

# **CANACOL ENERGY LTD.**

**INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
THREE MONTHS ENDED SEPTEMBER 30, 2011**



## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(UNAUDITED)

(in thousands of United States dollars)

	Note	September 30, 2011	June 30, 2011 (Note 23)	July 1, 2010 (Note 23)
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		\$ 108,986	\$ 101,627	\$ 56,240
Restricted cash	8	6,091	12,604	890
Trade and other receivables	20	27,403	37,976	7,266
Prepaid expenses and deposits		1,811	2,198	563
Prepaid transportation on overlifted volumes	10	4,088	4,024	-
Commodity contracts		39	-	227
Assets held for sale – Brazil	6	-	3,828	-
Crude oil inventory		7,945	12,348	2,330
		156,363	174,605	67,516
<b>Non-current assets</b>				
Restricted cash	8	454	444	399
Trade and other receivables		-	-	395
Exploration and evaluation assets	5	40,326	33,603	11,913
Property, plant and equipment	6	104,282	88,566	77,135
Pipeline investment	7	2,991	2,589	-
Deferred tax assets		12,158	16,763	-
		160,211	141,965	89,842
<b>Total assets</b>		\$ 316,574	\$ 316,570	\$ 157,358
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Bank debt	9	\$ -	\$ -	\$ 322
Trade and other payables		18,166	22,208	32,587
Commodity contracts		-	577	-
Overlifted volumes payable	10	31,856	38,199	-
Equity tax payable	15	995	1,180	-
Assets held for sale – Brazil		-	888	-
Taxes payable		20,245	17,006	292
Warrants		-	-	10,267
		71,262	80,058	43,468
<b>Non-current liabilities</b>				
Decommissioning obligations	11	4,918	4,541	3,783
Convertible debentures	12	24,311	31,454	3,998
Warrants		-	-	435
Equity tax payable	15	1,989	2,774	-
Deferred tax liabilities		5,170	7,015	5,927
<b>Total liabilities</b>		107,650	125,842	57,611
<b>Equity</b>				
Share capital	13	270,835	269,732	160,937
Contributed surplus	13	24,742	21,286	12,017
Accumulated other comprehensive loss		498	347	-
Deficit		(87,151)	(100,637)	(73,207)
<b>Total equity</b>		208,924	190,728	99,747
<b>Total liabilities and equity</b>		\$ 316,574	\$ 316,570	\$ 157,358

Commitments and contingencies (note 21)

Subsequent event (note 22)

See accompanying notes to interim condensed consolidated financial statements.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

For the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in thousands of United States dollars, except per share amounts)

	Note	2011	2010
			(Note 23)
<b>Revenues</b>			
Crude oil sales, net of royalties	17	\$ 26,453	\$ 15,219
Tariff revenue		8,877	1,579
		<b>35,330</b>	<b>16,798</b>
<b>Expenses</b>			
Operating and transportation		13,269	7,334
Pre-license costs for exploration prospects		1,456	-
General and administrative		2,541	2,850
Stock-based compensation		2,478	2,902
Depletion, depreciation and amortization	6	8,523	4,583
(Gain) loss on convertible debentures		(4,495)	14,485
Gain on overlifted volumes payable	10	(7,088)	-
Loss on sale of Brazilian assets		4,170	-
Impairment loss on Brazilian assets		-	11,742
		<b>20,854</b>	<b>43,896</b>
<b>Net finance income (expense)</b>	14	<b>5,685</b>	<b>(3,663)</b>
<b>Income (loss) before income taxes</b>		<b>20,161</b>	<b>(30,761)</b>
<b>Income taxes</b>			
Current		3,915	(168)
Deferred		2,760	(525)
		<b>6,675</b>	<b>(693)</b>
<b>Net income (loss) for the period</b>		<b>13,486</b>	<b>(30,068)</b>
<b>Other comprehensive loss</b>			
Foreign currency translation adjustment		151	(782)
<b>Comprehensive income (loss) for the period</b>		<b>\$ 13,637</b>	<b>\$ (30,850)</b>
<b>Earnings (loss) per share</b>			
Basic and diluted	16	\$ 0.03	\$ (0.07)

See accompanying notes to interim condensed consolidated financial statements.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in thousands of United States dollars, number of shares in thousands)

	Number of Common Shares	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Loss	Deficit	Total Equity
Balance as at July 1, 2010	421,466	\$ 160,937	\$ 12,017	\$ -	\$ (73,207)	\$ 99,747
Issue of common shares	46,981	59,307	-	-	-	59,307
Conversion of convertible debentures	18,835	27,159	-	-	-	27,159
Warrants exercised	16,122	20,708	-	-	-	20,708
Stock options exercised	8,233	4,629	(2,750)	-	-	1,879
Stock-based compensation	-	-	12,019	-	-	12,019
Share issue costs	-	(3,008)	-	-	-	(3,008)
Net loss for the year	-	-	-	347	(27,430)	(27,083)
Balance at June 30, 2011	511,637	269,732	21,286	347	(100,637)	190,728
Issue of common shares	78	72	-	-	-	72
Conversion of convertible debentures	833	767	-	-	-	767
Stock options exercised	405	264	(114)	-	-	150
Stock-based compensation	-	-	3,570	-	-	3,570
Net income for the period	-	-	-	151	13,486	13,637
<b>Balance at September 30, 2011</b>	<b>512,953</b>	<b>\$ 270,835</b>	<b>\$ 24,742</b>	<b>\$ 498</b>	<b>\$ (87,151)</b>	<b>\$ 208,924</b>

See accompanying notes to interim condensed consolidated financial statements.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in thousands of United States dollars)

	Note	2011	2010
<b>Operating activities</b>			
Net income (loss) for the period		\$ 13,486	\$ (30,068)
Adjustments for non-cash items:			
Stock-based compensation		2,478	2,902
Depletion, depreciation and amortization	6	8,523	4,583
(Gain) loss on convertible debentures		(4,495)	14,485
Gain on overlifted volumes payable	10	(7,088)	-
Loss on sale of Brazilian assets		4,170	-
Impairment loss on Brazilian assets		-	11,742
Net finance (revenue) expense		(2,270)	3,866
Deferred income tax		2,760	(525)
Other non-cash items		197	781
		17,761	7,766
Changes in non-cash working capital	17	12,375	(5,275)
		30,136	2,491
<b>Investing activities</b>			
Expenditures on exploration and evaluation assets	5	(6,723)	-
Expenditures on property, plant and equipment	6	(24,633)	(8,241)
Investment in pipeline		(402)	-
Proceeds on sale of Brazilian assets		3,152	-
Purchase of Gemini royalty	13	-	(18,000)
Change in restricted cash		6,503	849
Changes in non-cash working capital	17	(824)	(1,197)
		(22,927)	(26,589)
<b>Financing activities</b>			
Issue of common shares	13	150	3,038
Issue of convertible debentures	12	-	39,385
Financing and share issue costs		-	(1,892)
Change in bank debt		-	(22)
		150	40,509
Change in cash and cash equivalents		7,359	16,411
Cash and cash equivalents, beginning of period		101,627	56,240
<b>Cash and cash equivalents, end of period</b>		\$ 108,986	\$ 72,651
<b>Cash and cash equivalents consists of:</b>			
Cash		\$ 44,381	\$ 5,310
Cash equivalents		64,605	67,341
<b>Cash and cash equivalents, end of period</b>		\$ 108,986	\$ 72,651

See accompanying notes to interim condensed consolidated financial statements.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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### NOTE 1 - GENERAL INFORMATION

Canacol Energy Ltd. (the “Corporation”) and its subsidiaries are primarily engaged in petroleum and natural gas exploration and development activities in Colombia, Brazil and Guyana. The Corporation’s head office is located at 2110, 333 – 7<sup>th</sup> Avenue SW, Calgary, Alberta, T2P 2Z1, Canada. The Corporation’s shares are traded on the Toronto Stock Exchange under the symbol CNE and the Bolsa de Valores de Colombia under the symbol CNE.C.

### NOTE 2 - ADOPTION OF IFRS

The Corporation prepares its financial statements in accordance with Canadian generally accepted accounting principles. In 2010, the accounting principles were revised to incorporate International Financial Reporting Standards (“IFRS”), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Corporation has commenced reporting on this basis in these interim unaudited condensed interim financial statements (the “interim financial statements”). In these interim financial statements, the term “Canadian GAAP” refers to Canadian GAAP prior to the adoption of IFRS.

These interim financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 23, the Corporation has consistently applied the same accounting policies in its opening IFRS statement of financial position at July 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 23 discloses the impact of the transition to IFRS on the Corporation’s reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Corporation’s consolidated financial statements for the year ended June 30, 2011.

The policies applied in these interim financial statements are based on IFRSs issued and outstanding as of beginning of the period. The Board of Directors approved the interim financial statements for issuance on November 14, 2011. Any subsequent changes to IFRS that are given effect in the Corporation’s annual consolidated financial statements for the year ending June 30, 2012 could result in the restatement of these interim financial statements, including the transition adjustments recognized on the change-over to IFRS.

The interim financial statements should be read in conjunction with the Corporation’s Canadian GAAP annual consolidated financial statements for the year ended June 30, 2011.

### NOTE 3 - BASIS OF PREPARATION

#### Basis of Measurement

These interim financial statements have been prepared on an historical cost basis, except for commodity contracts, convertible debentures and overlifted volumes payable, which are measured at fair value with changes in fair value recorded in profit or loss.

The methods used to measure fair values are discussed in note 20.

These interim financial statements have been prepared on a going concern basis.

#### Functional and Presentation Currency

These interim financial statements are presented in United States dollars which is both the functional and presentation currency. Tabular amounts are stated in thousands of United States dollars.

#### Significant Estimates and Judgements

The timely preparation of financial statements in accordance with IFRS requires that management make estimates and assumptions and use judgement regarding the measured amounts of assets and liabilities at the date of the interim financial statements and the reported amounts of revenue and expenses during the reporting period. Such estimates related primarily to unsettled transactions and events as of the date of the interim financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Amounts recorded for depletion, depreciation, amortization, accretion, provisions for decommissioning obligations, deferred income taxes, the valuation of convertible debentures, the valuation of warrants, and the valuation of stock

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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options are based on their expected lives and other relevant assumptions. Further, the amounts used for impairment calculations are based on estimated crude oil and natural gas reserves, and other relevant assumptions. By their nature, these estimated reserves and their related future cash flows are subject to measurement uncertainty and the impact in the financial statements of future periods could be material.

Significant judgement is required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain in the ordinary course of business. The Corporation has recognized a valuation allowance for the net future tax asset created from Canadian and Brazilian non-capital losses carried forward due to the uncertainty of realization of such amounts.

### NOTE 4 - SIGNIFICANT ACCOUNTING POLICIES

#### Principles of Consolidation

**Subsidiaries** – Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation 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 interim financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. 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 the acquisition over the fair value of the identifiable assets acquired and liabilities and contingent liabilities assumed 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 profit or loss.

**Jointly-controlled operations and jointly-controlled assets** – Many of the Corporation's petroleum and natural gas activities involve jointly-controlled assets. The interim financial statements include the Corporation's share of these jointly-controlled assets and a proportionate share of the relevant revenue and related costs.

**Transactions eliminated on consolidation** – Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated on consolidation.

#### Foreign Currency

The United States dollar is the functional currency of the Corporation and its significant subsidiaries. Monetary assets and liabilities denominated in foreign currencies are translated to United States dollars at the period-end exchange rate. Non-monetary assets, liabilities, revenues and expenses are translated at exchange rates at the transaction date. Exchange gains or losses are included in the determination of profit or loss in the statement of operations.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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### Financial Instruments

**Non-derivative financial instruments** – Non-derivative financial instruments include cash and cash equivalents, restricted cash, deposits, trade and other receivables, bank debt, trade and other payables, and convertible debentures. Non-derivative financial instruments are initially recognized at fair value plus any directly attributable transaction costs, except for financial assets and liabilities 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 measured as described below.

**Cash and cash equivalents** – Cash and cash equivalents comprise cash on deposit with banks and short-term investments with original maturities of three months or less and is measured similar to other non-derivative financial instruments.

**Restricted cash** – Restricted cash relates to cash placed in trust accounts in Colombian and Brazilian banks to ensure the payment of its obligations pursuant to exploration agreements.

**Deposits** – Deposits relate to advances to suppliers.

**Convertible debentures** – Convertible debentures are recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss.

**Overlift volumes payable** – Overlift volumes payable are recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss.

**Other** – Other non-derivative financial instruments, such as trade and other receivables, bank debt and trade and other payables are measured at amortized cost using the effective interest method, less any impairment losses.

**Derivative financial instruments** – The Corporation has entered into certain financial derivative contracts to manage its exposure to market risks associated with fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Corporation has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting, even though the Corporation considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the statement of financial position at fair value. Transaction costs are expensed when incurred.

**Embedded derivatives** – Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

**Share capital** – Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and warrants are recognized as a deduction from equity, net of any tax effects.

### Property, Plant and Equipment and Exploration and Evaluation Assets

#### Recognition and measurement

**Exploration and evaluation (“E&E”) assets** – 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, initially are capitalized either as tangible or intangible E&E assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

When E&E assets are determined to be technically feasible and commercially viable, the accumulated costs are transferred to property, plant and equipment. When E&E assets are determined not to be technically feasible and



## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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commercially viable or the Corporation decides not to continue with its activity, the unrecoverable costs are charged to profit or loss as exploration and evaluation expense.

E&E assets are assessed for impairment in any circumstances where sufficient data exists to determine technical feasibility and commercial viability, and facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, E&E assets are allocated to cash-generating units (“CGUs”).

*Development and production costs* – Items of property, plant and equipment, which include petroleum and natural 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 CGUs for impairment testing. The cost of property, plant and equipment at July 1, 2010, the date of transition to IFRS, was determined as follows: E&E assets were recorded at their previous Canadian GAAP carrying amount as allowed under IFRS 1; and petroleum and natural gas assets were allocated to CGUs using reserve volumes, as allowed under the IFRS 1 exemption for full-cost oil and gas companies.

When significant parts of an item of property, plant and equipment, including petroleum 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 petroleum and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized net within profit or loss.

**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 recognized as petroleum and natural gas interests 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 petroleum and natural gas interests 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.

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

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 producible. There should be a 50% statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proved and probable and a 50% statistical probability that it will be less. The equivalent statistical probabilities for the proved component of proved and probable reserves are 90% and 10%, respectively.

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 producibility is supported by either actual production or conclusive formation tests. 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

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Corporation will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives for other assets for the current and comparative years are as follows:

Equipment and other	3-10 years
Leasehold improvements	Over the term of the leasing agreement

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

### Leased Assets

Leases where the Corporation assumes substantially all the risks and rewards of ownership are classified as finance leases.

Other leases are operating leases, which are not recognized on the Corporation's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

### Impairment

**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. 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.

**Non-financial assets** – The carrying amounts of the Corporation'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 petroleum and natural gas interests, and also if facts and circumstances suggest that their carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, 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 "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

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

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As at and for the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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E&E assets are allocated to related CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (petroleum 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 CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

In respect of assets other than goodwill, 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.

### Provisions

A provision is recognized if, as a result of a past event, the Corporation 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.

**Decommissioning obligations** – The Corporation'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 the expenditure required to settle the present obligation at the period-end date. Subsequent to 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.

### Inventory

Inventory consists of crude oil in transit or in storage tanks at the reporting date, and is valued at the lower of cost, using the weighted-average cost method, or net realizable value. Costs include direct and indirect expenditures incurred in bringing the crude oil to its existing condition and location.

### Pipeline Investment

The Corporation's interest in a pipeline construction project in Colombia is recorded at cost and assessed annually for impairment.

### Revenue

The Corporation's revenues are primarily derived from the production of crude oil ("net revenue interest" or "NRI" production) and from the production of crude oil under a risk service contract with Ecopetrol S.A. ("Ecopetrol"), the state oil company of Colombia, whereby the Corporation receives a set tariff price per barrel of oil produced ("tariff" production).

Revenue from the sale of crude oil is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer, which is usually when legal title passes to an external party.

Revenue is recorded net of any royalties.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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### Stock-Based Compensation

The grant date fair value of stock options and restricted share units granted to employees, directors and consultants is recognized as stock-based 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 awards that vest.

### Finance Income and Expenses

Net finance income or expense is comprised of interest income, interest expense on borrowings, accretion of the discount on provisions, gains or losses on commodity contracts, gains or losses on foreign exchange and impairment losses recognized on financial assets.

Borrowing costs incurred for the construction of qualifying assets are 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. 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.

### Income Taxes

Income tax expense comprises current and deferred income taxes. 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 income tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous periods.

Deferred income tax is recognized using the liability 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 income tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred income tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred income 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 income 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.

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

### Earnings per Share

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Corporation 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 stock options and convertible debentures.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### New Standards and Interpretations Not Yet Adopted

In November 2009, the IASB issued IFRS 9, “Financial Instruments”, which is the result of the first phase of the IASB’s project to replace IAS 39, “Financial Instruments: Recognition and Measurement”. In October 2010, the standard was revised. The new and revised standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The adoption of this standard is not expected to have a material impact on the Corporation’s financial statements.

In May 2011, the IASB issued IFRS 10, “Consolidated Financial Statements”, which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees including special purpose entities. The standard is required to be adopted for periods beginning January 1, 2013. The Corporation is evaluating the impact that this standard may have on our statements of operations and financial position.

In May 2011, the IASB issued IFRS 11, “Joint Arrangements”, which presents a new model for determining whether an entity should account for joint arrangements using proportionate consolidation or the equity method. An entity will have to follow the substance rather than legal form of a joint arrangement and will no longer have a choice of accounting method. The standard is required to be adopted for periods beginning January 1, 2013. The Corporation is evaluating the impact that this standard may have on our statements of operations and financial position.

In May 2011, the IASB issued IFRS 12, “Disclosure of Interests in Other Entities”, which aggregates and amends disclosure requirements included within other standards. The standard requires a company to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard is required to be adopted for periods beginning January 1, 2013. The Corporation is evaluating the impact that this standard may have on our statements of operations and financial position.

In May 2011, the IASB issued IFRS 13, “Fair Value Measurement”, to provide comprehensive guidance for instances where IFRS requires fair value to be used. The standard provides guidance on determining fair value and requires disclosures about those measurements. The standard is required to be adopted for periods beginning January 1, 2013. The Corporation is evaluating the impact that this standard may have on our statements of operations and financial position.

In May 2011, the IASB issued amendments to IAS 27, “Separate Financial Statements”, to establish the accounting and disclosure requirements for investments in subsidiaries, joint ventures, and associates when an entity prepares separate financial statements and replaces the current IAS 27, “Consolidated and Separate Financial Statements” as the consolidation guidance is included in IFRS 10, “Consolidated Financial Statements”. The Corporation is evaluating the impact that this standard may have on our statements of operations and financial position.

In May 2011, the IASB issued amendments to IAS 28, “Investments in Associates and Joint Ventures”, to establish the accounting for investments in associates and defines how the equity method is applied when accounting for associates and joint ventures. The Corporation is evaluating the impact that this standard may have on our statements of operations and financial position.

In June 2011, the IASB issued amendments to IAS 1, “Presentation of Items of Other Comprehensive Income”, to split items of other comprehensive income (OCI) between those that are reclassified to income and that are not. The standard is required to be adopted for periods beginning on or after July 1, 2012. The Corporation is evaluating the impact that this standard may have on our statements of operations and financial position.

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### NOTE 5 – EXPLORATION AND EVALUATION ASSETS

Balance at July 1, 2010	\$	11,913
Additions		21,690
Balance at June 30, 2011		33,603
Additions		6,723
<b>Balance at September 30, 2011</b>	<b>\$</b>	<b>40,326</b>

### NOTE 6 – PROPERTY, PLANT AND EQUIPMENT

	Crude Oil Assets		Corporate and Other Assets		Total
<b>Cost or deemed cost</b>					
Balance at July 1, 2010	\$	75,810	\$	1,618	\$ 77,428
Additions		54,321		-	54,321
Transfer to assets held for sale		(15,401)		-	(15,401)
Balance at June 30, 2011		114,730		1,618	116,348
Additions		25,347		679	26,026
Disposals		(1,787)		-	(1,787)
<b>Balance at September 30, 2011</b>	<b>\$</b>	<b>138,290</b>	<b>\$</b>	<b>2,297</b>	<b>\$ 140,587</b>
<b>Accumulated depletion, depreciation and impairment losses</b>					
Balance at July 1, 2010		-		(293)	(293)
Depletion and depreciation		(24,695)		(341)	(25,036)
Impairment loss on assets		(14,026)		-	(14,026)
Transfer to assets held for sale		11,573		-	11,573
Balance at June 30, 2011		(27,148)		(634)	(27,782)
Depletion and depreciation		(8,338)		(185)	(8,523)
<b>Balance at September 30, 2011</b>	<b>\$</b>	<b>(35,486)</b>	<b>\$</b>	<b>(819)</b>	<b>\$ (36,305)</b>
<b>Carrying amounts</b>					
At July 1, 2010	\$	75,810	\$	1,325	\$ 77,135
At June 30, 2011	\$	87,582	\$	984	\$ 88,566
<b>At September 30, 2011</b>	<b>\$</b>	<b>102,804</b>	<b>\$</b>	<b>1,478</b>	<b>\$ 104,282</b>

In September 2010, the Corporation negotiated the disposition of its non-core, non-operated producing properties in Brazil for cash consideration of approximately \$3.8 million, which have been presented as assets held for sale as at September 30, 2010 and June 30, 2011. In July 2011, the Brazilian regulatory authorities approved the disposition of these non-operated producing properties and the Corporation recognized disposition adjustments, resulting in a loss on sale of Brazilian assets of \$4.2 million.

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### NOTE 7 – PIPELINE INVESTMENT

The Corporation owns a 0.5% interest in the Oleoducto Bicentenario de Colombia (“OBC”) pipeline project, operated by Ecopetrol, which will link Llanos basin oil production to the Cano Limon oil pipeline system. At September 30, 2011, the Corporation had contributed approximately \$3.0 million of the capital commitment, which is recorded at cost. Under the terms of the OBC agreement, the Corporation may be required to provide financial support or guarantees for its proportionate equity interest in any future debt financings undertaken by OBC. Shareholders of OBC are obliged to execute a transport agreement at a set rate per barrel before the completion of the first phase of the project. The Corporation will also be eligible to receive any dividends on the project.

### NOTE 8 – RESTRICTED CASH

	September 30, 2011	June 30, 2011	July 1, 2010
Restricted cash – exploration commitments	\$ 6,091	\$ 12,604	\$ 890
Restricted cash – decommissioning obligations	454	444	399
	\$ 6,545	\$ 13,048	\$ 1,289

As required by the Agencia Nacional de Hidrocarburos (“ANH”) in Colombia and the Agencia Nacional de Petroleo (“ANP”) in Brazil, the Corporation is required to place funds in a trust in Colombian and Brazilian banks to ensure payment of its obligations pursuant to certain exploration agreements. In addition, the Corporation was required to place funds in trust for future decommissioning obligations with respect to its Entrerrios field in Colombia.

### NOTE 9 – BANK DEBT

At September 30, 2011, the Corporation had revolving lines of credit in place in Colombia with an aggregate borrowing base of \$40 million (COP\$ 75.2 billion). These lines of credit have interest rates ranging from 6% to 9% and are unsecured. At September 30, 2011, no amounts were drawn under the facilities.

At September 30, 2011, the Corporation had letters of credit outstanding totalling \$11.5 million to guarantee work commitments on exploration blocks. The total of these letters of credit reduce the amount available under the revolving lines of credit described above.

### NOTE 10 – OVERLIFTED VOLUMES

Under a participation contract with Ecopetrol, the Corporation is required to deliver Ecopetrol’s share of crude oil production volumes in kind at a particular delivery point. However, due to capacity restrictions at this delivery point, Ecopetrol typically takes delivery of its production volumes at the field. At times, Ecopetrol is not able to take delivery of all of its production volumes in kind and the Corporation is required to sell such production since sufficient on-site storage facilities are not available. When the Corporation sells these “overlifted” volumes, a liability is recorded for the amount of the sale and prepaid transportation is recorded for associated transportation costs. As overlifted volumes are delivered to Ecopetrol, the liability and prepaid transportation amounts are reduced with corresponding recognition of such amounts as revenue and transportation costs. Since the participation contract with Ecopetrol requires delivery of production volumes in kind, the Corporation revalues the liability at each period-end to reflect the fair value of the crude oil owing to Ecopetrol at that time; gains or losses related to such are recognized in profit or loss in the period. A summary of overlifted volumes and the related net liability is provided below.

	September 30, 2011	June 30, 2011	July 1, 2010
Overlifted volumes (Mbbbls)	386.9	368.4	-
Average valuation price (\$/bbl)	\$ 82.34	\$ 103.69	-
Overlifted volumes payable	\$ 31,856	\$ 38,199	-
Less: transportation costs	(4,088)	(4,024)	-
<b>Net payable on overlifted volumes</b>	<b>\$ 27,768</b>	<b>\$ 34,175</b>	<b>\$ -</b>

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### NOTE 11 – DECOMMISSIONING OBLIGATIONS

Balance at June 30, 2011	4,541
Accretion	144
Additions, disposals and revisions	233
<b>Balance at September 30, 2011</b>	<b>\$ 4,918</b>

The Corporation's decommissioning obligations result from its ownership interest in petroleum and natural gas assets, including well sites and gathering systems. The total decommissioning obligation is estimated based on the Corporation'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 Corporation has estimated the net present value of the decommissioning obligations to be \$4.9 million at September 30, 2011 (June 30, 2011 - \$4.5 million) based on an undiscounted total future liability of \$4.7 million (June 30, 2011 - \$4.7 million). These payments are expected to be made over the next 22 years with the majority of costs to be incurred between 2013 and 2017. The discount factor, being the risk-free rate related to the liability, is 5.0% (June 30, 2011 - 5.0%) and the inflation rate is 3.5% (June 30, 2011 - 3.5%).

### NOTE 12 – CONVERTIBLE DEBENTURES

#### 2015 Convertible Debentures

On July 16, 2010, the Corporation closed a Canadian dollar denominated convertible unsecured debenture financing for aggregate gross proceeds of \$39.4 million (C\$41.5 million) (the "2015 Debentures"). The 2015 Debentures bear interest at 8% per annum, payable semi-annually on the last day of June and December commencing on December 31, 2010. The 2015 Debentures mature on June 30, 2015 and are convertible at the holder's option into common shares of the Corporation at any time prior to the earlier of either the maturity date or the business day immediately preceding the date fixed by the Corporation for redemption at a conversion price of C\$1.0526 per common share, being the ratio of 950 common shares per C\$1,000 principal amount of 2015 Debentures. The 2015 Debentures are not redeemable prior to June 30, 2013. Transaction costs in connection with the financing were \$1.9 million and were recognized in profit or loss.

The 2015 Debentures were recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss. A reconciliation of the 2015 Debentures is provided below.

Balance at June 30, 2011	30,426
Unrealized gain	(4,234)
Foreign exchange gain	(1,881)
<b>Balance at September 30, 2011</b>	<b>\$ 24,311</b>



## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### 2011 Convertible Debentures

In September 2009, the Corporation closed a Canadian dollar denominated convertible unsecured subordinated debenture financing for aggregate gross proceeds of \$3.7 million (C\$4.0 million) (the “2011 Debentures”). The 2011 Debentures bear interest at 12% per annum, payable quarterly through the issue of common shares at a price equal to a 10% discount to the volume weighted-average trading price of the Corporation’s common shares for the 10 trading days immediately preceding the quarterly interest payment date. The 2011 Debentures mature within 24 months of issuance and are convertible into common shares of the Corporation at the holder’s option at a conversion price of C\$0.36 per common share.

The 2011 Debentures were recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss. A reconciliation of the 2011 Debentures is provided below.

Balance at June 30, 2011	1,028
Conversion to common shares	(767)
Gain on conversion to common shares	(261)
<b>Balance at September 30, 2011</b>	<b>\$ -</b>

At September 30, 2011, no 2011 Debentures remained outstanding.

### NOTE 13 – SHARE CAPITAL

#### Authorized

The Corporation is authorized to issue an unlimited number of common shares.

#### Issued and Outstanding

	Number (000s)	Amount
Balance at July 1, 2010	421,466	160,937
Issue of common shares	46,981	59,307
Issued on exercise of warrants	16,122	20,708
Issued on exercise of stock options	8,233	1,879
Issued on conversion of convertible debentures	18,835	27,159
Share issue costs	-	(3,008)
Transfer from contributed surplus for stock options exercised	-	2,750
Balance at June 30, 2011	511,637	269,732
Issued on exercise of stock options	405	150
Issued on conversion of convertible debentures	833	767
Issued on interest payments for convertible debentures	8	7
Issued to employees	70	65
Transfer from contributed surplus for stock options exercised	-	114
<b>Balance at September 30, 2011</b>	<b>512,953</b>	<b>270,835</b>

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### Warrants

	Number (000s)	Amount
Balance at July 1, 2010	16,122	10,702
Exercised	(16,122)	(10,702)
<b>Balance at June 30, 2011 and September 30, 2011</b>	<b>-</b>	<b>-</b>

### Equity Financing

In February 2011, the Corporation completed an equity financing for gross proceeds of \$58.3 million (C\$57.6 million) and net proceeds of \$55.3 million (C\$54.7 million). Pursuant to the financing, the Corporation issued 41,745,000 common shares at a price of C\$1.38 per share. Share issue costs with respect to this financing were \$3.0 million (C\$3.0 million).

### Gemini Royalty Interest

In 2009, the Corporation executed a series of agreements with Gemini Oil and Gas Fund II, L.P. ("Gemini") whereby Gemini agreed to invest up to \$9.0 million to fund a portion of the Corporation's development and appraisal programs on its producing assets in Colombia in exchange for an overriding royalty on certain properties. Effective June 30, 2010, the Corporation agreed to acquire the overriding royalty back from Gemini for \$21.4 million. On July 16, 2010, the Corporation settled the transaction through the issue 4,421,260 common shares and a cash payment of \$18.0 million.

### Contributed Surplus

Balance at July 1, 2010	\$	12,017
Stock-based compensation		12,019
Stock options exercised		(2,750)
Balance at June 30, 2011		21,286
Stock-based compensation		3,570
Stock options exercised		(114)
<b>Balance at September 30, 2011</b>	<b>\$</b>	<b>24,742</b>

### Stock Options

The Corporation has a stock option program that entitles officers, directors, employees and certain consultants to purchase shares in the Corporation. Options are granted at the market price of the shares at the date of grant, have a five year term and vest over three years.

The number and weighted-average exercise prices of stock options are as follows:

	Number (000s)	Weighted-Average Exercise Price (C\$)
Balance at July 1, 2010	24,909	0.36
Granted	17,937	1.20
Exercised	(8,233)	0.33
Forfeited and cancelled	(445)	1.06
Balance at June 30, 2011	34,168	0.81
Granted	8,162	0.93
Exercised	(405)	0.36
Forfeited and cancelled	(151)	1.26
<b>Balance at September 30, 2011</b>	<b>41,774</b>	<b>0.81</b>

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Information with respect to stock options outstanding at September 30, 2011 is presented below.

Stock Options Outstanding				Stock Options Exercisable	
Range of Exercise Prices	Number of Stock Options	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Stock Options	Weighted-Average Exercise Price
(C\$)	(000s)	(years)	(C\$)	(000s)	(C\$)
\$0.10 to \$0.35	10,732	2.81	0.25	8,558	0.22
\$0.36 to 0.70	5,049	3.25	0.60	3,049	0.60
\$0.71 to \$1.05	17,253	2.22	0.89	6,932	0.88
\$1.06 to \$1.40	1,610	4.07	1.21	582	1.23
\$1.41 and up	7,130	4.31	1.50	1,823	1.51
	<b>41,774</b>	<b>2.92</b>	<b>0.81</b>	<b>20,944</b>	<b>0.64</b>

### Restricted Share Units

In May 2010, the Corporation issued 360,000 restricted share units to an officer. The restricted share units vest as to 25% every six months from the grant date over a period of two years. In November 2010, the Corporation issued 300,000 restricted share units to an employee. The restricted share units vest as to 33% every six months from the grant date over a period of 18 months.

	Number	Weighted-Average Grant Price
	(000s)	(C\$)
Balance at July 1, 2010	360	0.75
Granted	300	1.68
Converted	(280)	1.08
<b>Balance at June 30, 2011 and September 30, 2011</b>	<b>380</b>	<b>1.24</b>

### Stock-Based Compensation

The fair value of the stock options granted was estimated using the Black-Scholes option pricing model with the following weighted-average inputs:

	Three months ended September 30, 2011	Year ended June 30, 2010
Weighted-average fair value at grant date (C\$)	0.70	0.57
Share price (C\$)	0.90 - 1.06	0.07 - 1.68
Exercise price (C\$)	0.90 - 1.06	0.10 - 1.68
Volatility	77 - 82%	72 - 126%
Option life	5 years	5 years
Dividends	nil	nil
Risk-free interest rate	1.51 - 2.32%	1.85 - 4.25%

A forfeiture rate of 5% (2010 - 5%) was used when recording stock-based compensation. This estimate is adjusted to the actual forfeiture rate. Stock-based compensation expense of \$2.5 million (2010 - \$2.9 million) was expensed during the three months ended September 30, 2011. In addition, stock-based compensation expense of \$1.1 million (2010 - \$nil) was capitalized during the three months ended September 30, 2011.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 14 – FINANCE INCOME AND EXPENSE

	Three months ended September 30, 2011	Three months ended September 30, 2010
<b>Finance income</b>		
Interest income on bank deposits	\$ 535	\$ 251
Commodity contract gains – unrealized	616	-
Net foreign exchange gain	5,045	-
	<b>6,196</b>	251
<b>Finance expense</b>		
Accretion on equity tax payable	26	-
Accretion on decommissioning obligations	144	258
Interest expense	262	2,018
Commodity contract loss – realized	79	-
Commodity contract loss – unrealized	-	443
Net foreign exchange loss	-	1,195
	<b>511</b>	3,914
<b>Net finance (income) expense</b>	<b>\$ (5,685)</b>	<b>\$ 3,663</b>

### NOTE 15 – EQUITY TAX

Equity tax represents a tax on the capital of Colombian corporations and branches of foreign corporations. The tax was approved by the Colombian government in December 2010 and was assessed for the calendar years 2011-2014 based on 6% of the net equity of the Corporation's Colombian entities as at January 1, 2011. The assessed amount of \$5.2 million is payable in semi-annual installments over the four-year period. The net present value of the assessed amount, being \$4.0 million, was expensed on January 1, 2011. The equity tax expense is classified as an operating expense in the statement of operations since it is not based on income.

### NOTE 16 – EARNINGS PER SHARE

Basic earnings per share were calculated as follows:

	Three months ended September 30, 2011	Three months ended September 30, 2010
<b>Net income (loss), basic and diluted</b>	<b>\$ 13,486</b>	<b>\$ (30,068)</b>
<b>Weighted-average common share adjustments</b>		
Weighted-average common shares outstanding, basic	512,294	430,260
Effect of stock options	9,671	-
Effect of restricted share units	380	-
<b>Weighted-average common shares outstanding, diluted</b>	<b>522,345</b>	<b>430,260</b>

For the three months ended September 30, 2011, the effect of the conversion of convertible debentures on earnings per share were anti-dilutive. For the three months ended September 30, 2010, all items were anti-dilutive due to the net loss for the period.

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### NOTE 17 – SUPPLEMENTED INFORMATION

The Corporation records crude oil sales net of royalties. Royalties were for the three months ended September 30, 2011 and 2010 were \$2,116,000 and \$1,289,000, respectively.

Income taxes and interest paid were as follows:

	Three months ended September 30, 2011	Three months ended September 30, 2010
Income taxes paid	\$ -	\$ -
Interest paid	-	10

Changes in non-cash working capital is comprised of:

	Three months ended September 30, 2011	Three months ended September 30, 2010
<b>Change in:</b>		
Trade and other receivables	\$ 7,853	\$ (3,280)
Prepaid expenses and deposits	387	(15)
Prepaid transportation on overlifted volumes	(64)	-
Crude oil inventory	4,403	-
Trade and other payables	(4,042)	(3,177)
Overlifted volumes payable	745	-
Equity tax payable	(970)	-
Taxes payable	3,239	-
	<b>11,551</b>	<b>(6,472)</b>
<b>Attributable to:</b>		
Operating activities	12,375	(5,275)
Investing activities	(824)	(1,197)
	<b>\$ 11,551</b>	<b>\$ (6,472)</b>

### NOTE 18 – SIGNIFICANT SUBSIDIARIES

The Corporation has the following significant subsidiaries:

	Country of Incorporation	Ownership Interest	
		September 30, 2011	June 30, 2011
Canacol Energy Inc.	Alberta, Canada	100%	100%
Canacol Energy Colombia S.A.	Colombia	100%	100%
Canacol Energy Inc. (Sucursal Colombia)	Colombia	100%	100%
Canacol Energy (Guyana) Inc.	Guyana	100%	100%
Brazalta Brazil Norte Ltda.	Brazil	100%	100%

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 19 – SEGMENTED INFORMATION

IFRS 8 requires operating segments be identified based on the Corporation's internal system for reporting information to senior management to allocate resources to the segments and to assess their performance.

The Corporation's reportable and geographical segments are Colombia, Guyana, Brazil and Corporate. Corporate activities include the Corporation's corporate office in Canada. The accounting policies used for the reportable segments are the same as the Corporation's accounting policies.

For the purposes of monitoring segment performance and allocating resources between segments, the Corporation's executive officers monitor the tangible, intangible and financial assets attributable to each segment. All assets are allocated to reportable segments. The following tables show information regarding the Corporation's reportable segments.

	Colombia	Brazil	Guyana	Corporate and Other	Total
<b>As at and for the three months ended September 30, 2011</b>					
Revenues	35,330	-	-	-	35,330
Expenses, excluding income taxes	(15,450)	(1,769)	-	2,050	(15,169)
Income taxes	(19,880)	(1,769)	-	2,050	20,161
Net income (loss)	(6,675)	-	-	-	(6,675)
Net income (loss)	13,205	(1,769)	-	2,050	13,486
Capital expenditures, net	29,538	-	1,202	616	31,356
Total assets	214,475	14,380	26,404	61,315	316,574
Total liabilities	80,614	232	1,263	25,541	107,650
<b>As at June 30, 2011</b>					
Total assets	210,365	13,651	24,813	67,741	316,570
Total liabilities	90,601	1,046	1,155	33,040	125,842
<b>As at and for the three months ended September 30, 2010</b>					
Revenues	15,939	859	-	-	16,798
Expenses, excluding income taxes	(12,312)	(14,697)	-	(20,550)	(47,559)
Income taxes	3,627	(13,838)	-	(20,550)	(30,761)
Net income (loss)	693	-	-	-	693
Net income (loss)	4,320	(13,838)	-	(20,550)	(30,068)
Capital expenditures, net	6,141	345	1,755	-	8,241
Total assets	106,793	7,756	8,218	44,580	167,347
Total liabilities	51,551	2,107	-	31,332	84,990

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 20 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

#### Fair Value of Financial Instruments

The carrying values and respective fair values of financial assets and liabilities at September 30, 2011 are summarized as follows:

	Carrying Value	Fair Value
<b>Fair value through profit or loss</b>		
Cash and cash equivalents	\$ 108,986	\$ 108,986
Restricted cash	6,545	6,545
Commodity contracts	39	39
Convertible debentures	24,311	24,311
Overlifted volumes payable	31,856	31,856
<b>Loans and receivables</b>		
Trade and other receivables	27,403	27,403
<b>Other liabilities</b>		
Trade and other payables	18,166	18,166

The Corporation classifies the fair value of financial instruments measured at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Corporation's financial instruments have been assessed on the fair value hierarchy described above. Cash and cash equivalents and convertible debentures are classified as Level 1. Commodity contracts and overlifted volumes payable are classified as Level 2. Assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the placement within the fair value hierarchy level.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### Commodity Price Risk

Commodity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in commodity prices. Lower commodity prices can also impact the Corporation's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. From time to time the Corporation may attempt to mitigate commodity price risk through the use of financial derivatives. The Corporation's policy is to only enter into commodity contracts considered appropriate to a maximum of 50% of forecasted production volumes.

At September 30, 2011, the Corporation had financial WTI oil collars outstanding under the following terms:

Period	Volume	Type	Price Range
Nov 2010 – Oct 2011	500 bbls/day	Financial WTI Oil Collar	\$70.00 – \$100.00
Dec 2010 – Nov 2011	500 bbls/day	Financial WTI Oil Collar	\$70.00 – \$100.00

For the three months ended September 30, 2011, a \$1.00/bbl increase/decrease in the price of a barrel of crude oil is estimated to increase/decrease the Corporation's earnings and operating cash flows by \$213,000, assuming all other variables are held constant.

### Foreign Currency Risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. The Corporation is exposed to foreign currency fluctuations as certain expenditures are denominated in Colombian pesos, Brazilian reais and Canadian dollars.

The Corporation had no forward exchange rate contracts in place as at or during the three months ended September 30, 2011.

For the three months ended September 30, 2011, a 1% increase/decrease in the US dollar vis-à-vis the Colombian peso, Brazilian real and Canadian dollar is estimated to increase/decrease the Corporation's earnings and operating cash flows by \$192,000, \$27,000 and \$17,000, respectively, assuming all other variables are held constant.

### Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate risk on certain variable interest rate Colombian peso denominated debt instruments, to the extent they are drawn, and interest rate price risk on fixed rate convertible debentures. The remainder of the Corporation's financial assets and liabilities are not exposed to interest rate risk. The Corporation had no interest rate swap or financial contracts in place as at or during the three months ended September 30, 2011.

The Corporation's sensitivity to interest rates is currently immaterial.

### Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. The Corporation's approach to managing liquidity is to ensure, within reasonable means, sufficient liquidity to meet its liabilities when due, under both normal and unusual conditions, without incurring unacceptable losses or jeopardizing the Corporation's business objectives. The Corporation prepares annual capital expenditure budgets which are monitored regularly and updated as considered necessary. Crude oil production is monitored daily to provide current cash flow estimates and the Corporation utilizes authorizations for expenditures on projects to manage capital expenditures.



## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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The following table outlines the contractual maturities of the Corporation's financial liabilities at September 30, 2011:

	Less than 1 year	1-2 years	Thereafter	Total
Trade and other payables	18,166	-	-	18,166
Overlifted volumes payable	31,856	-	-	31,856
Equity tax payable	1,152	2,302	-	3,454
Taxes payable	20,245	-	-	20,245
Convertible debentures – principal	-	-	24,563	24,563
	71,419	2,302	24,563	98,284

In addition to the above, the Corporation has issued letters of credit totaling \$11.5 million to guarantee certain obligations under its exploration contracts. Such amounts only become payable should the Corporation not meet those obligations.

Credit risk reflects the risk of loss if counterparties do not fulfill their contractual obligations. The majority of the Corporation's trade accounts receivable balances relate to crude oil sales. The Corporation's policy is to enter into agreements with customers that are well established and well financed entities in the oil and gas industry such that the level of risk is mitigated. To date, the Corporation has not experienced any material credit loss in the collection of trade accounts receivable. In Colombia, the majority of crude oil sales and tariff oil revenue are with three customers: Hocol, Ecopetrol and Petrobras Colombia. Ecopetrol and Petrobras Colombia are government controlled entities while Hocol is controlled by Ecopetrol. The Corporation has also entered into sales agreements with certain Colombian private sector companies.

Details of the Corporation's trade and other accounts receivable balances are as follows:

	September 30, 2011	June 30, 2011
Trade receivables – Hocol, Ecopetrol and Petrobras Colombia	\$ 13,322	\$ 25,542
Trade receivables – other entities	303	1,165
<b>Total trade receivables</b>	<b>13,625</b>	<b>26,707</b>
Cash calls receivable	7,445	9,140
Taxes receivable	6,333	2,129
<b>Total trade and other receivables</b>	<b>\$ 27,403</b>	<b>\$ 37,976</b>
<b>Aging of trade receivables:</b>		
Less than 30 days	\$ 13,398	\$ 26,550
31 – 60 days	122	21
61 – 90 days	49	90
Over 90 days	56	46
	<b>\$ 13,625</b>	<b>\$ 26,707</b>

The Corporation's trade receivables primarily relate to sales of crude oil, which are normally collected approximately 45 days after the month of production. The Corporation has historically not experienced any collection issues with its crude oil customers.

The cash calls receivable balance at September 30, 2011 is considered collectible. The cash calls receivable related to the Corporation's joint operations in Brazil were written off as part of the sale of the producing properties during the three months ended September 30, 2011.

The taxes receivable balance at September 30, 2011 can be applied to future required tax payments.

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### Market Risk

Market risk is the risk that changes in market factors, such as foreign exchange rates, commodity prices, and interest rates will affect the Corporation's cash flows, profit or loss, liquidity or the value of financial instruments. The objective of market risk management is to mitigate market risk exposures where considered appropriate and maximize returns.

### Capital Management

The Corporation's policy is to maintain a strong capital base in order to provide flexibility in the future development of the business and maintain investor, creditor and market confidence. The Corporation manages its capital structure and makes adjustments in response to changes in economic conditions and the risk characteristics of the underlying assets. The Corporation considers its capital structure to include common share capital, convertible debentures, bank debt and working capital, a non-IFRS measure defined as current assets less current liabilities. In order to maintain or adjust the capital structure, from time to time the Corporation may issue common shares or other securities, sell assets or adjust its capital spending to manage current and projected debt levels.

The Corporation monitors leverage and adjusts its capital structure based on the ratio of net debt to cash flow from operations before changes in non-cash working capital. This ratio is calculated as net debt, a non-IFRS measure the Corporation defines as outstanding bank debt plus the principal amount of its convertible debentures, unless the debentures are in-the-money, and working capital deficiency, divided by cash flow from operations before changes in non-cash working capital for the most recent calendar quarter, annualized. At September 30, 2011, the Corporation was not in a net debt position due to its working capital surplus. The Corporation uses the ratio of net debt to cash flow as a key indicator of the Corporation's leverage and to monitor the strength of its financial position. In order to facilitate the management of this ratio, the Corporation prepares annual budgets, which are updated as necessary depending on varying factors including current and forecast crude oil prices, changes in capital structure, execution of the Corporation's business plan and general industry conditions. The annual budget is approved by the Board of Directors and updates are prepared and reviewed as required.

### NOTE 21 – COMMITMENTS AND CONTINGENCIES

Presented below are the Corporation's contractual commitments at September 30, 2011:

	Less than 1 year	1-3 years	Thereafter	Total
Exploration contracts <sup>(1)</sup>	53,800	6,750	-	60,550
Pipeline investment	4,316	-	-	4,316
Office lease	722	1,864	2,030	4,616
	58,838	8,614	2,030	69,482

(1) Pursuant to exploration contracts, the Corporation has work commitments totalling \$60.6 million to be completed during the next three years. The work commitments are normal course of business exploration activities that include property costs, acquisition and processing of seismic data and drilling exploration wells. The Corporation has issued letters of credit totaling \$11.5 million to guarantee the obligations under these exploration contracts.

### Gas Purchases and Gas Plant

On August 31, 2011, the Corporation was awarded a contract by Ecopetrol to purchase produced natural gas from the Rancho Hermoso field at a fixed price of \$6.50/MMbtu, which includes the associated liquids – naphtha, propane and butane. The contract is effective on January 1, 2012 and is for a period of 5 years. Subsequent to September 30, 2011, the Corporation initiated the construction of a gas liquids separation facility with the intention of processing the future natural gas production and selling the resulting liquids. The gas plant construction has been awarded and is expected to cost \$28.4 million, all due within a year. The Corporation expects to fund the construction of the gas plant through a corporate term loan, which it is currently negotiating.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### Trucking Contract

The Corporation has signed an agreement with a Colombian trucking company for the exclusive use of 100 trucks for transportation of crude oil from the Corporation's operations in Colombia for a period of 3 years. The Corporation will pay transportation fees plus an additional 7.5% for administrative costs. Any excess of the fees charged over the actual operating costs will be shared equally between the Corporation and the trucking company at the end of each year. The Corporation has the option to purchase up to 50 trucks at the end of the 3 year agreement.

### NOTE 22 – SUBSEQUENT EVENT

On November 9, 2011, The Corporation entered into a pre-acquisition agreement with a private Colombian exploration company ("PrivateCo") to acquire all of PrivateCo's common shares and other securities (the "Acquisition"). Under the terms of the Acquisition, each common share of PrivateCo will be exchanged for 0.86 common shares of the Corporation. The purchase price per PrivateCo common share of C\$0.58 per share was calculated based on the trailing five-day volume weighted-average price of the Corporation's common shares of C\$0.67 per share. PrivateCo's working capital is estimated at \$14.5 million, before deduction of PrivateCo's expenditures on exploration commitments prior to closing, which are creditable against the working capital amount. In aggregate, the Corporation expects to issue between 103.1 million and 106.0 million common shares to effect the Acquisition, which is dependent on the ultimate treatment of outstanding PrivateCo stock options and warrants, and assuming no working capital adjustment at closing.

The Acquisition is subject to certain conditions and regulatory approvals. The Corporation expects the Acquisition to close by mid-December 2011, although there can be no assurance that this transaction will close as described.

### NOTE 23 – TRANSITION TO IFRS

The Corporation adopted IFRS on July 1, 2011 with a transition date of July 1, 2010. This note sets out how the transition from Canadian GAAP to IFRS has affected the Corporation's financial position and comprehensive income (loss). The accounting policies set out in note 4 have been applied in preparing the interim financial statements for the period ended September 30, 2011, the comparative information presented in these interim financial statements for the periods ended September 30, 2010 and June 30, 2010, and in the preparation of an opening IFRS statement of financial position at July 1, 2010 (the "Transition Date").

IFRS employs a conceptual framework that is similar to Canadian GAAP. While the adoption of IFRS has not changed the actual cash flows of the Corporation, the adoption has resulted in changes to the reported financial position and results of operations of the Corporation. The differences between IFRS and Canadian GAAP that affect the Corporation are described in the notes following the reconciliation tables below.

Under IFRS 1, "First Time Adoption of International Financial Reporting Standards", IFRS is applied to all accounts retrospectively at the Transition Date unless a specific exemption was available and is taken. The following are the significant exemptions the Corporation has elected to apply:

**Deemed cost exemption for property, plant and equipment** – The Corporation has elected to report items of property, plant and equipment on Transition Date at deemed cost instead of the actual cost that would be determined under IFRS. The deemed cost of an item may be either its fair value at the Transition Date or an amount determined by a previous revaluation under Canadian GAAP. The exemption can be applied on an asset-by-asset basis. Petroleum and natural gas assets that were part of the full cost pool and determined to be developed or producing assets were allocated to Cash Generating Units on the Transition Date pro rata using proved plus probable reserve volumes, subject to an impairment test on the Transition Date.

**Share-based payments** – The Corporation has elected not to apply IFRS 2, "Share-Based Payments", to equity instruments which vested before the Transition Date. As such, adjustments were made only to share-based payments that were granted before the Transition Date but had not vested.

**Decommissioning liabilities** – In accounting for changes in obligations to dismantle, remove and restore items of property, plant and equipment, the guidance under IFRS requires changes in such obligations to be added to or

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deducted from the cost of the asset to which it relates. The adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. Rather than recalculating the effect of all such changes throughout the life of the obligations, the Corporation has elected to measure the liability and the related depreciation effects at the Transition Date.

**Borrowing costs** – The Corporation applied an IFRS transitional exemption to prospectively capitalize borrowing costs from the Transition Date.

**Cumulative translation differences** – The Corporation elected to set the cumulative translation account, which is included in accumulated other comprehensive income, to \$nil at July 1, 2010. This exemption has been applied to all subsidiaries.

**Business combinations** – IFRS allows entities to apply IFRS 3 on business combinations to transactions which take place subsequent to the IFRS transition date without retrospectively restating any transactions that occurred prior to that date. The Corporation has taken this exemption and has not applied IFRS 3 to any business combinations that occurred prior to July 1, 2010. Accordingly, no amounts have been adjusted for previous business combinations.

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### Reconciliation of statement of financial position from Canadian GAAP to IFRS

At the date of IFRS transition – July 1, 2010:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		\$ 56,240	\$	\$ 56,240
Restricted cash		890		890
Trade and other receivables		7,266		7,266
Prepaid expenses and deposits		563		563
Commodity contracts		227		227
Crude oil inventory		2,330		2,330
		67,516		67,516
<b>Non-current assets</b>				
Restricted cash		399		399
Trade and other receivables		395		395
Exploration and evaluation assets	a	-	11,913	11,913
Property, plant and equipment	a,e	90,452	(13,317)	77,135
		91,246	(1,404)	89,842
<b>Total assets</b>		\$ 158,762	\$ (1,404)	\$ 157,358
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Bank debt		\$ 322	\$	\$ 322
Trade and other payables		32,587		32,587
Taxes payable		292		292
Warrants	g	-	10,267	10,267
		33,201	10,267	43,468
<b>Non-current liabilities</b>				
Decommissioning obligations	b	2,899	884	3,783
Convertible debentures	f	1,145	2,853	3,998
Warrants	g	-	435	435
Deferred tax liabilities	d	7,864	(1,937)	5,927
<b>Total liabilities</b>		45,109	12,502	57,611
<b>Equity</b>				
Share capital	g	161,535	(598)	160,937
Contributed surplus	c	12,088	(71)	12,017
Equity component of convertible debentures	f	159	(159)	-
Accumulated other comprehensive loss	a	(842)	842	-
Deficit		(59,287)	(13,920)	(73,207)
<b>Total equity</b>		113,653	(13,906)	99,747
<b>Total liabilities and equity</b>		\$ 158,762	\$ (1,404)	\$ 157,358

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### Reconciliation of statement of financial position from Canadian GAAP to IFRS

At the end of the last reporting year under Canadian GAAP – June 30, 2011:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		\$ 101,627	\$	\$ 101,627
Restricted cash		12,604		12,604
Trade and other receivables		37,976		37,976
Prepaid expenses and deposits		2,198		2,198
Prepaid transportation on overlifted volumes		4,024		4,024
Assets held for sale – Brazil	i	-	3,828	3,828
Crude oil inventory		12,348		12,348
		170,777	3,828	174,605
<b>Non-current assets</b>				
Restricted cash		444		444
Exploration and evaluation assets	a	-	33,603	33,603
Property, plant and equipment	a,e	125,260	(36,694)	88,566
Pipeline investment		2,589		2,589
Deferred tax assets		16,763		16,763
		145,056	(3,091)	141,965
<b>Total assets</b>		\$ 315,833	\$ 737	\$ 316,570
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Trade and other payables		22,208		22,208
Commodity contracts		577		577
Overlifted volumes payable		38,199		38,199
Equity tax payable	h	1,239	(59)	1,180
Assets held for sale – Brazil	i	-	888	888
Taxes payable		17,006		17,006
		79,229	829	80,058
<b>Non-current liabilities</b>				
Decommissioning obligations	b	4,400	141	4,541
Convertible debentures	f	19,657	11,797	31,454
Equity tax payable	h	3,211	(437)	2,774
Deferred tax liabilities	d	9,038	(2,023)	7,015
<b>Total liabilities</b>		115,535	10,307	125,842
<b>Equity</b>				
Share capital	f,g	243,733	25,999	269,732
Contributed surplus	c	21,783	(497)	21,286
Equity component of convertible debentures	f	5,427	(5,427)	-
Accumulated other comprehensive loss	a	(495)	842	347
Deficit		(70,150)	(30,487)	(100,637)
<b>Total equity</b>		200,298	(9,570)	190,728
<b>Total liabilities and equity</b>		\$ 315,833	737	\$ 316,570

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### Reconciliation of statement of financial position from Canadian GAAP to IFRS

At September 30, 2010:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		\$ 72,651	\$	\$ 72,651
Trade and other receivables		10,941		10,941
Prepaid expenses and deposits		578		578
Assets held for sale – Brazil	i	-	3,828	3,828
Crude oil inventory		292		292
		84,462	3,828	88,290
<b>Non-current assets</b>				
Restricted cash		440		440
Exploration and evaluation assets	a	-	12,554	12,554
Property, plant and equipment	a,e	94,247	(28,184)	66,063
		94,687	(15,630)	79,057
<b>Total assets</b>		\$ 179,149	\$ (11,802)	\$ 167,347
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Bank debt		\$ 344	\$	\$ 344
Trade and other payables		11,575		11,575
Commodity contracts		213		213
Assets held for sale – Brazil	i	-	843	843
Taxes payable		129		129
Warrants	g	-	10,620	10,620
		12,261	11,463	23,724
<b>Non-current liabilities</b>				
Decommissioning obligations	b	3,117	321	3,438
Convertible debentures <sup>(1)</sup>	f	29,650	21,666	51,316
Deferred tax liabilities	d	8,419	(1,907)	6,512
		53,447	31,543	84,990
<b>Equity</b>				
Share capital	g	165,392	6,681	172,073
Contributed surplus	c	14,498	(157)	14,341
Equity component of convertible debentures <sup>(1)</sup>	f	9,325	(9,325)	-
Accumulated other comprehensive loss	a	(1,624)	842	(782)
Deficit		(61,889)	(41,386)	(103,275)
		125,702	(43,345)	82,357
<b>Total liabilities and equity</b>		\$ 179,149	(11,802)	\$ 167,347

(1) Adjusted for a change in the discount rate from 26% to 16%, as previously presented – see audited consolidated financial statements for the year ended June 30, 2011.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### Reconciliation of statement of operations and comprehensive loss from Canadian GAAP to IFRS

For the year ended June 30, 2011:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>Revenue</b>				
Crude oil sales, net of royalties		\$ 91,680	\$	\$ 91,680
Tariff revenue		21,144		21,144
		112,824		112,824
<b>Expenses</b>				
Operating and transportation		39,213		39,213
General and administrative		13,995		13,995
Stock-based compensation	c	12,202	(183)	12,019
Depletion, depreciation and amortization	b,e	32,463	(7,427)	25,036
Loss on convertible debentures	f	-	16,256	16,256
Loss on overlifted volumes payable		5,093		5,093
Impairment loss on assets	i	9,673	4,353	14,026
Equity tax	h	5,169	(496)	4,673
		117,808	12,503	130,311
<b>Net finance expense</b>	b,g,h	671	4,448	5,119
<b>Loss before income taxes</b>		5,655	16,951	22,606
Income tax expense (reduction)		5,208	(384)	4,824
<b>Net loss for the year</b>		\$ 10,863	\$ 16,567	\$ 27,430
<b>Other comprehensive loss</b>				
Foreign currency translation adjustment		(347)		(347)
<b>Net loss and comprehensive loss for the year</b>		\$ 10,516	\$ 16,567	\$ 27,083



## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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### Reconciliation of statement of operations and comprehensive loss from Canadian GAAP to IFRS

For the three months ended September 30, 2010:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>Revenue</b>				
Crude oil sales, net of royalties		\$ 15,219	\$	\$ 15,219
Tariff revenue		1,579		1,579
		16,798		16,798
<b>Expenses</b>				
Operating and transportation		7,334		7,334
General and administrative		2,850		2,850
Stock-based compensation	c	2,988	(86)	2,902
Depletion, depreciation and amortization	b,e	6,052	(1,469)	4,583
Loss on convertible debentures	f	-	14,485	14,485
Impairment loss on Brazilian assets	i	-	11,742	11,742
		19,224	24,672	43,896
<b>Net finance expense</b>	b,g	899	2,764	3,663
<b>Loss before income taxes</b>		3,325	27,436	30,761
Income tax expense (reduction)		(723)	30	(693)
<b>Net loss for the period</b>		\$ 2,602	\$ 27,466	\$ 30,068
<b>Other comprehensive loss</b>				
Foreign currency translation adjustment		782		782
<b>Net loss and comprehensive loss for the period</b>		\$ 3,384	\$ 27,466	\$ 30,850

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The adoption of IFRS did not impact the amounts reported as operating, investing or financing cash flows in the consolidated statements of cash flows.

### Notes to IFRS Reconciliations

#### a) Reclassifications

##### (i) Exploration and Evaluation Assets

E&E assets consist of the Corporation's exploration projects where technical feasibility and commercial viability have not yet been determined. Under Canadian GAAP, these costs were grouped with property, plant and equipment. Under IFRS, E&E assets are classified as a separate line in the statement of financial position; and

(ii) the remaining full cost pool was allocated to the producing / development assets and components pro rata using proved plus probable reserve volumes. This resulted in a \$11.9 million increase in E&E assets at the Transition Date with a corresponding decrease in property, plant and equipment.

##### (ii) Accumulated Other Comprehensive Income

On Transition Date, the Corporation elected to reclassify foreign exchange translation losses included in other comprehensive income recognized under Canadian GAAP to deficit. These accumulated translation differences were generated when the Corporation changed its reporting currency from the Canadian dollar to the United States dollar on June 30, 2010. As a result, accumulated other comprehensive income at July 1, 2010 was reclassified to deficit.

#### b) Decommissioning Obligations

Under Canadian GAAP, asset retirement obligations were discounted at a credit adjusted risk free rate of 7.5% for Canadian assets and 9.5% for Colombian and Brazilian assets. Under IFRS, the estimated cash flows to abandon and remediate the wells and facilities has been risk adjusted; therefore the provision is discounted at a risk free rate of 5% for Colombian and Brazilian assets. Upon transition to IFRS, this resulted in a \$0.9 million increase in decommissioning obligations with a corresponding increase in deficit.

As a result of the change in decommissioning obligations, accretion expense increased by \$1.1 million during the year ended June 30, 2011 under IFRS compared to Canadian GAAP. Under Canadian GAAP, accretion of the discount was included in depletion and depreciation. Under IFRS, it is included in finance expenses.

Under Canadian GAAP, expenditures on remediation and abandonment were not included in changes in non-cash working capital as is done under IFRS.

#### c) Stock-Based Compensation

Under Canadian GAAP, the Corporation did not incorporate a forfeiture multiple when determining the fair value of stock options and restricted share units. Under IFRS, the Corporation is required to estimate a forfeiture rate.

Restricted share units are considered equity-settled awards under IFRS and the fair value determined at the grant date is recognized over the vesting period of the awards. Under Canadian GAAP, the awards were valued at the trading price of the underlying common shares at each reporting date, with changes in fair value recorded in profit and loss.

#### d) Deferred Taxes

The change in the deferred tax liability is mainly the result of the change in the accounting basis of the decommissioning liability on transition to IFRS, the change in accounting basis of property, plant and equipment, and as a result of decreased depletion and the change in accounting for foreign exchange gains and losses resulting from taxes denominated in foreign currencies.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three months ended September 30, 2011 and 2010 (UNAUDITED)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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e) Depletion

Upon transition to IFRS, the Corporation adopted a policy of depleting petroleum and natural gas interests on a units-of-production basis over proved plus probable reserves. The depletion policy under Canadian GAAP was based on units-of-production over proved reserves. Further, depletion was performed by country under Canadian GAAP whereas IFRS requires depletion and depreciation to be calculated based on individual components (i.e. fields or combinations thereof).

f) Convertible Debentures

Under Canadian GAAP, the convertible debentures were classified as a compound financial instrument whereby the instrument was bifurcated into debt and equity components and the equity component was recognized at its fair value. Under IFRS, the convertible debenture is considered a derivative liability and is required to be fair valued at each reporting period, with changes in that fair value being recorded in profit or loss. Further, conversions are recognized in share capital at the fair value of the shares issued, with any difference from the carrying value recorded in profit or loss.

g) Warrants

Under Canadian GAAP, the warrants were classified as a component of equity. Under IFRS, because the specified exercise price is denominated in Canadian dollars (a currency other than the functional currency of the Corporation), the warrants are considered derivative liabilities. The warrants are required to be fair valued at each reporting period, with changes in that fair value being recorded in profit or loss.

h) Equity Tax Payable

IFRS requires discounting of liabilities where the impact is considered significant. As the equity tax is scheduled to be paid over a three year term, the liability has been discounted.

i) Assets Held for Sale – Brazil

Certain non-core, non-operated producing assets in Brazil have been presented as assets held for sale following the commitment of the Corporation's management, on September 1, 2010, to a plan to sell such assets. Effective September 1, 2010, depletion charges ceased and an impairment charge was recorded to reflect the fair value of the assets. The impairment was recorded in profit or loss in the three months ended September 30, 2010.