Interim Condensed Consolidated Financial Statements of

# Brownstone Energy Inc.

(Unaudited – prepared in Canadian dollars)
December 31, 2011

Contents

Interim Condensed Consolidated Financial Statements:

**Notice to reader pursuant to National Instrument 51-102**

**Responsibility for Interim Condensed Consolidated Financial Statements:**

The accompanying unaudited interim condensed consolidated financial statements of Brownstone Energy Inc. ("Brownstone" or "the Company") as at and for the three and six months ended December 31, 2011 have been prepared by the Company's management in accordance with International Financial Reporting Standards applicable to interim financial statements (see note 2 to the interim condensed consolidated financial statements). Recognizing that the Company is responsible for both the integrity and objectivity of the interim condensed consolidated financial statements, management is satisfied that these interim condensed consolidated financial statements have been fairly presented.

**Auditors' involvement:**

Ernst & Young LLP, Chartered Accountants, the external auditors of the Company have not audited or performed review procedures applicable to auditor review of interim financial statements and the notes herein as at and for the three and six months ended December 31, 2011.

## BROWNSTONE ENERGY INC.

**Consolidated Statements of Financial Position**
**As at December 31, 2011 and June 30, 2011**
**(Unaudited - prepared in Canadian dollars)**

| | Notes | December 31, 2011 | June 30, 2011 [1] |
|---|---|---|---|
| **Assets** | | | |
| **Current** | | | |
| Cash and cash equivalents | | **$ 27,236,052** | $ 29,833,806 |
| Due from brokers | | **64,460** | 228,868 |
| Restricted cash - current | 6 | **-** | 4,165,776 |
| Prepaids and other receivables | | **530,109** | 371,573 |
| Investments, at fair value | 4, 5(b) | **11,139,408** | 12,350,483 |
| Income taxes receivable | | **476,886** | 1,053,614 |
| | | **39,446,915** | 48,004,120 |
| **Restricted cash** | 6 | **563,418** | 534,222 |
| **Exploration and evaluation assets** | 3 | **51,475,455** | 42,053,011 |
| | | **$ 91,485,788** | $ 90,591,353 |
| **Liabilities and Shareholders' Equity** | | | |
| **Current** | | | |
| Accounts payable and accrued liabilities | | **$ 1,718,936** | $ 1,497,064 |
| | | **1,718,936** | 1,497,064 |
| **Shareholders' equity** | | | |
| Share capital | 8 | **96,597,845** | 96,597,845 |
| Warrants and broker warrants | 8(e) | **6,873,384** | 6,873,384 |
| Contributed surplus | 8(f) | **15,714,556** | 14,856,513 |
| Foreign currency translation reserve | | **(901,026)** | (3,165,014) |
| Deficit | | **(28,517,907)** | (26,068,439) |
| | | **89,766,852** | 89,094,289 |
| | | **$ 91,485,788** | $ 90,591,353 |

1. Refer to note 14 to the interim condensed consolidated financial statements for the effects of the adoption of IFRS.

See accompanying notes to the interim condensed consolidated financial statements.

## BROWNSTONE ENERGY INC.

**Consolidated Statements of Comprehensive Income (Loss)**
**Three and Six Months Ended December 31,**
**(Unaudited - prepared in Canadian dollars)**

| | Notes | Three Months Ended 2011 | Three Months Ended 2010 [1] | Six Months Ended 2011 | Six Months Ended 2010 [1] |
|---|---|---|---|---|---|
| **Net investment income** | | | | | |
| Net realized gains (losses) on disposal of investments | | **$ (1,631,880)** | $ 279,670 | **$ (1,823,211)** | $ (724,176) |
| Net change in unrealized gains on investments | | **3,786,867** | 4,178,644 | **1,414,599** | 5,241,808 |
| | | **2,154,987** | 4,458,314 | **(408,612)** | 4,517,632 |
| **Interest and other income** | | **96,802** | 54,597 | **181,975** | 131,444 |
| | | **2,251,789** | 4,512,911 | **(226,637)** | 4,649,076 |
| **Expenses** | | | | | |
| Operating, general and administrative | 7, 11 | **1,336,231** | 1,298,277 | **2,172,669** | 2,298,489 |
| Finance expense | | **-** | 413,923 | **-** | 413,923 |
| | | **1,336,231** | 1,712,200 | **2,172,669** | 2,712,412 |
| **Profit (loss) before income taxes** | | **915,558** | 2,800,711 | **(2,399,306)** | 1,936,664 |
| **Income tax expense (benefit)** | | **21,700** | (245,869) | **50,162** | (515,718) |
| **Profit (loss) for the period** | | **$ 893,858** | $ 3,046,580 | **$ (2,449,468)** | $ 2,452,382 |
| **Other comprehensive income (loss)** | | | | | |
| Exchange differences on translation of foreign operations | | **(947,565)** | (1,144,541) | **2,263,988** | (2,000,252) |
| **Total comprehensive income (loss) for the period** | | **$ (53,707)** | $ 1,902,039 | **$ (185,480)** | $ 452,130 |
| **Earnings (loss) per common share based on profit (loss) for the period** | | | | | |
| Basic | | **$ 0.01** | $ 0.03 | **$ (0.02)** | $ 0.03 |
| Diluted | | **$ 0.01** | $ 0.03 | **$ (0.02)** | $ 0.02 |
| **Weighted average number of common shares outstanding** | | | | | |
| Basic | | **129,794,289** | 88,783,581 | **129,794,289** | 88,737,342 |
| Diluted | | **129,794,289** | 98,554,714 | **129,794,289** | 98,966,703 |

1. Refer to note 14 to the interim condensed consolidated financial statements for the effects of the adoption of IFRS.

See accompanying notes to the interim condensed consolidated financial statements.

# BROWNSTONE ENERGY INC.

**Consolidated Statements of Changes in Equity**
**Six Months Ended December 31, 2011 and 2010**
**(Unaudited - prepared in Canadian dollars)**

| | Share capital | Warrants and broker warrants | Contributed surplus | Foreign currency translation reserve | Deficit | Total equity |
|---|---|---|---|---|---|---|
| **Balance at July 1, 2010 [1]** | $ 65,017,344 | $ 4,028,875 | $ 13,407,473 | $ - | $ (24,487,142) | $ 57,966,550 |
| Profit for the period | - | - | - | - | 2,452,382 | 2,452,382 |
| Exchange differences on translation of foreign operations | - | - | - | (2,000,252) | - | (2,000,252) |
| Total comprehensive income for the period | - | - | - | (2,000,252) | 2,452,382 | 452,130 |
| Stock-based compensation value of services | - | - | 724,432 | - | - | 724,432 |
| Issued pursuant to exercise of stock options | 65,000 | - | (15,000) | - | - | 50,000 |
| Issued pursuant to exercise of warrants | 278,187 | (54,729) | - | - | - | 223,458 |
| Issuance of warrants | (4,516) | 4,516 | - | - | - | - |
| Reallocation of expired warrants | - | (60,000) | 60,000 | - | - | - |
| **Balance at December 31, 2010** | $ 65,356,015 | $ 3,918,662 | $ 14,176,905 | $ (2,000,252) | $ (22,034,760) | $ 59,416,570 |
| **Balance at July 1, 2011 [1]** | $ 96,597,845 | $ 6,873,384 | $ 14,856,513 | $ (3,165,014) | $ (26,068,439) | $ 89,094,289 |
| Loss for the period | **-** | **-** | **-** | **-** | **(2,449,468)** | **(2,449,468)** |
| Exchange differences on translation of foreign operations | **-** | **-** | **-** | **2,263,988** | **-** | **2,263,988** |
| Total comprehensive loss for the period | **-** | **-** | **-** | **2,263,988** | **(2,449,468)** | **(185,480)** |
| Stock-based compensation value of services | **-** | **-** | **858,043** | **-** | **-** | **858,043** |
| **Balance at December 31, 2011** | **$ 96,597,845** | **$ 6,873,384** | **$ 15,714,556** | **$ (901,026)** | **$ (28,517,907)** | **$ 89,766,852** |

1. Refer to note 14 to the interim condensed consolidated financial statements for the effects of the adoption of IFRS.

See accompanying notes to the interim condensed consolidated financial statements.

## BROWNSTONE ENERGY INC.

**Consolidated Statements of Cash Flows**
**Six Months Ended December 31,**
**(Unaudited - prepared in Canadian dollars)**

| | 2011 | 2010 |
|---|---|---|
| **Cash flows used in operating activities** | | |
| Profit (loss) for the period | $ (2,449,468) | $ 2,452,382 |
| Items not affecting cash | | |
| Realized losses on disposal of investments, net | 1,823,211 | 724,176 |
| Unrealized gains on investments, net | (1,414,599) | (5,241,808) |
| Stock-based compensation expense | 858,043 | 724,432 |
| | (1,182,813) | (1,340,818) |
| Changes in non-cash working capital balances | | |
| Prepaids and other receivables | (158,536) | (305,405) |
| Income taxes receivable | 576,728 | (478,464) |
| Accounts payable and accrued liabilities | 221,872 | (1,811,326) |
| | (542,749) | (3,936,013) |
| **Cash flows from financing activities** | | |
| Proceeds pursuant to exercise of stock options | - | 50,000 |
| Proceeds pursuant to exercise of warrants, broker warrants and underlying warrants | - | 223,458 |
| Proceeds from promissory note payable | - | 3,000,000 |
| Decrease (increase) in due from brokers | 164,408 | (931,651) |
| | 164,408 | 2,341,807 |
| **Cash flows used in investing activities** | | |
| Expenditures on exploration and evaluation assets, net | (6,873,335) | (4,230,778) |
| Proceeds on sale of oil and gas property | - | 263,328 |
| Repayment of promissory note receivable | - | 2,070,140 |
| Decrease in restricted cash | 4,136,580 | 3,124,706 |
| Proceeds on disposal of investments | 852,463 | 7,233,582 |
| Purchases of investments | (50,000) | - |
| | (1,934,292) | 8,460,978 |
| **Net increase (decrease) in cash and cash equivalents, during the period** | (2,312,633) | 6,866,772 |
| **Exchange rate changes on foreign operations' cash balances** | (285,121) | 1,054 |
| **Cash and cash equivalents, beginning of period** | 29,833,806 | 1,832,230 |
| **Cash and cash equivalents, end of period** | 27,236,052 | 8,700,056 |
| **Supplemental cash flow information** | | |
| Income tax paid | $ 50,162 | $ - |
| Income tax refunds | - | 37,253 |
| Finance expense paid | | 413,923 |

See accompanying notes to the interim condensed consolidated financial statements.

## 1. Nature of business:

Brownstone Energy Inc. ("Brownstone" or the "Company") was continued under the Canada Business Corporations Act on December 1, 2011 and its common shares are publicly traded on the TSX Venture Exchange ("TSXV") under the symbol "BWN" and on the OTCQX under the symbol "BWSOF". The Company is domiciled in the Province of Ontario and its head office is located at 130 King St. West, Suite 2500, Toronto, Ontario, Canada.

Brownstone is a Canadian-based, energy-focused company with direct interests in oil and gas exploration projects, including varying interests in three offshore Israel concessions and four blocks in the Llanos Basin of Colombia.

These interim condensed consolidated financial statements were approved by the Company's board of directors on February 28, 2012.

## 2. Basis of preparation:

(a) Statement of compliance:

These interim condensed consolidated financial statements (''interim financial statements'') are unaudited and have been prepared in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting* and International Financial Reporting Standards ("IFRS") 1, *First Time Adoption of International Financial Reporting Standards* (''IFRS 1'') issued by the International Accounting Standards Board using accounting policies consistent with those which the Company expects to adopt in its annual consolidated financial statements as at and for the year ended June 30, 2012. The Company's date of transition to IFRS and its opening IFRS statement of financial position are as at July 1, 2010 (the ''Transition Date''). Previously, the Company prepared its consolidated annual and interim consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles ("CGAAP").

The same accounting policies and methods of computation were followed in the preparation of these interim financial statements as were followed in the preparation of the interim financial statements for the three month period ended September 30, 2011, which were described in note 3 to the notes of the interim financial statements for the three months ended September 30, 2011. Accordingly, these interim financial statements for the three and six months ended December 31, 2011 should be read together with the interim financial statements for the three months ended September 30, 2011.

(b) Basis of presentation:

These interim financial statements have been prepared using the historical cost convention except for some financial instruments which have been measured at fair value.

All monetary references expressed in these notes are references to Canadian dollar amounts ("$").

## 2. Basis of preparation (continued):

In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for these interim periods are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2012. An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Company is provided in note 14. This includes reconciliations of Brownstone's consolidated statements of financial position and comprehensive loss, for comparative periods prepared and previously reported in accordance with CGAAP, to those prepared and reported in these interim financial statements in accordance with IFRS.

(c) Basis of consolidation:

These interim financial statements include the financial statements of Brownstone and its wholly-owned subsidiaries: Brownstone Ventures (US) Inc., Brownstone Ventures (Barbados) Inc., Brownstone Comercializadora de Petroleo Ltda., and 2121197 Ontario Ltd.

Subsidiaries are entities controlled by the Company. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are included in the interim financial statements from the date control is obtained until the date control ceases. All intercompany balances, transactions, income, expenses, profits and losses, including unrealized gains and losses have been eliminated on consolidation.

## 3. Exploration and evaluation assets:

All of the Company's oil and gas activities are conducted jointly with others. The Company enters into exploration agreements with other parties, pursuant to which Brownstone may earn interests in the underlying exploration and evaluation assets by issuing common shares and/or making cash payments and/or incurring expenditures in varying amounts by varying dates. Failure by the Company to issue such shares, make such cash payments or incur such expenditures can result in a reduction or loss of the Company's interests.

**(Unaudited – prepared in Canadian dollars)**

## 3. Exploration and evaluation assets (continued):

The Company's accounts reflect only the Company's proportionate interests in its oil and gas activities. The following is a summary of the Company's exploration and evaluation assets:

| | July 1, 2010 | Year ended June 30, 2011 | | **Six months ended December 31, 2011** | |
|---|---|---|---|---|---|
| | Net Book Value | Net Expenditures | Net Book Value | **Net Expenditures** | **Net Book Value** |
| **Joint ventures in Colombia properties (a)** | | | | | |
| Acquisition | $ 2,850,040 | $ - | $ 2,850,040 | **$ -** | **$ 2,850,040** |
| Exploration | 7,997,964 | 10,225,359 | 18,223,323 | **6,004,203** | **24,227,526** |
| Foreign currency translation | 253,774 | (1,317,457) | (1,063,683) | **1,461,491** | **397,808** |
| | 11,101,778 | 8,907,902 | 20,009,680 | **7,465,694** | **27,475,374** |
| **Joint ventures in USA properties** | | | | | |
| Acquisition | 14,271,014 | (263,328) | 14,007,686 | **-** | **14,007,686** |
| Exploration | 2,342,454 | 863,748 | 3,206,202 | **758,054** | **3,964,256** |
| Foreign currency translation | (675,641) | (1,357,785) | (2,033,426) | **771,534** | **(1,261,892)** |
| | 15,937,827 | (757,365) | 15,180,462 | **1,529,588** | **16,710,050** |
| **Joint ventures in Argentina properties** | | | | | |
| Acquisition | 4,128,331 | - | 4,128,331 | **-** | **4,128,331** |
| Foreign currency translation | 114,070 | (385,201) | (271,131) | **210,800** | **(60,331)** |
| | 4,242,401 | (385,201) | 3,857,200 | **210,800** | **4,068,000** |
| **Joint ventures in Canadian properties** | | | | | |
| Acquisition | 797,353 | - | 797,353 | **-** | **797,353** |
| Exploration | 205,929 | 71,540 | 277,469 | **41,935** | **319,404** |
| | 1,003,282 | 71,540 | 1,074,822 | **41,935** | **1,116,757** |
| **Joint ventures in Israel** | | | | | |
| Exploration | $ - | $ 2,011,871 | $ 2,011,871 | **$ 69,143** | **$ 2,081,014** |
| Foreign currency translation | - | (81,024) | (81,024) | **105,284** | **24,260** |
| | **-** | 1,930,847 | 1,930,847 | **174,427** | **2,105,274** |
| **Total exploration and evaluation assets** | $ 32,285,288 | $ 9,767,723 | $ 42,053,011 | **$ 9,422,444** | **$ 51,475,455** |

(a) For the six months ended December 31, 2011, the Company net expenditures on its exploration and evaluation assets included capitalized crude oil sales revenue of $1,168,144 (US$1,165,428) (year ended June 30, 2011 – $259,228 (US$265,385)), which was generated from the long-term production testing of the Canaguaro well in the Llanos Basin of Central Colombia.

**(Unaudited – prepared in Canadian dollars)**

## 4. Investments:

The fair value and cost of investments are as follows:

| | Fair Value | Cost |
|---|---|---|
| **December 31, 2011** | **$ 11,139,408** | **$ 19,593,901** |
| June 30, 2011 | 12,350,483 | 22,219,575 |

## 5. Financial instruments at fair value:

(a) Financial instruments carrying amount:

| | December 31, 2011 | June 30, 2011 |
|---|---|---|
| Investments | **$ 11,139,408** | $ 12,350,483 |
| Cash and cash equivalents | | |
| - Cash on hand | **2,745,790** | 447,721 |
| - Short-term investments with maturities of less than three months (i) | **24,490,262** | 29,386,085 |
| Due from brokers | **64,460** | 228,868 |
| Restricted cash, current | **-** | 4,165,776 |
| Restricted cash, long-term | **563,418** | 534,222 |
| Other receivables | **500,879** | 343,594 |
| Accounts payable and accrued liabilities | **(1,718,936)** | (1,497,064) |
| | **$ 26,645,873** | $ 33,609,202 |

(i) As at December 31, 2011, cash equivalents consisted of banker's acceptance notes with an average annual yield of 1.07% (June 30, 2011 – 1.16%).

The carrying values of cash and cash equivalents, due from brokers, restricted cash, other receivables, and accounts payable and accrued liabilities approximate their fair values due to the short term to maturity for these instruments.

(b) Financial instruments hierarchy:

The fair value measurements use a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

(i) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).

(ii) Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).

(iii) Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

**(Unaudited – prepared in Canadian dollars)**

**5. Financial instruments carrying amount and fair value (continued):**

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety.

If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

The following table presents the Company's financial instruments, measured at fair value and categorized into levels of the fair value hierarchy on the consolidated statements of financial position as at December 31, 2011 and June 30, 2011:

| Investments, at fair value | Level 1<br>Quoted market price | Level 2<br>Valuation technique – observable market inputs | Level 3<br>Valuation technique – non-observable market inputs | Total |
|---|---|---|---|---|
| **December 31, 2011** | **$ 6,939,408** | **$ -** | **$ 4,200,000** | **11,139,408** |
| June 30, 2011 | $ 8,200,483 | $ - | $ 4,150,000 | $ 12,350,483 |

There were no significant transfers from Level 1 to 2 or Level 2 to 1 during the six months ended December 31, 2011 and year ended June 30, 2011.

The following table presents the changes in fair value measurements of financial instruments classified as Level 3 for the six months ended December 31, 2011 and year ended June 30, 2011. These financial instruments are measured at fair value utilizing non-observable market inputs. The realized losses and net unrealized gains are recognized in the consolidated statements of comprehensive loss.

| Investments, at fair value | Opening balance | Net purchases | Realized losses | Net unrealized gains | Net transfer out of Level 3 | Ending balance |
|---|---|---|---|---|---|---|
| **December 31, 2011** | **$ 4,150,000** | **$ 50,000** | **$ -** | **$ -** | **$ -** | **$ 4,200,000** |
| June 30, 2011 | $ 2,469,700 | $ - | $ - | $ 2,680,300 | $ (1,000,000) | $ 4,150,000 |

For the year ended June 30, 2011, the net transfer out of Level 3 consists of investments in private companies as at July 1, 2010 which became publicly-traded investments during the year ended June 30, 2011.

**(Unaudited – prepared in Canadian dollars)**

## 6. Restricted cash:

As at December 31, 2011, the Company had restricted cash totaling $563,418 (US$554,000) as collateral to the Royal Bank of Canada ("RBC") for letters of guarantee issued by RBC. As at June 30, 2011, the Company had restricted cash totaling $4,699,998 (US$4,874,000) of which $4,165,776 (US$4,320,000) was current. The restricted cash is held in Guaranteed Investment Certificates ("GIC"), which are renewed on a monthly basis at the prevailing interest rate (0.02% per annum as at December 31, 2011 (June 30, 2011 – 0.03%)).

The GICs are held as collateral by RBC for letters of guarantee issued by RBC to Agencia Nacional de Hidrocarburos ("ANH"), the oil and gas agency of the Colombian government. The letters of guarantee are provided to secure Brownstone's interests and exploration in Colombia Llanos exploration Blocks 21, 27, and 36 and to ensure that the Company fulfills its commitments under the blocks.

In November 2010, Export Development Canada ("EDC"), a Canadian federal government agency, issued three Performance Security Guarantees ("PSG") totaling US$4,984,883 to RBC to secure certain of the letters of guarantee issued by RBC to ANH. As a result, the Company's restricted cash in the amount of the PSGs was released.

## 7. Related party transactions:

All transactions with related parties have occurred in the normal course of operations and are recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(a) Compensation to key management personnel and directors were as follows during the six months ended December 31:

| **Type of expense** | **2011** | 2010 |
|---|---|---|
| Salaries and consulting fees | **$ 418,375** | $ 353,583 |
| Other short-term benefits | **17,847** | 9,992 |
| Stock-based compensation expense | **644,247** | 471,050 |

Key management personnel are the Chairman and Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer and Vice President, Corporate & Legal Affairs.

(b) During the six months ended December 31, 2011 the Company granted 1,850,000 options to directors and officers of the Company, with an exercise price of $0.40 per share and expiring on October 10, 2016.

**(Unaudited – prepared in Canadian dollars)**

## 7. Related party transactions (continued):

During the year ended June 30, 2011, the Company granted the following options to directors and officers of the Company:

| Date Granted | Options Granted | Exercise Price | Expiry |
|---|---|---|---|
| September 21, 2010 | 1,000,000 | $ 0.51 | September 20, 2015 |
| March 30, 2011 | 1,050,000 | $ 1.20 | March 29, 2016 |
| Total granted | 2,050,000 | | |

## 8. Share capital:

Authorized: Unlimited number of common shares, no par value
Issued and outstanding:

| | # of Shares | | Amount |
|---|---|---|---|
| **Balance, July 1, 2010** | 88,691,104 | $ | 65,017,344 |
| Issued pursuant to exercise of stock options (a) | 440,520 | | 423,783 |
| Issued pursuant to exercise of warrants and broker warrants (b) | 10,399,507 | | 9,358,419 |
| Issued pursuant to private placement financing, net (c) | 30,263,158 | | 21,798,299 |
| **Balance, December 31, 2011 and June 30, 2011** | **129,794,289** | **$** | **96,597,845** |

(a) During the six months ended December 31, 2011, 1,455,000 options exercisable at prices ranging from $2.20 to $2.50 per share expired unexercised.

During the year ended June 30, 2011, 2,136,200 options exercisable at prices ranging from $0.61 to $2.08 per share expired unexercised and 440,520 options were exercised at prices ranging from $0.50 to $0.65 per share for total proceeds of $266,845. As a result of the exercise of stock options, $156,938 in contributed surplus was reallocated to share capital.

(b) During the six months ended December 31, 2011, no warrants or broker warrants were exercised.

During the year ended June 30, 2011, 2,000,000 broker warrants exercisable at $2.00 per share expired unexercised and 10,399,507 warrants, broker warrants, and underlying broker warrants were exercised at prices ranging from $0.50 and $0.75 per share for total proceeds of $7,511,812. Amounts of $1,874,549 in warrants were reallocated to share capital. Pursuant to the exercise of broker warrants, 590,245 purchase warrants were issued exercisable at $0.75 per share and expiring on April 13, 2012.

The purchase warrants were valued using the Black-Scholes option pricing model with the following assumptions: expected volatility of 96.9%; dividend yield of 0%; risk-free interest rate of 3.00%; and an expected life of 1.5 year. The value assigned to the purchase warrants was $27,942.

**(Unaudited – prepared in Canadian dollars)**

## 8. Share capital (continued):

(c) On March 11, 2011, the Company completed a brokered private placement financing raising gross proceeds of $28,750,000 through the issuance and sale of 30,263,158 units at a price of $0.95 per unit. Each unit was comprised of one common share of the Company and one-half common share purchase warrant, with each whole common share purchase warrant entitling the holder to acquire one common share of the Company at $1.25 per share on or before September 11, 2012. In connection with the private placement, the Company paid cash commissions and other expenses of $2,200,585, and issued an aggregate of 2,118,421 broker warrants. Each broker warrant entitles the holder to acquire one common share at an exercise price of $1.25 per unit until September 11, 2012.

The purchase warrants and broker warrants were valued using the Black-Scholes option pricing model with the following assumptions: expected volatility of 83.3%; dividend yield of 0%; risk-free interest rate of 3.0%; and an expected life of 1.5 years. The value assigned to the purchase warrants and broker warrants was $4,751,116.

(d) Stock options granted:

The Company grants stock options to eligible directors, officers, key employees and consultants under its 2006 stock option plan to enable them to purchase common shares of the Company. Under the terms of the plan, the number of common shares which may be issued pursuant to the exercise of options granted under the plan may not exceed 10% of the number of common shares outstanding at the time of grant.

The exercise price of an option granted under the plan cannot be less than the closing price of the common shares on the last day on which the common shares trade prior to the grant date of the option. An individual can receive grants of no more than 5% of the outstanding shares of the Company on a yearly basis and options are exercisable over a period not exceeding five years. Stock options granted vest at the rate of 1/6 of the grant every three months over an 18-month period. Stock options granted to consultants for investor relations vest at the rate of ¼ of the grant every four months over a 1 year period.

Options granted are accounted for by the fair value method of accounting for stock-based compensation. The Company records compensation expense and credits contributed surplus for all options granted.

During the six months ended December 31, 2011, 2,180,000 options exercisable at $0.40 per share until October 10, 2016 were granted.

The following options were granted during the year ended June 30, 2011:

| Date granted | Options granted | Exercise price | Expiry |
|---|---|---|---|
| September 21, 2010 | 1,195,000 | $ 0.51 | September 20, 2015 |
| December 17, 2010 (i) | 500,000 | 0.80 | December 16, 2015 |
| February 17, 2011 | 300,000 | 0.95 | February 17, 2013 |
| March 30, 2011 | 1,365,000 | 1.20 | March 29, 2016 |
| | 3,360,000 | | |

**(Unaudited – prepared in Canadian dollars)**

**8. Share capital (continued):**

(i) On March 3, 2011, the 500,000 options granted on December 17, 2010 to a consultant were terminated.

The fair value of the options granted during the six months ended December 31, 2011 was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

| Black-Scholes assumptions used | |
|---|---|
| Expected volatility | 115.5% |
| Expected dividend yield | 0% |
| Risk-free interest rate | 1.3% |
| Expected option life in years | 3.6 years |
| Expected forfeiture rate | 6.9% |
| Fair value per stock option granted on December 31, 2011 | $ 0.29 |

The fair value of the options granted during the year ended June 30, 2011 was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

| Black-Scholes assumptions used | |
|---|---|
| Expected volatility | 109.0% to 120.9% |
| Expected dividend yield | 0% |
| Risk-free interest rate | 1.7% to 2.3% |
| Expected option life in years | 2.0 to 4.5 years |
| Expected forfeiture rate | 2.7% to 4.0% |
| Fair value per stock option granted on September 21, 2010 | $ 0.37 |
| Fair value per stock option granted on December 17, 2010 | $ 0.59 |
| Fair value per stock option granted on February 17, 2011 | $ 0.54 |
| Fair value per stock option granted on March 30, 2011 | $ 0.89 |

For the six months ended December 31, 2011, included in operating, general and administrative expenses was stock-based compensation expense of $858,043 (six months ended December 31, 2010 - $724,432) relating to the stock options granted to directors, officers, employees and consultants of the Company.

**(Unaudited – prepared in Canadian dollars)**

**8. Share capital (continued):**

A summary of the status of the Company's stock options as at the beginning of the periods indicated and changes during those periods is shown below:

| | **December, 2011** | | June 30, 2011 | |
|---|---|---|---|---|
| | **# of options** | **Weighted average exercise price** | # of Options | Weighted average exercise price |
| Outstanding, at beginning of period | **8,425,080** | **$ 1.21** | 7,641,800 | $ 1.35 |
| Granted | **2,180,000** | **0.40** | 3,360,000 | 0.87 |
| Exercised | **-** | **-** | (440,520) | 0.61 |
| Terminated | **(1,455,000)** | **2.46** | (2,136,200) | 1.30 |
| Outstanding, at end of period | **9,150,080** | **$ 0.82** | 8,425,080 | $ 1.21 |
| Exercisable, at end of period | **5,937,863** | **$ 0.93** | 6,100,657 | $ 1.32 |

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

| **Number of options outstanding** | **Number of options exercisable** | **Exercise price** | **Expiry date** |
|---|---|---|---|
| **50,000** | **50,000** | **$ 1.80** | February 4, 2012 |
| **400,000** | **400,000** | **2.60** | April 1, 2012 |
| **300,000** | **150,000** | **0.95** | February 17, 2013 |
| **10,000** | **10,000** | **1.25** | February 21, 2013 |
| **40,000** | **40,000** | **1.20** | March 19, 2013 |
| **840,000** | **840,000** | **1.48** | June 25, 2013 |
| **100,000** | **100,000** | **0.50** | August 10, 2014 |
| **1,133,400** | **1,133,400** | **0.52** | August 12, 2014 |
| **35,000** | **35,000** | **0.61** | October 5, 2014 |
| **50,000** | **50,000** | **0.75** | November 26, 2014 |
| **200,000** | **200,000** | **0.75** | November 30, 2014 |
| **500,000** | **500,000** | **0.65** | March 2, 2015 |
| **630,000** | **630,000** | **0.65** | April 14, 2015 |
| **130,000** | **130,000** | **0.43** | May 25, 2015 |
| **1,186,680** | **986,980** | **0.51** | September 20, 2015 |
| **1,365,000** | **682,483** | **1.20** | March 29, 2016 |
| **2,180,000** | **-** | **0.40** | October 10, 2016 |
| **9,150,080** | **5,937,863** | | |

(e) A summary of the status of the Company's warrants and broker warrants at the reporting dates and the changes during the periods then ended are presented below:

| | **December 31, 2011** | | |
|---|---|---|---|
| **Warrants and broker warrants** | **# of warrants and broker warrants** | **Weighted average exercise price** | **Amount** |
| Outstanding, at beginning of period | **26,595,816** | **$ 1.06** | **$ 6,873,384** |
| Outstanding, at end of period | **26,595,816** | **$ 1.06** | **$ 6,873,384** |

**(Unaudited – prepared in Canadian dollars)**

## 8. Share capital (continued):

| | June 30, 2011 | | |
|---|---|---|---|
| **Warrants and Broker Warrants** | # of warrants and broker warrants | Weighted average exercise price | Amount |
| Outstanding, at beginning of year | 21,155,078 | $ 0.84 | $ 4,028,875 |
| Exercised | (10,399,507) | 0.72 | (1,874,548) |
| Issued | 17,840,245 | 1.23 | 4,779,057 |
| Expired | (2,000,000) | 2.00 | (60,000) |
| Outstanding, at end of year | 26,595,816 | $ 1.06 | $ 6,873,384 |

The following table summarizes information about warrants and broker warrants outstanding as at December 31, 2011 and June 30, 2011:

| **Number of warrants and broker warrants** | | **Exercise price** | **Expiry date** | **Warrants and broker warrants value** |
|---|---|---|---|---|
| 7,998,227 | | $ 0.75 | April 13, 2012 | $ 1,758,419 |
| 1,347,589 | (i) | 0.55 | April 13, 2012 | 363,849 |
| 15,131,579 | | 1.25 | September 11, 2012 | 4,167,645 |
| 2,118,421 | (ii) | 1.25 | September 11, 2012 | 583,471 |
| **26,595,816** | | | | **$ 6,873,384** |

(i) Each broker warrant is exercisable for one unit of the Company at $0.55 per unit on or before April 13, 2012. Each unit is comprised of one common share of the Company and one-half common share purchase warrant of the Company, with each whole common share purchase warrant entitling the holder to acquire one common share of the Company at a price of $0.75 per share on or before April 13, 2012.

(ii) Each broker warrant is exercisable for one common share of the Company at $1.25 per share on or before September 11, 2012.

(f) Contributed surplus transactions for the respective years are as follows:

| | **Amount** |
|---|---|
| **Balance, July 1, 2010** | $ 13,407,473 |
| Stock-based compensation | 1,545,978 |
| Exercise of stock options | (156,938) |
| Expiration of warrants | 60,000 |
| **Balance, June 30, 2011** | 14,856,513 |
| Stock-based compensation (note 8(d)) | **858,043** |
| **Balance, December 31, 2011** | **$ 15,714,556** |

**(Unaudited – prepared in Canadian dollars)**

## 8. Share capital (continued):

As at December 31, 2011 and June 30, 2011 contributed surplus was comprised of the following:

| | December 31, 2011 | June 30, 2011 |
|---|---|---|
| Fair value of stock-based compensation | **$ 8,955,353** | $ 8,097,310 |
| Fair value of expired warrants and broker warrants | **6,732,939** | 6,732,939 |
| Cancellation of common shares under normal course issuer bid | **20,639** | 20,639 |
| Value of cancelled escrowed shares | **5,625** | 5,625 |
| | **$ 15,714,556** | $ 14,856,513 |

## 9. Deferred taxes:

As at December 31, 2011, the Company has approximately $952,000 (June 30, 2011 - $961,600) of Canadian resource deductions and $22,341,000 (June 30, 2011 - $22,586,500) of foreign resource deductions available that have an unlimited carry-forward period to reduce future years' income for tax purposes, the tax effect of which has not been recorded in the accounts.

As at December 31, 2011, the Company has approximately $3,995,000 (June 30, 2011 - $2,400,900) of Canadian non-capital losses available to reduce future years' income for tax purposes, the tax effect of which has not been recorded in the accounts.

The non-capital losses will expire as follows:

| | |
|---|---|
| 2028 | $ 73,100 |
| 2031 | 2,327,800 |
| 2032 | 1,594,100 |
| | $ 3,995,000 |

The Company has not recognized any deferred tax assets in these interim financial statements relating to the losses or tax effects of other tax temporary differences.

## 10. Segmented information:

Operating segments are defined as components of an enterprise about which separate financial information is available, that is evaluated regularly by management in deciding how to allocate resources and in assessing performance. All of the Company's operations relate to direct and indirect investments in the oil and gas sector. The Company's significant segments include six distinct geographic areas: Colombia, Israel, Canada, United States, Argentina and Brazil. There were no changes in the reportable segments during the six months ended December 31, 2011.

The accounting policies applied to Brownstone's operating segments are the same as those described in the summary of significant accounting policies except that certain expenses and other items are not allocated to the individual operating segments when determining profit or loss, but are attributed to the Canadian operations where the corporate head office is located.

**(Unaudited – prepared in Canadian dollars)**

## 10. Segmented information (continued):

As at December 31, 2011 and June 30, 2011, no customer accounted for more than 10% of revenues.

The following is segmented information as at and for the six months ended December 31, 2011:

| | Six months ended December 31, 2011 | | As at December 31, 2011 | | |
|---|---|---|---|---|---|
| | **Interest and other income** | **Loss for the period** | **Exploration and evaluation assets** | **Other assets** | **Total assets** |
| Canada and other | **$ 152,704** | **$ 2,218,778** | **$ 1,116,758** | **$ 37,611,732** | **$ 38,728,490** |
| Colombia | **29,271** | **19,765** | **27,475,374** | **988,380** | **28,463,754** |
| United States | **-** | **-** | **16,710,049** | **1,225,837** | **17,935,886** |
| Argentina | **-** | **-** | **4,068,000** | **27,799** | **4,095,799** |
| Israel | **-** | **30,925** | **2,105,274** | **3,066** | **2,108,340** |
| Brazil | **-** | **-** | **-** | **153,519** | **153,519** |
| | **$ 181,975** | **$ 2,449,468** | **$ 51,475,455** | **$ 40,010,333** | **$ 91,485,788** |

The following is segmented information for the six months ended December 31, 2010 and as at June 30, 2011:

| | Six months ended December 31, 2010 | | As at June 30, 2011 | | |
|---|---|---|---|---|---|
| | Interest and other income | Loss for the period | Exploration and evaluation assets | Other assets | Total assets |
| Canada and other | $ 112,655 | $ 2,375,182 | $ 1,074,822 | $ 47,982,817 | $ 49,057,639 |
| Colombia | 18,789 | 77,200 | 20,009,680 | 352,860 | 20,362,540 |
| United States | - | - | 15,180,462 | 6,227 | 15,186,689 |
| Argentina | - | - | 3,857,200 | 20,931 | 3,878,131 |
| Israel | - | - | 1,930,847 | 1,652 | 1,932,499 |
| Brazil | - | - | - | 173,855 | 173,855 |
| | $ 131,444 | $ 2,452,382 | $ 42,053,011 | $ 48,538,342 | $ 90,591,353 |

**(Unaudited – prepared in Canadian dollars)**

## 11. Expenses by nature:

Included in general, administrative and operating expenses for the six months ended December 31:

| | | **2011** | | 2010 |
|---|---|---|---|---|
| Stock-based compensation expense | **$** | **858,043** | $ | 724,432 |
| Salaries and consulting fees | | **661,551** | | 482,266 |
| Other office and general | | **331,476** | | 381,056 |
| Travel and promotion | | **165,496** | | 74,401 |
| Professional fees | | **123,068** | | 165,425 |
| Shareholder relations, transfer agent and filing fees | | **86,251** | | 70,962 |
| Other employment benefits | | **19,089** | | 9,992 |
| Transaction costs | | **4,538** | | 34,826 |
| Foreign exchange loss (gain) | | **(76,843)** | | 355,129 |
| | **$** | **2,172,669** | $ | 2,298,489 |

## 12. Management of capital:

The Company includes the following in its capital:

| | | **December 31, 2011** | | June 30, 2011 |
|---|---|---|---|---|
| Shareholders' equity comprised of | | | | |
| Share capital | **$** | **96,597,845** | $ | 96,597,845 |
| Warrants and broker warrants | | **6,873,384** | | 6,873,384 |
| Contributed surplus | | **15,714,556** | | 14,856,513 |
| Foreign currency translation reserve | | **(901,026)** | | (3,165,014) |
| Deficit | | **(28,517,907)** | | (26,068,439) |
| | **$** | **89,766,852** | $ | 89,094,289 |

The Company's objectives when managing capital are:

(a) to ensure that the Company maintains the level of capital necessary to meet the requirements of cash calls for the exploration of properties and from operators in joint venture properties;

(b) to ensure that the Company maintains the level of capital necessary to meet the requirements of its brokers;

(c) to allow the Company to respond to changes in economic and/or marketplace conditions by maintaining the Company's ability to purchase new investments and acquisitions of exploration properties;

(d) to give shareholders sustained growth in shareholder value by increasing shareholders' equity; and

(e) to maintain a flexible capital structure which optimizes the cost of capital at acceptable levels of risk.

## 12. Management of capital (continued):

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its underlying assets. The Company maintains or adjusts its capital level to enable it to meet its objectives by:

(a) realizing proceeds from the disposition of its investments; and

(b) raising capital through equity or debt financings.

The Company is not subject to any capital requirements imposed by a regulator, except to the extent that it has pledged cash as collateral for certain letters of guarantee issued to the ANH (note 6).

There were no changes in the Company's approach to capital management during the six months ended December 31, 2011. To date, the Company has not declared any cash dividends to its shareholders as part of its capital management program. The Company's current capital resources are sufficient to discharge its liabilities as at December 31, 2011.

## 13. Risk management:

The investment operations of Brownstone's business involve the purchase and sale of securities and, accordingly, a portion of the Company's assets are currently comprised of financial instruments. The use of financial instruments can expose the Company to several risks, including market, credit, and liquidity risks. A discussion of the Company's use of financial instruments and their associated risks is provided below.

(a) Market risk:

Market risk is the risk that the fair value of, or future cash flows from, the Company's financial instruments will significantly fluctuate because of changes in market prices. The value of the financial instruments can be affected by changes in interest rates, foreign exchange rates, and equity and commodity prices. The Company is exposed to market risk in trading its investments, and unfavourable market conditions could result in dispositions of investments at less than favourable prices. Additionally, the Company adjusts its investments to fair value at the end of each reporting period. This process could result in significant write-downs of the Company's investments over one or more reporting periods, particularly during periods of overall market instability, which would have a significant unfavourable effect on Brownstone's financial position.

There were no changes to the way the Company manages market risk during the six months ended December 31, 2011. The Company manages market risk by having a portfolio which is not singularly exposed to any one issuer; however, its investment activities are currently concentrated primarily in the oil and gas resource industry.

**(Unaudited – prepared in Canadian dollars)**

## 13. Risk management (continued):

The following table shows the estimated sensitivity of the Company's after-tax net loss for the six months ended December 31, 2011 from a change in the closing bid price of the Company's investments with all other variables held constant as at December 31, 2011:

| **Percentage of change in closing bid prices** | **Decrease in net after-tax loss from % increase in closing bid price** | **Increase in net after-tax loss from % decrease in closing bid price** |
|---|---|---|
| **2%** | **$ 194,383** | **$ (194,383)** |
| **4%** | **388,765** | **(388,765)** |
| **6%** | **583,148** | **(583,148)** |
| **8%** | **777,531** | **(777,531)** |
| **10%** | **971,913** | **(971,913)** |

The following table shows the estimated sensitivity of the Company's after-tax net loss for the year ended June 30, 2011 from a change in the closing bid price of the Company's investments with all other variables held constant as at June 30, 2011:

| Percentage of change in closing bid prices | Decrease in net after-tax loss from % increase in closing bid price | Increase in net after-tax loss from % decrease in closing bid price |
|---|---|---|
| 2% | $ 214,775 | $ (214,775) |
| 4% | 429,550 | (429,550) |
| 6% | 644,325 | (644,325) |
| 8% | 859,100 | (859,100) |
| 10% | 1,073,875 | (1,073,875) |

(b) Credit risk:

Credit risk is the risk of loss associated with the inability of a third party to fulfill its payment obligations. The Company is exposed to the risk that third parties that owe it money or securities (in connection with convertible or debt securities, for example) will not perform their underlying obligations and for funds held with banks for cash and cash equivalents. The Company may, from time to time, invest in debt obligations. As at December 31, 2011 and June 30, 2011, the Company did not hold any debt obligations. All funds in cash and cash equivalents are held in financial institutions that have a credit rating above AA and the Company believes it is not exposed to any significant loss.

There were no changes to the way the Company manages credit risk during the six months ended December 31, 2011. The Company is also exposed, in the normal course of business, to credit risk from the sale of its investments and advances to investee and joint venture companies.

**(Unaudited – prepared in Canadian dollars)**

## 13. Risk management (continued):

The Company's maximum exposure to credit risk is:

| | December 31, 2011 | June 30, 2011 |
|---|---|---|
| Cash and cash equivalents | $ 27,236,052 | $ 29,833,806 |
| Restricted cash | 563,418 | 4,699,998 |
| Due from brokers | 64,460 | 228,868 |
| Income taxes receivable | 476,886 | 1,053,614 |
| Other receivables | 530,109 | 371,573 |
| | $ 28,870,925 | $ 36,187,859 |

As at December 31, 2011 and June 30, 2011, the Company had the following significant receivables:

(i) As at December 31, 2011, the Company had accrued income taxes receivable of $476,886 (June 30, 2011 - $1,053,614) relating to refunds of taxes previously paid, from taxable losses carried back to prior years. The Company believes it is not exposed to credit risk since the amount is fully collectible from the Canadian government.

(ii) As at December 31, 2011, included in other receivables is $315,723 (June 30, 2011 - $255,911) relating from oil sales revenue. The Company is exposed to this credit risk since the amount is due from one counterparty.

(iii) As at December 31, 2011, included in other receivables is $84,586 (June 30, 2011 - $84,366) relating to Goods and Services Tax and Harmonized Sales Tax input sales tax refunds. The Company believes it is not exposed to credit risk since the amount is fully collectible from the Canadian government.

(c) Liquidity risk:

Liquidity risk is the risk that the Company will have sufficient cash resources to meet its financial obligations as they come due. The Company's liquidity and operating results may be adversely affected if the Company's access to the capital markets is hindered, whether as a result of a downturn in stock market conditions generally or related to matters specific to the Company, or if the value of the Company's investments declines, resulting in losses upon disposition. The Company generates cash flow primarily from its financing activities and proceeds from the disposition of its investments, in addition to interest earned on its investments. The Company has sufficient investments which primarily consist of freely tradable and relatively liquid equity securities to fund its obligations as they become due under normal operating conditions.

There were no changes to the way the Company manages liquidity risk during the six months ended December 31, 2011. The Company manages liquidity risk by reviewing the amount of margin available on a daily basis, and managing its cash flow. The Company holds investments which can be converted into cash when required.

**(Unaudited – prepared in Canadian dollars)**

## 13. Risk management (continued):

As at December 31, 2011, the Company was not using any margin but had $64,460 (June 30, 2011 - $228,868) due from its broker (cash held at a brokerage account).

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at December 31, 2011:

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| **Liabilities and obligations** | **Total** | **Less than 1 year** | **1 – 3 years** | **4 – 5 years** | **After 5 years** |
| Accounts payable and accrued liabilities | **$ 1,718,936** | **$ 1,718,936** | **$ -** | **$ -** | **$ -** |
| | **$ 1,718,936** | **$ 1,718,936** | **$ -** | **$ -** | **$ -** |

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at June 30, 2011:

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| Liabilities and obligations | Total | Less than 1 year | 1 – 3 years | 4 – 5 years | After 5 years |
| Accounts payable and accrued liabilities | $ 1,497,064 | $ 1,497,064 | $ - | $ - | $ - |
| | $ 1,497,064 | $ 1,497,064 | $ - | $ - | $ - |

The following table shows the Company's source of liquidity by assets as at December 31, 2011:

| | Liquidity by period | | | | |
|---|---|---|---|---|---|
| **Assets** | **Total** | **Less than 1 year** | **1 – 3 years** | **After 4 years** | **Non-liquid assets** |
| Cash and cash equivalents | **$ 27,236,052** | **$ 27,236,052** | **$ -** | **$ -** | **$ -** |
| Due from brokers | **64,460** | **64,460** | **-** | **-** | **-** |
| Prepaids and other receivables | **530,109** | **530,109** | **-** | **-** | **-** |
| Investments at fair value | **11,139,408** | **-** | **11,139,408** | **-** | **-** |
| Income taxes receivable | **476,886** | **476,886** | **-** | **-** | **-** |
| Restricted cash | **563,418** | **-** | **563,418** | **-** | **-** |
| Exploration and evaluation assets | **51,475,455** | **-** | **-** | **-** | **51,475,455** |
| | **$ 91,485,788** | **$ 28,307,507** | **$ 11,702,826** | **$ -** | **$ 51,475,455** |

## 13. Risk management (continued):

The following table shows the Company's source of liquidity by assets as at June 30, 2011:

| | | Liquidity by period | | | |
|---|---|---|---|---|---|
| Assets | Total | Less than 1 year | 1 – 3 years | After 4 years | Non-liquid assets |
| Cash and cash equivalents | $ 29,833,806 | $ 29,833,806 | $ - | $ - | $ - |
| Due from brokers | 228,868 | 228,868 | - | - | - |
| Restricted cash – current | 4,165,776 | 4,165,776 | | | |
| Prepaids and other receivables | 371,573 | 371,573 | - | - | - |
| Investments at fair value | 12,350,483 | - | 12,350,483 | - | - |
| Income taxes receivable | 1,053,614 | 1,053,614 | - | - | - |
| Restricted cash | 534,222 | - | 534,222 | - | - |
| Exploration and evaluation assets | 42,053,011 | - | - | - | 42,053,011 |
| | $ 90,591,353 | $ 35,653,637 | $ 12,884,705 | $ - | $ 42,053,011 |

(d) Interest risk:

Interest risk is the impact that changes in interest rates could have on the Company's earnings and liabilities. As at December 31, 2011 and June 30, 2011, the Company did not have any interest rate risk liabilities. The Company holds a significant portion of cash equivalents in interest-bearing instruments and is exposed to the risk of changing interest rates.

The primary objective of the Company's investment activities is to preserve principal while at the same time maximizing the income it receives from its investments without significantly increasing risk. The Company places investments with high credit quality issuers. To minimize interest rate risk, the Company maintains its portfolio of cash equivalents in guaranteed investment certificates and bankers' acceptances with maturities of less than one year. The Company does not use any derivative instruments to reduce exposure to interest rate fluctuations.

(e) Currency risk:

Currency risk is the risk that the fair value of or future cash flows from the Company's financial instruments will fluctuate because of changes in foreign exchange rates. The Company's operations are exposed to foreign exchange fluctuations, which could have a significant adverse effect on its consolidated results of operations from time to time.

The Company presently holds funds in Canadian dollars but a significant amount of its costs are denominated in U.S. dollars, Argentinean pesos and Brazilian reals. The Company does not engage in any hedging activities to mitigate its foreign exchange risk.

A change in the foreign exchange rate of the Canadian dollar versus another currency may increase or decrease the value of the Company's financial instruments. The Company does not hedge its foreign currency exposure.

## 13. Risk management (continued):

The following assets and liabilities were denominated in foreign currencies:

| | December 31, 2011 | June 30, 2011 |
|---|---|---|
| Denominated in U.S. dollars: | | |
| Cash and cash equivalents | $ 1,226,716 | $ 69,779 |
| Due from (to) brokers | (15) | 157,095 |
| Restricted cash | 563,418 | 4,699,998 |
| Prepaids and other receivables | 395,351 | 260,309 |
| Exploration and evaluation assets | 50,358,696 | 40,978,189 |
| Accounts payable and accrued liabilities | (1,609,558) | (1,397,055) |
| Net assets denominated in U.S. dollars | 50,934,608 | 44,768,315 |
| Denominated in Brazilian reals: | | |
| Cash and cash equivalents | 153,519 | 173,855 |
| Net assets denominated in Brazilian reals | 153,519 | 173,855 |
| Denominated in Argentinean pesos: | | |
| Cash and cash equivalents | 6,857 | 1,538 |
| Prepaids and other receivables | 20,942 | 19,393 |
| Net assets denominated in Argentinean pesos | 27,799 | 20,931 |
| Denominated in Colombian pesos: | | |
| Cash and cash equivalents | 720,478 | 96,949 |
| Net assets denominated in Colombian pesos | 720,478 | 96,949 |

The following table shows the estimated sensitivity of the Company's total comprehensive loss for six months ended December 31, 2011 from a change in the U.S. dollar exchange rate in which the Company has significant exposure with all other variables held constant as at December 31, 2011:

| Percentage change in U.S. dollar | Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate | Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate |
|---|---|---|
| 2% | $ 758,926 | $ (758,926) |
| 4% | 1,517,851 | (1,517,851) |
| 6% | 2,276,777 | (2,276,777) |
| 8% | 3,035,703 | (3,035,703) |
| 10% | 3,794,628 | (3,794,628) |

## 13. Risk management (continued):

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2011 from a change in the U.S. dollar exchange rate in which the Company has significant exposure with all other variables held constant as at June 30, 2011:

| Percentage change in U.S. dollar exchange rate | Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate | Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate |
|---|---|---|
| 2% | $ 665,675 | $ (665,675) |
| 4% | 1,331,350 | (1,331,350) |
| 6% | 1,997,025 | (1,997,025) |
| 8% | 2,662,700 | (2,662,700) |
| 10% | 3,328,376 | (3,328,376) |

## 14. Transition to IFRS:

For all periods up to and including the year ended June 30, 2011, the Company prepared its consolidated financial statements in accordance with CGAAP. The interim financial statements for the three months ended September 30, 2011 were the first financial statements that the Company has prepared in accordance with IFRS, which contain certain disclosures not included in these interim financial statements. Accordingly, these interim financial statements as at and for the three and six months ended December 31, 2011 should be read in conjunction with the interim financial statements as at and for the three months ended September 30, 2011.

Reconciliations:

The reconciliations between the Company's previously reported financial results under CGAAP and the current reported financial results under IFRS are provided as follows:

(i) reconciliation of the consolidated statement of financial position and equity as at December 31, 2010; and

(ii) reconciliation of the consolidated statement of comprehensive loss for the three and six months ended December 31, 2010.

There is no reconciliation for the consolidated cash flow statement as there are no significant differences.

**(Unaudited – prepared in Canadian dollars)**

**14. Transition to IFRS (continued):**

(i) The following is a reconciliation of the consolidated statement of financial position and equity as at December 31, 2010:

| | Notes | CGAAP | IFRS Adjust. | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | | $ 8,700,056 | $ - | $ 8,700,056 |
| Due from brokers | | 931,651 | - | 931,651 |
| Prepaids and other receivables | | 408,298 | - | 408,298 |
| Investments, at fair value | | 14,458,169 | - | 14,458,169 |
| Income taxes receivable | | 1,806,740 | - | 1,806,740 |
| | | 26,304,914 | - | 26,304,914 |
| **Restricted cash** | | 2,162,261 | - | 2,162,261 |
| **Exploration and evaluation assets** | 1. | 40,134,618 | (5,883,186) | 34,251,432 |
| | | $ 68,601,793 | $ (5,883,186) | $ 62,718,607 |
| **Liabilities and Shareholders' Equity** | | | | |
| **Current** | | | | |
| Accounts payable and accrued liabilities | | $ 302,037 | $ - | $ 302,037 |
| Promissory note payable | | 3,000,000 | - | 3,000,000 |
| | | 3,302,037 | - | 3,302,037 |
| **Shareholders' equity** | | | | |
| Share capital | | 65,356,015 | - | 65,356,015 |
| Warrants and broker warrants | | 3,918,662 | - | 3,918,662 |
| Contributed surplus | 2. | 13,575,861 | 601,044 | 14,176,905 |
| Foreign currency translation reserve | 1., 3. | - | (2,000,252) | (2,000,252) |
| Deficit | 1., 3. | (17,550,782) | (4,483,978) | (22,034,760) |
| | | 65,299,756 | (5,883,186) | 59,416,570 |
| | | $ 68,601,793 | $ (5,883,186) | $ 62,718,607 |

1. Under CGAAP, there are various indicators to be considered in determining the appropriate functional currency of a foreign operation and such indicators are similar to those under IFRS. When the assessment of functional currency provides mixed indicators and the functional currency is not obvious, the IFRS standard requires that priority be given to certain primary indicators that may lead to a different functional currency determination under IFRS compared to CGAAP.

**(Unaudited – prepared in Canadian dollars)**

### 14. Transition to IFRS (continued):

As a result of the transition to IFRS, effective July 1, 2010, the Company determined that the U.S. dollar is the functional currency of certain of its foreign subsidiaries. Prior to the Transition Date, these subsidiaries were considered to be integrated foreign operations with the Canadian Dollar as their functional currency, meaning that non-monetary assets like exploration and evaluation assets (previously called oil and gas properties and related expenditures) are converted using the historic exchange rate. Under IFRS an adjustment is required to translate exploration and evaluation assets held by foreign subsidiaries using the closing exchange rate rather than the historic exchange rate. Also, the translation of foreign subsidiaries and the exchange differences on long-term monetary balances between the Company and the foreign subsidiaries under IAS 21 must be shown under exchange differences on translation of foreign operations in other comprehensive loss.

The following is a summary of the adjustments as at December 31, 2010:

| | |
|---|---|
| Adjustment to exploration and evaluation assets: | |
| Adjustment to exploration and evaluation assets at Transition Date, reflected directly in deficit | $ (307,797) |
| Adjustment at Transition Date for impairment review under IFRS 1 | (3,574,083) |
| Exchange loss on exploration and evaluation assets due to change to functional currency | (2,001,306) |
| | $ (5,883,186) |
| Net adjustment to foreign currency translation reserve: | |
| Exchange loss on exploration and evaluation assets due to change to functional currency | $ (2,001,306) |
| Exchange loss on intragroup long-term monetary balances reflected in the six months ended December 31, 2010 | (2,815,447) |
| Exchange gains on translating foreign operations reflected in the six months ended December 31, 2010 | 2,816,501 |
| | $ (2,000,252) |
| Net adjustment to accumulated deficit relating to IAS 21 and impairment review: | |
| Adjustment to exploration and evaluation assets at Transition Date, reflected directly in deficit | $ (307,797) |
| Adjustment at Transition Date for impairment review under IFRS 1 | (3,574,083) |
| Exchange loss on intragroup long-term monetary balances reflected in the six months ended December 31, 2010 | 2,815,447 |
| Exchange gains on translating foreign operations reflected in the six months ended December 31, 2010 | (2,816,501) |
| | $ (3,882,934) |

**(Unaudited – prepared in Canadian dollars)**

## 14. Transition to IFRS (continued):

2. Under CGAAP, the Company was permitted to elect to treat the stock options issued as a pool and determine fair value using the average life of the instruments, provided that compensation expense was then recognized on a straight-line basis and the Company was not required to use estimated future forfeitures of the options. Under IFRS 2 the Company is required to use the graded method in valuing stock options and use an estimated forfeiture rate, resulting in an accelerated compensation expense for these awards under IFRS.

   The following is a summary of the adjustments for the six months ended December 31, 2010:

| | |
|---|---|
| Increase in contributed surplus and a corresponding increase in accumulated deficit: | |
| Adjustment at Transition Date for stock options outstanding and not vested | $ 399,411 |
| Adjustment during the six months ended December 31, 2010 | 201,633 |
| | $ 601,044 |

3. The following is a reconciliation of the accumulated deficit balance as at December 31, 2010:

| | |
|---|---|
| Deficit as reported under CGAAP as at December 31, 2010 | $ (17,550,782) |
| Adjustment to exploration and evaluation assets at Transition Date, reflected directly in deficit | (307,797) |
| Adjustment at Transition Date for impairment review under IFRS 1 | (3,574,083) |
| Adjustment at Transition Date for stock options outstanding and not vested | (399,411) |
| Exchange loss on intragroup long-term monetary balances reflected in the six months ended December 31, 2010 | 2,815,447 |
| Exchange gains on translating foreign operations reflected in the six months ended December 31, 2010 | (2,816,501) |
| Adjustment for stock options in the six months ended December 31, 2010 | (201,633) |
| Deficit as reported under IFRS as at December 31, 2010 | $ (22,034,760) |

**(Unaudited – prepared in Canadian dollars)**

## 14. Transition to IFRS (continued):

(iii) The following is a reconciliation of the consolidated statement of comprehensive loss for the three and six months ended December 31, 2010:

| | Notes | Three Months Ended | | | Six Months Ended | | |
|---|---|---|---|---|---|---|---|
| | | CGAAP | IFRS Adjust. | IFRS | CGAAP | IFRS Adjust. | IFRS |
| **Net investment gains** | | | | | | | |
| Realized gains (losses) on disposal of investments, net | | $ 279,670 | $ - | $ 279,670 | $ (724,176) | $ - | $ (724,176) |
| Unrealized gains on investments, net | | 4,178,644 | - | 4,178,644 | 5,241,808 | - | 5,241,808 |
| | | 4,458,314 | - | 4,458,314 | 4,517,632 | - | 4,517,632 |
| **Interest and other income** | | 54,597 | - | 54,597 | 131,444 | - | 131,444 |
| | | 4,512,911 | - | 4,512,911 | 4,649,076 | - | 4,649,076 |
| **Expenses** | | | | | | | |
| Operating, general and administrative | 4., 5., 6. | 1,557,465 | (259,188) | 1,298,277 | 2,425,802 | (127,313) | 2,298,489 |
| Finance expense | 6. | 83,923 | 330,000 | 413,923 | 83,923 | 330,000 | 413,923 |
| | | 1,641,388 | 70,812 | 1,712,200 | 2,509,725 | 202,687 | 2,712,412 |
| **Profits before income taxes** | | 2,871,523 | (70,812) | 2,800,711 | 2,139,351 | (202,687) | 1,936,664 |
| **Income tax benefit** | | (245,869) | - | (245,869) | (515,718) | - | (515,718) |
| **Profits for the period** | | $ 3,117,392 | $ (70,812) | $ 3,046,580 | $ 2,655,069 | $ (202,687) | $ 2,452,382 |
| **Other comprehensive loss** | | | | | | | |
| Exchange differences on translation of foreign operatior | 5. | - | (1,144,541) | (1,144,541) | - | (2,000,252) | (2,000,252) |
| **Total comprehensive income for the period** | | $ 3,117,392 | $ (1,215,353) | $ 1,902,039 | $ 2,655,069 | $ (2,202,939) | $ 452,130 |
| **Earnings per common share based on profits for the period** | | | | | | | |
| Basic | | $ 0.04 | | $ 0.03 | $ 0.03 | | $ 0.03 |
| Diluted | | $ 0.03 | | $ 0.03 | $ 0.03 | | $ 0.02 |
| **Weighted average number of common shares outstanding** | | | | | | | |
| Basic | | 88,783,581 | | 88,783,581 | 88,737,342 | | 88,737,342 |
| Diluted | | 98,554,714 | | 98,554,714 | 98,966,703 | | 98,966,703 |

## 14. Transition to IFRS (continued):

4. Under CGAAP, the Company was permitted to elect to treat the stock options issued as a pool and determine fair value using the average life of the instruments, provided that compensation expense was then recognized on a straight-line basis and the Company was not required to use estimated future forfeitures of the options. Under IFRS 2, the Company is required to use the graded method in valuing stock options and use an estimated forfeiture rate, resulting in an accelerated compensation expense for these awards under IFRS.

   For the three months ended December 31, 2010, the adjustment was to increase the stock-based compensation expense (included in operating, general, and administrative expenses) by $109,515.

   For the six months ended December 31, 2010, the adjustment was to increase the stock-based compensation expense (included in operating, general, and administrative expenses) by $201,633.

5. Under CGAAP, there are various indicators to be considered in determining the appropriate functional currency of a foreign operation and such indicators are similar to those under IFRS. When the assessment of functional currency provides mixed indicators and the functional currency is not obvious, the IFRS standard requires that priority be given to certain primary indicators that may lead to a different functional currency determination under IFRS compared to CGAAP.

   As a result of the transition to IFRS, effective July 1, 2010, the Company determined that the U.S. dollar is the functional currency of certain of its foreign subsidiaries. Prior to the Transition Date, these subsidiaries were considered to be integrated foreign operations with the Canadian Dollar as their functional currency, meaning that non-monetary assets like exploration and evaluation assets (previously called oil and gas properties and related expenditures) are converted using the historic exchange rate. Under IFRS an adjustment is required to translate exploration and evaluation assets held by foreign subsidiaries using the closing exchange rate rather than the historic exchange rate. Also, the translation of foreign subsidiaries and the exchange differences on long-term monetary balances between the Company and the foreign subsidiary under IAS 21, must be shown under exchange differences on translation of foreign operations in other comprehensive loss.

   For the three months ended December 31, 2010, this adjustment was to decrease foreign exchange loss (included in operating, general, and administrative expenses) by $38,703 and the corresponding entry to increase comprehensive loss.

**(Unaudited – prepared in Canadian dollars)**

## 14. Transition to IFRS (continued):

The following is a summary of the adjustments for the three months ended December 31, 2010:

| | |
|---|---|
| Adjustment to foreign exchange loss (operating, general, and administrative expenses): | |
| Exchange gains on translating foreign operations reflected in the three months ended December 31, 2010 | $ 1,535,44 |
| Exchange loss on intragroup long-term monetary balances reflected in the three months ended December 31, 2010 | (1,574,147) |
| | $ (38,703) |
| Net adjustment to exchange differences on translation of foreign operations: | |
| Exchange gains on translating foreign operations reflected in the three months ended December 31, 2010 | $ 1,535,444 |
| Exchange loss on intragroup long-term monetary balances reflected in the three months ended December 31 2010 | (1,574,147) |
| Exchange loss on exploration and evaluation assets due to change to functional currency | (1,105,838) |
| | $ (1,144,541) |

For the six months ended December 31, 2010, this adjustment was to increase foreign exchange loss (included in operating, general, and administrative expenses) by $1,054 and the corresponding entry to increase comprehensive loss.

A summary of the adjustments for the six months ended December 31, 2010 is as follows:

| | |
|---|---|
| Adjustment to foreign exchange loss (operating, general, and administrative expenses): | |
| Exchange gains on translating foreign operations reflected in the six months ended December 31, 2010 | $ 2,816,501 |
| Exchange loss on intragroup long-term monetary balances reflected in the six months ended December 31, 2010 | (2,815,447) |
| | $ (1,054) |
| Net adjustment to exchange differences on translation of foreign operations: | |
| Exchange gains on translating foreign operations reflected in the six months ended December 31, 2010 | $ 2,816,501 |
| Exchange loss on intragroup long-term monetary balances reflected in the six months ended December 31, 2010 | (2,815,447) |
| Exchange loss on exploration and evaluation assets due to change to functional currency | (2,001,306) |
| | $ (2,000,252) |

**(Unaudited – prepared in Canadian dollars)**

## 14. Transition to IFRS (continued):

6. During fiscal 2011, the Company received gross proceeds of $3,000,000 in the form of a 12% one-year loan which was repaid during 2011. As consideration for the loan, the Company paid a financing fee of $330,000. Under IFRS, the Company has reallocated the financing fee of $330,000 from operating, general, and administrative expense to finance expense.

The following is a summary of the adjustment to operating, general and administrative expense for the three months ended December 31, 2010:

| | |
|---|---|
| Adjustment to operating, general, and administrative expenses: | |
| Exchange gains on translating foreign operations reflected f the three months ended December 31, 2010 | $ 1,535,444 |
| Exchange loss on intragroup long-term monetary balances reflected in the three months ended December 31, 2010 | (1,574,147) |
| Adjustment for stock-based compensation expense during the three months ended December 31, 2011 | 109,515 |
| Finance expense | (330,000) |
| | $ (259,188) |

The following is a summary of the adjustment to operating, general and administrative expense for the six months ended December 31, 2010:

| | |
|---|---|
| Adjustment to operating, general, and administrative expenses: | |
| Exchange gains on translating foreign operations reflected in the six months ended December 31, 2010 | $ 2,816,501 |
| Exchange loss on intragroup long-term monetary balances reflected in the six months ended December 31, 2010 | (2,815,447) |
| Adjustment for stock-based compensation expense during the six months ended December 31, 2011 | 201,633 |
| Finance expense | (330,000) |
| | $ (127,313) |

## 15. Future changes in accounting policies:

(a) *IFRS 10, Consolidation* ("IFRS 10")

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation—Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*. This standard is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted.

## 15. Future changes in accounting policies (continued):

(b) *IFRS 11, Joint Arrangements* ("IFRS 11")

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operative. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers.* This standard is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted.

(c) *IFRS 12, Disclosure of Interests in Other Entities* ("IFRS 12")

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities. This standard is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted.

(d) *IFRS 13, Fair Value Measurement* ("IFRS 13")

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. This standard is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted.

(e) Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, *Consolidated and Separate Financial Statements* ("IAS 27"), and IAS 28, *Investments in Associates and Joint Venture* ("IAS 28")*.* The amended IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 through 1.

(f) Implication of New and Amended Standards to the Company

The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its interim condensed consolidated financial statements or whether to early adopt any of the new requirements.

## 16. Subsequent events:

(a) Subsequent to December 31, 2011, the Company granted 225,000 options exercisable at $0.56 per share and expiring on February 7, 2017.

(b) Subsequent to December 31, 2011, 50,000 options exercisable at $1.80 per share expired unexercised.

(c) Subsequent to December 31, 2011, the Company pledged an additional US$1,850,000 to the ANH for phase 2 of exploration on the Colombia Llanos exploration Block 27 (note 6).