GREENFIELDS PETROLEUM CORPORATION

Consolidated Financial Statements

For the years ended
December 31, 2012 and 2011

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To the Shareholders of Greenfields Petroleum Corporation:

We have audited the accompanying consolidated financial statements of Greenfields Petroleum Corporation (the "Company"), which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, and the consolidated statements of net loss, comprehensive loss, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements.

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 as issued by the International Accounting Standards Board, 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.

Auditor's 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

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 auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Greenfields Petroleum Corporation as at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which indicates that the Company incurred a net loss of $16.1 million and had negative cash flow from operating activities of $14.5 million as at December 31, 2012. These conditions, along with the other matters as set forth in Note 2, indicate the existence of material uncertainties that cast significant doubt about the Company's ability to continue as a going concern.

We also draw attention to Note 27 to the consolidated financial statements which describes the restatements of the consolidated statement of financial position, the consolidated statement of net loss and comprehensive loss and the consolidated statement of changes in equity as at and for the year ended December 31, 2011 related to the expensing of $8.0 million categorized as advances for capital equipment on the previously issued consolidated financial statements of the Company. Our opinion is not qualified in respect of this matter.

Deloitte LLP

Chartered Accountants
May 3, 2013
Calgary, Alberta

GREENFIELDS PETROLEUM CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
US$000's

	Notes	As at December 31, 2012	As at December 31, 2011
			Restated (Note 27)
Assets			
Current Assets			
Cash and cash equivalents	5	15,419	25,289
Short term investments	6	1,693	3,488
Trade receivables	7	3,591	3,310
Receivables from related parties	8	4,401	1,838
Other receivable		300	61
Advances for operating services		134	-
Prepaid expenses and deposits	9	119	310
Inventories	10	1,590	2,263
		27,247	36,559
Non-Current Assets			
Investments		-	228
Note receivable from related party	8	37,919	8,965
Advances for capital equipment	11	386	2,752
Property and equipment	11	24,763	4,583
		90,315	53,087
Liabilities and Equity			
Current Liabilities			
Accounts payable and accrued liabilities	12	12,968	4,255
Short term borrowing	13	-	1,018
Provisions	14	-	1,000
Payables to related parties	8	902	612
Warrants	16	-	976
		13,870	7,861
Non-current Liabilities			
Notes payable to related parties	8	38,118	16,745
Convertible Debentures	15	20,542	-
Shareholders' Equity			
Common shares	17	16	15
Paid in capital		61,519	56,705
Share-based payments reserve	18	4,337	3,830
Deficit		(48,098)	(32,023)
Investments revaluation reserve		11	(46)
Total Shareholders' Equity		17,785	28,481
(Basis of presentation and going concern – Note 2 and Commitments and contingencies – Note 24)		90,315	53,087

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

(signed) "John W. Harkins"
John W. Harkins
Director

(signed) "Gerald F. Clark"
Gerald F. Clark
Director

GREENFIELDS PETROLEUM CORPORATION
CONSOLIDATED STATEMENTS OF NET LOSS

US$000's except per share amounts

	Years Ended December 31,	
	2012	2011
		Restated (Note 27)
Revenues		
Petroleum and natural gas	22,134	20,974
Transportation and storage fees	1,827	2,134
Management service fees	2,737	3,693
	26,698	26,801
Expenses		
Operating	21,150	20,407
Transportation	333	146
Exploration and evaluation	1,726	1,011
Asset impairment *(Note 11)*	1,800	8,040
Pre-licensing costs	613	2,613
Administrative *(Note 23)*	18,080	15,347
Depreciation and amortization *(Note 11)*	912	168
	44,614	47,732
Loss from operating activities	(17,916)	(20,931)
Dividends, interest and other income *(Note 19)*	(1,442)	(494)
Interest expense *(Note 19)*	3,208	293
Loss on investments	-	108
Impairment of receivables recovery *(Note 8)*	(1,087)	1,087
Provisions*(Notes 18)*	(125)	1,954
Foreign exchange loss	592	-
Change in fair value of derivative liability *(Note 15)*	(2,646)	-
Change in fair value of warrants *(Note 16)*	(341)	(1,225)
Loss before income taxes	(16,075)	(22,654)
Deferred income tax expense (recovery) *(Note 22)*	-	1,924
Net Loss	(16,075)	(24,578)
Per share		
Net loss per share, basic and diluted *(Note 17)*	($1.04)	($1.66)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

US$000's

	Years Ended December 31,	
	2012	2011
Net Loss	(16,075)	(24,578)
Gain (Loss) arising from revaluation of available for sale financial assets during the year	57	(46)
	57	(46)
Total comprehensive loss	(16,018)	(24,624)

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

GREENFIELDS PETROLEUM CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

US$000's

	Years Ended December 31, 2012	2011 Restated (Note 27)
Common shares *(Note 17)*		
Balance, beginning of year	15	15
Warrants/Options exercise	1	-
Balance, end of year	16	15
Paid in capital		
Balance, beginning of year	56,705	56,526
Issued pursuant to private placements	-	-
Repurchase of common shares	(138)	(208)
Share issue costs	-	(55)
Exercise of options	1,343	-
Warrant exercise and liability reclassification	3,237	44
Share-based payments	254	62
Excess tax benefit - share grants	-	336
Forfeiture of share options	118	-
Balance, end of year	61,519	56,705
Share-based payments reserve *(Note 18)*		
Balance, beginning of year	3,830	1,361
Share-based payments	1,389	2469
Share options exercised and other adjustments	(882)	-
Balance, end of year	4,337	3,830
Deficit		
Balance, beginning of year	(32,023)	(7,445)
Net loss	(16,075)	(24,578)
Balance, end of year	(48,098)	(32,023)
Investment revaluation reserve		
Balance, beginning of year	(46)	-
Unrealized gain on short term investments	57	(46)
Balance, end of year	11	(46)
Total Shareholders' Equity	17,785	28,481

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

GREENFIELDS PETROLEUM CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
US$000's

	Years Ended December 31,	
	2012	2011 Restated (Note 27)
Operating Activities		
Loss before income taxes	(16,075)	(22,654)
Items not affecting cash:		
Share-based compensation *(Note 18)*	1,367	2,531
Depreciation and amortization	912	168
Asset impairment *(Note 11)*	1,800	8,040
Dividends and interest from short term investments	(69)	(223)
Interest income related party notes	(1,373)	(265)
Interest expense long term debt	1,818	-
Interest expense note payable related party	1,390	293
Unrealized FX loss	576	-
Provision *(Note 18)*	(125)	-
(Gain)Loss from derivative liability *(Note 15)*	(2,646)	-
Cash interest income	-	40
Change in fair value of warrants *(Note 16)*	(341)	(1,225)
Cash used in operating activities before changes in non-cash working capital	(12,766)	(13,295)
Change in non-cash operating working capital *(Note 21)*	(1,777)	489
Cash From (Used in) Operating Activities	(14,543)	(12,806)
Financing Activities		
Proceeds from issue of common shares	3,581	28
Share issue costs	-	(55)
Convertible debenture proceeds	22,925	-
Convertible debenture issue costs	(1,197)	-
Cash interest paid on convertible debentures	(1,077)	-
Repurchase of common shares	(138)	(208)
Change in non-cash working capital *(Note 21)*	-	(318)
Proceeds from related party notes payable *(Note 8)*	19,983	16,452
Cash From (Used in) Financing Activities	44,077	15,899
Investing Activities		
Property and equipment	(5,887)	(2,947)
Advances for capital equipment	(8,427)	(10,792)
Notes receivable from related parties	(27,581)	(8,700)
Short term investments *(Note 6)*	1,865	(3,578)
Cash dividends received	-	117
Cash interest received	58	56
Dividends from equity investment	237	63
Cash Used in (From) Investing activities	(39,735)	(25,781)
Effect of exchange rates on changes on cash	331	-
(Decrease) Increase in Cash and Cash Equivalents	(9,870)	(22,688)
Cash and Cash Equivalents, beginning of year	25,289	47,977
Cash and Cash Equivalents, end of year *(Note 5)*	15,419	25,289

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

1. INCORPORATION AND NATURE OF OPERATIONS

Greenfields Petroleum Corporation ("**Greenfields**" or the "**Company**"), incorporated in the Cayman Islands, is a junior oil and natural gas exploration and development corporation focused on the development and production of proven oil and gas reserves principally in the Republic of Azerbaijan ("**Azerbaijan**"). The head office of the Company is located at 211 Highland Cross Drive, Suite 227, Houston, Texas, 77073, U.S.A., and the registered office is located at Walker House, 87 Mary Street, Grand Cayman, KY1-9005, Cayman Islands. The Company's common shares and convertible debentures are listed on Toronto's TSX – Venture Exchange ("**TSX-V**") under the trading symbols "GNF" and "GNF.DB", respectively.

On December 22, 2009, Bahar Energy Limited ("**Bahar Energy**"), a joint venture in which the Company owns a 33.33% interest, entered into an Exploration, Rehabilitation, Development and Production Sharing Agreement (the "**ERDPSA**") with the State Oil Company of Azerbaijan ("**SOCAR**") and its affiliate SOCAR Oil Affiliate ("**SOA**") in respect of the offshore block known as the Bahar Project, which project consists of the Bahar Gas Field and the Gum Deniz Oil Field. Bahar Energy has an 80% participating interest, and SOA has a 20% participating interest, in the ERDPSA (together the "**Contractors** or **Contractor Parties**"). Bahar Energy Operating Company Limited ("**BEOC**") was formed for the purpose of acting as Operator of the Bahar Project on behalf of the Contractor Parties under the ERDPSA.

For the first three years of the ERDPSA, 5% of the production (referred to as "Compensatory Production") is delivered to SOCAR. In year four, the percentage increases to 10% of production until the cumulative Compensatory Production delivered equals a specified target amount for oil and for natural gas, calculated separately.

On April 27, 2010, the Azerbaijan Parliament, also referred to as Milli Mejlis, ratified the ERDPSA with SOCAR and its affiliate SOA. On September 29, 2010, the Company was notified by SOCAR that all conditions precedent of the ERDPSA were satisfied and the ERDPSA became effective on October 1, 2010.

Upon assuming control of operations on October 1, 2010, Bahar Energy was required to complete and submit to SOCAR within 90 days the draft rehabilitation and production plan for the Bahar and Gum Deniz fields. The plan, referred to as the "Rehabilitation and Production Programme", was submitted to SOCAR in late December 2010. Under the ERDPSA, Bahar Energy will have the obligation to achieve, not later than three (3) years from the date of SOCAR's approval of the "Rehabilitation and Production Programme", an average daily rate of petroleum production from the contract rehabilitation area during ninety (90) consecutive days of 150% of the average 2008 production rates. The average 2008 production rate was the equivalent of 6,944 boe/d. Meeting the 150% production rate will result in the realization of the full 25 year term of the agreement for the Contract Rehabilitation Area. If Bahar Energy fails to meet the 150% production target within the three year timeframe, SOCAR shall have the right to terminate the ERDPSA in relation to the Contract Rehabilitation Area at their option. Approval of the "Rehabilitation and Production Programme" was received from SOCAR on June 22, 2011 establishing the start date for the three year period in which the production rate target must be met.

In addition to the 150% production levels for continuance of the ERDPSA for the 25 year term, Bahar Energy is obligated to carry SOA's 20% share of expenditures in the rehabilitation area until production rates are two times the 2008 production rates, or the equivalent of 9,259 boe/d, at which time SOA becomes fully responsible for funding their share of expenditures. The SOA carry for the rehabilitation area is reimbursed out of SOA's share of entitlement petroleum or revenues currently produced from the rehabilitation area. Any unrecovered balance is carried forward from one period to the next.

Operating Environment of the Company

The Republic of Azerbaijan displays certain characteristics of an emerging market, and, as such the operations of Bahar Energy are exposed to various levels of political, legal, and other risks and uncertainties including fluctuation in currency exchange rates, high rates of inflation, corruption, changes in taxation policies, changing political condition, currency controls and governmental regulations that favor the awarding of contracts to local contractors. The future economic direction of the country is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory and political developments. Management is unable to predict all developments which could have an impact on the Azerbaijani economy and consequently what effect, if any, they could have on the future financial position of the Company. Management believes it is taking all the necessary measures to support the sustainability and development of the Company's business.

2. BASIS OF PRESENTATION AND GOING CONCERN

These consolidated financial statements have been prepared in accordance with *International Financial Reporting Standards ("**IFRS**")* as issued by the *International Accounting Standards Board ("**IASB**")*.
These consolidated financial statements were approved by the Audit Committee of the Company's Board of Directors on May 3, 2013.

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments (warrants and convertible debentures) and share-based compensation transactions which are measured at fair value as discussed in *note 3 – Significant Accounting Policies*.

The Company is producing, developing and exploring oil and gas properties. The recovery of amounts capitalized for oil and gas properties and assets under construction in the statement of financial position are dependent upon its ability to increase production and complete the development of properties, including related financing requirements.

The Company incurred a loss of $16.1 million (2011 - $24.6 million) and had operating cash outflows of approximately $14.5 million (2011 - $12.8 million) during the year ended December 31, 2012. In addition, the Company had working capital of approximately $13.4 million as at December 31, 2012. Consequently, the Company's ability to continue as a going concern is dependent on management's ability to obtain additional financing, and, ultimately, the Company achieving profitable operations. The Company plans to raise equity or debt over the next twelve months to meet its commitments and obligations. However, there are no assurances it will be able to raise additional capital or that it will be on favorable terms. Without access to additional financing in 2013, there is significant doubt that the Company will be able to continue as a going concern due to, but not limited to:

a) The minimum work commitments and financial obligations required under the ERDPSA (*See Note 24 – Commitments and Contingencies*) raises doubt over the Company's ability to fund its commitments as they come due. If the Company fails to make its commitments and obligations in the prescribed timeframes, the Company could be at risk of losing its rights in the joint venture; and

b) Uncertainty related to expenditures associated with the 2013 Bahar Annual Work Program and Budget may impact the Company's working capital requirements.

These consolidated financial statements do not give effect to adjustments that would be necessary to the carrying values and classifications of assets and liabilities should the Company be unable to continue as a going concern.

The presentation and functional currency of the Company is the United States dollar.

3. SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Interests in jointly controlled entities are accounted for using the proportionate method of consolidation whereby the Company's proportionate share of revenues, expenses, assets and liabilities are included in the accounts. Inter-company transactions and balances are eliminated upon consolidation.

Investments in companies

Investments in affiliated companies over which the Company does not have control, but exercises significant influence, are accounted for on an equity basis. The carrying value is adjusted thereafter to include the Company's pro rata share of post-acquisition income of the investee, computed using the consolidation method, and is reduced by profit distributions received or receivable from the investee. The Company discontinues the use of the equity method from the date when it ceases to have significant influence over an investment and accounts for the investment as a financial instrument, subsidiary or a joint venture as appropriate.

Investments in companies in which the Company does not maintain significant influence or joint control are accounted for on the cost basis.

Critical judgments and estimation uncertainty

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the consolidated statement of financial position as well as the reported amounts of revenues, expenses, and cash flows during the years presented. Such estimates relate primarily to unsettled transactions and events as of the date of the consolidated financial statements.

In particular, the amounts recorded for depletion and depreciation of property and equipment, the provision for asset retirement obligations ("**ARO**") and the test for impairment and impairment reversals of property and equipment are based on estimates of oil production rates, commodity prices, future costs and other relevant assumptions.

Compensation costs recorded for the share option plan as well as the fair value measurement of the warrants are subject to estimation as they are calculated using the Black-Scholes option pricing model which is based on significant assumptions such as volatility, dividend yield, expected term and forfeiture rate.

Warrants, if converted by the holder, are settled in common shares at the option of the holder. This obligation results in a derivative liability in accordance with IFRS standards. As a result of measuring the liability at fair value under IFRS, fluctuations in the estimated fair value will affect the derivative liability gains and losses that are recognized. The fair value of the liability is determined using the Black Scholes valuation model which is based on the period end share price and the exercise price of the warrants, and assumptions for the risk-free interest rate, expected dividends, and the volatility of the share price. The fair value re-measurement process requires significant judgment and estimates and as such, the actual settlement of the derivative liability could differ materially from the fair value recorded and could impact future results.

The fair valuation of the convertible debentures embedded derivative employs a pricing model. The model requires estimates and assumptions to be made with regard to the model's inputs, with the main assumptions relating to share price volatility and the market interest rate which is based on credit ratings. Changes in assumptions about these factors could affect the reported fair value of the financial liability.

The measurement of income tax expense and the related assets on the consolidated statement of financial position is subject to uncertainty associated with future recoverability of oil and natural gas reserves, commodity prices, the timing of future events and changes in legislation, tax rates and interpretations by tax authorities.

Actual results could differ from these estimates and the differences could be material. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized prospectively.

Cash and cash equivalents

Cash and cash equivalents include bank deposits and money market investment accounts with maturities of three months or less when purchased.

Accounts receivable

Accounts receivable are recorded based on the Company's revenue recognition policy. The allowance for doubtful accounts provides for specific doubtful receivables, as well as general counterparty credit risk evaluated using observable market information and internal assessments.

Exploration and evaluation costs ("E&E")

Oil and gas exploration, development and production costs are accounted for using the modified successful efforts method. As such, pre-license costs, geological and geophysical costs, lease rentals of undeveloped properties and dry hole and bottom hole contributions are charged to expense when incurred.

All other E&E costs are capitalized, including the cost of acquiring unproved properties and the costs associated with drilling exploratory wells. When recoverable reserves are determined, the relevant expenditure is tested for potential impairment and then transferred to property and equipment. However, if recoverable reserves have not been established, the capitalized costs are charged to expense after the conclusion of appraisal activities. Exploration well costs for which sufficient reserves have been found to justify commercial production will continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well and/or related project. When this is no longer the case, the costs are written off.

Property and equipment ("P&E")

P&E is stated at cost less accumulated depreciation and impairment charges and includes the costs of transfers of commercially viable and technically feasible E&E assets, oil and gas development and production assets and Company assets. The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning liability and capitalized borrowing costs for qualifying assets.

Major replacements are capitalized if it is probable that future economic benefits associated with the item will flow to the Company; the replaced asset is derecognized. Repair and maintenance costs are charged as an expense when incurred.

Depreciation and amortization

Capitalized costs of oil and gas properties are depleted using the unit of production method; acquisition costs of properties are amortized over the Company's best estimate of recoverable reserves. For purposes of these calculations, production and reserves of natural gas are converted to barrels on an energy equivalent basis at a ratio of six thousand cubic feet of natural gas for one barrel of oil. To the extent significant development costs are incurred in connection with undeveloped reserves, such costs are excluded from depletion until the reserves are developed and the assets are ready for their intended use.

The Company's other assets consist mainly of leasehold improvements, computers, software, furniture and fixtures, and support equipment not directly related to oil and gas properties. For these assets depreciation methods and rates have been selected so as to amortize the net cost of each asset over its expected useful life to its estimated residual value.

For assets other than oil and gas properties associated with the Company's proportionate share in the Bahar Energy ERDPSA, depreciation is recorded over the useful life of the asset or the expected economic term of the ERDPSA, whichever is less. Residual values for these assets are assumed to be zero as ownership transfers to SOCAR once all capital costs have been recovered by Contractors. The Contractors to the ERDPSA and BEOC have continued rights to use these assets after transfer over the economic life of the contract.

Financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired except those reported at fair value through profit or loss. If evidence exists, the measurement of impairment depends on the type of financial asset under review.

The impairments of unquoted equity instruments that are not carried at fair value because their fair value cannot be reliably measured, are measured as the difference between the original carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for similar financial assets (if lower); this impairment loss cannot be reversed.

The impairments of assets carried at amortized cost are measured as the difference between the assets carrying amount and the present value of future cash flows discounted at the original effective interest rate. These impairment losses can be reversed if the decrease in impairment can be related objectively to an event occurring after the impairment was recognized.

Non-financial assets

Non-financial assets are assessed for indications of impairment or reversals of previous impairments at the end of each reporting period. If any indication of impairments exists, the recoverable amount of the assets is estimated and, if the carrying amount exceeds the recoverable amount, an impairment loss is recognized for the difference. An asset's recoverable amount is the higher of its 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 of the time value of money and the risks specific to the asset. In determining fair value less cost to sell, recent market transactions are taken into account, if available. If no transactions can be identified, an appropriate valuation model is used.

Impairment is measured for individual assets unless the asset does not generate separately identifiable cash inflows, in which case it is measured for the cash-generating unit ("**CGU**") that the asset belongs to. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

E&E assets are tested for impairment when indicators of impairment exist or when technical feasibility and commercial viability are established and the assets are reclassified to P&E. E&E assets are allocated to related CGUs when they are assessed for impairment, but the group of CGUs cannot exceed the operating segment. E&E assets that are determined not to be technically feasible and commercially viable are charged to profit or loss.

A previously recognized impairment loss (on assets other than goodwill) is reversed to the extent that the events or circumstances that triggered the original impairment have changed. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, or exceed the carrying amount that would have been determined, net of depreciation and amortization ("**D&A**"), had no impairment loss been recognized for the asset in prior years.

Share-based payments

Share-based payment costs attributed to all share options granted to employees, directors and service providers are measured at fair value at the date of grant using the Black-Scholes option pricing model and expensed over the vesting period with a corresponding increase to employee benefits reserve. Upon exercise of stock options, the consideration received, together with the amount previously recognized in share-based payments reserve, is recorded as an increase to common stock and paid in capital.

Income taxes

Income tax is recognized through profit or loss except to the extent that it relates to items recognized directly in shareholders' equity, in which case the income tax is recognized directly in shareholders' equity.

The Company uses the liability method to account for income taxes. Under this method, deferred income taxes are based on the difference between assets and liabilities reported for financial accounting purposes from those reported for income tax. Deferred income tax assets and liabilities are measured using the substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. Deferred income tax assets are recognized to the extent future recovery is probable. Deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered due to the uncertainty of timing or to the extent that other events not directly controlled by the Company must occur to allow future asset recovery. Deferred tax assets and tax liabilities are offset to the extent there is a legal right to settle on a net basis.

Revenue recognition

Revenues from the sale of crude oil, natural gas and natural gas liquids are recognized when title passes from the Company to its customer. Crude oil, condensate and natural gas produced and sold by the Company below or above its entitlement share in the related resource properties results in production underliftings or overliftings. Underliftings are recorded as inventory and overliftings are recorded as deferred revenue.

Revenue represents the Company's share of entitlement pursuant to the ERDPSA with SOCAR and does not include the government's share of profit sharing petroleum.

BEOC sells natural gas under a contract which includes clauses for Minimum Annual Quantity ("**MAQ**") and Minimum Payment Price ("**MPP**"). These clauses stipulate that when the buyer does not take the MAQ volumes, it will pay for the shortfall volumes at the MPP and it has twenty-four months to make-up the volumes and pay the difference between the contract price and the MPP or after twenty-four months buyer forfeits rights to the undelivered gas and the MPP paid for those volumes. The Company initially recognizes undelivered natural gas volumes as a deferred credit at the MPP value until which time the buyer either settles and revenue is recorded at the contract price or after twenty-four months the buyer forfeits rights in the undelivered gas and revenue is recorded at the MPP.

Transportation fees represent revenue for hydrocarbon volumes transported by the Company for another producer who requires pipeline access to oil markets. Storage fees represent revenue for storing, handling and other processing for the same previously mentioned producer who lacks its own field facilities. The transportation and storage fees are recognized on a monthly basis when earned and when ultimate collection is reasonably assured.

Management service fees represent revenue for administrative, operational and technical support provided to Bahar Energy and a legal entity in which the Company has an equity investment. The management fees are recognized on a monthly basis when earned and when ultimate collection is reasonably assured.

Interest income is recognized as earned, over the term of the investment.

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 recognizing the present value of the estimated future cash flows, discounted using a risk-free rate.

Asset retirement obligations

The Company, under the ERDPSA in Azerbaijan, will be responsible for the funding into an abandonment fund for the abandonment of assets managed under the agreement. For the Contract Rehabilitation Area, the obligation is to establish an Abandonment Fund escrow account and make systematic contributions into the fund which are immediately chargeable as operating costs for cost recovery purposes. The Company does not have abandonment obligations beyond this funding requirement. The maximum contractual commitment of the contractor parties is to fund up to 15% of cumulative capital costs.

Under the terms of the ERDPSA and the approved protocol regulating the formation of the Abandonment Fund for the Contract Rehabilitation Area, an abandonment plan with cost estimate shall be completed no later than one year prior to the tenth calendar year following the commencement date of June 22, 2011 with funding of the Abandonment Fund to commence July 1, 2021. The calculation of the quarterly amounts to be funded into the Abandonment Fund are based on the estimated abandonment costs (limited to 15% of cumulative capital costs), cumulative production from the date the Abandonment Fund is established and estimated remaining recoverable reserves.

For the Contract Exploration Area under the ERDPSA, no abandonment obligation exists until there has been a commercial discovery and cumulative production from this contract area reaches 50% of the recoverable reserves identified in the development plan. At that time, the same funding procedures noted for the Contract Rehabilitation Area will be employed. There is no abandonment obligation in the event that Bahar Energy terminates the ERDPSA or if the exploration term for the Contract Exploration Area is allowed to expire.

The Company will record expenses associated with the abandonment funding obligations as they become contractually due. Since this is a financial obligation only to make systematic cash deposits into the Abandonment Funds, which are then reimbursed through cost recovery under the ERDPSA, the Company records no ARO associated with the Bahar project and currently has no other assets that require abandonment recognition.

Carried interest

The Company conducts certain international operations jointly with foreign governments in accordance with production-sharing agreements pursuant to which proved reserves are recognized using the economic interest method. Under these agreements, the Company pays both its share and the government's share of operating and capital costs. The Company recovers the government's share of these costs from future revenues or production over several years. The government's share of operating costs is included in operating expense when incurred, and capital costs are included in P&E and expensed to DD&A in the period recovered. All recoveries are recorded as revenue in the period of recovery.

Leases

The Company classifies leases entered into as either finance or operating leases. Leases that transfer substantially all of the benefits and risks of ownership to the Company are accounted for as finance leases, which are capitalized and are amortized on a straight-line basis over the period of expected use. Rental payments under operating leases are expensed as incurred.

Per share amounts

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated based on the treasury stock method, which assumes that any proceeds obtained on the exercise of in-the-money stock options and warrants would be used to purchase common shares at the average market price during the period.

Financial instruments

Financial instruments are measured at fair value on initial recognition of the instrument, into one of the following five categories:

- fair value through profit or loss ("**FVTPL**")
- loans and receivables
- held-to-maturity investments
- available for-sale financial assets or
- other financial liabilities

Subsequent measurement of financial instruments is based on their initial classification. Financial assets and financial liabilities are either classified as FVTPL or "designated at fair value through profit or loss" and are measured at fair value and changes in fair value are recognized in profit or loss. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. The remaining categories of financial instruments are measured at amortized cost using the effective interest rate method.

Transaction costs related to financial assets and liabilities at fair value through profit or loss are recognized in profit or loss when incurred transaction costs are added to the fair value of the all other financial instruments on initial recognition.

Derivative instruments are carried at fair value and reported as assets when they have a positive fair value and as liabilities when they have a negative fair value. Derivatives may be embedded in other financial instruments or contractual arrangements. Derivatives embedded in other instruments are valued as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract, the terms of the embedded derivative are the same as those of a free standing derivative and the combined contract is not held for trading. When the Company is unable to measure the fair value of the embedded derivative separately, the combined contract is treated as a financial asset or liability that is FVTPL and measured at fair value with changes therein recognized in profit or loss.

Convertible Debentures

On issuance the convertible debentures are recognized in accordance to its components into a financial liability and an equity conversion feature. The debentures represent a liability in its entirety, as the conversion feature does not meet the fixed-for-fixed requirement for equity classification due to instruments being denominated in Canadian dollars while the functional currency of the Company is the U.S dollars, the convertible feature is required to be fair valued at each statement of financial position date using an options pricing model with changes in fair value (including the foreign exchange impact) recognized in profit or loss.

Warrants

Warrants have an exercise price denominated in Canadian dollars while the Company's functional currency is U.S. dollars. As the amount of U.S. dollars that the Company will ultimately receive for each share issued is variable, the warrants must be classified as a financial liability at fair value through profit or loss. Accordingly, they are measured at fair value each statement of financial position date using the Black-Scholes option pricing model with changes in fair value (including the foreign exchange impact) recognized in profit or loss.

Foreign currency translation

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The Company and its subsidiaries, joint ventures and partnerships have a United States ("**U.S.**") dollar functional currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation when items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Borrowing Costs

Borrowing costs that are directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use are capitalized as part of the cost of that asset. Borrowing costs are capitalized by applying interest rates attributable to the project being financed and includes both general and specific borrowings. Interests rates applied from general borrowings are computed using the weighted average borrowing rate for the period.

4. FUTURE ACCOUNTING CHANGES

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective as of December 31, 2012.

IFRS 9 "Financial Instruments"
This standard issued in November 2009 by the IASB 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 standard is required to be adopted for periods beginning January 1, 2015. The adoption of this standard should not have a material impact on the Company's consolidated financial statements.

In May 2011, the IASB issued IFRS 10 "Consolidated Financial Statement", IFRS 11 "Joint Arrangements", IFRS 12 "Disclosures of Interests in Other Entities", and amendments to IAS 27 "Separate Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures".

IFRS 10 "Consolidated Financial Statement"
The standard creates a single consolidation model by revising the definition of control in order to apply the same control criteria to all types of entities, including joint arrangements, associates and special purpose vehicles.

IFRS 11 "Joint Arrangements"
The standard establishes a principle-based approach to the accounting for joint arrangements by focusing on the rights and obligations of the arrangement and limits the application of proportionate consolidation accounting to arrangements that meet the definition of a joint operation.

IFRS 12 "Disclosures of Interests in Other Entities"
The standard consists of comprehensive disclosure requirements for all forms of interests in other entities, including joint arrangements, associates and special purpose vehicles.

IAS 27 "Separate Financial Statements"
The amended standard establishes 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.

IAS 28 "Investments in Associates and Joint Ventures"
The amended IAS 28 establishes the accounting for investments in associates and defines how the equity method is applied when accounting for associates and joint ventures.

Retrospective application of the five standards issued in May 2011, with relief for certain transactions, is effective for fiscal years beginning on or after January 1, 2013, with earlier application permitted if all five standards are collectively adopted. These five standards will be adopted by the Company for the annual period beginning January 1, 2013 and its implementation will have a significant impact on the Company's financial position and results. The application of IFRS 10 and 11 will result in changes in the accounting for the Company's jointly controlled entity currently accounted for using proportionate consolidation to the equity method of accounting (Note 20).

IFRS 13 "Fair Value Measurement"
The standard issued in May 2011 establishes a single source of guidance for all fair value measurements; clarifies the definition of fair value; and enhances the disclosures on fair value measurement. Prospective application of this standard is effective for fiscal years beginning on or after January 1, 2013, with early application permitted. The implementation of the issued standard is not expected to have a significant impact on the Company's financial position or results.

IAS 19 "Employee Benefits"
In June 2011, the IASB issued amendments to IAS 19 to improve the recognition and disclosure requirements for defined benefit plans. The new requirements are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. This amendment will not impact our financial statements.

IFRS 7 "Financial Instruments: Disclosures"
In December 2011, the IASB issued final amendments to IFRS 7 relating to the requirements for the offsetting of a financial asset and financial liabilities when offsetting is permitted under IFRS. The disclosure amendments are required to be adopted retrospectively for periods beginning January 1, 2013.

IAS 32 "Financial Instruments: Presentation"
In December 2011, the IASB issued amendments to IAS 32 to address inconsistencies when applying the offsetting criteria outlined in this standard. These amendments clarify the criteria required to be met in order to permit the offsetting of financial assets and financial liabilities. The standard is required to be adopted retrospectively for periods beginning January 1, 2014.

The Company intends to retrospectively adopt the IFRS 7 amendments on January 1, 2013 and the IAS 32 amendments on January 1, 2014. The adoption of these amended standards is not expected to have a material impact on the Company's consolidated financial statements.

5. CASH AND CASH EQUIVALENTS

The Company periodically invests its idle cash in deposits and short term money market investments with maturity dates of less than three months. At December 31, 2012, the Company had a total of $4.9 million (December 31, 2011 - $20.8 million) invested in cash equivalents earning a money market rate of interest.

Cash and cash equivalents include the Company's proportionate share of cash in Bahar Energy of $3.0 million at December 31, 2012 (2011 - $1.3 million).

6. SHORT TERM INVESTMENTS

(US$000's)	December 31, 2012	December 31, 2011
Corporate bonds at amortized cost	1,682	3,534
Fair market value adjustment	11	(46)
	1,693	3,488

The Company periodically invests in investment grade corporate bonds and income producing blue chip equity instruments. At December 31, 2012, the Company had a total of $1.7 million (December 31, 2011 $3.5 million) invested in BBB grade or better corporate bonds with maturities ranging from three to thirteen months. For the year ended December 31, 2012, the Company earned interest income from money market and bonds of $60 thousand (2011 $56 thousand).

7. TRADE RECEIVABLES

(US$000's)	December 31, 2012	December 31, 2011
Petroleum	2,867	1,923
Natural gas	452	529
Transportation and storage fees	272	858
	3,591	3,310

Petroleum and natural gas sales have an average collection cycle of 60 days from product lifting dates.

8. RELATED PARTY TRANSACTIONS

Current

Receivables from related parties

At December 31, 2012, the Company had a balance of $4.4 million (December 31, 2011 - $1.8 million) in accounts receivable with Bahar Energy. The receivable balance at December 31, 2011 was net of an impairment provision of $1.1 million related to pre-effective date costs billed to the Bahar project. As result of the Company collecting the $1.1 million in October 2012, a recovery of this prior receivable impairment was recorded in September 2012. Remaining balances due are attributable to work performed under Bahar Energy approved "Affiliate Service Orders" ("**ASO**"). Management does not believe balances due pose collection risk as these charges are associated with amounts invoiced in the normal course of business.

For the year ended December 31, 2012 the Company recorded $2.5 million (December 31, 2011 - $3.5 million) in management service fees for management, administrative and technical services performed at cost for Bahar Energy under ASO's noted above.

Payables to related parties

At December 31, 2012, the Company had a $ 0.9 million (December 31, 2011 $0.6 million) payable balance to certain shareholders of Bahar Energy, which included the Company, associated with amounts invoiced on ASO services and other direct invoicing for services provided by the Company to Bahar Energy and its subsidiary BEOC.

Under the terms of the ERDPSA, the affiliates of Bahar Energy, including the Company, may bill for management, administrative, support and technical support services provided to BEOC under ASO's. The billing rates are to be at the partners' cost and not to exceed commercial rates that would typically be charged by a third party. For the year ended December 31, 2012, the Company recorded $0.9 million associated with its proportionate share of costs billed by affiliates of Bahar Energy to BEOC (December 31, 2011 - $3.0 million), the majority of which were for services performed by the Company.

Non-Current

Note receivable from related party

At December 31, 2012, the Company has a note and interest receivable balance of $37.9 million (December 31, 2011 - $9 million) related to funding through loans made to Bahar Energy under the "Common Terms Agreement" ("**CTA**"). Interest accumulates at the three month average of annualized London Interbank Offer Rate ("**LIBOR**") quoted on a calendar quarter basis plus 4.5%. For the year ended December 31, 2012, the Company recorded interest income for $1.4 million (December 31, 2011 - $0.3 million).

Notes payable to related parties

At December 31, 2012, the Company, through its 33.33% interest in Bahar Energy, had a related party notes payable balance of $38.1 million (December 31, 2011 – $16.7 million), including interest, payable to shareholders of Bahar Energy. The notes and interest payable balance is the result of funding under the CTA between the shareholders of Bahar Energy whereby each shareholder agrees to grant a credit facility to Bahar Energy up to specific amounts during a commitment period, limited to the amounts included in the annual signed Loan Agreements, which are based on the annual work plan approved under the ERDPSA.

Bahar Energy may request a draw or advance under a Loan Agreement subject to the terms of the CTA. The proceeds from each loan that are advanced under the Loan Agreements are to be applied to funding costs associated with the approved Annual Work Program and Budget of the ERDPSA and for general corporate purposes as authorized by the shareholders of Bahar Energy. Interest accumulates at the three-month average of annualized LIBOR quoted on a calendar quarter basis plus 4.5%. Loan repayment will be funded from the future cash flows from operations under the ERDPSA in excess of Bahar Energy's funds required and retained for near term operations and adequate cash reserves. Because current projections of cash flows from the Bahar project to repay the loan extend beyond a twelve month period, the Company classifies both the "Notes receivable from related party" and the "Notes payable to related parties" as non-current assets and liabilities.

For the year ended December 31, 2012, the Company recorded interest expense related to notes payable to related parties of $1.4 million (December 31, 2011 - $0.3 million).

Compensation of key management personnel

Key management personnel include the Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Senior Vice President Exploration and Exploitation and Senior Vice President Operations. Compensation paid to and share-based compensation attributable to key management personnel consists of the following:

(US$000's)	December 31, 2012	December 31, 2011
Short-term benefits	2,138	1,543
Share-based payments	844	931
Termination benefits	-	182
	2,982	2,656

The compensation of directors and key executives is determined by the compensation committee having regard to the performance of individuals and market based.

9. PREPAID EXPENSES AND DEPOSITS

At December 31, 2012, the Company had non-refundable prepaid expenses and deposits balance of $0.1 million (December 31, 2011 - $0.3 million).

10. INVENTORIES

At December 31, 2012, the Company had inventories of $1.6 million (December 31, 2011 - $2.3 million), relating to operating materials and supplies consisting of spare parts, consumables, lubricants and fuel.

11. PROPERTY AND EQUIPMENT

(US$000's)	Assets Under Construction (1)	Oil and Gas Properties (1)	Corporate and Other	Total
Fixed Assets				
As at December 31, 2010	352	666	86	1,104
Additions	3,010	189	465	3,664
Transfers	(352)	352	-	-
As at December 31, 2011	3,010	1,207	551	4,768
Additions	20,299	-	793	21,092
Transfers	(7,816)	4,787	3,029	-
As at December 31, 2012	15,493	5,994	4,373	25,860
Accumulated DD&A				
As at December 31, 2010	-	3	14	17
Additions	-	69	99	168
As at December 31, 2011	-	72	113	185
Additions	-	578	334	912
As at December 31, 2012	-	650	447	1,097
Net property and equipment				
As at December 31, 2010	352	663	424	1,087
As at December 31, 2011	3,010	1,135	438	4,583
As at December 31, 2012	15,493	5,344	3,926	24,763

(1) Assets Under Construction and Oil and Gas Properties represent the Company's proportionate share in Bahar Energy.

At December 31, 2012 the Company has a balance of $0.4 million in non-refundable advances for capital equipment purchases (December 31, 2011 - $2.8 million). The balance at December 31, 2011 was primarily related to casing, tubing and wellhead equipment purchases for new drilling in the Gum Deniz and Bahar fields which were received and placed in inventory during 2012.

Asset Impairment

During 2012 the Company undertook a review of payments made to certain suppliers by their joint venture. As a result of this review, it was determined that the joint venture was charged amounts in excess of fair market value for certain well equipment and construction materials. As such, certain assets were deemed to exceed their recoverable amount at the asset level. Asset impairment reflects amounts expensed as a result of these excess amounts. For the year ended December 31, 2012, the Company recorded asset impairment expenses of $1.8 million (December 31, 2011 - $8.0 million).

Legal title to property and equipment

In accordance with the provisions of the ERDPSA, title to fixed and moveable assets will be transferred to SOCAR upon the earlier of the end of the calendar quarter following the date when all capital costs incurred by the Company are recovered or the termination of the ERDPSA. The definitions of operating costs and capital costs contained within the ERDPSA require subjective interpretation in determining the classification of these expenditures. The classification of these costs as operating expenditures is consistent with the annual work program and the budgets which have been approved by the Steering and Operating Committee of BEOC.

In accordance with the terms of the ERDPSA, Contractor parties and BEOC are granted the exclusive right of use for petroleum operations, without charge by SOCAR, all assets previously used by "Gum Adasi" Oil and Gas Production Division of SOCAR that existed prior to the ERDPSA effective date. These assets are made available for use in petroleum operations to the Company for the economic life of the ERDPSA. However, SOCAR retains the right of ownership to such capital assets, therefore the Company's property and equipment related to the ERDPSA do not include values of those assets transferred to the Company from SOCAR that existed prior to the effective date.

12. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

(US$000's)	December 31, 2012	December 31, 2011
Trade accounts payable	10,238	3,618
Accrued liabilities	2,730	617
Other payable	-	20
	12,968	4,255

13. SHORT TERM BORROWING

At December 31, 2012 the Company had no liability associated with short term borrowing (December 31, 2011 - $1.0 million). The balance at December 31, 2011 reflects the Company 33.33% share of a temporary bank loan arranged by BEOC to cover short-term working capital deficits which was repaid in January 2012.

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14. PROVISIONS

At December 31, 2012 the Company had a $nil balance in provisions (December 31, 2011 - $1.0 million) for potential claims settlement. The 2011 provision arose from a former consultant's claim which was settled by the Company in May 2012.

Provisions for other liabilities and Charges

(US$000's)	Amount
Balance December 31, 2010	-
Potential legal claim	1,000
Balance December 31, 2011	1,000
Legal Claim settled - balance transferred to accrued liabilities	(1,000)
Balance December 31, 2012	-

15. CONVERTIBLE DEBENTURES

On May 30, 2012 the Company issued CAD$23.7 million of convertible unsecured subordinated debentures (the "**Debentures**") for equivalent proceeds of USD$22.9 million. The Debentures pay a 9.0% annual rate of interest from the date of issue with interest payable semi-annually in arrears on May 31 and November 30 of each year starting on November 30, 2012 and will mature and be repayable on May 31, 2017 (the "**Maturity Date**").
Each CAD$1,000 Debenture principal amount can be convertible, at the option of the holder, at any time prior to the close of business on the earlier of the business day immediately preceding the Maturity Date and, if applicable, the last business day immediately preceding the date fixed for redemption, into approximately 117 common shares of the Company. The redemption ratio results from conversion price (the "**Conversion Price**") of CAD$8.55 per common share of the Company.

The Debentures cannot be redeemable by the Company prior to May 31, 2015. On or after June 1, 2015 and prior to the Maturity Date, the Debentures can be redeemable by the Company, in whole or in part, from time to time, at a price equal to the principal amount thereof, plus accrued and unpaid interest, at the Company's sole option provided that the common share current market price on the date on which notice of redemption is given is not less than 125% of the Conversion Price.

The Company has the option to satisfy its obligations to repay the principal amount of the Debentures upon redemption or at maturity by issuing and delivering that number of freely tradable common shares obtained by dividing the principal amount of the Debentures by 95% of the common share current market price on the date fixed for redemption or maturity, as the case may be.

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The following table summarizes the liability and derivative liability components of the convertible debentures:

	Financial Statement Components			
(US$000's)	Liability	Derivative Liability [1]	Carrying Value	Principal Amount
Issuance of convertible debenture [1]	15,804	5,924	21,728	22,925
Accretion	562	-	562	-
Change in fair value of derivative	-	(2,646)	(2,646)	-
Foreign exchange loss	644	253	898	922
Balance December 31, 2012	17,011	3,531	20,542	23,847

[1] On May 30, 2012 the Company issued CAD$23.725 million convertible debentures, equivalent to approximately USD$22.9 million as described above. The balance of the liability and derivative liability are net of transaction costs of approximately USD$1.6 million; USD$1.2 million was allocated to the liability and USD$0.4 million related to the derivative liability was expensed.

The liability portion of the Debentures is measured at amortized cost and accreted up to the principal balance at maturity using an effective interest rate of 19.4 percent. The accretion and the interest paid are expensed as interest expense in the consolidated statement of net loss. The derivative financial liability is measured at fair value through profit or loss, with adjustments recorded in "changes in fair value of derivative liability".
The fair value of the derivative financial liability is determined using the Binomial valuation model with the following assumptions:

	December 31, 2012
Market price per common share – CAD$	4.02
Conversion price per common share – CAD$	8.55
Risk-free interest rate range	1.35%
Expected life - years	4.48
Expected volatility	59.00%
Shares issuable at conversion	2,725,825

16. WARRANTS

(US$000's)	Warrants	Amount
Balance December 31, 2010	525,000	2,219
Fair Value Adjustment	-	(1,225)
Exercised (Exercise Price = CAD$5.00)	(5,500)	(18)
Balance December 31, 2011	519,500	976
Fair Value Adjustment	-	(341)
Exercised (Exercise Price = CND $5.00)	(519,500)	(635)
Balance December 31, 2012	-	-

During January and February 2012 all 519,500 warrants outstanding at December 31, 2011 were exercised. The Company raised CAD$2,597,500 (approximately $2,601,000) as a result of the warrants holders' exercise. All warrants issued pursuant to the private equity placement completed in February 2010 were exercised between the original issue date and the expiration date of February 24, 2012. For the year ended December 31, 2012 the Company recorded fair value adjustments to warrants of $0.3 million (December 31, 2011 - $1.2 million).

17. SHAREHOLDERS' EQUITY

Authorized Share Capital

Authorized share capital of the Company consists of 49,900,000 common shares and 100,000 preferred shares, each at US $.001 par value.

Common Shares

Each common share carries equal voting rights, is non-preferential and participates evenly in the event of a dividend payment or in the winding up of the Company.

Preferred Shares

The Board may issue Preferred Shares at any time and from time to time in one or more series. The Board has the authority to issue Preferred Shares in series and determine the price, number, designation, rights, privileges, restrictions and conditions, including dividend rights, conversion rights, and rights with respect to the distribution of assets in the event of the dissolution or winding up of the Corporation and preferential rights, of each series without further vote or action by shareholders.

There were no preferred shares issued and outstanding at December 31, 2012 and 2011.

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Common shares continuity schedule:

Outstanding common shares *(US$000's, except for share numbers)*	Number of Common Shares	Amount
As at December 31, 2010	14,866,021	56,541
Share issue costs	-	(55)
Repurchase of common shares	(20,641)	(208)
Warrants exercised	5,500	44
Share-based compensation	-	398
As at December 31, 2011	14,850,880	56,720
Warrants exercised	519,500	3,238
Share-based compensation 2012 awards	51,033	204
Share-based compensation	-	50
Repurchase of common shares	(20,026)	(138)
Exercise of share options	150,000	1,343
Forfeiture of share options	-	118
As at December 31, 2012	15,551,387	61,635

Reconciliation of issued and outstanding shares

	December 31, 2012	December 31, 2011
Issued	15,584,327	14,874,827
Shares acquired by Company	(43,973)	(23,947)
Shares issued from treasury	11,033	-
Total Outstanding	15,551,387	14,850,880

On June 30, 2011 all 23,947 shares acquired by the Company during 2010 and 2011 were cancelled. The Company further acquired 20,026 shares in February 2012. In September 2012 the Company issued a total of 11,033 shares from shares held in treasury and has a balance of 8,993 shares as at December 31, 2012. *(See Note 18 – Share-based Payments)*

Per Share Information

Per share loss *(US$000's, except for per share amount)*	December 31, 2012	December 31, 2011
Weighted average number of common shares outstanding	15,439,982	14,849,797
Net loss	(16,075)	(24,578)
Basic and diluted loss per share	($1.04)	($1.66)

The average market value of the Company's common shares used for purposes of calculating the dilutive effect of share options, convertible debentures and warrants is based on quoted market prices for the period that the equity instruments were outstanding. For the year ended December 31, 2012 the 1,291,000 options (December 31, 2011 – 1,392,250 options), nil warrants (December 31, 2011 – 519,500) and 2,725,825 shares issuable at conversion of debentures were excluded from calculating dilutive earnings per share as they were anti-dilutive.

Acquisition of common shares

In February 2012 the Company acquired 20,026 common shares at fair market value of CAD$6.00 per share (February 2011 – 20,641 at fair market value of CAD$10.00) from certain employees as a result of share grants vesting from the February 2, 2010 Long Term Incentive Plan ("**LTIP**"). The LTIP provides the opportunity to employees to pay cash or sell to the Company the number of shares equal to their statutory withholding tax due at vesting date in order to reimbursement the Company for remitting the employees' withholding tax obligation to the US Internal Revenue Service.

As a provision of the original 2010 LTIP, the Company is authorized to withhold from participants any amounts due in cash or shares for any applicable taxes payable at the minimum statutory rate in respect of the share grant awards. The tax withholding obligation of the participant in respect of the vesting share grants can be satisfied through the sale to the Company of such number of shares with a fair market value at vesting date equal to the tax withholding obligation.

In September 2012 the Company issued a total of 11,033 shares from shares held by the Company to cover an August 9, 2012 award to an officer of the Company. At December 31, 2012 the Company holds a balance of 8,993 shares (December 31, 2011 – nil).

The 20,641 shares acquired by the Company in February 2011 along with the 3,306 shares acquired during 2010 were cancelled June 30, 2011.

18. SHARE BASED PAYMENTS

The share-based payments recorded by the Company are associated with share options, restricted share grants and shareholder settled transactions. Share-based payment expenses for the year ended December 31, 2012 were $1.4 million (December 31, 2011 - $2.5 million).

Share Options

The Company has a stock option plan that governs the granting of options to employees, officers and directors. All options issued by the Company permit the holder to purchase a specific number of common shares of the Company at the stated exercise price. The Company has not issued stock options that permit the recipient to receive a cash payment equal to the appreciated value in lieu of stock.
As a provision of the Company's Stock Option Plan, the optionee may make the following election when exercising options at the discretion of the Compensation Committee:

> *When an optionee incurs a tax liability in connection with an option which is subject to tax withholding under applicable tax laws and the optionee is obligated to pay the Company the required withholding amount due, the optionee may satisfy the tax withholding obligation in two methods other than payment in cash; (i) by surrendering to the Company common shares that have been owned by the optionee for more than six months on the date of surrender with a market value equal to the withholding tax obligation or (ii) by electing to have the Company withhold from the common shares to be issued upon exercise of the options the number of common shares having a market value equal to*

All tabular amounts are expressed in US$000's unless otherwise stated except for share and per share amounts

the tax amount required to be withheld.

The fair value of each stock option granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2012	2011
Risk-free interest rate range	0.7%	0.9% - 2%
Expected life	4.0 years	4.0 years
Expected volatility	40%	47.25%
Expected dividend	-	-
Forfeiture	4%	-
Weighted average fair value	$1.07	$3.40

Continuity of Stock Options

	December 31, 2012		December 31, 2011	
	Number of shares underlying options	Average exercise price (CAD$)	Number of shares underlying options	Average exercise price (CAD$)
Outstanding, beginning of year	1,392,250	7.17	1,211,000	6.87
Granted	230,000	10.57	230,000	8.64
Forfeited	(181,250)	7.33	(48,750)	6.50
Exercised	(150,000)	6.50	-	-
Outstanding, end of year	1,291,000	7.83	1,392,250	7.17
Exercisable, end of year	933,250	8.08	721,750	6.98

The exercise prices of the share options ranges from CAD$6.00 to CAD$14.00 per common share with all options expiring on various dates between years 2016 and 2021. With the exception of the June 2012 150,000 share options award, the share options vest 25% at date of grant and 25% on each of the first, second and third anniversaries of the grant date. The 933,250 exercisable options as at December 31, 2012 have remaining contractual lives ranging from 4.1 to 8.4 years.

The fair value of each option granted is estimated at the time of the grant using the Black-Scholes option pricing model. For the 80,000 share options granted in February 2012 at an exercise price of CAD$6.00 per common share, the share options were fair valued on the date of grant using the Black-Scholes option pricing model assuming a risk-free interest rate of 0.71%, four years expected life, expected volatility of 40% and forfeiture rate of 4% resulting in a calculated options value of $0.1 million. The share options will vest 25% at date of grant and 25% each of the first, second and third anniversaries of the indicated grant date. The value associated with the first 25% of options vested on grant date was expensed during the period with the remaining 75% of the value amortized over each of the three vesting periods.

In June 2012 the Company completed the award of 150,000 share options at an average exercise price of CAD$13 per common share. The constructive obligation for this award was established in January 2012 and fair valued accordingly at $0.1 million using the Black-Scholes option pricing model assuming a risk-free interest rate of 0.71%, four years expected life and expected volatility of 40%. The share options will vest over a 12 month period, 1/12 each month. At December 31, 2012 100% of the award has been expensed.

Share options expenses for the year ended December 31, 2012 were $0.5 million (December 31, 2011 - $1.5 million).

Restricted Share Awards

On February 1, 2012 a 40,000 restricted share grant was awarded and shares issued by the Company to a new officer. The shares vest 25% at grant date and 25% on the anniversary date thereafter in 2013, 2014 and 2015. The shares were valued at CAD$6.00, the closing price of the Company's share on January 31, 2012, with the 25% vested on grant date included in the Company's share-based payments expense for the quarter. The remaining value of the unvested restricted share grant is amortized over the individual vesting periods.

For year ended December 31, 2012, the Company recorded share-based payments expense related to past and current share grants of $110 thousand (2011 - $62 thousand). Expenses associated with restricted share awards are recorded with an offset to share capital of the Company.

Share Awards

On August 9, 2012 the Company completed a grant of common shares and issued 11,033 common shares to an officer of the Company. The shares were valued at the closing price on the TSXV at June 4, 2012, that being CAD$4.80. For the year ended December 31, 2012, the Company recorded share-based payments expense related to this award of $84 thousand (2011 - $nil). The share-based payment expense is offset to share capital of the Company.

Restricted Cash Bonus Program

In June 2012 the Company established a Restricted Cash Bonus Program consisting of two cash settled incentives awarded in bonus units. The first incentive is the Full Value Based Cash Bonus ("**FVBCB**") with the cash settlement value of a bonus unit equal to the current market price of a common share of the Company on specific vesting dates. The second incentive is the Appreciation Based Cash Bonus ("**ABCB**") which is settled in cash when an awardee makes a call on vested bonus units with the value of the award calculated as the difference between the current market price of a common share of the Company at call date and the original grant price per bonus unit. The program does not grant any entitlement to common shares or other equity interest in the Company.

The FVBCB incentive awards vest in three tranches, 1/3 on each January 1 of the year immediately following the grant date and have a cash settlement on such vesting dates. The fair value of FVBCB awards were estimated considering forfeiture rates of 5% and 10% respectively for the second and third year of the award. The estimated FVBCB liability is amortized over the three year vesting period with each vesting tranche fully amortized at vesting date. The liability is also fair valued at each reporting date with adjustments recorded through profit and loss. The estimated FVBCB liability at December 31, 2012 was $0.3 million.

The ABCB incentive awards vest in four tranches, 25% at grant date and 25% on each January 1 of the year immediately following the grant date. The ABCB awards have a contractual life of five years and were fair valued using the Black-Scholes option pricing model assuming an average risk-free interest rate of 1.09%, two year expected life from its vesting date, average expected volatility of 58% and average forfeiture rate of 13%. The estimated ABCB liability is amortized over the vesting period and fair valued at each reporting date with the same Black-Scholes pricing model with adjustments recorded through profit and loss. The estimated ABCB liability at December 31, 2012 was $0.3 million.

Grant Date	FVBCB Units	ABCB Units	ABCB Units: Grant Price $CAD	Exercisable	Expiration Date	Remaining Contractual Life - Years
June 4, 2012	130,000	185,000	4.80	92,500	June 4, 2017	4.4
Sept. 4, 2012	10,000	10,000	5.65	5,000	Sept. 4, 2017	4.7
Oct. 5, 2012	20,000	30,000	5.63	15,000	Oct. 5, 2017	4.8
Dec. 1, 2012	3,600	3,600	4.80	1,800	Dec. 1, 2017	4.9
Dec. 24, 2012	172,500	232,500	3.50	58,125	Dec. 24, 2017	5.0
	336,100	461,100		172,425		

For year ended December 31, 2012, the Company recorded restricted cash bonus expense of $0.6 million (2011 - $nil).

Shareholder Settled Transactions

Under IFRS, when a shareholder transfers its own shares in a manner that benefits the Company, the Company must give recognition for the value of that transfer over the period in which the benefits are received. For the year December 31, 2012, the Company recorded $0.6 million (2011 - $nil) in share-based expenses for such transactions.

In December 2011 the Company recorded a $1.0 million provision expense associated with a claim shareholders of the Company anticipated settling through the transfer of their own shares to the claimant. For the year ended December 31, 2012, the Company has recorded a $125 thousand provision expense recovery to reflect the final settlement amount associated with this shareholder transaction. No treasury shares of the Company were issued as part of this settlement.

Share-based payments reserve

(US$000's)	Amount
Balance December 31, 2010	1,361
Stock options share-based payments	1,515
Share-based settlement provision	954
Balance December 31, 2011	3,830
Stock options share-based payments	839
Stock options share-based payments, benefits from shareholders	550
Share-based settlement provision	(125)
Exercised	(362)
Forfeitures	(395)
Balance December 31, 2012	4,337

19. DIVIDENDS, INTEREST INCOME, OTHER INCOME AND INTEREST EXPENSE

	Year ended December 31,	
(US$000's)	2012	2011
Dividend income	(9)	(117)
Interest income	(60)	(106)
Other income	-	(6)
Interest income – related party notes	(1,373)	(265)
Interest expense – related party notes	1,390	293
Interest expense – convertible debentures	1,818	-
	1,766	(201)

20. SEGMENTED INFORMATION

The Company's reportable and geographical segments are Azerbaijan and Corporate and Other. Other includes the Company's corporate offices and new venture business development activities outside of Azerbaijan. The accounting policies used for the reportable segments are the same as the Company's accounting policies.

The segment information related to Azerbaijan represents the Company's proportionate 33.33% share of Bahar Energy revenues, expenses, assets and liabilities.

Total Assets and Liabilities

(US$000's)	December 31, 2012			December 31, 2011		
	Azerbaijan	Corporate and Other	Total	Azerbaijan	Corporate and Other	Total
Current assets	8,392	18,855	27,247	7,082	29,477	36,559
Non-current assets	-	37,919	37,919	-	9,193	9,193
Capital assets (1)	24,954	195	25,149	7,264	71	7,335
Total assets	33,346	56,969	90,315	14,346	38,741	53,087
Current liabilities	(11,637)	(2,233)	(13,870)	(5,002)	(2,859)	(7,861)
Non-current liabilities	(38,118)	(20,542)	(58,660)	(16,745)	-	(16,745)
Total liabilities	(49,755)	(22,775)	(72,530)	(21,747)	(2,859)	(24,606)

(1) Capital Assets include property and equipment and advances made for capital equipment purchases.

Capital Expenditures

	Year ended					
(US$000's)	December 31, 2012			December 31, 2011		
	Azerbaijan	Corporate and Other	Total	Azerbaijan	Corporate and Other	Total
Capital Expenditures	12,312 (2)	202	12,514	5,990(2)	49	6,039

(2) Includes expenditures for property and equipment and advances for capital equipment.

Statement of net loss by segment	Year ended					
(US$000's)	December 31, 2012			December 31, 2011		
	Azerbaijan(3)	Corporate and Other	Total	Azerbaijan(3)	Corporate and Other	Total
Revenues						
Petroleum and natural gas (external)	22,134	-	22,134	20,974	-	20,974
Transportation and storage fees (external)	1,827	-	1,827	2,134	-	2,134
Management services fees	-	2,737	2,737	-	3,693	3,693
	23,961	2,737	26,698	23,108	3,693	26,801
Expenses						
Operating	21,150	-	21,150	20,407	-	20,407
Transportation	333	-	333	146	-	146
Exploration and evaluation	1,726	-	1,726	1,011	-	1,011
Asset impairment	1,800	-	1,800	8,040	-	8,040
Pre-licensing costs	-	613	613	-	2,613	2,613
Administrative	5,738	12,342	18,080	4,219	11,128	15,347
Depreciation and amortization	832	80	912	128	40	168
	31,579	13,035	44,614	33,951	13,781	47,732
Loss from operating activities	(7,618)	(10,298)	(17,916)	(10,843)	(10,088)	(20,931)
Dividends, interest and other income	-	(1,442)	(1,442)	-	(494)	(494)
Interest expense	1,390	1,818	3,208	293	-	293
Loss on investments	-	-	-	-	108	108
Impairment of receivables	-	(1,087)	(1,087)	-	1,087	1,087
Provisions	-	(125)	(125)	-	1,954	1,954
Foreign exchange loss	-	592	592	-	-	-
Change in fair value of derivative liability	-	(2,646)	(2,646)	-	-	-
Change in fair value of warrants	-	(341)	(341)	-	(1,225)	(1,225)
	(9,008)	(7,067)	(16,075)	(11,136)	(11,518)	(22,654)
Deferred Income tax expense (recovery)	-	-	-	281	1,643	1,924
Net loss	(9,008)	(7,067)	(16,075)	(11,417)	(13,161)	(24,578)

(3) All results reported under Azerbaijan represent the Company's 33.33% proportionate share in Bahar Energy.

Major customers

For the year ended December 31, 2012, 100% petroleum and natural gas revenues of $22.1 million (December 31, 2011 – $21.0 million) were sales to a single customer, the State Oil Company of Azerbaijan ("**SOCAR**").

For the year ended December 31, 2012, the Company recorded $2.5 million (December 31, 2011 - $3.5 million) in management service fees for management, administrative and technical support services performed for BEOC. These transactions are recorded at exchange amounts. *(See Note 8 – Related Party Transactions)*

21. SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash working capital items related to operating activities:

	Year Ended December 31,	
(US$000's)	2012	2011
Trade receivables	(281)	63
Receivables from related parties	(2,563)	889
Other receivable	(260)	(7)
Advances for operating supplies	(134)	-
Prepaid expenses and deposits	192	(36)
Accounts payable and accrued liabilities	2,324	1,574
Short term borrowing	(1.018)	1,018
Provisions	(1,000)	1,000
Inventories	674	(2,263)
Payables to related parties	289	(1,749)
	(1,777)	489

Changes in non-cash working capital items related to financing activities:

	Year Ended December 31,	
(US$000's)	2012	2011
Accounts payable and accrued liabilities	-	(318)
	-	(318)

Changes in non-cash working capital items related to investing activities:

(US$000's)	Year Ended December 31, 2012	2011
Accounts payable and accrued liabilities	6,232	718
	6,232	718

22. DEFERRED INCOME TAXES

The provision for income taxes differs from the result that would have been obtained by applying the U.S. federal income tax rate of 35% to the loss before income taxes. The difference results from the following items:

(US$000's)	Year Ended December 31, 2012	2011
Deferred income tax expense (recovery) per statements	-	1,924
Adjustments in respect to prior years	-	(1,588)
Deferred income tax expense (recovery) – current year	-	336
(US$000's)	**Year Ended December 31, 2012**	**2011**
Comprehensive loss before income taxes	(16,018)	(22,700)
U.S. federal corporate income tax rate	35%	35%
Expected income tax (recovery) expense computed at statutory rates	(5,606)	(7,945)
Add (deduct) the tax effect of:		
Non-taxable / deductible items	3,119	3,903
Warrants fair value adjustment	(119)	(428)
Share-based payments	256	784
Deferred income tax (recovery) expense per calculation	(2,351)	(3,686)
Derecognition of deferred tax asset for current year	2,351	4,022
Deferred Income tax (recovery) expense per statements	-	336
Current year deferred income taxes consists of:		
Current tax (recovery)	(3,226)	(2,838)
Deferred tax (recovery)	875	(848)
Deferred Income tax (recovery) before tax asset derecognition	(2,351)	(3,686)
Deferred tax asset not brought to account	2,351	4,022
Adjustments in respect to prior years (1)	-	1,588
Deferred income tax expense (recovery)	-	1,924

(1) Includes derecognition of deferred tax asset previously recognized in equity.

Deferred Income Tax Asset

The components of the Company's unrecognized deferred tax assets arising from temporary differences and loss carryforwards as well as the associated amount of deferred tax recovery or expense recognized in the Company's statements of operations and comprehensive income are as follows:

Continuity of net deferred income tax asset (liability)

(US$000's)	Recognized in profit or loss	Recognized in equity	Total
Balance at December 31, 2011	5,264	346	5,610
Current loss carryforwards	2,351	-	2,351
Share-based compensation	-	119	119
Other non-capital losses	-	-	-
As at December 31, 2012	7,614	465	8,079
Derecognition of deferred tax asset	(7,614)	(465)	(8,079)
As at December 31, 2012 after derecognition	-	-	-

At December 31, 2012, the Company has cumulative loss carryforward of approximately $20.4 million that will expire in 2030 and 2031. The Company expects to be able to fully utilize these losses and the associated deferred tax asset noted above, but has elected to derecognize the cumulative deferred tax asset until such time recovery and offset against future income can be assured.
Currently, the Company's primary income producing assets are held through its 33.3% ownership in Bahar Energy. The project, being in the early rehabilitation and development stage, requires significant development funding and re-investment of operating cash flows for the foreseeable future. Earnings from the Bahar project are not taxable to the Company until Bahar Energy declares dividends from the surplus funds generated from the ERDPSA. Before Bahar Energy can declare dividends, shareholders loans must be repaid with accumulated interest expense, which will be returned to the Company non-taxable.

Under IFRS, when an entity has a history of recent losses, the entity should recognize a deferred tax asset from unused tax losses and tax credits only to the extent that there is sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profits will be available against which unused taxable losses and tax credit can be utilized within the foreseeable future. IFRS also allows an entity to recognize previously unrecognized tax assets to the extent future profits will allow recovery before expiration.

With much of the early funds returned from Bahar Energy being non-taxable as loan repayments, the Company's potential taxable dividends horizon is beyond that normally allowed under IFRS for recognition of deferred tax assets. As noted above, the Company has elected to derecognize its accumulated deferred tax asset, but will continue to reassess the unrecognized deferred tax asset at the end of each reporting period.

Azerbaijan

The Company is tax protected under the terms of the ERDPSA in Azerbaijan. In accordance with the terms of the agreement, the Company determines the liability for income tax which would otherwise be payable in connection with its Azerbaijan operations. Any such tax determined in connection with the Company's operations is paid by the SOCAR from their share of production and the Company retains no liability for payment of income taxes.

23. EXPENSES BY NATURE

(US$000's)	Year ended December 31, 2012	Year ended December 31, 2011
ADMINISTRATIVE		
Employee wages and benefits	5,345	3,782
Share-based payments	1,367	1,577
Professional service costs	3,218	4,076
Office, travel and other	2,415	1,693
Foreign office costs	5,735	4,219
Total expenses by nature	18,080	15,347

24. COMMITMENTS AND CONTINGENCIES

The following is a summary of the Company's contractual obligations and commitments as of December 31, 2012:

(US$000's)	2013	2014	Thereafter
Operating leases [(1)]	152		-
Annual acreage fees	72	-	-
Debentures – interest payments [(2)]	2,171	2,171	5,427
	2,395	2,171	5,427

(1) The Company has extended its lease of office space for its corporate headquarters in the United States through December 2013.

(2) The coupon interest payments are denominated in Canadian Dollars. The USD value of the scheduled interest payments has been calculated at the December 31, 2012 exchange rate of 0.9949 USD/CAD.

The commitments of the Company include a $52.5 million loan commitment to Bahar Energy for the funding of the deficit cash flows associated with the 2013 Bahar Annual Work Program and Budget ("WP&B"), which is subject to change.

The Company's commitments to fund the Bahar project are based on the approved annual WP&B prepared by BEOC. Greenfields' management, through their participation at the project Steering Committee, Management Committee and Bahar Energy board of directors, provides significant input and technical guidance to the proposed annual work plan. Proposed budgets are reviewed and approved by the Management Committee (comprised of representatives from Bahar Energy and SOCAR), Bahar Energy board of directors and Greenfields board of directors. Budget approval by Bahar Energy must be unanimous. Failing unanimity on a work program and budget, the proposal capable of satisfying the minimum work and production obligations under the ERDPSA for the calendar year in question that receives the highest percentage vote is deemed approved. Greenfields' Chief Operating Officer currently serves as the Bahar Energy representative on the Management Committee for BEOC, which has the authority under the Joint Operating Agreement to exercise overall supervision, direction and control of all matters pertaining to the Joint Operations.

25. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company is exposed to the following risks in respect of certain of the financial instruments held:

a) Credit risk

Credit risk is the risk of financial loss to the Company if counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's receivables from subsidiaries and affiliates for services performed under certain administrative services agreements and from advances made under certain joint venture agreements.

The Company's current accounts receivable balances mainly consist of trade receivables from the Company's share of oil and gas revenue, transportation and storage fees generated under the ERDPSA, receivables from affiliates as result of the funding of administrative expenses and costs in connection with the ERDPSA operations, and management fees for administrative and technical support provided to an entity the Company has an equity interest. The Company historically has not experienced any collection issues with its accounts receivable and all of the balances due are considered by management to be collectable at December 31, 2012. See *Note 8 – Related Party Transactions* (Receivables from related parties).

Cash and cash equivalents consist of bank deposits and short term money market investments held in major United States banks except for cash held in the Bahar Energy joint venture which is limited for use in the ERDPSA. The Company manages the credit exposure related to short term investments by selecting counterparties based on credit rating and monitors all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset-backed commercial paper. Cash held in local bank accounts in Baku, Azerbaijan for the Bahar Energy joint venture are also exposed to the risk of bank failure. That risk is mitigated by keeping amounts in local accounts to only those funds required for near term operations as well as to keep deposits in only the largest and most reputable financial institutions.

The Company's maximum exposure to credit risk at the statement of financial position date is as follows:

Credit risk *(US$000's)*	December 31, 2012	December 31, 2011
Cash and cash equivalents	15,419	25,289
Trade receivables	3,591	3,310
Receivables from related parties	4,401	1,838
Other receivable	300	61
	23,711	30,498

b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure, as much as possible, that it will have sufficient liquidity to meet its obligations when due, under both normal and unusual conditions without incurring unacceptable costs, relinquishment of properties or risking harm to the Company's reputation.

The Company prepares annual and interim period capital expenditure budgets, which are regularly monitored and updated as considered necessary to provide current cash flow estimates. The Company also utilizes authorizations for expenditures on projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company may raise debt and capital through the issuance of shares. Additional financing may be required to complete planned capital programs. (*See Note 2 – Basis of Presentation and Going Concern*)

The Company's financial liabilities at December 31, 2012 and December 31, 2011 arose primarily from the recognition of its proportionate share of Bahar Energy liabilities for the Azerbaijan project. Payment terms on the Company's accounts payable and accrued liabilities are typically 30 to 60 days from invoice date and generally do not bear interest. Currently, the Company does not have any bank debt other than the short-term borrowing by Bahar Energy which is generally repaid with 30 days.

The following table summarizes the remaining contractual maturities of the Company's financial liabilities:

Liquidity Risk	December 31, 2012				December 31, 2011
(US$000's)	Within 1 year	Within 1 – 3 years	Over 3 years	Total	Total
Accounts payable and accrued liabilities	12,191	598	-	12,789	4,255
Debentures – interest payable	179			179	-
Short term borrowing	-	-	-	-	1,018
Provisions	-	-	-	-	1,000
Payables to related parties	902	-	-	902	612
Warrants	-	-	-	-	976
Notes payable to related parties	-	38,118	-	38,118	16,745
Debentures	-	-	23,847	23,847	-
	13,272	38,716	23,847	75,835	24,606

c) Currency risk

Foreign currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. The Company has minimal exposure to foreign currency fluctuations as a significant portion of the Company's transactions are denominated in the United States dollar and the Company holds almost all of its excess cash in United States dollars.

At December 31, 2012 and December 31, 2011 the Company had no forward exchange contracts in place.

d) Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are affected by the international economy that governs the level of supply and demand.

The Company's primary revenues are from oil and gas sales produced in Azerbaijan under the ERDPSA. Oil is sold through SOCAR and priced, on a quality differential basis, to the U.S. dollar-based Intercontinental Exchange ("**ICE**") at approximately 96% of Brent oil price at sales date. Natural gas is sold to SOCAR at a fixed price of $140/MCM (approximately $3.96/MCF) under a take or pay contract. Gas over/underliftings are settled also at a fixed price for an initial term of five years.

At December 31, 2012 and December 31, 2011, the Company has no outstanding financial instruments, financial derivatives or physical delivery contracts subject to commodity price risk. Purchases and sales of financial assets are recognized on the settlement date, the date on which the Company receives or delivers the asset.

e) Interest rate risk

Interest rate risk arises from changes in market interest rates that may affect the fair value or future cash flows from the Company's financial assets or liabilities. The Company may partially mitigate its exposure to interest rate changes by holding a mix of both fixed and floating rate debt.

At December 31, 2012, the sensitivity in net earnings for each one percent change in interest rates is not significant.

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Fair value of financial instruments

The fair values of financial instruments as at December 31, 2012 and 2011 are disclosed below by financial instrument category as follows:

(US$000's)		Hierarchy Level	December 31, 2012 Carrying Amount	December 31, 2012 Fair Value	December 31, 2011 Carrying Amount	December 31, 2011 Fair Value
Assets at FVTPL						
Cash and cash equivalents		1	15,419	15,419	25,289	25,289
Loans and receivables						
Trade receivables		-	3,591	3,591	3,310	3,310
Receivables from related party	(a)	-	4,401	4,401	1,838	1,838
Notes receivable from related party		-	37,919	37,919	8,965	8,965
Other receivables		-	300	300	61	61
Available for sale assets						
Short term investments		2	1,693	1,693	3,488	3,488
GFPI-USA	(b)	-	-	-	228	228
Other financial liabilities						
Accounts payable and accrued liabilities		-	12,370	12,370	4,255	4,255
Short term borrowing		-	-	-	1,018	1,018
Provisions		-	-	-	1,000	1,000
Payables to related party	(c)	-	902	902	612	612
Notes payable to related parties	(d)	-	38,118	38,118	16,745	16,745
Convertible Debentures		-	20,542	20,542	-	-
Liabilities at FVTPL						
Share based bonus		2	598	598	-	-
Derivative liability		2	3,531	3,531	-	-
Warrants		2	-	-	976	976

a. Balances consist of receivables from Bahar Energy resulting from amounts invoiced on "Affiliate Service Orders" **("ASO")** and other direct invoicing for services provided to Bahar Energy Operating Company Ltd. **("BEOC")**.
b. The investment is measured at cost, as the fair value of this instrument cannot reliably be determined.
c. Balances consist of liabilities to certain shareholders of Bahar Energy associated with amounts invoiced on "Affiliate Service Orders" **("ASO")** and other direct invoicing for services provided to Bahar Energy Operating Company Ltd. **("BEOC")**.
d. The balance represents liabilities arising from the funding of operations by shareholders of Bahar Energy in the form of interest bearing notes to be repaid from future cash flows from the ERDPSA. *See also Note 8, Related Party Transactions.*

<u>Fair Value Hierarchy</u>
Level 1 – Fair value measurement is determined by reference to unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2 – Fair value measurement is based on inputs other than unadjusted quoted prices that are observable, either directly or indirectly.
Level 3 – Fair value measurement using inputs for the asset or liability that are not based on observable market data.

26. CAPITAL STRUCTURE AND MANAGEMENT

The Company considers its capital structure to include common share capital and working capital (a measurement defined as current assets less current liabilities, with current liabilities being as per the number on the face of the consolidated statement of financial position excluding warrants). In order to maintain or adjust the capital structure, the Company may from time to time issue common shares or other securities, sell assets, issue debt or adjust its operating or capital spending to manage current and projected working capital levels. (*See Note 2 – Basis of Presentation and Going Concern*)

Composition of the Company's capital structure *(US$000's)*	December 31, 2012	December 31, 2011
Working Capital	13,377	29,674
Convertible debt and shareholders' equity	38,327	28,481
Ratios of working capital to convertible debt and shareholders' equity (1)	35%	104%

(1) Convertible debt is combined with shareholder's equity due to the Company's right to settle debt by issuing shares.

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27. RESTATEMENT

The Company has restated the comparative consolidated financial statements as at and for the year ended December 31, 2011 to expense certain costs previously deferred as advances for capital equipment ("Advances") as described in *Note 11 – Property and Equipment*. The restatement results in a cumulative adjustment to advances for capital equipment of $8.0 million from $10.8 million as stated on the December 31, 2011 statement of financial position to $2.8 million and a corresponding asset impairment expense in the consolidated statement of net loss of $8.0 million.

The following tables reflect the net impact of this restatement:

Consolidated Statement of Financial Position as at December 31, 2011

US$000's

Assets	As previously stated	Adjustment	Restated
Current Assets			
Cash and cash equivalents	25,289		25,289
Short term investments	3,488		3,488
Trade receivables	3,310		3,310
Receivables from related parties	1,838		1,838
Other receivable	61		61
Prepaid expenses and deposits	310		310
Inventories	2,263		2,263
	36,559		36,559
Non-Current Assets			
Investments	228		228
Note receivable from related party	8,965		8,965
Advances for capital equipment	10,792	(8,040)	2,752
Property and equipment	4,583		4,583
	61,127	(8,040)	53,087
Liabilities and Equity			
Current Liabilities			
Accounts payable and accrued liabilities	4,255		4,255
Short term borrowing	1,108		1,018
Provisions	1,000		1,000
Payables to related parties	612		612
Warrants	976		976
	7,861		7,861
Non-current Liabilities			
Notes payable to related parties	16,745		16,745
Convertible Debentures	-		-
Shareholders' Equity			
Common shares	15		15
Paid in capital	56,705		56,705
Share-based payments reserve	3,830		3,830
Deficit	(23,983)	(8,040)	(32,023)
Investments revaluation reserve	(46)		(46)
Total Shareholders' Equity	36,521	(8,040)	28,481
	61,127	(8,040)	53,087

Consolidated Statement of Net loss for the year ended December 31, 2011

US$000's except per share amounts

	As previously stated	Adjustment	Restated
Revenues			
Petroleum and natural gas	20,974		20,974
Transportation and storage fees	2,134		2,134
Management service fees	3,693		3,693
	26,801		26,801
Expenses			
Operating	20,407		20,407
Transportation	146		146
Exploration and evaluation	1,011		1,011
Asset impairment *(Note 11)*	-	8,040	8,040
Pre-licensing costs	2,613		2,613
Administrative*3)*	15,347		15,347
Depreciation and amortization	168		168
	39,692	8,040	47,732
Loss from operating activities	(12,891)	(8,040)	(20,931)
Dividends, interest and other income	(494)		(494)
Interest expense	293		293
Loss on investments	108		108
Impairment of receivables recovery	1,087		1,087
Provisions	1,954		1,954
Foreign exchange loss	-		-
Change in fair value of derivative liability	-		-
Change in fair value of warrants	(1,225)		(1,225)
Loss before income taxes	(14,614)	(8,040)	(22,654)
Deferred income tax expense (recovery) *(Note 22)*	1,924		1,924
Net Loss	(16,538)	(8,040)	(24,578)
Per share			
Net loss per share, basic and diluted	($1.11)		($1.66)

Consolidated statement of comprehensive loss for the year ended December 31, 2011

Net Loss	(16,538)	(8,040)	(24,578)
Gain (Loss) arising from revaluation of available for sale financial assets during the year	(46)		(46)
	(46)		(46)
Total comprehensive loss	(16,584)	(8,040)	(24,624)

Consolidated statement of equity for the year ended December 31, 2011
US$000's

	As previously stated	Adjustment	Restated
Common shares			
Balance, beginning of year	15		15
Warrants/Options exercise	-		-
Balance, end of year	15		15
Paid in capital			
Balance, beginning of year	56,526		56,526
Issued pursuant to private placements	-		-
Repurchase of common shares	(208)		(208)
Share issue costs	(55)		(55)
Exercise of options	-		-
Warrant exercise and liability reclassification	44		44
Share-based payments	62		62
Excess tax benefit - share grants	336		336
Forfeiture of share options	-		-
Balance, end of year	56,705		56,705
Share-based payments reserve *(Note 18)*			
Balance, beginning of year	1,361		1,361
Share-based payments	2,469		2,469
Share options exercised and other adjustments	-		-
Balance, end of year	3,830		3,830
Deficit			
Balance, beginning of year	(7,445)		(7,445)
Net loss	(16,538)	(8,040)	(24,578)
Balance, end of year	(23,983)	(8,040)	(32,023)
Investment revaluation reserve			
Balance, beginning of year	(46)		-
Unrealized gain on short term investments	57		(46)
Balance, end of year	11		(46)
Total Shareholders' Equity	36,521	(8,040)	28,481

This restatement did not have an impact on the cash flows from operating, investing, or financing activities.

28. SUBSEQUENT EVENTS

The Company has not had any subsequent events.