

Consolidated Financial Statements of

Brownstone Energy Inc.

(Prepared in Canadian dollars)

For the years ended June 30, 2013 and 2012

Contents

| | |
|---|-------------|
| Independent Auditors' Report | 2 |
| Consolidated Financial Statements: | |
| Consolidated Statements of Financial Position | 3 |
| Consolidated Statements of Comprehensive Loss | 4 |
| Consolidated Statements of Changes in Equity | 5 |
| Consolidated Statements of Cash Flows | 6 |
| Notes to the Consolidated Financial Statements | 7-47 |

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Brownstone Energy Inc.

We have audited the accompanying consolidated financial statements of **Brownstone Energy Inc.**, which comprise the consolidated statements of financial position as at June 30, 2013 and 2012, and the consolidated statements of comprehensive loss, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Brownstone Energy Inc.** as at June 30, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company has a history of operating losses. The Company has incurred a loss for the year ended June 30, 2013 of \$40,860,181 (2012 - \$27,053,898) and as at June 30, 2013 the Company has an accumulated deficit of \$93,982,518. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern.

Toronto, Canada
October 28, 2013



Chartered Accountants
Licensed Public Accountants

BROWNSTONE ENERGY INC.
Consolidated Statements of Financial Position
As at June 30,
(Prepared in Canadian dollars)

| | <u>Notes</u> | <u>2013</u> | <u>2012</u> |
|--|--------------|----------------------|----------------------|
| Assets | | | |
| Current | | | |
| Cash and cash equivalents | 6(a) | \$ 9,595,064 | \$ 18,197,006 |
| Prepays and receivables | 14(b) | 1,136,807 | 976,068 |
| Investments, at fair value | 5, 6(a) | 1,667,208 | 2,771,469 |
| Income taxes receivable | | 144,471 | - |
| | | <u>12,543,550</u> | <u>21,944,543</u> |
| Restricted cash | 7 | 634,925 | 564,581 |
| Exploration and evaluation assets | 4 | 17,274,483 | 45,141,148 |
| | | <u>\$ 30,452,958</u> | <u>\$ 67,650,272</u> |

Liabilities and Equity

| | | | |
|--|------|----------------------|----------------------|
| Current | | | |
| Accounts payable and accrued liabilities | | \$ 3,478,478 | \$ 1,150,868 |
| Income taxes payable | | 72,642 | - |
| | | <u>3,551,120</u> | <u>1,150,868</u> |
| Equity | | | |
| Share capital | 9(a) | 96,597,845 | 96,597,845 |
| Contributed surplus | 9(c) | 21,806,275 | 16,642,202 |
| Warrants and broker warrants | 9(d) | 2,559,317 | 7,310,433 |
| Foreign currency translation reserve | | (79,081) | (928,739) |
| Deficit | | (93,982,518) | (53,122,337) |
| | | <u>26,901,838</u> | <u>66,499,404</u> |
| | | <u>\$ 30,452,958</u> | <u>\$ 67,650,272</u> |

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

"Steven Mintz" Director

"Michael Sweatman" Director

BROWNSTONE ENERGY INC.**Consolidated Statements of Comprehensive Loss****Years Ended June 30,****(Prepared in Canadian dollars)**

| | <u>Notes</u> | <u>2013</u> | <u>2012</u> |
|---|--------------|------------------------|------------------------|
| Net investment losses | | | |
| Net realized losses on disposal of investments | | \$ - | \$ (5,008,726) |
| Net change in unrealized losses on investments | | <u>(1,604,261)</u> | <u>(610,098)</u> |
| | | (1,604,261) | (5,618,824) |
| Interest and other income | 4(a)(iii) | <u>213,781</u> | <u>302,955</u> |
| | | <u>(1,390,480)</u> | <u>(5,315,869)</u> |
| Expenses | | | |
| Operating, general and administrative | 8, 9(b) | <u>2,691,218</u> | <u>5,277,579</u> |
| Impairment of exploration and evaluation assets | 4 | <u>36,394,392</u> | <u>16,292,799</u> |
| | | <u>39,085,610</u> | <u>21,570,378</u> |
| Loss before income taxes | | <u>(40,476,090)</u> | <u>(26,886,247)</u> |
| Income tax expense | 10(a)(b) | <u>384,091</u> | <u>167,651</u> |
| Net loss for the year | | <u>(40,860,181)</u> | <u>(27,053,898)</u> |
| Other comprehensive income | | | |
| Exchange differences on translation of foreign operations | | <u>849,658</u> | <u>2,236,275</u> |
| Total comprehensive loss for the year | | <u>\$ (40,010,523)</u> | <u>\$ (24,817,623)</u> |
| Loss per common share based on net loss for the year | 9(e) | | |
| Basic and diluted | | <u>\$ (0.31)</u> | <u>\$ (0.21)</u> |
| Weighted average number of common shares outstanding | 9(e) | | |
| Basic and diluted | | <u>129,794,289</u> | <u>129,794,289</u> |

See accompanying notes to the consolidated financial statements.

BROWNSTONE ENERGY INC.**Consolidated Statements of Changes in Equity****Years Ended June 30, 2013 and 2012****(Prepared in Canadian dollars)**

| | | Number of | Warrants | Contributed | Foreign | | |
|---|---------|-------------|--------------|---------------|----------------|-----------------|---------------|
| | | shares | and broker | surplus | currency | Deficit | Total equity |
| | | | warrants | | translation | | |
| | Notes | | | | reserve | | |
| Balance at June 30, 2011 | | 129,794,289 | \$ 6,873,384 | \$ 14,856,513 | \$ (3,165,014) | \$ (26,068,439) | \$ 89,094,289 |
| Net loss for the year | | - | - | - | - | (27,053,898) | (27,053,898) |
| Exchange differences on translation of foreign operations | | - | - | - | 2,236,275 | - | 2,236,275 |
| Total comprehensive loss for the year | | - | - | - | 2,236,275 | (27,053,898) | (24,817,623) |
| Stock-based compensation expense | 9(b) | - | - | 1,412,741 | - | - | 1,412,741 |
| Reallocation of expired warrants | 9(d) | - | (372,948) | 372,948 | - | - | - |
| Cost of warrant expiry date extension | 9(d)(i) | - | 809,997 | - | - | - | 809,997 |
| Balance at June 30, 2012 | | 129,794,289 | \$ 7,310,433 | \$ 16,642,202 | \$ (928,739) | \$ (53,122,337) | \$ 66,499,404 |
| Net loss for the year | | - | - | - | - | (40,860,181) | (40,860,181) |
| Exchange differences on translation of foreign operations | | - | - | - | 849,658 | - | 849,658 |
| Total comprehensive loss for the year | | - | - | - | 849,658 | (40,860,181) | (40,010,523) |
| Stock-based compensation expense | 9(b) | - | - | 412,957 | - | - | 412,957 |
| Reallocation of expired warrants | 9(d) | - | (4,751,116) | 4,751,116 | - | - | - |
| Balance at June 30, 2013 | | 129,794,289 | \$ 2,559,317 | \$ 21,806,275 | \$ (79,081) | \$ (93,982,518) | \$ 26,901,838 |

See accompanying notes to the consolidated financial statements.

BROWNSTONE ENERGY INC.
Consolidated Statements of Cash Flows
Years Ended June 30,
(Prepared in Canadian dollars)

| | <u>Notes</u> | <u>2013</u> | <u>2012</u> |
|--|--------------|---------------------|----------------------|
| Cash flows used in operating activities | | | |
| Net loss for the year | | \$ (40,860,181) | \$ (27,053,898) |
| Items not affecting cash | | | |
| Net realized losses on disposal of investments | | - | 5,008,726 |
| Net change in unrealized losses on investments | | 1,604,261 | 610,098 |
| Impairment of exploration and evaluation assets | 4 | 36,394,392 | 16,292,799 |
| Stock-based compensation expense | 9(b) | 412,957 | 1,412,741 |
| Cost of warrant expiry date extension | 9(d)(i) | - | 809,997 |
| | | <u>(2,448,571)</u> | <u>(2,919,537)</u> |
| Changes in non-cash working capital balances | | | |
| Prepays and receivables | | (160,739) | (604,495) |
| Income taxes receivable | | (144,471) | 1,053,614 |
| Accounts payable and accrued liabilities | | (349,142) | (726,001) |
| Income taxes payable | | 72,642 | - |
| | | <u>(3,030,281)</u> | <u>(3,196,419)</u> |
| Cash flows from financing activities | | | |
| Decrease in due from brokers | | - | 228,868 |
| | | <u>-</u> | <u>228,868</u> |
| Cash flows used in investing activities | | | |
| Expenditures on exploration and evaluation assets, net | 4 | (10,935,983) | (16,717,003) |
| Proceeds on sale of exploration and evaluation assets | | 6,157,261 | 3,642 |
| Decrease (increase) in restricted cash | | (70,344) | 4,135,417 |
| Proceeds on disposal of investments | | - | 4,010,190 |
| Purchases of investments | | (500,000) | (50,000) |
| | | <u>(5,349,066)</u> | <u>(8,617,754)</u> |
| Net decrease in cash and cash equivalents during the year | | (8,379,347) | (11,585,305) |
| Exchange rate changes on foreign currency cash balances | | (222,595) | (51,495) |
| Cash and cash equivalents, beginning of year | | 18,197,006 | 29,833,806 |
| Cash and cash equivalents, end of year | | \$ 9,595,064 | \$ 18,197,006 |
| Supplemental cash flow information | | | |
| Income taxes paid | | \$ 455,920 | \$ 167,651 |
| Income taxes refunded | | - | 1,053,614 |

See accompanying notes to the consolidated financial statements.

BROWNSTONE ENERGY INC.

Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(Prepared in Canadian dollars)

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 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, Canada, M5X 2A2.

Brownstone is a Canadian-based, energy-focused company with direct interests in oil and gas exploration projects, including varying interests in offshore Israel and in the Llanos Basin, Colombia, as well as other oil and gas interests worldwide.

These consolidated financial statements were approved for issuance by the Company's board of directors on October 28, 2013.

These consolidated financial statements have been prepared using accounting policies applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they become due. The Company has incurred a loss for the year ended June 30, 2013 of \$40,860,181 (2012 - \$27,053,898) and has an accumulated deficit of \$93,982,518 (2012 - \$53,122,337). The Company is in the exploration and development stage and is subject to risks and challenges similar to other companies in a comparable stage of exploration. These risks include, but are not limited to, dependence on key individuals, successful exploration and the ability to secure adequate financing to meet the minimum capital required to successfully complete the projects, political risk relating to maintaining property licenses in good standing and continuing as a going concern. Management estimates that the funds available as at June 30, 2013 will not be sufficient to meet the Company's potential capital expenditures through June 30, 2014. The Company will have to raise additional funds to continue operations. Although the Company has been successful in raising funds to date, there can be no assurance that adequate funding will be available in the future, or available on terms acceptable to the Company. Failure to meet its funding commitments with its partners may result in the loss of the Company's exploration and evaluation interests.

The challenges of securing requisite funding beyond June 30, 2013 and the continued estimated operating losses cast significant doubt on the Company's ability to continue as a going concern. The consolidated statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts nor to the amounts or classification of liabilities that might be necessary should the Company not be able to continue as a going concern.

2. Basis of preparation:

(a) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

2. Basis of preparation (continued):

(b) Basis of presentation:

These consolidated financial statements have been prepared using the historical cost convention except for financial instruments, which have been measured at fair value. All monetary references expressed in these notes are references to Canadian dollar amounts (“\$”).

(c) Basis of consolidation:

These consolidated financial statements include the accounts of Brownstone and its wholly-owned subsidiaries: Brownstone Ventures (US) Inc., Brownstone Ventures (Barbados) Inc., Brownstone Comercializadora de Petroleo Ltda. and 2121197 Ontario Ltd. All inter-company account balances and transactions have been eliminated upon consolidation.

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 consolidated financial statements from the date control is obtained until the date control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company using consistent accounting policies. All intercompany balances, transactions, income, expenses, profits and losses, including unrealized gains and losses, have been eliminated on consolidation.

(d) Adoption of IFRS 9:

The effective date of IFRS 9, Financial Instruments (“IFRS 9”), is January 1, 2015. As permitted by the IASB, the Company has early adopted IFRS 9 in conjunction with the transition to IFRS on July 1, 2010. Specifically, the Company has adopted the recognition, de-recognition, and measurement of financial assets and liabilities. The Company’s significant class of financial assets is investments (designated at fair value through profit or loss).

(e) Critical accounting judgments, estimates and assumptions:

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management’s experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Uncertainty about these judgments, estimates and assumptions could result in outcomes that could require a material adjustment to the carrying amount of the asset or liability affected in future periods.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

2. Basis of preparation (continued):

The information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements is as follows:

(i) Impairment:

At the end of each financial reporting period the carrying amounts of the Company's non-financial assets are reviewed to determine whether there is any indication that those assets have suffered an impairment loss or reversal of previous impairment. Where such an indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. Refer to Note 4 for further details.

(ii) Fair value of investments in securities not quoted in an active market:

Where the fair values of financial assets and financial liabilities recorded on the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgment is required to establish fair values. Refer to Note 3(c)(iv) for further details.

(iii) Fair value of financial derivatives:

Investments in warrants that are not traded on a recognized securities exchange do not have a readily available market value. When there are sufficient and reliable observable market inputs, a valuation technique is used; if no such market inputs are available, the warrants and options are valued at intrinsic value that approximates fair value. Refer to Note 3(c)(iv) for further details.

(iv) Stock-based compensation expense:

The Company uses the Black-Scholes option pricing model to determine the fair value of options in order to calculate stock-based compensation expense. The Black-Scholes model involves six key inputs to determine fair value of an option: risk-free interest rate, exercise price, market price at date of issue, expected dividend yield, expected life, and expected volatility. Certain of the inputs are estimates that involve considerable judgment and are or could be affected by significant factors that are out of the Company's control. The Company is also required to estimate the future forfeiture rate of options based on historical information in its calculation of stock-based compensation expense. Refer to Note 9(b) for further details.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

2. Basis of preparation (continued):

The information about significant areas of judgment considered by management in preparing the consolidated financial statements are as follows:

(i) Going concern:

The Company's management has made an assessment of the Company's ability to continue as a going concern and the consolidated financial statements continue to be prepared on a going concern basis. However, management does not believe the Company has sufficient funds to meet the Company's potential capital expenditures through to June 30, 2014 which may cast doubt upon the Company's ability to continue as a going concern. These consolidated financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. Refer to Note 1.

(ii) Determination of functional currency:

The effects of Changes in Foreign Exchange Rates' (IAS 21) defines the functional currency as the currency of the primary economic environment in which an entity operates. The determination of functional currency, which is performed on an entity by entity basis, is based on various judgmental factors outlined in IAS 21. Based on assessment of the factors in IAS 21, primarily those that influence labour, material and other costs of goods or services received by its subsidiaries, management determined that the functional currency for the parent company is Canadian dollars, the US dollar for the Company's subsidiaries located in Barbados and the United States and the Brazilian real for the Company's subsidiary located in Brazil.

(iii) Deferred tax assets:

Deferred tax assets are recognized in respect of tax losses and other temporary differences to the extent it is probable that taxable income will be available against which the losses can be utilized. Judgment is required to determine the amount of deferred tax assets that can be recognized based upon the likely timing and level of future taxable income together with future tax planning strategies. Refer to Note 10 for further details.

3. Significant accounting policies:

The significant accounting policies used in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

(a) Exploration and evaluation assets and Oil and gas properties:

(i) Exploration and evaluation assets:

Amounts included under exploration and evaluation assets relate to properties that are in preproduction and are undergoing exploration and evaluation.

All costs incurred in connection with the Company's exploration and evaluation assets (acquisition and exploration for oil and gas reserves) including overhead and dry-holes are capitalized less accumulated impairment losses. Such amounts include land acquisition costs, geological and geophysical expenditures, cost of drilling both productive and non-productive wells, gathering production facilities and equipment, and overhead expenses directly related to exploration and development activities.

The Company capitalizes carrying costs directly attributable to its acquisition, exploration and development activities, such as interest costs.

Capitalized exploration and evaluation assets are assessed to determine whether it is likely such net costs may be recovered in the future. Assets that are unlikely to be recovered are written down to their recoverable amount. Impairment reviews take place where there is an indication of impairment or when an exploration and evaluation asset has been transferred into oil and gas properties. The Company considers both qualitative and quantitative factors when determining whether an exploration and evaluation asset may be impaired. Impairment reviews are based on each specific license or block. Each specific license or block has an operator (which may be similar) with different joint partners. Management may consider the following when reviewing an exploration and evaluation asset for impairment:

1. failure to receive approvals of or extensions of environmental/ drilling permits, aboriginal or similar approvals that allow the Company and its partners to proceed with a project;
2. valuations based on reserve or resource reports prepared by an independent engineering firm;
3. political changes in a country which the Company owns the exploration or evaluation asset;
4. seismic testing or drilling results;
5. the Company's intention of participating in a project;
6. management's estimate of the recoverable amount (fair value less costs to sell);
7. long-term oil and gas prices (considering current and historical prices, price trends and related factors);

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

- 8. operating costs;
- 9. future capital requirements;
- 10. and the financial capability of a partner;

(ii) Joint oil and gas activities:

All of the Company's oil and gas activities are conducted jointly with others. The Company's accounts reflect only the Company's proportionate interest in these activities.

For interests in jointly controlled assets and operations, the Company's share of the jointly controlled assets are classified according to the nature of the assets, the Company's share of any liabilities incurred jointly with the other parties, and the Company's share of any income and expenses incurred jointly with the partners are recognized in the consolidated financial statements.

Jointly controlled assets involve the joint control or joint ownership by partners of one or more assets dedicated to the purpose of the joint venture or partnership.

(b) Foreign currency:

(i) Functional currency:

These consolidated financial statements are presented in Canadian dollars, which is the parent's functional currency. Each entity in the group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

(ii) Transactions and balances:

Transactions in foreign currencies are initially recorded in the functional currency at the rate in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange in effect at the reporting date.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction.

(iii) Translation of foreign operations:

The results and financial position of Brownstone's subsidiaries that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

1. Assets and liabilities for each consolidated statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
2. Share capital is translated using the exchange rate at the date of the transaction;
3. Revenue and expenses for each consolidated statement of comprehensive loss are translated at average exchange rates; and
4. All resulting exchange differences are recognized as a separate component of equity and as an exchange difference on translation of foreign operations in other comprehensive loss in the consolidated statements of comprehensive loss.

The Company treats specific inter-company loan balances that are not intended to be repaid in the foreseeable future as part of its net investment in a foreign operation which is recorded as an exchange difference on translation of foreign operations in other comprehensive loss in the consolidated statements of comprehensive loss. When a foreign entity is sold, such exchange differences are reclassified to income or loss in the consolidated statements of comprehensive loss as part of the gain or loss on sale. Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

(c) Financial investments:

(i) Classification:

All investments are classified upon initial recognition at fair value through profit or loss, with changes in fair value reported in income (loss).

(ii) Recognition, de-recognition and measurement:

Purchases and sales of investments are recognized on the settlement date.

Investments at fair value through profit or loss are initially recognized at fair value where a reliable basis for determination exists. Transaction costs are expensed as incurred in the consolidated statements of comprehensive loss. Investments are derecognized when the rights to receive cash flows from the investments have expired or the Company has transferred the financial asset and the transfer qualifies for derecognition in accordance with IFRS 9.

Subsequent to initial recognition, all investments are measured at fair value. Gains and losses arising from changes in the fair value of the investments at fair value through profit or loss category are presented in the consolidated statements of comprehensive loss within unrealized gains or losses on investments in the period in which they arise.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

(iii) Reclassification of investments:

The Company only reclassifies any financial assets when it changes its business model for managing the financial asset.

Reclassifications are recorded at fair value at the date of reclassification, which becomes the new carrying value.

(iv) Determination of fair value:

The determination of fair value requires judgment and is based on market information, where available and appropriate. At the end of each financial reporting period, the Company's management estimates the fair value of investments based on the criteria below and reflects such valuations in the consolidated financial statements.

The Company is also required to disclose details of its investments (and other financial assets and liabilities reported at fair value) within three hierarchy levels (Level 1, 2, or 3) based on the transparency of inputs used in measuring the fair value, and to provide additional disclosure in connection therewith (see Note 6(b)).

1. Publicly-traded investments:

- a. Securities, including shares, options, and warrants that are traded in an active market (such as on a recognized securities exchange) and for which no sales restrictions apply are presented at fair value based on quoted closing bid prices at the consolidated statement of financial position date or the closing bid price on the last day the security traded if there were no trades at the consolidated statement of financial position date. These investments are included in Level 1 in Note 6(b).
- b. Securities that are traded on a recognized securities exchange but which are escrowed or otherwise restricted as to sale or transfer are recorded at amounts discounted from market value to a maximum of 10%. In determining the discount for such investments, the Company considers the nature and length of the restriction. These investments are included in Level 2 in Note 6(b).
- c. For options and warrants that are not traded on a recognized securities exchange, no market value is readily available. When there are sufficient and reliable observable market inputs, a valuation technique is used; if no such market inputs are available or reliable, the warrants and options are valued at intrinsic value, which is equal to the higher of the closing bid price at the consolidated statement of financial position date of the underlying security less the exercise price of the warrant or option, and zero, which approximates fair value. These investments are included in Level 2 in Note 6(b).

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

2. Private company investments:

All privately-held investments (other than options and warrants) are initially recorded at the transaction price, being the fair value at the time of acquisition. Thereafter, at each reporting period, the fair value of an investment may, depending upon the circumstances, be adjusted using one or more of the valuation indicators described below. These investments are included in Level 3 in Note 6(b).

The determinations of fair value of the Company's privately-held investments at other than initial cost are subject to certain limitations. Financial information for private companies in which the Company has investments may not be available and, even if available, that information may be limited and/or unreliable.

Use of the valuation approach described below may involve uncertainties and determinations based on the Company's judgment and any value estimated from these techniques may not be realized or realizable.

The following circumstances are used to determine if the fair value of a privately-held investment should be adjusted upward or downward at the end of each reporting period. In addition to the events described below, which may affect a specific investment, the Company will take into account general market conditions when valuing the privately-held investments in its portfolio. Absent the occurrence of any of these events or any significant change in general market conditions indicates generally that the fair value of the investment has not materially changed.

The fair value of a privately-held investment may be adjusted upward if:

- a. there has been a significant subsequent equity financing provided by outside investors at a valuation above the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place; or
- b. there have been significant corporate, political or operating events affecting the investee company that, in management's opinion, have a positive impact on the investee company's prospects and therefore its fair value. In these circumstances, the adjustment to the fair value of the investment will be based on management's judgment and any value estimated may not be realized or realizable.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

Such events include, without limitation:

- i. political changes in a country in which the investee company operates which, for example, reduce the corporate tax burden, permit drilling where or to an extent that it was not previously allowed, or reduce or eliminate the need for permitting or approvals;
- ii. receipt by the investee company of environmental, drilling, aboriginal or similar approvals that allow the investee company to proceed with its project(s);
- iii. filing by the investee company of a National Instrument 51-101 technical report in respect of a previously non-compliant resource;
- iv. release by the investee company of positive exploration results, which either proves or expands their resource prospects; and
- v. important positive management changes by the investee company that the Company's management believes will have a very positive impact on the investee company's ability to achieve its objectives and build value for shareholders.

In the circumstances described above under (i) through (v), or in circumstances where general market conditions so warrant it, an adjustment to the fair value of an investment will be based upon management's judgment and any value estimated may not be realized or realizable.

The fair value of a privately-held investment may be adjusted downward if:

- a. there has been a significant subsequent equity financing provided by outside investors, at a valuation below the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place;
- b. the investee company is placed into receivership or bankruptcy;
- c. based on financial information received from the investee company, it is apparent to the Company that the investee company is unlikely to be able to continue as a going concern; or
- d. there have been significant corporate, political, or operating events affecting the investee company that, in management's opinion, have a negative impact on the investee company's prospects and therefore its fair value. The amount of the change to the fair value of the investment is based on management's judgment and any value estimated may not be realized or realizable.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

Such events include, without limitation:

- i. political changes in a country in which the investee company operates that increase the tax burden on companies that prohibit drilling where it was previously allowed, that increase the need for permitting or approvals, etc.;
- ii. denial of the investee company's application for environmental, drilling, aboriginal or similar approvals that prohibit the investee company from proceeding with its project(s);
- iii. the investee company releases negative exploration results; and
- iv. changes to the management of the investee company take place that the Company believes will have a negative impact on the investee company's ability to achieve its objectives and build value for shareholders.

In the circumstances described above under (i) through (iv), or in circumstances where general market conditions so warrant it, an adjustment to the fair value of an investment will be based upon management's judgment and any value estimated may not be realized or realizable.

The resulting values for non-publicly-traded investments may differ from values that would be realized if a ready market existed. In addition, the amounts at which the Company's privately-held investments could be disposed of currently may differ from the carrying value assigned.

(d) Financial assets other than investments at fair value:

Financial assets that are managed to collect contractual cash flows made up of principal and interest on specified dates are classified as subsequently measured at amortized cost. All other financial assets are designated as at fair value through profit or loss. All financial assets are recognized initially at fair value plus, in the case of financial assets classified as subsequently measured at amortized cost, directly attributable transaction costs.

Financial assets at amortized cost are measured at initial cost plus interest calculated using the effective interest rate method less cumulative repayments and cumulative impairment losses.

A financial asset is derecognized when the rights to receive cash flows from the asset have expired or the Company has transferred substantially all the risks and rewards of the asset. The Company assesses at each reporting date whether there is any objective evidence that a financial asset is impaired. For amounts deemed to be impaired, the impairment provision is based upon the expected loss.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

(e) Cash and cash equivalents:

Cash and cash equivalents consist of cash on hand and short-term investments with remaining maturities of less than three months at the date of acquisition. Cash and cash equivalents include accrued interest on short-term investments.

(f) Restricted cash:

Restricted cash represents cash in the form of Guaranteed Investment Certificates (each a "GIC") deposited with the Company's bank as collateral for letters of guarantee provided by the bank. The restricted cash underlying a GIC (or part thereof) is classified as current if the GIC (or part thereof) is expected to be released within one year otherwise the restricted cash is classified as non-current.

(g) Revenue recognition:

Purchases and sales of investments are recognized on the settlement date. Realized gains and losses on disposal of investments and unrealized gains and losses in the value of investments are reflected in the consolidated statements of comprehensive loss.

Upon disposal of an investment, previously recognized unrealized gains or losses are reversed so as to recognize the full realized gain or loss in the period of disposition. All transaction costs associated with the acquisition and disposition of investments are expensed to the consolidated statements of comprehensive loss as incurred. Dividend income is recorded on the ex-dividend date and when the right to receive the dividend has been established. Interest income, other income, and income from securities lending are recorded on an accrual basis.

Interest and other income are recorded on an accrual basis.

Oil revenue:

The Company recognizes revenue from petroleum and natural gas production at the fair value of the consideration received or receivable when the significant risks and rewards of ownership are transferred to the buyer and it can be reliably measured and only at such time as a project becomes commercially viable and development approval is received.

Prior to this stage, any production is considered test production and the related revenue is capitalized, net of applicable costs.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

(h) Offsetting of financial instruments:

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statements of financial position if there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

(i) Non-monetary transactions:

Transactions in which shares or other non-cash consideration are exchanged for assets or services are valued at the fair value of the assets or services involved.

(j) Income taxes:

(i) Current income tax:

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the end of the reporting period. Current tax assets and current tax liabilities are only offset if a legally enforceable right exists to set off the amounts, and the intention is to settle on a net basis, or to realize the asset and settle the liability simultaneously. Current income tax relating to items recognized directly in equity is recognized in equity and not through profit or loss.

(ii) Deferred tax:

Deferred tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable income will be available against which the deductible temporary difference and the carry forward of unused tax credits and unused tax losses can be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the consolidated statement of financial position date. Deferred tax relating to items recognized directly in equity is also recognized in equity and not in the consolidated statements of comprehensive loss. Deferred tax assets and deferred tax liabilities are not offset unless a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

The carrying amount of deferred tax assets is reviewed at each consolidated statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each consolidated statement of financial position date and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered. The Company does not record deferred tax assets to the extent that it considers deductible temporary differences, the carry-forward of unused tax credits and unused tax losses cannot be utilized.

(k) Stock-based compensation plans:

The Company has a stock option plan that is described in Note 9(b). Employees (including officers), directors, and consultants of the Company receive remuneration in the form of stock options granted under the plan for rendering services to the Company. Any consideration received by Brownstone on the exercise of stock options is credited to share capital. The cost of options is recognized, together with a corresponding increase in contributed surplus, over the period in which the corresponding performance and/or service conditions are fulfilled, ending on the date on which the relevant optionee becomes fully entitled to the award ("the vesting date"). The cumulative expense recognized for option grants at each reporting date until the vesting date reflects the portion of the vesting period that passed and the Company's best estimate of the number of options that will ultimately vest on the vesting date. The Company records compensation expense and credits contributed surplus for all stock options granted, which represents the movement in cumulative expense recognized as at the beginning and end of that period.

Stock options granted during the period are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value for these options is estimated at the date of grant using the Black-Scholes option pricing model. The Company is also required to estimate the expected future forfeiture rate of options in its calculation of stock-based compensation expense.

Where the terms of a stock option award are modified, the minimum expense recognized in compensation expense is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the option or is otherwise beneficial to the optionee as measured at the date of modification.

Where an option is cancelled it is treated as if it had vested on the date of cancellation and any expense not yet recognized for the award is recognized immediately.

However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

(l) Earnings (loss) per common share:

Basic earnings (loss) per common share is determined by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period, excluding shares securing employee share purchase loans and shares in escrow. Diluted earnings (loss) per common share is calculated in accordance with the treasury stock method and based on the weighted average number of common shares and dilutive common share equivalents outstanding.

(m) Finance expense:

Interest expense is recorded on an accrual basis.

Incremental costs incurred in respect of raising capital through private placements are charged against equity proceeds raised.

(n) Financial liabilities:

Financial liabilities are presented at amortized cost except for financial derivatives and certain financial liabilities that from inception were designated at fair value through profit or loss. All financial liabilities are recognized initially at fair value net of directly attributable transaction costs, except for those designated at fair value through profit or loss. Financial liabilities at fair value through profit or loss are carried in the consolidated statements of financial position at fair value with changes in fair value recognized in the consolidated statements of comprehensive loss.

Other financial liabilities are subsequently recognized at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period.

(o) Due from broker:

Amounts due from broker represent receivables for securities sold that have been contracted for but not yet settled or delivered, respectively, as reflected on the consolidated statements of financial position date.

(p) Financial derivatives – options and warrants:

A financial derivative such as a warrant or option that will be settled with the issuing entity's own equity instruments will be classified as an equity instrument if the derivative is used to acquire a fixed number of the entity's own equity instruments for a fixed amount of Canadian dollars.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

3. Significant accounting policies (continued):

A financial derivative will be considered as a financial liability at fair value through profit or loss if it is used to acquire either a variable number of equity instruments or consideration in a foreign currency and the options and warrants were not offered pro rata to all existing owners of the same class of non-derivative equity instruments.

(q) Segment reporting:

Reportable segments are defined as components of an enterprise about which separate financial information is available, that are evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company has the following reportable segments: Colombia, Israel, Canada, United States, Argentina and Brazil.

(r) Provisions:

(i) General:

Provisions are recognized when (a) the Company has a present obligation (legal or constructive) as a result of a past event that is independent of future action by the Company, and (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

(ii) Asset retirement obligation:

Asset retirement obligation is the present value of estimated costs to restore operating locations in accordance with regulations and laws as defined by each oil and gas license.

4. 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 and maintain 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.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

4. Exploration and evaluation assets (continued):

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

| | Colombia (a) | Israel (b) | USA (c) | Canada (d) | Argentina (e) | Total |
|---|------------------|------------------|------------------|------------------|------------------|-------------------|
| | \$ | \$ | \$ | \$ | \$ | \$ |
| Balance at July 1, 2011 | 20,009,680 | 1,930,847 | 15,180,462 | 1,074,822 | 3,857,200 | 42,053,011 |
| Net additions | 13,309,405 | 2,575,117 | 1,170,351 | 41,935 | - | 17,096,808 |
| Disposals | - | - | (3,642) | - | - | (3,642) |
| Impairment of exploration and evaluation assets | - | - | (13,288,299) | - | (3,004,500) | (16,292,799) |
| Foreign currency translation | 1,425,970 | 108,153 | 587,247 | - | 166,400 | 2,287,770 |
| Balance at June 30, 2012 | 34,745,055 | 4,614,117 | 3,646,119 | 1,116,757 | 1,019,100 | 45,141,148 |
| Net additions | 6,255,290 | 6,067,145 | 1,148,394 | 13,711 | 111,334 | 13,595,874 |
| Disposals | (6,140,400) | - | - | - | - | (6,140,400) |
| Impairment of exploration and evaluation assets | (34,313,636) | (1,380,604) | (588,818) | - | (111,334) | (36,394,392) |
| Foreign currency translation | 504,891 | 364,260 | 171,002 | - | 32,100 | 1,072,253 |
| Balance at June 30, 2013 | 1,051,200 | 9,664,918 | 4,376,697 | 1,130,468 | 1,051,200 | 17,274,483 |

(a) Colombia:

During the year ended June 30, 2013, the Company spent \$6,255,290 (2012 - \$13,309,405) on exploration and evaluation of the blocks located in the Llanos Basin of Central Colombia, net of \$7,917,608 (2012 - \$4,515,621) in revenue from the sale of oil generated from long-term production testing (Block 27(i) and Canaguaro Block (iii)). Included in the statement of cash flows is the cash spent on expenditures and evaluation net of oil sales from long-term production testing.

A summary of the Company's private participating interests in the Colombian blocks as at June 30, 2013 is as follows:

| | Block 27 (i) | Block 36 (ii) |
|----------------------------------|-----------------|------------------|
| Private participation interest | 34.25% | 14% |
| Increased costs assumed | 50% | 20% |
| Increased participation interest | 45.275% | 18.2% |

- (i) Block 27: The Company has a 34.25% participating interest on the block and is required to pay 50% of the capital cost of the work program incurred during the exploration and production phases of the block, and will be entitled to receive 45.275% of all net production revenue, until all aggregate costs have been recouped, following which the Company will be obligated to fund 34.25% of any ongoing costs in order to be entitled to receive 34.25% of any further net production revenue.

BROWNSTONE ENERGY INC.

Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(Prepared in Canadian dollars)

4. Exploration and evaluation assets (continued):

For the year ended June 30, 2013, the Company considered a reserve report prepared by an independent engineering firm, Petrotech Engineering Ltd., for the Company in respect of Block 27. Based upon the information contained in the report, management determined the recoverable amount of the Company's interest on Block 27 to be approximately US\$1,000,000.

The recoverable amount was based on a 75% discount of the proved and probable amount of US\$4,000,000 before accounting for tax losses (with an after-tax discount rate of 10%) based upon the information contained in the reserve report. The Company chose to use an after-tax discount rate of 10% which reflects the evaluation and risks associated with Brownstone's interest in the Llanos basin, Colombia. The future cash flows at an after-tax discount rate of 5% and 15% is US\$6,007,100 and US\$2,951,800, respectively, with an average of US\$4,479,450. The Company reduced the amount by a further 75% discount based on the amount for which management believes the assets could be sold in a comparable arm's length transaction, less estimated costs to sell. As a result, for the year ended June 30, 2013, the Company recorded an impairment charge on Block 27 of \$19,219,802 (2012 – nil) to its estimated recoverable amount of \$1,051,200 (US\$1,000,000).

- (ii) Block 36: The Company has a 14% participating interest on the block and is required to pay 20% of the capital cost of the work program incurred during the exploration and production phases of the block and will be entitled to receive 18.2% of all net production revenue, until all aggregate costs have been recouped, following which the Company will be obligated to fund 14% of any ongoing costs in order to be entitled to receive 14% of any further net production revenue.

For the year ended June 30, 2013, the Company recorded an impairment charge on Block 36 of \$2,760,306 to its estimated recoverable amount of \$0. The impairment was recognized upon a review of the private participating interest of the exploration license. The Company does not intend to participate further in the exploration of this Block and the Company does not believe its private participating interest can be sold for any value. (See Note 16(e))

- (iii) Canaguay-1 Well: The Company had a 25% private participating interest and was required to pay 25% of any costs relating to the wells on the Block. The Company also had paid a 6% overriding royalty, proportional to its interest, to Concorcio Canaguaro on its share of production. During the year ended June 30, 2013, the Company recorded an impairment charge of \$4,586,574 on the Block. The impairment was recognized upon a review of the Block's long-term production testing and based on the difference between the carrying value of the asset and its estimated recoverable amount of approximately US\$6,000,000.

In June 2013, the Company sold its private participating interest to Petrominerales Ltd. for gross proceeds of US\$6,000,000. Included in the consolidated statements of comprehensive loss for the year ended June 30, 2013 as other income is a gain of \$77,567 from the sale of the Block.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

4. Exploration and evaluation assets (continued):

(iv) Block 21: Under an amending agreement dated February 28, 2012 to the original participation agreement in respect to the Block LLA 21, the Company has paid US\$3,875,000 towards the drilling of two wells. Following the completion and testing of the wells, which were subsequently abandoned, Brownstone waived its rights to an income production participation going forward and thus, has no further financial obligations.

For the year ended June 30, 2013, the Company recorded an impairment charge on Block 21 of \$7,746,954 to its estimated recoverable amount of \$0. The impairment was recognized as the Company has abandoned the Block.

(b) Israel:

As at June 30, 2013 and 2012, the Company has participating interests in the following Israeli Blocks:

| | Gabriella Block (i) | Yitzhak Block (ii) | Samuel Block (iii) |
|------------------------|--------------------------------|-------------------------------|-------------------------------|
| Participating Interest | 15% | 15% | 6.75% |

(i) Gabriella Block: On February 11, 2013, the Company was informed by Adira Energy Israel Ltd., the operator of the Israeli Blocks (the "Operator") that it had suspended all operations with regard to drilling the Gabriella well until further notice. The failure of the 70% party, Modi'in Energy LP, to finance its obligations under the joint operating agreement was given as the reason for the suspension. Brownstone has met its share of the financing obligations under the joint operating agreement.

During the year ended June 30, 2013, the milestone dates for certain work to maintain the license for the property were not met. On June 30, 2013, the Operator had applied to the Ministry of Energy and Water of the State of Israel (the "Ministry") for an extension of the milestone dates and approval was received in October 2013 with a new expiry date of the license of September 1, 2014. The following table sets out the work program that must be completed in order to maintain the Gabriella Block:

| Gabriella Work Program | Milestone Dates |
|--|------------------------|
| Submitting a request for approving an operator | February 28, 2014 |
| Signing a rig contract | April 30, 2014 |
| Submitting the results of an Anisotropic PSDM and coherent sub surface model | July 31, 2014 |
| Spud the first well | August 31, 2014 |

(ii) During the current year, the Operator received an extension of the Yitzhak license to December 2013. On June 30, 2013, the Operator had applied to the Ministry for an extension of the milestone dates and approval was received in October 2013 with a new expiry date of the license of October 15, 2014.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

4. Exploration and evaluation assets (continued):

The following table sets out the current work program that must be completed in order to maintain the Yitzhak Block:

| Yitzhak Work Program | Milestone Dates |
|---|------------------------|
| Submitting the Environmental Impact Assessment to the Central District Planning Committee | January 1, 2014 |
| Execute a contract with a drilling contractor | September 30, 2014 |
| Spud the first well | September 30, 2014 |

- (iii) During the year ended June 30, 2013, the milestone dates for certain work on the property were not met. On March 27, 2013, the Operator had applied to the Ministry for an extension of the dates for the execution of a drilling contract on the Samuel Block to March 31, 2014, and for the spud of the first well to September 30, 2014. The Samuel license expired on July 31, 2013.

For the year ended June 30, 2013, the Company recorded an impairment charge on the Samuel Block of \$1,380,604 to its estimated recoverable amount of \$0. The impairment was recognized upon a review of the participating interest of the exploration licenses in Israel. The Company believes there is a low probability of realization of the asset from the successful development and the Company has decided not to proceed with the development of the license. (See Note 16(c))

(c) USA:

The Company has participating interests of between 7.5% to 28.57% in various acreages in the Piceance/Uinta basin in the USA and is required to fund its share of the costs in proportion to its participating interests. For the year ended June 30, 2013, the Company recorded an impairment charge of \$588,818 on certain of its USA properties upon the abandonment of certain of its leases. The Company has satisfied its financial obligations in respect to the USA properties.

For the year ended June 30, 2012, the Company recorded an impairment charge on its USA exploration and evaluation assets in the Piceance/Uinta basin, USA, of \$12,699,480 to its estimated recoverable amount of approximately \$3,057,300 (US\$3,000,000) (2011 – nil) and impaired other USA exploration and evaluation assets by \$588,819 to a net balance of \$3,646,119. The impairment was recognized upon a review of the exploration licenses to confirm whether the Company intends further appraisal activity or to otherwise extract value from the property. The impairment was recognized based on the difference between the carrying value of the assets and their recoverable amounts. The recoverable amount was determined based on the amount for which management believes the assets could be sold in a comparable arm's length transaction, less estimated costs to sell.

For the year ended June 30, 2012, the Company considered reserve data prepared by an independent engineering firm, Gustavson Associates, for the Company in respect to its USA property in the Piceance/Uinta basin. Based upon the data, management determined that the recoverable amount of the USA exploration and evaluation assets in the Piceance/Uinta basin was approximately US\$3,000,000 (with a pre-tax discount rate of 25%).

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

4. Exploration and evaluation assets (continued):

The Company chose to use pre-tax discount rate of 25% due to the risks associated with the properties such as:

- (i) the Company's minority participation interest;
- (ii) the large upfront capital expenditures, their timing, and unknown gathering processing and transportation fees;
- (iii) non-operatorship of the properties;
- (iv) there was no certainty that the price of gas will be high enough to make the properties economically viable in the near future;
- (v) nor was there any certainty that the flat natural gas liquid price strip and oil price will remain consistent over the next several years.

(d) Canada:

The Company has a 50% interest in the exploration licenses of the Rimouski, Rimouski North, Trois-Pistoles and Shawinigan properties in the St. Laurent Lowlands, Quebec. The Company is required to fund its share of the costs incurred on the properties. The properties are in an area where there is a moratorium on drilling pending the results of the government of Quebec's review of fracking.

During 2013, the Company spent \$13,711 (2012 - \$41,935) to keep the properties in good standing and management believes there is no impairment.

(e) Argentina:

The Company has a 25% interest in the Vaca Mahuida Block in the Province of Rio Negro, Argentina. Under the terms of the participation agreement governing Brownstone's interest, the Company is required to fund 50% of the costs to be incurred in the conduct of the work program on the property.

During the year ended June 30, 2012, the Company considered a reserve report prepared by an independent engineering firm, GLJ Petroleum Consultants. Based upon the information contained in the report, management determined the recoverable amount of the Company's interest in Argentina to be approximately US\$1,000,000 as at June 30, 2013 and 2012. The future cash flows were discounted using a pre-tax discount rate of 10% that reflects current market assessments of the time value of money and the risk specific to the Company's asset in Argentina. The future cash flows at a pre-tax discount rate of 5% and 15% is US\$1,266,000 and US\$786,000, respectively, with an average of US\$1,026,000. In addition, the Argentinean government nationalized certain local oil assets controlled by a Spanish company, which creates an uncertainty for foreign investors investing in Argentina.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

4. Exploration and evaluation assets (continued):

As a result, for the year ended June 30, 2013 and 2012, the Company recorded an impairment charge on its Argentinean exploration and evaluation assets to its estimated recoverable amount of \$1,051,200 and \$1,019,100, respectively. The recoverable amount was determined based on the amount for which management believes the assets could be sold in a comparable arm's length transaction, less estimated costs to sell.

5. Investments:

The fair value and cost of investments are as follows:

| | Fair Value | Cost |
|----------------------|---------------------|----------------------|
| June 30, 2013 | \$ 1,667,208 | \$ 13,750,659 |
| June 30, 2012 | 2,771,469 | 13,250,659 |

6. Financial instruments carrying amount and fair value:

(a) Financial instruments carrying amounts are as follows as at June 30:

| | 2013 | 2012 |
|--|---------------------|----------------------|
| Investments | \$ 1,667,208 | \$ 2,771,469 |
| Cash and cash equivalents | | |
| - Cash on hand | 8,498,195 | 3,185,666 |
| - Short-term investments with maturities of less than three months (i) | 1,096,869 | 15,011,340 |
| Restricted cash, long-term | 634,925 | 564,581 |
| Receivables | 1,117,211 | 951,153 |
| Accounts payable and accrued liabilities | (3,478,478) | (1,150,868) |
| | \$ 9,535,930 | \$ 21,333,341 |

(i) As at June 30, 2013, short-term investments with maturities of less than three months consisted of banker's acceptance notes with an average annual yield of 1.09% (2012 – 1.11%).

The carrying values of cash and cash equivalents, restricted cash, 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.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

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

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).

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 June 30:

| Investments, at fair value | Level 1 | Level 2 | Level 3 | Total |
|----------------------------|---------------------|--|--|--------------|
| | Quoted market price | Valuation technique – observable market inputs | Valuation technique – non-observable market inputs | |
| 2013 | \$ 917,208 | \$ - | \$ 750,000 | \$ 1,667,208 |
| 2012 | \$ 1,746,469 | \$ - | \$ 1,025,000 | \$ 2,771,469 |

There were no transfers from Level 1 to 2 or Level 2 to 1 during the years ended June 30, 2013 and 2012.

The following table presents the changes in fair value measurements of financial instruments classified as Level 3 for the years ended June 30, 2013 and 2012. These financial instruments are measured at fair value utilizing non-observable market inputs. The net change in unrealized gains (losses) are recognized in the consolidated statements of comprehensive loss.

| Investments, at fair value | Opening balance | Purchases | Net unrealized losses | Net transfer | Ending balance |
|----------------------------|-----------------|-----------|-----------------------|----------------|----------------|
| | | | | out of Level 3 | |
| 2013 | \$ 1,025,000 | \$ - | \$ (275,000) | \$ - | \$ 750,000 |
| 2012 | \$ 4,150,000 | \$ 50,000 | \$ (3,175,000) | \$ - | \$ 1,025,000 |

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

7. Restricted cash:

As at June 30, 2013, the Company had restricted cash totaling \$634,925 (US\$604,000) (2012 - \$564,581 (US\$554,000) as collateral to the Royal Bank of Canada ("RBC") for letters of guarantee issued by RBC. The restricted cash is held in GICs, which are renewed on a monthly basis at the prevailing interest rate (0.02% per annum as at June 30, 2013 (2012 - 0.02%)). The GICs are held as collateral by RBC for letters of guarantee issued by RBC to Agencia Nacional de Hidrocarburos ("ANH"), a Colombian government agency, the oil and gas agency of the Colombian government. As at June 30, 2013, the Company has letters of guarantee totaling US\$5,700,000 (2012 - US\$7,388,883). 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 those blocks.

Export Development Canada ("EDC"), a Canadian federal government agency, has issued three Performance Security Guarantees ("PSG") totaling US\$5,096,000 (2012 - four PSGs totaling US\$6,834,883) to secure certain of the letters of guarantee issued by RBC to ANH as at June 30, 2013.

8. 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 during the years ended June 30 were as follows:

| Type of expense | 2013 | 2012 |
|----------------------------------|---------------------|---------------------|
| Salaries and consulting fees | \$ 776,750 | \$ 806,750 |
| Other short-term benefits | 22,536 | 51,420 |
| Stock-based compensation expense | 305,607 | 1,038,269 |
| | \$ 1,104,893 | \$ 1,896,439 |

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 year ended June 30, 2013, the Company granted 1,950,000 options to directors and officers of the Company, with an exercise price of \$0.17 per share and expiring on November 28, 2017.

During the year ended June 30, 2012, 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.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

9. Equity:

- (a) Authorized: unlimited number of common shares (no par value).
- (b) 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 that 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.

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 year ended June 30, 2013, the Company granted 2,390,000 options exercisable at \$0.17 per share expiring on November 28, 2017.

During the year ended June 30, 2012, the following options were granted:

| Date granted | Options granted | Exercise price | Expiry |
|---------------------|------------------------|-----------------------|------------------|
| October 11, 2011 | 2,180,000 | \$ 0.40 | October 10, 2016 |
| February 8, 2012 | 225,000 | 0.56 | February 7, 2017 |
| | 2,405,000 | | |

The fair value of the options granted during the year ended June 30, 2013 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

| Black-Scholes option valuation model assumptions used (weighted average) | |
|---|-----------|
| Expected volatility | 104.7% |
| Expected dividend yield | 0% |
| Risk-free interest rate | 1.2% |
| Expected option life in years | 3.7 years |
| Expected forfeiture rate | 5.5% |
| Fair value per stock option granted on November 29, 2012 | \$ 0.12 |

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

9. Equity (continued):

The fair value of the options granted during the year ended June 30, 2012 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

| Black-Scholes option valuation model assumptions used (weighted average) | |
|--|-----------|
| Expected volatility | 115.7% |
| Expected dividend yield | 0% |
| Risk-free interest rate | 1.3% |
| Expected option life in years | 3.6 years |
| Expected forfeiture rate | 6.8% |
| Fair value per stock option granted on October 11, 2011 | \$ 0.29 |
| Fair value per stock option granted on February 8, 2012 | \$ 0.41 |

The expected volatility is based on the historical volatility over the life of the option of Brownstone's share price. The Company has not paid any cash dividends historically and has no plans to pay cash dividends in the foreseeable future. The risk free interest rate is based on the yield of Canadian Benchmark Bond with equivalent terms. The expected option life in years represents the period of time that options granted are expected to be outstanding based on historical options granted.

For the year ended June 30, 2013, included in operating, general and administrative expenses was stock-based compensation expense of \$412,957 (2012 - \$1,412,741) relating to the stock options granted to directors, officers, employees and consultants of the Company.

A summary of the status of the Company's stock options and changes during the years ended June 30, 2013 and 2012 is presented below:

| | 2013 | | 2012 | |
|-----------------------------------|--------------|---------------------------------|--------------|---------------------------------|
| | # of options | Weighted average exercise price | # of options | Weighted average exercise price |
| Stock options | | | | |
| Outstanding, at beginning of year | 8,925,080 | \$ 0.72 | 8,425,080 | \$ 1.21 |
| Granted | 2,390,000 | 0.17 | 2,405,000 | 0.41 |
| Forfeited | (8,334) | 0.40 | - | - |
| Expired | (1,331,666) | 1.25 | (1,905,000) | 2.47 |
| Outstanding, at end of year | 9,975,080 | \$ 0.52 | 8,925,080 | \$ 0.72 |
| Exercisable, at end of year | 8,344,232 | \$ 0.59 | 7,006,731 | \$ 0.78 |

BROWNSTONE ENERGY INC.**Notes to the Consolidated Financial Statements**

June 30, 2013 and 2012

(Prepared in Canadian dollars)

9. Equity (continued):

The following table summarizes information about stock options outstanding and exercisable as at June 30, 2013:

| Number of options outstanding | Number of options exercisable | Exercise price | Expiry date |
|--------------------------------------|--------------------------------------|-----------------------|--------------------|
| 100,000 | 100,000 | \$ 0.50 | August 10, 2014 |
| 1,133,400 | 1,133,400 | 0.52 | August 12, 2014 |
| 10,000 | 10,000 | 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 |
| 1,136,680 | 1,136,680 | 0.51 | September 20, 2015 |
| 1,340,000 | 1,340,000 | 1.20 | March 29, 2016 |
| 2,130,000 | 2,130,000 | 0.40 | October 10, 2016 |
| 225,000 | 187,500 | 0.56 | February 7, 2017 |
| 2,390,000 | 796,652 | 0.17 | November 28, 2017 |
| 9,975,080 | 8,344,232 | | |

(c) Contributed surplus comprised the following as at June 30:

| | 2013 | 2012 |
|--|----------------------|----------------------|
| Stock-based compensation | \$ 9,923,008 | \$ 9,510,051 |
| Expired warrants and broker warrants | 11,857,003 | 7,105,887 |
| Cancellation of common shares under normal course issuer bid | 20,639 | 20,639 |
| Value of cancelled escrowed shares | 5,625 | 5,625 |
| | \$ 21,806,275 | \$ 16,642,202 |

(d) A summary of the status of the Company's warrants and broker warrants at the reporting dates and the changes during the years then ended are as follows:

| | June 30, 2013 | | |
|-----------------------------------|--|--|---------------|
| | # of warrants and broker warrants | Weighted average exercise price | Amount |
| Outstanding, at beginning of year | 25,201,454 | \$ 1.09 | \$ 7,310,433 |
| Expired | (17,250,000) | 1.25 | (4,751,116) |
| Outstanding, at end of year | 7,951,454 | \$ 0.75 | \$ 2,559,317 |
| | June 30, 2012 | | |
| | # of warrants and broker warrants | Weighted average exercise price | Amount |
| Outstanding, at beginning of year | 26,595,816 | \$ 1.06 | \$ 6,873,384 |
| Expired | (1,394,362) | 0.56 | (372,948) |
| Cost of warrant expiry extension | - | - | 809,997 |
| Outstanding, at end of year | 25,201,454 | \$ 1.09 | \$ 7,310,433 |

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

9. Equity (continued):

The following table summarizes information about warrants outstanding as at June 30, 2013:

| Number of warrants | Exercise price | Expiry date | Warrant value |
|--------------------|----------------|----------------|---------------|
| 7,951,454 | \$ 0.75 | April 13, 2014 | \$ 2,559,317 |

The following table summarizes information about warrants and broker warrants outstanding as at June 30, 2012:

| Number of warrants and broker warrants | Exercise price | Expiry date | Warrants and broker warrants value |
|--|----------------|--------------------|------------------------------------|
| 7,951,454 (i) | \$ 0.75 | April 13, 2014 | \$ 2,559,317 |
| 15,131,579 | 1.25 | September 11, 2012 | 4,167,645 |
| 2,118,421 | 1.25 | September 11, 2012 | 583,471 |
| 25,201,454 | | | \$ 7,310,433 |

(i) During the year ended June 30, 2012, 7,951,454 warrants expiring April 13, 2012 were extended to April 13, 2014. The fair value of these warrants immediately after the modification was \$809,998 using the Black-Scholes option pricing model with the following assumptions: expected volatility of 102.2%; dividend yield of 0%; risk-free interest rate of 1.2%; and an expected life of 1.77 years. The fair value of these warrants immediately prior to the extension was \$1. Accordingly, the incremental fair value of the warrants resulting from this modification of \$809,997 was credited to warrants and charged to the consolidated statements of comprehensive loss reflected in operating, general and administrative expenses.

(e) Basic and diluted loss per common share based on loss for the years ended June 30:

| Numerator: | 2013 | 2012 |
|---|-----------------|-----------------|
| Loss for the year | \$ (40,860,181) | \$ (27,053,898) |
| Denominator: | 2013 | 2012 |
| Weighted average number of common shares outstanding – basic | 129,794,289 | 129,794,289 |
| Weighted average effect of diluted stock options and warrants (i) | - | - |
| Weighted average number of common shares outstanding – diluted | 129,794,289 | 129,794,289 |
| Loss per common share based on loss for the year: | 2013 | 2012 |
| Basic and diluted | \$ (0.31) | \$ (0.21) |

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

9. Equity (continued):

(i) The determination of the weighted average number of common shares outstanding – diluted excludes 17,926,534 shares related to stock options, warrants, and broker warrants that were anti-dilutive for the year ended June 30, 2013 (2012 – 34,126,534 shares).

(f) Maximum share dilution:

The following table presents the maximum number of shares that would be outstanding if all outstanding stock options, warrants and broker warrants were exercised as at June 30:

| | 2013 | 2012 |
|---|-------------|-------------|
| Common shares outstanding | 129,794,289 | 129,794,289 |
| Stock options to purchase common shares | 9,975,080 | 8,925,080 |
| Warrants to purchase common shares | 7,951,454 | 23,083,033 |
| Broker warrants to purchase common shares | - | 2,118,421 |
| Fully diluted common shares outstanding | 147,720,823 | 163,920,823 |

10. Income tax expense and deferred taxes:

(a) Income tax expense attributable to loss before income taxes differs from the amounts computed by applying the combined federal and provincial tax rate of 26.50% (2012 – 27.25%) of pre-tax income as a result of the following:

| | 2013 | 2012 |
|---|-----------------|-----------------|
| Loss before income taxes | \$ (40,860,181) | \$ (26,886,247) |
| Computed "expected" income tax recovery | \$ (10,827,948) | \$ (7,326,502) |
| Non-taxable portion of capital losses | - | 682,439 |
| Non-taxable portion of unrealized losses | 212,565 | 83,126 |
| Expenses not deductible for income tax purposes | 88,257 | 613,112 |
| Impairment of exploration and evaluation assets not tax benefited | 9,644,514 | 4,439,788 |
| Net deferred tax assets not recognized | 882,612 | 1,508,037 |
| Minimum tax and income tax withheld in foreign jurisdictions | 384,091 | 167,651 |
| Income tax expense | \$ 384,091 | \$ 167,651 |

The 2013 statutory tax rate of 26.50% differs from the 2012 statutory tax rate of 27.25% because of a reduction in the Canadian federal tax rate.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

10. Income tax expense and deferred taxes (continued):

(b) Significant components of the income tax expense for the years ended June 30 are as follows:

| | 2013 | 2012 |
|--|-------------------|-------------------|
| Current income tax expense | | |
| Tax withheld in foreign jurisdiction | \$ 384,091 | \$ 167,651 |
| | 384,091 | 167,651 |
| Deferred taxes | | |
| Income taxes – origination and reversal of temporary differences | (10,527,126) | (5,947,825) |
| Relating to unrecognized temporary differences | 10,527,126 | 5,947,825 |
| | - | - |
| Income tax expense | \$ 384,091 | \$ 167,651 |

(c) The following deferred tax assets are not recognized in the consolidated financial statements due to the unpredictability of future income.

| | 2013 | 2012 |
|---|----------------------|----------------------|
| Non-capital losses carry-forward | \$ 4,637,322 | \$ 2,061,206 |
| Exploration and evaluation assets tax pools | 4,767,118 | 5,619,009 |
| Investments | 1,470,512 | 1,257,948 |
| Share issuance costs and other differences | 1,039,979 | 1,226,217 |
| Capital losses carry-forward | 666,403 | 666,403 |
| | \$ 12,581,334 | \$ 10,830,783 |

As at June 30, 2013, the Company has approximately \$821,000 (2012 - \$899,000) of Canadian resource deductions and \$18,298,000 (2012 - \$22,095,000) of foreign resource deductions available that have an unlimited carry-forward period to reduce future years' income for tax purposes, the benefit of which has not been recorded in the accounts.

As at June 30, 2013, the Company has approximately \$5,029,000 of capital losses (2012 - \$5,029,000) and \$12,465,000 (2012 - \$6,144,000) of Canadian non-capital losses available to reduce future years' income for tax purposes, the benefit 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 | 5,506,500 |
| 2033 | 4,557,600 |
| | \$ 12,465,000 |

In addition, the Company has unclaimed non-capital losses of approximately \$53,365,000 in Barbados that expires from 2017 to 2022 and \$66,000 in U.S. that expires from 2015 to 2019.

BROWNSTONE ENERGY INC.**Notes to the Consolidated Financial Statements****June 30, 2013 and 2012****(Prepared in Canadian dollars)**

11. Segmented information:

Reportable segments are defined as components of an enterprise about which separate financial information is available, that are evaluated regularly by the chief operating decision maker 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 year ended June 30, 2013. 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 income or loss, but are attributed to the Canadian operations where the corporate head office is located.

The following is segmented information as at and for the year ended June 30, 2013:

| | Year ended June 30, 2013 | | As at June 30, 2013 | | |
|------------------|---------------------------|-------------------|-----------------------------------|---------------|---------------|
| | Interest and other income | Loss for the year | Exploration and evaluation assets | Other assets | Total assets |
| Canada and other | \$ 73,819 | \$ 3,768,674 | \$ 1,130,468 | \$ 11,443,473 | \$ 12,573,941 |
| Israel | - | 1,529,724 | 9,664,918 | 78,918 | 9,743,836 |
| United States | 16,861 | 571,957 | 4,376,697 | 18,814 | 4,395,511 |
| Colombia | 123,101 | 34,829,460 | 1,051,200 | 1,488,705 | 2,539,905 |
| Argentina | - | 160,366 | 1,051,200 | 14,622 | 1,065,822 |
| Brazil | - | - | - | 133,943 | 133,943 |
| | \$ 213,781 | \$ 40,860,181 | \$ 17,274,483 | \$ 13,178,475 | \$ 30,452,958 |

The following is segmented information as at and for the year ended June 30, 2012:

| | Year ended June 30, 2012 | | As at June 30, 2012 | | |
|------------------|---------------------------|-------------------|-----------------------------------|---------------|---------------|
| | Interest and other income | Loss for the year | Exploration and evaluation assets | Other assets | Total assets |
| Canada and other | \$ 258,136 | \$ 10,441,224 | \$ 1,116,757 | \$ 20,288,293 | \$ 21,405,050 |
| Colombia | 44,819 | 393,278 | 34,745,055 | 1,779,469 | 36,524,524 |
| Israel | - | 57,150 | 4,614,117 | 177,012 | 4,791,129 |
| United States | - | 13,157,746 | 3,646,119 | 37,022 | 3,683,141 |
| Argentina | - | 3,004,500 | 1,019,100 | 84,666 | 1,103,766 |
| Brazil | - | - | - | 142,662 | 142,662 |
| | \$ 302,955 | \$ 27,053,898 | \$ 45,141,148 | \$ 22,509,124 | \$ 67,650,272 |

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

12. Expenses by nature:

Included in operating, general, and administrative expenses for the years ended June 30 are the following expenses:

| | 2013 | 2012 |
|---|---------------------|---------------------|
| Salaries and consulting fees | \$ 1,485,341 | \$ 1,425,379 |
| Other office and general | 414,176 | 638,817 |
| Stock-based compensation expense | 412,957 | 1,412,741 |
| Professional fees | 327,553 | 361,479 |
| Travel and promotion | 286,373 | 489,843 |
| Shareholder relations, transfer agent and filing fees | 113,902 | 162,330 |
| Other employment benefits | 28,654 | 55,198 |
| Cost of warrant extension | - | 809,997 |
| Transaction costs | - | 19,546 |
| Foreign exchange gain | (377,738) | (97,751) |
| | \$ 2,691,218 | \$ 5,277,579 |

13. Management of capital:

The Company includes the following in its capital as at June 30:

| | 2013 | 2012 |
|--------------------------------------|----------------------|----------------------|
| Equity comprising: | | |
| Share capital | \$ 96,597,845 | \$ 96,597,845 |
| Warrants and broker warrants | 2,559,317 | 7,310,433 |
| Contributed surplus | 21,806,275 | 16,642,202 |
| Foreign currency translation reserve | (79,081) | (928,739) |
| Deficit | (93,982,518) | (53,122,337) |
| | \$ 26,901,838 | \$ 66,499,404 |

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 broker;
- (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 that optimizes the cost of capital at acceptable levels of risk.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

13. 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 ANH (note 7).

There were no changes in the Company's approach to capital management during the year ended June 30, 2013. To date, the Company has not declared any cash dividends to its shareholders as part of its capital management program. The Company's current working capital is sufficient to discharge its liabilities as at June 30, 2013.

14. 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 year ended June 30, 2013. The Company manages market risk by having a portfolio that is not singularly exposed to any one issuer; however, its investment activities are currently concentrated primarily in the oil and gas resource industry.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

14. Risk management (continued):

The following table shows the estimated sensitivity of the Company's after-tax net loss for the year ended June 30, 2013 from a change in the closing bid price of the Company's investments with all other variables held constant as at June 30, 2013:

| Percentage of change in closing bid price | 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% | \$ 28,926 | \$ (28,926) |
| 4% | 57,852 | (57,852) |
| 6% | 86,778 | (86,778) |
| 8% | 115,704 | (115,704) |
| 10% | 144,630 | (144,630) |

The following table shows the estimated sensitivity of the Company's after-tax net loss for the year ended June 30, 2012 from a change in the closing bid price of the Company's investments with all other variables held constant as at June 30, 2012:

| Percentage of change in closing bid price | 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% | \$ 48,085 | \$ (48,085) |
| 4% | 96,170 | (96,170) |
| 6% | 144,255 | (144,255) |
| 8% | 192,340 | (192,340) |
| 10% | 240,425 | (240,425) |

(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 owing it money or securities 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 June 30, 2013 and 2012, 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 year ended June 30, 2013. 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.

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

14. Risk management (continued):

The following is the Company's maximum exposure to credit risk as at June 30:

| | 2013 | 2012 |
|---------------------------|----------------------|----------------------|
| Cash and cash equivalents | \$ 9,595,064 | \$ 18,197,006 |
| Restricted cash | 634,925 | 564,581 |
| Receivables | 1,117,211 | 951,153 |
| Income taxes receivable | 144,471 | - |
| | \$ 11,491,671 | \$ 19,712,740 |

As at June 30, 2013 and 2012, the Company had the following significant receivables:

- (i) As at June 30, 2013, included in receivables is \$1,047,044 (2012 - \$734,096) relating to oil sales revenue. The Company is exposed to this credit risk since the amount is due from three counterparties.
- (ii) As at June 30, 2013, included in receivables is \$35,026 (2012 - \$52,448) 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 become 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.

There were no changes to the way that the Company manages liquidity risk during the year ended June 30, 2013. 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 that can be converted into cash when required.

As at June 30, 2013 and 2012, the Company was not using any margin.

BROWNSTONE ENERGY INC.

Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(Prepared in Canadian dollars)

14. Risk management (continued):

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at June 30, 2013:

| Liabilities and obligations | Payments due by period | | | | |
|--|------------------------|---------------------|-------------|-------------|---------------|
| | Total | Less than 1 year | 1 – 3 years | 4 – 5 years | After 5 years |
| Accounts payable and accrued liabilities | \$ 3,478,478 | \$ 3,478,478 | \$ - | \$ - | \$ - |
| Income taxes payable | 72,642 | 72,642 | | | |
| | \$ 3,551,120 | \$ 3,551,120 | \$ - | \$ - | \$ - |

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at June 30, 2012:

| Liabilities and obligations | Payments due by period | | | | |
|--|------------------------|---------------------|-------------|-------------|---------------|
| | Total | Less than 1 year | 1 – 3 years | 4 – 5 years | After 5 years |
| Accounts payable and accrued liabilities | \$ 1,150,868 | \$ 1,150,868 | \$ - | \$ - | \$ - |
| | \$ 1,150,868 | \$ 1,150,868 | \$ - | \$ - | \$ - |

The following table shows the Company's source of liquidity by assets as at June 30, 2013:

| Assets | Liquidity by period | | | | |
|-----------------------------------|----------------------|----------------------|-------------------|---------------|----------------------|
| | Total | Less than 1 year | 1 – 3 years | After 4 years | Non-liquid assets |
| Cash and cash equivalents | \$ 9,595,064 | \$ 9,595,064 | \$ - | \$ - | \$ - |
| Prepays and receivables | 1,136,807 | 1,136,807 | - | - | - |
| Investments, at fair value | 1,667,208 | 1,667,208 | - | - | - |
| Income taxes receivable | 144,471 | 144,471 | - | - | - |
| Restricted cash | 634,925 | - | 634,925 | - | - |
| Exploration and evaluation assets | 17,274,483 | - | - | - | 17,274,483 |
| | \$ 30,452,958 | \$ 12,543,550 | \$ 634,925 | \$ - | \$ 17,274,483 |

The following table shows the Company's source of liquidity by assets as at June 30, 2012:

| Assets | Liquidity by period | | | | |
|-----------------------------------|----------------------|----------------------|-------------------|---------------|----------------------|
| | Total | Less than 1 year | 1 – 3 years | After 4 years | Non-liquid assets |
| Cash and cash equivalents | \$ 18,197,006 | \$ 18,197,006 | \$ - | \$ - | \$ - |
| Prepays and receivables | 976,068 | 976,068 | - | - | - |
| Investments, at fair value | 2,771,469 | 2,771,469 | - | - | - |
| Restricted cash | 564,581 | - | 564,581 | - | - |
| Exploration and evaluation assets | 45,141,148 | - | - | - | 45,141,148 |
| | \$ 67,650,272 | \$ 21,944,543 | \$ 564,581 | \$ - | \$ 45,141,148 |

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

14. Risk management (continued):

(d) Interest risk:

Interest risk is the impact that changes in interest rates could have on the Company's earnings and liabilities. As at June 30, 2013 and 2012, 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. To minimize interest rate risk, the Company maintains its portfolio of cash equivalents in GICs 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, Colombian pesos, and Argentinean pesos. 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.

The following assets and liabilities were denominated in foreign currencies:

| | 2013 | 2012 |
|---|--------------------|------------------|
| Denominated in U.S. dollars: | | |
| Cash and cash equivalents | \$ 8,014,927 | \$ 2,066,666 |
| Restricted cash | 634,925 | 564,581 |
| Prepays and receivables | 1,089,282 | 888,304 |
| Income tax receivable | 144,471 | - |
| Exploration and evaluation assets | 16,144,015 | 44,024,390 |
| Accounts payable and accrued liabilities | <u>(3,338,441)</u> | <u>(965,440)</u> |
| Net assets denominated in U.S. dollars | <u>22,689,179</u> | 46,578,501 |
| Denominated in Brazilian reals: | | |
| Cash and cash equivalents | <u>133,943</u> | 142,662 |
| Net assets denominated in Brazilian reals | <u>133,943</u> | 142,662 |

BROWNSTONE ENERGY INC.
Notes to the Consolidated Financial Statements
June 30, 2013 and 2012
(Prepared in Canadian dollars)

14. Risk management (continued):

| | 2013 | 2012 |
|---|------------------|---------|
| Denominated in Argentinean pesos: | | |
| Cash and cash equivalents | 14,622 | 63,639 |
| Prepays and receivables | - | 21,027 |
| Accounts payable and accrued liabilities | (53,469) | - |
| Income taxes payable | (72,642) | - |
| Net assets denominated in Argentinean pesos | <u>(111,489)</u> | 84,666 |
| Denominated in Colombian pesos: | | |
| Cash and cash equivalents | 282,773 | 902,211 |
| Net assets denominated in Colombian pesos | <u>282,773</u> | 902,211 |

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2013 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, 2013:

| 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% | \$ 333,531 | \$ (333,531) |
| 4% | 667,062 | (667,062) |
| 6% | 1,000,593 | (1,000,593) |
| 8% | 1,334,124 | (1,334,124) |
| 10% | 1,667,655 | (1,667,655) |

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2012 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, 2012:

| 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% | \$ 684,704 | \$ (684,704) |
| 4% | 1,369,408 | (1,369,408) |
| 6% | 2,054,112 | (2,054,112) |
| 8% | 2,738,816 | (2,738,816) |
| 10% | 3,423,520 | (3,423,520) |

BROWNSTONE ENERGY INC.

Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(Prepared in Canadian dollars)

15. Future accounting changes:

At the date of authorization of these consolidated financial statements, the IASB and the International Financial Reporting Interpretations Committee has issued the following new and revised Standards and Interpretations that are not yet effective for the relevant reporting periods and the Company has not early adopted these standards, amendments and interpretations. However, the Company is currently assessing what impact the application of these standards or amendments will have on the consolidated financial statements of the Company.

- (a) IFRS 7, *Financial Instruments, Disclosures* - effective for annual periods beginning on or after January 1, 2013, IFRS 7 has been amended to provide more extensive quantitative disclosures for financial instruments that are offset in the consolidated statement of financial position or that are subject to enforceable master netting similar arrangements.
- (b) Investment Entities: IFRS 10, *Consolidated Financial Statements*, IFRS 12, *Disclosure of Interests in Other Entities*, and IAS 27, *Separate Financial Statements* – effective for annual periods beginning on or after January 1, 2014, with early adoption permitted - define an investment entity and introduce an exception to consolidating particular subsidiaries for investment entities. These amendments require an investment entity to measure those subsidiaries at fair value through profit or loss in accordance with IFRS 9, *Financial Instruments* in its consolidated and separate financial statements. The amendments also introduce new disclosure requirements for investment entities in IFRS 12 and IAS 27.
- (c) IFRS 10, *Consolidated Financial Statements* – effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.
- (d) IFRS 11, *Joint Arrangements* - effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. IFRS removes the option to account for jointly controlled entities ("JCEs") using the proportionate consolidation. Instead, JCEs that meet the definition of a joint venture under IFRS 11 must be accounted for using the equity method.
- (e) IFRS 12, *Disclosure of Interests in Other Entities* - effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, an entity's interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.
- (f) IFRS 13, *Fair Value Measurement* - effective for annual periods beginning on or after January 1, 2013, with early adoption permitted; provides the guidance on the measurement of fair value and related disclosures through a fair value hierarchy.

BROWNSTONE ENERGY INC.

Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(Prepared in Canadian dollars)

15. Future changes in accounting policies (continued):

- (g) IAS 19, *Employee Benefits* - effective for annual periods beginning on or after January 1, 2013, a number of amendments have been made to IAS 19, which included eliminating the use of the "corridor" approach and requiring re-measurements to be presented in other comprehensive income. The standard also includes amendments related to termination benefits as well as enhanced disclosures.
- (h) IAS 27, *Separate Financial Statements* - effective for annual periods beginning on or after January 1, 2013, as a result of the issue of the new consolidation suite of standards, IAS 27 has been reissued as the consolidation guidance will now be included in IFRS 10. IAS 27 will now only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.
- (i) IAS 28, *Investments in Associates and Joint Ventures* - effective for annual periods beginning on or after January 1, 2013, as a consequence of the issue of IFRS 10, IFRS 11 and IFRS 12, IAS 28 has been amended and will provide the accounting guidance for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. The amended IAS 28 will be applied by all entities that are investors with joint control of, or significant influence over, an investee.
- (j) IAS 32, *Financial Instruments, Presentation* – in December 2011, effective for annual periods beginning on or after January 1, 2014, IAS 32 was amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right of offset must be available on the current date and cannot be contingent on a future date.

16. Subsequent events:

- (a) Subsequent to June 30, 2013, 178,332 options at a weighted average exercise price of \$0.53 per share expired and 16,668 options exercisable at \$0.17 per share were forfeited.
- (b) Subsequent to June 30, 2013, 2,980,000 options were granted at an exercise price of \$0.10 per share and expiring on September 9, 2018.
- (c) Subsequent to June 30, 2013, the Operator of the Israeli licenses receive milestone dates and license extensions for the Gabriella and Yitzhak Block. Also, Brownstone and the other license holders of the Samuel Block have relinquished their interests back to the State of Israel. (See Note 4(b))
- (d) Subsequent to June 30, 2013, the ANH called US\$567,027 of the US\$2,700,000 letter of guarantee on Block 21. The ANH informed the Company that the operator of the block breached their commitment to the ANH by not delivering certain information on an agreed date. The operator has denied this breach and the Company and the operator are currently negotiating with the ANH to return the funds to the Company.

BROWNSTONE ENERGY INC.**Notes to the Consolidated Financial Statements****June 30, 2013 and 2012****(Prepared in Canadian dollars)**

16. Subsequent events (continued):

- (e) Subsequent to June 30, 2013, the Company relinquished its private participating interest in Block 36 located in the Llanos Basin of Central Colombia. The Company has no further obligations or liabilities in respect of the Block subject to the release of the letters of credit associated with the Block. The operator of the block has submitted to the ANH a letter of guarantee to replace the Company's obligations totaling US\$1,100,000 of which US\$554,000 is held in restricted cash and US\$546,000 is guaranteed by a PSG from the EDC. (See Note 7)