KULCZYK OIL VENTURES

**KULCZYK OIL VENTURES INC.**
**CONSOLIDATED FINANCIAL STATEMENTS**
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
US dollars in '000's

KULCZYK OIL VENTURES

**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* | *"Signed" Paul H. Rose* |
| Timothy M. Elliott<br>Chief Executive Officer | Paul H. Rose, CA<br>Chief Financial Officer |

March 20, 2013

**KPMG LLP**
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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, 2012 and December 31, 2011, the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, 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, 2012 and December 31, 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

Calgary, Canada
March 20, 2013

**KULCZYK OIL VENTURES INC.**

Consolidated Statement of Financial Position

US dollars in '000's

| | | December 31, 2012 | December 31, 2011 |
|---|---|---|---|
| **Assets** | | | |
| Current | | | |
| Cash and cash equivalents | | $ 35,553 | $ 12,962 |
| Accounts receivable | | 2,226 | 4,840 |
| Prepaids and other | | 2,526 | 1,482 |
| Total current assets | | 40,305 | 19,284 |
| Restricted cash | (Note 5) | 143 | 3,649 |
| Investments | (Notes 6, 7) | 326 | 509 |
| Property and equipment | (Note 8) | 99,577 | 92,265 |
| Exploration and evaluation | (Note 9) | 47,358 | 104,568 |
| Total Assets | | $ 187,709 | $ 220,275 |
| **Liabilities** | | | |
| Current | | | |
| Accounts payable and accrued liabilities | | $ 22,822 | $ 4,874 |
| Income taxes payable | | 938 | 1,189 |
| Convertible debentures | (Note 12) | - | 10,955 |
| Convertible note payable | (Note 13) | 10,586 | - |
| Current portion of long-term debt | (Note 14) | 4,333 | 1,733 |
| Decommissioning provision | (Note 15) | 409 | - |
| Total current liabilities | | 39,088 | 18,751 |
| Decommissioning provision | (Note 15) | 822 | 935 |
| Deferred tax liability | (Note 17) | 7,237 | 5,262 |
| Long-term debt | (Note 14) | 17,112 | 20,800 |
| Total liabilities | | 64,259 | 45,748 |
| **Shareholders' Equity** | | | |
| Share capital | (Note 18) | 231,516 | 205,445 |
| Contributed surplus | | 15,135 | 13,264 |
| Accumulated other comprehensive income | | 742 | 735 |
| Non-controlling interest | | 31,396 | 23,653 |
| Deficit | | (155,339) | (68,570) |
| Total shareholders' equity | | 123,450 | 174,527 |
| Total liabilities and shareholders' equity | | $ 187,709 | $ 220,275 |
| Subsequent events | (Notes 13, 14) | | |
| Commitments | (Note 19) | | |

**KULCZYK OIL VENTURES INC.**

Consolidated Statement of Changes in Equity

US dollars in '000's (except Number of shares)

| | Common Shares | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Number of shares | Amount | Convertible debentures, equity component | Contributed surplus | Cumulative translation adjustment | Non-controlling interest | Deficit | Total |
| Balances, December 31, 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 | 10,672 | - | - | - | - | - | 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 Ukraine subsidiary | - | - | - | - | - | (1,077) | - | (1,077) |
| Net earnings (loss) | - | - | - | - | - | 3,959 | (20,875) | (16,916) |
| Balance, December 31, 2011 | 420,804,367 | 205,445 | - | 13,264 | 735 | 23,653 | (68,570) | 174,527 |
| Shares issued pursuant to option exercises | 453,333 | 277 | - | (97) | - | - | - | 180 |
| Convertible debentures converted (Note 12) | 60,499,029 | 25,794 | - | - | - | - | - | 25,794 |
| Stock-based compensation | - | - | - | 1,968 | - | - | - | 1,968 |
| Foreign currency translation adjustment on foreign operations | - | - | - | - | 7 | (44) | - | (37) |
| Net earnings (loss) | - | - | - | - | - | 7,787 | (86,769) | (78,982) |
| Balances, December 31, 2012 | 481,756,729 | $ 231,516 | $ - | $ 15,135 | $ 742 | $ 31,396 | $ (155,339) | $ 123,450 |

## KULCZYK OIL VENTURES INC.

Consolidated Statement of Operations and Comprehensive Loss

US dollars in '000's

| | | Year ended December 31, 2012 | 2011 |
|---|---|---|---|
| Oil and gas revenue | | $ 99,588 | $ 35,227 |
| Royalty expense | | (19,468) | (6,890) |
| Oil and gas revenue, net of royalties | | 80,120 | 28,337 |
| | | | |
| Operating expenses | | | |
| Production expenses | | (12,223) | (7,228) |
| General and administrative | | (9,498) | (9,021) |
| Transaction costs | (Note 11) | (4,193) | (1,047) |
| Stock based compensation | (Note 18(c)) | (1,968) | (2,672) |
| Loss on disposition of assets | | (205) | - |
| Depletion and depreciation | | (25,830) | (7,596) |
| Impairment of exploration and evaluation assets | (Note 10) | (87,739) | (8,664) |
| Total operating expenses | | (141,656) | (36,228) |
| | | | |
| Finance income/(expenses) | | | |
| Interest and other income | | 2,559 | (6) |
| Unrealized gain (loss) on investments | | (82) | (66) |
| Interest expense and accretion | | (8,087) | (3,861) |
| Foreign exchange gain (loss) | | (181) | (354) |
| Total finance income/(expenses) | | (5,791) | (4,287) |
| | | | |
| Loss of associates | | - | (1,516) |
| | | | |
| Loss before tax | | (67,327) | (13,694) |
| | | | |
| Current tax expense | (Note 17) | (9,681) | (2,554) |
| Deferred tax expense | (Note 17) | (1,974) | (668) |
| | | | |
| Net loss | | (78,982) | (16,916) |
| | | | |
| Foreign currency translation gain/(loss)of foreign operations | | (37) | 927 |
| | | | |
| Total comprehensive loss | | $ (79,019) | $ (15,989) |
| | | | |
| Earnings (loss) attributable to: | | | |
| Common shareholders | | (86,769) | (20,875) |
| Non-controlling interest | | 7,787 | 3,959 |
| | | | |
| Loss for the year | | $ (78,982) | $ (16,916) |
| | | | |
| Net loss per share attributable to common shareholders - basic and diluted | (Note 18(b)) | $ (0.20) | $ (0.04) |
| | | | |
| Total comprehensive earnings (loss) attributed to: | | | |
| Common shareholders | | (86,762) | (20,226) |
| Non-controlling interest | | 7,743 | 4,237 |
| | | | |
| Total comprehensive loss for the year | | $ (79,019) | $ (15,989) |

**KULCZYK OIL VENTURES INC.**

Consolidated Statement of Cash Flows

US dollars in '000's

| | | Year ended December 31, 2012 | 2011 |
|---|---|---|---|
| Net loss | | $ (78,982) | (16,916) |
| Items not involving cash: | | | |
| Equity loss of associates | | - | 1,516 |
| Depletion and depreciation | | 25,830 | 7,596 |
| Impairment | | 81,739 | 8,664 |
| Accretion on asset retirement obligation | | 153 | 1,423 |
| Stock based compensation | (Note 18 (c)) | 1,968 | 2,672 |
| Unrealized loss on investments | | 82 | 66 |
| Unrealized foreign exchange gain | | 495 | (67) |
| Deferred income tax expense | | 1,974 | 668 |
| Funds from operations | | 33,259 | 5,622 |
| Changes in non-cash working capital | | 5,488 | (4,467) |
| Total operating cash generated | | 38,747 | 1,155 |
| Financing | | | |
| Proceeds from exercise of share purchase options | | 180 | 34 |
| Issuance of long-term debt | | - | 23,000 |
| Long-term debt issuance costs | | - | (1,026) |
| Repayment of long-term debt | | (1,770) | - |
| Issuance of note payable | | 10,000 | - |
| Issuance of convertible debentures | | 13,000 | 10,500 |
| Changes in non-cash working capital related to financing activities | | - | (249) |
| Total financing cash generated | | 21,410 | 32,259 |
| Investing | | | |
| Property and equipment expenditures | | (27,351) | (4,708) |
| Restricted cash recovered | | 3,506 | 1,392 |
| Exploration and evaluation expenditures | | (29,581) | (35,045) |
| Changes in non-cash working capital related to investing | | 16,272 | 7,640 |
| Total investing cash used | | (37,154) | (30,721) |
| Effect of exchange rate changes | | (412) | 1,179 |
| Change in cash | | 22,591 | 3,872 |
| Cash and cash equivalents, beginning of year | | 12,962 | 9,090 |
| Cash and cash equivalents, end of year | | $ 35,553 | 12,962 |
| Supplemental cash flow information | | | |
| Interest paid | | $ (2,520) | $ - |
| Interest received | | $ 1,513 | $ 6 |
| Cash taxes paid | | $ (10,132) | $ (1,628) |

## 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 Company was incorporated under the Business Corporations Act (Alberta) and is headquartered in Calgary, Alberta, Canada.

The consolidated financial statements of the Company include the accounts of Kulczyk Oil Ventures Inc. and its subsidiaries together with its 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. 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 held 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**").

In August 2012 the Block M PSA expired and the value of the exploration assets were fully impaired.

**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 ("**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 Ninox Energy Pty Ltd. ("**Ninox**"). An unrelated third party has the right to take up a 5% working interest.

Syria is in the exploration phase and has no production. Effective July 16, 2012, the Company, in its capacity as Operator of Syria's Block 9, declared a Force Majeure event due to conditions arising from the current instability, including difficult operating conditions, and the inability to move funds into the country, rendering the performances of its obligation under the Contract impossible.

**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 20, 2013.

### (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) Functional and presentation currency

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

### (d) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported 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 3 – Impairment (determination of cash generating units "**CGU**")
- Note 4 – Determination of fair values
- Note 12 – 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 within the Company and all 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 the following indirect wholly-owned subsidiaries, Kulczyk Oil 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 and KOV Borneo Limited. KOV Cyprus also owns 70% of KUBGAS Holdings Limited ("**KUB Holdings**"), formerly Loon Ukraine Holding Ltd., which holds a 100% interest in KUB-Gas.

The acquisition 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 one equity accounted investment, which is not significant to the consolidated financial statements; Mauritania International Petroleum Inc. ("**MIPI**").

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, note payable, long-term debt and the liability portion of the convertible debenture. Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs, except for financial assets at fair value through profit or loss whereby any directly attributable transaction costs are expensed as incurred. Subsequent to initial recognition, non-derivative financial instruments are designated into one of the following categories and measured as described below.

<u>Held to maturity investments</u>

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.

<u>Available-for-sale assets</u>

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.

<u>Financial assets and liabilities at fair value through profit or loss</u>

The Company's investments in Jura Energy Corporation, Ninox and Karl Thomson Holdings Ltd. ("**Karl Thomson**") are financial assets recorded at fair value through profit or loss. The KI and Radwan convertible debentures issued in 2011 (note 12(a)) were 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.

<u>Financial liabilities at amortized cost</u>

The Company's long-term debt and note payable are recorded at amortized cost through profit or loss. Subsequent to the initial recognition at cost, this financial instruments are adjusted for accrued interest in the profit or loss.

<u>Cash and cash equivalents</u>

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.

<u>Other</u>

The Company's trade and other receivables, trade and other payables, long-term debt, note payable and the convertible debentures other than Kulczyk Investments S.A.("**KI**") and Radwan Investments GmBH ("**Radwan**") convertible debentures issued in 2011 (note 12), 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 had no fixed number of common shares that the holder was able to convert to, and therefore was not considered a compound instrument. This issuance of convertible debt was recorded as 100% debt and was measured at each reporting date at fair value.

The TIG/MWG debentures (note 12) 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 was classified as equity.

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.

(iii) 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 proved 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.

(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 proved 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.
Proved 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 proved and probable and a 50 percent statistical probability that it will be less. The equivalent statistical probabilities for the proved component of proved 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 proved and probable if the ability to produce is supported by either actual production or conclusive formation test. The area of reservoir considered proved 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 proved 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. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

(ii) Non-financial assets:

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

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. The Company has determined a CGU will be each producing field in its Ukraine operations (currently 4 fields on production).

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 proved 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 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, 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 2012 reporting period. The following standards are effective for annual periods beginning on or after January 1, 2013:

(i) IFRS 11 Joint arrangements:
This new standard establishes accounting principles for entities that have an interest in arrangements that are controlled jointly. The standard focuses on the rights and obligations of the arrangement rather than the legal form. A joint arrangement is an arrangement where two or more parties have joint control by a contractual arrangement and the contractual arrangement gives two or more parties joint control of the arrangement.

Joint arrangements are either joint ventures or joint operations. A joint venture is a separate financial structure where the venturers have rights to the net assets of the arrangements and a joint operation is where the investor has the rights to the assets and obligations to the liabilities of the arrangement.

The standard requires joint ventures to use the equity method of accounting and joint operations are to proportionate consolidate whereby each joint operator recognizes its share of the assets, liabilities, revenue and expenses of the arrangement.

As at January 1, 2013, the Company is party to two joint arrangements, Syria Block 9 and Brunei Block L. Management has determined there will be no material accounting impact related to the change in the accounting standard as the joint arrangements will be considered joint operations.

(ii) IFRS 12 Disclosure of interests in other entities:
This new standards requires disclosure for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off-statement financial position entities.

The standard requires an entity to disclose information that enables the users of its financial statements to evaluate:

a) The nature of, and risks associated with, its interests in other entities; and
b) The effects of those interests on its financial position, financial performance and cash flows.

The relevant incremental disclosures, if any, will be provided in the 2013 financial statements. Management will provide the disclosures to include the nature of and risks with its interest in other entities and the effects these interests have on the financial position, financial performance and cash flows of the Company.

(iii) IFRS 13 Fair value measurement:
This standard defines fair value, establishes a single IFRS framework for measuring fair value and requires increased disclosure on the fair value measurements. IFRS 13 applies to all IFRS standards that require or permit fair value measurements or disclosures about fair value measurements.

The standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This revised definition of fair value is viewed from the perspective of an exit price for the transaction that a market participant would expect.

Management expects no significant changes to the amounts recorded in the Company's financial statements from the adoption of this standard.

(iv) IFRS 9 Financial Instruments:

This standard sets out the recognition and measurement requirements for financial instruments and contracts to buy or sell non-financial items. The IASB is finalizing this standard as it completes the various phases of its comprehensive project on financial instruments. The Company will continue to monitor the changes to this standard as they arise and will determine the impact closer to the effective date which is for accounting periods commencing on or after January 1, 2015.

## 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 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, note payable and trade and other payables
The fair value of cash and cash equivalents, trade and other receivables, note payable, 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 fair value of the note payable and convertible debentures 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).

## 5. Restricted cash

Pursuant to the terms of a petroleum exploration Production Sharing Contract ("**PSC**") for Block 9 in Syria, the Company posted a performance guarantee in the amount of $7.5 million in 2007 secured by cash in the same amount. In July 2012 the performance guarantee for Block 9 in Syria expired and the remaining balance of cash posted as security, being $3.5 million, was returned to the Company. As at December 31, 2012 the Company has $0.1 million remaining as security posted for a bid bond.

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

## 6. Investments

***Jura Energy Corporation ("Jura")***
In the third quarter of 2012, Jura, a public company traded on the Toronto Stock Exchange, completed a share acquisition. The share acquisition reduced the Company's interest in Jura from an original 5.7% holding down to a 1.1% shareholding. The market value of the investment at December 31, 2012 was $225,533 (December 31, 2011 - $305,158).

***Neconde Purchase Option***
In 2011, the Company had a put and call option to join the Neconde Energy Limited ("**Neconde**") consortium with KI, the exercise of which would have left the Company with up to a 20% interest in Neconde. 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.

In March 2012, the Company and KI mutually agreed that it was not in the best interest of either company to continue the Neconde purchase option beyond its March 31, 2012 expiry date, and accordingly, the option expired on that date. The Company recorded approximately $1.0 million in related costs in 2011 and was reimbursed for these costs by KI in 2012. These costs and the related reimbursement are reported as transaction costs (note 11).

***Karl Thomson Holdings Ltd***
On September 15, 2009, the Company acquired Triton Hydrocarbons 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, 2012, the carrying value of the investment was $nil (December 31, 2011 - $103,810). The Company has an equal and offsetting liability for this investment.

***Ninox***
The Company acquired 50% of the common shares of Triton Petroleum – a private company incorporated in Singapore as part of the acquisition of Triton Hydrocarbons Pty Ltd ("**Triton**") in 2009. As a result of a share issuance by Triton Petroleum in 2010, the Company's investment in Triton Petroleum was reduced to an approximate 30% interest. In 2011, Ninox acquired 100% of Triton Petroleum in a share exchange transaction and the Company therefore now owns an approximate 1.63% interest in Ninox. Ninox's suite of assets includes a number of oil and gas interests in addition to 20% beneficial interest in Syria Block 9. Ninox is a private company and the estimated market value of its shares at December 31, 2012 and 2011 was nil.

## 7. Investments in associates

| *(Thousands of US dollars)* | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Investment in Mauritania International Petroleum Inc. ("MIPI") | $ 100 | $ 100 |

The Company acquired a 35% investment in MIPI as part of the Triton 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, 2012 and 2011.

## 8. Property and equipment

| *(Thousands of US dollars)* | Oil and natural gas interests | Plant and equipment | Other | Total |
|---|---|---|---|---|
| **Cost or deemed cost:** | | | | |
| Balance at December 31, 2010 | $ 62,173 | $ 9,535 | $ 2,735 | $ 74,443 |
| 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 | $ 88,908 | $ 10,541 | $ 3,775 | $ 103,224 |
| Additions | 23,230 | 4,057 | 493 | 27,780 |
| Reclassification from exploration and evaluation | 4,978 | - | - | 4,978 |
| Foreign currency translation adjustment | 608 | 96 | 38 | 742 |
| Balance at December 31, 2012 | $ 117,724 | $ 14,694 | $ 4,306 | $ 136,724 |
| **Depletion and depreciation:** | | | | |
| Balance at December 31, 2010 | $ (2,346) | $ (142) | $ (366) | $ (2,853) |
| Depletion and depreciation | (6,399) | (833) | (354) | (7,586) |
| Impairment of assets | - | - | (23) | (23) |
| Foreign currency translation adjustment | (417) | (71) | (9) | (497) |
| Balance at December 31, 2011 | $ (9,162) | $ (1,046) | $ (752) | $ (10,959) |
| Depletion and depreciation | (24,209) | (1,488) | (409) | (26,106) |
| Foreign currency translation adjustment | (55) | (15) | (12) | (82) |
| Balance at December 31, 2012 | $ (33,426) | $ (2,549) | $ (1,173) | $ (37,147) |
| **Net book value:** | | | | |
| Balance at December 31, 2011 | $ 79,746 | $ 9,496 | $ 3,024 | $ 92,265 |
| Balance at December 31, 2012 | $ 84,298 | $ 12,145 | $ 3,133 | $ 99,577 |

## 9. Exploration and evaluation assets

Reconciliation of the movements in Exploration and Evaluation ("**E&E**") assets:

| *(Thousands of US dollars)* | As at December 31, 2012 | As at December 31, 2011 |
|---|---|---|
| Carrying amount, beginning of period | $ 104,568 | $ 102,017 |
| Additions | 29,581 | 34,845 |
| Reclassification to property and equipment | (4,978) | (24,100) |
| Acquisition of AED South East Asia Ltd. | - | 200 |
| Impairment on Block M, Brunei | (79,491) | - |
| Impairment on Block 9, Syria | (2,248) | (8,641) |
| Cumulative translation adjustment | (74) | 247 |
| Carrying amount, end of period | $ 47,358 | $ 104,568 |

E&E assets consist of the Company's intangible exploration projects which are pending the determination of proved 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:

| *(Thousands of US dollars)* | As at December 31, 2012 | As at December 31, 2011 |
|---|---|---|
| Brunei | | |
| Block L | $ 40,820 | $ 21,876 |
| Block M | - | 77,749 |
| Total Brunei | 40,820 | 99,625 |
| Ukraine | 6,538 | 4,943 |
| | $ 47,358 | $ 104,568 |

## 10. Impairment

**Brunei – Block M**
On August 27, 2012 the PSA with PetroleumBRUNEI for Block M expired after efforts by the joint venture partners to obtain an extension to the terms of the PSA were unsuccessful. Accordingly, the Company recognized an impairment of $85.5 million, including $79.5 million for the balance of costs capitalized in respect of the Block and a $6.0 million provision for the non-performance penalty under the PSA.

**Syria – Block 9**

The Company reported an impairment in the amount of $2.2 million related to its Syria, Block 9 E&E assets and related miscellaneous property and equipment assets in 2012 (2011 - $8.7 million). The Company recognized indicators of 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.

Effective July 16, 2012, the Company, in its capacity as Operator of Syria's Block 9, declared a Force Majeure event due to the continued civil unrest which has made rendering the performance of its obligations under the Contract impossible. Management intends to resume the planned drilling program once the civil unrest has subsided and sanctions have been lifted. However, at this time, there is no definitive timeline to resume the drilling program.

## 11. Transaction costs

Transaction costs include costs associated with a potential AIM listing, acquisition costs for potential acquisitions and a recovery of $1.0 million for previously expensed Neconde acquisition costs from KI (note 6). For the year ended December 31, 2012, transaction costs were $4.2 million (2011 - $1.0 million).

## 12. Convertible debentures

### (a) Kulczyk Investments and Radwan convertible debentures

| *(Thousands of US dollars)* | Face Value | Liability |
|---|---|---|
| Balance December 31, 2010 | $ - | $ - |
| Issued | 10,500 | 10,500 |
| Interest | - | 455 |
| Balance December 31, 2011 | $ 10,500 | $ 10,955 |
| Issued | 13,000 | 13,000 |
| Interest | - | 1,839 |
| Converted | (23,500) | (25,794) |
| Balance December 31, 2012 | $ - | $ - |

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 had an interest rate of 8.0% per annum and matured on August 11, 2012. Notices of conversion were received prior to August 11, 2012 and shortly thereafter, the $23.5 million principle and all accrued interest were converted to 60,499,029 common shares. The convertible debentures also included a provision for an implied additional 12.0% in interest which was paid in Kulczyk Oil shares upon conversion.

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 was determined with any change in fair value 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) TIG/MWG convertible debentures

| *(Thousands of US dollars)* | Face Value | Liability Component | Equity Component |
|---|---|---|---|
| Balance December 31, 2010 | $ 10,010 | $ 9,042 | $ 2,160 |
| Interest | - | 662 | - |
| Accretion | - | 968 | - |
| Converted | (10,010) | (10,672) | (2,160) |
| Balance December 31, 2011 | $ - | $ - | $ - |
| Accrued interest as at December 31, 2011 | $ - | $ - | $ - |

On August 1, 2011, TIG sold its convertible debentures to a subsidiary of Milet Wirschaftsdeaten GesmbH ("**MWG**"), an unrelated third party, for their 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.

## 13. Note Payable

| *(Thousands of US dollars)* | Face Value | Liability |
|---|---|---|
| Balance December 31, 2011 | $ - | $ - |
| Issued | 10,000 | 10,000 |
| Interest | - | 586 |
| Balance December 31, 2012 | $ 10,000 | $ 10,586 |

On June 22, 2012, the Company entered into a loan agreement with KI for a maximum of $12.0 million. The loan bears interest at 15% and was initially due to mature on December 31, 2012. In December 2012, the terms of the loan were amended. Under the amended and restated agreement, the loan's maturity date has been extended to December 31, 2013. In addition, under the amended and restated agreement the debt is now convertible and the lender is able to exercise its option to convert the outstanding principle and accrued interest to the extent that the lender will not own less than 33% or more than 66% of the Company's common shares after the conversion is completed. The note is convertible at the volume weighted average share price for the five preceding days to the conversion date. In addition, the note converts automatically into common shares if the Company lists on certain exchanges prior to the maturity date.

At December 31, 2012, the Company had drawn $10.0 million on this convertible debenture. Subsequent to year end, a further $2.0 million has been drawn on this loan.

## 14. Long-term Debt

| *(Thousands of US dollars)* | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Current portion of long-term debt | $ 4,333 | $ 1,733 |
| Long-term debt | 17,112 | 20,800 |
| Total long-term debt | $ 21,445 | $ 22,533 |

On May 20, 2011, KUB-Gas finalized a $40.0 million loan agreement with the European Bank for Reconstruction and Development ("**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. The loan is to be repaid in 13 equal semi-annual instalments and the first payment was made on July 15, 2012. At December 31, 2012, KUB-Gas had drawn $23.0 million in loan proceeds against the EBRD loan, incurred $1.0 million in debt issuance costs and repaid $1.8 million. The second tranche of $17.0 million has not yet been drawn, but became available in 2012 in accordance with the loan agreement once the Olgovskoye and Makeevskoye licenses were converted to production licenses.

Subsequent to year end, KUB-Gas made a prepayment of $10 million under the terms of the EBRD loan agreement in addition to the second scheduled repayment of $1.8 million.

Interest expense on the EBRD debt has two interest rate components. One component is set at LIBOR + 6% and the other component is a variable rate based on revenue growth incremental to 2010, the base year. The balance drawn has a weighted average effective interest rate of approximately 9.0% and a nominal rate of 6.4%. Interest payments are made twice a year, in January and in July.

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 guaranteed by the Company through a parent company guarantee. At December 31, 2012, 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 table below describes the scheduled repayment terms for the loan. The loan is repayable in 13 equal bi-annual installments of $1.8 million, representing the drawn amount of $23 million over 13 payments. The amount due within one year includes accrued interest on the loan, in addition to the scheduled repayments of $3.5 million. The Company made a prepayment of the loan subsequent to year end which accelerates settlement of the debt, but it does not change the installment amount due every six months.

| *(Thousands of US dollars)* | **Within 1 Year** | **2-3 Years** | **3-4 Years** | **+5 Years** | **Total** |
|---|---|---|---|---|---|
| EBRD loan | $ 4,333 | $ 7,080 | $ 7,080 | $ 2,952 | $ 21,445 |

## 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 decommissioning obligation of Brunei's Block L and Block M to be $409,000. The obligation is expected to be settled within the next twelve months and is accordingly classified as a current liability.

The Company has estimated the future cash flows prior to discounting, of the decommissioning obligation for Ukraine to be $1.9 million as at December 31, 2012 (December 31, 2011 - $1.2 million). The decommissioning provision is discounted using a risk free interest rate of 5.8% (2011 – 5.1%) which is not credit adjusted. The Company does not expect the decommissioning for the Ukraine to be settled within a year and is therefore reported as a long-term liability.

| | Year ended December 31, | |
|---|---|---|
| *(Thousands of US dollars)* | 2012 | 2011 |
| Balance, beginning of year | $ 935 | $ 398 |
| Provisions for new wells | 280 | 194 |
| Changes in estimates | (127) | 330 |
| Accretion | 153 | 10 |
| Translation adjustment | (10) | 3 |
| Balance, end of year | $ 1,231 | $ 935 |
| Due within on year | 409 | - |
| Long-term liability | 822 | 935 |
| Total decommissioning provision | $ 1,231 | $ 935 |

## 16. Capital Management

As at December 31, 2012, the Company's total capital resources amounted to $155.5 million (December 31, 2011 - $208.0 million), consisting of $123.5 million (December 31, 2011 - $174.5 million) in shareholders' equity, $21.4 million in long-term debt (December 31, 2011 - $22.5 million) and $10.6 million (December 31, 2011 - $11.0 million) in note payable. 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.

Dividends can be paid out of the Ukrainian subsidiary, KUB-Gas, providing that the terms and conditions of the EBRD Loan agreement are met. These terms do restrict the ability of KUB-Gas to pay dividends as such payments are subject to maintaining certain covenant restrictions, namely a current ratio test. During 2012, the Ukrainian subsidiary successfully declared and paid a dividend to its parent Company.

## 17. Income taxes

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

| *(Thousands of US dollars)* | Year ended December 31, 2012 | Year ended December 31, 2011 |
|---|---|---|
| Loss before income taxes | $ (67,327) | $ (13,694) |
| *Federal and provincial statutory rate* | *25.0%* | *26.5%* |
| Expected income tax reduction | $ (16,832) | $ (3,629) |
| Non-deductible expenditures | 2,237 | 2,094 |
| Tax rate differences and net change in tax attributes not recognized | 26,250 | 4,757 |
| Income tax expense/(recovery) | $ 11,655 | $ 3,222 |

The general federal/provincial tax rate lowered to 25.0% in 2012 from 26.5% in 2011 due to the Federal rate dropping from 16.5% (2011) to 15.0% in 2012.

The current tax expense is generated from the Company's operations in Ukraine. The corporate income tax rate effective during 2012 in Ukraine is 21%.

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

| *(Thousands of US dollars)* | Year ended December 31, 2012 | Year ended December 31, 2011 |
|---|---|---|
| Property and equipment and E&E assets | $ (7,348) | $ (5,352) |
| Decommissioning provision | 5 | 26 |
| Other | 106 | 64 |
| Deferred income tax liability | $ (7,237) | $ (5,262) |

**Unrecognized deferred tax assets**

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

| *(Thousands of US dollars)* | Year ended December 31, 2012 | Year ended December 31, 2011 |
|---|---|---|
| Property and equipment and E&E assets | $ 90,817 | $ 2,467 |
| Share issuance costs | 2,752 | 4,177 |
| Decommissioning provision | 18 | 17 |
| Non-capital losses carried forward and other | 46,937 | 24,076 |
| | $ 140,524 | $ 30,737 |

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 $32.7 million that expire between 2027 and 2032, and Cyprus tax losses of $14.2 million 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.

The Company operates in multiple jurisdictions with complex tax laws and regulations, which are evolving over time. The Company has taken certain tax positions in its tax filings and these filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax impact may differ significantly from that estimated and recorded by management. Management has assessed the maximum potential exposure to be $4.7million with respect to certain tax filing positions which might be challenged by the tax authorities in the Ukraine.

## 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.

During August 2012, debentures were converted resulting in an increase of 60,499,029 outstanding common shares at a price of $0.43 per share (note 12(a)).

### (b) Loss per share

| | Year ended December 31, 2012 | Year ended December 31, 2011 |
|---|---|---|
| Basic and diluted weighted average number of shares outstanding | 444,522,984 | 409,460,443 |

As the Company recorded a net loss in 2012 and 2011, the impact of the outstanding options, convertible debt and the note payable is anti-dilutive to the basic loss per share.

**(Stated in US dollars)**

### (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, 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 |
| Granted | 5,190,000 | $0.44 |
| Excerised | (453,333) | $0.40 |
| Expired | (2,460,000) | $0.68 |
| Forfeited | (2,227,667) | $0.40 |
| Balance, December 31, 2012 | 41,294,000 | $0.53 |

On various dates throughout 2012, the Company granted 5,190,000 share purchase options at a weighted average price of $0.44 per share to certain directors and certain employees of Kulczyk Oil.

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.

**(Stated in US dollars)**

The following table summarizes information about the options outstanding as at December 31, 2012:

| | Exercise price (US$) | Options outstanding | Options exercisable | Contractual life remaining, years (weighted average) |
|---|---|---|---|---|
| $ | 0.40 | 475,000 | 475,000 | 0.76 |
| $ | 0.40 | 75,000 | 75,000 | 1.13 |
| $ | 0.69 | 1,660,000 | 1,660,000 | 1.37 |
| $ | 0.60 | 10,250,000 | 10,250,000 | 1.71 |
| $ | 0.56 | 14,193,000 | 14,193,000 | 2.40 |
| $ | 0.40 | 42,000 | 42,000 | 2.77 |
| $ | 0.47 | 970,000 | 646,667 | 3.21 |
| $ | 0.40 | 150,000 | 100,000 | 3.36 |
| $ | 0.40 | 698,000 | 465,333 | 3.59 |
| $ | 0.40 | 7,621,000 | 5,080,667 | 3.93 |
| $ | 0.38 | 900,000 | 300,000 | 4.04 |
| $ | 0.40 | 250,000 | 83,333 | 4.06 |
| $ | 0.51 | 120,000 | 40,000 | 4.20 |
| $ | 0.49 | 530,000 | 176,667 | 4.34 |
| $ | 0.49 | 180,000 | 60,000 | 4.35 |
| $ | 0.41 | 900,000 | 300,000 | 4.59 |
| $ | 0.43 | 2,100,000 | 700,000 | 4.62 |
| $ | 0.42 | 60,000 | 20,000 | 4.71 |
| $ | 0.40 | 120,000 | 40,000 | 4.86 |
| $ | 0.52 | 41,294,000 | 34,707,667 | 2.75 |

**(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, 2012 | Year ended December 31, 2011 |
|---|---|---|
| Weighted average fair value per option | $0.27 | $0.41 |
| Exercise price | $0.44 | $0.46 |
| Volatility | 90.5% | 65.8% |
| Interest rate | 1.23% | 2.53% |
| Expected life (years) | 4 | 4 |
| Forfeiture rate | 3.33% | 3.33% |
| Dividends | Nil | Nil |

## 19. Commitments

The Company's commitments are all in the ordinary course of business and include the work commitments for Brunei Block L, Syria Block 9 and Ukraine.

***Brunei Block L***

The Block L PSA provides for an exploration period of six years from the date of the Block L PSA, August 27, 2006, divided into two phases, Phase 1 and Phase 2, each of which was initially for a period of three years, with Phase 2 now extended and expiring on August 27, 2013.

In August 2010, the Company and its partners (collectively, the "**Contractor**") elected to proceed to the Phase 2 exploration period. The minimum work obligations for Phase 2 include i) 130 square kilometres of onshore 3D seismic; ii) 13.5 square kilometres of onshore 3D swath data; iii) 13 kilometres of onshore 2D seismic, (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 Contractor is required to spend a minimum of $16 million during Phase 2. The Company has exceeded the minimum spend commitment and the remaining work commitment is to drill two exploration wells, the first of which is scheduled to start drilling in April 2013.

The Company had posted a letter of credit in the amount of $2.1 million in support of a 40% share of the performance guarantee required under the Block L PSA. In the third quarter 2012, the Company received notification from PetroleumBrunei confirming that the minimum spend commitments related to the Block L PSA have been satisfied and that the letter of credit is no longer required. Accordingly, the letter of credit has been canceled.

Pursuant to an agreement reached in 2012, to settle a legal challenge to the Company's title under the Block L 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 Block L PSA. No amount has been accrued in the financial statements as there is not yet production from Block L.

***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 Syrian authorities, subject to certain conditions, extended the term of the first exploration period under the Block 9 PSC to October 26, 2012. The drilling of the first of the two exploratory wells commenced on July 22, 2011 and was suspended in October 2011 due to unfavourable operating conditions in Syria.

Effective July 16, 2012, the Company, in its capacity as Operator of Syria's Block 9, declared a Force Majeure event due to conditions arising from the current instability, including difficult operating conditions, and the ability to move funds into the country, rendering the performance of its obligations under the contract impossible. 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 $45 million during the period from 2013 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 has drilled two wells in 2012 with a further four wells expected to be drilled over the next three 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.

## 20. Personnel expenses

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

| *(Thousands of US dollars)* | Year ended December 31, 2012 | Year ended December 31, 2011 |
|---|---|---|
| Wages, salaries and benefits | $ 9,848 | $ 9,942 |
| Bonuses | 641 | 259 |
| Stock based compensation (i) | 1,968 | 2,672 |
| Total remuneration | $ 12,457 | $ 12,873 |

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. Fees paid to the directors of the Company are included in wages, salaries and benefits.

(b) Key management personnel include the following: the Directors, 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:

| *(Thousands of US dollars)* | Year ended December 31, 2012 | Year ended December 31, 2011 |
|---|---|---|
| Wages and salaries | $ 2,825 | $ 2,629 |
| Bonuses | 300 | 100 |
| Stock based compensation (i) | 1,140 | 1,370 |
| Total remuneration | $ 4,265 | $ 4,099 |

(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 $12.5 million (2011 - $12.9 million) of which $5.4 million (2011 - $4.7 million) was included in production expenses, $5.1 million (2011 - $5.5 million) was included in general and administrative expenses and $2.0 million ($2011 - $2.7 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, accounts receivable, accounts payable and accrued liabilities, note payable 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 note payable are not considered material because the costs 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 of 19%. A 1% change in the LIBOR rate would affect interest expense by $0.2 million (2011 - $0.2 million), based on the debt balance outstanding at year end. Restricted cash 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.

The Company's accounts receivable consist of receivables from other joint venture partners that are anticipated to be applied against future capital expenditures, receivables for revenue in Ukraine, commodity taxes recoverable from the federal government of Canada and interest earned on restricted cash deposits, for which credit risk is assessed as being low as the funds are on deposit with major financial institutions.

In 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.

All account receivable held by the Company are due immediately.

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, Polish zloty, Ukraine hryvnia, Syrian pound and the United States dollar. At December 31, 2012 the Company's primary currency exposure related to Canadian dollar ("**CAD**") and Ukraine hryvnia ("**UAH**") balances. The following table summarizes the Company's foreign currency exchange risk for each of the currencies indicated:

| | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| *(Thousands)* | CAD | UAH | CAD | UAH |
| Cash and cash equivalents | 124 | 127,488 | 249 | 71,655 |
| Accounts receivable | 267 | 11,759 | 424 | 3,579 |
| Prepaid expenses | 248 | 2,796 | 16 | 5,837 |
| Accounts payable and accrued liabilities | (422) | (92,943) | (435) | (26,867) |
| Net foreign exchange exposure | 217 | 49,100 | 254 | 54,204 |
| US $ equivalent at period end exchange rate | $ 218 | $ 6,143 | $ 249 | $ 6,683 |

For the year ended December 31, 2012, 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 $10,000 (2011 - $25,000). Earnings are not impacted by fluctuations in the hryvnia as translation gains and losses are included in accumulated other comprehensive income (loss).

**(d) Liquidity risk**

The Company monitors its liquidity position regularly to assess whether it has the resources necessary to fund planned exploration commitments on its petroleum and natural gas properties or that viable options are available to fund such commitments from operating cash flow, new equity issuances or alternative sources of financing such as farm-out agreements. However, as an exploration and development company 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

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, 2012, the fees totalled $712,224 (2011 - $624,780). At December 31, 2012, $25,538 was owed to Nemmoco (2011 - $52,065).

Loon Energy Corporation ("**Loon Energy**"), a publicly traded Canadian corporation, has no employees. Management and administrative services are provided by the management and staff of Kulczyk Oil. For the year ended December 31, 2012, these fees totalled $12,605 (2011 - $12,600). At December 31, 2012, Loon Energy owed $12,605 (2011 – $8,400) 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, 2012, Loon Energy owed $85,508 (2011 – $35,388) for these costs. Kulczyk Oil and Loon Energy are related as they have four common directors and officers and the same principal shareholder.

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, the parent company of Loon Peru Limited, had begun the process of replacing the Loon Guarantee, however, the block to which the guarantee related is in the process of being relinquished and it is not currently anticipated that the guarantee will be replaced.

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.

The Company provided services pursuant to a shared services agreement to Jura, a public company in which the Company owned 1.1% of the outstanding common shares at December 31, 2012. In 2012, the Company charged fees and associated costs to Jura totalling $56,317 (2011 – $116,780). At December 31, 2012, $nil (2011 – $10,299) was due from Jura. Until the third quarter of 2012, three directors of the Company were directors of Jura, and the Chief Financial Officer of the Company was also the Chief Financial Officer of Jura. During the third quarter of 2012, Jura completed an acquisition at which point the board of directors was reconstituted and a change in management occurred, the result of which is one of the directors and the CFO of the Company are no longer associated with Jura. The shared services agreement was terminated in the third quarter of 2012 and now only office rental costs are charged to Jura.

At December 31, 2012, KI owned 49.99% of the issued and outstanding shares of the Company (December 31, 2011 – 44.3%). 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, 2012 the Company paid $nil to KI (2011 - $210,000) and $nil to KH (2011 - $90,000) respectively. There were no amounts payable to KI or KH in the current or comparative period.

In 2011, certain expenditures of Neconde have been paid by Kulczyk Oil and were reimbursable by Neconde. During 2012, $1.0 million was received from KI for these costs.

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

## 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, 2012** | **Brunei** | **Syria** | **Ukraine** | **Corporate** | **Total** |
|---|---|---|---|---|---|
| Total Assets | $ 41,987 | $ 620 | $ 139,904 | $ 5,198 | $ 187,709 |
| **For the year ended December 31, 2012** | | | | | |
| Oil and gas revenue, net of royalties | $ - | $ - | $ 80,120 | $ - | $ 80,120 |
| Operating expenses: | | | | | |
| Production expense | - | - | (12,223) | - | (12,223) |
| General and administrative | - | - | - | (9,498) | (9,498) |
| Transaction costs | - | - | - | (4,193) | (4,193) |
| Stock based compensation | - | - | - | (1,968) | (1,968) |
| Loss on disposition of assets | (205) | - | - | - | (205) |
| Depletion/depreciation | - | - | (25,824) | (6) | (25,830) |
| Impairment on exploration and evaluation assets | (85,491) | (2,248) | - | - | (87,739) |
| Finance income/(expense) | | | | | |
| Interest and other income | - | - | 1,580 | 979 | 2,559 |
| Unrealized loss on investment | - | - | - | (82) | (82) |
| Interest expense and accretion | - | - | (5,578) | (2,509) | (8,087) |
| Foreign exchange gain/(loss) | - | - | 310 | (491) | (181) |
| Earnings (loss) before tax | $ (85,696) | $ (2,248) | $ 38,385 | $ (17,768) | $ (67,327) |
| Capital expenditures | $ 20,687 | $ 154 | $ 35,947 | $ 144 | $ 56,932 |

*(Thousands of US dollars)*

| **As at December 31, 2011** | **Brunei** | **Syria** | **Ukraine** | **Corporate** | **Total** |
|---|---|---|---|---|---|
| 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) |
| Transaction costs | - | - | - | (1,047) | (1,047) |
| Stock based compensation expense | - | - | - | (2,672) | (2,672) |
| Impairment on exploration and evaluation assets | - | (8,664) | - | | (8,664) |
| Depletion/depreciation | - | - | (7,520) | (76) | (7,596) |
| Finance income/(expense) | | | | | |
| Interest and other income | - | - | (10) | 4 | (6) |
| Unrealized gain on investment | - | - | - | (66) | (66) |
| Interest expense and accretion | - | - | (1,999) | (1,862) | (3,861) |
| Foreign exchange gain | - | - | - | (354) | (354) |
| Equity loss of associates | - | - | - | (1,516) | (1,516) |
| Gain/(Loss) before tax | $ - | $ (8,664) | $ 11,580 | $ (16,610) | $ (13,694) |
| Capital expenditures | $ 6,252 | $ 3,586 | $ 29,816 | $ 99 | $ 39,753 |