



**Condensed Consolidated Financial Statements**  
(Unaudited)

**For the nine months ended September 30, 2011**  
(In United States Dollars)

**GREENFIELDS PETROLEUM CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)  
(In United States Dollars)

(\$ Thousands)		As at September 30, 2011	As at December 31, 2010
			(Note 22.1)
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents	(Note 5)	28,615	47,977
Short term investments	(Note 6)	4,593	-
Trade receivables	(Note 7)	4,792	3,373
Receivables from related party	(Note 8)	3,734	2,727
Note receivable from related party	(Note 8)	8,851	-
Other receivable		291	-
Prepaid expenses and deposits	(Note 9)	2,112	273
		52,988	54,350
<b>Non-Current Assets</b>			
Investments		254	291
Deferred tax assets		3,528	1,588
Property and equipment	(Note 10)	6,324	1,087
		63,094	57,316
<b>Liabilities and Equity</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities	(Note 11)	2,645	2,278
Payables to related parties	(Note 8)	1,235	2,361
Notes payable	(Note 8)	8,068	-
Warrants	(Note 12)	1,043	2,219
		12,991	6,858
Deferred tax liabilities		188	-
<b>Shareholders' Equity</b>			
Common stock	(Note 13)	15	15
Paid in capital		56,742	56,526
Contributed surplus		2,627	1,361
Deficit		(9,440)	(7,445)
Accumulated other comprehensive loss		(30)	-
Total Shareholders' Equity		49,914	50,457
Non-controlling interest		1	1
Total Equity		49,915	50,458
		63,094	57,316

See accompanying Notes to Condensed Consolidated Financial Statements

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

(signed) "Michael J. Hibberd"  
Michael J. Hibberd  
Director

**GREENFIELDS PETROLEUM CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF NET LOSS**

(Unaudited)  
(In United States Dollars)

(\$ Thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
		(Note 22.3)		(Note 22.3)
<b>Revenues</b>				
Petroleum and natural gas	5,172	-	15,953	-
Transportation and storage fees	582	-	1,704	-
Management service fees	568	84	3,025	419
	6,322	84	20,682	419
<b>Expenses</b>				
Operating	3,858	-	12,196	-
Transportation	136	-	433	-
Exploration and evaluation	214	-	570	-
Administrative	4,425	2,048	12,038	4,608
Depreciation and amortization	35	3	73	8
	8,668	2,051	25,310	4,616
Loss from operating activities	(2,346)	(1,967)	(4,628)	(4,197)
Dividends and interest income	(181)	-	(352)	-
Interest expense	110	-	173	-
Loss on investments	108	-	108	226
Change in fair value of warrants	(1,170)	(183)	(1,163)	(113)
Loss before income taxes and non-controlling interest	(1,213)	(1,784)	(3,394)	(4,310)
Income tax recovery	(752)	(657)	(1,399)	(1,176)
Net Loss	(461)	(1,127)	(1,995)	(3,134)
Income attributable to non-controlling interest	-	-	-	(24)
<b>Net loss attributable to shareholders of Greenfields Petroleum Corporation</b>	(461)	(1,127)	(1,995)	(3,158)
<b>Per share</b>				
Net loss per share, basic and diluted (Note 13)	(\$0.03)	(\$0.13)	(\$0.13)	(\$0.40)

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(Unaudited)  
(In United States Dollars)

(\$ Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net Loss	(461)	(1,127)	(1,995)	(3,158)
Unrealized loss on short term investments	(87)	-	(46)	-
Income tax recovery	30	-	16	-
	(57)	-	(30)	-
<b>Comprehensive loss</b> (Note 15)	(518)	(1,127)	(2,025)	(3,158)

See accompanying Notes to Condensed Consolidated Financial Statements

**GREENFIELDS PETROLEUM CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

(Unaudited)

(In United States Dollars)

(\$ Thousands)	Nine Months Ended September 30,	
	2011	2010
		(Note 22.4)
<b>Membership units</b>		
Balance, beginning of period	-	4,255
Issued per long term incentive plan	-	330
Value of unvested restricted units	-	(176)
Distribution to unitholders	-	(4)
		4,405
Cancellation of membership units	-	(4,405)
Balance, end of period	-	-
<b>Common stock</b>		
Balance, beginning of period	15	-
Common shares issued upon conversion	-	8
Issued pursuant to private placements	-	2
Balance, end of period	15	10
<b>Paid in Capital</b>		
Balance, beginning of period	56,526	-
Common shares issued upon conversion	-	4,399
Issued pursuant to private placements	-	15,996
Repurchase of common shares	(208)	(21)
Share issue costs	-	(1,203)
Private placement broker commission	(54)	209
Warrant exercise	27	-
Stock-based compensation	49	45
Excess tax benefit - share grants	337	9
Forfeiture of stock options	65	-
Balance, end of period	56,742	19,434
<b>Contributed Surplus</b>		
Balance, beginning of period	1,361	-
Stock-based compensation	1,331	726
Forfeiture of stock options	(65)	-
Balance, end of period	2,627	726
<b>Deficit</b>		
Balance, beginning of period	(7,445)	(2,576)
Net loss	(1,995)	(3,158)
Balance, end of period	(9,440)	(5,734)
<b>Accumulated Other Comprehensive Loss</b>		
Balance, beginning of period	-	-
Unrealized loss on short term investments	(30)	-
Balance, end of period	(30)	-
<b>Total Shareholders' Equity</b>	<b>49,914</b>	<b>14,436</b>
<b>Non-controlling Interest</b>		
Balance, Beginning of period	1	5
Change	-	(4)
<b>Total Non-controlling Interest</b>	<b>1</b>	<b>1</b>
<b>Total Equity</b>	<b>49,915</b>	<b>14,437</b>

See accompanying Notes to Condensed Consolidated Financial Statements

**GREENFIELDS PETROLEUM CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)  
(In United States Dollars)

(\$ Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
		(Note 22.5)		(Note 22.5)
<b>Operating Activities</b>				
Net loss	(461)	(1,127)	(1,995)	(3,158)
<u>Items not affecting cash:</u>				
Stock-based compensation	464	743	1,380	925
Depreciation and amortization	35	4	73	8
Loss on investment	-	-	-	217
Non-controlling interest	-	( 1)	-	24
Income tax (recovery) - loss from operations	(752)	(657)	(1,575)	(1,176)
Other deferred tax asset changes	-	-	176	-
Excess tax benefit - share grant compensation	-	-	(337)	-
Change in fair value of warrants	(1,170)	(183)	(1,163)	(113)
	(1,884)	(1,221)	(3,441)	(3,273)
Change in non-cash operating working capital (Note 17)	(567)	215	(5,317)	611
<b>Cash Used in Operating Activities</b>	<b>(2,451)</b>	<b>(1,006)</b>	<b>(8,758)</b>	<b>(2,662)</b>
<b>Financing Activities</b>				
Proceeds from issue of common shares	-	12,511	15	17,245
Share issue costs	(5)	(790)	(55)	(918)
Deferred share issue costs	-	(181)	-	(617)
Distributions paid to unitholders	-	-	-	(4)
Repurchase of common shares	-	(21)	(208)	(21)
Proceeds from notes payable (Note 8)	109	-	8,068	-
Non-controlling interest cash distributions	-	-	-	(29)
Excess tax benefit - share grant compensation	-	-	337	-
<b>Cash From Financing Activities</b>	<b>104</b>	<b>11,519</b>	<b>8,157</b>	<b>15,656</b>
<b>Investing Activities</b>				
Property and equipment	(4,361)	(8)	(5,308)	(37)
Notes receivable from related parties (Note 8)	(108)	-	(8,851)	-
Investments	5,136	-	(4,602)	(182)
<b>Cash Used in Investing Activities</b>	<b>667</b>	<b>(8)</b>	<b>(18,761)</b>	<b>(219)</b>
<b>(Decrease) Increase in Cash and Cash Equivalents</b>	<b>(1,680)</b>	<b>10,505</b>	<b>(19,362)</b>	<b>12,775</b>
<b>Cash and Cash Equivalents, beginning of period</b>	<b>30,295</b>	<b>3,596</b>	<b>47,977</b>	<b>1,326</b>
<b>Cash and Cash Equivalents, end of period</b> (Note 5)	<b>28,615</b>	<b>14,101</b>	<b>28,615</b>	<b>14,101</b>
<b>Supplementary Cash Flow Information</b>				
Cash received from interest	40	-	79	-
Cash received from dividends	44	-	109	-

See accompanying Notes to Condensed Consolidated Financial Statements

**GREENFIELDS PETROLEUM CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011**

(Unaudited)

(In United States Dollars)

**1. INCORPORATION AND NATURE OF OPERATIONS**

Greenfields Petroleum Corporation (the “**Company**” or “**Greenfields**”), was incorporated in Cayman Islands on August 18, 2011. The corporate office of the Company is located at 211 Highland Cross Drive, Suite 227, Houston, Texas, 77073, U.S.A., and the registered office is Walker House, 87 Mary Street, Grand Cayman, Ky1-9005, Cayman Islands. The Company’s common shares are listed on Toronto’s TSX – Venture Exchange (“**TSX-V**”) under the trading symbol “**GNF**”.

The Company was originally incorporated under the laws of the State of Texas as Greenfields Petroleum, Inc. on November 28, 2007, and subsequently converted to Greenfields Petroleum, LLC on April 4, 2008, a State of Texas Limited Liability Company. On February 19, 2010, the Company converted to an incorporated company registered in the State of Delaware and concurrently changed its name to Greenfields Petroleum Corporation. On August 18, 2011 the Company completed a redomestication changing its corporate status and domicile from a State of Delaware corporation into a new Cayman Islands corporation. See *Note 21, Redomestication of the Company*.

The Company is a junior oil and natural gas exploration and development corporation focused on the development and production of proven oil and gas reserves principally in the Republic of Azerbaijan (“**Azerbaijan**”).

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

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

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

Upon assuming control of operations on October 1, 2010, Bahar Energy was required to complete and submit to SOCAR within 90 days the draft rehabilitation and production plan for the Bahar and Gum Deniz fields. The plan, referred to as the “Rehabilitation and Production Programme”, was submitted to SOCAR in late December 2010. Under the ERDPSA, Bahar Energy has the obligation to achieve, not later than three (3) years from the date of SOCAR’s approval of the “Rehabilitation and Production Programme”, an average daily rate of petroleum production from the contract rehabilitation area during ninety (90) consecutive days 150% of the average 2008 production rates.

Meeting the 150% production rate will result in the realization of the full 25 year term of the agreement for

the Contract Rehabilitation Area. If Bahar Energy fails to meet the 150% production target within the three year timeframe, SOCAR shall have the right to terminate the ERDPSA in relation to the Contract Rehabilitation Area. Approval of the “Rehabilitation and Production Programme” was received from SOCAR on June 22, 2011 establishing the start date for the three year period in which the production target must be met.

In addition to the 150% production levels for continuance of the ERDPSA for the 25 year term, Bahar Energy is obligated to carry SOA's 20% share of expenditures in the rehabilitation area until production rates are two times the 2008 production rates at which time SOA becomes responsible for fully funding their share of expenditures. The SOA carry for the rehabilitation area is reimbursed out of SOA's share of entitlement petroleum or revenues currently produced from the rehabilitation area. Any unrecovered balance is carried forward from one period to the next. Since the carried costs are reimbursed from current petroleum production and the revenues they create, the impact on Bahar Energy's cash flows are not materially affected.

The Company's principal business activity is in the country of Azerbaijan. Laws and regulations affecting businesses operating in Azerbaijan are subject to rapid changes and the Company's assets and operations could be at risk in the event of negative changes in the political and business environment.

## 2. BASIS OF PRESENTATION

These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). Previously, the Company prepared its annual and interim consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”) then applicable to publicly accountable enterprises.

As these condensed consolidated financial statements present the Company's initial financial results of operations and financial position under IFRS for the three and nine months ended September 30, 2011 including 2010 comparative periods, they have been prepared in accordance with IFRS 1 “First-time Adoption of International Financial Reporting Standards” and with International Accounting Standard (“IAS”) 34 “Interim Financial Reporting”.

These condensed consolidated financial statements are unaudited and do not include all the necessary annual disclosures in accordance with IFRS; therefore, they should be read in conjunction with the unaudited condensed consolidated financial statements for the three months ended March 31, 2011 and the six months ended June 30, 2011 prepared in accordance with IAS 34 and IFRS 1 and the audited consolidated financial statements for the year ended December 31, 2010, which were prepared in accordance with GAAP.

The preparation of these condensed consolidated financial statements resulted in changes to accounting policies as compared with the most recent annual consolidated financial statements prepared in accordance with GAAP. The accounting policies set out in Note 3 have been retrospectively and consistently applied except where specific exemptions permitted an alternative treatment upon transition to IFRS in accordance with IFRS 1. The impact of the transition from GAAP to IFRS is presented in Note 22.

The policies applied in these condensed consolidated financial statements are based on IFRS issued and outstanding as of November 28, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect to in the Company's annual financial statements for the year ending December 31, 2011 could result in restatement of these condensed financial statements, including the transition adjustments described in Note 22.

These condensed consolidated financial statements were prepared on a going concern basis, under the historical cost convention, except for certain financial assets and liabilities measured at fair value through the Consolidated Statements of Net Loss and the Consolidated Statements of Comprehensive Loss.

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

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### Consolidation

The interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and its proportionate share of the accounts of joint ventures. Investments in companies in which the Company exercises control are consolidated in these financial statements. The equity in the subsidiary that is not controlled by the Company is presented in equity as a non-controlling interest. All inter-company transactions and balances have been eliminated.

#### Investments in companies

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

Investments in companies in which the Company does not maintain significant influence or joint control are accounted for at fair value or cost as described in the "Fair Value of Financial Instruments" section of Note 19.

#### Critical judgments and estimation uncertainty

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

In particular, the test for impairment and impairment reversals of property and equipment are based on estimates of oil production rates, commodity prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the interim condensed consolidated financial statements of changes in such estimates could be significant.

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

The measurements of income tax expense and the related provisions on the interim consolidated balance sheets are subject to uncertainty associated with future recoverability of oil and natural gas reserves, commodity prices, the timing of future events and changes in legislation, tax rates and interpretations by tax authorities.

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



## **Cash and cash equivalents**

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

## **Accounts receivable**

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

## **Exploration and evaluation costs ("E&E")**

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

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

## **Property and equipment ("P&E")**

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

Major replacements are capitalized if it is probable that future economic benefits associated with the item will flow to the Company. The replaced asset is derecognized with the gain or loss arising from the derecognition included in profit or loss. Repairs and maintenance costs are charged as an expense when incurred.

## **Depreciation and amortization**

Capitalized costs of oil and gas properties are depleted using the unit of production method; acquisition costs of properties are amortized over the Company's best estimate of recoverable reserves. For purposes of these calculations, production and reserves of natural gas are converted to barrels on an energy equivalent basis at a ratio of six thousand cubic feet of natural gas for one barrel of oil. To the extent significant development costs are incurred in connection with undeveloped reserves, such costs are excluded from depreciation until the reserves are developed and the assets are ready for their intended use. Company assets are depreciated on a straight-line basis over their estimated service lives. E&E assets are not amortized.

## **Impairment**

### **Financial assets**

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired except those reported at fair value through profit or loss. If evidence exists,

the measurement of impairment depends on the type of financial asset under review.

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

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

### **Non-financial assets**

Non-financial assets are assessed for indications of impairment or reversals of previous impairments at the end of each reporting period. If any indication of impairments exists, the recoverable amount of the assets is estimated and, if the carrying amount exceeds the recoverable amount, an impairment loss is recognized for the difference. An asset's recoverable amount is the higher of its fair value less costs to sell or its value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less cost to sell, recent market transactions are taken into account, if available. If no transactions can be identified, an appropriate valuation model is used.

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

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

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

### **Share-based payments**

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

### **Income taxes**

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

The Company uses the liability method to account for income taxes. Under this method, future income

taxes are based on the difference between assets and liabilities reported for financial accounting purposes from those reported for income tax. Future income tax assets and liabilities are measured using the substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. Deferred income tax assets are recognized to the extent future recovery is probable. Deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered. Deferred tax assets and tax liabilities are offset to the extent there is a legal right to settle on a net basis.

The Company's contractual arrangements in foreign jurisdictions stipulate that income taxes are paid by the respective government out of its entitlement share of production sharing petroleum. Such amounts are included in income tax expense at the statutory rate in effect at the time of production.

### **Revenue recognition**

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

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

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

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

Management service fees represent revenues for administrative, operational and technical support provided to third parties and affiliates. The management fees are recognized when the related services have been provided, no further obligations are required to earn the management fees and when ultimate collection is reasonably assured.

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

### **Provisions**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by recognizing the present value of the estimated future cash flows, discounted using a risk-free rate.

The Company, under the ERDPSA is responsible for the direct funding of an Asset Retirement Obligation ("ARO") for the assets managed under the agreement into an Abandonment Fund. However, such

obligation is not enforceable until such time that the Contractors and SOCAR have agreed to the mechanism of funding. Under the ERDPSA, within twelve months following the effective date (October 1, 2010), the Contractors and SOCAR must agree and accept the mechanism for making contributions to an Abandonment Fund for the Contract Rehabilitation Area.

Once the funding mechanisms have been agreed upon and the obligation can be determined, the Company will record expenses associated with recognizing the obligations as they become contractually due. The Company has no other abandonment obligations under the ERDPSA other than to fund its share of Abandonment Fund contributions as contractually established. As at September 30, 2011 no abandonment obligation existed under the ERDPSA.

As of the date of these financial statements, an Abandonment Fund protocol has been developed by the steering committee of BEOC and submitted to SOCAR for review and approval.

### **Carried interest**

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

### **Leases**

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

### **Per share amounts**

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

### **Financial instruments**

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

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

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

effective interest rate method. Transaction costs related to financial assets and liabilities at fair value through profit or loss are expensed as incurred; all other transaction costs are added to the fair value of the associated financial instrument on initial recognition.

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

### **Warrants**

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

### **Comprehensive income (loss)**

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss) ("OCI"). OCI may include gains and losses from:

- the foreign exchange translation of net investments in foreign operations
- the effective portion of derivatives used as a hedging item in a cash flow hedge or net investment hedge
- "available-for-sale" financial instruments that are fair value measured

Accumulated other comprehensive income ("AOCI") is a separate component of shareholders' equity comprised of the cumulative amounts of OCI.

### **Foreign currency translation**

The Company and its subsidiaries, joint ventures and partnerships have a United States ("US") dollar functional currency. Revenues and expenses are translated at estimated transaction date exchange rates except depreciation and amortization expense, which is translated at the same historical rates as the related assets. Foreign currency denominated monetary assets and liabilities are translated at the period-end exchange rate. Foreign currency denominated non-monetary assets and liabilities are translated at their historical rate. Gains and losses arising from foreign currency translation are recognized in the consolidated statement of income (loss).

### **Measurement uncertainty**

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses for the periods presented.

Key areas where management has made complex or subjective judgments include asset retirement obligations, assessment of impairments and deferred taxes. Actual results could differ from these and other estimates.

#### **4. FUTURE ACCOUNTING CHANGES**

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective as of November 29, 2011.

IFRS 9 “Financial Instruments”, which is the result of the first phase of the IASB’s project to replace IAS 39, “Financial Instruments: Recognition and Measurement”. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The standard is required to be adopted for periods beginning January 1, 2015. The adoption of this standard should not have a material impact on the Company’s consolidated financial statements.

IFRS 13 “Fair Value Measurement” will improve consistency and reduce complexity by providing, for the first time, a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS. The standard is required to be adopted for periods beginning January 1, 2013 with early adoption permitted. The Company has not yet assessed the impact of the standard or whether it will adopt the standard early.

IFRS 10 “Consolidated Financial Statements”, IFRS 11 “Joint Arrangements”, IFRS 12 “Disclosure of Involvement with Other Entities”; as well as revisions to IAS 27 “Separate Financial Statements” and IAS 28 “Investments in Associates”. These standards are required to be adopted for periods beginning January 1, 2013 with early adoption permitted as long as all five standards are adopted at the same time. The Company has not yet assessed the impact of the standards or whether it will adopt the standards early.

IFRS 10 replaces the consolidation requirements in SIC-12 “Consolidation—Special Purpose Entities” and IAS 27 “Consolidated and Separate Financial Statements” and builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess.

IFRS 11 provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method (equity method) to account for interests in most jointly controlled entities. The Company has not yet assessed the impact of the standard.

IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities.

#### **5. CASH AND CASH EQUIVALENTS**

The Company periodically invests its idle cash in deposits and short term money market investments with maturity dates of less than three months. At September 30, 2011, the Company had a total of \$23.7 million (December 31, 2010 - \$ 40.0 million) invested in cash equivalents earning a money market rate of interest.

At September 30, 2011, the Company also had \$4.2 million (December 31, 2010 - \$3.1 million) of cash in Bahar Energy, which is limited to the use in the rehabilitation and development activities of the ERDPSA project in Azerbaijan.

## 6. SHORT TERM INVESTMENTS

(\$ Thousands)	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Corporate bonds	4,593	4,593	-	-
	4,593	4,593	-	-

The Company periodically invests in investment grade corporate bonds and income producing blue chip equity instruments. At September 30, 2011, the Company had a total of \$4.6 million (December 31, 2010 - \$ nil) invested in BBB grade or better corporate bonds with maturities ranging from three to thirty one months and a yield to maturity of 1.11%.

## 7. TRADE RECEIVABLES

(\$ Thousands)	September 30, 2011	December 31, 2010
Petroleum	2,696	1,683
Natural gas	484	1,690
Transportation and storage fees	1,612	-
	4,792	3,373

## 8. RELATED PARTY TRANSACTIONS

### Receivables from related party

At September 30, 2011, the Company had a balance of \$3.7 million (December 31, 2010 - \$2.7 million) in accounts receivable from Bahar Energy, an investee accounted for as a joint venture.

### Note receivable from related party

At September 30, 2011, the Company has a note and interest receivable balance of \$8.9 million (December 31, 2010 - \$ nil) related to a loan made to Bahar Energy under the Common Terms Agreement (“CTA”).

Interest accumulates at the three month London Interbank Offer Rate (“LIBOR”) quoted on a calendar quarter plus 4.5%. See Note 18, *Commitments and Contingencies* and Note 8, *Notes payable below*.

### Payables to related parties

At September 30, 2011, the Company had a \$1.2 million (December 31, 2010 - \$2.4 million) payable balance to certain shareholders of Bahar Energy for their services performed under “Affiliate Service Orders” (ASO).

### Notes payable

At September 30, 2011, the Company, through its 33.33% interest in Bahar Energy, had a related party notes payable balance of \$8.1 million (December 31, 2010 – \$ nil) owed to shareholders of Bahar Energy. The notes payable are the result of the CTA between the shareholders of Bahar Energy whereby each shareholder agrees to grant a credit facility to Bahar Energy up to specific amounts during a commitment period.

Bahar Energy may request a draw or advance under a Loan Agreement subject to the terms of the CTA. The proceeds from each advance under the Loan Agreement shall be used for the approved Annual Work Program and Budget of the ERDPSA and for general corporate purposes as authorized by the shareholders of Bahar Energy. Interest accumulates at the three month LIBOR rate quoted on a calendar

quarter plus 4.5%, which the Company has deemed to be an appropriate commercial rate.

Loan repayment will be funded from the future cash flows of the ERDPSA that remain after retention by Bahar Energy of funds required for near term operations and adequate cash reserves.

### Repurchase of common stock

In February 2011, the Company repurchased 20,641 shares of common stock at CDN\$10.00 per share as a result of cashless vesting elections of share grants issued to certain employees on February 2, 2010 under a Long Term Incentive Plan (“LTIP”). The cashless vesting provision of the LTIP provides the option for the employees to sell to the Company the number of shares equal to their statutory withholding tax due at vesting date.

During the third quarter of 2010, the Company repurchased 3,306 shares of common stock at CDN\$6.50 per share from a former officer who had elected the same cashless vesting option noted above.

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

As at September 30, 2011, all shares of Treasury stock previously held by the Company as a result of the repurchase of common stock under the Company’s LTIP have been cancelled.

## 9. PREPAID EXPENSES AND DEPOSITS

At September 30, 2011, the Company had a \$2.1 million balance of prepaid expenses and deposits (December 31, 2010 - \$.3 million). Most of the 2011 balance is made up of advances to vendors related to the company’s interest in Bahar Energy. The advances were made to various foreign and local vendors for the purchase of drilling materials and equipment, platform refurbishment supplies and machinery spare parts.

## 10. PROPERTY AND EQUIPMENT

(\$ Thousands)	Azerbaijan	Corporate and Other	Total
<u>Cost</u>			
As at December 31, 2010	1,026	78	1,104
Additions	5,261	47	5,308
As at September 30, 2011	6,287	125	6,412
<u>Accumulated D&amp;A</u>			
As at December 31, 2010	3	14	17
Additions	41	30	71
As at September 30, 2011	44	44	88
<u>Net property and equipment</u>			
As at December 31, 2010	1,023	64	1,087
As at September 30, 2011	6,243	81	6,324



## 11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

(\$ Thousands)	September 30, 2011	December 31, 2010
Trade accounts payable	1,566	1,987
Accrued liabilities	1,023	291
Taxes payable	56	-
	<u>2,645</u>	<u>2,278</u>

## 12. WARRANTS

	Warrants	US\$000's Amount
<b>Balance December 31, 2010</b>	525,000	2,219
Fair Value Adjustment	-	(1,163)
Exercised (Exercise Price = CND \$5.00)	(3,000)	(13)
<b>Balance September 30, 2011</b>	<u>522,000</u>	<u>1,043</u>

The initial recorded value of the Canadian dollar denominated purchase warrants issued on February 24, 2010 was calculated using the Black-Scholes pricing model over the 24 month term of the warrants with a risk free interest rate of 0.87% based on 2 year term US treasury bonds and 104% volatility calculated on a composite of six Toronto Stock Exchange and TSX-V traded companies with similar company profiles.

The fair value as at the measurement dates of September 30, 2011 and December 31, 2010 was calculated using the Black-Scholes pricing model with reassessed volatility of 44% and 50% respectively, along with term, interest rate, and exchange rate assumptions consistent with these measurement dates and applied over both the warrant exercises and remaining net balances.

## 13. SHAREHOLDERS' EQUITY

### Common Stock

Authorized share capital consists of 49,900,000 common shares and 100,000 preferred shares, each at US \$.001 par value. There were no preferred shares issued and outstanding at September 30, 2011 (December 31, 2010 - nil; January 1, 2010 nil).

### Reconciliation of Outstanding Shares

	September 30, 2011	December 31, 2010
Issued	14,872,327	14,869,327
Cancelled Treasury Stock (See Note 8 Related Party Transactions)	(23,947)	(3,306)
Total Outstanding	<u>14,848,380</u>	<u>14,866,021</u>

As at September 30, 2011, the Company did not have any outstanding Treasury stock.

### Per Share Information

For the three and nine months ended September 30, 2011, basic per share amounts are calculated using the weighted average number of common shares outstanding of 14,848,380 and 14,850,140 (2010 – 8,010,000 and 7,611,215).

There is a loss for each of the periods ended September 30, 2011 and 2010, and as a result there is no difference between the basic and diluted earnings per share.

Potentially Dilutive Ordinary Shares	September 30,	
	2011	2010
Warrants	522,000	530,000
Stock Options	1,392,250	-

At January 1, 2010, the Company had no dilutive securities outstanding.

#### 14. SHARE BASED PAYMENTS

The Company has a stock option plan that governs the granting of options to employees, officers and directors. All options issued by the Company permit the holder to purchase a specific number of common shares of the Company at the stated exercise price. The Company has not issued stock options that permit the recipient to receive a cash payment equal to the appreciated value in lieu of stock.

Continuity of Stock Options	Nine Months Ended September 30, 2011		Year Ended December 31, 2010	
	Number of shares underlying options	Average exercise price (CND\$)	Number of shares underlying options	Average exercise price (CND\$)
<b>Outstanding, beginning of period</b>	1,211,000	6.87	-	-
Granted	30,000	9.50	1,211,000	6.87
Granted	100,000	9.00	-	-
Granted	100,000	8.00	-	-
Exercised for common shares	-	-	-	-
Expired	-	-	-	-
Forfeited	(48,750)	6.50	-	-
<b>Outstanding, end of period</b>	<b>1,392,250</b>	<b>7.17</b>	<b>1,211,000</b>	<b>6.87</b>
<b>Exercisable, end of period</b>	<b>665,500</b>	<b>6.85</b>	<b>302,750</b>	<b>6.87</b>

(\$ Thousands)	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
<b>Stock option related share based compensation expense</b>	444	726	1,331	726

The exercise prices of the stock options range from CDN\$6.50 to CDN\$9.50 per common share. All options expire on various dates between years 2020 and 2021. For the initial grant of 986,000 stock options, 25% vest on the date of grant and 25% vest on each of May 1, 2011, May 1, 2012 and May 1, 2013, except for stock options issued to a certain executive officer, which vest as to 25% on August 31, 2010 and 25% vest on each of the first, second and third anniversaries of February 1, 2010. For the second grant of 225,000 stock options, 25% vest on the date of the grant and 25% vest on each of the first, second and third anniversaries of November 1, 2011.

For the third grant of 30,000 stock options, 25% vest on the date of the grant and 25% vest on each of the first, second and third anniversaries of March 14, 2011. For the fourth grant of 100,000 stock options, 25% vest on the date of the grant and 25% vest on each of the first, second and third anniversaries of May 19, 2011. For the fifth grant of 100,000 stock options, 25% vest on the date of the grant and 25% vest on each of the first, second and third anniversaries of September 1, 2011.

A total of 48,750 stock options initially granted to a member of the Company's board of directors were forfeited as result of his resignation which took effect on April 19, 2011.

The Company's Stock Option Plan includes a provision which, upon exercising his or her options, allows an optionee to satisfy his or her tax withholding obligations (i) by surrendering to the Company common shares that have been owned by the optionee for more than six months on the date of surrender with a market value equal to the withholding tax obligation or (ii) by electing to have the Company withhold from the common shares to be issued upon exercise of the option the number of common shares having a market value equal to the amount required to be withheld.

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

Risk-free interest rate range	1.33% - 2%
Expected life	4.0 years
Expected volatility range	44.29% - 49.53%
Expected dividend	-
Forfeiture	-
Fair value range of options at grant date	\$2.42 - \$3.94

## 15. COMPREHENSIVE LOSS

(\$ Thousands)	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Portion attributable to				
Shareholders of the Company	(518)	(1,127)	(2,025)	(3,134)
Income attributable to non-controlling interest	-	-	-	(24)
Net loss and comprehensive loss	(518)	(1,127)	(2,025)	(3,158)

## 16. SEGMENTED INFORMATION

The Company defines its reportable segments based on geographic locations.

The Company began its operations in Azerbaijan in the fourth quarter of 2010. Accordingly, there is no reportable segmented information for Azerbaijan for the first half of 2010.

### Total Assets

(\$Thousands)	September 30, 2011			December 31, 2010		
	Azerbaijan	United States	Total	Azerbaijan	United States	Total
Total Assets	16,280	46,814	63,094	7,991	49,325	57,316

### Capital Expenditures

(\$Thousands)	Nine months ended					
	September 30, 2011			September 30, 2010		
	Azerbaijan	United States	Total	Azerbaijan	United States	Total
Capital Expenditures	5,261	47	5,308	-	47	47

**Statement of income  
(loss) by segment**

(\$Thousands)

**Nine months ended**

	September 30, 2011			September 30, 2010		
	Azerbaijan	United States	Total	Azerbaijan	United States	Total
<b>Revenues</b>						
Petroleum and natural gas	15,953	-	15,953	-	-	-
Transportation and storage fees	1,704	-	1,702	-	-	-
Management services fees	-	3,025	3,025	-	419	419
	17,657	3,025	20,682	-	419	419
<b>Expenses</b>						
Operating	12,196	-	12,196	-	-	-
Transportation	433	-	433	-	-	-
Exploration and evaluation	570	-	570	-	-	-
Administrative	2,587	9,451	12,038	-	4,608	4,608
Depreciation and amortization	44	29	73	-	8	8
	15,830	9,480	25,310	-	4,616	4,616
Income (loss) from operating activities	1,827	(6,455)	(4,628)	-	(4,197)	(4,197)
Dividends and interest income	173	(352)	(179)	-	-	-
Loss on investments	-	108	108	-	226	226
Change in fair value of warrants	-	(1,163)	(1,163)	-	(113)	113
	1,654	(5,048)	(3,394)	-	(4,310)	(4,310)
Income tax expense (recovery)	364	(1,763)	(1,399)	-	(1,176)	(1,176)
<b>Net income (loss)</b>	1,290	(3,285)	(1,995)	-	(3,134)	(3,134)

**Statement of income (loss) by segment**

**Three months ended**

(\$Thousands)	September 30, 2011			September 30, 2010		
	Azerbaijan	United States	Total	Azerbaijan	United States	Total
<b>Revenues</b>						
Petroleum and natural gas	5,172	-	5,172	-	-	-
Transportation and storage fees	582	-	582	-	-	-
Management services fees	-	568	568	-	84	84
	5,754	568	6,322	-	84	84
<b>Expenses</b>						
Operating	3,858	-	3,858	-	-	-
Transportation	136	-	136	-	-	-
Exploration and evaluation	214	-	214	-	-	-
Administrative	1,056	3,369	4,425	-	2,047	2,047
Depreciation and amortization	24	11	35	-	4	4
	5,288	3,380	8,668	-	2,051	2,051
Income (loss) from operating activities	466	(2,812)	(2,346)	-	(1,967)	(1,967)
Dividends and interest income	110	(181)	(71)	-	-	-
Loss on investments	-	108	108	-	-	-
Change in fair value of warrants	-	(1,170)	(1,170)	-	(183)	(183)
	356	(1,569)	(1,213)	-	(1,784)	(1,784)
Income tax expense (recovery)	79	(831)	(752)	-	(657)	(657)
<b>Net income (loss)</b>	277	(738)	(461)	-	(1,127)	(1,127)

## 17. SUPPLEMENTAL CASH FLOW INFORMATION

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

(\$ Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Trade receivables	(1,222)	-	(1,419)	-
Receivables from related parties	(105)	-	(1,007)	-
Other receivable	(124)	(16)	(291)	45
Prepaid expenses and deposits	718	(6)	(1,839)	(17)
Accounts payable and accrued liabilities	75	237	366	583
Payables to related parties	91	-	(1,127)	-
	(567)	215	(5,317)	611

## 18. COMMITMENTS AND CONTINGENCIES

Other than the commitment noted below, there have been no significant changes in the Company's commitments for operating leases or ERDPSA related annual acreage fees, and the timing of those payments as reflected in the 2010 Audited Consolidated Financial Statements.

The Company has signed the Common Term Agreement between the shareholders of Bahar Energy Limited whereby each shareholder agrees to grant a credit facility to Bahar Energy up to specific amounts during a commitment period. As part of the CTA, the Company has also signed the 2011 Loan Agreement to fund up to \$17.4 million during the period January 1, 2011 to December 31, 2011. During May 2011, the Company made the first advance under the 2011 Loan Agreement for \$8.7 million. See also Note 8, *Related Party Transactions*).

## 19. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

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

### a) Credit risk

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

The Company's current accounts receivable balances mainly consist of trade receivables from the Company's share of petroleum and natural gas revenues and transportation and storage fees generated under the ERDPSA, receivables from affiliates as a result of the funding of administrative expenses and costs in connection with the ERDPSA operations, and management fees for administrative and technical support provided to the entity the Company has an equity interest in. The Company historically has not experienced any collection issues with its accounts receivable and all of the balances due are considered by management to be collectable at September 30, 2011 and December 31, 2010; therefore, no impairment is recorded.

Cash and cash equivalents consist of bank deposits and short term money market investments held in major United States banks except for cash held in the Bahar Energy joint venture which is limited for use in the ERDPSA. The Company manages the credit exposure related to short term investments by selecting counterparties based on credit rating and monitors all investments to ensure low risk to principals invested and related earnings. The Company avoids complex investment vehicles with higher risk such as asset-backed commercial paper.

b) Liquidity risk

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

The Company prepares annual and interim period capital expenditure budgets, which are regularly monitored and updated as considered necessary to provide current cash flow estimates. The Company also uses authorizations for expenditures on projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company may raise debt and capital through the issuance of debt or shares. Additional financing may be required to complete planned capital programs.

The Company's financial liabilities as at September 30, 2011 and December 31, 2010 consist of accounts payable, payables to related parties, notes payable and warrants due within one year. The settlement of warrants will not affect the Company's liquidity as these equity instruments are settled by collecting cash for the issuance of Company shares at the exercise price of CND\$5.00 per share. Currently, the Company does not have any bank debt.

c) Currency risk

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

As at September 30, 2011 and December 31, 2010 the Company had no forward exchange contracts in place.

d) Commodity price risk

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

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

At September 30, 2011 and December 31, 2010, the Company has no outstanding financial instruments, financial derivatives or physical delivery contracts subject to commodity price risk. Purchases and sales of financial assets are recognized on the settlement date, the date on which the Company receives or delivers the asset.

e) Interest rate risk

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

At September 30, 2011, the sensitivity in net earnings for each one percent change in interest rates is not material.

## Fair value of financial instruments

The fair values of financial instruments as at September 30, 2011 and December 31, 2010 are disclosed below by financial instrument category as follows:

(\$ Thousands)	Level	September 30, 2011		December 31, 2010	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Assets at FVTPL*</b>					
Cash and cash equivalents	1	28,615	28,615	47,977	47,977
<b>Loans and receivables</b>					
Trade	-	4,792	4,792	3,373	3,373
Related party	(a)	3,734	3,734	2,727	2,727
Notes receivable from related party	-	8,851	8,851	-	-
Other	-	291	291	-	-
<b>Available for sale assets</b>					
Corporate bonds	2	4,593	4,593	-	-
GFPI-USA	(b)	254	254	291	(b)
<b>Other financial liabilities</b>					
Accounts payable and accrued liabilities	-	2,645	2,645	2,278	2,278
Payables to related parties	(c)	1,235	1,235	2,361	2,361
Notes payable	(d)	8,068	8,068	-	-
<b>Liabilities at FVTPL</b>					
Warrants	2	1,043	1,043	2,219	2,219

- Balance consist of receivables from Bahar Energy resulting from the funding of cost recoverable administrative expenses associated with pre-effective date petroleum operations for the ERDPSA and for services provided under a Master Service Agreement between Bahar Energy and Greenfields Petroleum International Company LTD.
- The investment is measured at cost, as the fair value of this instrument cannot reliably be determined.
- Balances consist of liabilities to certain shareholders of Bahar Energy for the funding of cost recoverable administrative expenses associated with pre-effective date petroleum operations and for services provided under Master Service Agreements between Bahar Energy and its shareholders.
- The balance represents liabilities arising from the funding of operations by shareholders of Bahar Energy in the form of interest bearing notes to be repaid from future cash flows from the ERDPSA. See also Note 8, *Related Party Transactions*.

\* FVTPL – Fair Value through Profit and Loss



## 20. CAPITAL STRUCTURE AND MANAGEMENT

The Company considers its capital structure to include working capital, long term debt and shareholders' equity. In order to maintain or adjust the capital structure, the Company may from time to time issue common shares or other securities, sell assets, issue debt or adjust its operating or capital spending to manage current and projected working capital levels.

### Composition of the Company's capital structure

(\$ Thousands)	September 30, 2011	December 31, 2010
Working Capital	41,040	49,711
Shareholders' Equity	49,914	50,457
Working Capital to Shareholders' Equity Ratio	82%	99%

## 21. REDOMESTICATION OF THE COMPANY

On August 18, 2011, the Company completed a corporate redomestication to the Cayman Islands, resulting in holders of securities of the Company holding securities of a Cayman Islands exempted company rather than a Delaware Corporation (the "Redomestication").

The Redomestication involved three primary steps:

- First, the Company merged with Greenfields Petroleum (Arizona) Corporation ("**AZco**"), an Arizona corporation and a wholly-owned subsidiary of the Company, with AZco surviving the merger and resulting in shareholders of the Company becoming shareholders of AZco ("**AZco Shareholders**");
- Second, AZco became a Cayman Islands exempted company pursuant to a transfer of domicile procedure under Arizona law and continuation procedure under Cayman Islands law; and
- Third, AZco amalgamated with Greenfields Petroleum (Cayman-Sub) Corporation ("**Cayco**"), a wholly-owned subsidiary of AZco formed in the Cayman Islands, pursuant to a scheme of arrangement involving AZco, Cayco and the AZco Shareholders at the effective time of the amalgamation, with Cayco surviving the amalgamation (following the amalgamation, referred to as "**Amalco**").

Prior to the Redomestication, the shares of the Company (the "**Greenfields Shares**") were subject to a one year distribution compliance period and deemed to be "restricted securities" under United States securities laws and were therefore subject to certain restrictions on transfer to U.S. persons (the "**Resale Restrictions**"). As such, all certificates evidencing the Greenfields Shares ("**Share Certificates**") bore a restrictive transfer legend and the Company's trading symbol on the TSX-V contained a ".S" qualifier to alert investors to the existence of the Resale Restrictions.

Pursuant to the Redomestication, shareholders of the Company received one common share in the capital of Amalco ("**Amalco Share**") for each common share in the capital of the Company formerly held. All outstanding Company options and warrants will remain in effect and survive pursuant to the instruments governing such options and warrants, and represent the right to acquire Amalco Shares.

As a result of the Redomestication, Amalco qualifies as a "foreign private issuer" for the purposes of the United States securities laws, resulting in no restrictive transfer legend on the Amalco Shares currently outstanding, the ".S" qualifier not applying to the Amalco Shares and its trading symbol, and the Amalco Shares becoming generally freely tradeable by its current U.S. Shareholders.

Immediately following the Redomestication, Amalco changed its name from "Greenfields Petroleum (Cayman-Sub) Corporation" and adopted "Greenfields Petroleum Corporation" as the final legal name to be used by Amalco. Trading in respect of the Amalco Shares on the TSX-V commenced on August 23,

2011 under the symbol “GNF” (with no “.S” qualifier applying to the new company’s trading symbol).

### **Principal Effects of the Redomestication on Financial Reporting and Accounting**

The financial accounting and reporting effects of the Redomestication transaction will, in all material respects, remain substantially similar to the accounting and reporting of the Company prior to the Redomestication. The series of Redomestication steps were business combinations of entities that were under the common control of the same parties.

The accounting of combinations involving common control are outside the scope of IFRS 3 2008 and as yet there is no other specific IFRS guidance. In the absence of specific guidance, entities involved in common control transactions are required to select an appropriate accounting policy using the hierarchy as described in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Because the hierarchy permits the consideration of other standard-setting bodies, the guidance on group reorganization in US GAAP is useful in this circumstance.

Under US GAAP, the assets and liabilities of the combined companies are recorded and reported at book value. As a result, the post-amalgamation balances of the consolidated financial statements of the newly amalgamated companies vary little, if at all, from the amounts reflected in the consolidated financial statements of the Company pre-amalgamation.

### **Addresses and Locations**

Effective August 18, 2011, the new registered address is Walker House, 87 Mary Street, Grand Cayman, KY1-9005, Cayman Islands.

The corporate offices remain as 211 Highland Cross Drive, Suite 227, Houston, Texas, 77073, U.S.A.

## **22. TRANSITION TO IFRS**

For all periods up to and including the year ended December 31, 2010, the Company prepared its Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles (“Canadian GAAP” or “previous GAAP”). As a publicly listed company in Canada, the Company is required to prepare consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) for all periods after January 1, 2010, including comparative historical information.

In accordance with transitional provisions, the Company prepared its opening balance sheet as at January 1, 2010 (the transition date) and 2010 financial information using the accounting policies set out in Note 3. The consolidated financial statements for the year ending December 31, 2011 will be the first annual financial statements that comply with IFRS by applying existing IFRS with an effective date of December 31, 2011 or earlier. This transition note explains the material adjustments required to adjust the financial statements from Canadian GAAP to IFRS.

In preparing these consolidated financial statements in accordance with IFRS 1, the following mandatory exceptions from full retrospective application of IFRS were applied.

- Estimates
  - The estimates made under Canadian GAAP are required to be applied to the balances in accordance with IFRS unless there is evidence that the estimates were in error or to reflect any adjustments made to accounting policies to comply with IFRS. Hindsight was not used to create or revise estimates and, accordingly, estimates previously made under Canadian GAAP are consistent with their application under IFRS.
- Non-controlling interests

- At the date of transition, IFRS prescribes that certain requirements of IAS 27 “Consolidated and Separate Financial Statements” be applied prospectively. The company has adopted these exceptions and applies the relevant IAS 27 requirements prospectively.

The Company has applied the following optional exemptions under IFRS 1 to its opening balance sheet as at January 1, 2010:

- Business Combinations
  - IFRS 1 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 exemption and has applied IFRS 3 only to business combinations that occurred on or after January 1, 2010.

The following schedules represent the reconciliations from Canadian GAAP to IFRS for the respective periods. The adjustments presented in those reconciliations are noted below.

### **IFRS Adjustments**

The following explains the significant differences between the Company’s previous GAAP accounting policies and those applied by the Company under IFRS. IFRS policies have been retrospectively and consistently applied.

#### **(a) Warrants**

Warrants were issued as part of a private placement in February 2010 and were treated under previous GAAP as an equity instrument in Shareholders’ Equity. Under IFRS they are be classified as a financial liability at fair value through profit or loss for two reasons:

- the warrants have an exercise price denominated in Canadian dollars while the Company’s functional currency is US dollars. As such, the amount of US dollars that the Company will receive for each share issued is variable.
- the warrants were not “offered pro rata to all existing owners of the same class of its own shares”.

As a result of this reclassification adjustment, the following adjustments are also made:

- Under IFRS, transaction costs related to financial assets and liabilities at fair value through profit or loss are recognized as an expense when incurred. As a result, the \$0.124 million of warrant issue costs were reclassified to administrative expense when incurred in Q1 2010. Under previous GAAP, these costs were reflected in equity and netted against the value of the warrants issued.

Financial liabilities at fair value through profit and loss must be remeasured to fair value at each balance sheet date. As such, the revaluation adjustment is reflected as loss on fair value adjustment of warrants in the condensed consolidated statements of net loss for the three and nine months ended September 30, 2010 and 2011 and the year ended December 31, 2010. Under previous GAAP, the warrants were not remeasured at fair value as they were classified as equity instruments.

#### **(b) Non-Controlling Interest**

The Company owns an 85% controlling interest in Greenfields Petroleum (Indonesia) Company Ltd. Under previous GAAP, the portion attributable to the non-controlling interest (15%) was presented on the balance sheet as a separate category between total liabilities and equity. Under IFRS, the

non-controlling interest is classified within equity but is presented separately from shareholders' equity.

**(c) Restricted Cash**

Under previous GAAP, cash subject to restrictions preventing its use for current general corporate purposes is not included among cash and cash equivalents; it is presented on the balance sheet separately. Under IFRS, a restriction on the use of cash or cash equivalents does not alter the classification of the restricted amounts.

**(d) Administrative expenses – billed to Bahar Energy**

Under previous GAAP, the Company's billings in 2010 to Bahar Energy for expenses covered under the Technical Services Agreements were accounted for as a contra expense to administrative expenses. Under IFRS such billings are recognized as revenues.

## 22.1 TRANSITION TO IFRS

### Consolidated Balance Sheet

(\$ Thousands)	as at December 31, 2010		
	Previous GAAP	IFRS Adjustment	IFRS
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents	44,839	(c) 3,138	47,977
Trade receivables	3,373	-	3,373
Receivable from related parties	2,727	-	2,727
Prepaid expenses and deposits	273	-	273
	51,212	3,138	54,350
<b>Non-Current Assets</b>			
Restricted cash	3,138	(c) (3,138)	-
Investments	291	-	291
Deferred tax asset	1,588	-	1,588
Property and equipment	1,087	-	1,087
	57,316	-	57,316
<b>Liabilities and Equity</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities	2,278	-	2,278
Payable to related parties	2,361	-	2,361
Warrants	-	(a) 2,219	2,219
	4,639	2,219	6,858
Non-controlling interest	1	(b) (1)	-
<b>Shareholders' Equity</b>			
Common stock / membership units	15	-	15
Paid in capital	56,527	(a) (1)	56,526
Warrants	1,186	(a) (1,186)	-
Contributed surplus	1,361	-	1,361
Deficit	(6,413)	(a) (1,032)	(7,445)
Total Shareholders' Equity	52,676	(2,219)	50,457
Non-controlling interest	-	(b) 1	1
Total Equity	52,676	(2,218)	50,458
	57,316	-	57,316

## 22.2 TRANSITION TO IFRS

### Consolidated Balance Sheet

(\$ Thousands)	as at September 30, 2010		
	Previous GAAP	IFRS Adjustment	IFRS
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents	13,101	(c) 1,000	14,101
Other receivable	32	-	32
Prepaid expenses and deposits	57	-	57
	13,190	1,000	14,190
<b>Non-Current Assets</b>			
Restricted cash	1,000	(c) (1,000)	-
Deferred share issue costs	617	-	617
Investments	291	-	291
Deferred tax asset	1,185	-	1,185
Property and equipment	37	-	37
	16,320	-	16,320
<b>Liabilities and Equity</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities	674		674
Warrants	-	(a) 1,209	1,209
	674	1,209	1,883
Non-controlling interest	1	(b) (1)	-
<b>Shareholders' Equity</b>			
Common stock	10	-	10
Paid in capital	19,425	* 9	19,434
Contributed surplus	726	-	726
Warrants	1,198	(a) (1,198)	-
Deficit	(5,714)	(a) (20)	(5,734)
Total Shareholders' Equity	15,645	(1,209)	14,436
Non-controlling interest	-	1	1
Total Equity	15,645	(1,208)	14,437
	16,320	-	16,320

\* Non IFRS adjustment related to the tax impact of stock grants

## 22.3 TRANSITION TO IFRS

### Consolidated Statements of Loss

(\$ Thousands, except per share amounts)	Three months ended September 30, 2010			Nine months ended September 30, 2010		
	Previous GAAP	IFRS Adjustment	IFRS	Previous GAAP	IFRS Adjustment	IFRS
<b>Revenues</b>						
Management service fees	84	-	84	419	-	419
	84		84	419		419
<b>Expenses</b>						
Administrative	2,048	-	2,048	4,484	124	4,608
Depreciation and amortization	3	-	3	8	-	8
	2,051	-	2,051	4,492	124	4,616
Loss from operating activities	(1,967)	-	(1,967)	(4,073)	(124)	(4,197)
Loss on investments	-	-	-	226	-	226
Change in fair value of warrants	-	(183)	(183)	-	(113)	(113)
Loss from operations before tax	(1,967)	183	(1,784)	(4,299)	(11)	(4,310)
Income tax recovery	(666)	* 9	(657)	(1,185)	* 9	(1,176)
Net loss	(1,301)	174	(1,127)	(3,114)	(20)	(3,134)
Income attributable to non-controlling interest	-	-	-	(24)	-	(24)
<b>Net loss attributable to shareholders of Greenfields Petroleum Corporation</b>	(1,301)	174	(1,127)	(3,138)	(20)	(3,158)
<b>Per share</b>						
Net loss per share, basic & diluted	(\$0.15)	\$0.02	(\$0.13)	(\$0.40)	-	(\$0.40)

\* Non IFRS adjustment related to the tax impact of stock grants

## 22.4 TRANSITION TO IFRS

### Consolidated Statement of Changes in Equity

(\$ Thousands)	Nine months ended September 30, 2010		
	Previous GAAP	IFRS Adjustment	IFRS
<b>Membership units</b>			
Balance, Beginning of Year	4,255	-	4,255
Issued per long term incentive plan	330	-	330
Value of unvested restricted units	(176)	-	(176)
Distribution to unitholders	(4)	-	(4)
	4,405	-	4,405
Cancellation of membership units	(4,405)	-	(4,405)
Balance, End of period	-	-	-
<b>Common stock</b>			
Balance, Beginning of Year	-	-	-
Common shares issued upon conversion	8	-	8
Issued pursuant to private placements	2	-	2
Issued pursuant to public offering	-	-	-
Balance, End of period	10	-	10
<b>Paid in Capital</b>			
Balance, Beginning of Year	-	-	-
Common shares issued upon conversion	4,399	-	4,399
Issued pursuant to private placements	15,996	-	15,996
Repurchase of common shares	(21)	-	(21)
Share issue costs	(1,203)	-	(1,203)
Private placement broker commission	209	-	209
Stock-based compensation	45	-	45
Excess tax benefit – share grants	-	* 9	9
Balance, End of period	19,425	9	19,434
<b>Contributed Surplus</b>			
Balance, Beginning of Year	-	-	-
Stock-based compensation	726	-	726
Balance, End of period	726	-	726
<b>Warrants</b>			
Balance, Beginning of Year	-	-	-
Issued pursuant to private placement	1,247	(a) (1,247)	-
Warrant issued costs, net of tax	(124)	(a) 124	-
Private placement broker commission	75	(a) (75)	-
Balance, End of period	1,198	(1,198)	-
<b>Deficit</b>			
Balance, Beginning of Year	(2,576)	-	(2,576)
Net loss	(3,138)	(20)	(3,158)
Balance, End of period	(5,714)	(20)	(5,734)
<b>Total Shareholders' Equity</b>	<b>15,645</b>	<b>(1,209)</b>	<b>14,436</b>
<b>Non-Controlling Interest</b>			
Balance, Beginning of Year	-	(b) 5	5
Change	-	(b) (4)	(4)
<b>Total Non-Controlling Interest</b>	<b>-</b>	<b>1</b>	<b>1</b>
<b>Total Equity</b>	<b>15,645</b>	<b>(1,208)</b>	<b>14,437</b>

\* Non IFRS adjustment related to the tax impact of stock grants



## 22.5 TRANSITION TO IFRS

### Consolidated Statements of Cash Flows

(\$ Thousands)	Three months ended September 30, 2010			Nine months ended September 30, 2010		
	Previous GAAP	IFRS Adjustment	IFRS	Previous GAAP	IFRS Adjustment	IFRS
<b>Operating activities</b>						
Net loss	(1,301)	(a) 174	(1,127)	(3,138)	(a) (20)	(3,158)
<u>Items not affecting cash:</u>						
Stock-based compensation	743	-	743	925	-	925
Depreciation and amortization	4	-	4	8	-	8
Loss on investment	-	-	-	217	-	217
Non-controlling interest	(1)	-	(1)	24	-	24
Income tax recovery - loss from operations	(666)	* 9	(657)	(1,185)	* 9	(1,176)
Change in fair value of warrants	-	(a) (183)	(183)	-	(a) (113)	(113)
	(1,221)	-	(1,221)	(3,149)	(124)	(3,273)
Change in non-cash operating working capital	215	-	215	611	-	611
Cash Used in Operating Activities	(1,006)	-	(1,006)	(2,538)	(124)	(2,662)
<b>Financing activities</b>						
Proceeds from issue of common shares	12,511	-	12,511	17,245	-	17,245
Share issue costs	(790)	-	(790)	(1,042)	(a) 124	(918)
Deferred share issue costs	(181)	-	(181)	(617)	-	(617)
Distributions paid to unitholders	-	-	-	(4)	-	(4)
Repurchase of common shares	(21)	-	(21)	(21)	-	(21)
Non-controlling interest cash distributions	-	-	-	(29)	-	(29)
Restricted cash held for use in a joint venture	(1,000)	(c) 1,000	-	(1,000)	(c) 1,000	-
Cash From Financing Activities	10,519	1,000	11,519	14,532	1,124	15,656
<b>Investing activities</b>						
Property and equipment	(8)	-	(8)	(37)	-	(37)
Investments	-	-	-	(182)	-	(182)
Cash Used in Investing Activities	(8)	-	(8)	(219)	-	(219)
<b>Increase in Cash and Cash Equivalents</b>	<b>9,505</b>	<b>1,000</b>	<b>10,505</b>	<b>11,775</b>	<b>1,000</b>	<b>12,775</b>
<b>Cash and Cash Equivalents, Begin of Year</b>	<b>3,596</b>		<b>3,596</b>	<b>1,326</b>	<b>-</b>	<b>1,326</b>
<b>Cash and Cash Equivalents, End of period</b>	<b>13,101</b>	<b>1,000</b>	<b>14,101</b>	<b>13,101</b>	<b>1,000</b>	<b>14,101</b>

\* Non IFRS adjustment related to the tax impact of stock grants