



**LOON ENERGY CORPORATION**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011  
US\$



## Management's Report

The Consolidated Financial Statements of Loon Energy Corporation and related financial information were prepared by, and are the responsibility of Management. The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards. The Consolidated Financial Statements and related financial information reflect amounts which must of necessity be based upon informed estimates and judgments of Management with appropriate consideration to materiality. The Company has developed and maintains systems of controls, policies and procedures in order to provide reasonable assurance that assets are properly safeguarded, and that the financial records and systems are appropriately designed and maintained, and provide relevant, timely and reliable financial information to Management.

KPMG LLP are the external auditors appointed by the shareholders, and they have conducted an independent examination of the corporate and accounting records in order to express an Auditors' Opinion on these Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the Consolidated Financial Statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim financial statements prior to their release, as well as annually to review the Company's annual Consolidated Financial Statements and Management's Discussion and Analysis and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.

Signed: "*Norman W. Holton*"  
Chief Executive Officer

Signed: "*Paul H. Rose, CA*"  
Chief Financial Officer

April 23, 2013



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## **INDEPENDENT AUDITORS' REPORT**

To the Directors and Shareholders of Loon Energy Corporation

We have audited the accompanying consolidated financial statements of Loon Energy Corporation, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, and notes, comprising 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 as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our 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, we 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 consolidated financial position of Loon Energy Corporation as at December 31, 2012 and 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in



accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

***Emphasis of matter***

Without qualifying our opinion, we draw attention to note 2(a) in the consolidated financial statements which describes that Loon Energy Corporation will require capital to fund the exploration and development program on its oil and gas properties. This condition, as described further in note 2(a), indicates the existence of a material uncertainty that may cast significant doubt about Loon Energy Corporation's ability to continue as a going concern.

*KPMG LLP*

Chartered Accountants

Calgary, Canada

April 23, 2013

**Loon Energy Corporation**  
**Consolidated Statements of Financial Position**  
**US\$**

	December 31 2012	December 31 2011
Assets		
Current		
Cash and cash equivalents	\$ 890,692	\$ 134,134
Accounts receivable	248,105	289,885
Commodity taxes receivable	24,073	193,202
	<u>1,162,870</u>	<u>617,221</u>
Property and equipment (note 5)	<u>1</u>	<u>1</u>
Total Assets	<u>\$ 1,162,871</u>	<u>\$ 617,222</u>
Liabilities		
Current		
Accounts payable and accrued liabilities	\$ 594,096	\$ 663,773
Decommissioning provision (note 8)	120,000	120,000
	<u>714,096</u>	<u>783,773</u>
Decommissioning provision (note 8)	<u>205,556</u>	<u>203,638</u>
	<u>919,652</u>	<u>987,411</u>
Shareholders' Equity (Deficiency)		
Share capital (note 9)	16,570,265	15,591,236
Contributed surplus	2,351,076	2,148,686
Deficit	(18,678,122)	(18,110,111)
	<u>243,219</u>	<u>(370,189)</u>
Total Liabilities and Shareholders' Equity	<u>\$ 1,162,871</u>	<u>\$ 617,222</u>

See accompanying notes to the consolidated financial statements.

**Loon Energy Corporation**  
**Consolidated Statement of Changes in Equity**  
**US\$**

	Number of Shares	Share Capital	Contributed Surplus	Deficit	Total
Balances, December 31, 2010	9,949,136	\$ 15,591,236	\$ 1,684,579	\$ (16,624,712)	\$ 651,103
Net loss and comprehensive loss		-	-	(1,485,399)	(1,485,399)
Stock based compensation		-	464,107	-	464,107
Balances, December 31, 2011	9,949,136	\$ 15,591,236	\$ 2,148,686	\$ (18,110,111)	\$ (370,189)
Shares issued on private placement	10,000,000	1,006,395	-	-	1,006,395
Share issuance costs		(27,366)	-	-	(27,366)
Net loss and comprehensive loss		-	-	(568,011)	(568,011)
Stock based compensation		-	202,390	-	202,390
Balances, December 31, 2012	19,949,136	\$ 16,570,265	\$ 2,351,076	\$ (18,678,122)	\$ 243,219

See accompanying notes to the consolidated financial statements.

**Loon Energy Corporation**  
**Consolidated Statements of Operations and Comprehensive Loss**  
**US\$**

	Year ended December 31,	
	2012	2011
Expenses		
General and administrative	\$ 356,210	\$ 485,678
Stock based compensation (note 10)	202,390	464,107
Impairment of petroleum and natural gas properties (note 7)	-	528,926
	<u>558,600</u>	<u>1,478,711</u>
Finance costs		
Accretion	1,918	1,366
Foreign exchange loss	7,493	5,322
	<u>9,411</u>	<u>6,688</u>
Net loss and comprehensive loss	<u>\$ (568,011)</u>	<u>\$ (1,485,399)</u>
Net loss per share		
Basic and diluted	<u>\$ (0.04)</u>	<u>\$ (0.15)</u>

See accompanying notes to the consolidated financial statements.

**Loon Energy Corporation**  
**Consolidated Statements of Cash Flows**  
**US\$**

	Year ended Dec 31,	
	2012	2011
Operating activities		
Net loss	\$ (568,011)	\$ (1,485,399)
Items not involving cash:		
Accretion	1,918	1,366
Impairment of petroleum and natural gas properties	-	528,926
Stock based compensation	202,390	464,107
Foreign exchange loss	6,938	2,473
	(356,765)	(488,527)
Changes in non-cash working capital	133,739	63,727
	(223,026)	(424,800)
Investing		
Proceeds on issuance of share capital	1,006,395	-
Share issuance costs	(27,366)	-
Evaluation and exploration expenditures	-	(343,337)
Changes in non-cash working capital related to capital expenditures	-	323,640
	979,029	(19,697)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	555	2,849
Change in cash and cash equivalents	756,558	(441,648)
Cash and cash equivalents, beginning of year	134,134	575,782
Cash and cash equivalents, end of year	\$ 890,692	\$ 134,134

See accompanying notes to the consolidated financial statements.



**Loon Energy Corporation**  
Notes to the Consolidated Financial Statements  
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**1. Reporting Entity**

Loon Energy Corporation (“**Loon**” or the “**Company**”) was incorporated pursuant to the provisions of the Business Corporation Act (Alberta) on October 30, 2008 in conjunction with the reorganization of Loon Energy Inc. (“**Loon Energy**”). The reorganization of Loon Energy resulted in the Company receiving the net assets associated with resource properties located in Colombia and Peru. Upon implementation of the re-organization, Loon Energy’s name was changed to Kulczyk Oil Ventures Inc. (“**Kulczyk Oil**”).

Loon is incorporated under the laws of the Province of Alberta and is domiciled in Canada. The address of its registered head office is 1170, 700 - 4th Avenue SW, Calgary, Alberta.

**2. Basis of Preparation**

**(a) Statement of compliance**

These consolidated financial statements have been prepared using International Financial Reporting Standards (“**IFRS**”) as issued by the International Accounting Standards Board.

These consolidated financial statements were approved by the Company’s Board of Directors on April 23, 2013.

The Company is an oil and gas exploration and development company. The Company’s only properties at present are in Colombia, and have no proved reserves and do not generate positive net production revenue.

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities in the normal course of business. To date, the Company’s exploration and development operations have been financed by way of equity issuances, debt facilities and by farm-out arrangements with third parties who pay for all or a portion of the Company’s expenditures to earn a portion of the Company’s ownership interests. As at December 31, 2012 the Company has working capital of \$0.5 million and incurred a net loss of \$0.6 million for the year ended December 31, 2012. As a result of the private placement funds received in June 2012, the Company has improved its short term and medium term liquidity position. The Company is pursuing international oil and gas opportunities and will require capital to fund its international exploration activities. The need to raise capital to acquire additional concessions and for exploration and development opportunities creates a significant doubt as to the Company’s ability to continue as a going concern. There are no guarantees that additional capital, either through additional equity, debt or farm-out arrangements will be available when needed.

**(b) Basis of measurement**

The consolidated financial statements have been prepared using the historical cost basis.

**(c) Functional and presentation currency**

The consolidated financial statements are presented in U.S. dollars, which is the functional currency of the Company and its subsidiaries.

**(d) Use of estimates and judgements**

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reporting amounts of assets, liabilities, income and expenses. Actual results could differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

**Loon Energy Corporation**  
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**2. Basis of Preparation (continued)**

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following notes:

- Notes 5, 6 and 7 – Impairment of property and equipment and evaluation and exploration assets
- Note 8 – Decommissioning provision
- Note 10 – Stock-based compensation

At December 31, 2012, there were no critical judgments required to be made by management when applying the Company's significant accounting policies.

**3. International operations and commitments**

**Colombia**

Buganviles Association Contract

Through a farm-in agreement, the Company earned a 20% non-operated participating interest in the Buganviles Association Contract. The Company has fulfilled its required work commitments with respect to this contract. The license for the Buganviles Association Contract expired on June 30, 2012. The Operator has applied for a two year extension of the contract and an update on the status of the extension is expected from Ecopetrol, the Colombian national oil company.

In September 2010, Loon entered into a farm-out agreement with Petrodorado South America S.A. ("**Petrodorado**") under which Petrodorado agreed to pay the Company's 20% share of the authorized costs to drill and complete two wells in Colombia to earn 75% (net 15%) of the Company's interest in the Buganviles Association Contract. The Company then exercised its option to acquire a reversionary interest equal to a 5% working interest through a payment of 10% (net) of the authorized completion costs for both wells to Petrodorado. As such, at December 31, 2012, the Company holds a 10% working interest in the Buganviles Association Contract.

The Company has received cash calls from the Operator to fund the drilling and completion of two Buganviles wells in Colombia. Upon the execution of the farm-out agreement in September 2010, these cash call amounts became payable by Petrodorado. The Company has recorded a receivable from Petrodorado for \$232,708 representing the unpaid cash calls to be paid by Petrodorado under the terms of the farm-out agreement and the same amount as an account payable due to the Operator.

The Company does not currently have any definitive plans to return to the drilling program or further develop the association contract and has recorded an impairment of its Colombian assets of \$528,926 in 2011 (note 7).

**Peru**

In 2010, the Operator, Compañía Española de Petróleos, S.A. ("**CEPSA**"), and Loon decided to not enter into the second exploration phase and withdraw from Block 127. All petroleum and natural gas property expenditures related to Block 127 were fully written off in 2010. CEPSA and the Company are currently executing an abandonment plan for Block 127. All abandonment activities are expected to be completed in 2013.

**Loon Energy Corporation**  
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**4. Significant Accounting Policies**

**(a) Principles of consolidation**

The accompanying consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries.

**(i) Subsidiaries**

The consolidated financial statements include the accounts of the Company and its controlled subsidiaries. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Loon has one direct wholly-owned subsidiary, Loon Energy Holdings Limited (“**LEHL**”). Through LEHL, Loon has two indirect wholly-owned subsidiaries, Loon Colombia Limited (“**LCL**”) and Loon Peru Limited (“**LPL**”).

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the income statement.

**(ii) Jointly controlled operations and jointly controlled assets**

Many of the Company’s oil and natural gas activities involve jointly controlled assets. The consolidated financial statements include the Company’s share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

**(iii) Transactions eliminated on consolidation**

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

**(b) Foreign currency**

The reporting and functional currency of the Company and all its subsidiaries is the United States dollar (“**US\$**” or “**\$**”). Transactions in foreign currencies are translated to United States dollars at exchange rates as of the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to the Company’s functional currency at the period-end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in profit or loss.

**(c) Property and equipment and intangible exploration assets**

**(i) Recognition and measurement**

Exploration and evaluation (“**E&E**”) expenditures

Pre-license costs are recognized in the statement of operations as incurred.

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable general and administrative costs, are capitalized as either tangible or intangible exploration and evaluation assets according to the nature of the assets acquired. Interest and borrowing costs incurred on E&E assets are not capitalized. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

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**4. Significant Accounting Policies (continued)**

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are grouped by concession or field area.

The technical feasibility and commercial viability of extracting a resource is considered to be determinable based on several factors including the assignment of proven reserves. A review of each exploration license or field is carried out, at least annually, to ascertain whether the project is technically feasible and commercially viable. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within property and equipment referred to as oil and natural gas interests.

Development and production costs

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into cash generating units (“CGU”) for impairment testing and categorized within property and equipment as oil and natural gas interests.

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized within profit or loss.

(ii) Subsequent costs:

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property and equipment are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized costs generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

(iii) Depletion and depreciation:

The net carrying value of development or production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers annually.

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially viable.

**(d) Impairment**

(i) Financial assets:

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

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**4. Significant Accounting Policies (continued)**

All impairment losses are recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

(ii) Non-financial assets:

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property and equipment as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets, except E&E assets, are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the CGU). The recoverable amount of an asset or a CGU is the greater of its value-in-use and its fair value less costs to sell.

In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value-in-use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit or group of units on a pro rata basis.

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

**(e) Finance income and expenses**

Finance expense comprises interest expense on borrowings, accretion of the discount on provisions and impairment losses recognized on financial assets.

Borrowing costs incurred on exploration and evaluation assets are expensed as incurred. Borrowing costs derived from debt specifically related to the construction of qualifying assets, if any, in the development stage will be capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate that will be used to determine the amount of borrowing costs to be capitalized will be the weighted average interest rate applicable to the Company's outstanding borrowings during the period.

Interest income is recognized as it accrues in profit or loss, using the effective interest method.

Foreign currency gains and losses, reported under finance income and expenses, are reported on a net basis.

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**4. Significant accounting policies (continued)**

**(f) Cash and cash equivalents**

Cash and cash equivalents include cash on hand and short-term, highly liquid investments with original maturities of three months or less.

**(g) Decommissioning obligation**

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the asset retirement obligations are charged against the provision to the extent the provision was established.

**(h) Financial instruments**

All financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as fair value through profit or loss ("FVTPL"), available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities.

Financial assets and financial liabilities classified as FVTPL are measured at fair value with changes in fair values recognized in net earnings or loss. Financial assets available-for-sale are measured at fair value, with changes in fair values recognized in other comprehensive income. Financial assets held-to-maturity, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization.

Cash and cash equivalents and accounts receivable are designated as loans and receivables. Accounts payable and accrued liabilities are designated as other financial liabilities.

The fair value of cash and cash equivalents, accounts receivable and accounts payable approximates their carrying value. The Company does not hold any other financial instruments.

**(i) Stock based compensation**

The Company has issued options to directors, officers and employees to purchase common shares. The fair value of options on the date they are granted to employees is recognized as compensation expense with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

**(j) Loss per share**

Basic loss per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

**(k) Income tax**

Income tax expense includes current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

**Loon Energy Corporation**  
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**4. Significant accounting policies (continued)**

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

**(I) Future changes in accounting policies**

Certain new accounting standards and interpretations have been published that the Company is mandated to adopt effective January 1, 2013. These changes will not have any impact on the consolidated financial statements of the Company.

- (i) *IFRS 10, "Consolidated Financial Statements" ("IFRS 10")* replaces *IAS 27, "Consolidated and Separate Financial Statements" ("IAS 27")* and Standing Interpretations Committee ("SIC") 12, "*Consolidation – Special Purpose Entities*". IFRS 10 revises the definition of control and focuses on the need to have power and variable returns for control to be present. IFRS 10 provides guidance on participating and protective rights and also addresses the notion of "de facto" control. It also includes guidance related to an investor with decision making rights to determine if it is acting as a principal or agent.
- (ii) *IFRS 11, "Joint Arrangements" ("IFRS 11")* replaces *IAS 31, "Interest in Joint Ventures" ("IAS 31")* and SIC 13, "*Jointly Controlled Entities – Non-Monetary Contributions by Venturers*". IFRS 11 defines a joint arrangement as an arrangement where two or more parties have joint control. A joint arrangement is classified as either a "joint operation" or a "joint venture" depending on the facts and circumstances. A joint operation is a joint arrangement where the parties that have joint control have rights to the assets and obligations for the liabilities, related to the arrangement. A joint operator accounts for its share of the assets, liabilities, revenues and expenses of the joint arrangement. A joint venturer has the rights to the net assets of the arrangement and accounts for the arrangement as an investment using the equity method.
- (iii) *IFRS 12, "Disclosure of Interest in Other Entities" ("IFRS 12")* replaces the disclosure requirements previously included in IAS 27, IAS 31, and IAS 28, "Investments in Associates". It sets out the extensive disclosure requirements relating to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. An entity is required to disclose information that helps users of its financial statements evaluate the nature of and risks associated with its interests in other entities and the effects of those interests on its financial statements.
- (iv) *IFRS 13, "Fair Value Measurement"* provides a consistent and less complex definition of fair value, establishes a single source for determining fair value and introduces consistent requirements for disclosures related to fair value measurement. IFRS 13 is applied prospectively from the beginning of the annual period in which the standard is adopted. Early adoption is permitted.

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**5. Property and equipment**

	Colombia	Peru	Total
Opening balance at January 1, 2011	\$ 149,588	\$ -	\$ 149,588
Impairment	(149,587)	-	(149,587)
Balance at December 31, 2011 and 2012	\$ 1	\$ -	\$ 1

The Company does not currently have any definitive plans to return to the drilling program or further develop the concession and recorded an impairment of \$149,587 in 2011 (note 7).

**6. Evaluation and exploration**

	Colombia	Peru	Total
Opening balance at January 1, 2011	\$ -	\$ -	\$ -
Additions	\$ 379,339		379,339
Impairment	(379,339)	-	(379,339)
Balance at December 31, 2011 and 2012	\$ -	\$ -	\$ -

The Company does not currently have any definitive plans to return to the drilling program or further develop the association contract and recorded an impairment of its Colombian assets of \$379,339 in 2011 (note 7).

**7. Impairment**

In 2011, the Company reported an impairment in the amount of \$528,926 related to its Colombian property and equipment and exploration and evaluation assets. The Company recognized indicators of impairment for both property and equipment and exploration and evaluation assets principally due to not having any definitive plans to return to the drilling program or further develop the association contract. The recoverable amount of assets was determined based on the estimated fair value less costs to sell as at December 31, 2011. Fair value was estimated taking into account various factors including drilling results, the stage of development of the assets, the Company's working interest and the development potential of the assets.

**8. Decommissioning Provision**

The Company's decommissioning provisions result from its working interest ownership in petroleum and natural gas properties in Colombia and Peru, including well sites, gathering systems and processing facilities. The Company's estimate of the total undiscounted cash flows required to settle the obligations is \$341,296 (December 31, 2011 - \$332,919) which are expected to be incurred between 2013 and 2016. A risk-free rate of 4.75 percent and inflation at a rate of 3.20 percent were used to calculate the decommissioning provision. The Company recognized accretion expense and revisions of \$1,918 for the year ended December 31, 2012 (\$1,366 – 2011).

	Colombia	Peru	Total
Balance at December 31, 2010	\$ 166,270	\$ 120,000	\$ 286,270
Accretion expense	1,366	-	1,366
Provision for new wells	36,002	-	36,002
Balance at December 31, 2011	203,638	120,000	323,638
Accretion expense	3,574	-	3,574
Revisions in estimate	(1,656)	-	(1,656)
Balance at December 31, 2012	\$ 205,556	\$ 120,000	\$ 325,556



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**9. Share capital**

**(a) Authorized**

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. On February 13, 2012, the board of directors of Loon resolved to consolidate the common shares of Loon on the basis of ten pre-consolidation common shares for one post-consolidation common share. The shareholders subsequently approved this share consolidation. Accordingly, share transactions and balances, and per share disclosures have been revised to reflect the impact of the consolidation for all periods presented.

In June 2012, the Company completed a non-brokered private placement consisting of 10,000,000 common shares at an issue price of CAD\$0.10 per share for gross proceeds of CAD\$1,000,000 (USD\$ 1,006,395). The Company paid \$27,366 in share issuance costs.

	<u>Number of Shares</u>	<u>Carrying amount</u>
Balance, December 31, 2010 and December 31, 2011	9,949,136	\$ 15,591,236
Shares issued on private placement	10,000,000	1,006,395
Share issuance costs	-	(27,366)
Balance, December 31, 2012	<u>19,949,136</u>	<u>\$ 16,570,265</u>

**(b) Per share amounts**

The following table summarized the weighted average common shares used in calculating the net loss per share.

	<u>2012</u>	<u>2011</u>
Weighted average number of shares outstanding	<u>15,675,163</u>	<u>9,949,136</u>

**(c) Stock Options**

The following table summarizes information about the options outstanding as at December 31, 2012 and 2011, adjusted for the 10 for 1 share consolidation (note 9) and the repricing of options:

	<u>Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Contractual Life (years)</u>
Balance outstanding, December 31, 2010	958,000	\$ 0.16	4.9
Options forfeited/cancelled	(66,500)	0.16	4.9
Balance outstanding, December 31, 2011	891,500	\$ 0.16	3.9
Options granted	411,000	0.10	4.7
Options forfeited/cancelled	(594,000)	0.16	2.9
Balance outstanding, December 31, 2012	<u>708,500</u>	<u>\$ 0.13</u>	<u>3.9</u>
Exercisable At December 31, 2012	<u>434,500</u>	<u>\$ 0.14</u>	<u>3.5</u>

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**10. Stock Based Compensation**

During the year ended December 31, 2012, the Company recorded \$202,390 (2011 – \$464,107) of stock based compensation expense. Share purchase options have a term of five years and vest annually with one third vesting immediately and one third vesting on each of the first and second anniversaries of the grant date. The Company has not capitalized any of the stock based compensation expense. During the second quarter of 2012, the Board approved a repricing of options, from an exercise price of \$1.30 per option to \$0.16 per option, which is reflected in the stock based compensation expense for the period ended December 31, 2012.

The fair value of options granted during 2012 was estimated to be \$0.05 per option (2011 - \$0.12) using a black-scholes options pricing model with the following assumptions: option life – 5 years (2011 – 2.9 years); volatility of 85% based on historical volatility and peer analysis (2011 - 184%); risk free rate of 1.33% (2011 – 1.77%); and dividend rate of nil (2011 – nil).

**11. Personnel Expenses**

The Company has no employees, and management and administrative services are provided by the management and staff of Kulczyk Oil pursuant to a services agreement. Therefore, the company incurs no salary and benefits costs for personnel.

The Company incurred \$188,962 (2011 - \$394,491) of stock-based compensation expenses related to options granted to Officers and Directors of the Company.

The Company recorded \$nil (2011 - \$81,878) of Directors' fees expense.

**12. Financial risk management**

**(a) Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's net income or the value of its financial instruments.

**(i) Interest rate risk**

The Company maintains its cash and cash equivalents in instruments that are redeemable at any time without penalty thereby reducing its exposure to interest rate fluctuations thereon. Interest rate risk is not considered material.

**(ii) Foreign currency exchange risk**

The Company is exposed to risks arising from fluctuations in currency exchange rates between the Canadian dollar ("CAD") and the United States dollar. At December 31, 2012 and 2011 the Company's primary foreign currency exposure relates to Canadian dollar cash balances net of accounts payable and accrued liabilities in Canada as follows:

	December 31,	
	2012	2011
Cash and cash equivalents	\$ 855,493	\$ 104,593
Accounts receivable	12,299	13,346
Accounts payable and accrued liabilities	(115,417)	(213,607)
Net foreign exchange exposure	<u>\$ 752,375</u>	<u>\$ (95,668)</u>

At December 31, 2012 and 2011, the Company's net loss is not significantly impacted by changes in the US to Canadian dollar exchange rates.

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**12. Financial risk management (continued)**

**(b) Credit risk**

Management monitors credit risk by reviewing the credit quality of the financial institutions that hold the cash and cash equivalents.

The Company's accounts receivable as at December 31, 2012 included \$24,073 (2011 - \$193,202) of recoverable goods and services taxes. The Company does not consider the credit risk relating to the outstanding amounts to be significant.

The Company has received cash calls from the Operator to fund the drilling and completion of two Bugarvilles wells in Colombia. Upon the execution of the farm-out agreement in September 2010, these cash call amounts became payable by Petrodorado. The Company has recorded a receivable from Petrodorado for \$232,708 (2011 - \$232,708) representing the unpaid cash calls to be paid by Petrodorado under the terms of the farm-out agreement and the same amount as an account payable due to the Operator. The Company does not consider the credit risk relating to Petrodorado to be significant given the nature of the farm in agreements.

The Company does not have a provision for doubtful accounts at December 31, 2012 and 2011 and was not required to write off any significant balances in the years then ended.

**(c) Liquidity risk**

The Company monitors its liquidity position regularly to assess whether it has the resources necessary to fund planned exploration commitments on its petroleum and natural gas properties or that viable options are available to fund such commitments from new equity issuances or alternative sources of financing such as farm-out agreements. However, as an exploration company at an early stage of development and without internally generated cash flow, there are inherent liquidity risks, including the possibility that additional financing may not be available to the Company on either a timely or commercial basis or that actual exploration expenditures may exceed those planned. Additional equity, debt or farm-out arrangements may be required and there are no guarantees that such additional capital funding will be available when needed.

**(d) Capital management**

As at December 31, 2012, the Company's working capital amounted to \$448,774 (December 31, 2011 - \$166,552 deficit). Consistent with prior years, the Company manages its capital structure to maximize financial flexibility making adjustments in light of changes in economic conditions and risk characteristics of the underlying assets. Further, each potential acquisition and investment opportunity is assessed to determine the nature and total amount of capital required together with the relative proportions of debt and equity to be deployed. The Company does not presently utilize any quantitative measures to monitor its capital.

**13. Related party transactions**

The Company has no employees, and management and administrative services are provided by the management and staff of Kulczyk Oil pursuant to a services agreement. Administrative costs incurred by Kulczyk Oil for the benefit of the Company are

allocated to the Company based on specific identification and an allocation of administrative costs that relate to both Kulczyk Oil and the Company. For the year ended December 31, 2012, these fees totalled \$12,081 (2011 - \$11,856). At December 31, 2012, the Company owed \$20,873 (2011 - \$8,543) to Kulczyk Oil for these services. Certain expenditures of the Company are paid by Kulczyk Oil on behalf of the Company and as at December 31, 2012 the Company owed \$82,965 (2011 - \$49,718) for these costs. Kulczyk Oil and the Company are related as they have four common directors, five common officers (two of whom are also directors) and the same principal shareholder.

Kulczyk Oil remains legally responsible for a guarantee issued in August 2007 ("the **Loon Peru Guarantee**") to the Government of Peru regarding the granting of the Block 127 license contract to Loon Peru Limited, a wholly-owned subsidiary of the Company. The Company has begun the process of replacing the Loon Peru Guarantee. However, the block to which the guarantee is related is in the process of being relinquished and it is not currently anticipated that the guarantee will be replaced. The Company has entered into an indemnification agreement with Kulczyk Oil in respect of the Loon Peru Guarantee. The Company has fulfilled its work commitments under the first phase of the exploration program, and the Company and its partners in the Block announced on October 25, 2010 that the joint venture will not proceed to the second exploration phase.

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**14. Income tax**

The differences between the income tax provisions calculated using statutory rates and those reported are as follows:

	December 31, 2012	2011
Loss before income taxes	\$ (568,011)	\$ (1,485,399)
<i>Federal and provincial statutory rate</i>	25.00%	26.50%
Expected income tax recovery	\$ (142,003)	\$ (393,631)
Stock based compensation	50,598	122,988
Changes in unrecognized deferred tax assets	75,616	364,020
Tax rate differences and other	15,789	(93,377)
Current income tax expense (recovery)	\$ (15,789)	\$ 93,377

The general federal and provincial tax rate decreased to 25.00% in 2012 from 26.50% in 2011 due to the Federal rate dropping from 16.50% (2011) to 15.00% in 2012.

**Unrecognized deferred tax assets**

Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

	December 31, 2012	2011
Property and equipment	\$ 2,648,023	\$ 2,648,023
Asset retirement obligations	325,556	323,638
Non-capital losses	4,523,887	4,177,806
	\$ 7,497,466	\$ 7,149,467

Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profits will be available against which they can be utilized.

The Company has Canadian non-capital losses of \$2.2 million that expire between 2028 and 2032 and Peru tax losses of \$1 million, Colombia tax losses of \$0.7 million and Cyprus tax losses of \$0.5 million that have no expiry period.

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**15. Segmented information**

<b>As at December 31, 2012</b>	<b>Colombia</b>	<b>Peru</b>	<b>Corporate</b>	<b>Total</b>
Total assets, at period end	<u>\$ 253,827</u>	<u>\$ 31,047</u>	<u>\$ 877,997</u>	<u>\$ 1,162,871</u>
<b>For the year ended December 31, 2012</b>				
General and administrative	\$ 60,309	\$ 79,863	\$ 216,038	\$ 356,210
Stock based compensation	-	-	202,390	202,390
Accretion	1,918	-	-	1,918
Foreign exchange loss	2,871	(51)	4,673	7,493
Net loss	<u>\$ 65,098</u>	<u>\$ 79,812</u>	<u>\$ 423,101</u>	<u>\$ 568,011</u>
Capital expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<b>As at December 31, 2011</b>	<b>Colombia</b>	<b>Peru</b>	<b>Corporate</b>	<b>Total</b>
Total assets, at period end	<u>\$ 249,410</u>	<u>\$ 229,881</u>	<u>\$ 137,931</u>	<u>\$ 617,222</u>
<b>For the year ended December 31, 2011</b>				
General and administrative	\$ 93,561	\$ 63,852	\$ 328,265	\$ 485,678
Stock based compensation	-	-	464,107	464,107
Accretion	1,366	-	-	1,366
Foreign exchange loss	2,465	31	2,826	5,322
Impairment of P&NG properties	528,926	-	-	528,926
Net loss	<u>\$ 626,318</u>	<u>\$ 63,883</u>	<u>\$ 795,198</u>	<u>\$ 1,485,399</u>
Capital expenditures	<u>\$ 379,339</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 379,339</u>