CANACOL ENERGY LTD.

CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Canacol Energy Ltd:

We have audited the accompanying consolidated financial statements of Canacol Energy Ltd., which comprise the consolidated statements of financial position as at June 30, 2012, June 30, 2011 and July 1, 2010, and the consolidated statements of operations and comprehensive income (loss), consolidated statements of changes in equity, and consolidated statements of cash flows for the years ended June 30, 2012 and June 30, 2011 and the notes to the consolidated financial statements.

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.

Auditor's 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 the auditor's 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 auditor considers 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 Canacol Energy Ltd. as at June 30, 2012, June 30, 2011, and July 1, 2010, and their financial performance and cash flows for the years ended June 30, 2012 and June 30, 2011 in accordance with International Financial Reporting Standards.

Deloitte & Touche LLP

Chartered Accountants
September 24, 2012

MANAGEMENT'S REPORT

Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements of Canacol Energy Ltd. (the "Corporation") within reasonable limits of materiality. The accompanying consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgements. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Corporation's financial position, financial performance and cash flows, within International Financial Reporting Standards. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The Corporation's external auditors, Deloitte & Touche LLP, have audited the consolidated financial statements. Their audit provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported financial results and the financial performance of the Corporation.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.

(signed) " Charle Gamba"

Charle Gamba
President and Chief Executive Officer

(signed) "George Gramatke"

George Gramatke
Chief Financial Officer

September 24, 2012

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands of United States dollars)

As at	Note		June 30, 2012		June 30, 2011		July 1, 2010
					(Note 26)		(Note 26)
ASSETS							
Current assets							
Cash and cash equivalents		**$**	**30,789**	$	101,627	$	56,240
Restricted cash	9		**6,072**		12,604		890
Trade and other receivables			**32,801**		37,976		7,266
Prepaid expenses and deposits			**4,630**		2,198		563
Prepaid transportation on overlifted volumes	11		**-**		4,024		-
Embedded derivatives asset	24		**3,156**		-		-
Commodity contracts	23		**-**		-		227
Assets held for sale – Brazil	7		**-**		3,828		-
Crude oil inventory			**8,136**		12,348		2,330
			85,584		174,605		67,516
Non-current assets							
Restricted cash	9		**483**		444		399
Trade and other receivables			**-**		-		395
Embedded derivatives asset	24		**3,942**		-		-
Exploration and evaluation assets	6		**126,295**		33,603		11,913
Property, plant and equipment	7		**187,208**		88,566		77,135
Pipeline investment	8		**2,690**		2,589		-
Deferred tax assets	18		**626**		16,763		-
			321,244		141,965		89,842
Total assets		**$**	**406,828**	$	316,570	$	157,358
LIABILITIES AND EQUITY							
Current liabilities							
Bank debt	10	**$**	**12,000**	$	-	$	322
Trade and other payables			**47,602**		22,208		32,587
Commodity contracts	23		**303**		577		-
Overlifted volumes payable	11		**-**		38,199		-
Equity tax payable	16		**1,236**		1,180		-
Assets held for sale – Brazil	7		**-**		888		-
Taxes payable			**3,893**		17,006		292
Warrants			**-**		-		10,267
			65,034		80,058		43,468
Non-current liabilities							
Bank debt	10		**15,986**		-		-
Commodity contracts	23		**124**		-		-
Decommissioning obligations	12		**6,642**		4,541		3,783
Convertible debentures	13		**25,381**		31,454		3,998
Warrants	14		**896**		-		435
Equity tax payable	16		**1,671**		2,774		-
Deferred tax liabilities	18		**-**		7,015		5,927
Total liabilities			**115,734**		125,842		57,611
Equity							
Share capital	14		**340,775**		269,732		160,937
Other reserves	14		**32,053**		21,286		12,017
Accumulated other comprehensive loss			**347**		347		-
Deficit			**(82,081)**		(100,637)		(73,207)
Total equity			**291,094**		190,728		99,747
Total liabilities and equity		**$**	**406,828**	$	316,570	$	157,358

Commitments and contingencies (note 24); Subsequent event (note 25)
See accompanying notes to consolidated financial statements.

Approved by the Board of Directors

(signed) "Jason Bednar"
Director

(signed) "Michael Hibberd"
Director

CANACOL ENERGY LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(in thousands of United States dollars, except per share amounts)

Year ended June 30	Note		2012		2011 (Note 26)
Revenues					
Crude oil sales, net of royalties	20	$	**136,623**	$	91,680
Tariff revenue			**48,281**		21,144
			184,904		112,824
Expenses					
Operating and transportation			**75,986**		39,213
Pre-license exploration costs			**3,506**		-
General and administrative			**17,925**		13,995
Stock-based compensation	14		**7,114**		12,019
Depletion, depreciation and amortization	7		**63,848**		25,036
(Gain) loss on convertible debentures and warrants			**(4,268)**		16,256
Gain on overlifted volumes payable	11		**(7,088)**		5,093
Foreign exchange (gain) loss			**(2,770)**		70
Unrealized gain on embedded derivatives	24		**(7,098)**		-
(Gain) loss on commodity contracts	23		**(150)**		1,812
Equity tax	16		**-**		4,673
Net loss on sale of assets	6,7		**3,750**		-
Settlement of legal claim	24		**1,625**		-
Impairment loss on Brazilian assets	7		**-**		14,026
			152,380		132,193
Net finance expense	15		**3,119**		3,237
Income (loss) before income taxes			**29,405**		(22,606)
Income taxes (recovery)					
Current	18		**15,206**		20,797
Deferred	18		**(4,420)**		(15,973)
			10,786		4,824
Non-controlling interest			**63**		-
Net income (loss) for the year			**18,556**		(27,430)
Other comprehensive income					
Foreign currency translation adjustment			**-**		(347)
Comprehensive income (loss) for the year		$	**18,556**	$	(27,083)
Earnings (loss) per share					
Basic and diluted	17	$	**0.03**	$	(0.06)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(in thousands of United States dollars, number of shares in thousands)

	Number of Common Shares	Share Capital	Other Reserves	Accumulated Other Comprehensive Loss	Deficit	Total Equity
Balance as at July 1, 2010	421,466	$ 160,937	$ 12,017	$ -	$ (73,207)	$ 99,747
Issue of common shares	46,892	59,307	-	-	-	59,307
Conversion of convertible debentures	18,924	27,159	-	-	-	27,159
Warrants exercised	16,122	20,708	-	-	-	20,708
Stock options exercised	8,233	4,629	(2,750)	-	-	1,879
Stock-based compensation	-	-	12,019	-	-	12,019
Share issue costs	-	(3,008)	-	-	-	(3,008)
Net loss for the year	-	-	-	347	(27,430)	(27,083)
Balance at June 30, 2011	511,637	269,732	21,286	347	(100,637)	190,728
Issue of common shares, net	105,257	69,577	(491)	-	-	69,086
Conversion of convertible debentures	841	774	-	-	-	774
Stock options exercised	1,247	819	(284)	-	-	535
Stock-based compensation	-	-	11,542	-	-	11,542
Share issue costs	-	(127)	-	-	-	(127)
Net income for the year	-	-	-	-	18,556	18,556
Balance at June 30, 2012	**618,982**	**$ 340,775**	**$ 32,053**	**$ 347**	**$ (82,081)**	**$ 291,094**

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of United States dollars)

Year ended June 30	Note		2012		2011
Operating activities					
Net income (loss) for the period		$	18,556	$	(27,430)
Adjustments for non-cash items:					
Stock-based compensation	14		7,114		12,019
Depletion, depreciation and amortization	7		63,848		25,036
Accretion on decommissioning liabilities	15		297		196
(Gain) loss on convertible debentures and warrants			(4,268)		16,256
Gain on overlifted volumes payable	11		(7,088)		5,093
Loan impairment			529		-
Equity tax			-		3,954
Net loss on sale of assets			3,750		-
Impairment loss on Brazilian assets	7		-		14,026
Unrealized (gain) loss on commodity contracts	23		(150)		812
Unrealized foreign exchange (gain) loss and other			(2,105)		7,389
Unrealized gain on embedded derivatives	24		(7,098)		
Deferred income tax	18		(4,420)		(15,973)
			68,965		41,378
Changes in non-cash working capital	20		(32,224)		9,394
			36,741		50,772
Investing activities					
Expenditures on exploration and evaluation assets			(18,577)		-
Expenditures on property, plant and equipment			(156,116)		(73,381)
Investment in pipeline			(1,922)		(2,589)
Net cash acquired in business combination	5		8,419		-
Proceeds on sale of Brazilian assets			3,152		-
Purchase of Gemini royalty	14		-		(18,000)
Change in restricted cash			10,847		(11,759)
			(154,197)		(105,729)
Changes in non-cash working capital	20		18,032		2,055
			(136,165)		(103,674)
Financing activities					
Issue of common shares			600		64,126
Issue of convertible debentures			-		39,385
Financing and share issue costs			-		(4,900)
Change in bank debt			27,986		(322)
			28,586		98,289
Change in cash and cash equivalents			(70,838)		45,387
Cash and cash equivalents, beginning of period			101,627		56,240
Cash and cash equivalents, end of period		$	30,789	$	101,627
Cash and cash equivalents consists of:					
Cash		$	27,315	$	36,899
Cash equivalents			3,474		64,728
Cash and cash equivalents, end of period		$	30,789	$	101,627

See accompanying notes to consolidated financial statements.

NOTE 1 - GENERAL INFORMATION

Canacol Energy Ltd. (the "Corporation") and its subsidiaries are primarily engaged in petroleum and natural gas exploration and development activities in Colombia, Brazil, Ecuador and Guyana. The Corporation's head office is located at 4500, 525 - 8th Avenue SW, Calgary, Alberta, T2P 1G1, Canada. The Corporation's shares are traded on the Toronto Stock Exchange under the symbol CNE and the Bolsa de Valores de Colombia under the symbol CNE.C.

NOTE 2 - ADOPTION OF IFRS

The Corporation prepares its financial statements in accordance with Canadian generally accepted accounting principles. In 2010, the accounting principles were revised to incorporate International Financial Reporting Standards ("IFRS") and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Corporation has reported on this basis in these consolidated financial statements (the "financial statements"). In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP prior to the adoption of IFRS.

These financial statements have been prepared in accordance with IFRS. The Corporation has consistently applied the same accounting policies in its opening IFRS statement of financial position at July 1, 2010 and throughout all years presented, as if these policies had always been in effect.

The Board of Directors approved the financial statements for issuance on September 24, 2012.

NOTE 3 - BASIS OF PREPARATION

Basis of Measurement

These financial statements have been prepared on an historical cost basis, except for commodity contracts, convertible debentures, warrants and overlifted volumes payable, which are measured at fair value with changes in fair value recorded in profit or loss ("fair value through profit or loss").

The methods used to measure fair values are discussed in note 23.

These financial statements have been prepared on a going concern basis.

Functional and Presentation Currency

These financial statements are presented in United States dollars, which is both the functional and presentation currency. Tabular amounts are stated in thousands of United States dollars.

Significant Estimates and Judgements

The timely preparation of financial statements in accordance with IFRS requires that management make estimates and assumptions and use judgement regarding the measured amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Such estimates related primarily to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Petroleum and natural gas assets are grouped into cash generating units ("CGUs") identified as having largely independent cash flows and are geographically integrated. The determination of the CGUs was based on management's interpretation and judgement.

Amounts recorded for depletion, depreciation, amortization, accretion, provisions for decommissioning obligations, the valuation of convertible debentures, the valuation of warrants and the valuation of stock options are based on their expected lives and other relevant assumptions. Further, the amounts used for impairment calculations are based on estimated crude oil and natural gas reserves, and other relevant assumptions. By their nature, these estimated reserves and their related future cash flows are subject to measurement uncertainty and the impact in the financial statements of future periods could be material.

Significant judgement is required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Corporation has not recognized a benefit for the net deferred tax asset created from Canadian and Brazilian non-capital losses carried forward due to the uncertainty of realization of such amounts.

The calculation of stock-based compensation expense is subject to uncertainty as it reflects the Corporation's best estimate of whether or not performance will be achieved and obligations incurred.

NOTE 4 - SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

Subsidiaries – Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation 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 financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. 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 the acquisition over the fair value of the identifiable assets acquired and liabilities and contingent liabilities assumed 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 profit or loss.

Jointly-controlled operations and jointly-controlled assets – Many of the Corporation's petroleum and natural gas activities involve jointly-controlled assets. The financial statements include the Corporation's share of these jointly-controlled assets and a proportionate share of the relevant revenue and related costs.

Transactions eliminated on consolidation – Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated on consolidation.

Foreign Currency

The United States dollar is the functional currency of the Corporation and its significant subsidiaries. Monetary assets and liabilities denominated in foreign currencies are translated to United States dollars at the period-end exchange rate. Non-monetary assets, liabilities, revenues and expenses are translated at exchange rates at the transaction date. Exchange gains or losses are included in the determination of profit or loss in the statement of operations.

Financial Instruments

Non-derivative financial instruments – Non-derivative financial instruments include cash and cash equivalents, restricted cash, trade and other receivables, bank debt, trade and other payables, and convertible debentures. Non-derivative financial instruments are initially recognized at fair value plus any directly attributable transaction costs, except for financial assets and liabilities at fair value through profit or loss whereby any directly attributable transaction costs are expensed as incurred. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

Cash and cash equivalents – Cash and cash equivalents comprise cash on deposit with banks and short-term investments with original maturities of three months or less and is measured similar to other non-derivative financial instruments.

Restricted cash – Restricted cash relates to cash placed in trust accounts in Colombian and Brazilian banks to ensure the payment of its obligations pursuant to exploration agreements.

Bank debt – Bank debt is recorded at amortized cost, net of directly attributable transaction costs. Subsequent to initial recognition, the directly attributable transaction costs are amortized into the debt balance on a straight-line basis over the term of the facility through profit or loss.

Convertible debentures – Convertible debentures are recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss.

Overlift volumes payable – Overlift volumes payable, as defined in note 11, are recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss.

Other – Other non-derivative financial instruments, such as trade and other receivables and trade and other payables are measured at amortized cost, less any impairment losses.

Derivative financial instruments – The Corporation has entered into certain financial derivative contracts to manage its exposure to market risks associated with fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Corporation has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting, even though the Corporation considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the statement of financial position at fair value. Transaction costs are expensed when incurred.

Embedded derivatives – Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

Property, Plant and Equipment and Exploration and Evaluation Assets

Recognition and measurement

Exploration and evaluation ("E&E") assets – Pre-license costs incurred prior to obtaining the rights to explore lands 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, initially are capitalized either as tangible or intangible E&E assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

When E&E assets are determined to be technically feasible and commercially viable, the accumulated costs are transferred to property, plant and equipment. When E&E assets are determined not to be technically feasible and commercially viable or the Corporation decides not to continue with its activity, the unrecoverable costs are charged to profit or loss as exploration and evaluation expense.

E&E assets are assessed for impairment in any circumstances where sufficient data exists to determine technical feasibility and commercial viability, and facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, E&E assets are allocated to cash-generating units ("CGUs").

Development and production costs – Items of property, plant and equipment, which include petroleum and natural gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production ("D&P") assets are grouped into CGUs for impairment testing. The cost of property, plant and equipment at July 1, 2010, the date of transition to IFRS, was determined as follows: E&E assets were recorded at their previous Canadian GAAP carrying amount as allowed under IFRS 1; and petroleum and natural gas assets were allocated to CGUs using reserve volumes, as allowed under the IFRS 1 exemption for full-cost oil and gas companies.

When significant parts of an item of property, plant and equipment, including petroleum and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

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

Subsequent costs – Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as petroleum and natural gas interests 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 petroleum and natural gas interests 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, plant and equipment are recognized in profit or loss as incurred.

Depletion and depreciation – The net carrying value of development or production assets is depleted using the units-of-production method by reference to the ratio of production in the period to the related proved plus probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated by taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proved 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 producible.

Reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Corporation will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives for other assets for the current and comparative years are as follows:

Equipment and other	3-10 years
Leasehold improvements	Over the term of the leasing agreement

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

Leased Assets

Leases where the Corporation assumes substantially all the risks and rewards of ownership are classified as finance leases.

Other leases are operating leases, which are not recognized on the Corporation's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

Impairment

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.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

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

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.

Non-financial assets – The carrying amounts of the Corporation'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 recoverable amount of the asset is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment as petroleum and natural gas interests, and also if facts and circumstances suggest that their carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, 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 (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 proved and probable reserves.

E&E assets are allocated to related CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (petroleum and natural gas interests in property, plant and equipment).

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 CGUs 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 (group of units) on a pro rata basis.

In respect of assets other than goodwill, 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.

Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

Decommissioning obligations – The Corporation'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 period-end date. Subsequent to 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 decommissioning obligations are charged against the provision to the extent the provision was established.

Inventory

Inventory consists of crude oil in transit or in storage tanks at the reporting date, and is valued at the lower of cost, using the weighted-average cost method, or net realizable value. Costs include direct and indirect expenditures incurred in bringing the crude oil to its existing condition and location.

Pipeline Investment

The Corporation's interest in a pipeline construction project in Colombia is recorded at cost and assessed annually for impairment.

Revenue

The Corporation's revenues are primarily derived from the production of crude oil ("net revenue interest" or "NRI" production) and from the production of crude oil under a risk service contract with Ecopetrol S.A. ("Ecopetrol"), the state oil company of Colombia, whereby the Corporation receives a set tariff price per barrel of oil produced ("tariff" production).

Revenue from the sale of crude oil is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer, which is usually when legal title passes to an external party.

Revenue is recorded net of any royalties.

Stock-Based Compensation

The grant date fair value of stock options and restricted share units granted to officers, employees and directors is recognized as stock-based 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 awards that vest.

Finance Income and Expenses

Net finance income or expense is comprised of interest income, interest expense on borrowings, fair value adjustments on equity tax and accretion of the discount on provisions.

Borrowing costs incurred for the construction of qualifying assets are 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.

Income Taxes

Income tax expense comprises current and deferred income taxes. 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.

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

Deferred income tax is recognized using the liability 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 income tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred income tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred income 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 income 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.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred income 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.

Earnings per Share

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Corporation 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 stock options, warrants and convertible debentures.

Recent Accounting Pronouncements

All accounting standards effective for periods on or after January 1, 2011 have been adopted as part of the transition to IFRS. The following are new IFRS pronouncements that have been issued, although not yet effective and have not been early adopted, and may have an impact on the Corporation in the future as discussed below.

On January 1, 2015 , the Corporation will be required to adopt IFRS 9 "Financial Instruments", which is the result of the first phase of the International Accounting Standards Board ("IASB") project to replace IAS 39 "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. Portions of the standard remain in development and the full impact of the standard on the Corporation's financial statements will not be known until the project is complete.

In May 2011, the IASB released the following new standards: IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements", IFRS 12 "Disclosures of Interests in Other Entities" and IFRS 13 "Fair Value Measurement". Each of these standards is to be adopted for fiscal years beginning January 1, 2013, with earlier adoption permitted. A brief description of each new standard follows below:

(i) Consolidated Financial Statements

IFRS 10 "Consolidated Financial Statements" supersedes IAS 27 "Consolidation and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities". This standard provides a single model to be applied in control analysis for all investees, including special purpose entities.

The Corporation is currently assessing the impact of this new standard, but does not anticipate that the adoption of this standard will have a significant impact on the Corporation's financial statements.

(ii) Joint Arrangements

IFRS 11 "Joint Arrangements" divides joint arrangements into two types, joint operations and joint ventures, each with their own accounting model. All joint arrangements are required to be reassessed on transition to IFRS 11 to determine their type to apply the appropriate accounting.

The Corporation is currently assessing the impact of this new standard. The adoption of this standard may have a material impact on the Corporation's financial statements.

(iii) Disclosure of Interests in Other Entities

IFRS 12 "Disclosure of Interests in Other Entities" combines in a single standard the disclosure requirements for subsidiaries, associates and joint arrangements as well as unconsolidated structured entities.

The Corporation is currently assessing the impact of this new standard, but does not anticipate that the adoption of this standard will have a significant impact on the Corporation's financial statements.

(iv) Fair Value Measurement

IFRS 13 "Fair Value Measurement" defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Corporation is currently assessing the impact of this new standard, but does not anticipate that the adoption of this standard will have a significant impact on the Corporation's financial statements.

NOTE 5 – BUSINESS ACQUISITION

In November 2011, the Corporation entered into an agreement to acquire all of the issued and outstanding shares of Carrao Energy Ltd. ("Carrao"), a private company engaged in the evaluation, acquisition, exploration and development of oil and gas properties in Colombia.

On November 29, 2011, the closing date of the transaction, the Corporation acquired approximately 96% of the issued and outstanding securities of Carrao through the issuance of an aggregate 99,930,109 common shares of the Corporation to former holders of Carrao shares, warrants and stock options. The closing price of the Corporation's common shares on the closing date was C$0.64 per share. On January 30, 2012, the Corporation issued a further 4,806,445 common shares to acquire the remaining 4% interest in accordance with the compulsory acquisition provisions of the *Business Corporations Act* (British Columbia).

Holders of certain options to purchase Carrao shares elected to convert their Carrao options into options to purchase 5,795,110 common shares of the Corporation. The options were fair-valued at $0.39 per option using a Black-Scholes model. Certain warrants exercisable into Carrao shares were also exchanged for warrants exercisable into 3,286,920 common shares of the Corporation. The warrants were also fair-valued at $0.39 per warrant using a Black-Scholes model.

The President, Chief Executive Officer and Director of the Corporation, Mr. Charle Gamba, was also an independent director of Carrao at the time of the acquisition. During the acquisition process, the Corporation and Carrao each struck special committees of their respective boards which excluded Mr. Gamba. Mr. Gamba had no involvement in the formulation, negotiation or acceptance of the offer to acquire Carrao either in his capacity as President, Chief Executive Officer and Director of the Corporation, or as an independent director of Carrao.

Acquisition related costs, other than share issue costs, of approximately $0.2 million have been expensed as period costs in the statement of operations during the year.

The acquisition has been accounted for using the purchase method with the results of Carrao's operations included in the Corporation's financial and operating results commencing November 30, 2011. The allocation of the purchase price based on fair values was as follows:

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

Consideration:		
Issue of common shares, warrants and options	$	68,591
Share issue costs		(127)
	$	**68,464**

Net assets acquired:		
Cash	$	8,419
Restricted cash		4,354
Other current assets		508
Exploration and evaluation assets		70,917
Trade and other payables		(2,191)
Deferred income tax liability		(13,543)
	$	**68,464**

Upon acquisition of the 96% interest on November 29, 2011, $3.0 million of non-controlling interest was recognized. The non-controlling interest was derecognized when the remaining 4% interest was acquired on January 30, 2012. Revenue and expenses recognized in Carrao subsequent to the acquisition cannot be reasonably measured due to the successful integration of Carrao into the Corporation.

NOTE 6 – EXPLORATION AND EVALUATON ASSETS

Balance at July 1, 2010	$	11,913
Net additions		21,690
Balance at June 30, 2011		33,603
Acquisition of Carrao		70,917
Net additions		23,469
Transfers to D&P assets		(1,694)
Balance at June 30, 2012	**$**	**126,295**

In April 2012, the Corporation entered into a farm-out agreement with ExxonMobil Exploration Colombia Limited ("ExxonMobil") for the exploration of the Corporation's non-operated VMM 2 E&P contract located in the Middle Magdalena basin of Colombia. Upon execution of the farm-out agreement, ExxonMobil paid $2.2 million for back-costs incurred by the Corporation, resulting in a gain on sale of exploration assets of $0.4 million.

In February 2012, the Corporation acquired an additional 9% interest in the LLA 23 block and an additional 10% interest in the Santa Isabel block for a total consideration of $4.5 million, paid in common shares of the Corporation.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

NOTE 7 – PROPERTY, PLANT AND EQUIPMENT

	Crude Oil Assets	Gas Processing Facilities	Corporate and Other Assets	Total
Cost or deemed cost				
Balance at July 1, 2010	$ 75,810	$ -	$ 1,618	$ 77,428
Net additions	54,321	-	-	54,321
Transfer to assets held for sale	(15,401)	-	-	(15,401)
Balance at June 30, 2011	114,730	-	1,618	116,348
Net additions	125,158	31,745	3,838	160,741
Transfers from E&E assets	1,694	-	-	1,694
Balance at June 30, 2012	**$ 241,582**	**$ 31,745**	**$ 5,456**	**$ 278,783**
Accumulated depletion, depreciation and impairment losses				
Balance at July 1, 2010	-	-	(293)	(293)
Depletion and depreciation	(24,695)	-	(341)	(25,036)
Impairment loss on assets	(14,026)	-	-	(14,026)
Transfer to assets held for sale	11,573	-	-	11,573
Balance at June 30, 2011	(27,148)	-	(634)	(27,782)
Depletion and depreciation	(61,457)	(847)	(1,544)	(63,848)
Derecognition, reclassifications and other	520	-	(465)	55
Balance at June 30, 2012	**$ (88,085)**	**$ (847)**	**$ (2,643)**	**$ (91,575)**
Carrying amounts				
At July 1, 2010	$ 75,810	$ -	$ 1,325	$ 77,135
At June 30, 2011	$ 87,582	$ -	$ 984	$ 88,566
At June 30, 2012	**$ 153,497**	**$ 30,898**	**$ 2,813**	**$ 187,208**

During the year ended June 30, 2012, $8.5 million (2011 - $nil) of compensation and other costs were capitalized, which reduced general and administrative and stock-based compensation expenses for the year.

In September 2010, the Corporation negotiated the disposition of its non-core, non-operated producing properties in Brazil for cash consideration of approximately $3.8 million, which have been presented as assets held for sale as at June 30, 2011. In July 2011, the Brazilian regulatory authorities approved the disposition of these non-operated producing properties and the Corporation recognized disposition adjustments, resulting in a loss on sale of Brazilian assets of $4.2 million.

NOTE 8 – PIPELINE INVESTMENT

The Corporation owns a 0.5% interest in the Oleoducto Bicentenario de Colombia ("OBC") pipeline project, operated by Ecopetrol, which will link Llanos basin oil production to the Cano Limon oil pipeline system. At June 30, 2012, the Corporation had contributed approximately $1.9 million (2011 - $1.6 million) of the capital commitment, which is recorded at cost. Under the terms of the OBC agreement, the Corporation may be required to provide financial support or guarantees for its proportionate equity interest in any future debt financings undertaken by OBC. Shareholders of OBC are obliged to execute a transport agreement at a set rate per barrel before the completion of the first phase of the project. The Corporation will also be eligible to receive any dividends on the project.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

In addition to the capital commitment above, at June 30, 2012, the Corporation had advanced $2.6 million (2011 - $1.0 million) to OBC for the initial pipeline construction. OBC has undertaken to secure bank financing to fund 70% of the pipeline costs, and re-pay the advances made by its investors. In exchange, the OBC investors are required to enter into ship-or-pay arrangements with OBC to guarantee pipeline revenues. As a result, the Corporation has reclassified $1.8 million of the advances to accounts receivable at June 30, 2012, which were received subsequent thereto.

NOTE 9 – RESTRICTED CASH

	June 30, 2012	June 30, 2011	July 1, 2010
Restricted cash – exploration commitments	$ 6,072	$ 12,604	$ 890
Restricted cash – decommissioning obligations	483	444	399
	$ 6,555	$ 13,048	$ 1,289

As required by the Agencia Nacional de Hidrocarburos ("ANH") in Colombia and the Agencia Nacional de Petroleo ("ANP") in Brazil, the Corporation is required to place funds in a trust in Colombian and Brazilian banks to ensure payment of its obligations pursuant to certain exploration agreements. In addition, the Corporation was required to place funds in trust for future decommissioning obligations with respect to its Entrerrios field in Colombia.

NOTE 10 – BANK DEBT

Term Facility – Gas Plant

In November 2011, the Corporation, through its wholly-owned subsidiary, Canacol Energy Colombia S.A. ("Canacol Colombia"), entered into a credit agreement for up to $32.0 million to fund the construction of a gas liquids separation facility at its Rancho Hermoso field. The facility was repayable in ten equal principal payments plus interest due at the end of each three month period starting on September 1, 2012. The facility bore interest at LIBOR plus 2.50% and is unsecured. In June 2012, the facility was replaced by the credit facility explained below. $30.0 million was drawn on the credit facility to fund the abovementioned construction costs immediately prior to its replacement.

Credit Facility

In June 2012, the Corporation, through Canacol Colombia, entered into an agreement for a total credit facility of $200.0 million with an approved $85.0 million borrowing base at the time. The credit facility included a reserve-based revolving facility of $55.0 million and a term facility of $30.0 million.

The revolving facility has a three-year term maturing on June 29, 2015 and is subject to re-determination of the borrowing base semi-annually on April 1 and October 1 each year. The borrowing base is determined based on, among other things, the Corporation's current reserve report, results of operations, the lender's view of the current and forecasted commodity prices and the current economic environment. Advances under the revolving facility bear interest at rates ranging from LIBOR plus 2.50% - 3.25% per annum, depending on utilization. Undrawn amounts under the revolving facility bear a commitment fee of 0.50% per annum.

The term facility bears interest at LIBOR plus 2.50% and is repayable in ten equal principal payments plus accrued interests due at the end of each three month period starting on September 1, 2012.

The combined credit facility is secured by the Corporation's oil and gas assets and reserves.

Other

In addition to the above, the Corporation had revolving lines of credit in place in Colombia with an aggregate borrowing base of $19.6 million (COP$ 38.1 billion). These lines of credit have interest rates ranging from 6% to 9% and are unsecured. At June 30, 2012, no amounts were drawn under the facilities.

At June 30, 2012, the Corporation had letters of credit outstanding totalling $14.0 million to guarantee work commitments on exploration blocks. The total of these letters of credit reduce the amounts available under the revolving lines of credit described above.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

NOTE 11 – OVERLIFTED VOLUMES

Under its contracts with Ecopetrol, the Corporation would normally deliver Ecopetrol's share of crude oil production volumes in kind at a designated delivery point. However, due to capacity restrictions at this delivery point, Ecopetrol typically takes delivery of its production volumes at the Rancho Hermoso field. Ecopetrol has not always been able to take delivery of its production volumes in kind and the Corporation has often been required to sell such volumes since sufficient on-site storage facilities were not available. When the Corporation sold these "overlifted" volumes, a liability was recorded for the amount of the sale and prepaid transportation was recorded for associated transportation costs. As overlifted volumes were to be delivered to Ecopetrol in future periods, the liability and prepaid transportation amounts were reduced with corresponding recognition of such amounts as revenue and transportation costs. Since the participation contract with Ecopetrol required delivery of production volumes in kind, the Corporation revalued the liability at each period-end to reflect the fair value of the crude oil owing to Ecopetrol at that time and gains or losses related to such were recognized in profit or loss in the period. In December 2011, the Corporation signed an agreement with Ecopetrol and repaid its outstanding overlifted volumes in cash for approximately $24.8 million, which reflected the actual sales value the Corporation received for the crude oil less actual transportation costs. Related to this settlement, the Corporation also commenced additional discussions with Ecopetrol regarding transportation tariffs on previous shipments of crude oil. Consequently, the Corporation has not recognized the finalization of the settlement of the overlifted volumes payable pending the outcome of those discussions.

A summary of overlifted volumes and the related net liability is provided below. At June 30, 2012, the Corporation did not have any overlifted volumes.

	June 30, 2012	June 30, 2011	July 1, 2010
Overlifted volumes (Mbbls)	-	368.4	-
Average valuation price ($/bbl)	$ -	$ 103.69	$ -
Overlifted volumes payable	$ -	$ 38,199	$ -
Less: transportation costs	-	(4,024)	-
Net payable on overlifted volumes	$ -	$ 34,175	$ -

NOTE 12 – DECOMMISSIONING OBLIGATIONS

Balance at July 1, 2010	$ 3,783
Accretion	196
Additions	1,450
Reclassified to liabilities held for sale	(888)
Change in estimate	-
Balance at June 30, 2011	4,541
Accretion	297
Additions	1,804
Change in estimate	-
Balance at June 30, 2012	**$ 6,642**

The Corporation's decommissioning obligations result from its ownership interest in petroleum and natural gas assets, including well sites, facilities, and gathering systems. The total decommissioning obligation is estimated based on the Corporation's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities, and the estimated timing of the costs to be incurred in future years. The Corporation has estimated the net present value of the decommissioning obligations to be $6.6 million at June 30, 2012 (June 30, 2011 - $4.5 million; July 1, 2010 - $3.8 million) based on an undiscounted total future liability of $8.7 million (June 30, 2011 - $4.7 million; July 1, 2010 - $3.5 million). These payments are expected to be made over the next 22 years with the majority of costs to be incurred between 2013 and 2017. The discount factor, being the risk-free rate related to the liability, is 5.0% (June 30, 2011 - 5.0%; July 1, 2010 - 5.0%) and the inflation rate is 3.2% (June 30, 2011 - 3.5%; July 1, 2010 - 5.0%).

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

NOTE 13 – CONVERTIBLE DEBENTURES

2015 Convertible Debentures

On July 16, 2010, the Corporation closed a Canadian dollar denominated convertible unsecured debenture financing for aggregate gross proceeds of $39.4 million (C$41.5 million) (the "2015 Debentures"). The 2015 Debentures bear interest at 8% per annum, payable semi-annually on the last day of June and December commencing on December 31, 2010. The 2015 Debentures mature on June 30, 2015 and are convertible at the holder's option into common shares of the Corporation at any time prior to the earlier of either the maturity date or the business day immediately preceding the date fixed by the Corporation for redemption at a conversion price of C$1.0526 per common share, being the ratio of 950 common shares per C$1,000 principal amount of 2015 Debentures. The 2015 Debentures are not redeemable prior to June 30, 2013. Transaction costs in connection with the financing were $1.9 million and were recognized in profit or loss.

The 2015 Debentures were recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss. A reconciliation of the 2015 Debentures is provided below.

Balance at July 1, 2010	$	-
Issuance of convertible debentures		39,385
Conversion to common shares		(21,800)
Unrealized loss		9,754
Foreign exchange loss		3,087
Balance at June 30, 2011		30,426
Unrealized gain		(3,335)
Foreign exchange gain		(1,710)
Balance at June 30, 2012	**$**	**25,381**

2011 Convertible Debentures

In September 2009, the Corporation closed a Canadian dollar denominated convertible unsecured subordinated debenture financing for aggregate gross proceeds of $3.7 million (C$4.0 million) (the "2011 Debentures"). The 2011 Debentures bear interest at 12% per annum, payable quarterly through the issue of common shares at a price equal to a 10% discount to the volume weighted-average trading price of the Corporation's common shares for the 10 trading days immediately preceding the quarterly interest payment date. The 2011 Debentures mature within 24 months of issuance and are convertible into common shares of the Corporation at the holder's option at a conversion price of C$0.36 per common share.

The 2011 Debentures were recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss. A reconciliation of the 2011 Debentures is provided below.

Balance at July 1, 2010	$	3,998
Conversion to common shares		(4,638)
Unrealized loss		1,588
Foreign exchange loss		80
Balance at June 30, 2011		1,028
Conversion to common shares		(767)
Gain on conversion to common shares		(261)
Balance at June 30, 2012	**$**	-

At June 30, 2012, no 2011 Debentures remained outstanding.

NOTE 14 –SHARE CAPITAL

Authorized

The Corporation is authorized to issue an unlimited number of common shares.

Issued and Outstanding

	Number (000s)		Amount
Balance at July 1, 2010	421,466	$	160,937
Issue of common shares	46,612		58,823
Issued on exercise of warrants	16,122		20,708
Issued on exercise of stock options	8,233		1,879
Issued on conversion of convertible debentures	18,835		27,159
Issued on interest payments for convertible debentures	89		119
Issued on conversion of restricted share units	280		365
Share issue costs	-		(3,008)
Transfer from other reserves for stock options exercised	-		2,750
Balance at June 30, 2011	511,637		269,732
Issued on exercise of stock options	1,247		535
Issued on conversion of convertible debentures	832		767
Issued on interest payments for convertible debentures	9		7
Issued to employees	140		130
Issued on conversion of restricted share units	380		491
Issued on Carrao acquisition	104,737		67,414
Issued on property acquisitions	5,057		4,468
Cancellation of common stocks [(1)]	(5,057)		(2,926)
Share issue costs	-		(127)
Transfer from other reserves for stock options exercised	-		284
Balance at June 30, 2012	**618,982**	**$**	**340,775**

(1) Actual cancellation occurred subsequent to June 30, 2012.

Warrants

	Number (000s)		Amount
Balance at July 1, 2010	16,122	$	10,702
Exercised	(16,122)		(10,702)
Balance at June 30, 2011	-		-
Issued on Carrao acquisition	3,287		1,548
Unrealized gain	-		(652)
Balance at June 30, 2012	**3,287**	**$**	**896**

The warrants outstanding at June 30, 2012 are exercisable into common shares of the Corporation at C$0.52 per share; 645,000 warrants expire on September 8, 2014 while the remaining 2,641,920 warrants expire on February 9, 2016 (note 5).

Equity Financing

In February 2011, the Corporation completed an equity financing for gross proceeds of $58.3 million (C$57.6 million) and net proceeds of $55.3 million (C$54.7 million). Pursuant to the financing, the Corporation issued 41,745,000 common shares at a price of C$1.38 per share. Share issue costs with respect to this financing were $3.0 million (C$3.0 million).

Gemini Royalty Interest

In 2009, the Corporation executed a series of agreements with Gemini Oil and Gas Fund II, L.P. ("Gemini") whereby Gemini agreed to invest up to $9.0 million to fund a portion of the Corporation's development and appraisal programs on its producing assets in Colombia in exchange for an overriding royalty on certain properties. Effective June 30, 2010, the Corporation agreed to acquire the overriding royalty back from Gemini for $21.4 million. On July 16, 2010, the Corporation settled the transaction through the issue 4,421,260 common shares and a cash payment of $18.0 million.

Other reserves

Balance at July 1, 2010	$	12,017
Stock-based compensation		12,019
Stock options exercised		(2,750)
Balance at June 30, 2011		21,286
Stock-based compensation		11,542
Conversion of restricted share units		(491)
Stock options exercised		(284)
Balance at June 30, 2012	**$**	**32,053**

Stock Options

The Corporation has a stock option program that entitles officers, directors and employees to purchase shares in the Corporation. Options are granted at the market price of the shares at the date of grant, have a five year term and vest over three years.

The number and weighted-average exercise prices of stock options are as follows:

	Number	**Weighted-Average Exercise Price**
	(000s)	(C$)
Balance at July 1, 2010	24,909	0.36
Granted	17,937	1.20
Exercised	(8,233)	0.33
Forfeited and cancelled	(445)	1.06
Balance at June 30, 2011	34,168	0.81
Granted	22,643	0.79
Exercised	(1,247)	0.30
Forfeited and cancelled	(584)	0.98
Balance at June 30, 2012	**54,980**	**0.79**

On July 17, 2012, the Corporation granted 3,719,198 stock options to its directors, officers and employees. The options have an exercise price of $0.45, which was the market price of the shares on July 17, 2012. The options have a five year term and vest over three years.

Information with respect to stock options outstanding at June 30, 2012 is presented below.

Stock Options Outstanding				Stock Options Exercisable	
Range of Exercise Prices	Number of Stock Options	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Stock Options	Weighted-Average Exercise Price
(C$)	(000s)	(years)	(C$)	(000s)	(C$)
$0.10 to $0.35	9,906	2.05	0.25	9,906	0.25
$0.36 to 0.70	11,528	3.30	0.56	11,061	0.56
$0.71 to $1.05	24,913	3.88	0.89	9,179	0.88
$1.06 to $1.40	1,520	3.39	1.21	815	1.22
$1.41 and higher	7,113	3.56	1.50	4,198	1.51
	54,980	**3.38**	**0.79**	**35,159**	**0.67**

The fair value of the stock options granted was estimated using the Black-Scholes option pricing model with the following weighted-average inputs:

Year ended June 30	2012	2011
Weighted-average fair value at grant date (C$)	**0.48**	0.57
Share price (C$)	**0.52 - 1.06**	0.88 - 1.68
Exercise price (C$)	**0.52 - 1.06**	0.88 - 1.68
Volatility	**55% - 82%**	52% - 126%
Option life	**5 years**	5 years
Dividends	**Nil**	Nil
Risk-free interest rate	**1.36% - 2.32%**	1.97% - 2.78%

A forfeiture rate of 5% (2011 – 5%) was used when recording stock-based compensation for the year ended June 30, 2012. Stock-based compensation expense of $7.1 million (2011 – $12.0 million) was expensed and $4.4 million (2011 – $nil) was capitalized during the year ended June 30, 2012.

Restricted Share Units

In June 2010, the Corporation issued 360,000 restricted share units to an officer. The restricted share units vest as to 25% every six months from the grant date over a period of two years. In November 2010, the Corporation issued 300,000 restricted share units to an employee. The restricted share units vest as to 33% every six months from the grant date over a period of 18 months.

	Number	Weighted-Average Grant Price
	(000s)	(C$)
Balance at July 1, 2010	360	0.75
Granted	300	1.77
Converted	(280)	1.21
Balance at June 30, 2011	380	1.21
Converted	(380)	1.21
Balance at June 30, 2012	-	-

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

NOTE 15 – FINANCE INCOME AND EXPENSE

Year ended June 30		**2012**		2011
Finance income				
Interest and other income	**$**	**50**	$	1,574
Finance expense				
Fair value adjustment on equity tax payable		**168**		105
Accretion on decommissioning obligations		**297**		196
Interest and other expense		**2,704**		4,510
		3,169		4,811
Net finance expense	**$**	**3,119**	$	3,237

NOTE 16 – EQUITY TAX

Equity tax represents a tax on the capital of Colombian corporations and branches of foreign corporations. The tax was approved by the Colombian government in December 2010 and was assessed for the calendar years 2011-2014 based on 6% of the net equity of the Corporation's Colombian entities as at January 1, 2011. The assessed amount of $5.2 million is payable in semi-annual instalments over the four-year period. The net present value of the assessed amount, being $4.7 million, was expensed on January 1, 2011. The equity tax expense is classified as an operating expense in the statement of operations since it is not based on income.

NOTE 17 – EARNINGS PER SHARE

Basic and diluted earnings per share were calculated as follows:

Year ended Jun 30		**2012**		2011
Net income (loss), basic and diluted	**$**	**18,556**	$	(27,430)
Weighted-average common share adjustments				
Weighted-average common shares outstanding, basic		**576,024**		464,110
Effect of stock options		**10,187**		-
Effect of warrants		**1,128**		-
Weighted-average common shares outstanding, diluted		**587,339**		464,110

For the year ended June 30, 2012, the effect of the conversion of convertible debentures on earnings per share was anti-dilutive. For the year ended June 30, 2011, all items were anti-dilutive due to the net loss for the year.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

NOTE 18 – INCOME TAXES

The following table reconciles income taxes calculated at the Colombian Statutory rate with actual income taxes:

Year ended Jun 30	2012	2011
Net income (loss) before taxes	$ 29,405	$ (22,606)
Statutory rates	25.75%	27.25%
Expected income taxes	$ 7,572	$ (6,160)
Effect on taxes resulting from:		
Non-deductible stock-based compensation	1,832	3,275
Tax differential on foreign jurisdictions	3,160	1,042
Change in unrecognized tax benefit, foreign exchange and other	(1,778)	6,667
Provision for income taxes	10,786	4,824
Current	15,206	20,797
Deferred	(4,420)	(15,973)
	10,786	4,824

The net deferred tax asset is comprised of:

	June 30, 2012	June 30, 2011
Tax base over net book value of plant, property and equipment	$ (11,582)	$ (1,610)
Timing differences on revenue and expenses recognition	9,339	(323)
Non-capital losses carried forward	24,327	18,578
Decommissioning liabilities	2,192	1,499
Overlifted volumes	-	12,606
Net capital losses and other	908	1,935
Deferred tax asset	25,184	32,685
Deferred tax asset not recognized	(24,558)	(22,937)
Net deferred tax asset	626	9,748

At June 30, 2012, the Corporation had non-capital losses carried forward of approximately $5.3 million available to reduce future years taxable income. At June 30, 2012, the Corporation had available deferred income tax assets of $23.8 million related to income tax pools in Canada, Guyana and Brazil that were not recognized in the financial statements due to uncertainties associated with its ability to utilize these balances in the future.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

NOTE 19 – KEY MANAGEMENT PERSONNEL COMPENSATION

The Corporation has determined that the key management personnel of the Corporation consists of its executive management and its Board of Directors. In addition to the salaries and fees paid to key management, the Corporation also provides compensation to both groups under its stock-based compensation plans. Compensation expenses paid to key management personnel were as follows:

Year ended June 30	2012	2011
Salaries	**3,006**	2,669
Termination benefits	**379**	-
Stock-based compensation	**4,139**	4,194
Key management personnel compensation	**7,524**	6,863

NOTE 20 – SUPPLEMENTED INFORMATION

The Corporation records crude oil sales net of royalties. Royalties incurred were as follows:

Year ended June 30		2012		2011
Royalties	**$**	**16,196**	$	6,275

Income taxes and interest paid were as follows:

Year ended June 30		2012		2011
Income taxes paid	**$**	**22,059**	$	12,838
Interest paid		**2,289**		2,682

Changes in non-cash working capital is comprised of:

Year ended June 30		2012		2011
Change in:				
Trade and other receivables	**$**	**756**	$	(30,315)
Prepaid expenses		**2,165**		(5,659)
Crude oil inventory		**4,212**		(10,018)
Trade and other payables		**23,946**		40,727
Overlifted volumes payable		**(31,111)**		-
Equity tax payable		**(1,047)**		-
Taxes payable		**(13,113)**		16,714
		(14,192)		11,449
Attributable to:				
Operating activities		**(32,224)**		9,394
Investing activities		**18,032**		2,055
	$	**(14,192)**	$	11,449

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

NOTE 21 – SIGNIFICANT SUBSIDIARIES

The Corporation has the following significant subsidiaries:

	Country of Incorporation	Ownership Interest June 30, 2012	Ownership Interest June 30, 2011
Canacol Energy Inc.	Canada	100%	100%
Canacol Energy Colombia S.A.	Colombia	100%	100%
Canacol Energy Inc. (Sucursal Colombia)	Colombia	100%	100%
Canacol Energy (Guyana) Inc.	Guyana	100%	100%
Carrao Energy Ltd.	Canada	100%	-
Brazalta Brazil Norte Ltda.	Brazil	100%	100%
Ice Peak Investments S.L.	Spain	100%	-

NOTE 22 – SEGMENTED INFORMATION

IFRS 8 requires operating segments be identified based on the Corporation's internal system for reporting information to senior management to allocate resources to the segments and to assess their performance.

The Corporation's reportable and geographical segments are Colombia, Corporate and Other. Corporate activities include the Corporation's corporate office in Canada. Other includes the Corporation's exploration and development activities in Brazil, Guyana and Ecuador. The accounting policies used for the reportable segments are the same as the Corporation's accounting policies.

For the purposes of monitoring segment performance and allocating resources between segments, the Corporation's executive officers monitor the tangible, intangible and financial assets attributable to each segment. All assets are allocated to reportable segments. The following tables show information regarding the Corporation's reportable segments.

	Colombia	Corporate	Other	Total
Year ended June 30, 2012				
Revenues	$ 184,904	$ -	$ -	$ 184,904
Expenses, excluding income taxes	(136,613)	(14,776)	(4,173)	(155,562)
	48,291	(14,776)	(4,173)	29,342
Income taxes	(10,786)	-	-	(10,786)
Net income (loss)	**$ 37,505**	**$ (14,776)**	**$ (4,173)**	**$ 18,556**
Capital expenditures, net	$ 176,706	$ 3,838	$ 5,588	$ 186,132
Year ended June 30, 2011				
Revenues	$ 108,794	$ -	$ 4,030	$ 112,824
Expenses, excluding income taxes	(95,243)	(25,122)	(15,065)	(135,430)
	13,551	(25,122)	(11,035)	(22,606)
Income taxes	(4,824)	-	-	(4,824)
Net income (loss)	**$ 8,727**	**$ (25,122)**	**$ (11,035)**	**$ (27,430)**
Capital expenditures, net	$ 60,617	$ 1,618	$ 13,735	$ 75,970

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

		Colombia		Corporate		Other		Total
As at June 30, 2012								
Total assets	$	314,394	$	61,922	$	30,512	$	406,828
Total liabilities	$	64,958	$	51,076	$	-	$	115,734
As at June 30, 2011								
Total assets	$	210,365	$	67,741	$	38,464	$	316,570
Total liabilities	$	90,601	$	33,040	$	2,201	$	125,842

Major customers are customers which represent more than 10% of total revenue for a given period. For the year ended June 30, 2012, three major customers represented 48%, 26% and 18% of total revenue, respectively. For the year ended June 30, 2011, two major customers represented 71% and 16% of total revenue, respectively.

NOTE 23 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value of Financial Instruments

The carrying values and respective fair values of financial assets and liabilities at June 30, 2012 are summarized as follows:

		Carrying Value		Fair Value
Fair value through profit or loss				
Cash and cash equivalents	$	30,789	$	30,789
Restricted cash		6,555		6,555
Convertible debentures		25,381		25,381
Commodity contracts liabilities		427		427
Embedded derivatives asset		7,098		7,098
Warrants		896		896
Loans and receivables				
Bank debt		27,986		30,000
Trade and other receivables		32,801		32,801
Other liabilities				
Trade and other payables		47,602		47,602

The Corporation classifies the fair value of financial instruments measured at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Corporation's financial instruments have been assessed on the fair value hierarchy described above. Cash and cash equivalents and convertible debentures are classified as Level 1. Commodity contracts payable are classified as Level 2. Warrants and embedded derivatives asset are classified as Level 3. Assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the placement within the fair value hierarchy level.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

Market Risk

Market risk is the risk that changes in market factors, such as commodity prices, foreign exchange rates, and interest rates will affect the Corporation's cash flows, profit or loss, liquidity or the value of financial instruments. The objective of market risk management is to mitigate market risk exposures where considered appropriate and maximize returns.

(i) Commodity Price Risk

Commodity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in commodity prices. Lower commodity prices can also impact the Corporation's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. From time to time the Corporation may attempt to mitigate commodity price risk through the use of financial derivatives. The Corporation's policy is to only enter into commodity contracts considered appropriate to a maximum of 50% of forecasted production volumes.

During the year ended June 30, 2012, the Corporation had entered into four financial oil collars under the following terms:

Period	Volume	Type	Price Range
Dec 2011 – Jun 2012	1,000 bbls/day	Financial WTI Oil Collar	$85.00 – $108.50
Jul 2012 – Jun 2013	750 bbls/day	Financial Brent Oil Collar	$85.00 – $107.50
Jul 2012 – Jun 2013	750 bbls/day	Financial Brent Oil Collar	$85.00 – $106.80
Jul 2013 – Dec 2013	500 bbls/day	Financial Brent Oil Collar	$85.00 – $107.50
Jul 2013 – Dec 2013	500 bbls/day	Financial Brent Oil Collar	$85.00 – $106.80

Gains and losses on commodity contracts recognized in profit or loss during the period are summarized below:

Year ended June 30		2012		2011
Unrealized change in fair value	$	150	$	(812)
Realized cash settlement		-		(1,000)
Total gain (loss)	$	150	$	(1,812)

For the year ended June 30, 2012, a $1.00/bbl increase/decrease in the price of a barrel of crude oil is estimated to increase/decrease the Corporation's earnings by $971,000 (2011 - $705,000) assuming all other variables are held constant.

(ii) Foreign Currency Risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. The Corporation is exposed to foreign currency fluctuations as certain expenditures are denominated in Colombian pesos, Brazilian reais and Canadian dollars.

The Corporation had no forward exchange rate contracts in place as at or during the year ended June 30, 2012.

For the year ended June 30, 2012, a 1% increase/decrease in the US dollar vis-à-vis the Colombian peso and Canadian dollar is estimated to increase/decrease the Corporation's earnings by $251,000 and $99,000 (2011 - $59,000 and $168,000), respectively, assuming all other variables are held constant.

The Corporation's sensitivity to Brazilian reais in the years ended March 31, 2012 and 2011 was immaterial.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

(iii) Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate risk on certain variable interest rate debt instruments, to the extent they are drawn. The remainder of the Corporation's financial assets and liabilities are not exposed to interest rate risk. The Corporation had no interest rate swap or financial contracts in place as at or during the year ended June 30, 2012.

For the year ended June 30, 2012, a 1% increase/decrease in interest rate is estimated to increase/decrease the Corporation's earnings by $101,000, assuming all other variables are held constant. The Corporation's sensitivity to interest rate fluctuation for the year ended June 30, 2011 was immaterial.

Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. The Corporation's approach to managing liquidity is to ensure, within reasonable means, sufficient liquidity to meet its liabilities when due, under both normal and unusual conditions, without incurring unacceptable losses or jeopardizing the Corporation's business objectives. The Corporation prepares annual capital expenditure budgets which are monitored regularly and updated as considered necessary. Crude oil production is monitored daily to provide current cash flow estimates and the Corporation utilizes authorizations for expenditures on projects to manage capital expenditures.

The following table outlines the contractual maturities of the Corporation's financial liabilities at June 30, 2012:

	Less than 1 year	1-2 years	Thereafter	Total
Bank debt – principal	12,000	18,000	-	30,000
Trade and other payables	47,602	-	-	47,602
Equity tax payable – undiscounted	1,236	1,854	-	3,090
Convertible debentures – principal	-	-	25,519	25,519
Commodity contracts	303	124	-	427
Warrants	896	-	-	896
	62,037	19,978	25,519	107,534

In addition to the above, the Corporation has issued letters of credit totalling $14.0 million to guarantee certain obligations under its exploration contracts. Such amounts only become payable should the Corporation not meet those obligations.

Credit Risk

Credit risk reflects the risk of loss if counterparties do not fulfill their contractual obligations. The majority of the Corporation's trade accounts receivable balances relate to crude oil sales. The Corporation's policy is to enter into agreements with customers that are well established and well financed entities in the oil and gas industry such that the level of risk is mitigated. To date, the Corporation has not experienced any material credit loss in the collection of trade accounts receivable. In Colombia, a significant portion of crude oil sales and tariff oil revenue are with customers that are directly or indirectly controlled by the government. The Corporation has also entered into sales agreements with certain Colombian private sector companies.

Aging of trade receivables:	June 30, 2012	June 30, 2011
Less than 30 days	$ 5,111	$ 26,550
31 – 60 days	-	21
61 – 90 days	-	90
Over 90 days	-	46
	$ 5,111	$ 26,707

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

The Corporation's trade receivables primarily relate to sales of crude oil, which are normally collected within 45 days of the month of production. The Corporation has historically not experienced any collection issues with its crude oil customers.

Capital Management

The Corporation's policy is to maintain a strong capital base in order to provide flexibility in the future development of the business and maintain investor, creditor and market confidence. The Corporation manages its capital structure and makes adjustments in response to changes in economic conditions and the risk characteristics of the underlying assets. The Corporation considers its capital structure to include common share capital, convertible debentures, bank debt and working capital, defined as current assets less current liabilities, excluding the current portion of commodity contracts and the current portion of any embedded derivatives asset/liability. In order to maintain or adjust the capital structure, from time to time the Corporation may issue common shares or other securities, sell assets or adjust its capital spending to manage current and projected debt levels.

The Corporation monitors leverage and adjusts its capital structure based on the ratio of net debt to annual cash flow from operations before changes in non-cash working capital ("funds from operations"). This ratio is calculated as net debt, defined as the principal amount of its outstanding bank debt plus the principal amount of its convertible debentures, unless the debentures are in-the-money, less working capital, adjusted for the current portion of bank debt and convertible debentures included above, divided by funds from operations. The Corporation uses the ratio of net debt to funds from operations as a key indicator of the Corporation's leverage and to monitor the strength of its financial position. In order to facilitate the management of this ratio, the Corporation prepares annual budgets, which are updated as necessary depending on varying factors including current and forecast crude oil prices, changes in capital structure, execution of the Corporation's business plan and general industry conditions. The annual budget is approved by the Board of Directors and updates are prepared and reviewed as required.

	June 30, 2012	June 30, 2011
Bank debt (current and long-term) – principal	$ 30,000	$ -
Convertible debentures – principal	25,519	41,900
Working capital deficiency (surplus), excluding the current portion of bank debt and convertible debentures	(29,697)	(94,547)
Net debt (surplus)	25,822	(52,647)
Funds from operations for the year ended June 30	$ 68,965	$ 41,378
Net debt to cash flows from operations	0.4	n/a

NOTE 24 – COMMITMENTS AND CONTINGENCIES

Presented below are the Corporation's contractual commitments at June 30, 2012:

	Less than 1 year	1-3 years	Thereafter	Total
Exploration contracts (1)	22,440	27,327	-	49,767
Incremental production contract (2)	9,000	48,700	29,800	87,500
Office lease	1,213	1,759	5,866	8,838
	32,653	77,786	35,666	146,105

(1) Pursuant to exploration contracts, the Corporation has work commitments totalling $49.8 million to be completed during the next three years. The work commitments are normal course of business exploration activities that include property costs, acquisition and processing of seismic data and drilling exploration wells. The Corporation has issued letters of credit totalling $14.0 million to guarantee the obligations under these exploration contracts.

(2) In February 2012, a company in which the Corporation has a non-operated 25.0% equity participation interest (27.9% capital participation interest) was awarded a 15 year incremental production contract by the national oil company of Ecuador ("Petroecuador" or "EPPE") for the Libertador and Atacapi mature fields in Northern Ecuador. The operator is required to spend a total of $334.0 million ($93.3 million, net to the Corporation) over the 15 year period of the contract. In return for increased production at EPPE's mature fields, the operator will receive a fixed price tariff of $39.53 for each incremental barrel of oil produced, which is insensitive to oil price fluctuations. All operating expenses are paid for by EPPE.

Trucking Contract

The Corporation has signed an agreement with a Colombian trucking company for the exclusive use of 100 trucks for transportation of crude oil from the Corporation's operations in Colombia for a period of three years. The Corporation will pay transportation fees plus an additional 7.5% for administrative costs. Any excess or shortage of the fees charged over the actual operating costs will be shared equally between the Corporation and the trucking company at the end of each year. The Corporation has the option to purchase up to 50 trucks at the end of the three year agreement.

The Corporation's share of excess fees charged over the term of the contract was discounted and recognized as an embedded derivatives asset of $7.1 million as at June 30, 2012.

Contingencies

In the normal course of operations, the Corporation has disputes with industry participants for which it currently cannot determine the ultimate results. The Corporation has a policy to record contingent liabilities as they become determinable and the probability of loss is more likely than not.

During the year ended June 30, 2012, the Corporation settled a legal claim related to trespass. The Corporation paid a total settlement of $1.8 million, of which $0.2 million was related to the purchase of the plaintiff's property.

NOTE 25 – SUBSEQUENT EVENT

On July 17, 2012, the Corporation granted 3,719,198 stock options its directors, officers and employees (Note 14).

NOTE 26 – TRANSITION TO IFRS

The Corporation adopted IFRS on July 1, 2011 with a transition date of July 1, 2010. This note sets out how the transition from Canadian GAAP to IFRS has affected the Corporation's financial position and comprehensive income (loss). The accounting policies set out in note 4 have been applied in preparing the financial statements for the year ended June 30, 2012, the comparative information presented in these financial statements for the year ended June 30, 2011, and in the preparation of an opening IFRS statement of financial position at July 1, 2010 (the "Transition Date").

IFRS employs a conceptual framework that is similar to Canadian GAAP. While the adoption of IFRS has not changed the actual cash flows of the Corporation, the adoption has resulted in changes to the reported financial position and results of operations of the Corporation. The differences between IFRS and Canadian GAAP that affect the Corporation are described in the notes following the reconciliation tables below.

Under IFRS 1 "First Time Adoption of International Financial Reporting Standards", IFRS is applied to all accounts retrospectively at the Transition Date unless a specific exemption was available and is taken. The following are the significant exemptions the Corporation has elected to apply:

Deemed cost exemption for property, plant and equipment – The Corporation has elected to report items of property, plant and equipment on Transition Date at deemed cost instead of the actual cost that would be determined under IFRS. The deemed cost of an item may be either its fair value at the Transition Date or an amount determined by a previous revaluation under Canadian GAAP. The exemption can be applied on an asset-by-asset basis. Petroleum and natural gas assets that were part of the full cost pool and determined to be developed or producing assets were allocated to CGUs on the Transition Date pro rata using proved plus probable reserve volumes, subject to an impairment test on the Transition Date.

Share-based payments – The Corporation has elected not to apply IFRS 2 "Share-Based Payments", to equity instruments which vested before the Transition Date. As such, adjustments were made only to share-based payments that were granted before the Transition Date but had not vested.

Decommissioning obligations – In accounting for changes in obligations to dismantle, remove and restore items of property, plant and equipment, the guidance under IFRS requires changes in such obligations to be added to or deducted from the cost of the asset to which it relates. The adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. Rather than recalculating the effect of all such changes throughout the life of the obligations, the Corporation has elected to measure the liability and the related depreciation effects at the Transition Date.

Borrowing costs – The Corporation applied an IFRS transitional exemption to prospectively capitalize borrowing costs from the Transition Date.

Cumulative translation differences – The Corporation elected to set the cumulative translation account, which is included in accumulated other comprehensive income, to $nil at July 1, 2010. This exemption has been applied to all subsidiaries.

Business combinations – IFRS allows entities to apply IFRS 3 on business combinations to transactions which take place subsequent to the IFRS transition date without retrospectively restating any transactions that occurred prior to that date. The Corporation has taken this exemption and has not applied IFRS 3 to any business combinations that occurred prior to July 1, 2010. Accordingly, no amounts have been adjusted for previous business combinations.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

Reconciliation of statement of financial position from Canadian GAAP to IFRS

At the date of IFRS transition – July 1, 2010:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
ASSETS				
Current assets				
Cash and cash equivalents		$ 56,240	$	$ 56,240
Restricted cash		890		890
Trade and other receivables		7,266		7,266
Prepaid expenses and deposits		563		563
Commodity contracts		227		227
Crude oil inventory		2,330		2,330
		67,516		67,516
Non-current assets				
Restricted cash		399		399
Trade and other receivables		395		395
Exploration and evaluation assets	a	-	11,913	11,913
Property, plant and equipment	a,e	90,452	(13,317)	77,135
		91,246	(1,404)	89,842
Total assets		**$ 158,762**	**$ (1,404)**	**$ 157,358**
LIABILITIES AND EQUITY				
Current liabilities				
Bank debt		$ 322	$	$ 322
Trade and other payables		32,587		32,587
Taxes payable		292		292
Warrants	g	-	10,267	10,267
		33,201	10,267	43,468
Non-current liabilities				
Decommissioning obligations	b	2,899	884	3,783
Convertible debentures	f	1,145	2,853	3,998
Warrants	g	-	435	435
Deferred tax liabilities	d	7,864	(1,937)	5,927
Total liabilities		**$ 45,109**	**$ 12,502**	**$ 57,611**
Equity				
Share capital	g	$ 161,535	$ (598)	$ 160,937
Other reserves	c	12,088	(71)	12,017
Equity component of convertible debentures	f	159	(159)	-
Accumulated other comprehensive loss	a	(842)	842	-
Deficit		(59,287)	(13,920)	(73,207)
Total equity		113,653	(13,906)	99,747
Total liabilities and equity		**$ 158,762**	**$ (1,404)**	**$ 157,358**

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

Reconciliation of statement of financial position from Canadian GAAP to IFRS

At the end of the last reporting year under Canadian GAAP – June 30, 2011:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
ASSETS				
Current assets				
Cash and cash equivalents		$ 101,627	$	$ 101,627
Restricted cash		12,604		12,604
Trade and other receivables		37,976		37,976
Prepaid expenses and deposits		2,198		2,198
Prepaid transportation on overlifted volumes		4,024		4,024
Assets held for sale – Brazil	i	-	3,828	3,828
Crude oil inventory		12,348		12,348
		170,777	3,828	174,605
Non-current assets				
Restricted cash		444		444
Exploration and evaluation assets	a	-	33,603	33,603
Property, plant and equipment	a,e	125,260	(36,694)	88,566
Pipeline investment		2,589		2,589
Deferred tax assets		16,763		16,763
		145,056	(3,091)	141,965
Total assets		**$ 315,833**	**$ 737**	**$ 316,570**
LIABILITIES AND EQUITY				
Current liabilities				
Trade and other payables		$ 22,208	$	$ 22,208
Commodity contracts		577		577
Overlifted volumes payable		38,199		38,199
Equity tax payable	h	1,239	(59)	1,180
Assets held for sale – Brazil	i	-	888	888
Taxes payable		17,006		17,006
		79,229	829	80,058
Non-current liabilities				
Decommissioning obligations	b	4,400	141	4,541
Convertible debentures	f	19,657	11,797	31,454
Equity tax payable	h	3,211	(437)	2,774
Deferred tax liabilities	d	9,038	(2,023)	7,015
Total liabilities		**$ 115,535**	**$ 10,307**	**$ 125,842**
Equity				
Share capital	f,g	$ 243,733	$ 25,999	$ 269,732
Other reserves	c	21,783	(497)	21,286
Equity component of convertible debentures	f	5,427	(5,427)	-
Accumulated other comprehensive loss	a	(495)	842	347
Deficit		(70,150)	(30,487)	(100,637)
Total equity		200,298	(9,570)	190,728
Total liabilities and equity		**$ 315,833**	**$ 737**	**$ 316,570**

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

Reconciliation of statement of operations and comprehensive loss from Canadian GAAP to IFRS

For the year ended June 30, 2011:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
Revenue				
Crude oil sales, net of royalties		$ 91,680	$	$ 91,680
Tariff revenue		21,144		21,144
		112,824		112,824
Expenses				
Operating and transportation		39,213		39,213
General and administrative		13,995		13,995
Stock-based compensation	c	12,202	(183)	12,019
Depletion, depreciation and amortization	b,e	32,463	(7,427)	25,036
Loss on convertible debentures	f	-	16,256	16,256
Loss on overlifted volumes payable		5,093		5,093
Foreign exchange (gain) loss		(2,976)	3,046	70
(Gain) loss on commodity contracts		1,812		1,812
Impairment loss on assets	i	9,673	4,353	14,026
Equity tax	h	5,169	(496)	4,673
		116,644	15,549	132,193
Net finance expense	b,g,h	1,835	1,402	3,237
Loss before income taxes		**(5,655)**	**(16,951)**	**(22,606)**
Income tax expense (reduction)		5,208	(384)	4,824
Net loss for the year		**(10,863)**	**(16,567)**	**(27,430)**
Other comprehensive income				
Foreign currency translation adjustment		(347)		(347)
Comprehensive loss for the year		**$ (10,516)**	**$ (16,567)**	**$ (27,083)**

The adoption of IFRS did not impact the amounts reported as operating, investing or financing cash flows in the consolidated statements of cash flows.

Notes to IFRS Reconciliations

a) Reclassifications

(i) Exploration and Evaluation ("E&E") Assets

E&E assets consist of the Corporation's exploration projects where technical feasibility and commercial viability have not yet been determined. Under Canadian GAAP, these costs were grouped with property, plant and equipment. Under IFRS, E&E assets are classified as a separate line in the statement of financial position; and the remaining full cost pool was allocated to the producing/development assets and components pro rata using proved plus probable reserve volumes. This resulted in an $11.9 million increase in E&E assets at the Transition Date with a corresponding decrease in property, plant and equipment.

(ii) Accumulated Other Comprehensive Income

On Transition Date, the Corporation elected to reclassify foreign exchange translation losses included in other comprehensive income recognized under Canadian GAAP to deficit. These accumulated translation differences were generated when the Corporation changed its reporting currency from the Canadian dollar to the United States dollar on June 30, 2010. As a result, accumulated other comprehensive income at July 1, 2010 was reclassified to deficit.

b) Decommissioning Obligations

Under Canadian GAAP, asset retirement obligations were discounted at a credit adjusted risk free rate of 7.5% for Canadian assets and 9.5% for Colombian and Brazilian assets. Under IFRS, the estimated cash flows to abandon and remediate the wells and facilities has been risk adjusted; therefore the provision is discounted at a risk free rate of 5% for Colombian and Brazilian assets. Upon transition to IFRS, this resulted in a $0.9 million increase in decommissioning obligations with a corresponding increase in deficit.

As a result of the change in decommissioning obligations, accretion expense increased by $1.1 million during the year ended June 30, 2011 under IFRS compared to Canadian GAAP. Under Canadian GAAP, accretion of the discount was included in depletion and depreciation. Under IFRS, it is included in net finance expenses.

Under Canadian GAAP, expenditures on remediation and abandonment were not included in changes in non-cash working capital as is done under IFRS.

c) Stock-Based Compensation

Under Canadian GAAP, the Corporation did not incorporate a forfeiture rate when determining the fair value of stock options and restricted share units. Under IFRS, the Corporation is required to estimate a forfeiture rate.

Restricted share units are considered equity-settled awards under IFRS and the fair value determined at the grant date is recognized over the vesting period of the awards. Under Canadian GAAP, the awards were valued at the trading price of the underlying common shares at each reporting date, with changes in fair value recorded in profit and loss.

d) Deferred Taxes

The change in the deferred tax liability is mainly the result of the change in the accounting basis of the decommissioning liability on transition to IFRS, the change in accounting basis of property, plant and equipment, and as a result of decreased depletion and the change in accounting for foreign exchange gains and losses resulting from taxes denominated in foreign currencies.

e) Depletion

Upon transition to IFRS, the Corporation adopted a policy of depleting petroleum and natural gas interests on a units-of-production basis over proved plus probable reserves. The depletion policy under Canadian GAAP was based on units-of-production over proved reserves. Further, depletion was performed by country under Canadian GAAP whereas IFRS requires depletion and depreciation to be calculated based on individual components (i.e. fields or combinations thereof).

f) Convertible Debentures

Under Canadian GAAP, the convertible debentures were classified as a compound financial instrument whereby the instrument was bifurcated into debt and equity components and the equity component was recognized at its fair value. Under IFRS, the convertible debenture is considered a derivative liability and is required to be fair valued at each reporting period, with changes in that fair value being recorded in profit or loss. Further, conversions are recognized in share capital at the fair value of the shares issued, with any difference from the carrying value recorded in profit or loss..

g) Warrants

Under Canadian GAAP, the warrants were classified as a component of equity. Under IFRS, because the specified exercise price is denominated in Canadian dollars (a currency other than the functional currency of the Corporation), the warrants are considered derivative liabilities. The warrants are required to be fair valued at each reporting period, with changes in that fair value being recorded in profit or loss.

h) Equity Tax Payable

IFRS requires discounting of liabilities where the impact is considered significant. As the equity tax is scheduled to be paid over a three year term, the liability has been discounted.

i) Assets Held for Sale – Brazil

Certain non-core, non-operated producing assets in Brazil have been presented as assets held for sale following the commitment of the Corporation’s management, on September 1, 2010, to a plan to sell such assets. Effective September 1, 2010, depletion charges ceased and an impairment charge was recorded to reflect the fair value of the assets. The impairment was recorded in profit or loss in the year ended June 30, 2011.