



KULCZYK OIL VENTURES INC.
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010
US\$ in '000's



Management's Report

The Consolidated Financial Statements of Kulczyk Oil Ventures Inc. and related financial information were prepared by, and are the responsibility of Management. The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards. The Consolidated Financial Statements and related financial information reflect amounts which must of necessity be based upon informed estimates and judgments of Management with appropriate consideration to materiality. The Company has developed and maintains systems of controls, policies and procedures in order to provide reasonable assurance that assets are properly safeguarded, and that the financial records and systems are appropriately designed and maintained, and provide relevant, timely and reliable financial information to Management.

KPMG LLP are the external auditors appointed by the shareholders, and they have conducted an independent examination of the corporate and accounting records in order to express an Auditors' Opinion on these Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the Consolidated Financial Statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim financial statements prior to their release, as well as annually to review the Company's annual Consolidated Financial Statements and Management's Discussion and Analysis and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.

"Signed" Timothy M. Elliott

Timothy M. Elliott
Chief Executive Officer

"Signed" Paul H. Rose

Paul H. Rose, CA
Chief Financial Officer

March 19, 2012



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Kulczyk Oil Ventures Inc.

We have audited the accompanying consolidated financial statements of Kulczyk Oil Ventures Inc., which comprise the consolidated statements of financial position as at December 31, 2011 and 2010, the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years ended December 31, 2011 and 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Kulczyk Oil Ventures Inc. as at December 31, 2011 and 2010 and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 2(c) in the consolidated financial statements which describes that Kulczyk Oil Ventures Inc. will require capital to fund the exploration and development program on its oil and gas properties. This condition, as described further in note 2(c), indicates the existence of a material uncertainty that may cast significant doubt about Kulczyk Oil Ventures Inc.'s ability to continue as a going concern.

(signed) "KPMG LLP"

Chartered Accountants
March 19, 2012
Calgary, Canada

KULCZYK OIL VENTURES INC.
Consolidated Statement of Financial Position
US\$ in '000's

		December 31, 2011	December 31, 2010
Assets			
Current			
Cash and cash equivalents		\$ 12,962	\$ 9,090
Accounts receivable		4,840	6,524
Inventory and other		1,482	840
Restricted cash	(Note 6)	-	2,000
		19,284	18,454
Restricted cash	(Note 6)	3,649	3,041
Investments	(Note 7)	409	607
Investment in associates	(Note 8)	100	1,616
Property and equipment	(Note 9)	92,265	71,590
Exploration and evaluation	(Note 10)	104,568	102,017
		\$ 220,275	\$ 197,325
Liabilities			
Current			
Accounts payable and accrued liabilities		\$ 4,874	\$ 4,703
Income taxes payable		1,189	369
Convertible debentures	(Note 13)	10,955	9,042
Current portion of long term debt	(Note 14)	1,733	-
		18,751	14,114
Decommissioning provision	(Note 15)	935	398
Deferred tax liability	(Note 17)	5,262	4,594
Long-term debt	(Note 14)	20,800	-
		45,748	19,106
Shareholders' Equity			
Share capital	(Note 18)	205,445	192,520
Convertible debentures, equity component	(Note 13)	-	2,160
Contributed surplus		13,264	10,655
Accumulated other comprehensive income		735	86
Non-controlling interest		23,653	20,493
Deficit		(68,570)	(47,695)
		174,527	178,219
		\$ 220,275	\$ 197,325
Going concern	(Note 2(c))		
Commitments	(Note 19)		
Neconde purchase option	(Note 5)		

KULCZYK OIL VENTURES INC.
Consolidated Statement of Changes in Equity
US\$ in '000's (except Number of shares)

	Common Shares		Convertible debentures, equity component	Contributed surplus	Cumulative translation adjustment	Non- controlling interest	Deficit	Total
	Number of shares	Amount						
Balances, December 31, 2009	200,491,549	\$ 84,727	\$ -	\$ 7,293	\$ -	\$ -	\$ (29,134)	\$ 62,886
Shares issued pursuant to option exercises	1,350,000	498	-	(311)	-	-	-	187
Shares issued pursuant to initial public offering	166,394,000	93,053	-	-	-	-	-	93,053
Share issuance costs	-	(6,539)	-	-	-	-	-	(6,539)
Share repurchase under reverse green shoe	(1,219,061)	(608)	-	-	-	-	60	(548)
Convertible debentures converted in the period	35,086,842	21,389	2,160	-	-	-	-	23,549
Convertible debentures issued in the period	-	-	-	-	-	-	-	-
Stock-based compensation	-	-	-	3,673	-	-	-	3,673
Foreign currency translation adjustment on foreign operations	-	-	-	-	86	37	-	123
Non-controlling interest on KUB-Gas acquisition	-	-	-	-	-	18,952	-	18,952
Non-controlling interest investment in KUB-Gas	-	-	-	-	-	1,140	-	1,140
Net loss for the period	-	-	-	-	-	364	(18,621)	(18,257)
Balances, December 30, 2010	402,103,330	\$ 192,520	\$ 2,160	\$ 10,655	\$ 86	\$ 20,493	\$ (47,695)	\$ 178,218
Shares issued pursuant to option exercises	200,000	95	-	(63)	-	-	-	32
Convertible debentures converted in the period	18,501,037	10,670	-	-	-	-	-	10,670
Convertible debentures converted in the period - equity	-	2,160	(2,160)	-	-	-	-	-
Stock-based compensation	-	-	-	2,672	-	-	-	2,672
Foreign currency translation adjustment on foreign operations	-	-	-	-	650	278	-	928
Non-controlling interest investment in KUB-Gas	-	-	-	-	-	(1,077)	-	(1,077)
Net earnings (loss)	-	-	-	-	-	3,959	(20,875)	(16,916)
Balances, December 31, 2011	420,804,367	\$ 205,445	\$ -	\$ 13,264	\$ 735	\$ 23,653	\$ (68,570)	\$ 174,527

KULCZYK OIL VENTURES INC.
Consolidated Statement of Operations and Comprehensive Loss
US\$ in '000's

	Year ended December 31,	
	2011	2010
Oil and gas revenue	\$ 35,227	\$ 8,945
Royalty expense	(6,890)	(1,476)
Oil and gas revenue, net of royalties	<u>28,337</u>	<u>7,469</u>
Operating expenses		
Production expenses	(7,228)	(4,127)
General and administrative	(9,021)	(9,376)
Acquisition costs (Note 12)	(1,047)	(1,570)
Stock based compensation (Note 18(d))	(2,672)	(3,673)
Depletion and depreciation	(7,596)	(2,742)
Impairment of exploration and evaluation assets (Note 11)	(8,664)	-
	<u>(36,228)</u>	<u>(21,488)</u>
Finance income/(expenses)		
Interest and other income	(6)	183
Unrealized gain (loss) on investments	(66)	158
Interest expense and accretion	(3,861)	(4,459)
Mark to market on derivative liability (Note 13)	-	193
Gain on sale of assets	-	315
Foreign exchange loss	(354)	(659)
	<u>(4,287)</u>	<u>(4,269)</u>
Equity loss of associates, including impairment loss	<u>(1,516)</u>	<u>(226)</u>
Loss before tax	(13,694)	(18,514)
Current tax (expense) (Note 17)	(2,554)	(778)
Deferred tax reduction (expense) (Note 17)	(668)	1,035
Net loss	(16,916)	(18,256)
Foreign currency translation gain of foreign operations	<u>927</u>	<u>122</u>
Total comprehensive loss	<u>\$ (15,989)</u>	<u>\$ (18,134)</u>
Earnings (loss) attributable to:		
Common shareholders	(20,875)	(18,621)
Non-controlling interest	<u>3,959</u>	<u>364</u>
Loss for the year	<u>\$ (16,916)</u>	<u>\$ (18,257)</u>
Net loss per share attributable to common shareholders - basic and diluted	<u>\$ (0.04)</u>	<u>\$ (0.06)</u>
Total comprehensive earnings (loss) attributed to:		
Common shareholders	(20,226)	(18,536)
Non-controlling interest	<u>4,237</u>	<u>401</u>
Total comprehensive loss for the year	<u>\$ (15,989)</u>	<u>\$ (18,135)</u>

KULCZYK OIL VENTURES INC.

Consolidated Statement of Cash Flows

US\$ in '000's

	Year ended December 31,	
	2011	2010
Net loss	\$ (16,916)	\$ (18,257)
Items not involving cash:		
Equity loss of associates	1,516	226
Depletion and depreciation	7,596	2,742
Impairment (Note 11)	8,664	-
Accretion	1,423	2,988
Gain on sale of assets	-	(315)
Stock based compensation (Note 18(d))	2,672	3,673
Unrealized loss on investments	66	(158)
Mark to market gain on derivative liability (Note 13)	-	(193)
Unrealized foreign exchange gain	(67)	-
Deferred income tax expense (reduction) (Note 17)	668	(1,035)
	5,622	(10,329)
Changes in non-cash working capital	(4,467)	953
	1,155	(9,376)
Financing		
Proceeds from exercise of options	34	-
Initial public offering costs	-	(4,839)
Issuance of common shares	-	93,240
Repurchase IPO shares	-	(547)
Issuance of long-term debt	23,000	-
Long-term debt issuance costs	(1,026)	-
Issuance of convertible debentures	10,500	12,000
Advances by non-controlling interest to KUB-Gas	-	1,140
Changes in working capital related to financing activities	(249)	(853)
	32,259	100,141
Investing		
Property and equipment expenditures	(4,708)	(3,342)
Restricted cash	1,392	(310)
Acquisition of KUB-Gas	-	(42,814)
Proceeds on sale of assets	-	127
Cash injection into Triton Petroleum	-	(3,000)
Exploration and evaluation expenditures	(35,045)	(30,515)
Changes in non-cash working capital related to investing	7,640	(2,609)
	(30,721)	(82,463)
Effect of exchange rate changes on cash	1,179	4
Change in cash	3,872	8,305
Cash and cash equivalents, beginning of year	9,090	785
Cash and cash equivalents, end of year	\$ 12,962	\$ 9,090
<u>Supplemental cash flow information</u>		
Interest paid	\$ -	\$ 1,346
Interest received	\$ (6)	\$ 183
Cash taxes paid	\$ 1,628	\$ 387

Kulczyk Oil Ventures Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2011 and 2010
(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 trade on the Warsaw Stock Exchange (“**WSE**”).

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 with an option to acquire a future interest in Nigeria. The Company conducts many of its activities jointly with other companies; however, these financial statements reflect only the Company’s proportionate interest in such activities. The following is a summary of the Company’s properties:

Ukraine (70% interest)

On June 11, 2010, Kulczyk Oil completed the acquisition of an effective 70% indirect ownership interest in the statutory charter capital of KUB-Gas LLC (“**KUB-Gas**”), a Ukrainian registered company. All of the Company’s producing properties are held by KUB-Gas.

Brunei – Block L (90% interest)

In 2006, the Company, through a subsidiary, signed a Production Sharing Agreement (“**PSA**”) in which it holds a 90% working interest in the right to explore for and produce oil and gas from Block L situated on both onshore and shallow offshore areas of northern Brunei. In 2010, AED (SE Asia) Limited (“**AED**”) acquired a 50% interest in the Block L PSA. In December 2011, the Company purchased AED, including its 50% interest in the PSA resulting in the Company holding a 90% working interest in Block L. In addition, in December 2011, the Company became the operator of Block L.

Block L is in the exploration phase and has no production.

Brunei – Block M (36% interest)

The Company acquired a 36% interest in the Brunei Block M PSA in September 2009 with the acquisition of Triton Hydrocarbons Pty Ltd. (“**Triton Hydrocarbons**”).

Block M is in the exploration phase and has no production.

Syria – Block 9 (50% interest)

Loon Latakia Limited (“**Loon Latakia**”), an indirect wholly-owned subsidiary of Kulczyk Oil, holds a 50% working interest in an Exploration, Development, and Production of Petroleum Contract in the Syrian Arab Republic. This agreement gives the Company the right to explore for and produce oil and gas from Block 9 located in north-western Syria. In March 2011, the Syrian authorities approved the assignment of a 30% working interest to MENA Hydrocarbons (Syria) Ltd. (“**MENA**”) pursuant to a farmout agreement. In July 2011, the Syrian authorities approved the assignment of a 20% working interest to Triton Petroleum Pte Ltd. (“**TPPL**”) which was acquired by Ninnox Energy Pty Ltd. (“**Ninnox**”). An unrelated third party has the right to take up a 5% working interest.

Syria is in the exploration phase and has no production. Exploration activities in Syria have been suspended due to civil unrest in the country.

Nigeria – Option to join Neconde (9% interest)

Kulczyk Oil has an option to join the Neconde Energy Limited (“**Neconde**”) consortium. On November 30, 2011, Neconde acquired a 45% participating interest in Oil Mining Licence (“**OML**”) 42, a large block containing previously-discovered oil fields in the Niger Delta area of Nigeria.

Kulczyk Oil is the technical partner in the consortium and has the option to own up to 20% of Neconde’s ordinary issued equity, which would give the Company an effective indirect 9% ownership interest in OML 42. The OML 42 licence expires in 2019.

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Kulczyk Investments S.A. (“**KI**”), the major shareholder of the Company, has provided bridge financing in respect of the funding of the Company’s share of the acquisition costs. KI and the Company have a put and call option agreement in place, the exercise of which would leave the Company with up to a 20% interest in Neconde. The put and call option agreement, together with the bridge financing agreement both expire on March 31, 2012. The Company’s share in Neconde is held in trust by KI, and some or all of these shares will be released and the trust extinguished upon exercise of the call or put option and repayment by the Company of the funds owed to KI under the bridge loan facility. Conversely, some or all of the Neconde shares owned by the Company will revert to KI if the Company does not fully exercise its option and does not fully repay the bridge loan facility.

Dividends

To date, the Company has not paid a dividend and does not anticipate paying dividends in the foreseeable future. Should the Company decide to pay dividends in the future, the Company would be required to satisfy certain liquidity tests as established in the Alberta Business Corporations Act.

2. Basis of preparation

(a) Statement of compliance

These consolidated financial statements have been prepared using International Financial Reporting Standards (“**IFRS**”) as issued by the International Accounting Standards Board.

These consolidated financial statements were approved by the Company’s Board of Directors on March 19, 2012.

(b) Basis of measurement

The 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 notes 3 and 4.

(c) Going concern

The Company is an oil and gas exploration and development company. The Company’s properties in Brunei and Syria are in the exploration stage and have no proved reserves and do not generate any production revenue. The production from the Company’s Ukrainian operations is not sufficient to fund the continued exploration and development of all of the Company’s oil and gas properties. To fund ongoing operations and the continued exploration and development, the Company has obtained capital from the following sources in the current fiscal year:

- In the second quarter of 2011, KUB-Gas signed a loan facility of up to \$40 million with the European Bank for Reconstruction and Development (“**EBRD**”) (note 14). The facility is intended to provide sufficient financing to KUB-Gas to support its capital expenditure program for at least the next three to four years.
- The owners of the Tiedemann Investment Group (“**TIG**”) convertible debentures (note 13(c)) sold the debentures to an unrelated party in advance of the maturity date of August 12, 2011. The convertible debentures were converted by the new owner to common shares at a conversion price of \$0.5767 per share upon maturity. No cash payment was made by the Company to settle the debenture.
- The Company obtained financing from KI and Radwan Investments GmbH (“**Radwan**”), by way of an issuance of convertible debentures up to a maximum of \$23.5 million (note 13(a)).

These 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 and do not reflect adjustments that would otherwise be necessary if the going concern assumption was not valid. To date, the Company’s exploration and development operations have been financed by way of equity issuances, debt facilities and by farm-out arrangements with third parties who pay for all or a portion of the Company’s expenditures to earn a portion of the Company’s ownership interests. The Company’s cash, restricted cash and existing farm-out arrangements in place are likely not sufficient to fund the committed exploration and

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development program for the next twelve months and this condition creates a material uncertainty that may cast a significant doubt about the Company's ability to continue as a going concern. Additional equity, debt or farm-out arrangements will be required and there are no guarantees that such additional capital funding will be available when needed. The Company, along with its joint venture partners, is applying to extend the licence period in Brunei Block M (note 19). If the extension is approved, committed cash requirements over the next twelve months could be significantly reduced. The exploration licence period for Block L has been extended to August 2013.

(d) 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.

(e) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions 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 consolidated financial statements is included in the following notes:

- Note 3 – Reserves estimates and depletion
- Note 4 – Determination of fair values
- Note 13 – Convertible debentures (fair value measurement)
- Note 17 – Income taxes
- Note 18 – Stock options (measurement of share-based payments)

3. 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 six indirect wholly-owned subsidiaries, KOV Brunei Limited and AED South East Asia Ltd. which hold the Company's interests in Brunei Block L, Loon Latakia Limited which holds the Company's interest in Syria Block 9, KOV Borneo Limited which holds the Company's interest in Brunei Block M and KOV Africa Limited which holds a 100% interest in KOV Nigeria B.V. (Netherlands) which in turn will own up to 20% of Neconde (Nigeria), if the put or call is exercised. KOV Cyprus also owns 70% of KUBGAS Holdings Limited (“**KUB Holdings**”), formerly Loon Ukraine Holding Ltd., which holds a 100% interest in KUB-Gas.

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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. Generally, acquisitions of exploration and evaluation assets do not meet the definition of a business.

(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; Mauritania International Petroleum Inc. (“MIPI”) and Ninox.

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. The Company evaluates at each period the investment’s outlook and when deemed appropriate impairs the value of the investment when realization of the carrying amount the investment is no longer likely.

(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 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 the Company’s functional currency at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency 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, restricted cash, 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.

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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 and liabilities 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. The convertible debentures issued in 2011 (note 13(a)) are 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.

Cash and cash equivalents

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. Restricted cash is comprised of cash held in trust by a financial institution for the benefit of a third party as a guarantee that certain work commitments will be met. Once the work commitments are met, the restricted cash is released from the trust and returned to cash.

Other

The Company's trade and other receivables, trade and other payables and the convertible debentures other than convertible debentures issued in 2011 (note 13(a)), are classified as other non-derivative financial instruments. Subsequent to their initial recognition, other non-derivative financial instruments are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Convertible debentures

The convertible debentures issued in 2011 have no fixed number of common shares that the holder is able to convert to, and therefore are not considered a compound instrument. This issuance of convertible debt is recorded as 100% debt and is measured at each reporting date at fair value.

The KI Debenture (note 13(b)) and the TIG/MWG Debentures (note 13(c)) were classified as other financial liabilities. The debt component of the debentures was recorded at amortized cost using the effective interest method. The embedded conversion features within the debenture were considered a derivative liability which was recorded at fair value with changes in fair value included in profit and loss. The debentures, at the option of the holder, could be converted into common shares, however, the conversion price was not fixed until the Company listed on Warsaw exchange in 2010. As such, IFRS requires the embedded conversion feature to be accounted as a liability. Once the Company listed on the Warsaw exchange, the fair value of the embedded conversion feature was re-classified to equity as a result of the settlement of the KI Debentures and the fixing of the conversion price on the TIG/MWG Debentures. Once in equity, the conversion feature was no longer required to be re-measured each period.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method.

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

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(iii) Derivative financial instruments

The Company has the option (“**Neconde Option**”), to effectively acquire up to a 20% interest in Neconde. The Neconde option is a derivative financial instrument and is marked to market at each period based on the change in value of Neconde. Neconde is not publicly traded and therefore, the Neconde’s fair value is determined using valuation techniques (see note iv).

(iv) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance 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:

Exploration and evaluation (“E&E”) expenditures:

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, or (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 license 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.

Development and production costs:

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 within 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 within 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.

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(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 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 viable. 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 successfully 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.

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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.

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.

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 or 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 unit and then to reduce the carrying amounts of the other assets in the unit 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 remediation 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

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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. The Company has no onerous contracts.

(g) Revenue recognition

Revenue from the sale of gas and gas condensate is recognised in 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 in Ukraine is determined based on the application of prices for gas sales as approved 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.

(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 derived on debt specifically related to the construction of qualifying assets, if any, 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 directors, officers and employees to purchase common shares. 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,

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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 2011 reporting period. The following standards and updates have not yet been assessed as to their impact on the Company's financial statements:

(i) IFRS 9 Financial Instruments:

Effective for accounting periods commencing on or after 1 January 2015;

(ii) IFRS 11 Joint arrangements:

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

(iii) IFRS 12 Disclosure of interests in other entities:

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

(iv) IFRS 13 Fair value measurement:

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

4. 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 or used in an impairment test (fair value less cost to sell) 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

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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 and resource reports.

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

The impairment test for property and equipment is also impacted by the various judgements made by management in determining the assets that comprise each CGU and a field/area for exploration and evaluation assets.

(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) Fair value measurements

The investments in Jura and Karl Thomson are recorded at fair value based on the quoted market prices for the shares (level 1 fair values). The convertible debentures are recorded at fair value which is estimated based on current interest rates for similar instruments, credit spreads applicable to the Company and the term of the instrument (level 2 fair values). The fair value of the long-term debt approximates to carrying value as interest rates and credit spreads applicable to the Company have not estimated to have changed significantly since the credit facility was established (level 2 fair value). The fair value of the Neconde Purchase Option (note 5) is based on numerous factors including changes in the value of the underlying concession since inception of the option, development activity and a planned financing to be done by the Company. The fair value of the option at inception and at December 31, 2011 was not estimated to be significant (level 3 fair value).

5. Neconde Purchase Option

On November 30, 2011, Neconde completed the acquisition of OML 42 for a purchase price of \$585.0 million, excluding closing costs. KI has provided the Company with bridge financing in respect of funding of the Company's share of Neconde's acquisition costs of OML 42 and until the amount outstanding under the bridge lending facility is retired, KI holds the Company's 20% share of Neconde in trust. The Company and KI have a put and call option agreement in place; the Company can exercise its option to take up to its 20% ownership of Neconde by repaying the bridge lending facility for the interest in Neconde taken with a consequent release of those Neconde shares from trust. KI has the right to exercise the option to put the 20% ownership interest in Neconde to the Company, but can only do so if KOV has sufficient funds on hand, obtained either from the issuance of new debt or equity, to fund the acquisition costs. If the Company takes less than its 20% allotment of Neconde shares, ownership of the remaining balance reverts to KI, and the related portion of the bridge lending facility is retired. The put and call option agreement and bridge lending facility arrangement are currently set to expire on March 31, 2012.

The Company's cost to acquire a 20% interest is approximately \$162.5 million, comprised of 31.96% of the cash portion of the purchase price and 31.96% of the interest charges related to \$150 million of Neconde debt financing plus \$19.0 million of additional costs, mostly related to the bridge financing provided by KI. There have been no material events between the closing of the acquisition on November 30, 2011 and December 31, 2011, therefore the value of the option is not considered significant.

6. 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 \$7.5 million 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 December 31, 2011 the Company had a total of \$3.6 million (December 31, 2010 - \$5.0 million) remaining on the performance guarantee. Due to the current political and economic conditions in Syria, it is not likely that any of the restricted cash will be released within the

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next 12 months and therefore the full amount is reported as non-current. As at December 31, 2010, \$2.0 million was classified as long-term.

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

7. Investments

Jura Energy Corporation

The Company owns approximately 7.5 million common shares of Jura representing 5.7% of the shares outstanding. As at December 31, 2011, the quoted market value of the investment was \$305,158 (December 31, 2010 - \$371,113) (level 1 fair value) and for the year ended December 31, 2011 an unrealized loss of \$66,000 (December 31, 2010 gain of \$157,618) has been recorded in the statement of operations.

Karl Thomson Holdings Ltd

On September 15, 2009, the Company acquired Triton Hydrocarbons (note 12) which included 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 December 31, 2011, the quoted market value of the investment was \$103,810 (December 31, 2010 - \$235,496) (level 1 fair value). The Company has an equal and offsetting payable for this investment.

8. Investments in associates

(Thousands of US dollars)

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Investment in Mauritania International Petroleum Inc.	\$ 100	\$ 100
Investment in NinoxEnergy Pty Ltd.	-	<u>1,516</u>
Total investments in associates	<u>\$ 100</u>	<u>\$ 1,616</u>

The Company acquired a 35% investment in MIPI 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 years ended December 31, 2011 and 2010.

The Company presently owns 30% of Ninox which acquired TPPL in 2011 in a share for share acquisition. As of December 31, 2011 Ninox's only asset is a 20% working interest in Syria Block 9. As a result of the cessation of operations and the current political environment in Syria, the Company has impaired the value of the investment in Ninox from \$1.5 million to \$nil.

In the second quarter of 2010, as part of the consideration due for the Triton Hydrocarbons acquisition (note 12), the Company recorded the transfer of a 20% beneficial interest in Syria Block 9 to TPPL based on the book value of the asset being \$1,741,842. On December 20, 2010 TPPL raised new equity through the issuance of common shares which reduced the Company's ownership to 30%. As a result of the dilution of ownership interest, as well as the recognition of the Company's share of the net loss of TPPL, a loss of \$225,973 was recorded in 2010.

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9. Property and equipment

<i>(Thousands of US dollars)</i>	<u>Oil and Natural gas interests</u>	<u>Plant and equipment</u>	<u>Other</u>	<u>Total</u>
Cost or deemed cost:				
Balance at December 31, 2009	\$ -	\$ -	\$ 375	\$ 375
Acquisition through business combinations	53,096	9,000	1,719	63,815
Reclassification from exploration and evaluation	6,551	-	-	6,551
Additions	2,476	497	635	3,608
Foreign currency translation adjustment	50	38	6	94
Balance at December 31, 2010	<u>\$ 62,173</u>	<u>\$ 9,535</u>	<u>\$ 2,735</u>	<u>\$ 74,443</u>
Additions	3,309	1,035	1,220	5,564
Reclassification from exploration and evaluation	24,100	-	-	24,100
Foreign currency translation adjustment	(674)	(29)	(180)	(883)
Balance at December 31, 2011	<u><u>\$ 88,908</u></u>	<u><u>\$ 10,541</u></u>	<u><u>\$ 3,775</u></u>	<u><u>\$ 103,224</u></u>
Depletion and depreciation:				
Balance at December 31, 2009	\$ -	\$ -	\$ (117)	\$ (117)
Depletion and depreciation	(2,347)	(145)	(249)	(2,741)
Foreign currency translation adjustment	1	3	1	5
Balance at December 31, 2010	<u>\$ (2,346)</u>	<u>\$ (142)</u>	<u>\$ (366)</u>	<u>\$ (2,853)</u>
Depletion and depreciation	(6,399)	(833)	(354)	(7,586)
Impairment of assets	(332)	-	(23)	(355)
Foreign currency translation adjustment	(84)	(71)	(9)	(164)
Balance at December 31, 2011	<u><u>\$ (9,162)</u></u>	<u><u>\$ (1,046)</u></u>	<u><u>\$ (752)</u></u>	<u><u>\$ (10,959)</u></u>
Net book value:				
Balance at December 31, 2010	<u>\$ 59,827</u>	<u>\$ 9,394</u>	<u>\$ 2,370</u>	<u>\$ 71,590</u>
Balance at December 31, 2011	<u><u>\$ 79,746</u></u>	<u><u>\$ 9,496</u></u>	<u><u>\$ 3,024</u></u>	<u><u>\$ 92,265</u></u>

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10. Exploration and evaluation assets

Reconciliation of the movements in Exploration and Evaluation (“E&E”) assets:

<i>(Thousands of US dollars)</i>	As at December 31, 2011	As at December 31, 2010
Carrying amount, beginning of year	\$ 102,017	\$ 72,680
Additions	34,845	31,515
Reclassification to property and equipment	(24,100)	(6,551)
Acquisition of AED South East Asia Ltd.	200	-
Acquisition of KUB-Gas and Triton Hydrocarbons	-	7,959
Impairment on Syria, Block 9	(8,641)	-
Farm-out of assets in Syria	-	(3,616)
Cumulative translation adjustment	247	30
Carrying amount, end of year	<u>\$ 104,568</u>	<u>\$ 102,017</u>

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:

<i>(Thousands of US dollars)</i>	As at December 31, 2011	As at December 31, 2010
Brunei		
Block L	\$ 21,876	\$ 17,421
Block M	77,749	75,952
Total Brunei	<u>99,625</u>	<u>93,373</u>
Syria, Block 9	-	5,078
Ukraine	4,943	3,566
	<u>\$ 104,568</u>	<u>\$ 102,017</u>

11. Impairment

The Company reported an impairment in the amount of \$8.7 million related to its Syria, Block 9 E&E assets and related miscellaneous property and equipment assets. The Company recognized indicators the impairment principally due to the cessation of operations, continued civil unrest, and ongoing international sanctions imposed by various countries. The recoverable amount of the assets was determined based on the estimated fair value less cost to sell as at December 31, 2011. The current environment in Syria coupled with the stage of development on the concession resulted in the recognition of an impairment of the Syrian E&E assets.

Management intends to continue the planned drilling program once the civil unrest has subsided and sanctions have been lifted. However, at this time, there are no definitive plans to return to the drilling program.

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12. Acquisitions

2011

Acquisition of Nigeria

The Company has the option to join the Neconde consortium (note 5), which has acquired a 45% participating interest in Block OML 42 in Nigeria.

As of December 31, 2011, the Company has incurred \$1,046,648 in acquisition costs associated with the Nigeria acquisition, not including interest expense on the bridge loan from KI. Interest is not charged on the bridge loan unless the option is exercised.

2010

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. Acquisition costs incurred prior to the acquisition closing on June 11, 2010 totaled \$2,862,435 of which \$1,372,200 were incurred during the year ended December 31, 2010.

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<i>(Thousands of US dollars)</i>	Pre-Acquisition Carrying Amounts	Fair Value Adjustments	Recognized values on acquisition
Cash and cash equivalents	\$ 57	\$ -	\$ 57
Accounts receivable	242	-	242
Prepaid expenses and deposits	49	-	49
Other current assets	145	-	145
Property and equipment	14,793	49,022	63,815
Exploration and evaluation assets	6,217	-	6,217
Accounts payable and accrued liabilities	(1,632)	-	(1,632)
Decommissioning provision	(110)	-	(110)
Deferred tax liability	(1,770)	(3,840)	(5,610)
Net identifiable assets and liabilities	<u>\$ 17,991</u>	<u>\$ 45,182</u>	63,173
Non-controlling interest			<u>(18,951)</u>
Consideration			<u>\$ 44,222</u>
Consideration per agreements			\$ 45,000
Closing adjustments			<u>(779)</u>
Cash consideration			44,221
Cash and cash equivalents acquired			<u>(57)</u>
Acquisition of subsidiary, net of cash acquired			<u>\$ 44,164</u>
Acquisition of subsidiary, net of cash acquired			\$ 44,164
Deposit for acquisition as at December 31, 2009			<u>(1,350)</u>
Cash outflow for acquisition during 2010			<u>\$ 42,814</u>

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:

<i>(Thousands of US dollars)</i>	Year ended December 31, 2010
Oil and natural gas revenue	\$ 13,992
Net loss for the period	\$ (17,316)
Per share - basic and diluted	\$ (0.06)

Acquisition of Triton Hydrocarbons (Pty) Ltd

Effective September 15, 2009, the Company acquired all of the issued and outstanding ordinary shares of Triton Hydrocarbons, a private Australian company, in exchange for newly issued common shares of Kulczyk Oil. Triton Hydrocarbons held a 36% interest in Brunei Block M and a 35% interest in MIPI which has exploration assets in Mauritania.

The transaction resulted in the shareholders of Triton Hydrocarbons receiving consideration of: (a) 75,065,944 Kulczyk Oil common shares; (b) a 50% direct interest in TPPL; (c) a 20% beneficial interest in Syria Block 9 held by Loon Latakia for TPPL; and (d) a cash contribution of \$3 million to TPPL after the completion of Kulczyk Oil's initial public offering. TPPL is a private

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company which was formerly a wholly-owned subsidiary of Triton Hydrocarbons, and which was managed by the former Triton Hydrocarbons management team. In 2011, Ninox acquired 100% of TPPL in a share for share acquisition transaction and as a result, the Company owns approximately 30% of Ninox.

In 2011, the Syrian authorities formally approved the assignment of a 20% interest in Block 9 to TPPL.

As part of the completion of the transaction, Kulczyk Oil issued a secured subordinated convertible debenture, the Tiedemann Investment Group (“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 13).

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. In June 2010, the Company recorded the assignment of 20% of Syria Block 9 and the cash contribution of \$3 million was completed.

<i>(Thousands of US dollars)</i>	Transactions completed at September 15, 2009	Transaction completed in June 2010	Total
Consideration			
Common shares	\$ 52,000	\$ -	\$ 52,000
Convertible debenture - liability component	7,010	-	7,010
Derivative liability on convertible debenture	3,000	-	3,000
Assignment of 20% of Syria Block 9	-	484	484
Cash	-	3,000	3,000
	\$ 62,010	\$ 3,484	\$ 65,494
Allocation of Consideration			
Working capital (including cash of \$1.7 million)	\$ (466)	\$ -	\$ (466)
Investment - Karl Thompson Shares (Note 7)	473	-	473
Exploration and evaluation assets	61,903	1,742	63,645
Investment in Mauritania International Petroleum Inc.	100	-	100
Investment in Triton Petroleum (Note 8)	-	1,742	1,742
	\$ 62,010	\$ 3,484	\$ 65,494

In connection with the Triton Hydrocarbons acquisition, the Company incurred \$197,828 of acquisition costs during the year ended December 31, 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.

The Triton Hydrocarbons Acquisition was not accounted for as a business combination as it is in the exploration and evaluation stage.

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13. Convertible debentures

(a) Kulczyk Investments and Radwan convertible debentures

<i>(Thousands of US dollars)</i>	<u>Face Value</u>	<u>Liability Component</u>
Balance December 31, 2010	\$ -	\$ -
Issued	10,500	10,500
Interest	-	455
Balance December 31, 2011	<u>\$ 10,500</u>	<u>\$ 10,955</u>

On August 11, 2011, the Company entered into convertible debenture agreements with KI and Radwan for up to \$21.2 million and \$2.3 million, respectively. Both convertible debentures have an interest rate of 7.16% per annum and mature on August 11, 2012. The convertible debenture agreements include a provision for an implied additional 12.84% interest to be paid in Kulczyk Oil shares upon conversion. The convertible debentures are convertible to common shares at the offer price of a new equity offering, if made, the Alternative Investment Market of the London Stock Exchange, or at the weighted average price of common shares traded on the Warsaw Stock Exchange in the five trading days prior to August 11, 2012.

The Company elected to record the convertible debentures at fair value at the time the convertible debentures were advanced. At each reporting date, fair value is determined and any change in fair value is included in profit and loss.

At December 31, 2011, \$9.9 million had been drawn on the KI convertible debenture and \$600,000 on the Radwan convertible debenture.

(b) KI Debenture

<i>(Thousands of US dollars)</i>	<u>Face Value</u>	<u>Liability Component</u>	<u>Derivative Liability</u>
Balance January 1, 2009	\$ -	\$ -	\$ -
Issued	8,000	6,761	1,239
Mark to market adjustment	-	-	(347)
Accretion	-	511	-
Balance December 31, 2009	8,000	7,272	892
Issued	12,000	11,311	690
Converted	(20,000)	(20,000)	(1,389)
Mark to market adjustment	-	-	(193)
Accretion	-	1,417	-
Balance December 31, 2010	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Accrued interest for the year ended December 31, 2010	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Company entered into agreements for an unsecured convertible debt facility for up to \$20.0 million with KI. The convertible debenture bore interest at a rate of 7.16% compounding semi-annually and was scheduled to mature on August 31, 2010.

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Of the \$20.0 million then outstanding under the debenture agreement, \$14.4 million was converted to 25 million common shares in June 2010. In July 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 \$616,857 was paid in cash, of which \$121,861 related to 2009.

(c) TIG/MWG convertible debentures

<i>(Thousands of US dollars)</i>	<u>Face Value</u>	<u>Liability Component</u>	<u>Derivative Liability</u>	<u>Equity Component</u>
Balance December 31, 2009	\$ 10,010	\$ 7,471	\$ 2,160	\$ -
Accretion	-	1,571	-	-
Reclassified to equity	-	-	(2,160)	2,160
Balance December 31, 2010	\$ 10,010	\$ 9,042	\$ -	\$ 2,160
Converted	(10,010)	(10,672)	-	(2,160)
Interest	-	662	-	-
Accretion	-	968	-	-
Balance December 31, 2011	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Accrued interest as at December 31, 2011	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

On August 1, 2011, TIG sold its convertible debentures to a subsidiary of Milet Wirtschaftsdeuten GesmbH (“**MWG**”), an unrelated third party, for the face value of \$10.0 million plus accrued interest. On August 12, 2011, MWG converted the debentures into 18,501,037 common shares at \$0.5767 per share.

The TIG debenture note was originally issued to various arms-length parties on September 15, 2009 as secured convertible debentures in the aggregate amount of \$10.0 million with a maturity date of on August 12, 2011 in connection with the Triton Hydrocarbon acquisition (note 12). The convertible debenture was secured by a floating charge on all of the Company’s present and after-acquired property and bore interest at a rate of 7.16% compounding semi-annually, payable annually. In September 2010, the Company paid accrued interest of \$729,545 in cash.

During the period in which the conversion price of the debentures was variable, an embedded derivative existed which was marked to market at each reporting date. The derivative was included as a liability and the change in mark to market value was included in profit and loss. Once the conversion price was fixed in 2010 as a result of an amending agreement between the Company and the debenture holders, the derivative was reclassified to equity.

The conversion price of the debentures into common shares, as amended, was \$0.5767 per common share. The conversion of the debentures into common shares of Kulczyk Oil could happen at the holder’s discretion at any time up to, and including, the maturity date.

Interest expense for the year ended December 31, 2011 was \$356,296 (2010 - \$943,412).

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14. Long-term Debt

<i>(Thousands of US dollars)</i>	As at December 31, 2011	As at December 31, 2010
Current portion of long-term debt	\$ 1,733	\$ -
Long-term debt	<u>20,800</u>	<u>-</u>
Total long-term debt	<u>\$ 22,533</u>	<u>\$ -</u>

On May 20, 2011, KUB-Gas finalized a \$40.0 million loan agreement with the EBRD. The loan is denominated in US dollars and consists of two tranches which must be drawn within a commitment period of two years from the date of signing the loan agreement and will be repaid in 13 equal semi-annual instalments starting July 15, 2012. At December 31, 2011 KUB-Gas had drawn \$23.0 million in loan proceeds against the ERBD loan, incurred \$1.0 million in debt issuance costs and accrued \$1.6 million in interest expense. The second tranche of \$17.0 million is to be drawn in 2012 once the Olgovskoye and Makeevskoye licenses have been converted to production licenses.

Interest expense on the ERBD debt has two interest rate components. One component is set at LIBOR + 6% and the other component is a variable rate based on incremental revenue growth. The balance drawn has a weighted average effective interest rate of approximately 9.0% and a nominal rate of 6.4%.

The loan is secured by pledges on certain tangible assets in Ukraine as well as on future revenues earned in Ukraine. The debt is fully secured by the Company through a parent company guarantee. At December 31, 2011, KUB-Gas was in compliance with all debt covenants. The terms and conditions of the EBRD loan agreement restrict the ability of KUB-Gas to pay dividends or repay loans or loan money to the Company.

The fair value approximates book value. All of the draws of the loan have been made since June 2011, and the loan bears interest at a variable rate based on LIBOR.

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 \$935,268 as at December 31, 2011 (December 31, 2010 - \$398,214). The risk free discount rate is 5.1% and is not credit adjusted.

<i>(Thousands of US dollars)</i>	Year ended December 31,	
	<u>2011</u>	<u>2010</u>
Balance, beginning of year	\$ 398	\$ 16
Obligations acquired (Note 12)	-	110
Provisions for new wells	194	267
Changes in estimates	330	-
Accretion	10	2
Translation adjustment	<u>3</u>	<u>3</u>
Balance, end of year	<u>\$ 935</u>	<u>\$ 398</u>

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16. Capital Management

As at December 31, 2011, the Company's total capital resources amounted to \$189.2 million (December 31, 2010 - \$185.0 million), consisting of \$174.0 million (December 31, 2010 - \$178.2 million) in shareholders' equity and \$11.0 million (December 31, 2010 - \$9.0 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.

17. Income taxes

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

<i>(Thousands of US dollars)</i>	Year ended December 31, 2011	Year ended December 31, 2010
Loss before income taxes	\$ (13,694)	\$ (18,514)
<i>Federal and provincial statutory rate</i>	26.5%	28.0%
Expected income tax reduction	\$ (3,629)	\$ (5,184)
Non-deductible expenditures	2,094	1,457
Tax rate differences and net change in tax attributes not recognized	4,757	3,470
Income tax expense/(recovery)	<u>\$ 3,222</u>	<u>\$ (257)</u>

The general federal/provincial tax rate lowered to 26.5% in 2011 from 28.0% in 2010 due to the Federal rate dropping from 18% (2010) to 16.5% in 2011.

The current tax expense is generated from the Company's operations in Ukraine. The corporate income tax rate effective during 2011 in Ukraine is 23%.

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

<i>(Thousands of US dollars)</i>	Year ended December 31, 2011	Year ended December 31, 2010
Property and equipment and E&E assets	\$ (5,352)	\$ (5,360)
Finance lease	-	711
Decommissioning provision	26	24
Other	64	31
Deferred income tax liability	<u>\$ (5,262)</u>	<u>\$ (4,594)</u>

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Unrecognized deferred tax assets

Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

<i>(Thousands of US dollars)</i>	Year ended December 31, 2011	Year ended December 31, 2010
Property and equipment and E&E assets	\$ 10,889	\$ 337
Share issuance costs	4,177	5,548
Decommissioning provision	17	17
Non-capital losses carried forward and other	41,888	26,027
	<u>\$ 56,971</u>	<u>\$ 31,929</u>

Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profits will be available against which they can be utilized.

The Company has Canadian non-capital losses of \$19,505,423 that expire between 2027 and 2031, and Cyprus tax losses of \$22,382,832 that have an indefinite expiry period.

The Company has temporary differences associated with its investments in its foreign subsidiaries. The Company has no deferred tax liabilities in respect to these temporary differences.

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. There are no preferred shares issued.

<i>(Thousands of US dollars, except share data)</i>	Number of Shares	Carrying amount
Balance, December 31, 2009	200,491,549	\$ 84,727
Issued pursuant to the initial public offering	166,394,000	93,053
Share issue costs	-	(6,539)
Repurchased pursuant to stabilization activities	(1,219,061)	(608)
Issued on conversion of convertible debentures	35,086,842	20,000
Transfer equity portion of convertible debt	-	1,389
Options exercised	1,350,000	498
Balance, December 31, 2010	402,103,330	\$ 192,520
Options Exercised	200,000	32
Issued on conversion of convertible debentures	18,501,037	10,733
Transfer equity portion of convertible debt	-	2,160
Balance, December 31, 2011	<u>420,804,367</u>	<u>\$ 205,445</u>

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On August 12, 2011 MWG converted a debenture resulting in an increase of 18,501,037 outstanding common shares at a price of \$0.5767 per share (note 13(c))

(b) Loss per share

	Year ended December 31,	
	2011	2010
Weighted average number of shares outstanding	409,460,443	320,302,911

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.

(c) Stock Options

The Company has 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, January 1, 2010	20,040,000	\$0.63
Granted	16,356,000	\$0.62
Exercised	(1,350,000)	\$0.14
Expired	(410,000)	\$0.57
Balance, December 31, 2010	34,636,000	\$0.64
Granted	11,130,000	\$0.41
Exercised	(200,000)	\$0.17
Expired	(1,900,000)	\$0.73
Forfeited	(2,421,000)	\$0.61
Balance, December 31, 2011	41,245,000	\$0.54

On various dates throughout 2011, the Company granted 11,130,000 share purchase options at a weighted average price of \$0.41 per share to certain directors and certain employees of Kulczyk Oil.

On December 6, 2011 the Company revalued 5,007,000 share purchase options outstanding and held by Kulczyk Oil employees to \$0.40 per share option. The share purchase options held by the directors, Chief Executive Officer, Executive Vice President and Vice Chairman were not revalued. The revaluing of the options resulted in an increase of stock based compensation expense in 2011 of approximately \$184,000.

Each tranche of the share purchase options have a five year term and vest one-third immediately with the remaining two-thirds at one-third per year each on the anniversary of the grant date.

The following table summarizes information about the options outstanding as at December 31, 2011:

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Exercise price (US\$)	Options outstanding	Options exercisable	Contractual life remaining, years (weighted average)
\$ 0.68	2,460,000	2,460,000	0.55
\$ 0.40	475,000	475,000	1.76
\$ 0.40	75,000	75,000	2.13
\$ 0.69	1,660,000	1,660,000	2.37
\$ 0.60	10,500,000	10,500,000	2.71
\$ 0.56	14,873,000	9,915,333	3.40
\$ 0.40	72,000	48,000	3.77
\$ 0.47	1,530,000	510,000	4.21
\$ 0.40	320,000	106,667	4.36
\$ 0.40	1,289,000	429,667	4.59
\$ 0.40	7,991,000	2,663,667	4.93
\$ 0.54	41,245,000	28,843,333	3.36

(d) 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:

	Year ended December 31, 2011	Year ended December 31, 2010
Weighted average fair value per option	\$0.41	\$ 0.22
Exercise price	\$0.46	\$ 0.62
Volatility	65.8%	50.0%
Interest rate	2.53%	1.95%
Expected life (years)	4	3
Forfeiture rate	3.33%	3.33%
Dividends	Nil	Nil

19. Commitments

Brunei – Block L

The Company has a 90% working interest in Block L. The Brunei Block L PSA provides for an initial exploration period of six years from August 27, 2006 and is divided into two phases. Phase 1 expired on August 27, 2010 and Phase 2 has been extended and now expires on August 27, 2013. All Phase 1 work commitments were met prior to August 27, 2010.

In August 2010, the Company and its joint venture partners elected to proceed to the Phase 2 exploration period. The minimum work obligations for Phase 2 include (i) acquire and process 13 kilometres of onshore 2D seismic data, (ii) acquire and process not less than 130 square kilometres of onshore 3D seismic data, (iii) acquire and process 13.5 square kilometres of onshore 3D swath data (iv) acquire and process not less than 34.5 square kilometres of onshore 3D seismic and drill at least two onshore exploration wells, each to a minimum depth of 2,000 metres. The Block L joint venture parties are required to spend a minimum of \$16.0 million during Phase 2 and the work commitments are required to be completed during the Phase 2 period. With \$11.7 million of expenditures having been made against the minimum spend, the Company's share of the remaining minimum spend is

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\$3.7 million. The Company expects to invest more expenditures than the minimum spend requirements in order to meet the work commitments.

The Company has arranged a letter of credit in the amount of \$2.1 million in support of 40% of the performance guarantee required under the Block L PSA. As at the date of the report, no amount had been drawn on the letter of credit.

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 share of profit oil as defined in the Brunei PSA. No amount has been accrued in the financial statements as there is not yet production from Block L.

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 August 27, 2006, and is divided into Phase 1 (five years) and Phase 2 (two years) which may run concurrently. Phase 1 expired on August 27, 2011 and Phase 2 expires on August 27, 2012. At September 30, 2011 all Phase 1 work commitments, except for drilling a 2,000 metre well, had been completed. The Company's share of the expected well cost is approximately \$4.2 million.

In the first quarter of 2011, Kulczyk Oil and its joint venture partners in Block M elected to enter in to the Phase 2 under the terms of the Block M PSA. The Phase 2 exploration program expires August 27, 2012. The minimum work obligations under the terms of the Block M PSA are to (i) acquire and process not less than 80 kilometres of 2D seismic data; and (ii) drill at least two onshore exploration wells, each to a minimum depth of 1,150 metres. The Phase 2 seismic obligation was completed in 2010. The work commitments for Block M parties require a minimum expenditure of \$7.3 million during Phase 2, although the Company expects to expend more than that amount to meet the work commitments. The Company's share of the minimum spend is \$2.6 million plus an obligation under a farm-in agreement to fund an additional 4% (\$293,000) towards a partner's share of expenditures.

Syria

Under the terms of the Block 9 PSC, the Company has a first phase exploration period of four years, originally expiring on November 27, 2011 during which it has committed to acquire and process 350 square kilometres of 3D seismic and drill two exploratory wells. The remaining work commitment outstanding is to drill two exploration wells. The drilling of the first of the two exploratory wells commenced on July 22, 2011.

As a result of the current operating conditions in the country, the drilling program on the first commitment well was suspended. The Syrian authorities extended the term of the first exploration period under the Block 9 PSC to October 26, 2012. In the meantime, the Company will continue to monitor operating conditions in Syria to assess when a recommencement of its Syrian operations is possible.

Ukraine

The Company has an obligation to incur certain capital expenditures to comply with the Ukrainian exploration license requirements. Under these license maintenance commitments, the Company is required to acquire and process seismic, conduct geophysical studies and drill exploratory wells on licensed fields. 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 \$42.0 million during the period from 2012 to 2015 as part of the planned development program. 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. In respect of the North Makeevskoye license awarded in December 2010, the Company has conducted a seismic program and is planning to spend a minimum of \$3.0 million on seismic and drilling six wells over the next four years.

Office Space

The Company has a lease agreement for office space in Calgary, Canada which expires on October 31, 2014. The commitment is approximately \$325,000 per year for the term of the lease.

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20. Personnel expenses

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

<i>(Thousands of US dollars)</i>	Year ended December 31, 2011	Year ended December 31, 2010
Wages, salaries and benefits	\$ 9,942	\$ 7,045
Bonuses	259	1,036
Stock based compensation (i)	<u>2,672</u>	<u>3,673</u>
Total remuneration	<u>\$ 12,873</u>	<u>\$ 11,754</u>

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, Vice President Geosciences and General Counsel – Vice President Legal. Key management personnel compensation consists of the following:

<i>(Thousands of US dollars)</i>	Year ended December 31, 2011	Year ended December 31, 2010
Wages and salaries	\$ 2,629	\$ 2,168
Bonuses	100	1,036
Stock based compensation (i)	<u>1,370</u>	<u>1,845</u>
Total remuneration	<u>\$ 4,099</u>	<u>\$ 5,049</u>

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

(ii) The Company presents its statement of operations predominately by function with the exception that personnel costs are included in production expenses and general and administrative expenses and stock based compensation is presented separately. Total personnel costs included in the statement of operations was \$12.9 million (2010 - \$11.8 million) of which \$4.7 million (2010 - \$2.1 million) was included in production expenses, \$5.5 million (2010 - \$6.0 million) was included in general and administrative expenses and \$2.7 million (\$2010 - \$3.7 million) was reported as stock based compensation.

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, investments, an option on Neconde, 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 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 convertible debentures are not considered material because the costs of the convertible debentures are fixed. Interest on the EBRD loan (note 14) is based on LIBOR plus a margin and a portion is variable based on incremental revenue growth, up to a stated maximum. A 1% change in the LIBOR rate would affect interest expense by \$0.2 million, based on the debt balance outstanding at year end. Restricted cash

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is in instruments that are redeemable only upon completion of certain work commitments and therefore is subject to interest rate fluctuations. However, the interest rate risk thereon is not significant.

(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 December 31, 2011 includes \$1.2 million due from MENA, in respect of MENA's farm-in on Syria Block 9 as well as certain costs related to the 2011 drilling program paid for on MENA's behalf by the Company. The Company's balance of accounts receivable consists 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 commodity taxes recoverable from the federal government of Canada, interest earned on restricted cash deposits for which credit risk is assessed as being low as the funds are on deposit with major financial institutions and to the sales of its production in Ukraine.

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) Foreign currency exchange risk

The Company is exposed to risks arising from fluctuations in currency exchange rates between the Canadian dollar, Australian dollar, Polish zloty, Ukraine hryvnia, Syrian pound and the United States dollar. At December 31, 2011 the Company's primary currency exposure related to Canadian dollar ("CAD") and Ukraine hryvnia ("UAH") balances. The following table summarizes in U.S. dollars the Company's foreign currency exchange risk for each of the currencies indicated:

<i>(Thousands of US dollars)</i>	December 31, 2011		December 31, 2010	
	CAD	UAH	CAD	UAH
Cash and cash equivalents	\$ 249	\$ 71,655	\$ 123	\$ 562
Accounts receivable	424	3,579	101	601
Prepaid expenses	16	5,837	-	368
Accounts payable and accrued liabilities	(435)	(26,867)	(744)	(6,598)
Net foreign exchange exposure	\$ 254	\$ 54,204	\$ (520)	\$ (5,067)
US \$ equivalent at year end exchange rate	\$ 249	\$ 6,683	\$ (511)	\$ (625)

For the year ended December 31, 2011, 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 \$25,000. Earnings are not impacted by fluctuations in the Ukraine hryvnia as translation gains and losses are included in accumulated other comprehensive income (loss).

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(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 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 to retain concession licences, farm-out arrangements and securing new equity or debt capital.

22. Related party transactions

The Company provides financial and accounting services, pursuant to a shared services agreement to Jura Energy Corporation (“**Jura**”), a public company in which the Company owns 5.7% of the outstanding common shares. For the year ended December 31, 2011, the Company charged fees and associated costs to Jura totalling \$116,780 (2010 – \$109,333). At December 31, 2011, \$10,299 (2010 – \$2,000) was due from Jura. Three directors of the Company, Timothy M. Elliott, Norman W. Holton and Stephen C. Akerfeldt, 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 year ended December 31, 2011, the fees totalled \$624,780 (2010 - \$523,032). At December 31, 2011, \$52,065 was owing to Nemmoco (2010 - \$nil).

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 first exploration phase. The minimum work program for the first phase has been completed and the Company does not anticipate 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 year ended December 31, 2011, these fees totalled \$12,600 (2010 - \$11,976). At December 31, 2011, Loon Energy owed \$8,400 (2010 – \$nil) to Kulczyk Oil for these services. Certain expenditures of Loon Energy are paid for by Kulczyk Oil and Loon Energy reimburses Kulczyk Oil for these expenditures. As at December 31, 2011, Loon Energy owed \$35,388 (2010 – \$nil) for these costs. Kulczyk Oil and Loon Energy are related as they have four common directors and officers and the same principal shareholder.

KI owns approximately 44.3% of the issued and outstanding shares of the Company (December 31, 2010 – 49.8%). The Company had service agreements with KI and Kulczyk Holdings S.A. (“**KH**”) for ongoing administrative, acquisition and consulting services which expired on June 30, 2011. For the year ended December 31, 2011 the Company paid \$210,000 to KI (2010 - \$210,000) and \$90,000 to KH (2010 - \$90,000). For the year ended December 31, 2010 the Company paid KI a \$450,000 fee for their assistance with the KUB-Gas acquisition.

Certain expenditures of Neconde have been paid by Kulczyk Oil and are reimbursable by Neconde. At December 31, 2011 Neconde owed \$53,000 to Kulczyk Oil.

The above related party transactions were at exchange amounts agreed to by both parties.

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(Stated in U.S. dollars)

23. Segmented information

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

(Thousands of US dollars)

As at December 31, 2011	<u>Brunei</u>	<u>Syria</u>	<u>Ukraine</u>	<u>Corporate</u>	<u>Total</u>
Total Assets	\$ 99,059	\$ 3,649	\$ 119,131	\$ (1,564)	\$ 220,275
For the year ended December 31, 2011					
Oil and gas revenue, net of royalties	\$ -	\$ -	\$ 28,337	\$ -	\$ 28,337
Operating expenses:					
Production expense	\$ -	\$ -	\$ (7,228)	\$ -	\$ (7,228)
General and administrative	-	-	-	(9,021)	(9,021)
Acquisition costs	-	-	-	(1,047)	(1,047)
Stock based compensation	-	-	-	(2,672)	(2,672)
Depletion/depreciation	-	-	(7,520)	(76)	(7,596)
Impairment on of exploration and evaluatio	-	(8,664)	-	-	(8,664)
Finance income/(expense)					
Interest and other income	-	-	(10)	4	(6)
Unrealized loss on investment	-	-	-	(66)	(66)
Interest expense and accretion	-	-	(1,999)	(1,862)	(3,861)
Gain on sale of assets	-	-	-	-	-
Foreign exchange loss	-	-	-	(354)	(354)
Equity loss of associates	\$ -	\$ -	\$ -	\$ (1,516)	\$ (1,516)
Earnings (loss) before tax	\$ -	\$ (8,664)	\$ 11,580	\$ (16,610)	\$ (13,694)
Capital expenditures	\$ 6,252	\$ 3,586	\$ 30,148	\$ 99	\$ 40,085

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(Thousands of US dollars)

As at December 31, 2010	<u>Brunei</u>	<u>Syria</u>	<u>Ukraine</u>	<u>Corporate</u>	<u>Total</u>
Total Assets	\$ 91,705	\$ 15,782	\$ 76,725	\$ 13,113	\$ 197,325
For the year ended December 31, 2010					
Oil and gas revenue, net of royalties	\$ -	\$ -	\$ 7,469	\$ -	\$ 7,469
Operating expenses:					
Production expense	\$ -	\$ -	\$ (4,127)	\$ -	\$ (4,127)
General and administrative	-	-	-	(9,376)	(9,376)
Acquisition costs	-	-	-	(1,570)	(1,570)
Stock based compensation expense	-	-	-	(3,673)	(3,673)
Depletion/depreciation	-	-	(2,565)	(177)	(2,742)
Finance income/(expense)					
Interest and other income	-	-	(334)	516	182
Unrealized gain on investment	-	-	-	158	158
Interest expense and accretion	-	-	(55)	(4,404)	(4,459)
Gain on sale of assets	-	-	-	315	315
Foreign exchange gain	-	-	(37)	(621)	(659)
Mark to market on derivative liability	-	-	-	193	193
Equity loss of associates	-	-	-	(226)	(226)
Gain/(Loss) before tax	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 351</u>	<u>\$ (18,865)</u>	<u>\$ (18,514)</u>
Capital expenditures	<u>\$ 22,130</u>	<u>\$ 1,904</u>	<u>\$ 7,649</u>	<u>\$ 309</u>	<u>\$ 31,992</u>