
EAST WEST PETROLEUM CORP.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED
JUNE 30, 2012

(Unaudited - Expressed in Canadian Dollars)

**NOTICE OF NO AUDITOR REVIEW OF
CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

In accordance with National Instrument 51-102 Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of these condensed consolidated interim financial statements they must be accompanied by a notice indicating that the condensed consolidated interim financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

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

	Note	June 30, 2012 \$	December 31, 2011 \$
ASSETS			
Current assets			
Cash	3	24,299,739	25,601,140
Amounts receivable	4	99,089	62,794
Prepaid expenses		<u>32,086</u>	<u>31,225</u>
Total current assets		<u>24,430,914</u>	<u>25,695,159</u>
Non-current assets			
Restricted cash	5(a)	3,566,850	3,561,442
Property, plant and equipment	6	<u>928,410</u>	<u>996,572</u>
Total non-current assets		<u>4,495,260</u>	<u>4,558,014</u>
TOTAL ASSETS		<u>28,926,174</u>	<u>30,253,173</u>
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		135,072	222,778
Non-current liabilities			
Decommissioning liabilities	7	<u>58,064</u>	<u>56,837</u>
TOTAL LIABILITIES		<u>193,136</u>	<u>279,615</u>
SHAREHOLDERS' EQUITY			
Share capital	8	38,003,360	38,382,398
Share-based compensation reserve		4,009,448	3,620,539
Deficit		<u>(13,279,770)</u>	<u>(12,029,379)</u>
TOTAL SHAREHOLDERS' EQUITY		<u>28,733,038</u>	<u>29,973,558</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		<u>28,926,174</u>	<u>30,253,173</u>

Nature of Operations - see Note 1

Commitments - see Note 11

Subsequent Events - see Note 14

These condensed consolidated interim financial statements were approved for issue by the Board of Directors on August 24, 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 condensed consolidated interim financial statements.

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

Note	Three Months Ended June 30,		Six Months Ended June 30,		
	2012 \$	2011 \$	2012 \$	2011 \$	
Revenue					
	Petroleum and natural gas sales	33,778	80,393	81,903	127,732
	Royalties	<u>(4,698)</u>	<u>(8,197)</u>	<u>(8,981)</u>	<u>(10,801)</u>
		<u>29,080</u>	<u>72,196</u>	<u>72,922</u>	<u>116,931</u>
Expenses					
	Operating	10,413	14,415	22,029	29,636
	Depletion and depreciation	6 32,851	40,734	69,327	85,819
	Finance expense of decommissioning liabilities	7 32	385	62	403
	General and administrative	544,672	488,259	1,091,717	1,292,504
	Share-based compensation	8(d) <u>303,895</u>	<u>1,151,785</u>	<u>388,909</u>	<u>2,444,496</u>
		<u>891,863</u>	<u>1,695,578</u>	<u>1,572,044</u>	<u>3,852,858</u>
	Loss before other items	<u>(862,783)</u>	<u>(1,623,382)</u>	<u>(1,499,122)</u>	<u>(3,735,927)</u>
Other items					
	Interest and other income	86,258	95,057	163,374	131,400
	Write-off of other costs	-	(727,399)	-	(727,399)
	Gain on disposal of exploration and evaluation assets	5(b) -	218,879	-	218,879
	Foreign exchange	<u>107,698</u>	<u>(35,684)</u>	<u>30,213</u>	<u>(212,008)</u>
		<u>193,956</u>	<u>(449,147)</u>	<u>193,587</u>	<u>(589,128)</u>
	Net loss and comprehensive loss for the period	<u>(668,827)</u>	<u>(2,072,529)</u>	<u>(1,305,535)</u>	<u>(4,325,055)</u>
	Basic and diluted loss per common share	<u>\$(0.01)</u>	<u>\$(0.02)</u>	<u>\$(0.02)</u>	<u>\$(0.05)</u>
	Weighted average number of common shares outstanding	<u>83,002,898</u>	<u>83,599,426</u>	<u>83,466,520</u>	<u>82,890,759</u>

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

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

	Six Months Ended June 30, 2012				
	Share Capital		Share-Based Compensation Reserve	Deficit	Total Equity
	Number of Shares	Amount \$			
Balance on December 31, 2011	83,700,648	38,382,398	3,620,539	(12,029,379)	29,973,558
Repurchase of common shares	(759,000)	(379,038)	-	55,144	(323,894)
Share-based compensation	-	-	388,909	-	388,909
Net loss and comprehensive loss	-	-	-	(1,305,535)	(1,305,535)
Balance at June 30, 2012	82,941,648	38,003,360	4,009,448	(13,279,770)	28,733,038

	Six Months Ended June 30, 2011				
	Share Capital		Share-Based Compensation Reserve	Deficit	Total Equity
	Number of Shares	Amount \$			
Balance on December 31, 2010	81,313,648	37,581,656	1,292,742	(6,916,989)	31,957,409
Common shares issued for:					
Cash - exercise of share options	45,000	10,250	-	-	10,250
Cash - exercise of warrants	1,975,000	671,500	-	-	671,500
Cash - exercise of compensation options	300,000	75,000	-	-	75,000
Share-based compensation	-	-	2,444,496	-	2,444,496
Transfer on exercise of share options	-	9,800	(9,800)	-	-
Transfer on exercise of compensation options	-	39,000	(39,000)	-	-
Net loss and comprehensive loss	-	-	-	(4,325,055)	(4,325,055)
Balance at June 30, 2011	83,633,648	38,387,206	3,688,438	(11,242,044)	30,833,600

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

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

	Six Months Ended June 30,	
	2012 \$	2011 \$
Operating activities		
Net loss for the period	(1,305,535)	(4,325,055)
Adjustments for:		
Depletion and depreciation	69,327	85,819
Finance expense of decommissioning liabilities	62	403
Share-based compensation	388,909	2,444,496
Gain on disposal of exploration and evaluation assets	-	(218,879)
Write-off of other costs	-	727,399
Foreign exchange	(5,408)	151,900
	<u>(852,645)</u>	<u>(1,133,917)</u>
Changes in non-cash working capital items:		
Decrease (increase) in amounts receivable	(36,295)	30,784
Increase in prepaid expenses	(861)	(43,730)
Decrease in accounts payable and accrued liabilities	(87,706)	(352,207)
	<u>(124,862)</u>	<u>(365,153)</u>
Net cash used in operating activities	<u>(977,507)</u>	<u>(1,499,070)</u>
Investing activities		
Expenditures on property, plant and equipment	-	(23,176)
Proceeds on sale of exploration and evaluation assets	-	250,000
Net cash provided by investing activities	<u>-</u>	<u>226,824</u>
Financing activities		
Issuance of share capital	-	756,750
Repurchase of common shares	(323,894)	-
Net cash (used in) provided by financing activities	<u>(323,894)</u>	<u>756,750</u>
Net change in cash	(1,301,401)	(515,496)
Cash at beginning of period	<u>25,601,140</u>	<u>26,912,843</u>
Cash at end of period	<u>24,299,739</u>	<u>26,397,347</u>

Supplemental cash flow information - See Note 12.

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

EAST WEST PETROLEUM CORP.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2012
(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

These condensed consolidated interim financial statements have been prepared using accounting policies consistent with International Financial Reporting Standards (“IFRS”), and in accordance with International Accounting Standards (“IAS”) 34, *Interim Financial Reporting*, as issued by the International Accounting Standards Board (“IASB”). These condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2011, which have been prepared in accordance with IFRS as issued by the IASB. The accounting policies followed in these condensed consolidated interim financial statements are consistent with those applied in the Company’s consolidated financial statements for the year ended December 31, 2011.

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.

Comparative Figures

Certain comparative figures have been reclassified to conform to the presentation used in the current period.

3. Cash

	June 30, 2012 \$	December 31, 2011 \$
Cash on hand	3,027,047	7,883,527
Demand deposits	<u>21,272,692</u>	<u>17,717,613</u>
	<u>24,299,739</u>	<u>25,601,140</u>

4. Amounts Receivable

	June 30, 2012 \$	December 31, 2011 \$
Production receivable	10,953	19,079
Canadian harmonized sales tax	17,681	42,678
Other	<u>70,455</u>	<u>1,037</u>
	<u>99,089</u>	<u>62,794</u>

EAST WEST PETROLEUM CORP.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
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5. Exploration and Evaluation Assets

	Cost \$
Balance at December 31, 2010	31,121
Disposal	<u>(31,121)</u>
Balance at December 31, 2011 and June 30, 2012	<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 to cost 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 to cost 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 to cost 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 \$3,566,850) 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.

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 retains a 15% carried interest in each block until the achievement of commercial production, at which time the Company will then be responsible for its 15% interest. During fiscal 2011 the Company recorded a gain of \$218,879 resulting from the application of the \$250,000 against capitalized costs.

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5. Exploration and Evaluation Assets (continued)

- (c) 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.
- (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 June 30, 2012 the Company had no amounts capitalized to exploration and evaluation assets.

6. Property, Plant and Equipment

Cost:	Petroleum and Natural Gas Properties \$	Office Furniture and Equipment \$	Leasehold Improvements \$	Total \$
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
Revision of estimate for decommissioning costs	1,165	-	-	1,165
Balance at June 30, 2012	1,181,211	28,460	23,668	1,233,339
	Petroleum and Natural Gas Properties \$	Office Furniture and Equipment \$	Leasehold Improvements \$	Total \$
Accumulated Depletion and Depreciation:				
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)
Depletion and depreciation for the period	(62,099)	(4,270)	(2,958)	(69,327)
Balance at June 30, 2012	(289,986)	(10,013)	(4,930)	(304,929)
	Petroleum and Natural Gas Properties \$	Office Furniture and Equipment \$	Leasehold Improvements \$	Total \$
Carrying Value:				
Balance at December 31, 2011	952,159	22,717	21,696	996,572
Balance at June 30, 2012	891,225	18,447	18,738	928,410

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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7. Decommissioning Liabilities

	Six Months Ended June 30, 2012 \$	Year Ended December 31, 2011 \$
Balance, beginning of period	56,837	168,546
Finance cost	62	927
Revision of estimate	1,165	(112,636)
Balance, end of period	<u>58,064</u>	<u>56,837</u>

The total amount of estimated cash flows required to settle the Company's estimated obligation is \$97,386 which has been discounted using pre-tax risk-free rates of between 1.21% to 2.82%. 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.

8. Share Capital

(a) *Authorized Share Capital*

At June 30, 2012 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 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>-</u>	<u>39,000</u>
Balance at December 31, 2011	83,700,648	38,382,398
Repurchase of common shares under normal course issuer bid	<u>(759,000)</u>	<u>(379,038)</u>
Balance at June 30, 2012	<u>82,941,648</u>	<u>38,003,360</u>

EAST WEST PETROLEUM CORP.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
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(Expressed in Canadian Dollars)

8. Share Capital (continued)

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 June 30, 2012 the Company has purchased 759,000 common shares, which have not yet been cancelled, for \$323,894 cash consideration. The average carrying value of the common shares was \$0.43 per share. The difference between the purchase price and the carrying value of the common shares was \$55,144. See also Note 14 (a).

(c) *Warrants*

A summary of the number of common shares reserved pursuant to the Company's outstanding warrants at June 30, 2012 and 2011 and the changes for the six months ended on those dates is as follows:

	2012		2011	
	Number	Weighted Average Exercise Price \$	Number	Weighted Average Exercise Price \$
Balance, beginning of period	26,105,595	1.12	28,020,595	1.07
Issued	-	-	300,000	0.34
Exercised	-	-	<u>(1,975,000)</u>	0.34
Balance, end of period	<u>26,105,595</u>	1.12	<u>26,345,595</u>	1.11

The following table summarizes information about the number of common shares reserved pursuant to the Company's warrants outstanding and exercisable at June 30, 2012:

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 the six months ended June 30, 2012 the Company granted 300,000 (2011 - 3,126,000) share options to its directors, employees and consultants and recorded compensation expense of \$354,689 (2011 - \$2,444,496) on the granting and vesting of share options.

During the six months ended June 30, 2012 the Company repriced stock options previously granted to purchase 686,000 common shares, from original exercise prices ranging from \$0.87 to \$1.16 per share to a revised exercise price of \$0.40 per share. The fair value of the repriced stock options have been estimated using the Black-Scholes option pricing model. The assumptions used were: risk-free interest rate 1.21% - 1.47%; estimated volatility 106% - 124%; expected life 2 years - 4 years; expected dividend yield 0%; and estimated forfeiture rate 0%. The value assigned to the re-pricing of the stock options was \$34,220.

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(Expressed in Canadian Dollars)

8. Share Capital (continued)

The fair value of share options granted and vested during the six months ended June 30, 2012 and 2011 is estimated using the Black-Scholes option pricing model using the following assumptions:

	<u>2012</u>	<u>2011</u>
Risk-free interest rate	0.96% - 1.34%	1.71 - 2.82%
Estimated volatility	109% - 131%	79% - 169%
Expected life	2 years - 4 years	1 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 and vested during the six months ended June 30, 2012 to the Company's directors, employees and consultants was \$0.20 (2011 - \$0.65) 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 June 30, 2012 and 2011 and the changes for the six months ended on those dates, is as follows:

	<u>2012</u>		<u>2011</u>	
	Number of Options Outstanding	Weighted Average Exercise Price \$	Number of Options Outstanding	Weighted Average Exercise Price \$
Balance, beginning of period	8,033,530	0.56	4,727,530	0.25
Granted	300,000	0.40	3,126,000	1.03
Exercised	-	-	(45,000)	0.23
Expired	<u>(100,000)</u>	0.50	<u>-</u>	-
Balance, end of period	<u>8,233,530</u>	0.40	<u>7,808,530</u>	0.56

The following table summarizes information about the share options outstanding and exercisable at June 30, 2012:

Number Outstanding	Number Exercisable	Exercise Price \$	Expiry Date
36,000	36,000	0.87	April 6, 2014
1,160,000	773,333	0.83	May 31, 2014
225,000	75,000	0.45	September 14, 2014
300,000	300,000	0.26	January 7, 2015
300,000	100,000	0.40	April 11, 2015
1,700,000	1,700,000	0.16	June 11, 2015
720,000	520,000	0.20	July 19, 2015
1,252,530	849,197	0.25	October 1, 2015
610,000	443,333	0.50	October 1, 2015
1,280,000	853,333	1.16	February 2, 2016
570,000	380,000	0.40	February 2, 2016
<u>80,000</u>	<u>80,000</u>	0.90	March 14, 2016
<u>8,233,530</u>	<u>6,110,196</u>		

See also Note 14(b) and(c).

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(Expressed in Canadian Dollars)

8. Share Capital (continued)

(e) *Compensation Options*

During fiscal 2010 the Company granted 1,031,000 compensation options with each compensation option entitling the holder to purchase one unit for \$0.25 per unit. Each unit comprises 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.

A summary of the Company's compensation options at June 30, 2012 and 2011 and the changes for the six months ended on those dates, is as follows:

	2012		2011	
	Number Outstanding	Weighted Average Exercise Price \$	Number Outstanding	Weighted Average Exercise Price \$
Balance, beginning of period	731,000	0.25	1,031,000	0.25
Exercised	-	-	(300,000)	0.25
Balance, end of period	731,000	0.25	731,000	0.25

As at June 30, 2012, 731,000 compensation options were outstanding and exercisable at an exercise price of \$0.25 expiring September 29, 2013.

(f) *Escrow Shares*

As at June 30, 2012 there are 2,995,536 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.

9. 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 the six months ended June 30, 2012 and 2011 the following amounts were incurred with respect to the President, Chairman, Chief Financial Officer and Vice-President of Engineering of the Company:

	2012 \$	2011 \$
Professional fees	76,500	69,825
Salaries	219,567	97,681
Health benefit premiums	7,064	1,894
Share-based compensation	266,290	1,212,873
	569,421	1,382,273

As at June 30, 2012, \$8,000 (2011 - \$29,072) remained unpaid and has been included in accounts payable and accrued liabilities.

See also Note 11(b).

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9. Related Party Transactions and Balances (continued)

(b) *Transactions with Other Related Parties*

During the six months ended June 30, 2012 and 2011 the following amounts were incurred with respect to other officers and directors of the Company and family members:

	2012 \$	2011 \$
Professional fees	222,000	235,000
Legal	8,128	19,660
Rent	-	5,250
Share-based compensation	<u>228,062</u>	<u>829,615</u>
	<u>458,190</u>	<u>1,089,525</u>

As at June 30, 2012, \$41,560 (2011 - \$9,000) remained unpaid and has been included in accounts payable and accrued liabilities.

The Company also paid \$1,984 (2011 - \$2,208) to the spouse of the President of the Company for professional services rendered.

See also Note 11.

10. 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	June 30, 2012 \$	December 31, 2011 \$
Cash	FVTPL	24,299,739	25,601,140
Amounts receivable	Loans and receivables	99,089	62,794
Restricted cash	FVTPL	3,566,850	3,561,442
Accounts payable and accrued liabilities	Other liabilities	(135,072)	(222,778)

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.

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

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10. Financial Instruments and Risk Management (continued)

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 June 30, 2012 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 June 30, 2012				
	Less than 3 Months \$	3 - 12 Months \$	1 - 5 Years \$	Over 5 Years \$	Total \$
Cash	24,299,739	-	-	-	24,299,739
Amounts receivable	99,089	-	-	-	99,089
Restricted cash	-	-	3,566,850	-	3,566,850
Accounts payable and accrued liabilities	(135,072)	-	-	-	(135,072)
	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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10. Financial Instruments and Risk Management (continued)

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 June 30, 2012, 1 Canadian Dollar was equal to 0.98 US Dollar.

Balances are as follows:

	US Dollar	Canadian Dollar Equivalent
Cash	1,213,088	1,237,845
Restricted cash	3,500,000	3,566,850
Accounts payable and accrued liabilities	<u>(60,223)</u>	<u>(61,452)</u>
	<u>4,652,865</u>	<u>4,743,243</u>

Based on the net exposures as of June 30, 2012 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 \$427,000 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.

11. 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 the six months ended June 30, 2012 the Company received \$16,530 from the public company for shared premises.

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11. Commitments (continued)

- (b) The Company and Greg Renwick have 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 is currently paying Mr. Renwick a base salary of US \$250,000 per annum. The agreement expires on September 30, 2013.

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 5(a) and 5(b).

12. Supplemental Cash Flow Information

During the six months ended June 30, 2012 and 2011 non-cash activities were conducted by the Company as follows:

	2012 \$	2011 \$
Investing activity		
Expenditures on property, plant and equipment	<u>(1,165)</u>	<u>(14,941)</u>
Operating activity		
Provision for decommissioning liabilities	<u>1,165</u>	<u>14,941</u>

13. 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.

	<u>As at June 30, 2012</u>		
	Canada \$	Other \$	Total \$
Current assets	24,319,719	111,195	24,430,914
Restricted cash	3,566,850	-	3,566,850
Property, plant and equipment	<u>928,410</u>	<u>-</u>	<u>928,410</u>
	<u>28,814,979</u>	<u>111,195</u>	<u>28,926,174</u>
	<u>As at December 31, 2011</u>		
	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	<u>996,572</u>	<u>-</u>	<u>996,572</u>
	<u>30,147,181</u>	<u>105,992</u>	<u>30,253,173</u>

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14. Subsequent Events

- (a) Subsequent to June 30, 2012 the Company repurchased an additional 59,000 common shares under its Normal Course Issuer Bid for \$19,658 cash consideration.
- (b) In July 2012 the Company extended the expiry dates:
 - (i) on 36,000 share options with an exercise price of \$0.40 per share expiring on April 6, 2014 to a revised expiry date of April 6, 2016; and
 - (ii) on 1,160,000 share options with an exercise price of \$0.83 per share expiring on May 31, 2014 to a revised expiry date of May 31, 2016.

All other terms of the options remained the same.

- (c) On July 5, 2012 the Company received disinterested shareholder approval to amend 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.