
EAST WEST PETROLEUM CORP.

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED
DECEMBER 31, 2011 AND 2010

(Expressed in Canadian Dollars)

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
East West Petroleum Corp.

We have audited the accompanying consolidated financial statements of East West Petroleum Corp., which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010 and the consolidated statements of comprehensive loss, changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of East West Petroleum Corp. as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

“DAVIDSON & COMPANY LLP”

Vancouver, Canada

Chartered Accountants

April 25, 2012



EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in Canadian Dollars)

	Note	December 31, 2011 \$	December 31, 2010 \$ <i>(Note 18)</i>	January 1, 2010 \$ <i>(Note 18)</i>
ASSETS				
Current assets				
Cash	4	25,601,140	26,912,843	714,192
Amounts receivable	5	62,794	141,340	18,764
Prepaid expenses		31,225	13,402	-
Total current assets		25,695,159	27,067,585	732,956
Non-current assets				
Restricted cash	6(a)	3,561,442	-	-
Exploration and evaluation assets	6	-	31,121	25,000
Property, plant and equipment	7	996,572	1,227,520	4,014
Deposit and other costs	8	-	4,254,349	-
Total non-current assets		4,558,014	5,512,990	29,014
TOTAL ASSETS		30,253,173	32,580,575	761,970
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities		222,778	456,489	184,541
Due to related parties	11	-	-	218,351
Total current liabilities		222,778	456,489	402,892
Non-current liabilities				
Decommissioning liabilities	9	56,837	168,546	-
TOTAL LIABILITIES		279,615	625,035	402,892
SHAREHOLDERS' EQUITY				
Share capital	10	38,382,398	37,581,656	4,333,051
Share-based compensation reserve		3,620,539	1,139,911	-
Deficit		(12,029,379)	(6,766,027)	(3,973,973)
TOTAL SHAREHOLDERS' EQUITY		29,973,558	31,955,540	359,078
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		30,253,173	32,580,575	761,970

Nature of Operations - see Note 1

Commitments - see Note 14

Subsequent Events - see Note 17

These consolidated financial statements were approved for issue by the Board of Directors on April 25, 2012 and are signed on its behalf by:

/s/ Greg Renwick
 Greg Renwick
 Director

/s/ Nick DeMare
 Nick DeMare
 Director

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

EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Expressed in Canadian Dollars)

	Note	Year Ended December 31,	
		2011 \$	2010 \$ <i>(Note 18)</i>
Revenue			
Petroleum and natural gas sales		227,485	76,878
Royalties		<u>(12,426)</u>	<u>(3,976)</u>
		<u>215,059</u>	<u>72,902</u>
Expenses			
Operating		70,136	16,690
Depletion and depreciation	7	170,440	65,162
Finance expense of decommissioning liabilities	9	927	864
General and administrative		2,504,277	1,888,589
Share-based compensation	10	<u>2,529,428</u>	<u>699,535</u>
		<u>5,275,208</u>	<u>2,670,840</u>
Loss before other items		<u>(5,060,149)</u>	<u>(2,597,938)</u>
Other items			
Interest and other income		272,359	7,937
Loss on disposal of property, plant and equipment		-	(4,014)
Write-off of deferred finance costs	8	(727,399)	-
Gain on disposal of exploration and evaluation assets	6(b)	218,879	-
Impairment of exploration and evaluation assets	6(c)	-	(158,178)
Foreign exchange		<u>30,868</u>	<u>(39,861)</u>
		<u>(205,293)</u>	<u>(194,116)</u>
Net loss and comprehensive loss for the year		<u>(5,265,442)</u>	<u>(2,792,054)</u>
Basic and diluted loss per common share		<u>\$(0.06)</u>	<u>\$(0.08)</u>
Weighted average number of common shares outstanding		<u>83,300,229</u>	<u>34,099,786</u>

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

EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Expressed in Canadian Dollars)

Year Ended December 31, 2010					
	Share Capital		Share-Based Compensation Reserve \$	Deficit \$	Total Equity \$
	Number of Shares	Amount \$			
Balance on January 1, 2010	23,452,806	4,333,051	-	(3,973,973)	359,078
Common shares issued for:					
Cash - private placements	40,873,000	33,400,300	-	-	33,400,300
Cash - exercise of warrants	16,095,000	1,757,000	-	-	1,757,000
Cash - exercise of share options	223,334	46,067	-	-	46,067
Debenture holders bonus	669,508	707,000	-	-	707,000
Share subscriptions received	-	36,250	-	-	36,250
Share issue costs	-	(2,748,145)	-	-	(2,748,145)
Share-based compensation - share options	-	-	699,535	-	699,535
Share-based compensation - compensation options	-	-	247,440	-	247,440
Share-based compensation - brokers' warrants	-	-	243,069	-	243,069
Transfer on exercise of share options	-	50,133	(50,133)	-	-
Net loss for the year	-	-	-	(2,792,054)	(2,792,054)
Balance at December 31, 2010 - Note 18	81,313,648	37,581,656	1,139,911	(6,766,027)	31,955,540

Year Ended December 31, 2011					
	Share Capital		Share-Based Compensation Reserve \$	Deficit \$	Total Equity \$
	Number of Shares	Amount \$			
Balance on January 1, 2011	81,313,648	37,581,656	1,139,911	(6,766,027)	31,955,540
Common shares issued for:					
Cash - exercise of share options	45,000	10,250	-	-	10,250
Cash - exercise of warrants	2,215,000	753,100	-	-	753,100
Cash - exercise of compensation options	300,000	75,000	-	-	75,000
Repurchase of common shares	(173,000)	(86,408)	-	2,090	(84,318)
Share-based compensation	-	-	2,529,428	-	2,529,428
Transfer on exercise of share options	-	9,800	(9,800)	-	-
Transfer on exercise of compensation options	-	39,000	(39,000)	-	-
Net loss for the year	-	-	-	(5,265,442)	(5,265,442)
Balance at December 31, 2011	83,700,648	38,382,398	3,620,539	(12,029,379)	29,973,558

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

EAST WEST PETROLEUM CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in Canadian Dollars)

	Year Ended	
	December 31,	
	2011	2010
	\$	\$
		<i>(Note 18)</i>
Operating activities		
Net loss for the year	(5,265,442)	(2,792,054)
Adjustments for:		
Depletion and depreciation	170,440	65,162
Finance expense of decommissioning liabilities	927	864
Share-based compensation	2,529,428	699,535
Loss on disposal of property, plant and equipment	-	4,014
Write-off of deferred finance expenses	727,399	-
Gain on disposal of exploration and evaluation assets	(218,879)	-
Impairment of exploration and evaluation assets	-	158,178
	<u>(2,056,127)</u>	<u>(1,864,301)</u>
Changes in non-cash working capital items:		
Decrease (increase) in amounts receivable	78,546	(122,576)
Increase in prepaid expenses	(17,823)	(13,402)
(Decrease) increase in accounts payable and accrued liabilities	(233,711)	223,201
	<u>(172,988)</u>	<u>87,223</u>
Net cash used in operating activities	<u>(2,229,115)</u>	<u>(1,777,078)</u>
Investing activities		
Restricted cash	(3,561,442)	-
Expenditures on exploration and evaluation assets	-	(1,314,299)
Expenditures on property, plant and equipment	(52,128)	-
Proceeds on disposal of exploration and evaluation assets	250,000	25,000
Deposit refund	3,526,950	-
Additions to deposit and other costs	-	(3,547,349)
Net cash provided by (used in) investing activities	<u>163,380</u>	<u>(4,836,648)</u>
Financing activities		
Issuance of share capital	838,350	35,203,367
Share issue costs	-	(2,208,889)
Share subscriptions received	-	36,250
Repurchase of common shares	(84,318)	-
Repayment of advances from related parties	-	(218,351)
Net cash provided by financing activities	<u>754,032</u>	<u>32,812,377</u>
Net change in cash	(1,311,703)	26,198,651
Cash at beginning of year	<u>26,912,843</u>	<u>714,192</u>
Cash at end of year	<u>25,601,140</u>	<u>26,912,843</u>

Supplemental cash flow information - See Note 15

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

EAST WEST PETROLEUM CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2011 AND 2010
(Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS

East West Petroleum Corp. (the “Company”) was incorporated on October 23, 1987 under the provisions of the Company Act (British Columbia). The Company is listed and trades on the TSX Venture Exchange (“TSXV”) under the symbol “EW”. The Company’s principal office is located at #1210 - 1095 West Pender Street, Vancouver, British Columbia V6E 2M6 Canada.

The Company carries on business in one operating segment, being the acquisition of, exploration for and production from petroleum and natural gas properties. Management considers that the Company has adequate resources to maintain its core operations and planned exploration programs for the next twelve months. However, the Company recognizes that exploration expenditures may change with ongoing results and, as a result, it may be required to obtain additional financing. While the Company has been successful in securing financings in the past, there can be no assurance that it will be able to do so in the future.

2. BASIS OF PREPARATION

Adoption of International Financial Reporting Standards (“IFRS”) and Statement of Compliance

These are the Company’s first annual consolidated financial statements prepared in accordance with IFRS in effect at December 31, 2011. These consolidated financial statements have been prepared in accordance with IAS 1, *Presentation of Financial Statements* and IFRS 1, *First-Time Adoption of International Financial Reporting Standards* (“IFRS 1”) and the impact of the transition from previous Canadian GAAP to IFRS is explained in Note 18, including the effects of the transition to IFRS on the Company’s financial position, equity, comprehensive income and cash flows.

Subject to the application of the transition elections described in Note 18, the accounting policies applied in these consolidated financial statements and described below, have been applied consistently to all periods presented, including the opening statement of financial position as at January 1, 2010 (the Company’s “Transition Date”), except where the Company applied certain exemptions upon transition to IFRS.

Basis of Measurement

The Company’s consolidated financial statements have been prepared on the historical cost basis except for certain financial assets and liabilities measured fair value.

Significant Accounting Estimates

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and the disclosure of contingencies. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements. Significant judgments, estimates and assumptions made by management in the preparation of these financial statements are described below:

- (i) Fair values of petroleum and natural gas properties, depletion and depreciation and amounts used in impairment calculations are based on estimates of crude oil and natural gas reserves, oil and gas prices and future costs required to develop those reserves. By their nature, estimates of reserves and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.
- (ii) Petroleum and natural gas properties, exploration and evaluation assets and other corporate assets are aggregated into cash-generating-units (“CGUs”) based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company’s CGUs is subject to management’s judgment.

EAST WEST PETROLEUM CORP.
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2. BASIS OF PREPARATION (continued)

- (iii) The decision to transfer exploration and evaluation assets to property, plant and equipment is based on management's determination of an area's technical feasibility and commercial viability based partially on proved and probable reserves.
- (iv) The calculation of decommissioning liabilities includes estimates of the future costs to settle the liability, the timing of the cash flows to settle the liability, the risk-free rate and the future inflation rates. The impact of differences between actual and estimated costs, timing and inflation on the consolidated financial statements of future periods may be material.
- (v) The estimated fair value of the Company's financial assets and liabilities, are by their nature, subject to measurement uncertainty.
- (vi) The calculation of income taxes requires judgment in applying tax laws and regulations, estimating the timing of the reversals of temporary differences, and estimating the realizability of deferred tax assets. These estimates impact current and deferred income tax assets and liabilities, and current and deferred income tax expense (recovery).
- (vii) The calculation of share-based compensation requires estimates of volatility, forfeiture rates and market prices surrounding the issuance of stock options. These estimates impact share-based compensation expense and contributed surplus.
- (viii) Contingencies are resolved only when one or more events transpire. As a result, the assessment of contingencies inherently involves estimating the outcome of future events.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Details of the Group

In addition to the Company, the consolidated financial statements include all subsidiaries. Subsidiaries are all corporations over which the Company is able, directly or indirectly, to control financial and operating policies, which is the authority usually connected with holding majority voting rights. Subsidiaries are fully consolidated from the date on which control is acquired by the Company. Inter-company transactions and balances are eliminated upon consolidation. They are de-consolidated from the date that control by the Company ceases. The subsidiaries of the Company are as follows:

(i)	Avere Energy Corp (USA)	- 100%
(ii)	EW Petroleum Holdings Ltd. (BVI)	- 100%
(iii)	East West India Inc. (BVI)	- 100%
(iv)	East West Petroleum North Africa Inc. (BVI)	- 100%
(v)	East West Petroleum Europe Inc. (BVI)	- 100%

Cash and Cash Equivalents

Cash includes cash on hand and demand deposits. Cash equivalents include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. The Company is not exposed to significant credit or interest rate risk although cash is held in excess of federally insured limits with a major financial institution. The Company did not have any cash equivalents as at December 31, 2011 and 2010.

EAST WEST PETROLEUM CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2011 AND 2010
(Expressed in Canadian Dollars)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Amounts Receivable

Receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. Receivables are classified as loans and receivable. A provision for impairment of receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables.

Accounts Payable and Accrued Liabilities

Payables are obligations to pay for materials or services that have been acquired in the ordinary course of business from suppliers. Payables are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Payables are classified as other financial liabilities initially at fair value and subsequently measured at amortized cost using the effective interest method.

Exploration and Evaluation Expenditures

Pre-license costs are recognized in the statement of comprehensive loss as incurred. Exploration and evaluation expenditures directly attributable to the exploration for petroleum and natural gas reserves are capitalized as exploration and evaluation assets on a field-by-field basis. These costs include, but are not limited to: lease acquisition either directly or by business combination, lease rentals on undeveloped properties, acquisition of rights to explore, geological, and geophysical costs, exploratory drilling of both productive and unproductive wells and overhead charges. No depletion or amortization is charged during the exploration and evaluation phase.

Exploration and evaluation expenditures are capitalized until reserves are evaluated and determined to be commercially viable and technically feasible. If reserves are not identified, these costs are expensed. The balance of exploration and evaluation expenditures is carried forward as an exploration and evaluation asset in the statement of financial position where the resource rights are current and it is considered probable that costs will be recovered through the future development or sale of the property.

If it is determined that a commercial discovery of reserves will not be achieved, the capitalized exploration and evaluation assets are written down to their recoverable amounts. Where commercial discovery of reserves has been made, the exploration and evaluation assets are tested for impairment and transferred to property, plant and equipment as petroleum and natural gas properties.

Property, Plant and Equipment

Property, plant and equipment are carried at cost, less accumulated depreciation and accumulated impairment losses.

The cost of an item of property, plant and equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Where commercial production in an area has commenced, petroleum and natural gas properties are depreciated on a unit-of-production basis over the proved reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. The unit-of-production rate for the amortization of field development costs takes into account expenditures incurred to date, plus future development expenditures to develop the proved and probable reserves. Changes in factors such as estimates of proved reserves that affect unit-of-production calculations do not give rise to prior year financial period adjustments and are accounted for on a prospective basis.

EAST WEST PETROLEUM CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2011 AND 2010
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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Other equipment and leasehold improvements are depreciated annually on a straight-line basis over the estimated useful life of the assets, at a rate of between 20% and 30% commencing when the related asset is available for use.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss in the condensed consolidated interim statement of comprehensive income or loss.

Where an item of plant and equipment comprises major components with different useful lives, the components are accounted for as separate items of plant and equipment. Expenditures incurred to replace a component of an item of plant and equipment that is accounted for separately, including major inspection and overhaul expenditures are capitalized.

The Company compares the carrying value of property, plant and equipment to estimated net recoverable amounts, based on estimated future cash flows, to determine whether there is any indication of impairment whenever events or circumstances warrant.

Joint Operations

A portion of the Company's operations are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Impairment of Assets

Non-Financial Assets

The Company reviews the carrying amounts of its non-financial assets, other than exploration and evaluation assets and deferred tax assets, at each reporting date to determine whether there is any indication of impairment. If such indication exists, then the asset's recoverable amount is estimated. For goodwill and other intangible assets that have indefinite lives or that are not yet available for use, an impairment test is completed annually. Exploration and evaluation assets are tested for impairment when reclassified to property, plant and equipment as petroleum and natural gas properties, and also if facts and circumstances suggest that the carrying value exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the lowest level at which there is identifiable cash flows that are largely independent of the cash flows of other groups of assets, known as a cash-generating unit ("CGU"). Exploration and evaluation assets are grouped on an area basis for impairment assessment purposes. The goodwill acquired in a business combination, for the purposes of impairment testing, is allocated to the CGU's that are expected to benefit from the synergies of the combination.

An impairment loss is recognized if the asset or CGU's carrying amount exceeds its recoverable amount determined as the higher of: its fair value less costs to sell, and its value in use. In assessing value in use, the estimated future after-tax cash flows are adjusted for the risks specific to the asset group and are discounted to present value using a discount rate that reflects current market assessments of the time value of money. Fair value less costs to sell is based on discounted cash flow forecasts using market assumptions, including market assessment of reserves, future prices and a risk-adjusted discount rate appropriate to the asset by reference to general market conditions, market expectations of current and future development, and the costs of future development. Impairment losses are recognized in the statement of operations and comprehensive loss.

For other assets, impairment losses recognized in prior years are assessed at each reporting date for indications that previously recognized impairment losses may no longer exist or may have decreased. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. The impairment loss is reversed only to the extent that the asset's or CGU's carrying amount does not exceed the carrying amount that would have been determined, net of depletion, had no impairment loss been recognized in prior years. An impairment loss in respect of goodwill is not reversed.

EAST WEST PETROLEUM CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Assets

Financial assets are assessed for impairment at each reporting date to determine whether there is any objective evidence that they are impaired. Objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of the asset and will not be realized. For loans and receivables, the amount of impairment is the difference between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

If there is impairment, the carrying amount of the financial asset is reduced by the impairment loss, except for trade receivables where the carrying amount is reduced through the use of an allowance account, and the loss is recognized in the statement of operations and comprehensive loss. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the statement of operations and comprehensive loss.

Decommissioning Liabilities

Liabilities for decommissioning costs are recognized when the Company has an obligation to dismantle or remove a facility and to restore the site on which it is located, and when a reliable estimate of that liability can be made. Cost is estimated upon current regulation and technology. Normally an obligation arises for a new facility or well during the construction or installation phase. Obligations may also be created through a change in legislation. The amount recognized is the fair value of the estimated future cost determined in accordance with local conditions and requirements.

Fair value is determined using the present value of the estimated future cash outflows to abandon the asset and restore the site, discounted using a pre-tax risk-free rate. Costs and the discount rate are updated at each reporting date to reflect current market assessments of the time value of money. The provision is reviewed regularly by the Company's management based on current regulations, costs, technologies and industry standards.

The corresponding amount is capitalized to petroleum and natural gas assets and is amortized on a unit-of-production basis as part of depletion and depreciation. Any adjustments arising from the reassessment of estimated costs or the current estimate of the discount rate used are reflected as an adjustment to the cost of petroleum and natural gas assets. The unwinding of the discount is recognized as a finance cost in income. Actual restoration expenditures are charged as reductions to the accumulated provision when incurred.

Provisions

Provisions are recognized when the Company has a present obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The provisions are measured at Management's best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect of time is material.

Financial Instruments

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held to maturity, available for sale, loans and receivables or at fair value through profit or loss.

Financial assets classified as fair value through profit or loss are measured at fair value with unrealized gains and losses recognized through comprehensive loss. Cash and restricted cash are classified as fair value through profit or loss.

Financial assets classified as loans and receivables and held to maturity are measured at amortized cost. Amounts receivable are classified as loans and receivables.

Financial assets classified as available for sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) except for losses in value that are considered other than temporary.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Transaction costs associated with fair value through profit or loss are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

All financial liabilities are initially recorded at fair value and designated upon inception as fair value through profit or loss or other financial liabilities.

Financial liabilities classified as other financial liabilities are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities.

Financial liabilities classified as fair value through profit or loss are measured at fair value with unrealized gains and losses recognized through comprehensive loss. At December 31, 2011 the Company has not classified any financial liabilities as fair value through profit or loss.

Share Capital

Common shares issued by the Company are classified as equity. Costs directly attributable to the issue of common shares, share purchase warrants and share options are recognized as a deduction from equity, net of any related income tax effects.

Share-Based Compensation Transactions

The share option plan allows Company employees and consultants to acquire shares of the Company. The fair value of share options granted is recognized as a share-based compensation expense with a corresponding increase in the equity settled share-based payments reserve in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee.

For employees the fair value is measured at grant date and each tranche is recognized separately on a straight line basis over the period during which the share options vest. The fair value of the share options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the share options were granted. At the end of each reporting period, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

Equity-settled share-based compensation transactions with non-employees are measured at the fair value of the goods or services received. However, if the fair value cannot be estimated reliably, the share-based compensation transaction is measured at the fair value of the equity instruments granted at the date the Company receives the goods or the services.

Current and Deferred Income Taxes

The tax expense comprises current and deferred tax. Tax is recognized in the statement of comprehensive loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case the tax is also recognized in other comprehensive income or directly in equity, respectively.

Current Tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position loss date in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred Tax

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Loss Per Share

Basic loss per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period. The computation of diluted loss per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on loss per share. The Company computes the dilutive impact of common shares assuming the proceeds received from the pro forma exercise of in-the-money share options and warrants are used to purchase common shares at average market prices.

Revenue Recognition

Revenue is recognized when it is probable that the economic benefits will flow to the Company and delivery has occurred, the sale price is fixed or determinable, and collectability is reasonably assured. These criteria are generally met at the time the product is shipped and delivered to the customer and, depending on the delivery conditions, title and risk have passed to the customer and acceptance of the product, when contractually required, has been obtained. Revenue is measured based on the sales contract.

Foreign Currency Translation

Functional and Presentation Currency

The financial statements of each of the Company's subsidiaries are prepared in the local currency of their home jurisdictions. Consolidation of each subsidiary includes re-measurement from the local currency to the subsidiary's functional currency. Each subsidiary's functional currency and the functional currency of the parent, being the currency of the primary economic environment in which the subsidiary and the parent operates, is the Canadian dollar. The consolidated financial statements are presented in Canadian dollars.

Exchange rates published by the Bank of Canada were used to translate subsidiary financial statements into the consolidated financial statements. Income and expenses for each statement of comprehensive loss presented are translated using the rates prevailing on the transaction dates. All resulting foreign exchange differences are recognized in comprehensive loss.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign Currency Transactions

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in comprehensive loss.

Accounting Standards and Interpretations Issued but Not Yet Adopted

- (i) *IFRS 7 Financial Instruments: Disclosures:* In 2011, the IASB issued amendments to IFRS 7 Financial Instruments: Disclosures relating to disclosure requirements for the offsetting of financial assets and liabilities when offsetting is permitted under IFRS. The disclosure amendments are required to be adopted retrospectively for periods beginning January 1, 2013.
- (ii) *IFRS 10 Consolidated Financial Statements:* In 2011, the IASB issued IFRS 10 which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees, including special purpose entities. The standard is required to be adopted for periods beginning January 1, 2013.
- (iii) *IFRS 11 Joint Arrangements:* In 2011, the IASB issued IFRS 11 which presents a new model for determining whether an entity should account for joint arrangements using proportionate consolidation or the equity method. An entity will have to follow the substance rather than legal form of a joint arrangement and will no longer have a choice of accounting method. The standard is required to be adopted for periods beginning January 1, 2013.
- (iv) *IFRS 12 Disclosure of Interests in Other Entities:* In 2011, the IASB issued IFRS 12 which aggregates and amends disclosure requirements included within other standards. The standard requires a company to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard is required to be adopted for periods beginning January 1, 2013.
- (v) *IFRS 13 Fair Value Measurement:* In 2011, the IASB issued IFRS 13 to provide comprehensive guidance for instances where IFRS requires fair value to be used. The standard provides guidance on determining fair value and requires disclosures about those measurements. The standard is required to be adopted for periods beginning January 1, 2013.
- (vi) *IAS 1 Presentation of Items of Other Comprehensive Income:* In 2011, the IASB issued amendments to IAS 1 Presentation of Financial Statements to split items of other comprehensive income (“OCI”) between those that are reclassified to income and those that are not. The standard is required to be adopted for periods beginning on or after July 1, 2012.
- (vii) *IAS 27 Separate Financial Statements:* The IASB issued amendments to IAS 27 Separate Financial Statements to coincide with the changes made in IFRS 10, but retains the current guidance for separate financial statements.
- (viii) *IAS 28 Investments in Associates and Joint Ventures:* The IASB issued amendments to IAS 28 Investments in Associates and Joint Ventures to coincide with the changes made in IFRS 10 and IFRS 11.

The Company is currently analyzing the impact, if any, that the adoption of these standards will have on its financial statements.

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4. CASH

	December 31, 2011 \$	December 31, 2010 \$	January 1, 2010 \$
Cash on hand	7,883,527	26,912,843	714,192
Demand deposits	<u>17,717,613</u>	<u>-</u>	<u>-</u>
	<u>25,601,140</u>	<u>26,912,843</u>	<u>714,192</u>

5. AMOUNTS RECEIVABLE

	December 31, 2011 \$	December 31, 2010 \$	January 1, 2010 \$
Trade receivables	19,079	31,457	-
Canadian harmonized sales tax	42,678	98,285	7,263
Other	<u>1,037</u>	<u>11,598</u>	<u>11,501</u>
	<u>62,794</u>	<u>141,340</u>	<u>18,764</u>

6. EXPLORATION AND EVALUATION ASSETS

	Cost \$
Balance at January 1, 2010	25,000
Additions	189,299
Disposal	(25,000)
Impairment	<u>(158,178)</u>
Balance at December 31, 2010	31,121
Disposal	<u>(31,121)</u>
Balance at December 31, 2011	<u>-</u>

(a) Effective November 28, 2011 the Company and the Office National des Hydrocarbures et des Mines (“ONHYM”), an agency of the Moroccan government, entered into agreements whereby the Company has been granted an exploration permit (the “Exploration Permit”) to earn a 75% participation interest in a prospective exploration block (the “Doukkala Block”) situated along the Atlantic coast southwest from Casablanca, Morocco. The Exploration Permit has an overall duration of eight years, comprising :

- (i) Phase 1 program under which the Company is committed to carry out a specified exploration work program, estimated at approximately US \$5,500,000, over three years;
- (ii) on completion of the Phase 1 program, the Company can elect to enter into an extension for a Phase 2 program under which, amongst other things, the Company will be committed to drill two wells, estimated at approximately US \$14,000,000 over a two year duration; and
- (iii) on completion of the Phase 2 program the Company can elect to enter into an extension for a Phase 3 program under which, amongst other things, the Company will be committed to acquire 3D seismic and drilling of one well, estimated at approximately US \$14,000,000 over a three year duration.

ONHYM retains a 25% carried interest to declaration of commerciality on the Doukkala Block.

The Company has provided a US \$3,500,000 (Cdn \$3,561,442) guarantee in favour of ONHYM as security for performance of the Phase 1 program. The amount is deposited in a savings account with a major Canadian bank. As the Company implements its work programs the guarantee will be reduced.

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6. EXPLORATION AND EVALUATION ASSETS (continued)

There is a gross royalty of 10% on crude oil and 5% on natural gas on production in excess of certain thresholds from the Doukkala Block, which would be payable to the Moroccan government. In addition, the Moroccan government is also entitled to certain bonuses based on daily production targets to a total of US \$9,000,000.

- (b) During fiscal 2010 the Company was informed by the government of Romania that it had been awarded four exploration blocks located in the Pannonian Basin, in western Romania. In May 2011 the Company signed petroleum concession agreements with government agencies in Romania which regulate the oil and gas industry, however the agreements have yet to be ratified by all authorities.

The four concessions have specific mandatory work programs (the “Romania Work Programs”), currently estimated at US \$56,630,000 for all four programs, to be completed over two years. The concessions are also subject to royalties of between 3.5% to 13.5% based on quarterly gross production payable to the government.

On May 20, 2011 the Company and Naftna Industrija Srbije j.s.c. Novi Sad (“NIS”), an arm’s length corporation, signed a memorandum of understanding (“MOU”) to jointly explore the four exploration blocks in Romania. Under the terms of the MOU, NIS paid the Company \$250,000 and will pay a further \$275,000 upon final concession approvals by the government of Romania and assignment of an 85% participation interest and operatorship of the Romania Work Programs to NIS. NIS will also fully fund the Romania Work Programs including environmental work, 2D and 3D seismic acquisition and processing, and the drilling of 12 wells to earn an 85% participation interest. The Company will retain a 15% carried interest to each block in the event of a declaration of commerciality on each of the four blocks. During fiscal 2011 the Company recorded a gain of \$218,879 resulting from the application of the \$250,000 against capitalized costs.

- (c) On January 27, 2010, as amended February 23, 2010, the Company entered into a farm-in letter agreement (the “Letter Agreement”) with American Exploration Corp. (“American Exploration”) to acquire a 20% interest in the Haynesville shale gas prospect located in Mississippi. The Company was required to pay 20% of the costs of drilling and completion of an initial deep gas well, and pay payments aggregating US \$850,000, including a non-refundable deposit of \$77,725 (US \$75,000). The Company was subsequently unable to complete a financing to fund the Letter Agreement and the arrangement was terminated with an additional \$80,453 (US \$75,000) paid to American Exploration. Accordingly, during fiscal 2010 the Company recorded a \$158,178 impairment in exploration and evaluation assets.
- (d) Exploration and evaluation assets are tested for impairment when classified to property, plant and equipment within petroleum and natural gas interests, and also if facts and circumstances suggest that the carrying value exceeds the recoverable amount. As at December 31, 2011 the Company had no amounts capitalized to exploration and evaluation assets.
- (e) See also Note 17(a).

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7. PROPERTY, PLANT AND EQUIPMENT

Cost:	Petroleum and Natural Gas Properties \$	Office Furniture and Equipment \$	Leasehold Improvements \$	Total \$
Balance at January 1, 2010	-	4,014	-	4,014
Additions	1,125,000	-	-	1,125,000
Disposal	-	(4,014)	-	(4,014)
Provision for site restoration	147,937	-	-	147,937
Revision of estimate for decommissioning costs	19,475	-	-	19,475
Balance at December 31, 2010	1,292,682	-	-	1,292,682
Additions	-	28,460	23,668	52,128
Revision of estimate for decommissioning costs	(112,636)	-	-	(112,636)
Balance at December 31, 2011	1,180,046	28,460	23,668	1,232,174
	Petroleum and Natural Gas Properties \$	Office Furniture and Equipment \$	Leasehold Improvements \$	Total \$
Accumulated Depletion and Depreciation:				
Balance at January 1, 2010	-	-	-	-
Depletion and depreciation for the year	(65,162)	-	-	(65,162)
Balance at December 31, 2010	(65,162)	-	-	(65,162)
Depletion and depreciation for the year	(162,725)	(5,743)	(1,972)	(170,440)
Balance at December 31, 2011	(227,887)	(5,743)	(1,972)	(235,602)
	Petroleum and Natural Gas Properties \$	Office Furniture and Equipment \$	Leasehold Improvements \$	Total \$
Carrying Value:				
Balance at January 1, 2010	-	4,014	-	4,014
Balance at December 31, 2010	1,227,520	-	-	1,227,520
Balance at December 31, 2011	952,159	22,717	21,696	996,572

Effective September 1, 2010 the Company executed a purchase and sale agreement with Sphere Energy Corp. ("Sphere"), a private company, whereby the Company paid \$1,125,000 to acquire Sphere's working interests, ranging from 4.12% to 20%, in three producing oil wells and thirteen gas wells (the "Carbon Property") located northeast of Calgary, Alberta.

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8. DEPOSIT AND OTHER COSTS

	December 31, 2011 \$	December 31, 2010 \$	January 1, 2010 \$
Refundable deposit	-	3,526,950	-
Capitalized interest and financing costs	-	727,399	-
	<u>-</u>	<u>4,254,349</u>	<u>-</u>

On December 6, 2010 the Company entered into a sale and purchase agreement whereby the Company agreed to acquire a 20% participation interest in the Burg El Arab field (the "BEA Field") in Egypt from Kuwait Energy Egypt Limited ("Kuwait Energy"), a private corporation, for US \$17,500,000. Under the terms of the agreement, the Company made a refundable deposit of US \$3,500,000. The closing of the agreement was subject to a number of conditions precedent and regulatory approvals.

In fiscal 2010 the Company arranged bridge loan financings totalling US \$3,500,000 to provide funding of the deposit. In December 2010 the Company repaid the bridge loans plus interest of \$20,399. In addition the Company issued 669,508 common shares of the Company, at a fair value of \$707,000, as a bonus to the lenders. As the bridge loans were incurred to provide funding for the participation in the BEA Field, the Company had capitalized \$727,399 for interest and financing costs ("Finance Costs").

Certain of the directors of the Company had provided US \$1,000,000 of the bridge loan financings.

During fiscal 2011 the Company and Kuwait Energy mutually agreed to terminate the sale and purchase agreement on the BEA Field and Kuwait Energy refunded the US \$3,500,000 (Cdn \$3,526,950) deposit. Accordingly the Company has written off the Finance Costs.

9. DECOMMISSIONING LIABILITIES

	<u>Year Ended December 31.</u>	
	2011 \$	2010 \$
Balance, beginning of year	168,546	-
Initial estimated liability	-	147,937
Finance cost	927	864
Revision of estimate	<u>(112,636)</u>	<u>19,745</u>
Balance, end of year	<u>56,837</u>	<u>168,546</u>

The total amount of estimated cash flows required to settle the Company's estimated obligation is \$97,386 (2010 - \$195,000) which has been discounted using risk free rates between 1.08% to 2.88% (December 31, 2010 - 1.15%). The decommissioning liabilities relate to the Carbon Property in Canada. The present value of the decommissioning liabilities may be subject to change based on management's current estimates, changes in remediation technology or changes to the applicable laws and regulations. Such changes will be recorded in the accounts of the Company as they occur.

The total future asset decommissioning obligations were estimated based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future years. These liabilities will be settled at the end of the useful lives of the underlying assets which are currently expected to extend up to 48 years. Settlement of the liabilities is expected to be funded from general corporate funds at the time of retirement.

See also Note 7.

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10. SHARE CAPITAL

(a) *Authorized Share Capital*

At December 31, 2011 the Company's authorized share capital consisted of an unlimited number of common shares without par value. All issued common shares are fully paid.

(b) *Reconciliation of Changes in Share Capital*

Common shares issued:	Number of Shares	Amount \$
Balance at January 1, 2010	23,452,806	4,333,051
Shares issued for cash		
Private placements	40,873,000	33,400,300
Exercise of share options	223,334	46,067
Exercise of warrants	16,095,000	1,757,000
Subscriptions receivable	-	36,250
Transfer from reserves on exercise of share options	-	50,133
Bonus shares issued (Note 8)	669,508	707,000
Share issue costs	-	<u>(2,748,145)</u>
Balance at December 31, 2010	<u>81,313,648</u>	<u>37,581,656</u>
Shares issued for cash		
Exercise of share options	45,000	10,250
Exercise of warrants	2,215,000	753,100
Exercise of compensation options	300,000	75,000
Repurchase of common shares under normal course issuer bid	(173,000)	(86,408)
Transfer from reserves on exercise of share options	-	9,800
Transfer from reserves on exercise of compensation options	-	<u>39,000</u>
Balance at December 31, 2011	<u>83,700,648</u>	<u>38,382,398</u>

On October 11, 2011 the Company filed a normal course issuer bid (the "Normal Course Issuer Bid"), which authorized the Company to repurchase for cancellation for up to 7,995,189 common shares until October 13, 2012 or the date by which the Company has acquired the maximum number of common shares under the bid. As at December 31, 2011 the Company has purchased 173,000 common shares, which have not yet been cancelled, for \$84,318 cash consideration. The average carrying value of the common shares was \$0.50 per share. The difference between the purchase price and the carrying value of the common shares was \$2,090. See also Note 17 (b).

During fiscal 2010 the Company completed private placements of:

- (i) 13,600,000 units at a price of \$0.25 per unit for gross proceeds of \$3,400,000. Each unit consisted of one common share of the Company and one non-transferable share purchase warrant. Each warrant entitles the holder to purchase an additional common share at a price of \$0.34 per share on or before September 29, 2013.

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10. SHARE CAPITAL (continued)

The Company paid finders' fees totalling \$257,750 cash and granted 1,031,000 compensation options (the "Compensation Options") with each Compensation Option entitling the holder to purchase one unit for \$0.25 per unit. Each unit will comprise of one common share and one warrant to purchase an additional common share at a price of \$0.34 per share on or before September 29, 2013. The fair value of \$247,440 assigned to the Compensation Options have been estimated using the Black-Scholes option pricing model. The assumptions used were: expected dividend yield - 0%; expected forfeiture rate - 0%; expected volatility - 79%; a risk-free interest rate of 1.81%; and an expected life of three years. The Company also incurred \$70,081 in filing and legal fees associated with the private placement.

Certain directors, officers and family members of directors and officers have purchased 490,000 units of this private placement; and

- (ii) 27,273,000 units at a price of \$1.10 per unit, for gross proceeds of \$30,000,300. Each unit consisted of one common share of the Company and one-half non-transferable share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at a price of \$1.75 per share on or before December 22, 2012.

The Company paid agents fees totalling \$1,725,009 cash and granted broker warrants exercisable to acquire 784,095 common shares at a price of \$1.75 per share on or before December 22, 2012. The fair value of \$243,069 assigned to the broker warrants have been estimated using the Black-Scholes option pricing model. The assumptions used were: expected dividend yield - 0%; expected forfeiture rate - 0%; expected volatility - 76%; a risk-free interest rate of 1.38%; and an expected life of two years. The Company also incurred \$200,762 in filing and legal fees associated with the private placement.

A director purchased 21,000 units of this private placement.

- (c) *Warrants*

A summary of the number of common shares reserved pursuant to the Company's outstanding warrants at December 31, 2011 and 2010 and the changes for the years ended on those dates is as follows:

	2011		2010	
	Number	Weighted Average Exercise Price \$	Number	Weighted Average Exercise Price \$
Balance, beginning of year	28,020,595	1.07	20,000,000	0.13
Issued	300,000	0.34	28,020,595	1.07
Exercised	(2,215,000)	0.34	(16,095,000)	0.11
Expired	-	-	(3,905,000)	0.19
Balance, end of year	26,105,595	1.12	28,020,595	1.07

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10. SHARE CAPITAL (continued)

The following table summarizes information about the number of common shares reserved pursuant to the Company's warrants outstanding and exercisable at December 31, 2011:

Number	Exercise Price \$	Expiry Date
14,420,595	1.75	December 22, 2012
<u>11,685,000</u>	0.34	September 29, 2013
<u>26,105,595</u>		

(d) *Share Option Plan*

The Company has established a rolling share option plan (the "Plan"), in which the maximum number of common shares which can be reserved for issuance under the Plan is 10% of the issued and outstanding shares of the Company. The minimum exercise price of the share options is set at the Company's closing share price on the day before the grant date, less allowable discounts in accordance with the policies of the TSXV. Options granted may be subject to vesting provisions as determined by the Board of Directors and have a maximum term of ten years from the date of grant.

During fiscal 2011 the Company granted 3,351,000 (2010 - 6,589,530) share options to its directors, employees and consultants and recorded compensation expense of \$2,529,428 (2010 - \$699,535) on the granting and vesting of share options.

The fair value of share options granted during fiscal 2011 and 2010 is estimated using the Black-Scholes option pricing model using the following assumptions:

	<u>2011</u>	<u>2010</u>
Risk-free interest rate	1.04% - 2.44%	1.99% - 2.82%
Estimated volatility	139% - 169%	79% - 100%
Expected life	2 years - 5 years	4 years - 5 years
Expected dividend yield	0%	0%
Expected forfeiture rate	0%	0%

The weighted average grant date fair value of all share options granted during fiscal 2011 to the Company's directors, employees and consultants was \$0.95 (2010 - \$0.42) per share option.

Option-pricing models require the use of estimates and assumptions including the expected volatility. Changes in the underlying assumptions can materially affect the fair value estimates and, therefore, existing models do not necessarily provide reliable measure of the fair value of the Company's share options.

A summary of the Company's share options at December 31, 2011 and 2010 and the changes for the years ended on those dates, is as follows:

	<u>2011</u>		<u>2010</u>	
	Number of Options Outstanding	Weighted Average Exercise Price \$	Number of Options Outstanding	Weighted Average Exercise Price \$
Balance, beginning of year	4,727,530	0.25	-	-
Granted	3,351,000	0.99	6,589,530	0.25
Exercised	(45,000)	0.23	(223,334)	0.21
Expired	<u>-</u>	-	<u>(1,638,666)</u>	0.26
Balance, end of year	<u>8,033,530</u>	0.56	<u>4,727,530</u>	0.25

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10. SHARE CAPITAL (continued)

The following table summarizes information about the share options outstanding and exercisable at December 31, 2011:

Number Outstanding	Number Exercisable	Exercise Price \$	Expiry Date
36,000	24,000	0.87	April 6, 2014
1,160,000	386,666	0.83	May 31, 2014
225,000	75,000	0.45	September 14, 2014
300,000	200,000	0.26	January 7, 2015
1,700,000	1,133,333	0.16	June 11, 2015
720,000	520,000	0.20	July 19, 2015
1,252,530	849,197	0.25	October 1, 2015
710,000	510,000	0.50	October 1, 2015
1,850,000	616,666	1.16	February 2, 2016
<u>80,000</u>	<u>80,000</u>	0.90	March 14, 2016
<u>8,033,530</u>	<u>4,394,862</u>		

(e) *Compensation Options*

A summary of the Company's compensation options at December 31, 2011 and 2010 and the changes for the years ended on those dates, is as follows:

	2011		2010	
	Number	Weighted Average Exercise Price \$	Number	Weighted Average Exercise Price \$
Balance, beginning of year	1,031,000	0.25	-	-
Granted	-	-	1,031,000	0.25
Exercised	<u>(300,000)</u>	0.25	<u>-</u>	-
Balance, end of year	<u>731,000</u>	0.25	<u>1,031,000</u>	0.25

As at December 31, 2011, 731,000 compensation options were outstanding and exercisable at an exercise price of \$0.25 expiring September 29, 2013.

(f) *Escrow Shares*

As at December 31, 2011 there are 3,994,049 common shares which remain held in escrow and will be released in accordance with the requirements of the TSXV over a remaining period ending October 4, 2013.

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11. RELATED PARTY TRANSACTIONS AND BALANCES

A number of key management personnel, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities. Certain of these entities transacted with the Company during the reporting period.

(a) *Transactions with Key Management Personnel*

During fiscal 2011 and 2010 the following amounts were incurred with respect to the current and former President, Chairman, Chief Financial Officer and Vice-President of Engineering of the Company:

	2011 \$	2010 \$
Professional fees	134,825	148,640
Salaries	258,455	266,039
Health benefits	6,399	2,023
Rent	-	3,790
Share-based compensation	<u>923,096</u>	<u>365,802</u>
	<u>1,322,775</u>	<u>786,294</u>

The Company also paid \$3,759 (2010 - \$587) to the spouse of the President of the Company for professional services rendered.

As at December 31, 2011, \$42,748 (2010 - \$76,575) remained unpaid and has been included in accounts payable and accrued liabilities.

(b) *Transactions with Other Related Parties*

During fiscal 2011 and 2010 the following amounts were incurred with respect to other officers and directors of the Company and family members:

	2011 \$	2010 \$
Legal	24,420	204,087
Rent	6,750	-
Professional fees	457,000	16,000
Share-based compensation	<u>985,135</u>	<u>160,420</u>
	<u>1,473,305</u>	<u>380,507</u>

As at December 31, 2011, \$430 (2010 - \$66,443) remained unpaid and has been included in accounts payable and accrued liabilities.

(c) During fiscal 2010 the Company repaid advances of \$218,351 due to former directors and officers of the Company. The advances were non-interest bearing and were due on demand.

(d) See also Notes 8, 10 and 14.

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12. INCOME TAX

A reconciliation of taxes at statutory rates to the Company's effective tax expense is as follows:

	2011 \$	2010 \$
Loss before income taxes	5,265,442	2,792,054
Statutory tax rate	<u>26.5%</u>	<u>28.5%</u>
Expected income tax recovery	(1,395,000)	(795,000)
Permanent differences	638,000	190,000
Effect of change in tax rates	34,000	67,000
Share issuance costs	-	(630,000)
Change in deductible temporary differences	<u>723,000</u>	<u>1,168,000</u>
Tax recovery	<u>-</u>	<u>-</u>

Unrecognized deferred tax assets:

	2011 \$	Expiry Thru (Year)	2010 \$
Share issuance costs	1,325,000	2014	1,767,000
Tax losses	5,432,000	2031	3,233,000
Other	318,000	N/A	146,000

Deferred income tax assets have not been recognized in respect of these items because it is not probable that the Company will be able to generate sufficient taxable income upon which these deferred tax assets can be realized.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Categories of Financial Assets and Financial Liabilities

Financial instruments are classified into one of the following four categories: fair value through profit or loss ("FVTPL"); held-to-maturity investments; loans and receivables; and available-for-sale. The carrying values of the Company's financial instruments are classified into the following categories:

Financial Instrument	Category	December 31, 2011 \$	December 31, 2010 \$
Cash	FVTPL	25,601,140	26,912,843
Amounts receivable	Loans and receivables	62,794	141,340
Deposit	Loans and receivables	-	3,526,950
Restricted cash	FVTPL	3,561,442	-
Accounts payable and accrued liabilities	Other liabilities	(222,778)	(456,489)

The Company's financial instruments recorded at fair value require disclosure about how the fair value was determined based on significant levels of inputs described in the following hierarchy:

Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and value to provide pricing information on an ongoing basis.

Level 2 - Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the market place.

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13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

Level 3 - Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The recorded amounts for amounts receivable and accounts payable and accrued liabilities approximate their fair value due to their short-term nature. The recorded amount for the deposit approximates its fair value. The fair value of cash and restricted cash under the fair value hierarchy is measured using Level 1 inputs.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

Credit Risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash, restricted cash and amounts receivable. Management believes that the credit risk concentration with respect to financial instruments included in cash and restricted cash is remote.

The Company is not the operator of certain petroleum and natural gas properties in which it has an ownership interest. The Company is dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the Company's activities may be impacted by the ability, expertise, judgement and financial capability of the operators.

Commodity Price Risk

Commodity prices for petroleum and natural gas are impacted by global economic events that dictate the levels of supply and demand, as well as the relationship between the Canadian dollar and the US dollar. Significant changes in commodity prices may materially impact the Company's ability to raise capital. The Company does not have any financial risk management contracts in place at December 31, 2011 to manage these risks.

Liquidity Risk

Liquidity risk is the risk that the Company will not have the resources to meet its obligations as they fall due. The Company manages this risk by closely monitoring cash forecasts and managing resources to ensure that it will have sufficient liquidity to meet its obligations. All of the Company's financial liabilities are classified as current and are anticipated to mature within the next fiscal period. The following table is based on the contractual maturity dates of financial assets and the earliest date on which the Company can be required to settle financial liabilities.

	Contractual Maturity Analysis at December 31, 2011				
	Less than 3 Months \$	3 - 12 Months \$	1 - 5 Years \$	Over 5 Years \$	Total \$
Cash	25,601,140	-	-	-	25,601,140
Amounts receivable	62,794	-	-	-	62,794
Restricted cash	-	-	3,561,442	-	3,561,442
Accounts payable and accrued liabilities	(222,778)	-	-	-	(222,778)

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13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

	Contractual Maturity Analysis at December 31, 2010				
	Less than 3 Months \$	3 - 12 Months \$	1 - 5 Years \$	Over 5 Years \$	Total \$
Cash	26,912,843	-	-	-	26,912,843
Amounts receivable	141,340	-	-	-	141,340
Deposit	-	-	3,526,950	-	3,526,950
Accounts payable and accrued liabilities	(456,489)	-	-	-	(456,489)

Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices. These fluctuations may be significant.

(a) Interest Rate Risk

The Company is exposed to interest rate risk to the extent that the cash bears floating rates of interest. The interest rate risk on cash and on the Company's obligations are not considered significant.

(b) Foreign Currency Risk

The Company maintains cash deposits in US Dollars with its Canadian bank and conducts activities denominated in US dollars. As such, the fluctuation of the Canadian Dollar in relation to the US Dollar will have an impact upon the operations of the Company and may also affect the value of the Company's assets and the amount of shareholders' equity. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks. At December 31, 2011, 1 Canadian Dollar was equal to 0.98 US Dollar.

Balances are as follows:

	US Dollar	Canadian Dollar Equivalent
Cash	901,757	918,454
Restricted cash	3,501,909	3,561,442
Accounts payable and accrued liabilities	<u>(34,508)</u>	<u>(35,212)</u>
	<u>4,369,158</u>	<u>4,444,684</u>

Based on the net exposures as of December 31, 2011 and assuming that all other variables remain constant, a 10% fluctuation on the Canadian Dollar against the US Dollar would result in the Company's net loss being approximately \$393,000 higher (or lower).

Capital Management

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of petroleum and natural gas properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain development of the business. The Company defines capital that it manages as share capital. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

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14. COMMITMENTS

- (a) Effective August 1, 2011, the Company entered into an operating lease, expiring July 31, 2016, for the rental of an office in Vancouver, BC with a gross monthly lease payment of \$5,511. The Company has entered into a sub-lease with a public company, which is related through common directors and officers, whereby the Company will be reimbursed \$2,755 per month. During fiscal 2011 the Company received \$5,510 from the public company for shared premises.
- (b) Effective June 11, 2010 the Company and Greg Renwick entered into an executive agreement whereby Mr. Renwick provides his services as the President and Chief Executive officer of the Company. Under the agreement the Company was paying Mr. Renwick a base salary of US \$200,000 per annum. Effective April 1, 2012 Mr. Renwick's base salary was increased to US \$250,000 per annum.

The agreement provides that, in the event Mr. Renwick's services are terminated, a severance payment of six months of compensation is payable.

See also Notes 6(a), 6(b) and 17(a).

15. SUPPLEMENTAL CASH FLOW INFORMATION

During fiscal 2011 and 2010 non-cash activities were conducted by the Company as follows:

	2011 \$	2010 \$
Investing activities		
Additions to deposit and other costs	-	(707,000)
Initial estimated decommissioning liabilities	-	(147,937)
Revision of estimated decommissioning liabilities	<u>112,636</u>	<u>(19,745)</u>
	<u>112,636</u>	<u>(874,682)</u>
Operating activities		
Increase in accounts payable and accrued liabilities	-	48,747
Provision for decommissioning liabilities	<u>(112,636)</u>	<u>167,682</u>
	<u>(112,636)</u>	<u>216,429</u>
Financing activities		
Common shares issued for non-cash consideration	48,800	757,133
Share-based compensation reserve	(48,800)	440,376
Share issue costs	<u>-</u>	<u>(539,256)</u>
	<u>-</u>	<u>658,253</u>
Other supplemental cash flow information:		
	2011 \$	2010 \$
Interest paid in cash	<u>-</u>	<u>20,399</u>
Income taxes paid in cash	<u>-</u>	<u>-</u>

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16. SEGMENTED INFORMATION

The Company currently operates in one business segment, being the acquisition, exploration and production of oil and gas properties. The Company's main oil and gas operations and corporate assets are located in Canada.

	As at December 31, 2011		
	Canada \$	Other \$	Total \$
Current assets	25,589,167	105,992	25,695,159
Restricted cash	3,561,442	-	3,561,442
Property, plant and equipment	996,572	-	996,572
	<u>30,147,181</u>	<u>105,992</u>	<u>30,253,173</u>
	As at December 31, 2010		
	Canada \$	Other \$	Total \$
Current assets	27,056,565	11,020	27,067,585
Exploration and evaluation assets	-	31,121	31,121
Property, plant and equipment	1,227,520	-	1,227,520
Deposit and other costs	-	4,254,349	4,254,349
	<u>28,284,085</u>	<u>4,296,490</u>	<u>32,580,575</u>

17. SUBSEQUENT EVENTS

- (a) Effective March 28, 2012 the Company (10% interest), Oil India Limited (40% interest), Oil and Natural Gas Corporation Limited (30% interest) and Gail (India) Limited (20% interest) (collectively the "Partners") and the government of India signed a production sharing contract (the "PSC") for Block AA-ONN-2010/2 (the "AA Block") located in the Assam-Arakan Basin of northeast India. Under the terms of the PSC work program commitment, the Partners will acquire certain 3D seismic data and drill two wells, at an estimated cost to the Company of US \$2.8 million.
- (b) Subsequent to December 31, 2011 the Company repurchased 737,000 common shares under its Normal Course Issuer Bid for \$315,825 cash consideration.
- (c) In April 2012 the Company granted share options to a director and a consultant of the Company to purchase up to 300,000 common shares of the Company at an exercise price of \$0.40 per share for a period of three years. In addition, subject to disinterested shareholder approval at the Company's next annual general meeting, the Company has amended the terms of 1,040,000 share options previously granted to a director of the Company, whereby the exercise price of the share options was reduced from \$1.16 per share to \$0.40 per share. Other than the imposition of certain trading restrictions, all other terms of the options remained the same.
- (d) See also Note 14(b).

18. TRANSITION TO IFRS

The Company's financial statements for the year ending December 31, 2011 are the first annual financial statements that comply with IFRS and these consolidated financial statements were prepared as described in Note 2, including the application of IFRS 1. IFRS 1 requires an entity to adopt IFRS in its first annual financial statements prepared under IFRS by making an explicit and unreserved statement, in those financial statements, of compliance with IFRS.

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18. TRANSITION TO IFRS (continued)

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which the Company has applied IFRS was January 1, 2010 (the “transition date”). IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company is December 31, 2011. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adoption. The Company has applied the following exemptions to its opening statement of financial position dated January 1, 2010:

Business Combinations

IFRS1 indicates that a first-time adopter may elect not to apply IFRS 3 “Business Combinations” retrospectively to business combinations that occurred before the date of transition to IFRS. The Company has taken advantage of this election and will apply IFRS 3 to business combinations that occur on or after January 1, 2010. There is no adjustment required to the January 1, 2010 statement of financial position on the transition date.

Share-based Payments

IFRS 1 encourages, but does not require, first-time adopters to apply IFRS 2 “Share-based Payment” to equity instruments that were granted on or before November 7, 2002, or equity instruments that were granted subsequent to November 7, 2002 and vested before the later of the date of transition to IFRS and January 1, 2005. The Company has elected not to apply IFRS 2 to awards that vested prior to January 1, 2010.

IAS 27 – Consolidated and Separate Financial Statements

In accordance with IFRS 1, if a company elects to apply IFRS 3 “Business Combinations” retrospectively, IAS 27 “Consolidated and Separate Financial Statements” must also be applied retrospectively. As the Company elected to apply IFRS 3 prospectively, the Company has also elected to apply IAS 27 prospectively.

IFRS 1 also outlines specific guidelines that a first-time adopter must adhere to under certain circumstances. The Company has applied the following guidelines to its opening statement of financial position dated January 1, 2010:

Estimates

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

Reconciliations of Canadian GAAP to IFRS

IFRS 1 requires an entity to reconcile equity, comprehensive income and cash flows for prior periods. The Company’s first time adoption of IFRS did not have an effect on the total operating, investing and financing cash flows. The following represents the reconciliations from Canadian GAAP to IFRS for the respective periods noted for equity and comprehensive income.

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18. TRANSITION TO IFRS (continued)

Reconciliation of Assets, Liabilities and Equity

	Note	As at January 1, 2010		
		Canadian GAAP \$	Effect of Transition to IFRS \$	IFRS \$
ASSETS				
Current assets				
Cash		714,192	-	714,192
Amounts receivable		18,764	-	18,764
Total current assets		<u>732,956</u>	<u>-</u>	<u>732,956</u>
Non-current assets				
Exploration and evaluation assets		-	25,000	25,000
Property, plant and equipment	18(a)	4,014	-	4,014
Mineral property interests	18(a)	25,000	(25,000)	-
Total non-current assets		<u>29,014</u>	<u>-</u>	<u>29,014</u>
TOTAL ASSETS		<u>761,970</u>	<u>-</u>	<u>761,970</u>
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities		184,541	-	184,541
Due to related parties		218,351	-	218,351
TOTAL CURRENT LIABILITIES		<u>402,892</u>	<u>-</u>	<u>402,892</u>
SHAREHOLDERS' EQUITY				
Share capital		4,333,051	-	4,333,051
Deficit		(3,973,973)	-	(3,973,973)
TOTAL SHAREHOLDERS' EQUITY		<u>359,078</u>	<u>-</u>	<u>359,078</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u>761,970</u>	<u>-</u>	<u>761,970</u>

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18. TRANSITION TO IFRS (continued)

Reconciliation of Assets, Liabilities and Equity (continued)

	Note	As at December 31, 2010		
		Canadian GAAP \$	Effect of Transition to IFRS \$	IFRS \$
ASSETS				
Current assets				
Cash		26,912,843	-	26,912,843
Amounts receivable		141,340	-	141,340
Prepaid expenses		13,402	-	13,402
Total current assets		27,067,585	-	27,067,585
Non-current assets				
Exploration and evaluation assets	18(a)	-	31,121	31,121
Property, plant and equipment	18(a), 18(c)	1,163,990	63,530	1,227,520
Deposit and other costs		4,254,349	-	4,254,349
Total non-current assets		5,418,339	94,651	5,512,990
TOTAL ASSETS		32,485,924	94,651	32,580,575
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities		456,489	-	456,489
Non-current liabilities				
Provision for site restoration	18(c)	67,475	101,071	168,546
TOTAL LIABILITIES		523,964	101,071	625,035
SHAREHOLDERS' EQUITY				
Share capital		37,581,656	-	37,581,656
Share-based compensation reserve	18(b)	1,405,090	(265,179)	1,139,911
Deficit	18(b)	(7,024,786)	258,759	(6,766,027)
TOTAL SHAREHOLDERS' EQUITY		31,961,960	(6,420)	31,955,540
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		32,485,924	94,651	32,580,575

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18. TRANSITION TO IFRS (continued)

Reconciliation of Comprehensive Loss

	Note	Year Ended December 31, 2010		
		Canadian GAAP \$	Effect of Transition to IFRS \$	IFRS \$
Revenue				
Petroleum and natural gas sales		76,878	-	76,878
Royalties		<u>(3,976)</u>	<u>-</u>	<u>(3,976)</u>
		<u>72,902</u>	<u>-</u>	<u>72,902</u>
Expenses				
Operating		16,690	-	16,690
Depletion and depreciation		56,250	8,912	65,162
Accretion of provision for site restoration		3,356	(2,492)	864
General and administrative		1,888,589	-	1,888,589
Share-based compensation	18(b)	<u>964,714</u>	<u>(265,179)</u>	<u>699,535</u>
		<u>2,929,599</u>	<u>(258,759)</u>	<u>2,670,840</u>
(Loss) income before other items		<u>(2,856,697)</u>	<u>258,759</u>	<u>(2,597,938)</u>
Other items				
Loss on disposal of property, plant and equipment		(4,014)	-	(4,014)
Interest and other income		7,937	-	7,937
Foreign exchange		(39,861)	-	(39,861)
Abandonment of acquisition	18(a)	(158,178)	158,178	-
Impairment of exploration and evaluation assets	18(a)	<u>-</u>	<u>(158,178)</u>	<u>(158,178)</u>
		<u>(194,116)</u>	<u>-</u>	<u>(194,116)</u>
Comprehensive (loss) income for the year		<u>(3,050,813)</u>	<u>258,759</u>	<u>(2,792,054)</u>

IFRS Adjustments

(a) Exploration and Evaluation Assets

Exploration and evaluation assets at January 1, 2010 were deemed to be \$25,000 representing mineral property interests balance under Canadian GAAP. This resulted in a reclassification of \$25,000 from mineral property interests to exploration and evaluation assets on the Company's statement of financial position as at January 1, 2010.

Exploration and evaluation assets at December 31, 2010 were deemed to be \$31,121 representing the unproved properties balance under Canadian GAAP. This resulted in a reclassification of \$31,121 from property, plant and equipment to exploration and evaluation assets on the Company's statement of financial position as at December 31, 2010.

As at December 31, 2010 the Company's exploration and evaluation assets were \$31,121. In addition, the Company has reclassified \$158,178 from abandonment of acquisition to impairment of exploration and evaluation assets on the Company's statement of comprehensive loss for fiscal 2010.

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18. TRANSITION TO IFRS (continued)

(b) Share Based Options

Previously, under Canadian GAAP, the Company used the straight-line method of calculating vested options and the share-based compensation arising therefrom. Under this method, the fair value of share-based awards with graded vesting was calculated as one grant and the resulting fair value was recognised on a straight line basis over the vesting period.

However, IFRS requires that each tranche of an award with different vesting dates be considered a separate grant for the calculation of fair value, and the resulting fair value is recognised over the vesting period of the respective tranche using the graded vesting method.

There were no options outstanding at January 1, 2010, therefore, no adjustment was required at this date. However, adjustments were required for the options granted and the share-based compensation recognized during fiscal 2010.

(c) Provision for Decommissioning Obligations

Under Canadian GAAP the Company's provision for decommissioning liabilities at December 31, 2010 was \$67,475. Under IFRS, the Company is required to evaluate the pre-tax risk-free interest rate and inflation rate for each period. At December 31, 2010 a revision of estimates for decommissioning liabilities required an adjustment of \$19,745.