# PETROMIN RESOURCES LTD.

Consolidated Annual Financial Statements

Year ended September 30, 2012

Prepared by Management

# INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Petromin Resources Ltd.

We have audited the accompanying consolidated financial statements of Petromin Resources Ltd., which comprise the consolidated statements of financial position as at September 30, 2012, September 30, 2011 and October 1, 2010 and the consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows for the years ended September 30, 2012 and September 30, 2011, and a summary of significant accounting policies and other explanatory information.

***Management's Responsibility for the Consolidated Financial Statements***

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

***Auditors' Responsibility***

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

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

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

NEXIA INTERNATIONAL

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***Opinion***

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Petromin Resources Ltd. as at September 30, 2012, September 30, 2011 and October 1, 2010 and its financial performance and its cash flows for the years ended September 30, 2012 and September 30, 2011 in accordance with International Financial Reporting Standards.

***Emphasis of Matter***

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes conditions and matters that indicate the existence of a material uncertainty that may cast significant doubt about Petromin Resources Ltd.'s ability to continue as a going concern.

**"DAVIDSON & COMPANY LLP"**

Vancouver, Canada

Chartered Accountants

January 28, 2013

# PETROMIN RESOURCES LTD.

## Consolidated Financial Statements

## Year Ended September 30, 2012

# PETROMIN RESOURCES LTD.

Consolidated Statements of Financial Position
(Expressed in Canadian dollars)
AS AT

| | | September 30 2012 | | September 30, 2011 (Note 21) | | October 1, 2010 (Note 21) |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| **Current** | | | | | | |
| Cash (Note 5) | **$** | **153,626** | $ | 612,823 | $ | 71,634 |
| Accounts receivable (Note 6) | | **303,533** | | 265,504 | | 580,815 |
| | | **457,159** | | 878,327 | | 652,449 |
| **Prepaid expenses** | | **8,139** | | 7,241 | | 7,241 |
| **Long-term equity investment** (Note 7) | | **1,106,612** | | 1,195,151 | | 1,246,474 |
| **Exploration and evaluation assets** (Note 9) | | **163,824** | | 17,253 | | - |
| **Equipment** (Note 8) | | **12,095** | | 29,073 | | 35,370 |
| **Oil and gas interests** (Note 10) | | **865,943** | | 884,934 | | 1,016,088 |
| **Total assets** | **$** | **2,613,772** | $ | 3,011,979 | $ | 2,957,622 |
| **Liabilities** | | | | | | |
| **Current** | | | | | | |
| Accounts payable and accrued liabilities | **$** | **662,499** | $ | 431,681 | $ | 662,387 |
| Payable to related parties (Note 11) | | **217,443** | | 268,584 | | 266,940 |
| Project advance (Note 12) | | **131,311** | | 525,530 | | - |
| | | **1,011,253** | | 1,225,795 | | 929,327 |
| **Decommissioning liabilities** (Note 13) | | **93,158** | | 90,213 | | 86,323 |
| **Shareholders' Equity** | | | | | | |
| Share capital (Note 14) | | **18,169,374** | | 17,748,045 | | 17,748,045 |
| Share-based payments reserve (Note 14) | | **1,978,264** | | 1,747,355 | | 1,738,965 |
| Convertible debentures (Note 15) | | **630,000** | | 630,000 | | 630,000 |
| Deficit | | **(19,268,277)** | | (18,429,429) | | (18,175,038) |
| **Total shareholders' equity** | | **1,509,361** | | 1,695,971 | | 1,941,972 |
| **Total liabilities and shareholders' equity** | **$** | **2,613,772** | $ | 3,011,979 | $ | 2,957,622 |

Nature and continuance of operations (Note 1)
Commitments (Note 20)
Subsequent events (Note 22)

**Approved by the Board of Directors and authorized for issue on January 28, 2013:**

"A. Ross Gorrell" Director "Kenny Chan" Director

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

# PETROMIN RESOURCES LTD.

Consolidated Statements of Operations and Comprehensive Loss
For the year ended September 30, 2012 and 2011
(Expressed in Canadian dollars)

| | | 2012 | | 2011 (Note 21) |
|---|---|---|---|---|
| **Revenue** | | | | |
| Petroleum and natural gas sales | **$** | **844,399** | $ | 1,236,378 |
| Royalties | | **28,266** | | 39,543 |
| | | **872,665** | | 1,275,921 |
| Other income (Note 11) | | **30,200** | | 30,000 |
| | | **902,865** | | 1,305,921 |
| **Expenses** | | | | |
| Operating and production | | **651,426** | | 713,008 |
| General and administrative (Note 16) | | **626,404** | | 613,033 |
| Share-based compensation (Note 14) | | **224,738** | | 8,390 |
| Depletion and depreciation (Notes 8 and 10) | | **93,012** | | 159,685 |
| | | **(1,595,580)** | | (1,494,116) |
| Loss on equity investment (Note 7) | | **(88,539)** | | (51,323) |
| Interest and financing charges | | **(57,554)** | | (59,723) |
| Recovery of allowance for doubtful accounts | | **-** | | 44,850 |
| Loss on foreign exchange | | **(40)** | | - |
| **Net loss and comprehensive loss for the year** | **$** | **(838,848)** | $ | (254,391) |
| **Basic and diluted loss per share** | **$** | **(0.01)** | $ | (0.00) |
| **Weighted average number of common shares outstanding** | | **60,858,758** | | 58,294,374 |

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

# PETROMIN RESOURCES LTD.

Consolidated Statement of Changes in Shareholders' Equity
For the years ended September 30, 2012 and 2011
(Expressed in Canadian dollars)

| | Number of common shares | | Share capital | | Share-based payments reserve | | Convertible debentures (Note 15) | | Deficit | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance, October 1, 2010** | **58,294,374** | **$** | **17,748,045** | **$** | **1,738,965** | **$** | **630,000** | **$** | **(18,175,038)** | **$** | **1,941,972** |
| Share-based compensation | - | | - | | 8,390 | | - | | - | | 8,390 |
| Loss for the year | - | | - | | - | | - | | (254,391) | | (254,391) |
| **Balance, September 30, 2011** | **58,294,374** | **$** | **17,748,045** | **$** | **1,747,355** | **$** | **630,000** | **$** | **(18,429,429)** | **$** | **1,695,971** |
| Common shares issued | 9,000,000 | | 450,000 | | - | | - | | - | | 450,000 |
| Share issuance costs - cash | - | | (22,500) | | - | | - | | - | | (22,500) |
| Share issuance costs - warrants | - | | (6,171) | | 6,171 | | - | | - | | - |
| Share-based compensation | - | | - | | 224,738 | | - | | - | | 224,738 |
| Loss for the year | - | | - | | - | | - | | (838,848) | | (838,848) |
| **Balance, September 30, 2012** | **67,294,374** | **$** | **18,169,374** | **$** | **1,978,264** | **$** | **630,000** | **$** | **(19,268,277)** | **$** | **1,509,361** |

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

# PETROMIN RESOURCES LTD.

Consolidated Statements of Cash Flows
For the years ended September 30, 2012 and 2011
(Expressed in Canadian dollars)

| | | 2012 | | 2011 (Note 21) |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Loss for the year | **$** | **(838,848)** | $ | (254,391) |
| Add items not affecting cash | | | | |
| Interest on decommissioning liabilities | | **1,325** | | 2,947 |
| Share-based compensation | | **224,738** | | 8,390 |
| Depletion and depreciation | | **93,012** | | 159,685 |
| Loss on re-measurement of equity investment | | **88,539** | | 51,323 |
| (Gain)/Loss on allowance for doubtful accounts | | **30,800** | | (44,850) |
| Net changes in non-cash working capital items related to operations | | | | |
| Accounts receivable | | **(68,829)** | | 360,161 |
| Prepaid expenses | | **(898)** | | - |
| Payable to related parties | | **(51,141)** | | 1,644 |
| Accounts payable and accrued liabilities | | **117,084** | | (195,437) |
| Net cash flows from (used in) operating activities | | **(404,218)** | | 89,472 |
| **Cash flows from investing activities** | | | | |
| Acquisition of equipment | | **(3,336)** | | (2,186) |
| Project advance | | **(394,219)** | | 525,530 |
| Additions to exploration and evaluation assets | | **(11,734)** | | (17,253) |
| Additions to oil and gas properties | | **(73,190)** | | (54,374) |
| Net cash flows from (used in) investing activities | | **(482,479)** | | 451,717 |
| **Cash flows from financing activities** | | | | |
| Proceeds from private placement, net of share issuance costs | | **427,500** | | - |
| Net cash flows from financing activities | | **427,500** | | - |
| **Change in cash for the year** | | **(459,197)** | | 541,189 |
| **Cash, beginning of year** | | **612,823** | | 71,634 |
| **Cash, end of year** | | **153,626** | | 612,823 |
| **Supplementary Cash Flow Information** | | | | |
| Interest paid | **$** | **1,224** | $ | 1,302 |
| Income taxes paid | **$** | **-** | $ | - |
| **Supplementary Non-Cash Information** | | | | |
| Change in estimate relating to decommissioning liabilities | **$** | **1,620** | $ | 943 |
| Accounts payable related to exploration and evaluation assets | **$** | **134,837** | $ | - |
| Fair value of agents warrants issued | | **67,877** | | - |
| Accounts payable related to capitalized oil and gas properties | **$** | **-** | $ | 21,103 |

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

**1. Nature and Continuance of Operations**

Petromin Resources Ltd. (the "Company") was incorporated under the laws of British Columbia in 1985, and is a publicly traded company with its shares listed on the TSX Venture Exchange. The Company is principally engaged in the acquisition, exploration and development of interests in oil and natural gas projects in Canada.

The address of the Company's corporate office and principal place of business is #1120 – 1090 West Pender Street, Vancouver B.C., Canada, V6E 3N7.

These consolidated financial statements comprise the financial statements of Petromin Resources Ltd. and its wholly owned subsidiaries, International King Jack Hydrocarbons Inc. and Far East Oil & Gas Ltd. All inter-company balances and transactions have been eliminated upon consolidation.

The business of exploring and developing oil and natural gas properties involves a high degree of risk, and there can be no assurance that planned exploration and development programs will result in profitable oil and natural gas operations. The recoverability of amounts shown for capitalized exploration and evaluation assets and oil and gas interests are dependent on the ability of the Company to obtain necessary financing to complete the development and future profitable production or, alternatively, upon disposition of such properties at a profit. Changes in future conditions could require material write-downs of the carrying values of oil and natural gas interests.

Although the Company has taken steps to verify title to exploration and evaluation assets, and oil and gas interests in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements or transfers and may be affected by undetected defects.

At September 30, 2012, the Company had working capital deficit of $554,094 and had not yet achieved profitable operations and is expected to incur further losses in the development of its business. For the year ended September 30, 2012, the Company reported a comprehensive loss of $838,848 and as at September 30, 2012 had an accumulated deficit of $19,268,277.

The Company has financed its exploration activities and operations through equity issuances and expects to continue to do so to the extent such instruments are issuable under terms acceptable to the Company until such time as its operations provide positive cash flows. Accordingly, the Company's financial statements are presented on a going concern basis, which assumes that the Company will continue to realize its assets and discharge its liabilities in the normal course of operations. Management believes that the going concern assumption is appropriate for these financial statements based on their continuing ability to raise financing through share issuances. If future financing is unavailable, the Company may not be able to meet its ongoing obligations, in which case the realizable value of its assets may decline materially from current estimates. If the going concern assumption was not appropriate for these financial statements, then potentially material adjustments may be necessary to the carrying value of assets and liabilities, the reported expenses and the statement of financial position classifications used.

**1. Nature and Continuance of Operations** (cont'd...)

The current market conditions and volatility increases the uncertainty of the Company's ability to continue as a going concern given the need to both curtail expenditures and to raise additional funds. The Company is experiencing, and has experienced, negative operating cash flows. The Company will continue to search for new or alternate sources of financing but anticipates that the current market conditions may impact the ability to source such funds. These items may cast a significant doubt upon the Company's ability to continue as a going concern.

**2. Basis of Presentation**

**a) Statement of compliance**

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by Canada on January 1, 2011 and by the Company on October 1, 2011, as issued by the International Accounting Standards Board ("IASB"). The Company adopted International Financial Reporting Standards ("IFRS") in accordance with IFRS 1, First-Time Adoption of International Financial Reporting Standards. The first date at which IFRS was applied was October 1, 2010.

The Company's consolidated annual financial statements were prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") until September 30, 2011. Canadian GAAP differs in some areas from IFRS, and accordingly, in preparing these consolidated financial statements, management has amended certain accounting and measurement methods previously applied in the Canadian GAAP consolidated financial statements to comply with IFRS. Note 21 contains reconciliations and descriptions of the effect of the transition from Canadian GAAP to IFRS on equity and comprehensive loss along with line by line reconciliations of the consolidated statements of financial position as at October 1, 2010, and September 30, 2011, and the consolidated statements of loss and comprehensive loss and cash flows for the year ended September 30, 2011.

These consolidated financial statements were authorized by the Company's Board of Directors on January 28, 2013.

The consolidated financial statements have been prepared on a historical cost basis, except for financial instruments classified as financial instruments at fair value through profit and loss, and available-for-sale, which are stated at their fair value. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting except for cash flow information.

**b) Functional and presentation currency**

These consolidated financial statements are presented in Canadian dollars, which is also the Company's functional currency. The functional currency of the Company's wholly owned subsidiaries, International King Jack Hydrocarbons Inc. and for East Oil & Gas Ltd. is also the Canadian dollar.

**2. Basis of Presentation** (cont'd...)

**c) Critical accounting estimates, judgments and assumptions** (cont'd...)

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities and contingent liabilities as at the date of the consolidated financial statements, and the reported amount of revenues and expenses during the reporting period. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The key sources of estimation uncertainty and judgment that have a significant risk of causing material adjustment to the amounts recognized in the consolidated financial statements are as follows:

***Critical Judgments***

The preparation of these consolidated financial statements requires management to make judgments regarding the going concern of the Company as discussed in Note 1.

***Key Sources of Estimation Uncertainty***

**(i) Assessment of commercial reserves**

Management is required to assess the level of the Company's commercial reserves together with the future expenditures required to access those reserves. These assessments are utilized in determining the depletion charge for the period, assessing whether any impairment charge is required against producing and developed projects. By their nature, these estimates of discovered and probable crude oil and natural gas reserves, including the estimates of future prices, costs, related future cash flows and the selection of a pre-tax risk adjusted discount rate relevant to the asset in question, are subject to measurement uncertainty. The Company employs an independent reserves specialist who periodically assesses the Company's level of commercial reserves by reference to data sets including geological, geophysical and engineering data together with reports, presentation and financial information pertaining to the contractual and fiscal terms applicable to the Company's assets. Significant judgment is involved when determining whether there have been any significant changes in the Company's crude oil and natural gas reserves.

**2. Basis of Presentation** (cont'd...)

**(ii) Share-based payments**

The Company has a stock option plan for directors, officers, employees and consultants. Services received, and the corresponding increase in equity, are measured by reference to the fair value of the equity instruments at the date of the grant, excluding the impact of any non-market vesting conditions. The fair value of share options are estimated by using the Black-Scholes model on the date of the grant based on certain assumptions. Those assumptions are described in Note 14 and include, among others, expected volatility, expected life of the options and number of options expected to vest.

**(iii) Useful lives of equipment and depreciation**

The Company estimates the useful lives of equipment based on the period over which the assets are expected to be available for use. The depreciation method and useful lives reflect the pattern in which management expects the asset's future economic benefits to be consumed by the Company. The amounts and timing of recorded expenses for any period would be affected by changes in assumptions and estimates used.

**(iv) Deferred tax assets and liabilities**

Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable income realized, including the use of tax planning strategies.

**(v) Decommissioning liabilities**

The Company recognizes the liability for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of oil and gas interests, when those obligations result from the exploration or development of its properties. The Company assesses its provision for site reclamation at each reporting date. Significant estimates and assumptions are made in determining the provision for site reclamation as there are numerous factors that will affect the ultimate liability payable. These factors include estimates of the extent and costs of rehabilitation activities, technological changes, regulatory changes, cost increases as compared to inflation rates, and discount rates. Those uncertainties may result in future actual expenditures differing from the amounts currently provided. The provision at the reporting date represents management's best estimate of the present value of the future reclamation costs required.

**(vi) Identification of cash generating units**

Cash generating units are defined as the lowest grouping of integrated assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The classification of assets into cash generating units requires significant judgment and interpretations with respect to the integration between assets, the existence of active markets, external users, shared infrastructure, and the way in which management monitors the Company's operations.

**2. Basis of Presentation** (cont'd...)

**(vii) Impairment of non-financial assets**

Impairment exists when the carrying value of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the budget for the next five years and do not include restructuring activities that the Company is not yet committed to or significant future investments that will not enhance the assets' performance of the cash generating unit being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash inflows and the growth rate used.

**3. Significant Accounting Policies**

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

**a) Principles of consolidation**

These consolidated financial statements include the accounts of the Company and its wholly owned and controlled subsidiaries as described in Note 1. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. All inter-company transactions and balances have been eliminated upon consolidation.

**b) Foreign currency**

The Company's functional and reporting currency is the Canadian dollar. The functional currency of the Company's subsidiaries, as described in Note 1, is also the Canadian dollar. Transactions denominated in foreign currencies are translated into Canadian dollars at the rate of exchange in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the rate of exchange in effect at the consolidated statement of financial position date. Non-monetary assets and liabilities are translated at historical rates. Any gains or losses resulting from translation have been included in net loss.

**3. Significant Accounting Policies** (cont'd...)

**c) Cash and cash equivalents**

The Company considers cash and cash equivalents to include cash on deposit and highly liquid short-term interest bearing investments that are readily convertible to known amounts of cash and subject to insignificant risk of changes in value.

**d) Revenue recognition**

Revenue from the sale of oil and gas is recognized when title and the risks and rewards of ownership passes to the buyer, normally at the pipeline delivery point for natural gas and at the wellhead for crude oil, and when collection is reasonably assured.

**e) Exploration and evaluation assets**

Costs of exploring for and evaluating oil and natural gas properties are capitalized within exploration and evaluation assets. Exploration and evaluation assets do not include costs of general prospecting or evaluation costs incurred prior to having obtained the legal right to explore an area, which are expensed as incurred.

Exploration and evaluation assets are not depleted or depreciated and are carried forward until technical feasibility and commercial viability is considered to be determined. The technical feasibility and commercial viability is generally considered to be determined when proved plus probably reserves are determined to exist and the commercial production of oil and gas has commenced. A review of each exploration license or field is carried out at least annually to ascertain whether the project is technically feasible and commercially viable. Upon determination of technical feasibility and commercial viability, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to oil and gas interests.

**f) Oil and gas interests**

All costs directly associated with the development of oil and natural gas reserves are capitalized on an area-by-area basis. Development costs include expenditures for areas where technical feasibility and commercial viability has been determined. These costs include proved property acquisitions, development drilling, completion, gathering and infrastructure costs and transfers of exploration and evaluation assets.

Costs accumulated within each area are depleted using the unit-of-production method based on proved plus probable reserves using estimated future prices and costs. Costs subject to depletion include estimated future costs to be incurred in developing proved and probable reserves.

**3. Significant Accounting Policies** (cont'd...)

**f) Oil and gas interests** (cont'd...)

For divestitures of properties, a gain or loss is recognized in net earnings. Exchanges of properties are measured at fair value, unless the transaction lacks commercial substance or fair value cannot be reliably measured. Where the exchange is measured at fair value, a gain or loss is recognized in net earnings.

**g) Equipment**

Equipment is recorded at cost less accumulated depreciation and accumulated impairment losses. The cost of an item of equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. Depreciation is provided at rates calculated to write off the cost of equipment, less its estimated residual value, using the declining balance method at the following rates per annum:

| | |
|---|---|
| Leasehold improvements | 20% |
| Computer equipment | 30% |
| Office equipment | 20% |

**h) Impairment of non-financial assets**

Non-financial assets are evaluated at the end of each reporting period by management for indicators that carrying value is impaired and may not be recoverable. When indicators of impairment are present, the recoverable amount of an asset is evaluated at the level of a cash generating unit, the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets, where the recoverable amount of the cash generating unit is the greater of the cash generating unit's fair value less costs to sell and its value in use. 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 to the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset or cash generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash generating unit is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of operations and comprehensive loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset or cash generating unit is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset or cash generating unit in prior years. A reversal of an impairment loss is recognized immediately in the statement of operations and comprehensive loss.

**3. Significant Accounting Policies** (cont'd...)

**i) Income taxes**

Income tax on profit or loss for the year comprises of current and deferred tax. Current tax is the expected tax paid or payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax paid or payable in respect of previous years.

Deferred tax is recorded 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.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the year that includes the date of the enactment or substantive enactment of the change. Deferred tax assets and liabilities are presented separately except where there is a right of set-off within fiscal jurisdictions.

**j) Earnings (loss) per share**

Basic earnings (loss) per share ("EPS") is calculated by dividing profit or loss attributable to ordinary equity holders (numerator) by the weighted average number of ordinary shares outstanding (denominator) during the period. The denominator is calculated by adjusting the shares issued at the beginning of the period by the number of shares bought back during the period, multiplied by a time-weighting factor.

Diluted EPS is calculated by adjusting the earnings and number of shares for the effects of dilutive options and other dilutive potential units. The effects of anti-dilutive potential units are ignored in calculating diluted EPS. All options are considered anti-dilutive when the Company is in a loss position.

**k) Segmented reporting**

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's President and CEO to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available. The Company manages its business on the basis of one reportable segment under one geographic region, being Canada.

**3. Significant Accounting Policies** (cont'd...)

**l) Share-based payments**

The Company recognizes share-based compensation expense based on the estimated fair value of the options granted. A fair value measurement is made for each vesting instalment within each option grant and is determined using the Black-Scholes option pricing model. The fair value of the options is recognized over the vesting period of the options granted as both share-based compensation expense and reserves. This includes a forfeiture estimate, which is revised for actual forfeitures in subsequent periods. The reserves account is subsequently reduced if the options are exercised and the amount initially recorded is then credited to share capital.

**m) Provisions**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost in the statement of comprehensive loss.

**n) Financial instruments**

All financial instruments are classified into one of five categories: fair-value-through-profit-and-loss, held-to-maturity, loans and receivables, available-for-sale or other financial liabilities. All financial instruments and derivatives are recognized in the consolidated statement of financial position at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are recognized at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification. Fair-value-through-profit-and-loss financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is sold or impaired.

The Company has classified its cash as fair-value-through-profit-and-loss. Accounts receivable are classified as loans and receivables. Accounts payable and accrued liabilities are payable to related parties are classified as other financial liabilities, all of which are measured or recognized at amortized cost. The Company has no derivatives or embedded derivatives at the date of these consolidated financial statements.

The Company also provides the required disclosure about the inputs used in making fair value measurements, including their classification within a hierarchy that prioritizes their significance. The three levels of the fair value hierarchy are:

**3. Significant Accounting Policies** (cont'd...)

**n) Financial instruments** (cont'd...)

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
Level 3 – Inputs that are not based on observable market data

See Note 18 for relevant disclosures.

**o) Long-term equity investment**

The Company utilizes the equity method of accounting for investments subject to significant influence. Under this method, investments are originally recorded at cost and adjusted thereafter to include the Company's pro-rata share of post-acquisition earnings or losses. Any dividends received or receivable from this investee would reduce the carrying value of the investment.

**p) Comprehensive loss**

Comprehensive loss consists of net loss and other comprehensive income (loss) and represents the change in shareholders' equity which results from transactions and events from sources other than the Company's shareholders. For the years presented, comprehensive loss is the same as net loss.

**4. Recent Accounting Pronouncements**

Financial Instruments IFRS 9, "Financial Instruments" ("IFRS 9") was issued by the IASB on November 12, 2009 and will replace IAS 39. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classification options in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2015.

Amendments to IFRS 7, *Financial Instruments: Disclosures* are effective for annual periods beginning on or after January 1, 2013 and introduce enhanced disclosure around transfer of financial assets and associated risks. These amendments are not anticipated to impact the disclosures made by the Company.

Amendments to IAS 1, *Presentation of Financial Statements* (effective for annual periods beginning on or after July 1, 2012) require that elements of other comprehensive income that may subsequently be reclassified through profit and loss be differentiated from those items that will not be reclassified.

(Expressed in Canadian dollars)

**4. Recent Accounting Pronouncements** (cont'd...)

IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements,* IFRS 12 *Disclosure of Interests in Other Entities*, and consequential revisions to IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (all effective January 1, 2013) provide revised guidance on the accounting treatment and associated disclosure requirements for joint arrangements and associates, and a revised definition of 'control' for identifying entities which are to be consolidated.

IFRS 13 *Fair Value Measurement* (effective January 1, 2013) provides new guidance on fair value measurement and disclosure requirements.

Amendments to IAS 32, *Financial Instruments: Presentation,* are effective for annual periods beginning on or after January 1, 2014. This provides for amendments relating to offsetting financial assets and financial liabilities

The Company is currently evaluating the impact of these new and amended standards on its consolidated financial statements.

**5. Cash**

Cash is comprised of cash at banks and on hand. The Company had no cash equivalents as at September 30, 2012, September 30, 2011, or October 1, 2010.

**6. Accounts Receivable**

Accounts receivable are all current and include the following:

| | **September 30, 2012** | **September 30, 2011** | **October 1, 2010** |
|---|---|---|---|
| Accounts receivable (net of allowance) | **$** 297,397 | $ 263,005 | $ 579,467 |
| HST receivable | 6,136 | 2,499 | 1,348 |
| | **$** 303,533 | $ 265,504 | $ 580,815 |

As of September 30 2012, an allowance of $30,800 was estimated for doubtful accounts. No allowances were considered necessary as at September 30, 2011 and October 1, 2010.

**7. Long-term Equity Investment**

Terrawest Energy Corp. ("Terrawest") is a Canadian privately owned coal bed methane development company. On November 6, 2007, the Company subscribed for 40,000,000 units of a private placement in Terrawest at a price of $0.015 per unit, each unit consisting of one common share and one common share purchase warrant, with each full warrant exercisable into one additional common share of Terrawest for a period of two years at a price of $0.03 per share. On December 28, 2007, the Company purchased 700,000 preferred shares at a price of $0.015 per share from preferred shareholders of Terrawest. On March 18, 2009, the Company exercised warrants to purchase an additional 16,666,667 common share of Terrawest at a price of $0.03 per share. On November 1, 2009, the Company exercised warrants to purchase an additional 16,666,667 common shares of Terrawest at a price of $0.03 per share. The remaining 6,666,666 warrants expired unexercised. As at September 30, 2012, the Company holds 22.28% interest in Terrawest, and the investment has been accounted for using the equity method of accounting. The Company recognized investment losses of $88,539 (September 30, 2011 - $51,323) for the year ended September 30, 2012. The Company has two directors in common with Terrawest.

(Expressed in Canadian dollars)

## 8. Equipment

| | Leasehold improvements | Computer equipment | Office equipment | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance, October 1, 2010 | $ 37,781 | $ 61,961 | $ 18,738 | $ 118,480 |
| Additions | - | 2,186 | - | 2,186 |
| Balance, September 30, 2011 | 37,781 | 64,147 | 18,738 | 120,666 |
| Additions | - | 2,056 | 1,280 | 3,336 |
| Balance, September 30, 2012 | $ 37,781 | $ 66,203 | $ 20,018 | $ 124,002 |
| **Accumulated depreciation** | | | | |
| Balance, October 1, 2010 | $ (17,152) | $ (54,438) | $ (11,520) | $ (83,110) |
| Depreciation for the year | (4,127) | (2,912) | (1,444) | (8,483) |
| Balance, September 30, 2011 | (21,279) | (57,350) | (12,964) | (91,593) |
| Depreciation for the year | (16,502) | (2,656) | (1,156) | (20,314) |
| Balance, September 30, 2012 | $ (37,781) | $ (60,006) | $ (14,120) | $ (111,907) |
| **Net book value** | | | | |
| October 1, 2010 | $ 20,629 | $ 7,523 | $ 7,218 | $ 35,370 |
| September 30, 2011 | $ 16,502 | $ 6,797 | $ 5,774 | $ 29,073 |
| September 30, 2012 | $ - | $ 6,197 | $ 5,898 | $ 12,095 |

## 9. Exploration and Evaluation Assets

The Company has two producing wells on the Morningside property (Note 10). The Company also acquired an adjacent land parcel which the Company is currently exploring and evaluating.

Exploration and evaluation assets consist of acquisition costs and drilling expenditures in the Morningside area, which is an unproved property as at September 30, 2012.

| | Morningside |
|---|---|
| Balance, October 1, 2010 | $ - |
| Acquisition costs | 13,913 |
| Drilling costs | 3,340 |
| Balance, September 30, 2011 | 17,253 |
| Acquisition costs | 11,734 |
| Drilling costs | 134,837 |
| Balance, September 30, 2012 | $ 163,824 |

(Expressed in Canadian dollars)

## 10. Oil and Gas Interests

| | Frog Lake | Redwater North | Gibly | Morningside | Total |
|---|---|---|---|---|---|
| Balance, October 1, 2010 | $ 865,762 | $ 69,163 | $ 62,427 | $ 18,736 | $ 1,016,088 |
| Expenditures | 34,325 | - | - | - | 34,325 |
| Recovery of expenditures | - | - | (15,220) | - | (15,220) |
| Decommissioning liability | 540 | 279 | 124 | - | 943 |
| Depletion | (103,020) | (18,798) | (18,703) | (10,681) | (151,202) |
| Balance, September 30, 2011 | 797,607 | 50,644 | 28,628 | 8,055 | 884,934 |
| Expenditures | 52,087 | - | - | - | 52,087 |
| Decommissioning liability | 1,570 | - | 50 | - | 1,620 |
| Depletion | (53,279) | (7,542) | (8,167) | (3,710) | (72,698) |
| Balance, September 30, 2012 | $ 797,985 | $ 43,102 | $ 20,511 | $ 4,345 | $ 865,943 |

(Expressed in Canadian dollars)

**10. Oil and Gas Interests** (cont'd...)

During the year ended September 30, 2012, no general and administrative expenditures were capitalized to oil and gas interests.

An impairment test was performed on the Company's proved oil and natural gas producing interests at September 30, 2012 due to declining forward natural gas prices. The recoverable amount of the Company's cash generating units were estimated as the fair value less costs to sell based on the net present value of the before tax cash flows from oil and gas proved plus probable reserves. In determining the appropriate discount rate, the Company considered the acquisition metrics of recent transactions completed on assets similar to those in the specific cash generating unit.

The following estimates were used in determining whether impairment to the carrying value of the cash generating units existed at September 30, 2012:

| Year | Hardisty Heavy (Cdn$/bbl) | AE CO Gas (Cdn$/mmbtu) |
|---|---|---|
| 2012 | $ 64.03 | $ 3.15 |
| 2013 | 65.98 | 3.58 |
| 2014 | 67.56 | 4.13 |
| 2015 | 68.95 | 4.70 |
| 2016 | 70.60 | 5.27 |
| Thereafter prices escalating at 2.0% annually thereafter | | |

No impairment was considered necessary to the cash generating units.

**11. Related Party Transactions**

Related parties and related party transactions impacting the accompanying financial statements are summarized below and include transactions with the following individuals or entities:

Key management personnel:

Key management personnel include those persons having authority and responsibility for planning, directing and controlling the activities of the Company as a whole. The Company has determined that key management personnel consists of executive and non-executive members of the Company's Board of Directors and corporate officers.

(Expressed in Canadian dollars)

**11. Related Party Transactions** (cont'd...)

Remuneration attributed to key management personnel can be summarized as follows:

| | Year ended September 30, 2012 | 2011 |
|---|---|---|
| Share-based compensation | $ 189,422 | $ - |
| Short-term benefits* | 182,400 | 215,321 |
| | $ 371,822 | $ 215,321 |

*include base salaries pursuant to contractual employment, consulting, or management agreements. These have been recorded in wages and benefits and consulting fees.

Amounts due to related parties consist of $217,443 (September 30, 2011 - $268,584; October 1, 2010 - $266,940) to directors or officers of the Company, or to companies controlled by directors or officers of the Company.

The following transactions were carried out with other related parties:

i) Received or accrued $30,000 (September 30, 2011 - $30,000) in management fees or reimbursements of expenses from Terrawest Energy Corp., a company with two directors in common, included in other income.

ii) Included in accounts receivable at September 30, 2012 is $57, 500 (September 30, 2011 - $27, 500; October 1, 2010 - $157,644) due from Terrawest Energy Corp., a company with two directors in common.

iii) Paid or accrued $30,513 (2011 - $43,514) in consulting fees and royalties to a Company controlled by a former director of the Company.

The amounts due to related parties are unsecured, non-interest bearing, and have no specific terms of repayment.

**12. Project Advance**

During the year-ended September 30, 2011, the Company farmed out its Morningside lease included in exploration and evaluation assets whereby the farmee will pay 100% of the drilling and completion costs to earn a 50% working interest after payout. As at September 30, 2011, the Company had received $525,530 from the farmee, which is recorded as a project advance. During the year ended September 30, 2012, the Company received another $180,000 advance from the farmee and as at September 30, 2012, the project advance balance was $131,311. Expenditures of $574,219 were incurred for the Morningside project.

(Expressed in Canadian dollars)

## 13. Decommissioning Liabilities

| | September 30, 2012 | September 30, 2011 | October 1, 2010 |
|---|---|---|---|
| Balance, beginning of year | $ 90,213 | $ 86,323 | $ 81,067 |
| Change in estimate | 1,620 | 943 | - |
| Interest | 1,325 | 2,947 | 5,256 |
| Balance, end of year | $ 93,158 | $ 90,213 | $ 86,323 |

The following assumptions were used to estimate the decommissioning liabilities:

| | September 30, 2012 | September 30, 2011 | October 1, 2010 |
|---|---|---|---|
| Total escalated future costs | $ 105,150 | $ 102,412 | $ 96,742 |
| Discount rate, per annum | 2.0% | 1.40% | 1.90% |
| Inflation rate, per annum | 2% | 2% | 2% |

These costs are expected to be made over 10 years with the majority of the costs to be incurred between 2013 and 2023.

## 14. Share Capital

### a) Authorized capital

The authorized share capital consists of an unlimited number of common voting shares without nominal or par value.

### b) Share and warrant issuances

On June 18, 2012, the Company completed a 9,000,000 unit private placement at a price of $0.05 per unit for total proceeds of $450,000. Each unit is comprised of one common share and one half common share purchase warrant. Each whole warrant is exercisable into one common share of the Company at a price of $0.10 until June 17, 2013. The residual value associated with the finance warrants is $Nil. The Company incurred cash share issuance costs of $22,500, and issued 450,000 agent warrants with a value of $6,171 in connection with this financing. The agent warrants have an exercise price of $0.10 and expire on June 17, 2013.

There were no share or warrant issuances during the year ended September 30, 2011.

(Expressed in Canadian dollars)

**14. Share Capital** (cont'd...)

**c) Warrants**

As at September 30, 2012, 4,950,000 purchase warrants were outstanding (September 30, 2011 – Nil). One purchase warrant is entitled to purchase one common share at a price of $0.10 before June 17, 2013.

The fair value of the warrants issued during the years ended September 30, 2012 and the year ended September 30, 2011, 2011 was determined using the Black-Scholes Option Pricing Model with the following assumptions:

| | September 30 2012 | September 30 2011 |
|---|---|---|
| Risk-free interest rate | 2.41% | N/A |
| Expected life | 1 year | N/A |
| Annualized volatility | 119.63% | N/A |
| Dividend rate | 0% | N/A |

The following is a summary of warrants outstanding:

| | Number of Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, October 1, 2010 and September 30, 2011 | - | $ - |
| Issued | 4,950,000 | 0.10 |
| Outstanding, September 30, 2012 | 4,950,000 | $ 0.10 |

The following is a summary of the outstanding warrants, with their respective expiry dates and exercise prices.

| September 30, 2012 | | | |
|---|---|---|---|
| Exercise Price | Number Outstanding | Expiry Date | Remaining Life (Years) |
| $ 0.10 | 4,500,000 | June 17, 2013 | 0.71 |
| 0.10 | 450,000 [1] | June 17, 2013 | 0.71 |
| $ 0.10 | 4,950,000 | | |

[1] Agents warrants

(Expressed in Canadian dollars)

**14. Share Capital** (cont'd...)

**d) Stock options**

The Company has adopted an incentive stock option plan under the rules of the TSX-V pursuant to which it is authorized to grant stock options to executive officers, directors, employees and consultants, enabling them to acquire up to 10% of the issued and outstanding common shares of the Company. Under the stock option plan, the option exercise price of any option granted shall not be less than the market price of the Company's common shares. The options can be granted for a maximum term of 5 years, and vest immediately on the date of the grant or otherwise at the discretion of the Board. The plan must be approved each year at the annual general meeting of the shareholders.

During the year ended September 30, 2012, the Company granted 3,500,000 stock options (September 30, 2011 – Nil). Each option is exercisable into one common share of the Company. The exercise price is $0.10 per common share. These options vest immediately and expire on September 16, 2017. The Company recognized share-based compensation expense of $224,738 (2011 - $8,390) for options vesting during the year. The weighted average fair value of the options granted in the year was $0.06 (2011 - $Nil).

The following weighted average assumptions were used for the Black-Scholes method of valuation of stock options granted during the years ended September 30, 2012 and 2011:

| | September 30, 2012 | September 30, 2011 |
|---|---|---|
| Risk-free interest rate | 2.00% | N/A |
| Expected life of options | 5 years | N/A |
| Annualized volatility | 119.63% | N/A |
| Dividend rate | 0% | N/A |
| Forfeiture rate | 0% | N/A |

Stock option transactions for the year ended September 30, 2012 and for the year ended September 30, 2011 are as follow:

| | **Number of options** | | **Weighted average exercise price** |
|---|---|---|---|
| Balance outstanding as at October 1, 2010 | 4,266,177 | $ | 0.23 |
| Expired | (3,123,310) | | 0.24 |
| Balance outstanding at September 30, 2011 | 1,142,867 | $ | 0.21 |
| **Granted** | **3,500,000** | | **0.10** |
| **Expired** | **(392,867)** | | **0.29** |
| **Balance outstanding and exercisable as at September 30, 2012** | **4,250,000** | **$** | **0.11** |

(Expressed in Canadian dollars)

**14. Share Capital** (cont'd...)

**d) Stock options** (cont'd...)

As at September 30, 2012, the following stock options were outstanding and exercisable:

| Number of Options Outstanding | Exercise Price | Expiry Date | Exercisable | Remaining Life (years) |
|---|---|---|---|---|
| 200,000 | $ 0.12 | October 7, 2013 | 200,000 | 1.02 |
| 100,000 | $ 0.20 | November 27, 2014 | 100,000 | 2.16 |
| 400,000 | $ 0.20 | February 19, 2015 | 400,000 | 2.39 |
| 50,000 | $ 0.13 | April 19, 2015 | 50,000 | 2.55 |
| 3,500,000 | $ 0.10 | September 16, 2017 | 3,500,000 | 4.96 |

**15. Convertible Debentures**

During the year ended September 30, 2009, the Company issued 630 subordinated unsecured convertible debentures for proceeds of $630,000 to a company with two directors in common. Each debenture is convertible into 5,000 common shares in the capital of the Company for a price of $0.20 per share (the "Conversion Price"). The convertible debentures mature in August 2014. Interest is payable quarterly in arrears at 9% per annum. To the extent that the right to convert the debentures is not exercised before the maturity date, each unconverted debenture will automatically convert into common shares at the Conversion Price on the maturity date. As the Company has unrestricted ability to settle the principal through the issuance of fixed number of common shares at fixed Conversion Price, the convertible debentures are classified as shareholders' equity.

| September 30, 2012 | September 30, 2011 | October 1, 2010 |
|---|---|---|
| **$ 630,000** | $ 630,000 | $ 630,000 |

(Expressed in Canadian dollars)

## 16. Expenses by Nature

General and administration expenses for year ended September 30, 2012 and 2011 consist of the following:

| | | **Year ended September 30 2012** | | Year ended September 30 2011 |
|---|---|---|---|---|
| Consulting fees | **$** | 120,776 | $ | 115,717 |
| Filing agent and transfer fees | | 16,913 | | 15,487 |
| Office and miscellaneous | | 184,658 | | 211,952 |
| Professional fees | | 60,924 | | 56,308 |
| Travel and promotion | | 18,456 | | 32,165 |
| Allowance for doubtful accounts | | 30,800 | | - |
| Wages and benefits | | 193,877 | | 181,404 |
| Total | **$** | 626,404 | $ | 613,033 |

## 17. Income Taxes

A reconciliation of current income taxes at statutory rates with the reported taxes is as follows:

| | | 2012 | | 2011 |
|---|---|---|---|---|
| Net income (loss) before income taxes | $ | (838,848) | $ | (254,391) |
| Expected income tax expense (recovery) | $ | (213,000) | $ | (69,000) |
| Non-deductible expenditures and non-taxable revenues | | 57,000 | | 2,000 |
| Impact of future income tax rates applied versus current statutory rate | | 2,000 | | 5,000 |
| Share issue costs | | (6,000) | | - |
| Change in unrecognized deductible temporary difference | | 160,000 | | 62,000 |
| Total deferred tax recovery | $ | - | $ | - |

(Expressed in Canadian dollars)

**17.**

**17. Income Taxes** (cont'd...)

Significant components of deductible and taxable temporary differences, unused tax losses and unused tax credits that have not been included on the statement of financial position are as follows:

| | **2012** | **Expiry dates** | **2011** | **Expiry dates** | **2010** | **Expiry dates** |
|---|---|---|---|---|---|---|
| Exploration & evaluation assets | $ ,102,000 | No expiry | $8,349000 | No expiry | $ 2,055,000 | No expiry |
| Property & equipment | 12,000 | No expiry | 31,000 | No expiry | 6,000 | No expiry |
| Share issue costs | 5,000 | 2033-2036 | 25,000 | 2033-2036 | 13,000 | 2033-2036 |
| Non-capital losses available for future periods | 2,102,000 | 2014-2032 | 3,656,000 | 2014-2031 | 897,000 | 2014-2030 |

**18. Financial Risk Factors**

The Company's financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities, and payable to related parties. The fair value of the Company's accounts receivable, accounts payable and accrued liabilities, and payable to related parties approximate their carrying value, due to their short-term maturities or ability of prompt liquidation. The Company's other financial instrument, cash, recorded at fair value, under the fair value hierarchy, is based on level one quoted prices in active markets for identical assets or liabilities.

The Company is exposed in varying degrees to a variety of financial instrument related risks.

Credit risk

Credit risk is the risk of loss if counterparties do not fulfill their contractual obligations. The Company's credit risk is primarily attributable to cash and amounts receivable. The Company's credit risk is limited to the carrying amount on the statement of financial position.

The Company's cash is held through Canadian chartered banks, which are high-credit quality financial institutions. The Company's receivables are primarily from customers operating in petroleum and natural gas industry within Canada and from related parties. The Company has recorded an allowance for doubtful accounts this year for some of its customers. The Company expects credit risk with the other remaining customers to be low.

**18. Financial Risk Factors** (cont'd...)

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages liquidity risk by maintaining cash and short-term investment balances. Liquidity requirements are managed based on expected cash flow to ensure there is capital to meet short term and long term obligations. As disclosed in Note 1, the ability of the Company to continue as a going concern is dependent on many factors. The Company's cash is primarily invested in bank accounts. On September 30, 2012, the Company had current assets of $457,174 to settle current liabilities of $1,011,253 The Company expects to fund these liabilities through the issuance of capital stock over the coming year.

Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and commodity and equity prices.

a) Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The risk that the Company will realize a loss as a result of a decline in the fair value of the short-term investments included in cash is minimal because the Company's interest rate risk arises primarily from the interest received on cash and short-term investment, which is invested on a short term basis to enable adequate liquidity for payment of operational and capital expenditures.

The Company's convertible debentures bear interest at a fixed rate and therefore the Company does not have interest rate risk associated with its convertible debentures.

b) Commodity Price risk

The value of the Company's exploration and evaluation assets and oil and gas properties are dependent on the price of oil and gas. Market prices for the oil and gas historically have fluctuated widely and are affected by numerous factors outside the Company's control, including but not limited to, levels of worldwide production short term changes in supply and demand, industrial and retail demand, as well as certain other factors related specifically to oil and gas. If oil and gas prices decline for a prolonged period below the cost of production, it may not be economically feasible to continue towards production.

**18. Financial Risk Factors** (cont'd...)

Market Risk (cont'd...)

c) Foreign Currency Risk

The Company's functional currency is the Canadian dollar and major purchases are transacted in Canadian dollars. The Company funds certain operations, exploration and administrative expenses in Asia by using the US dollar currency from its Canadian dollar bank accounts. Management believes the foreign exchange risk derived from currency conversions is negligible and therefore does not hedge its foreign exchange risk

**19. Capital Management**

The Company's objectives when managing capital are to safeguard its assets while at the same time maintain investor, creditor and market confidence and to sustain future development of the business.

The oil and gas properties in which the Company currently has an interest have just begun commercial operation and are currently incurring losses; as such the Company is dependent on external financing to fund its activities. In order to carry out current operations and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so. In the management capital, the Company includes its components of shareholders' equity.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

The Company and its subsidiaries are not subject to externally imposed capital requirements. There have been no changes to the Company's approach to capital management during the year-ended September 30, 2012, or for the year ended September 30, 2011.

(Expressed in Canadian dollars)

### 20. Commitments

The Company entered into a lease agreement for its office premises commencing October 1, 2012 and ending October 1, 2015. Lease payments in the amount of $77, 946 are required as follows:

| | |
|---|---|
| September 30, 2013 | $ 25,982 |
| September 30, 2014 | 25,982 |
| September 30, 2015 | 25,982 |
| | $ 77,946 |

### 21. First Time Adoption of IFRS

The Company adopted IFRS effective October 1, 2011, with a transition date of October 1, 2010. Prior to the adoption of IFRS the Company prepared its financial statements in accordance with Canadian GAAP.

The accounting policies in Note 3 have been applied in preparing the consolidated financial statements for the year ended September 30, 2012, the comparative information for the year ended September 30, 2011, and the preparation of an opening IFRS statement of financial position on the transition date, October 1, 2010.

Additionally, in accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's IFRS estimates as of October 1, 2010 are consistent with its GAAP estimates on the same date.

In preparing its opening IFRS statement of financial position, the Company has adjusted amounts reported previously in accordance with Canadian GAAP. An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's financial position, financial performance, and cash flows is set out below.

**Initial elections upon adoption**

The Company adopted IFRS in accordance with IFRS 1, *First-time Adoption of International Financial Reporting Standards* ("IFRS 1"). IFRS 1 allows first-time adopters certain mandatory and optional exemptions. The Company has elected to take the following optional exemptions:

***(i) Share-based payments***

IFRS 1 permits the application of IFRS 2 Share Based Payments only to equity instruments granted after November 7, 2002 that had not vested by the date of transition to IFRS.

**21. First Time Adoption of IFRS** (cont'd...)

**Initial elections upon adoption** (cont'd...)

***(ii) Decommissioning liabilities (asset retirement obligations)***

IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities requires remeasurement of the decommissioning liability at each period end to reflect changes due to changes in various assumptions. The Company has elected to utilize this exemption which allows the Company to not retrospectively adjust the decommissioning liability and related assets; the decommissioning liability has been accounted for in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as at the transition date and thereafter.

***(iii) Business Combinations***

IFRS-1 permits the application of IFRS 3, *Business Combinations* on a prospective basis from the date of transition to IFRS. The Company has applied this exemption, and will apply IFRS-3 for business combinations after October 1, 2010.

**Reconciliations from Canadian GAAP to IFRS**

An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's consolidated statements of financial position as at October 1, 2010 and September 30, 2011, statements of operations and comprehensive loss for the year ended September 30, 2011 and statement of cash flows for the year ended September 30, 2011 is set out in the following reconciliations and in the notes that accompany the reconciliations. Certain amounts and descriptions on the statements of financial position and the statements of operations and comprehensive loss have been reclassified to conform to the presentation adopted under IFRS.

(Expressed in Canadian dollars)

**21. First Time Adoption of IFRS** (cont'd...)

**Reconciliations from Canadian GAAP to IFRS** (cont'd...)

Reconciliation of consolidated statement of financial position as at October 1, 2010

| | Notes | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | | $ 71,634 | $ - | $ 71,634 |
| Accounts receivable | | 580,815 | - | 580,815 |
| | | 652,449 | - | 652,449 |
| Deposit | | 7,241 | - | 7,241 |
| Long-term equity investment | | 1,246,474 | - | 1,246,474 |
| Equipment | | 35,370 | - | 35,370 |
| Oil and gas interests | | 1,016,088 | - | 1,016,088 |
| **Total assets** | | **$ 2,957,622** | **-** | **$ 2,957,622** |
| **Liabilities** | | | | |
| **Current** | | | | |
| Accounts payable and accrued liabilities | | $ 662,387 | $ - | $ 662,387 |
| Payable to related parties | | 266,940 | - | 266,940 |
| | | 929,327 | - | 929,327 |
| Decommissioning liabilities | a) | 69,483 | 16,840 | 86,323 |
| **Shareholders' Equity** | | | | |
| Capital stock | | 17,748,045 | - | 17,748,045 |
| Share-based payments reserve | c) | 1,725,280 | 13,685 | 1,738,965 |
| Convertible debentures | | 630,000 | - | 630,000 |
| Deficit | a) c) | (18,144,513) | (30,525) | (18,175,038) |
| **Total shareholders' equity** | | 1,958,812 | (16,840) | 1,941,972 |
| **Total liabilities and shareholders' equity** | | **$ 2,957,622** | **-** | **$ 2,957,622** |

(Expressed in Canadian dollars)

## 21. First Time Adoption of IFRS (cont'd...)

**Reconciliations from Canadian GAAP to IFRS** (cont'd...)

Reconciliation of consolidated statement of financial position as at September 30, 2011

| | Notes | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | | $ 612,823 | $ - | $ 612,823 |
| Accounts receivable | | 265,504 | - | 265,504 |
| | | 878,327 | - | 878,327 |
| **Deposit** | | 7,241 | - | 7,241 |
| **Long-term equity investment** | | 1,195,151 | - | 1,195,151 |
| **Exploration and evaluation assets** | b) | - | 17,253 | 17,253 |
| **Equipment** | | 29,073 | - | 29,073 |
| **Oil and gas interests** | a) b) | 887,541 | (2,607) | 884,934 |
| **Total assets** | | **$ 2,997,333** | **14,646** | **$ 3,011,979** |
| **Liabilities** | | | | |
| **Current** | | | | |
| Accounts payable and accrued liabilities | | $ 431,681 | $ - | $ 431,681 |
| Payable to related parties | | 268,584 | - | 268,584 |
| Project advance | | 525,530 | - | 525,530 |
| | | 1,225,795 | - | 1,225,795 |
| Decommissioning liabilities | a) | 62,003 | 28,210 | 90,213 |
| **Equity** | | | | |
| Share capital | | 17,748,045 | - | 17,748,045 |
| Share-based payments reserve | | 1,747,355 | - | 1,747,355 |
| Convertible debentures | | 630,000 | - | 630,000 |
| Deficit | a) c) | (18,415,865) | (13,564) | (18,429,429) |
| **Total equity** | | 1,709,535 | (13,564) | 1,695,971 |
| **Total liabilities and shareholders' equity** | | **$ 2,997,333** | **$ 14,646** | **$ 3,011,979** |

# PETROMIN RESOURCES LTD.

Notes to the Consolidated Financial Statements
For the years ended September 30, 2012 and 2011
(Expressed in Canadian dollars)

**21. First Time Adoption of IFRS** (cont'd...)

**Reconciliations from Canadian GAAP to IFRS** (cont'd...)

Reconciliation of consolidated statement of comprehensive loss for the year ended September 30, 2011

| | Notes | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Revenue** | | | | |
| Petroleum and natural gas sales | | $ 1,236,378 | $ - | $ 1,236,378 |
| Royalties | | 39,543 | - | 39,543 |
| | | 1,275,921 | - | 1,275,921 |
| Other income | | 30,000 | - | 30,000 |
| | | **1,305,921** | **-** | **1,305,921** |
| **Expenses** | | | | |
| Operating and production | | $ 713,008 | $ - | $ 713,008 |
| General and administrative (Note 15) | | 613,033 | - | 613,033 |
| Share-based payments | c) | 22,075 | (13,685) | 8,390 |
| Depletion and depreciation | | 159,685 | - | 159,685 |
| | | (1,507,801) | 13,685 | (1,494,116) |
| Loss on re-measurement of equity investee | | (51,323) | - | (51,323) |
| Recovery of allowance for doubtful accounts | | 44,850 | | 44,850 |
| Interest and financing charges | a) | (62,999) | 3,276 | (59,723) |
| **Net loss and comprehensive loss for the year** | | **$ (271,352)** | **$ 16,961** | **$ (254,391)** |

**Comment [AS1]:** Should be u nder financing?

(Expressed in Canadian dollars)

## 21. First Time Adoption of IFRS (cont'd...)

**Reconciliations from Canadian GAAP to IFRS** (cont'd...)

Statement of Cash Flows for the year ended September 30, 2011

| | Note | GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | |
| Loss for the year | a) c) | $ (271,352) | 16,961 | $ (254,391) |
| Interest on decommissing liabilities | a) | 6,223 | (3,276) | 2,947 |
| Depletion and amortization | | 159,685 | - | 159,685 |
| Share-based compensation | c) | 22,075 | (13,685) | 8,390 |
| Loss on investment | | 51,323 | - | 51,323 |
| Gain on allowance for doubtful accounts | | (44,850) | - | (44,850) |
| Changes in non-cash working capital | | | | |
| Accounts receivable | | 360,161 | - | 360,161 |
| Accounts payable and accrued liabilities | | (195,437) | - | (195,437) |
| Payable to related parties | | 1,644 | - | 1,644 |
| Net cash provided by operating activities | | 89,472 | - | 89,472 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | |
| Additions of oil and gas properties | | (54,374) | - | (54,374) |
| Additions of E&E | | (17,253) | | (17,253) |
| Additions of equipment | | (2,186) | - | (2,186) |
| Property advance | | 525,530 | - | 525,530 |
| Net cash provided by investimg activities | | 451,717 | - | 451,717 |
| Change in cash and cash equivalents during the year | | 541,189 | - | 541,189 |
| | | | | - |
| Cash and cash equivalents, beginning of year | | 71,634 | - | 71,634 |
| | | | | - |
| Cash and cash equivalents, end of year | | $ 612,823 | - | $ 612,823 |

**21. First Time Adoption of IFRS** (cont'd...)

**Notes to the IFRS Reconciliation**

**a) Decommissioning liabilities**

In accordance with IFRS transitional provisions for assets, the Company re-measured the liability associated with its decommissioning liabilities activities at the date of transition, resulting in an increase in decommissioning liabilities of $16,840 at October 1, 2010, and a corresponding increase in interest expense. The difference between Canadian GAAP and IFRS asset retirement obligations related primarily to discount rates.

As at September 30, 2011, an additional liability of $11,370 was recognized, oil and gas interests increased by $14,646, and net loss for the year decreased by $3,276 to reflect the impact of the change in interest charges.

**b) Exploration and evaluation assets**

Under IFRS 6, the Company has accessed the classification of activities designated as developmental or exploratory which then determines the accounting treatment of the costs incurred. The Company has presented capitalized costs associated with exploration activities of unproved properties separately on the statement of financial position as "exploration and evaluation assets". No costs were reclassified as at October 1, 2010. As at September 30, 2011, $17,253 was reclassified from oil and gas interests to exploration and evaluation assets.

**c) Share based payments**

Under IFRS 2, where share based payment transactions vest in instalments, IFRS 2 requires that each tranche within the award be treated as a separate award. Compensation cost for each tranche is recognized over its own distinct vesting period. At October 1 2010, deficit was increased by $13,685 to account for this graded vesting. For the year ended September 30, 2011, net loss decreased by $13,685. All of the options were fully vested as at September 30, 2011.

**22. Subsequent Events**

1. The Company intends to complete a private placement at $0.10/ share. This transaction has not closed as at the date of these financial statements.

2. The Company took over 40% working interests in Frog Lake well (00/07-17-057-03W4/0) from the original farmee for a consideration of one dollar. After the transaction, the Company owns 100% working interest in the well, subject to gross override royalty.