note 18) | 192,232,629 | 84,727,754 | 32,727,754 |
| Convertible debentures, equity component (note 16) | 2,160,000 | 3,051,989 | - |
| Contributed surplus | 10,258,688 | 7,292,773 | 4,060,940 |
| Accumulated other comprehensive income | 248,142 | - | - |
| Non-controlling interest | 19,928,909 | - | - |
| Deficit | (44,388,398) | (29,134,378) | (16,938,503) |
| | 180,439,970 | 65,938,138 | 19,850,191 |
| | $ 200,500,439 | $ 85,236,449 | $ 21,805,238 |

Commitments (note 19)

**KULCZYK OIL VENTURES INC.**

Consolidated Statements of Changes in Equity

US$

(Unaudited)

| | Common Shares | | Preferred Shares | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Number of shares | Amount | Number of shares | Amount | Convertible debentures, equity component | Contributed surplus | Cumulative translation adjustment | Non-controlling interest | Deficit | Total |
| Balances, January 1, 2009 | 125,425,605 | $ 32,727,754 | - | $ - | $ - | $ 4,060,940 | $ - | $ - | $ (16,938,503) | $ 19,850,191 |
| Shares issued for Triton Hydrocarbons Pty. | 75,065,944 | 52,000,000 | 13,670,723 | - | - | - | - | - | - | 52,000,000 |
| Convertible debentures issued in the year | - | - | - | - | 3,051,989 | - | - | - | - | 3,051,989 |
| Stock-based compensation charged to operations | - | - | - | - | - | 3,231,833 | - | - | - | 3,231,833 |
| Loss and comprehensive loss for the year | - | - | - | - | - | - | - | - | (12,195,875) | (12,195,875) |
| Balances, December 31, 2009 | 200,491,549 | $ 84,727,754 | 13,670,723 | $ - | $ 3,051,989 | $ 7,292,773 | $ - | $ - | $ (29,134,378) | $ 65,938,138 |
| Shares issued pursuant to option exercises | 750,000 | 210,732 | - | - | - | (120,000) | - | - | - | 90,732 |
| Shares issued pursuant to initial public offering | 166,394,000 | 93,052,866 | - | - | - | - | - | - | - | 93,052,866 |
| Share issuance costs | - | (6,538,762) | - | - | - | - | - | - | - | (6,538,762) |
| Shares repurchased pursuant to stabilization activities | (1,219,061) | (608,498) | - | - | - | - | - | - | 61,200 | (547,298) |
| Convertible debentures converted in the period | 35,086,842 | 21,388,537 | - | - | (1,388,537) | - | - | - | - | 20,000,000 |
| Preferred shares redeemed | - | - | (13,670,723) | - | - | - | - | - | - | - |
| Convertible debentures issued in the period | - | - | - | - | 496,548 | - | - | - | - | 496,548 |
| Stock-based compensation charged to operations | - | - | - | - | - | 3,085,915 | - | - | - | 3,085,915 |
| Foreign currency translation adjustment on foreign operations | - | - | - | - | - | - | 248,142 | - | - | 248,142 |
| Non-controlling interest on initial KUB-Gas acquisition | - | - | - | - | - | - | - | 18,951,944 | - | 18,951,944 |
| Non-controlling interest, additional investment in KUB-Gas | - | - | - | - | - | - | - | 1,140,000 | - | 1,140,000 |
| Loss for the period | - | - | - | - | - | - | - | (163,035) | (15,315,220) | (15,478,255) |
| Balances, September 30, 2010 | 401,503,330 | $ 192,232,629 | - | $ - | $ 2,160,000 | $ 10,258,688 | $ 248,142 | $ 19,928,909 | $ (44,388,398) | $ 180,439,970 |
| | | | | | | | | | | |
| Balances, January 1, 2009 | 125,425,605 | $ 32,727,754 | - | $ - | $ - | $ 4,060,940 | $ - | $ - | $ (16,938,503) | $ 19,850,191 |
| Stock-based compensation charged to operations | - | - | - | - | - | 78,289 | - | - | - | 78,289 |
| Net loss and comprehensive loss for the period | - | - | - | - | - | - | - | - | (5,700,023) | (5,700,023) |
| Balances, September 30, 2009 | 125,425,605 | $ 32,727,754 | - | $ - | $ - | $ 4,139,229 | $ - | $ - | $ (22,638,526) | $ 14,228,457 |

## KULCZYK OIL VENTURES INC.

Consolidated Statements of Operations and Comprehensive Loss

US$

(Unaudited)

| | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| Oil and gas revenue, net of royalties | $ 2,827,824 | $ - | $ 3,827,686 | $ - |
| Operating expenses | | | | |
| Production expenses | (583,653) | - | (772,035) | - |
| General and administrative | (3,004,770) | (2,126,714) | (7,132,727) | (3,908,835) |
| Acquisition costs, Triton (note 14) | - | (1,642,416) | (197,828) | (1,642,416) |
| Acquisition costs, KUB-Gas (note 13) | (450,000) | - | (1,372,200) | - |
| Stock based compensation | (857,086) | (27,552) | (3,085,915) | (78,289) |
| Impairment of exploration and evaluation assets | - | - | - | (178,000) |
| Depletion and depreciation | (1,569,680) | (49,161) | (2,289,795) | (74,895) |
| | (6,465,189) | (3,845,843) | (14,850,500) | (5,882,435) |
| Finance income/(expenses) | | | | |
| Interest and other income | (27,589) | 4,657 | 99,319 | 31,826 |
| Unrealized loss on investments | (58,102) | (230,264) | (60,830) | (261,976) |
| Interest expense and accretion | (565,291) | (145,512) | (3,629,725) | (145,982) |
| Gain on sale of assets (note 1) | 315,339 | - | 315,339 | - |
| Foreign exchange gain/(loss) | 894,399 | (587,120) | (546,311) | (371,960) |
| | 558,756 | (958,239) | (3,822,208) | (748,092) |
| Equity loss of associates (note 9) | (369,616) | - | (409,988) | - |
| Loss before tax | (3,448,225) | (4,804,082) | (15,255,010) | (6,630,527) |
| Current tax expense (note 23) | (130,420) | - | (381,163) | - |
| Deferred tax (expense) reduction (note 23) | (148,053) | 930,504 | 157,918 | 930,504 |
| Loss for the period | (3,726,698) | (3,873,578) | (15,478,255) | (5,700,023) |
| Foreign currency translation gain of foreign operations | 263,025 | - | 248,142 | - |
| Total comprehensive loss | $ (3,463,673) | $ (3,873,578) | $ (15,230,113) | $ (5,700,023) |
| Loss attributable to: | | | | |
| Common shareholders | (3,593,338) | (3,873,578) | (15,315,220) | (5,700,023) |
| Non-controlling interest | (133,360) | - | (163,035) | - |
| Loss for the period | $ (3,726,698) | $ (3,873,578) | $ (15,478,255) | $ (5,700,023) |
| Net loss per share attributable to common shareholders - basic and diluted | $ (0.01) | $ (0.03) | $ (0.05) | $ (0.04) |
| Total comprehensive loss attributed to: | | | | |
| Common shareholders | (3,330,313) | (3,873,578) | (15,067,078) | (5,700,023) |
| Non-controlling interest | (133,360) | - | (163,035) | - |
| Total comprehensive loss for the period | $ (3,463,673) | $ (3,873,578) | $ (15,230,113) | $ (5,700,023) |

**KULCZYK OIL VENTURES INC.**

Consolidated Statements of Cash Flows

US$

(Unaudited)

| | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| Net loss | $ (3,726,698) | $ (3,873,578) | $ (15,478,255) | $ (5,700,023) |
| Items not involving cash: | | | | |
| Depletion and depreciation | 1,569,680 | 49,161 | 2,289,795 | 74,895 |
| Impairment | - | - | - | 178,000 |
| Accretion on convertible debentures and provisions | 391,661 | 107,819 | 2,593,160 | 108,289 |
| Proceeds on sale of Slovenia | (313,339) | - | (313,339) | - |
| Stock based compensation | 857,086 | 27,552 | 3,085,915 | 78,289 |
| Unrealized loss on investments | 427,718 | 230,264 | 470,818 | 261,976 |
| Foreign exchange loss | - | 123,074 | - | (225,184) |
| Deferred income tax (reduction) | 148,053 | (930,504) | (157,918) | (930,504) |
| | (645,839) | (4,266,212) | (7,509,824) | (6,154,262) |
| Changes in non-cash working capital | (1,698,329) | 100,159 | (1,949,056) | (1,305,773) |
| | (2,344,168) | (4,166,053) | (9,458,880) | (7,460,035) |
| Financing | | | | |
| Issuance of common stock (note 18) | 90,732 | - | 93,143,598 | - |
| Initial public offering costs | (572,103) | (704,948) | (5,691,711) | (704,948) |
| Repurchased IPO shares (note 18 (b)) | - | - | (547,298) | - |
| Advances on convertible debenture (note 16) | - | 2,000,000 | 12,000,000 | 2,000,000 |
| Advances by non-controlling interest to KUB-Gas | 840,000 | - | 1,140,000 | - |
| | 358,629 | 1,295,052 | 100,044,589 | 1,295,052 |
| Investing | | | | |
| Property and equipment expenditures | (1,291,396) | (62,737) | (1,498,404) | (140,418) |
| Acquistion of KUB-Gas (note 13) | - | - | (42,814,480) | - |
| Proceeds on sale of Slovenia | 313,339 | - | 313,339 | - |
| Acquistion of Triton Hydrocarbons (note 14) | - | 2,287,254 | - | 2,287,254 |
| Cash injection into Triton Petroleum (note 14) | - | - | (3,000,000) | - |
| Exploration and evaluation expenditures | (8,272,741) | (2,273,039) | (20,790,692) | (3,033,683) |
| Proceeds from farm-out agreement | 1,000,000 | - | 1,000,000 | - |
| | (8,250,798) | (48,522) | (66,790,237) | (886,847) |
| Effect of exchange rate changes on cash | 5,895 | (354,297) | (23,452) | 37,012 |
| Change in cash | (10,230,442) | (3,273,820) | 23,772,020 | (7,014,818) |
| Cash and cash equivalents, beginning of period | 34,787,272 | 5,581,227 | 784,810 | 9,322,225 |
| Cash and cash equivalents, end of period | $ 24,556,830 | $ 2,307,407 | $ 24,556,830 | $ 2,307,407 |
| Supplemental cash flow information | | | | |
| Interest paid | $ (1,346,402) | $ - | $ (1,346,402) | $ - |
| Interest received | $ (27,589) | $ 4,657 | $ 99,319 | $ 31,826 |

**(Stated in U.S. Dollars)**

## 1. Reporting Entity

Kulczyk Oil Ventures Inc. ("**Kulczyk Oil**" or "the **Company**") is a publicly listed company whose common shares commenced trading on the Warsaw Stock Exchange on May 25, 2010. Kulczyk Oil is the successor to Loon Energy Inc. ("**Loon**") in accordance with a Plan of Arrangement under the Business Corporations Act (Alberta) that was approved on December 9, 2008 (the "**Arrangement**").

The consolidated financial statements of the Company include the accounts of Kulczyk Oil Ventures Inc. and its subsidiaries together with its equity investments in certain companies. The Company is principally engaged in the exploration for and development of oil and gas properties in Ukraine, Brunei and Syria and conducts many of its activities jointly with other companies; these financial statements reflect only the Company's proportionate interest in such activities. The following is a general summary of the Company's properties:

### Ukraine

On June 11, 2010, Kulczyk Oil completed the acquisition of an effective 70% ownership interest in the statutory charter capital of KUB-Gas LLC ("**KUB-Gas**"), a Ukrainian registered company with 100% ownership interests in three exploration licenses and one production license, plus processing facilities and various well servicing assets in Ukraine. Included in the acquisition, but separate from the ownership of KUB-Gas shares, is a 70% interest in a 1,000 horsepower drilling rig built in Canada in 2007.

| **Production license** | **Issue date** | **Prolongation date** | **Expiry date** |
|---|---:|---:|---:|
| Vergunskoye field | 27 September 2006 | - | 27 September 2026 |
| | | | |
| **Exploration licences** | | | |
| Makeevskoye field | 18 May 2001 | 11 August 2009 | 11 August 2014 |
| Krutogorovskoye field | 16 July 2004 | 11 August 2009 | 11 August 2014 |
| Olgovskoye field | 31 May 2006 | 11 August 2009 | 11 August 2014 |

Under the exploration licence terms, KUB-Gas may produce natural gas and gas condensate from the exploration fields to a limit of 10% of total reserves estimated and approved by the licensor, the Ministry for Environmental Protection of Ukraine, and may not exceed the cap during the exploration period. Should KUB-Gas wish to produce more, it would need to convert the exploration license into a production license. The production license allows unlimited production of gas and gas condensate over the terms of the license. Management expects that KUB-Gas will be able to convert the exploration licences into production licences when this is necessary.

### Brunei – Block L (40% interest)

On August 28, 2006 KOV Brunei Limited ("**KOV Brunei**"), an indirect wholly-owned subsidiary of Kulczyk Oil, and QAF Brunei Sdn. Bhd. ("**QAF**") (collectively, together with assignees, referred to as the "**Contractor**") signed a Production Sharing Agreement ("**PSA**") with Brunei National Petroleum Company Sendirian Berhad ("**PetroleumBRUNEI**"). The PSA granted QAF (as to a 10% working interest) and KOV Brunei (as to a 90% working interest) the right to explore for and produce oil and gas from Block L. Block L comprises approximately 2,220 square kilometres (550,000 acres) which includes both onshore and shallow offshore areas of northern Brunei.

On April 23, 2007, KOV Brunei signed an Option Agreement with AED (SE Asia) Limited ("**AED**") pursuant to which AED was granted the option to acquire a 50% interest in the PSA, with consideration consisting of the reimbursement to KOV Brunei of approximately $1.4 million of previously incurred costs, and agreeing to fund 100% of the Phase 1 work program required by the PSA to a maximum expenditure of approximately $21.7 million. On January 28, 2008, AED gave notice of its exercise of the option and by deed of assignment dated May 23, 2008, was assigned a 50% working interest in Block L. As part of the approval of the assignment, the Contractor agreed to spend $4.5 million on work in addition to that specified in the PSA for Phase 1.

As at September 30, 2010, approximately $54.4 million in expenditures have been incurred by the Contractor in meeting its work commitments, and pursuant to the Option Agreement, AED funded 100% of the first $21.7 million in Phase 1 costs incurred. The Company funded 50% of all expenditures between $21.7 million and $25 million and 40% of all expenditures thereafter. As at September 30, 2010, the Company has spent $16.0 million.

In August 2010, the Company and its joint venture partners elected to proceed with the Phase 2 exploration period.

**Brunei – Block M (36% interest)**

The Company acquired a 36% interest in the Brunei Block M Production Sharing Agreement effective September 15, 2009 with the acquisition of Triton Hydrocarbons Pty Ltd. ("**Triton Hydrocarbons**"). Block M covers an onshore area of Brunei approximately 3,011 square kilometres (744,000 acres) in area and is immediately south of the Company's interest in Block L.

As at September 30, 2010 approximately $35.3 million in expenditures have been incurred by the Contractor in meeting its work commitments. Since acquiring its interest in Block M, the Company has spent $7.5 million.

**Syria – Block 9 (45% interest)**

Loon Latakia Limited ("**Loon Latakia**"), an indirect wholly-owned subsidiary of Kulczyk Oil, holds a 100% participating interest in a Contract for the Exploration, Development, and Production of Petroleum ("**PSC**") between the Government of the Syrian Arab Republic, Syrian Petroleum Company ("**SPC**") and the Company which became effective on November 29, 2007. This agreement gives the Company the right to explore for and produce oil and gas from Block 9, a 10,032 square kilometre block in north-western Syria.

As part of the consideration for purchasing Triton Hydrocarbons in September 2009, the Company has agreed to transfer a 20% beneficial interest in Block 9 to Triton Petroleum Pte Ltd. ("**Triton Petroleum**") subject to obtaining the consent of the Syrian government The Company has also agreed to assign a 5% interest in Block 9 to an unrelated party.

On September 1, 2010, the Company entered into a farm-out agreement with MENA Hydrocarbons (Syria) Ltd ("**MENA**") whereby Loon Latakia agreed to assign a 30% ownership interest in Syria Block 9 to MENA effective as of June 17, 2010. The transfer of the 30% ownership interest to MENA is subject to the approval of Syrian authorities, and until such approval is received, MENA will retain an economic interest in Syria Block 9 equivalent to a 30% ownership interest. In the event that approval of the Syrian authorities is not obtained by February 15, 2011, the farm-out agreement may be terminated at the request of either party, and any payments made by MENA returned. As consideration, MENA agreed to pay: (i) 30% of historical costs incurred by the Company to June 30, 2010, being $3.1 million of which $2.9 million directly relate to Block 9, (ii) 30% of the value of the bank guarantee outstanding at June 17, 2010, being $2,027,472 and (iii) pay 60% of the authorized drilling costs of the first exploratory well. The farm-out agreement was amended by agreement dated October 14, 2010 to change the payment dates specified in the farm-out agreement such that an initial payment of $1.0 million was made on October 14, 2010 with the remaining $2.1 cash consideration due for reimbursement of historical costs and funding of the bank guarantee due by January 31, 2011 at the latest.

The aggregate effect of the disposition of a 20% ownership interest to Triton Petroleum, the assignment of 5% to the unrelated 3rd party and the MENA farm-out of a 30% interest leaves the Company with an effective interest in Block 9 of 45%.

The Company initially posted a guarantee in the amount of $7.5 million, an amount which represents the minimum exploration expenditure level specified in the PSC, with the amount of the guarantee reduced to $6.76 million in November 2009 to recognize the fulfillment of specified work commitments. The farm-out agreement pursuant to which MENA agreed to fund 30% of the bank guarantee reduced the Company's share of the bank guarantee to $4.7 million as at September 30, 2010, with the amount of the bank guarantee due from MENA reflected as an accounts receivable.

As at September 30, 2010, approximately $9.8 million in expenditures have been incurred on Block 9. The Company's portion of these expenditures as at September 30, 2010 was $4.9 million, (net of $2.9 million of historical costs reimbursed by MENA).

**Slovenia**

The Company had interests in a project in Slovenia for which there were no plans to invest further capital and accordingly, all amounts related to Slovenia had been written off as of June 30, 2009. The Company then completed the sale of its Slovenia assets in August 2010. The sale of these previously written off assets resulted in a gain of $315,339 being recognized in the statement of operations.

## 2. Basis of preparation

### (a) Statement of compliance

These interim consolidated financial statements are unaudited and have been prepared in accordance with IAS 34 'Interim Financial Reporting' ("**IAS 34**") using accounting policies consistent with the International Financial Reporting Standards ("**IFRS**") issued by the International Accounting Standards Board and Interpretations of the International Financial Reporting Interpretations Committee ("**IFRIC**").

This is the first year for which the Company has adopted IFRS and therefore the interim consolidated financial statements include as comparative information the period included with the Company's annual consolidated financial statements for the year ending December 31, 2009 prepared in accordance with IFRS. Previously, the Company prepared its annual and interim consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles ("**GAAP**").

This is the first year for which the Company has adopted IFRS and the Company's disclosures exceed the minimum requirements under IAS 34. The Company has elected to exceed the minimum requirements in order to present the Company's accounting policies in accordance with IFRS and the additional disclosures required under IFRS, which also highlight the changes from the Company's 2009 annual consolidated financial statements prepared in accordance with Canadian GAAP. In 2011, and beyond, the Company may not provide the same amount of disclosure in the Company's interim consolidated financial statements under IFRS as the reader will be able to rely on the annual consolidated financial statements which will be prepared in accordance with IFRS.

These interim consolidated financial statements were authorized by the Company's Board of Directors on November 10, 2010.

### (b) Basis of Measurement

The interim consolidated financial statements have been prepared using the historical cost basis except for certain financial instruments which are measured at fair value as explained in the significant accounting policies set out in note 4. The comparative figures presented in these consolidated financial statements are in accordance with IFRS and have not been audited.

These interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities in the normal course of business. The Company's exploration activities and overhead costs have been financed to date by way of equity issuances and by farm-out agreements through which third parties pay for all or a portion of the Company's expenditures to earn a portion of the Company's ownership interest.

In May 2010, the Company completed an initial public offering of its common shares on the Warsaw Stock Exchange which resulted in the issuance of 166,394,000 shares for gross proceeds of approximately $93 million (PLN 314,484,660). These funds, after completing the KUB-Gas acquisition, are anticipated to be sufficient to fund the Company's capital program for the remainder of the year. However, additional capital may be required to complete the exploration and development of the Company's oil and gas concessions. There can be no guarantees that additional equity will be available in the future if needed.

### (c) Functional and presentation currency

The consolidated financial statements are presented in U.S. dollars, which is the functional currency of the Company and its subsidiaries with the exception of KUB-Gas which uses the Ukraine Hryvnia as its functional currency.

### (d) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumption that affect the application of accounting policies and the reporting amounts of assets, liabilities, income and expenses. Actual results could differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the interim consolidated financial statements is included in the following notes:

- Note 11 – valuation of property and equipment
- Note 12 – valuation of exploration and evaluation assets
- Note 13 – acquisition of KUB-Gas
- Note 14 – acquisition of Triton
- Note 16 – convertible debentures; allocation of proceeds between debt and equity
- Note 18 – measurement of share-based payments
- Note 23 – deferred taxes

## 3. First Time adoption of IFRS

The Company adopted IFRS on January 1, 2010 with a transition date of January 1, 2009. Under IFRS 1 'First time Adoption of International Financial Reporting Standards', IFRS is applied retrospectively at the transition date with the offsetting adjustments to assets and liabilities generally included in the deficit.

IFRS employs a conceptual framework that is similar to Canadian GAAP. While the adoption of IFRS has not changed the actual cash flows of the Company, the adoption has resulted in significant changes to the reported financial position and results of operations of the Company.

### 3.1 Consolidated Statement of Financial Position

Presented below are reconciliations to IFRS of the consolidated statements of financial position of the Company from the amounts reported under Canadian GAAP.

# Kulczyk Oil Ventures Inc.
## Notes to Interim Consolidated Financial Statements
## For the three and nine months ended September 30, 2010 and 2009
## (Stated in U.S. Dollars)
## (Unaudited)

| | Cdn GAAP January 1, 2009 | Notes a | Notes b | Notes d | IFRS January 1, 2009 (unaudited) |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Current Assets** | | | | | |
| Cash and cash equivalents | $ 9,322,225 | | | | $ 9,322,225 |
| Accounts receivable | 289,696 | | | | 289,696 |
| Prepaid expenses | 165,526 | | | | 165,526 |
| **Total Current Assets** | 9,777,447 | | | | 9,777,447 |
| **Non Current Assets** | | | | | |
| Restricted cash | 7,500,000 | | | | 7,500,000 |
| Investments | 610,764 | | | | 610,764 |
| Property and equipment | 4,483,162 | (566,135) | (3,692,304) | | 224,723 |
| Exploration and evaluation assets | - | | 3,692,304 | | 3,692,304 |
| **Total Assets** | $ 22,371,373 | | | | $ 21,805,238 |
| **Liabilities** | | | | | |
| **Current Liabilities** | | | | | |
| Accounts payable and accrued liabilities | $ 1,936,112 | | | | $ 1,936,112 |
| Income taxes payable | 3,563 | | | | 3,563 |
| **Total Current Liabilities** | 1,939,675 | | | | 1,939,675 |
| Decommissioning provision | 15,372 | | | | 15,372 |
| **Total Liabilities** | 1,955,047 | | | | 1,955,047 |
| **Shareholders' Equity** | | | | | |
| Share capital | 32,727,754 | | | | 32,727,754 |
| Contributed surplus | 4,097,012 | | | (36,072) | 4,060,940 |
| Accumulated other comprehensive income | (2,128,526) | | 2,128,526 | | - |
| Deficit | (14,279,914) | (566,135) | (2,128,526) | 36,072 | (16,938,503) |
| **Total Shareholders' Equity** | 20,416,326 | | | | 19,850,191 |
| **Total Liabilities and Shareholders' Equity** | $ 22,371,373 | | | | $ 21,805,238 |

**(Stated in U.S. Dollars)**

| | Cdn GAAP December 31, 2009 | Notes b | c | d | e | IFRS December 31, 2009 (unaudited) |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| **Current Assets** | | | | | | |
| Cash and cash equivalents | $ 784,810 | | | | | $ 784,810 |
| Accounts receivable | 659,899 | | | | | 659,899 |
| Prepaid expenses | 367,280 | | | | | 367,280 |
| **Total Current Assets** | 1,811,989 | | | | | 1,811,989 |
| **Non Current Assets** | | | | | | |
| Deposit on acquisition | 1,350,000 | | | | | 1,350,000 |
| Restricted cash | 6,758,241 | | | | | 6,758,241 |
| Investments | 578,649 | | | | | 578,649 |
| Investment in affiliates | 100,000 | | | | | 100,000 |
| Other assets | 1,699,903 | | | | | 1,699,903 |
| Property and equipment | 139,137,747 | (138,879,758) | | | | 257,989 |
| Exploration and evaluation assets | - | 138,879,758 | | | (66,200,080) | 72,679,678 |
| **Total Assets** | $151,436,529 | | | | | $ 85,236,449 |
| **Liabilities** | | | | | | |
| **Current Liabilities** | | | | | | |
| Accounts payable and accrued liabilities | $ 4,538,627 | | | | | $ 4,538,627 |
| Convertible debentures | 7,272,229 | | | | | 7,272,229 |
| **Total Current Liabilities** | 11,810,856 | | | | | 11,810,856 |
| Decommissioning provision | 16,247 | | | | | 16,247 |
| Convertible debentures | 7,471,208 | | | | | 7,471,208 |
| Deferred taxes | 66,200,080 | | | | (66,200,080) | - |
| **Total Liabilities** | 85,498,391 | | | | | 19,298,311 |
| **Shareholders' Equity** | | | | | | |
| Share capital | 84,727,754 | | | | | 84,727,754 |
| Convertible debentures equity component | 4,238,873 | | (1,186,884) | | | 3,051,989 |
| Contributed surplus | 7,649,395 | | | (356,622) | | 7,292,773 |
| Accumulated other comprehensive income | (2,128,526) | 2,128,526 | | | | - |
| Deficit | (28,549,358) | (2,128,526) | 1,186,884 | 356,622 | | (29,134,378) |
| **Total Shareholders' Equity** | 65,938,138 | | | | | 65,938,138 |
| **Total Liabilities and Shareholders' Equity** | $151,436,529 | | | | | $ 85,236,449 |

### 3.2 Consolidated Statement of Operations and Comprehensive Loss

Presented below are reconciliations to IFRS of the net loss and comprehensive loss of the Company from the amounts reported under Canadian GAAP:

# Kulczyk Oil Ventures Inc.
## Notes to Interim Consolidated Financial Statements
## For the three and nine months ended September 30, 2010 and 2009
## (Stated in U.S. Dollars)
## (Unaudited)

| | Cdn GAAP Three months September 30, 2009 | Notes | | | | | IFRS Three months September 30, 2009 |
|---|---|---|---|---|---|---|---|
| | (unaudited) | a | b | c | d | f | (unaudited) |
| Operating Expenses | | | | | | | |
| General and administrative | $ 1,786,044 | 340,670 | | | | | $ 2,126,714 |
| Acquisition costs | 1,642,416 | | | | | | 1,642,416 |
| Stock based compensation | 53,569 | | | | (26,017) | | 27,552 |
| Depreciation | 49,364 | | (203) | | | | 49,161 |
| Impairment | - | | | | | | - |
| | 3,531,393 | | | | | | 3,845,843 |
| Finance income (expense) | | | | | | | |
| Interest and other Income | 4,657 | | | | | | 4,657 |
| Unrealized loss on investment | - | | (32,626) | | | (197,638) | (230,264) |
| Interest and accretion | (145,309) | | (203) | | | | (145,512) |
| Foreign exchange gain | (619,746) | | 32,626 | | | | (587,120) |
| | (760,398) | | | | | | (958,239) |
| Loss before tax | (4,291,791) | | | | | | (4,804,082) |
| Deferred tax reduction | - | | | 930,504 | | | 930,504 |
| Net loss | (4,291,791) | | | | | | (3,873,578) |
| Other comprehensive loss | | | | | | | |
| Unrealized loss on investment | (197,638) | | | | | 197,638 | - |
| Comprehensive Loss | $ (4,489,429) | | | | | | $ (3,873,578) |
| Basic and Diluted Loss per Share | $ (0.03) | | | | | | $ (0.03) |

# Kulczyk Oil Ventures Inc.
## Notes to Interim Consolidated Financial Statements
## For the three and nine months ended September 30, 2010 and 2009
## (Stated in U.S. Dollars)
## (Unaudited)

| | Cdn GAAP Nine months September 30, 2009 (unaudited) | Notes a | b | c | d | f | IFRS Nine months September 30, 2009 (unaudited) |
|---|---|---|---|---|---|---|---|
| Operating Expenses | | | | | | | |
| General and administrative | $ 3,334,542 | 574,293 | | | | | $ 3,908,835 |
| Acquisition costs | 1,642,416 | | | | | | 1,642,416 |
| Stock based compensation | 156,340 | | | | (78,051) | | 78,289 |
| Depreciation | 75,568 | | (673) | | | | 74,895 |
| Impairment | 178,000 | | | | | | 178,000 |
| | 5,386,866 | | | | | | 5,882,435 |
| Finance income (expense) | | | | | | | |
| Interest and other Income | 31,826 | | | | | | 31,826 |
| Unrealized gain on investment | - | | | | | (261,976) | (261,976) |
| Interest and accretion | (145,309) | | (673) | | | | (145,982) |
| Foreign exchange loss | (371,960) | | | | | | (371,960) |
| | (485,443) | | | | | | (748,092) |
| Loss before tax | (5,872,309) | | | | | | (6,630,527) |
| Deferred tax reduction | - | | | 930,504 | | | 930,504 |
| Net loss | (5,872,309) | | | | | | (5,700,023) |
| Other comprehensive loss | | | | | | | |
| Unrealized loss on investment | (261,976) | | | | | 261,976 | - |
| Comprehensive Loss | $ (6,134,285) | | | | | | $ (5,700,023) |
| Basic and Diluted Loss per Share | $ (0.05) | | | | | | $ (0.05) |

**(Stated in U.S. Dollars)**

| | Cdn GAAP Year ended December 31, 2009 | Notes a | b | c | d | IFRS Year ended December 31, 2009 (unaudited) |
|---|---|---|---|---|---|---|
| Operating Expenses | | | | | | |
| General and administrative | $ 4,463,732 | 161,873 | | | | $ 4,625,605 |
| Acquisition costs - Triton | 2,526,650 | | | | | 2,526,650 |
| Acquisition costs - KUB | 1,490,235 | | | | | 1,490,235 |
| Stock based compensation | 3,552,383 | | | | (320,550) | 3,231,833 |
| Depreciation | 117,666 | | (875) | | | 116,791 |
| Impairment of exploration and evaluation assets | 906,008 | (728,008) | | | | 178,000 |
| | 13,056,674 | | | | | 12,169,114 |
| Finance income (expense) | | | | | | |
| Interest and other Income | 37,935 | | | | | 37,935 |
| Interest and accretion | (1,305,089) | | (875) | | | (1,305,964) |
| Unrealized loss on investment | (300,307) | | (96,962) | | | (397,269) |
| Foreign exchange gain | 354,691 | | 96,962 | | | 451,653 |
| | (1,212,770) | | | | | (1,213,645) |
| Net loss before taxes | (14,269,444) | | | | | (13,382,759) |
| Deferred tax reduction | - | | | 1,186,884 | | 1,186,884 |
| Net Loss and Comprehensive Loss | $ (14,269,444) | | | | | $ (12,195,875) |
| Basic and Diluted Loss per Share | $ (0.10) | | | | | $ (0.09) |

### 3.3 Statement of Cash Flows

The adoption of IFRS did not impact the amounts reported as the operating, investing and financing cash flows in the consolidated statements of cash flows except as to the presentation of acquisition costs. Under Canadian GAAP acquisition costs were presented as an investing activity. Under IFRS they are presented as an operating activity.

**Notes to the IFRS reconciliations**

**(a) Pre-exploration costs**

The Company incurred pre-exploration costs to evaluate projects, acquisition and farm-ins. Under Canadian GAAP pre-acquisition costs were capitalized to property and equipment. At December 31, 2009, all the pre-acquisition costs were considered impaired and expensed. Under IFRS pre-acquisition costs are expensed as incurred.

**(b) Reclassifications**

**(i) Exploration and evaluation (E&E) assets**

E&E assets consist of the Company's exploration projects which are pending the determination of proven or probable reserves. Under Canadian GAAP these costs were grouped with property and equipment. Under IFRS E&E assets are classified as a separate line in the balance sheet.

**(ii) Accumulated other comprehensive income**

On the date of adoption of IFRS, the Company elected to reclassify foreign exchange translation losses included in accumulated other comprehensive income recognized in accordance with Canadian GAAP to the deficit. As such, the accumulated other comprehensive income at January 1, 2009, which was made up entirely of cumulative translation differences, was reclassified to the deficit.

**(iii) Accretion on decommission provision**

Under Canadian GAAP accretion on the decommissioning provision was included in depreciation and depletion. Under IFRS it is required to be included in interest expense.

**(iv) Foreign exchange on investment**

Under Canadian GAAP foreign exchange on the Jura Energy Corporation ("**Jura**") investment was included in foreign exchange gains and losses. Under IFRS it is required to be included in the gains and losses on the investment.

**(c) Adjustment of deferred taxes**

The Company issued convertible debentures in 2009. A portion of the proceeds was allocated to liabilities and the residual was allocated to equity under both Canadian GAAP and IFRS; however, the deferred tax treatment differs. Under Canadian GAAP no deferred tax liability is recorded on the temporary difference that arises on allocating a portion of the proceeds to equity. Under IFRS the Company is required to recognize a deferred income tax liability on the temporary difference that arises on allocating a portion of the proceeds to equity. The offsetting entry on initial recognition of the deferred tax liability is a decrease in the equity portion of the convertible debenture. When the liability is recognized, the Company simultaneously records the benefit of temporary differences not previously recognized on unrecognized deferred tax assets, with an offsetting recognition of a deferred tax reduction in the statement of operations.

**(d) Adjustment of stock based compensation expense**

Recognition of expense – Under Canadian GAAP the Company used the straight line method to expense vested options. The fair value of stock based awards was calculated as one grant and the resulting fair value was recognized on a straight line basis over the vesting period. Under IFRS each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value, and the resulting fair value is amortized over the vesting period of the respective tranches.

Forfeitures – Under Canadian GAAP forfeitures of awards were recognized as they occurred. Under IFRS forfeiture estimates are recognized on the grant date and revised for actual experiences in subsequent periods.

**(e) Acquisition adjustment**

On September 14, 2009, the Company announced that it had made an offer to the shareholders of Triton, a private Australian company, to acquire all of the issued and outstanding ordinary shares of Triton in exchange for newly issued common shares of Kulczyk Oil and that it had received acceptances from Triton shareholders holding more than 75% of the total number of Triton shares then outstanding, enabling Kulczyk Oil to acquire the remaining Triton shares through an extension of the offer and by using the compulsory acquisition rights provided for in Triton's constitution.

Under Canadian GAAP, the purchase allocation calculated on the Triton acquisition resulted in a deferred tax liability of $66,200,080. The Triton acquisition did not meet the definition of a business under IFRS or Canadian GAAP; under IFRS a deferred tax liability is not recognized on the amount allocated to exploration and evaluation assets.

**(f) Re-designation of investment**

The Company owns approximately 7.5 million common shares of Jura. Under Canadian GAAP the investment was classified as an available for sale investment. The gains or losses on the change in the fair value of the investment from period to period were recorded in other comprehensive loss until such time that the change is considered not to be temporary, which occurred as at December 31, 2009 and 2008. When the decline in fair value was considered not to be temporary the losses that accumulated in other comprehensive income were reclassified to the statement of operations.

Under IFRS the investment is accounted for at fair value with changes in fair value included directly in the statement of operations.

## 4. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Company and its subsidiaries.

### (a) Basis of consolidation

(i) Subsidiaries
The consolidated financial statements include the accounts of the Company and its controlled subsidiaries. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. KOV has one direct wholly-owned subsidiary, Kulczyk Oil Ventures Limited ("**KOV Cyprus**"). Through KOV Cyprus, KOV has three indirect wholly-owned subsidiaries, KOV Brunei Limited which holds the Company's interest in Brunei Block L, Loon Latakia Limited ("**Loon Latakia**") which holds the Company's interest in Syria Block 9 and KOV Borneo Limited ("**KOV Borneo**") which holds the Company's interest in Brunei Block M. KOV Cyprus also owns 70% of Loon Ukraine Holding Limited ("**Loon Ukraine**") which holds a 100% interest in KUB-Gas.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the income statement.

(ii) Equity accounted investees
Associates are those entities in which the Company has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Company holds between 20% and 50% of the voting power of another entity. The Company has two equity accounted investments; one in Mauritania International Petroleum Inc. ("**MIPI**") and the other in Triton Petroleum.

Equity accounted investees are recognized initially at cost. The Company's investment includes goodwill (if any) identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Company's share of the net income or loss and equity movements of equity accounted investees, after adjustments to align accounting policies with those of the Company, from the date that significant influence commences until the date that significant influence ceases. When the Company's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest (including any long-term investments) is reduced to nil and the recognition of further losses is discontinued except to the extent that the Company has an obligation or has made payments on behalf of the investee.

(iii) Jointly controlled operations and jointly controlled assets
Many of the Company's oil and natural gas activities involve jointly controlled assets. The consolidated financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

(iv) Transactions eliminated on consolidation
Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

**(b) Foreign Currency**

(i) Foreign currency transactions
Transactions in foreign currencies are translated to United States dollars at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to United States dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in profit or loss.

(ii) Foreign currency translation
KUB-Gas uses the Ukraine Hryvnia as its functional currency. The assets and liabilities of KUB-Gas are translated into U.S. dollars at the period end exchange rate. The income and expenses of KUB-Gas are translated into U.S. dollars at the average exchange rate for the period. Translation gains and losses are included in other comprehensive income.

**(c) Financial instruments**

(i) Non-derivative financial instruments

Non-derivative financial instruments include cash and cash equivalents, trade and other receivables, investments, trade and other payables, and the liability portion of the convertible debenture. Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs, except for financial assets at fair value through profit or loss whereby any directly attributable transaction costs are expensed as incurred. Subsequent to initial recognition non-derivative financial instruments are designated into one of the following categories and measured as described below.

Held to maturity investments
Subsequent to the initial recognition, held to maturity investments are measured at amortized cost using the effective interest method, less any impairment losses. The Company has no held to maturity investments.

Available-for-sale assets
Subsequent to the initial recognition, available-for-sale assets are measured at fair value and changes therein, other than impairment losses, and foreign currency differences on available-for-sale monetary items are recognized directly to equity. When an investment is derecognized, the cumulative gain or loss in equity is transferred to profit or loss. The Company has no available for sale assets.

Financial assets at fair value through profit or loss
The Company's investments in Jura Energy Corporation and Karl Thomson Holdings Ltd. ("**Karl Thomson**") are financial assets recorded at fair value through profit or loss. Subsequent to the initial recognition, these financial instruments are measured at fair value, and changes therein are recognized in profit or loss.

The Company has designated cash and cash equivalents at fair value. Cash and cash equivalents are comprised of cash on hand, term deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management, whereby management has the ability and intent to net bank overdrafts against cash, are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Other
The Company's trade and other receivables, trade and other payables and the liability portion of the convertible debentures, are classified as other non-derivative financial instruments. Subsequent to the initial recognition, other non-derivative financial instruments are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Compound financial instruments

Compound financial instruments issued by the Company consist of convertible debt that can be converted to common shares at the option of the holder, and the number of shares to be issued does not vary with the changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not remeasured subsequent to initial recognition.

Interest, dividends, losses and gains relating to the financial liability are recognized in the profit and loss. Distribution to the equity holders are recognized against equity, net of any tax benefit.

(iii) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

**(d) Property, plant and equipment and intangible exploration assets:**

(i) Recognition and measurement:

<u>Exploration and evaluation (“E&E”) expenditures:</u>
Pre-license costs are recognized in the statement of operations as incurred.

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable general and administrative costs, are capitalized as either tangible or intangible exploration and evaluation assets according to the nature of the assets acquired. Interest and borrowing costs incurred on E&E assets are not capitalized. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are grouped by concession or field area.

The technical feasibility and commercial viability of extracting a resource is considered to be determinable based on several factors including the assignment of proven reserves. A review of each exploration license or field is carried out, at least annually, to ascertain whether the project is technically feasible and commercially viable. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within property and equipment referred to as oil and natural gas interests.

<u>Development and production costs:</u>
Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into cash generating units (“**CGU**”) for impairment testing and categorized as property and equipment as oil and natural gas interests. Plant and equipment is comprised of drilling and well servicing assets, office equipment

and other corporate assets. When significant parts of an item of property, plant and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized net within "other income" or "other expenses" in profit or loss.

(ii) Subsequent costs:

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized costs generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

(iii) Depletion and depreciation:

The net carrying value of development or production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable and a 50 percent statistical probability that it will be less. The equivalent statistical probabilities for the proven component of proven and probable reserves are 90 percent and 10 percent, respectively.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered proven and probable if the ability to produce is supported by either actual production or conclusive formation test. The area of reservoir considered proven includes (a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, or both, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geophysical, geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of oil and natural gas controls the lower proved limit of the reservoir.

Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are only included in the proven and probable classification when successful tested by a pilot project, the operation of an installed program in the reservoir, or other reasonable evidence (such as, experience of the same techniques on similar reservoirs or reservoir simulation studies) provides support for the engineering analysis on which the project or program was based.

Plant and equipment are recorded at cost and are depreciated over the estimated useful lives of the asset using the declining balance basis at rates ranging from 10% to 30%. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

**(e) Impairment**

(i) Financial assets:

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

(ii) Non-financial assets:

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. The recognition of deferred tax assets is described more fully in note 4(j).

For the purpose of impairment testing, assets, except E&E assets, are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the CGU). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

Goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to the CGU's that are expected to benefit from the synergies of the combination. E&E assets are assessed for impairment at the level of a concession or area, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (oil and natural gas interests in property, plant and equipment).

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

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

**(f) Provisions**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

(i) Decommissioning obligations:

The Company’s activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management’s best estimate of expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(ii) Onerous contracts:

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognises any impairment loss on associated assets.

**(g) Revenue recognition**

Revenue from the sale of gas and gas condensate is recognised in the profit or loss when the significant risks and rewards of ownership are transferred to the buyer and if collection is reasonably assured.

The selling price of gas is determined based on the application of prices for gas sales as approved (capped) by the Ukrainian National Commission on Energy Regulation.

Prices for gas condensate are established at the market based on actual correspondence of supply and demand at a particular period of time.

Tariffs and tolls charged to other entities for use of pipelines and facilities owned by the Company are recognized as revenue as they accrue in accordance with the terms of the service or tariff and tolling agreements.

**(h) Finance income and expenses**

Finance expense comprises interest expense on borrowings, accretion of the discount on provisions and impairment losses recognized on financial assets.

Borrowing costs incurred on exploration and evaluation assets are expensed as incurred. Borrowing costs, if any, for the construction of qualifying assets in the development stage will be capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate that will be used to determine the amount of borrowing costs to be capitalized will be the weighted average interest rate applicable to the Company’s outstanding borrowings during the period.

Interest income is recognized as it accrues in profit or loss, using the effective interest method.

Foreign currency gains and losses, reported under finance income and expenses, are reported on a net basis.

**(i) Share based payments**

The Company has issued options to acquire common shares to directors, officers and employees. The fair value of options on the date they are granted to employees is recognized as compensation expense with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

**(j) Income tax**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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

**(k) Loss per share**

Basic loss per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

**(l) Recent accounting pronouncements**

Certain new accounting standards and interpretations have been published that are not mandatory for the 2010 reporting period. The following standards are assessed to not have a significant impact on the Company's financial statements:

(i) IAS 24 Related Party Disclosure:

Effective for accounting periods commencing on or after 1 January 2011;

(ii) IAS 32, Amendment for Classification of Rights Issues:

Effective for accounting periods commencing on or after 1 February 2010;

(iii) IFRS 9 Financial Instruments:

Effective for accounting periods commencing on or after 1 January 2013;

(iv) IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments:

Effective for accounting periods commencing on or after 1 July 2010;

## 5. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(i) Property and equipment and intangible exploration assets:

The fair value of property and equipment recognized in a business combination is based on market values. The market value of property and equipment is the estimated amount for which property and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in property and equipment) and intangible exploration assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports.

The market value of other items of property and equipment is based on the quoted market prices for similar items.

(ii) Cash and cash equivalents, trade and other receivables, and trade and other payables

The fair value of cash and cash equivalents, trade and other receivables, and trade and other payables approximate their carrying value due to their short term to maturity.

(iii) Stock options

The fair value of employee stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information and peer comparisons), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

(iv) Financial assets and liabilities

The carrying value of the Company's financial assets and liabilities, except for its investment in Jura and Karl Thomson and the convertible debentures approximate their fair values due to their demand nature or because of their relatively short term to maturity. The investments in Jura and Karl Thomson are recorded at fair value based on the quoted market prices for the shares. The fair value of the convertible debentures approximate their fair values at September 30, 2010 due to the proximity of the issuance date to the end of the reporting period.

## 6. Deposit on acquisition

Kulczyk Oil entered into two Sale and Purchase Agreements in November 2009 with Gastek LLC ("**Gastek**") under which the Company agreed to acquire effective ownership of 70% of the shares of KUB-Gas, a Ukrainian company with natural gas producing assets, and drilling and other service equipment for a purchase price of $45 million. A deposit of $1.35 million was paid to Gastek upon the signing of the acquisition agreement and a further deposit of $1.4 million was paid on April 28, 2010. The acquisition closed on June 11, 2010 and the deposits were applied against the purchase price (see note 13).

**(Stated in U.S. Dollars)**

## 7. Restricted cash

Pursuant to the terms of a petroleum exploration license for Block 9 in Syria, the Company posted a performance guarantee in the amount of $7,500,000 in 2007. The funds posted as a performance guarantee are released as the Company completes the work commitments required under the agreement. The Company is entitled to earn interest on these funds. As at September 30, 2010 the Company had $4,749,995 (December 31, 2009 - $6,758,241) remaining on the performance guarantee. The reduction of the bank guarantee is due to the completion of work commitments in Syria and the farm-out agreement pursuant to which MENA agreed to fund 30% of the bank guarantee; the amount of the bank guarantee due from MENA is reflected as an accounts receivable.

The fair value of the restricted cash approximates its carrying value.

## 8. Investments

***Jura Energy Corporation***
The Company owns approximately 7.5 million common shares of Jura. As at September 30, 2010, the quoted market value of the investment was $152,665 (December 31, 2009 - $213,495) and for the three and nine month period ended September 30, 2010 an unrealized loss of $58,102 and $60,830, respectively (September 30, 2009 loss of $261,976) has been recorded in the statement of operations.

***Karl Thomson Holdings Ltd***
On September 15, 2009, the Company acquired Triton Hydrocarbons and one of the assets acquired in the purchase was an investment in common shares of Karl Thomson Holdings Ltd. – a company whose common shares are traded on the Hong Kong Stock Exchange. As at September 30, 2010, the quoted market value of the investment was $238,969 (December 31, 2009 - $365,154).

## 9. Investments in associates

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Investment in MIPI | $ 100,000 | $ 100,000 |
| Investment in Triton Petroleum | 1,331,873 | - |
| Total investments in associates | $ 1,431,873 | $ 100,000 |

The Company acquired a 35% investment in Mauritania International Petroleum Inc. as part of the Triton Hydrocarbons acquisition. MIPI holds a 100% interest in four contiguous exploration blocks located offshore Mauritania. The Company intends to review the resource potential of these exploration blocks in the future. MIPI conducted no operations during the current period.

The Company owns 50% of Triton Petroleum. In the second quarter of 2010, as part of the Triton Hydrocarbons acquisition the Company transferred $3,000,000 in cash to Triton Petroleum, which is 50% owned by the Company. The Company also recorded the transfer of a 20% beneficial interest in Syria Block 9 to Triton Petroleum based on the book value of the asset. The transfer of the cash and the recognition for accounting purposes of the transfer of the 20% beneficial interest in Syria Block 9 resulted in an investment in Triton Petroleum of $1.7 million. Included in the unrealized loss on investments for the three and nine month periods ended September 30, 2010 is $369,616 and $409,988 with respect to the Company's share of the loss of Triton Petroleum.

## 10. Other assets

In May 2010, the Company completed an initial public offering ("**IPO**") and listed its common shares for trading on the Warsaw Stock Exchange. As at December 31, 2009, $1,699,903 of costs associated with the IPO and the Warsaw Stock Exchange listing were recorded as other assets and are now included in the $6,538,762 included in equity as share issue costs.

**(Stated in U.S. Dollars)**

## 11. Property and equipment

| | Oil and Natural gas interests | Plant and equipment | Other | Total |
|---|---|---|---|---|
| **Cost or deemed cost:** | | | | |
| Balance at January 1, 2009 | $ - | $ - | $ 224,723 | $ 224,723 |
| Additions | - | - | 150,684 | 150,684 |
| Balance at December 31, 2009 | - | - | 375,407 | 375,407 |
| Acquisition through business combinations | 53,096,040 | 9,000,063 | 1,718,635 | 63,814,738 |
| Additions | 674,904 | 153,097 | 715,326 | 1,543,327 |
| Foreign currency translation adjustment | 119,581 | 78,836 | 25,851 | 224,268 |
| Balance at September 30, 2010 | $ 53,890,525 | $ 9,231,996 | $ 2,835,219 | $ 65,957,740 |
| **Depletion, depreciation and impairments:** | | | | |
| Balance at January 1, 2009 | $ - | $ - | $ - | $ - |
| Depletion and depreciation | - | - | (117,419) | (117,419) |
| Balance at December 31, 2009 | - | - | (117,419) | (117,419) |
| Depletion and depreciation | (1,689,036) | (399,084) | (201,675) | (2,289,795) |
| Foreign currency translation adjustment | 149 | 141 | 34 | 324 |
| Balance at September 30, 2010 | $ (1,688,887) | $ (398,943) | $ (319,060) | $ (2,406,890) |
| **Net book value:** | | | | |
| At December 31, 2009 | $ - | $ - | $ 257,988 | $ 257,988 |
| Balance at September 30, 2010 | $ 52,201,638 | $ 8,833,053 | $ 2,516,159 | $ 63,550,850 |

**(Stated in U.S. Dollars)**

## 12. Exploration and evaluation assets

Reconciliation of the movements in E&E assets:

| | Nine months ended September 30, 2010 | Year ended December 31, 2009 |
|---|---|---|
| Carrying amount - beginning of period | $ 72,679,678 | $ 3,692,304 |
| Additions | 22,157,949 | 7,262,097 |
| Reduction of working interest in Syria | (3,131,520) | - |
| Acquisition of KUB-Gas | 6,216,812 | - |
| Acquisition of Triton Hydrocarbons (note 14) | 1,741,861 | 61,903,277 |
| Farm-out of 20% of Syria Block 9 | (483,722) | - |
| Impairment loss | - | (178,000) |
| Cumulative translation adjustment | 93,796 | - |
| Carrying amount, end of period | $ 99,274,854 | $ 72,679,678 |

E&E assets consist of the Company's intangible exploration projects which are pending the determination of proven or probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the period. The following is a breakdown of the carrying value of the E&E assets:

| | As at September 30, 2010 | As at December 31, 2009 |
|---|---|---|
| Brunei | | |
| Block L | $ 16,231,644 | $ 6,442,524 |
| Block M | 69,868,794 | 63,058,794 |
| Total Brunei | 86,100,438 | 69,501,318 |
| Syria, Block 9 | 4,874,363 | 3,178,360 |
| Ukraine, KUB-Gas | 8,300,053 | - |
| | $ 99,274,854 | $ 72,679,678 |

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(a) Additions, dispositions and acquisitions:

Pursuant to a farm-out agreement dated September 1, 2010, the Company agreed to assign a 30% ownership interest in Syria Block 9 to MENA effective as of June 17, 2010. As consideration, MENA agreed to pay: (i) 30% of the historical costs incurred by the Company to June 30, 2010, being $3,131,520, (ii) 30% of the value of the bank guarantee outstanding at June 17, 2010, being $2,027,472 and (iii) pay 60% of the authorized drilling costs of the first exploratory well. As at September 30, 2010 these amounts were accrued.

During the second quarter of 2010, the Company completed the KUB-Gas acquisition (note 13). The allocation of the purchase consideration paid resulted in a value of $6,216,812 being assigned to intangible E&E assets.

During the third quarter of 2009, the Company completed the Triton Hydrocarbons acquisition (note 14). The allocation of the purchase consideration paid resulted in a value of $61,903,277 being assigned to intangible E&E assets representing Triton's interest in Block M in Brunei.

**(Stated in U.S. Dollars)**

(b) Amortization and impairment charge:
The impairment of intangible exploration and evaluation assets, and any eventual reversal thereof, is recognized in the statement of profit and loss. During the year ended December 31, 2009, the Company wrote-off the carrying value of $178,000 with respect to other prospective projects as it intends to focus on Ukraine, Brunei and Syria.

(c) Recoverability of exploration and evaluation assets:
The Company assesses the recoverability of E&E assets, before and at the moment of reclassification to property and equipment, at the concession or area level.

(d) Contingencies:
Although the Company believes that it has title to its oil and natural gas properties, it cannot control or completely protect itself against the risk of title disputes or challenges.

## 13. Acquisition of KUB-Gas

On November 10, 2009, Kulczyk Oil entered into two Sale and Purchase Agreements with Gastek, a United States company, pursuant to which the Company agreed to acquire an effective 70% ownership interest in the statutory charter capital of KUB-Gas, a Ukrainian company with natural gas and gas condensate producing assets and other service equipment, together with a Canadian built drilling rig, for a purchase price of $45 million, less closing adjustments. A deposit of $1.35 million was paid to Gastek upon the signing of the acquisition agreements and an additional $1.4 million deposit paid to Gastek in April 2010. The acquisition closed on June 11, 2010. Total acquisition costs incurred prior to the acquisition closing on June 11, 2010 totaled $2.8 million of which $1,372,200 were incurred during the nine month period ended September 30, 2010.

| | Pre-Acquisition Carrying Amounts | Fair Value Adjustments | Recognized values on acquisition |
|---|---|---|---|
| Cash and cash equivalents | $ 56,724 | $ - | $ 56,724 |
| Accounts receivable | 242,479 | - | 242,479 |
| Prepaid expenses and deposits | 49,417 | - | 49,417 |
| Other current assets | 145,138 | - | 145,138 |
| Property and equipment | 14,792,934 | 49,021,804 | 63,814,738 |
| Exploration and evaluation assets | 6,216,812 | - | 6,216,812 |
| Accounts payable and accrued liabilities | (1,631,751) | - | (1,631,751) |
| Decommissioning provision | (110,161) | - | (110,161) |
| Deferred tax liability | (1,770,168) | (3,840,079) | (5,610,247) |
| Net identifiable assets and liabilities | $ 17,991,424 | $ 45,181,725 | 63,173,149 |
| Non-controlling interest | | | (18,951,944) |
| Consideration | | | $ 44,221,205 |
| Consideration per agreements | | | $ 45,000,000 |
| Closing adjustments | | | (778,795) |
| Cash consideration | | | 44,221,205 |
| Cash and cash equivalents acquired | | | (56,724) |
| Acquisition of subsidiary, net of cash acquired | | | $ 44,164,481 |
| Acquisition of subsidiary, net of cash acquired | | | $ 44,164,481 |
| Deposit for acquisition as at December 31, 2009 | | | (1,350,000) |
| Cash outflow for acquisition during 2010 | | | $ 42,814,481 |

(Stated in U.S. Dollars)

The following table shows selected pro forma financial information as if the acquisition had occurred on January 1, 2010 instead of the actual closing of June 11, 2010:

| | Nine months ended September 30, 2010 |
|---|---|
| Oil and natural gas revenue | $ 9,618,171 |
| Net loss for the period | $ (14,537,553) |
| Per share - basic and diluted | $ (0.05) |

## 14. Acquisition of Triton Hydrocarbons (Pty) Ltd

In September 2009, the Company made an offer to the shareholders of Triton Hydrocarbons, a private Australian company, to acquire all of the issued and outstanding ordinary shares of Triton Hydrocarbons in exchange for newly issued common shares of Kulczyk Oil. The Company received acceptances from Triton Hydrocarbons shareholders holding more than 75% of the total number of Triton Hydrocarbons shares then outstanding, enabling Kulczyk Oil to acquire the remaining Triton shares through an extension of the offer and by using the compulsory acquisition rights provided for in Triton's constitution (the "**Triton Hydrocarbons Acquisition**"). In October, 2009, the Company had acquired all of the issued and outstanding shares of Triton Hydrocarbons. The Triton Hydrocarbons Acquisition was deemed to be effective September 15, 2009, which is the date that the outcome of the proposed transaction became certain.

The Triton Hydrocarbons Acquisition resulted in the shareholders of Triton Hydrocarbons receiving as consideration for such shares: (a) an aggregate of 75,065,944 Kulczyk Oil common shares which, at the time of the closing of the Triton Hydrocarbons Acquisition, was equal to approximately 37% of the total number of issued and outstanding common shares of Kulczyk Oil on a fully-diluted basis; (b) 13,670,723 Series A Preferred Shares of Kulczyk Oil, which, as part of the post-acquisition restructuring of Triton Hydrocarbons, were redeemed in exchange for shares of Triton Petroleum on a 1:1 ratio, such that the former shareholders of Triton Hydrocarbons hold an aggregate 50% direct interest in Triton Petroleum; (c) Kulczyk Oil caused Loon Latakia to hold a 20% beneficial interest in Syria Block 9 for Triton Petroleum; and (d) a commitment by Kulczyk Oil to make a capital contribution of $3 million in cash to Triton Petroleum after the completion of Kulczyk Oil's initial public offering. Triton Petroleum is a private company which was formerly a wholly-owned subsidiary of Triton Hydrocarbons, and which is managed by the former Triton Hydrocarbons management team. The Company holds the remaining 50% in Triton Petroleum indirectly.

Loon Latakia has submitted a request to the Syrian government for its consent to assign a 20% interest to Triton Petroleum. In June 2010, Kulczyk Oil made the capital contribution of $3 million in cash to Triton Petroleum.

As part of the completion of the Triton Hydrocarbons Acquisition, Kulczyk Oil issued a secured subordinated convertible debenture, the TIG convertible debenture, on September 15, 2009 in the amount of US$10,010,000 to replace a convertible note that had been previously issued by Triton Hydrocarbons (Note 16).

Triton Hydrocarbons holds a 36% interest in Brunei Block M. In accordance with the terms of the Block M Production Sharing Agreements, PetroleumBRUNEI had the right to purchase Triton's 36% interest in Brunei Block M at its fair market value upon a change in control of Triton Hydrocarbons. On January 20, 2010 Kulczyk Oil received notification that PetroleumBRUNEI accepted the change in control from Triton to Kulczyk Oil and waived its right to purchase Triton's interest in Brunei Block M.

The effective date of the Triton Hydrocarbons acquisition for accounting purposes is September 15, 2009. As discussed above, certain aspects of the post-acquisition restructuring for the Triton Hydrocarbons acquisition were completed in June 2010, and accordingly certain components of the purchase allocation were recorded in 2009 and the remainder was recorded in June 2010. The table below presents the purchase allocation that was recorded in 2009 and 2010. In June 2010, the Company recorded the assignment of 20% of Syria Block 9 and the capital contribution of $3 million was completed.

**(Stated in U.S. Dollars)**

| | Transactions completed at September 15, 2009 | Transaction completed in June, 2010 | Total |
|---|---|---|---|
| **Consideration** | | | |
| Shares | $ 52,000,000 | $ - | $ 52,000,000 |
| Convertible debenture - liability component | 7,010,000 | - | 7,010,000 |
| Convertible debenture - equity component | 3,000,000 | - | 3,000,000 |
| Assignment of 20% of Syria Block 9 | - | 483,722 | 483,722 |
| Cash | - | 3,000,000 | 3,000,000 |
| | **$ 62,010,000** | **$ 3,483,722** | **$ 65,493,722** |
| **Allocation of Consideration** | | | |
| Working capital (including cash of $1.7 million) | $ (465,741) | $ - | $ (465,741) |
| Investment - Karl Thompson Shares (note 8) | 472,464 | - | 472,464 |
| Exploration and evaluation assets | 61,903,277 | 1,741,861 | 63,645,138 |
| Investment in Mauritania International Petroleum Inc. | 100,000 | - | 100,000 |
| Investment in Triton Petroleum | - | 1,741,861 | 1,741,861 |
| | **$ 62,010,000** | **$ 3,483,722** | **$ 65,493,722** |

In connection with the Triton Hydrocarbons acquisition, the Company incurred $2.6 million of acquisition costs during the year ended December 31, 2009 and $197,828 of acquisition costs in the nine months ended September 30, 2010 that were expensed in the statement of operations. The Company's consolidated statement of operations reflects the expenses of Triton Hydrocarbons and its subsidiaries from September 15, 2009 onwards.

Triton Hydrocarbons also held a 35% interest in MIPI which has exploration assets in Mauritania. The Triton Hydrocarbons Acquisition was not accounted for as a business combination in part as it is in the exploration and evaluation stage and has no production revenues generated from its petroleum and natural gas properties.

## 15. Decommissioning provisions

The Company's provisions consist entirely of decommission obligations, which result from its ownership interests in oil and natural gas assets including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning obligations to be $404,051 as at September 30, 2010 (December 31, 2009 – $16,247). The discount factor is 5%. Accretion for the nine months ended September 30, 2010 was $1,361 (September 30, 2009: $552).

| | As at September 30, 2010 | As at December 31, 2010 |
|---|---|---|
| Balance, beginning of period | $ 16,247 | $ 15,372 |
| Obligations acquired | 110,161 | - |
| Provision for new wells and change in estimates | 274,627 | |
| Accretion | 1,361 | 875 |
| Translation adjustment | 1,655 | - |
| Balance, end of period | $ 404,051 | $ 16,247 |

## (Stated in U.S. Dollars)

### 16. Convertible debentures

**Kulczyk Investments - convertible debenture (current)**

| | Face Value | Liability Component | Equity Component |
|---|---|---|---|
| Balance January 1, 2009 | $ - | $ - | $ - |
| Issued | 8,000,000 | 6,761,128 | 1,238,872 |
| Related deferred tax effect | - | - | (346,883) |
| Accretion | - | 511,101 | - |
| Balance December 31, 2009 | 8,000,000 | 7,272,229 | 891,989 |
| Issued | 12,000,000 | 11,310,346 | 689,654 |
| Converted | (20,000,000) | (20,000,000) | (1,388,537) |
| Related deferred tax effect | - | - | (193,106) |
| Accretion | - | 1,417,425 | - |
| Balance September 30, 2010 | $ - | $ - | $ - |

The Company entered into agreements for an unsecured convertible debt facility for up to $20 million with Kulczyk Investments S.A. ("**KI**") (the Company's major shareholder, owning 49.9% of common shares issued at September 30, 2010). The convertible debenture bore interest at a rate of 7.16% compounding semi annually and was scheduled to mature on August 31, 2010.

Of the $20 million outstanding under the debenture agreement, $14.4 million was converted to 25 million common shares in June 2010. On July 8, 2010, the remaining principal outstanding of approximately $5.6 million was converted to 10,086,842 shares and the interest accrued to the conversion date of $616,000 was paid in cash.

**TIG convertible debenture (current)**

| | Face Value | Liability Component | Equity Component |
|---|---|---|---|
| Balance January 1, 2009 | $ - | $ - | $ - |
| Issued | 10,010,000 | 7,010,000 | 3,000,000 |
| Related deferred tax effect | - | - | (840,000) |
| Accretion | - | 461,208 | - |
| Balance December 31, 2009 | 10,010,000 | 7,471,208 | 2,160,000 |
| Accretion | - | 1,174,374 | - |
| Balance September 30, 2010 | $ 10,010,000 | $ 8,645,582 | $ 2,160,000 |
| Accrued interest for the nine months ended September 30, 2010 | $ - | $ 545,660 | $ - |

On September 15, 2009, the Company issued secured convertible debentures in the aggregate amount of $10,010,000 ("**TIG note**") which mature on August 12, 2011 in connection with the Triton Hydrocarbon acquisition (note 14) to various arms length parties. These convertible debentures are secured by a floating charge on all of the Company's present and after-acquired property. These secured convertible debentures bear interest at a rate of 7.16% compounding semi annually, payable annually. In September 2010, the Company paid the annual accrued interest of $717,000 in cash

**(Stated in U.S. Dollars)**

The conversion price of the debentures into common shares, as amended on August 16, 2010, is $0.5767 per common share. The conversion of the debentures into common shares of Kulczyk Oil may happen at the holder's discretion at any time prior to maturity.

## 17. Capital Management

As at September 30, 2010, the Company's total capital resources amounted to $189.4 million (December 31, 2009 - $80.6 million), consisting of $180.8 million (December 31, 2009 - $65.9 million) in shareholders' equity, and $8.6 million (December 31, 2009 - $14.7 million) in convertible debentures. Consistent with prior years, the Company manages its capital structure to maximize financial flexibility making adjustments in light of changes in economic conditions and risk characteristics of the underlying assets. Further, each potential acquisition and investment opportunity is assessed to determine the nature and total amount of capital required together with the relative proportions of debt and equity to be deployed. The Company does not presently utilize any quantitative measures to monitor its capital. The Company has a floating charge on its assets in relation to the TIG note.

## 18. Share capital

### (a) Authorized

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. The preferred shares may be issued in one or more series, with rights and privileges as determined by the Board of Directors.

### (b) Issued and outstanding

***Common shares issued and outstanding:***

| | Number of Shares | Carrying amount |
|---|---|---|
| Balance, January 1, 2009 | 125,425,605 | $ 32,727,754 |
| Issued pursuant to acquisition of Triton | 75,065,944 | 52,000,000 |
| Balance, December 31, 2009 | 200,491,549 | 84,727,754 |
| Issued pursuant to the initial public offering | 166,394,000 | 93,052,866 |
| Share issue costs | - | (6,538,762) |
| Repurchased pursuant to stabilization activities | (1,219,061) | (608,498) |
| Issued on conversion of convertible debentures | 35,086,842 | 20,000,000 |
| Transfer equity portion of convertible debt | | 1,388,537 |
| Options exercised | 750,000 | 210,732 |
| Balance, September 30, 2010 | 401,503,330 | $ 192,232,629 |

In connection with the initial public offering, and in accordance with the underwriting agreement, an investment banker/broker retained 15% of the IPO funds for a period of 30 days from the first day of trading to be used for market stabilization transactions conducted in accordance with European Union regulations. Approximately 1.2 million Kulczyk Oil shares were purchased for cash of $547,298 and were returned to the Company's treasury and cancelled at the historical carrying amount of $608,498. Unexpended IPO funds have been returned to the Company.

At September 30, 2010, KI owned approximately 49.9% of the issued and outstanding shares of the Company (December 31, 2009 – 46.1%).

The Company's common shares were delisted from trading on the Toronto Venture Exchange at the Company's request on December 10, 2008. The Company's common shares were listed and commenced trading on the Warsaw Stock Exchange on May 25, 2010.

**(Stated in U.S. Dollars)**

***Preferred shares issued and outstanding:***

The Company issued 13,670,723 Series A Preferred Shares to former Triton Hydrocarbons shareholders in connection with the Triton Acquisition. In June 2010, the post acquisition re-structuring steps were completed which resulted in the Series A Preferred Shares being redeemed and cancelled in exchange for 50% of the shares of Triton Petroleum.

**(c) Loss per share**

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Weighted average number of shares outstanding | *400,002,984* | *137,664,617* | *292,830,976* | *129,550,107* |

As the Company is in a loss position, the effect of outstanding options and convertible debentures are anti-dilutive to the net loss per share.

**(d) Stock Options**

The Company granted common share purchase options to officers, directors, employees and certain consultants with exercise prices equal to or greater than the fair value of the common shares on the grant date. Upon exercise, the options are settled in common shares issued from treasury. Options generally vest over 2 years and have a life of 5 years.

| | *Number of Options* | Weighted average exercise price per option (US$) |
|---|---|---|
| Balance, December 31, 2008 | *9,110,000* | $0.54 |
| Forfeited | *(250,000)* | $0.41 |
| Expired | *(1,550,000)* | $0.14 |
| Replacement of expired options on plan amendment | *1,550,000* | $0.14 |
| Granted | *11,180,000* | $0.69 |
| Balance, December 31, 2009 | *20,040,000* | $0.63 |
| Granted | *15,834,000* | $0.62 |
| Exercised | *(750,000)* | $0.12 |
| Balance, September 30, 2010 | *35,124,000* | $0.63 |

On November 12, 2009, the Company amended its stock option plan, and all previously issued share purchase options. These amendments included the following:

- The expiry date of the options was extended for the period of time from when the Company's shares were delisted from the Toronto Venture Exchange, December 10, 2008, to May 25, 2010 the date the Company's shares commenced trading on the Warsaw Stock Exchange. The options that otherwise expired during that period were replaced with the same number of new options.

- The grant price of each option was reduced to 82% of the original grant price. This reduction is intended to reflect the transfer of assets to Loon Energy Corporation as part of the Arrangement.

**(Stated in U.S. Dollars)**

- The grant price has been adjusted to USD from CDN based on the exchange rate in effect on September 15, 2009.

The Company recognized additional stock based compensation expense of $1,724,058 in the last quarter of 2009 as a result of these amendments.

On November 12, 2009, the Company granted 11,180,000 share purchase options at a price of US$0.69 per share to certain directors, officers, employees and consultants of Kulczyk Oil. These share purchase options have a five year term and vest one-third immediately with the remaining two-thirds at one-third per year on the anniversary of the grant date.

On May 25, 2010, the Company granted 15,834,000 share purchase options at a price of USD$0.62 per share to certain directors, officers, employees and consultants of Kulczyk Oil. These share purchase options have a five year term and vest one-third immediately with the remaining two-thirds at one-third per year on the anniversary of the grant date.

The following table summarizes information about the options outstanding as at September 30, 2010:

| Options outstanding | | | Options exercisable | |
|---|---|---|---|---|
| Exercise price (US$) | *Options* | *Contractual life remaining, years (weighted average)* | *Options* | Exercise price (US$) |
| $ 0.16 | 700,000 | 0.3 | 700,000 | $ 0.16 |
| $ 0.19 | 100,000 | 0.3 | 100,000 | $ 0.19 |
| $ 0.53 | 500,000 | 0.8 | 500,000 | $ 0.53 |
| $ 0.73 | 1,930,000 | 1.1 | 1,930,000 | $ 0.73 |
| $ 0.73 | 2,460,000 | 1.8 | 2,460,000 | $ 0.73 |
| $ 0.42 | 475,000 | 3.0 | 475,000 | $ 0.42 |
| $ 0.49 | 75,000 | 3.4 | 75,000 | $ 0.49 |
| $ 0.47 | 1,660,000 | 3.6 | 1,660,000 | $ 0.47 |
| $ 0.54 | 210,000 | 0.3 | 210,000 | $ 0.54 |
| $ 0.69 | 11,180,000 | 4.0 | 3,726,667 | $ 0.69 |
| $ 0.62 | 15,834,000 | 4.7 | 5,278,000 | $ 0.62 |
| $ 0.63 | 35,124,000 | 3.8 | 17,114,667 | $ 0.43 [1] |

[1] The exercise price listed is the weighted average of all the options

**(e) Stock Based Compensation expense**

The weighted average fair value of the options granted and the assumptions used in the Black-Scholes option pricing are as follows:

**(Stated in U.S. Dollars)**

| | Nine months September 30, 2010 | Year ended December 31, 2009 |
|---|---|---|
| Weighted average fair value per option | $ 0.22 | $ 0.34 |
| Exercise price | $ 0.62 | $ 0.69 |
| Volatility | 50.0% | 63.1% |
| Interest rate | 1.95% | 2.78% |
| Expected life (years) | 3 | 4 |
| Forfeiture rate | 3.33% | 3.00% |
| Dividends | Nil | Nil |

## 19. Commitments

**Brunei – Block L**

The Company has a 40% working interest in Block L. The Brunei Block L PSA provides for an exploration period of six years from the date of the Brunei Block L PSA, August 27, 2006 and is divided into two phases. Phase 1 expired on August 27, 2010 and Phase 2 expires August 27, 2012.

The minimum work commitment for the Company and its partners for Phase 1 under the Block L PSA consisted of (i) reprocessing all existing seismic data (to the extent that it is capable of being reprocessed), (ii) acquiring 350 km$^2$ of 3D seismic, (iii) drilling 2 wells, each to a depth of at least 2000 metres, and (iv) conducting $4.5 million of additional work, which is to be agreed with PetroleumBRUNEI. The consequent minimum expenditure requirement specified in the PSA for the Phase 1 exploration period increased from $20.5 million to $25.0 million. AED was required to fund 100% of the first $21.7 million in Phase 1 expenditures and the Company was required to fund 50% of the expenditures between $21.7 and 25 million and 40% of all expenditures thereafter. As at September 30, 2010, all Phase 1 work commitments have been met, and the Company has spent $16.0 million for its share of expenditures on Block L.

In August 2010, the Company and its joint venture partners elected to proceed with the Phase 2 exploration period. The minimum work obligations for Phase 2 include (i) acquire and process not less than 500 km of onshore 2D seismic data and 500 km of offshore 2D seismic data, (ii) acquire and process not less than 150 km$^2$ of offshore 3D seismic data and (iii) drill at least two onshore exploration wells, each to a minimum depth of 2,020 metres. During Phase 2, the Block L joint venture parties are required to spend a minimum of $16 million. The Company's share of the minimum spend is $6.4 million.

Pursuant to an agreement reached to settle a legal challenge to the Company's title under the PSA, the Company agreed to pay a maximum of $3.5 million out of 10% of its future share of profit oil as defined in the Brunei PSA which has not been accrued in these financial statements.

**Brunei – Block M**

The Company has a 36% working interest in Brunei Block M. The Brunei Block M PSA provides for an exploration period of six years from the date of the Brunei Block M PSA, August 27, 2006, and is divided into two phases which may run concurrently.. Phase 1 expires on August 27, 2011 and Phase 2 expires on August 27, 2012, Before January 27, 2011, the Block M contractors shall either: (i) elect to relinquish 50% of the original Agreement Area and enter into Phase 2 of the Exploration Period; or (ii) relinquish all of the Agreement Area.

The minimum work commitment for the Company and its partners in Block M for Phase 1 under the PSA consists of: (i) re-processing at least 1,378 kilometres of seismic data to the extent that the data is capable of being reprocessed; (ii) acquiring and processing not less than 200 kilometres of 2D seismic data; (iii) acquiring and processing not less than 200 km$^2$ of 3D seismic data; (iv) drilling at least two wells, each to a minimum depth of 1,150 metres; and (v) drilling one well to a minimum depth of 2,000 metres. The work commitments for the Block M parties require a minimum expenditure of US$12.525 million during Phase 1. The Company's share of the minimum spend for Phase 1 is $4.5 million plus an obligation under a farm-in agreement to fund an additional 4% ($501,000) towards a partner's share of expenditures.

As at September 30, 2009, two wells have been drilled, both over 1,150 metres, a portion of the 2D and 3D seismic data have been processed and approximately $30.2 million in expenditures have been incurred by the joint venture partners in meeting the work commitments for Phase 1. As at September 30, 2010 , the outstanding work commitments for Phase 1 include the acquisition of 140 kilometres of 2D seismic data and 82 kilometres$^2$ of 3D seismic data, plus the drilling of one well to a minimum depth of 2,000 metres. On July 15, 2010, field operations commenced for a 136 kilometres$^2$ 3D seismic survey in the northern part of Block M.

Before January 27, 2011, the Company and its partners must decide whether or not to elect to move to Phase 2, which would require a minimum work commitment to be completed by August 27, 2012 of: (i) acquiring and processing not less than 80 kilometres of 2D seismic data; and (ii) drilling at least three wells, each to a minimum depth of 1,150 metres. The work commitments for Block M parties require a minimum expenditure of US$7.325 million during Phase 2. The Company's share of the minimum spend is $2.637 million plus an obligation under a farm-in agreement to fund an additional 4% ($293,000) towards a partner's share of expenditures.

**Syria**

The aggregate effect of the disposition of a 20% ownership interest to Triton Petroleum and the MENA farm-out of a 30% interest leaves the Company with a remaining interest in Block 9 of 50%. An unrelated third party also has the right to be assigned a 5% interest in Block 9.

Under the terms of the Block 9 PSC, the Company has a first phase exploration period of four years, ending on November 27, 2011. The remaining work committed to and outstanding at the beginning of the year was to acquire and process 350 km$^2$ of 3D seismic and drill two exploration wells. The remaining minimum expenditure for the Block 9 partners at the beginning of the year was $6.7 million for Phase 1 (note 7), including $1.75 million for the seismic acquisition, $400,000 for the seismic reprocessing and $2 million for each well to be drilled. During the first nine months of 2010, the Company and its partners acquired the 350 km$^2$ seismic, which is currently being processed. The Company expects that drilling of the first of two exploratory wells will commence in the first half of 2011. Before the end of Phase 1 the Block 9 contractors shall either: (i) elect to relinquish 25% of the original Agreement Area and enter into Phase 2 of the Exploration Period; or (ii) relinquish all of the Agreement Area.

In connection with the Triton Hydrocarbons acquisition (note 14) in September 2009, and as part of the consideration payable, Kulczyk Oil also agreed to cause Loon Latakia to hold a 20% beneficial interest in Syria Block 9 for Triton Petroleum and will submit a request to the Syrian government for its consent to assign such interest to Triton Petroleum.

On September 1, 2010, the Company agreed to assign a 30% ownership interest in Syria Block 9 to MENA effective as of June 17, 2010, subject to obtaining the consent of Syrian authorities to the assignment. As consideration, MENA agreed to pay: (i) 30% of historical costs incurred by the Company to June 1, 2010, being $3,131,520, (ii) 30% of the value of the bank guarantee outstanding at June 17, 2010, being $2,027,472 and (iii) pay 60% of the authorized drilling costs of the first exploratory well.

**Ukraine**

The Company has an obligation to make certain capital expenditures to comply with the Ukrainian exploration license requirements. Under these license maintenance commitments the Company is required to commit to seismic, geophysical, exploratory drilling works on licensed fields according to the capital expenditure programmes. Although these commitments are not binding and may be modified based on results of exploration work, the Company's potential capital expenditures relating to qualifying activities on gas and gas condensate fields may reach $36.3 million (UAH 291,200 thousand) during 2010 to 2014. Justified deviation from the capital expenditures committed is permitted and should be agreed with the licensor, while failure to commit exploration works and substantiate the different capital expenditure schedule may result in termination of the license.

**Office Space**

The Company has a lease agreement for office space in Calgary, Canada which expires on October 31, 2014. The commitment is approximately $125,000 per year for the term of the lease.

## (Stated in U.S. Dollars)

## 20. Personnel expenses

**(a)** The aggregate payroll expense of employees and executive management was:

| | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|
| Wages and salaries | $ 3,223,044 | $ 934,995 |
| Bonuses | 1,018,133 | - |
| Benefits and other personnel costs | 1,117,666 | 291,484 |
| Stock based compensation (i) | 2,228,829 | 50,737 |
| Total remuneration | 7,587,672 | 1,277,216 |

Personnel expenses directly attributed to exploration activities have been capitalized and included in exploration assets. Personnel expenses directly attributed to oil and gas properties have been capitalized and included in property and equipment.

**(b)** Key management personnel include the following: the President and Chief Executive Officer, Chief Financial Officer, Vice Chairman, Executive Vice President, Vice President – Operations and Engineering, Vice President Investor Relations and Vice President Geosciences. Key management personnel compensation consists of the following:

| | Three months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|
| Wages and salaries | $ 886,890 | $ 786,492 |
| Bonuses | 1,018,133 | - |
| Other long-term benefits | 476,074 | 276,102 |
| Stock based compensation (i) | 1,135,414 | 25,945 |
| Total remuneration | $ 3,516,511 | $ 1,088,539 |

(i) Represents the amortization of stock based compensation associated with options granted as recorded in the financial statements.

## 21. Financial risk management

The Company as part of its operations carries a number of financial instruments including cash and short-term deposits, restricted cash, accounts receivable, accounts payable and accrued liabilities and convertible debentures. The Company is exposed to the following risks related to its financial assets and liabilities:

### (a) Interest rate risk

The Company maintains its cash and cash equivalents and restricted cash in instruments that are redeemable at any time without penalty, thereby reducing its exposure to interest rate fluctuations thereon. Interest rate risks on the Company's obligations are not considered material because the costs on the convertible debentures are fixed.

### (b) Credit risk

The Company's cash and cash equivalents and restricted cash are held with major financial institutions. Management monitors credit risk by reviewing the credit quality of the financial institutions that hold the cash, cash equivalents and restricted cash.

Accounts receivable as at September 30, 2010 includes $4.2 million due from MENA with the balance of accounts receivable consisting predominately of receivables from other joint venture partners that are anticipated to be applied against future capital expenditures. In addition, the Company has receivables pertaining to the sales of its production in Ukraine, commodity taxes recoverable from the federal government of Canada and interest earned on restricted cash deposits for which credit risk is assessed as being low.

In the Ukraine, credit evaluations are performed on customers requiring credit over a certain amount. The Company does not require collateral in respect of financial assets. Management believes that the Company's exposure to the Ukrainian credit risk is not significant, as the gas sold under contract is paid for at the beginning of each month and therefore prior to the gas being delivered to the customer.

Management has no formal credit policy in place for customers outside the Ukraine and the exposure to credit risk is approved and monitored on an ongoing basis individually for all significant customers.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the statement of financial position.

**(c) Market risk**

The Company is exposed to risks arising from fluctuations in currency exchange rates between the Canadian dollar, Australian dollar, Polish zloty, Ukraine Hryvnia and the United States dollar. At December 31, 2009, the Company's primary currency exposure related to Canadian dollar denominated working capital and cash balances. At September 30, 2010 the Company's primary currency exposure related to Canadian dollar ("**CDN**"), Ukraine Hryvnia ("**UAH**") and Polish Zloty ("**PLN**"). The following table summarizes in U.S. dollars the Company's foreign currency exchange risk for each of the currencies indicated:

| | September 30, 2010 | | | December 31, 2009 |
|---|---|---|---|---|
| | CDN | UAH | PLN | CDN |
| Cash and cash equivalents | $ 204,161 | $ 1,017,123 | $ 1,034,767 | $ 105,340 |
| Accounts receivable | 109,642 | 253,996 | - | 147,199 |
| Prepaid expenses and other current assets | - | 235,789 | - | 39,000 |
| Accounts payable and accrued liabilities | (2,081,392) | (1,354,394) | (116,832) | (137,805) |
| Net foreign exchange exposure | $ (1,767,589) | $ 152,514 | $ 917,935 | $ 153,734 |
| Foreign exchange rate to USD | $ 1.0290 | $ 8.0408 | $ 0.3506 | $ 1.0510 |

For the nine months ended September 30, 2010 and 2009, based on the net foreign exchange exposure at the end of the period, if the Canadian dollar had strengthened or weakened by 10% compared to the U.S. dollar and all other variables were held constant, the after tax net loss would have decreased or increased by approximately $177,000 respectively. For the nine months ended September 30, 2010, based on the net foreign exchange exposure at the end of the period, if the Polish Zloty had strengthened or weakened by 10% compared to the U.S. dollar and all other variables were held constant, the after tax net loss would have decreased or increased by approximately $92,000 respectively. Earnings are not impacted by fluctuations in the Ukraine Hryvnia as translation gains and losses are included in other comprehensive income/(loss).

For the nine months ended September 30, 2010, if the value of Jura and Karl Thomson shares had been 10% higher, the impact would have been a $39,163 (September 30, 2009 - $32,170) reduction in the loss recorded in the statement of operations. If the share price had been 10% lower, the same amount would have increased the net loss.

**(d) Liquidity risk**

The Company monitors its liquidity position regularly to assess whether it has the resources necessary to fund planned exploration commitments on its petroleum and natural gas properties or that viable options are available to fund such commitments from operating cash flow, new equity issuances or alternative sources of financing such as farm-out agreements. However, as an exploration and development company at an early stage of development and without sufficient internally generated cash flow to fund the exploration program, there are inherent liquidity risks, including the possibility that additional financing may not be available to the Company, or that actual exploration expenditures may exceed those planned. Alternatives available to the Company to manage its liquidity risk include deferring planned capital expenditures that exceed amounts required by work programmes to retain concession licences, farm-out arrangements and securing new equity or debt capital.

The Company believes that its cash resources at September 30, 2010 may not be sufficient to finance current operations and planned capital spending anticipated for the next twelve months, and therefore additional funding may be required. The Company completed an equity offering in the second quarter of 2010 through an Initial Public Offering on the Warsaw Stock Exchange which raised gross proceeds of approximately $93 million. In the current quarter, the Company farmed out a 30% working interest in Syria Block 9 to MENA. The Company's current capital planning contemplates the pursuit of additional farm-out opportunities to raise cash and a possible reduction in capital expenditures, and the raising of further equity depending on market conditions.

## 22. Related party transactions

The Company provides financial and accounting services, pursuant to a shared services agreement, to Jura, a public company in which the Company owns 6.4% of the outstanding common shares. Prior to November 2009 Jura provided those services to the Company. For the three months ended September 30, 2010, the fees charged by Jura totalled $nil (September 30, 2009: $58,153). For the nine months ended September 30, 2010, the fees charged by Jura totalled $nil (September 30, 2009: $112,595) and at September 30, 2010, the Company owed $nil to Jura (December 31, 2009- $13,121). For the three months ended September 30, 2010, the Company charged fees and associated costs to Jura totalling $23,945. For the nine months ended September 30, 2010, the Company charged fees and associated costs to Jura totalling $71,837. At September 30, 2010, $nil (September 30, 2009 – $nil) was due from Jura and included in accounts receivable on the consolidated balance sheet. Two directors of the Company, Timothy M. Elliott and Norman W. Holton, are directors of Jura and Paul H. Rose, Chief Financial Officer of the Company is also the Chief Financial Officer of Jura.

Nemmoco Petroleum Corporation ("**Nemmoco**"), a private company of which 37.5% is owned by Timothy M. Elliott, an officer and director of the Company, provides certain personnel and general, accounting and administrative services to the Company at its offices in Dubai on a cost sharing basis. For the nine months ended September 30, 2010, the fees totalled $392,274 (September 30, 2009: $257,400). There were no amounts due to Nemmoco in relation to these administrative services at September 30, 2010 or December 31, 2009.

The Company remains legally responsible for a guarantee issued in August 2007 (the "**Loon Guarantee**") to the Government of Peru regarding the granting of a license contract to a former subsidiary company, Loon Peru Limited. Loon Energy Corporation ("**Loon Energy**"), the parent Company of Loon Peru Limited, has begun the process to replace the Loon Guarantee. This process requires the formal approval of the Government of Peru which has not yet been obtained.

Loon Energy and the Company have entered into an indemnification agreement in respect of the Loon Guarantee. Loon Energy announced on October 25, 2010 that it will not proceed to the second exploration stage and therefore the maximum liability to the Company that may arise from the Loon Guarantee is based on the minimum work obligation for the first exploration phase. The first exploration minimum work program has been completed and the Company does not have a material exposure to the guarantee.

Loon Energy has no employees, and management and administrative services are provided by the management and staff of Kulczyk Oil. For the three months ended September 30, 2010, these fees totalled $2,895. For the nine months ended September 30, 2010, these fees totalled $8,686. At September 30, 2010, Loon Energy owed $nil (December 31, 2009 – $ nil) to Kulczyk Oil for these services. Certain expenditures of Loon Energy are paid for by Kulczyk Oil, Loon Energy reimburses Kulczyk Oil for these expenditures. As at September 30, 2010 Loon Energy owed $nil (December 31, 2009 – $28,382) for these costs. Kulczyk Oil and Loon Energy are related as they have common directors and officers and the same principal shareholder.

The Company paid a $450,000 fee to KI for their assistance with the KUB-Gas acquisition.

The above related party transactions were at exchange amounts agreed to by both parties which approximate fair value.

**(Stated in U.S. Dollars)**

## 23. Income taxes

The differences between the income tax provisions calculated using statutory rates and those reported are as follows:

| | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 | Year ended December 31, 2009 |
|---|---|---|---|
| Loss before income taxes | $ (15,255,010) | $ (6,630,527) | $ (13,382,759) |
| *Federal and provincial statutory rate* | *28.0%* | *29.0%* | *29.0%* |
| Expected income tax reduction | $ (4,271,403) | $ (1,922,853) | $ (3,881,000) |
| Non-deductible expenditures | 864,056 | 22,704 | 937,232 |
| Tax rate differences and net change in tax attributes not recognized | 3,184,102 | 2,830,653 | 1,756,884 |
| Income tax reduction | $ (223,245) | $ 930,504 | $ (1,186,884) |

The tax effects of temporary differences that give rise to future tax assets/(liabilities) are:

| | As at September 30, 2010 | As at December 31, 2009 |
|---|---|---|
| Property and equipment and E&E assets | $ (4,841,570) | $ 85,270 |
| Share issuance costs | 1,679,195 | 44,504 |
| Decommissioning provision | 101,013 | 4,062 |
| Convertible debt | (382,037) | (914,638) |
| Non-capital losses carried forward | 5,932,298 | 2,890,024 |
| | 2,488,898 | 2,109,222 |
| Less: Temporary differences not recognized | (8,161,150) | (2,109,222) |
| Deferred income tax liability | $ (5,672,252) | $ - |

Non-capital losses, arising from Canadian operations, are expected to expire by 2029.

The current tax expense is generated from the Companies operations in Ukraine. The corporate income tax rate in Ukraine is 25%.

## 24. Segmented information

The Company's reportable segments are organized by geographical areas and consist of Brunei, Syria, Ukraine and corporate.

| **Brunei** | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| Capital expenditures - Block L | $ 5,365,146 | $ 747,644 | $ 9,789,120 | $ 3,719,896 |
| Capital expenditures - Block M | 3,156,594 | 439,808 | 6,810,000 | 439,808 |
| Capital expenditures - Brunei | $ 8,521,740 | $ 1,187,452 | $ 16,599,120 | $ 4,159,704 |
| Total assets | $ 86,100,438 | $ 5,180,239 | $ 86,100,438 | $ 5,180,239 |

**Kulczyk Oil Ventures Inc.**
**Notes to Interim Consolidated Financial Statements**
**For the three and nine months ended September 30, 2010 and 2009**
**(Stated in U.S. Dollars)**
**(Unaudited)**

| **Syria** | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| Capital expenditures | $ (2,969,211) | $ 153,807 | $ 1,700,403 | $ 401,565 |
| Total assets | $ 4,874,363 | $ 2,844,764 | $ 4,874,363 | $ 2,844,764 |

| **Ukraine** | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| Oil and Gas Revenue | $ 3,373,836 | $ - | $ 4,571,555 | $ - |
| Royalty Expense | (546,012) | - | (743,869) | - |
| | 2,827,824 | - | 3,827,686 | - |
| Operating income/(expenses): | | | | |
| Operating expense | (583,653) | - | (772,035) | - |
| General and administrative | (492,121) | - | (648,563) | - |
| Depreciation | (1,524,483) | - | (2,168,946) | - |
| Finance income/(expense) | | | | |
| Interest and other income | 3,163 | - | 21,082 | - |
| Interest and accretion | 45,293 | - | 22,147 | - |
| Foreign exchange loss | (8,144) | - | (11,504) | - |
| Profit before tax | $ 267,878 | $ - | $ 269,866 | $ - |
| Current tax expense | $ (130,420) | $ - | $ (381,163) | $ - |
| Capital expenditures | $ 2,773,780 | $ - | $ 3,301,912 | $ - |
| Total assets | $ 70,903,560 | $ - | $ 70,903,560 | $ - |

# Kulczyk Oil Ventures Inc.
## Notes to Interim Consolidated Financial Statements
## For the three and nine months ended September 30, 2010 and 2009
## (Stated in U.S. Dollars)
## (Unaudited)

| **Corporate** | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| Operating expenses: | | | | |
| Operating expense | $ - | $ - | $ - | $ - |
| General and administrative | (2,512,649) | (2,126,714) | (6,484,164) | (3,908,835) |
| Acquisition costs, Triton | - | (1,642,416) | (197,828) | (1,642,416) |
| Acquisition costs, KUB-Gas | (450,000) | - | (1,372,200) | - |
| Stock based compensation expense | (857,086) | (27,552) | (3,085,915) | (78,289) |
| Gain on sale of assets | 315,339 | - | 315,339 | - |
| Impairment of oil and gas assets | - | - | - | (178,000) |
| Depreciation | (45,197) | (49,161) | (120,849) | (74,895) |
| Finance income/(expense) | | | | |
| Interest and other income | (30,752) | 4,657 | 78,237 | 31,826 |
| Unrealized gain /(loss) on investment | (17,730) | (230,264) | (60,830) | (261,976) |
| Interest and accretion | (610,584) | (145,512) | (3,651,872) | (145,982) |
| Foreign exchange gain (loss) | 902,543 | (587,120) | (534,807) | (371,960) |
| Loss before tax | $ (3,306,114) | $ (4,804,082) | $ (15,114,888) | $ (6,630,527) |
| Capital expenditures | $ 249,404 | $ - | $ 323,944 | $ 414,541 |
| Total assets | $ 38,622,078 | $ 13,311,173 | $ 38,622,078 | $ 13,311,173 |