

Veraz Petroleum Ltd.
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Veraz Petroleum Ltd.

We have audited the accompanying consolidated financial statements of Veraz Petroleum Ltd., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of operations, comprehensive income (loss) and deficit, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

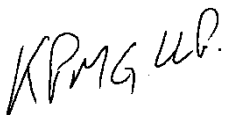
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Veraz Petroleum Ltd. as at December 31, 2010 and 2009, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Calgary, Canada
April 8, 2011

Veraz Petroleum Ltd.
Consolidated Balance Sheets
As at December 31

	2010	2009
Assets		
Current assets		
Cash	\$ 16,048,388	\$ 3,937,687
Accounts receivable	191,571	4,092,046
Prepaid expenses and deposits	48,408	38,697
	<u>16,288,367</u>	<u>8,068,430</u>
Property and equipment (note 4)	<u>2,514,193</u>	<u>9,508,329</u>
	<u>\$ 18,802,560</u>	<u>\$ 17,576,759</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 730,015	\$ 7,913,425
Loan payable (note 4c)	-	8,121,007
	<u>730,015</u>	<u>16,034,432</u>
Shareholders' Equity		
Share capital (note 5)	21,902,175	9,786,106
Warrants (note 5)	1,979,990	-
Contributed surplus (note 6)	2,383,639	2,087,839
Deficit	(7,592,907)	(9,809,577)
Accumulated other comprehensive loss	(600,352)	(522,041)
	<u>(8,193,259)</u>	<u>(10,331,618)</u>
	<u>18,072,545</u>	<u>1,542,327</u>
	<u>\$ 18,802,560</u>	<u>\$ 17,576,759</u>

Commitments (note 8)

Approved by the Board

_____, Director
 "Trevor Mitzel"

_____, Director
 "Paul Baay"

The accompanying notes are an integral part of these consolidated financial statements.

Veraz Petroleum Ltd.**Consolidated Statement of Operations, Comprehensive Income (Loss) and Deficit
For the years ended December 31**

	2010	2009
Interest income	\$ 10,411	\$ 47
Expenses		
General and administrative	1,911,981	1,362,672
Foreign exchange gain	(104,398)	(418,107)
Interest on loan payable (note 4c)	194,966	42,475
Interest on note payable	-	321,346
Stock - based compensation (note 5)	295,800	228,271
Depreciation	14,017	10,703
	<u>2,312,366</u>	<u>\$ 1,547,360</u>
Gain on disposition of unproven property (note 4)	4,518,625	-
Net income (loss) for the year	2,216,670	(1,547,313)
Other comprehensive loss		
Cumulative translation adjustment	(78,311)	(450,599)
Comprehensive income (loss) for the year	<u>2,138,359</u>	<u>\$ (1,997,912)</u>
Deficit, beginning of year	\$ (9,809,577)	\$ (8,262,264)
Net income (loss) for the year	2,216,670	(1,547,313)
Deficit, end of year	<u>\$ (7,592,907)</u>	<u>\$ (9,809,577)</u>
Income (loss) per share, basic (note 5)	\$ 0.06	\$ (0.05)
Income (loss) per share, diluted (note 5)	\$ 0.06	\$ (0.05)

The accompanying notes are an integral part of these consolidated financial statements.

Veraz Petroleum Ltd.

Consolidated Statement of Cash Flows

For the years ended December 31, 2010 and 2009

	2010	2009
Operating activities		
Net income (loss) for the year	\$ 2,216,670	\$ (1,547,313)
Items not affecting cash		
Gain on disposition of unproven property (note 4)	(4,518,625)	
Unrealized foreign exchange gains	(66,260)	(322,564)
Stock-based compensation (note 6)	295,800	228,271
Interest on loan payable (note 4)	194,966	42,475
Depreciation	14,017	10,703
	<u>(1,863,432)</u>	<u>(1,588,428)</u>
Changes in non-cash working capital	<u>(6,991,237)</u>	<u>7,714,015</u>
	<u>(8,854,669)</u>	<u>6,125,587</u>
Investing activities		
Property and equipment expenditures	(163,887)	(6,281,272)
Proceeds from sale of working interest (note 4)	2,256,750	524,252
Changes in non-cash working capital	3,878,784	(4,366,223)
	<u>5,971,647</u>	<u>(10,123,243)</u>
Financing activities		
Proceeds from share issue (note 5)	15,330,000	-
Share issue costs (note 5)	(1,233,941)	(5,433)
Proceeds from note payable	-	3,204,726
Proceeds from loan payable (note 4)	979,647	3,533,030
Changes in non-cash working capital	-	136,484
	<u>15,075,706</u>	<u>6,868,807</u>
Effect of exchange rate changes on cash	<u>(81,983)</u>	<u>(70,382)</u>
Increase in cash	12,110,701	2,800,769
Cash, beginning of year	<u>3,937,687</u>	<u>1,136,918</u>
Cash, end of year	<u>\$ 16,048,388</u>	<u>\$ 3,937,687</u>

The accompanying notes are an integral part of these consolidated financial statements.

Veraz Petroleum Ltd.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

1. Nature of operations

Veraz Petroleum Ltd. ("Veraz" or the "Company") is a junior resource exploration stage company that focuses its business activities on international oil and gas exploration and development. The Company has entered into formal agreements (the "Exploration Agreements") to explore Ucayali Blocks 126 and 161 located in east central Peru, and Block 141 located in the Titicaca Basin of Peru.

Notwithstanding income earned in the current period, the Company has experienced recurring losses, has not generated profitable operations and as at December 31, 2010, has accumulated losses of \$7,592,907 since inception. Current oil and gas activities are in the exploration stage and have not identified oil and gas reserves. Continuing operations are dependent on attaining commercial production and profitable operations from its oil and gas properties as well as raising sufficient capital to complete ongoing exploration and development activities.

2. Basis of Presentation and Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. ("Canadian GAAP")

The consolidated financial statements include the accounts of the Company and its two wholly - owned subsidiaries, Veraz Petroleum Peru S.A.C. (formerly North American Vanadium Peru S.A.C.), incorporated under the laws of Peru on August 17, 2006 and acquired by the Company on November 22, 2006, and Veraz Petroleum (Barbados) Ltd., incorporated under the laws of Barbados on October 24, 2008. All significant inter-company transactions and balances have been eliminated.

Cash and Cash Equivalents

Cash includes cash on hand and demand deposits. Cash equivalents include short - term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. At December 31, 2010 and 2009, the Company did not hold any cash equivalents.

Property and Equipment

Oil & Gas Properties

The Company follows the full cost method of accounting for oil and gas properties and facilities whereby all costs associated with the acquisition, exploration for and development of petroleum and natural gas properties and related reserves are capitalized. Such costs include all direct costs relating to the development of the oil and gas properties, the cost of the acquisition of leases, and exploration and development and administrative costs directly related to development activities. As the Company's oil and gas activities are in the pre-production stage, any incidental revenues are netted against costs until commercial production begins. These costs are evaluated in each reporting period to determine if the costs recorded are recoverable. Any costs that are considered unlikely to be recovered are written off. If commercial production begins, these capitalized costs will be depleted following the unit-of-production method based on proved reserves. Any gain or loss on disposition of unproven properties would be recognized on a relative basis.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

2. Basis of Presentation and Accounting Policies (continued)

The carrying values of oil and gas properties may not reflect their future value. In particular, the future value of the oil and gas properties depends on the start-up of commercial production, the ability of the Company to obtain adequate financing and the future profitability of the oil and gas properties.

A limit is placed on the carrying value of the net capitalized assets in order to test impairment. The Company is required to perform this impairment test at least annually. An impairment loss may be indicated when the carrying value of the assets exceeds the estimated undiscounted future net cash flows associated with the asset's proved reserves. If there is indication of an impairment loss, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the asset's proved plus probable reserves are charged to depletion, depreciation and accretion on the statement of operations.

Other Assets

Equipment is stated at cost less accumulated depreciation. Depreciation is charged to operations based on the estimated useful life of the asset and is calculated as follows:

Office equipment	20% diminishing balance basis
Computer equipment	30% straight line basis

Joint Interest Operations

The Company's exploration and development activities are conducted jointly with others. These financial statements reflect only the Company's interest in such activities.

Income Taxes

Income taxes are accounted for using the asset and liability method of income tax allocation. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values. Income tax assets are also recognized for the benefits from tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on substantively enacted tax laws and rates that are anticipated to apply in the period of realization.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

2. Basis of Presentation and Accounting Policies (continued)

Asset Retirement Obligations

The fair value of obligations associated with the retirement of tangible long-lived assets is recorded in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset. At December 31, 2010 and 2009, the asset retirement obligation has been determined to be \$NIL as the Company's exploration activities have been limited to geological and geophysical work.

Stock - Based Compensation

The Company uses the fair value method to account for all stock-based payments to employees and non-employees by measuring the compensation cost of the stock-based payments using the Black-Scholes option-pricing model. The fair value of stock-based compensation is recorded as a charge to net earnings based on the vesting period with a credit to contributed surplus. The fair value of each option granted will be estimated using the Black-Scholes option pricing model that takes into account, on the date of grant; the exercise price and expected life of the option; the price of the underlying security; the expected volatility and dividends (if any) on the underlying security; and the risk-free interest rate. Upon exercise of the stock options, consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest, rather, the Company accounts for actual forfeitures as they occur.

Per Share Information

Per share amounts are calculated by dividing the earnings (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated using the treasury stock method. Under the treasury stock method only instruments with exercise amounts less than market prices impact the diluted calculations. It is also assumed that any proceeds obtained upon the exercise of options and the unrecognized portion of stock-based compensation costs would be used to repurchase shares at the weighted average market price during the period. The weighted average number of shares is then reduced by the number of shares repurchased.

Revenue Recognition

Interest income is recognized as earned on a time proportion basis.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
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2. Basis of Presentation and Accounting Policies (continued)

Financial Instruments

All financial assets and liabilities are recognized on the balance sheet when the Company becomes a party to the contractual provisions of the instrument and are initially recognized at fair value. Subsequent measurement of the financial instruments is based on their classification. The classification depends on the characteristics and the purpose for which the financial instruments were acquired.

Financial assets are classified into one of four categories which are accounted for as follows:

- Held – to - maturity investments (measured at amortized cost);
- Loans and receivables (measured at amortized cost);
- Held for trading assets (measured at fair value with changes in fair value recognized in earnings immediately);
- Available – for - sale assets (measured at fair value with changes in fair value accumulated in Other Comprehensive Income until the asset is sold or impaired).

Financial liabilities, which include long – term debt and other similar instruments, must be measured at their amortized cost, except for those items classified as held for trading, which must be measured at fair value.

Principles of Consolidation and Translation of Foreign Currencies

The consolidated financial statements include the amounts of the Company and its subsidiaries, all of which are wholly-owned and are accounted for as self - sustaining operations. The Company has adopted the current rate method of foreign currency translation. Under this method, revenues and expenses are translated using the average exchange rates for the applicable period, assets and liabilities are translated using the exchange rates in effect on the balance sheet dates, and shareholder's equity is translated using historical rates in effect at the date of each transaction. Resulting exchange differences are reported as a separate component of other comprehensive income.

Use of Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's best estimate as additional information becomes available.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

2. Basis of Presentation and Accounting Policies (continued)

Measurement Uncertainty

The recoverability of unproved properties is dependent on the discovery of economical reserves, the ability of the Company to obtain financing to complete development of the properties and on future production. The recoverability was reviewed for impairment based on management's assessment of potential indicators of impairment and best estimates of likely courses of action by the Company. The carrying value is not intended to reflect present or future values of the properties. The recorded costs are subject to measurement uncertainty and it is reasonably possible, based on existing knowledge, that changes in future conditions could require a material change in the recognized amounts.

The amounts recorded relating to fair values of stock options issued are based on estimates of future volatility of the Company's share price, expected lives of the options, expected dividends to be paid by the Company and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effects of changes in such estimates on the financial statements of future periods could be material.

3. Changes in significant accounting policies

International Financial Reporting Standards ("IFRS")

The AcSB has confirmed the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") which will be effective for years beginning on or after January 1, 2011. The transition from current Canadian GAAP to IFRS may materially affect the Company's reported financial position and results of operations. Specific changes resulting from implementation of IFRS have not been determined at this time. Key information will be disclosed as it becomes available during the transition period.

4. Property and equipment

	2010		
	Cost	Accumulated Depreciation	Net Book Value
Oil and natural gas properties	\$ 2,412,632	\$ -	\$ 2,412,632
Equipment	133,467	31,906	101,561
	\$ 2,546,099	\$ 31,906	\$ 2,514,193

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

4. Property and equipment (continued)

	2009		
	Cost	Accumulated Depreciation	Net Book Value
Oil and natural gas properties	\$ 9,393,738	\$ -	\$ 9,393,738
Equipment	132,061	17,470	114,591
	<u>\$ 9,525,799</u>	<u>\$ 17,470</u>	<u>\$ 9,508,329</u>

- (a) During the year ended December 31, 2010, the Company capitalized general and administrative expenses in the amount of \$217,397 (\$389,073 - December 31, 2009).

As the Company is in the development stage, all costs capitalized to oil and natural gas properties have been classified as unproved properties and accordingly, no depletion and depreciation expense has been recorded. If commercial production begins, these capitalized costs will be depleted following the unit-of-production method based on proved reserves.

- (b) On November 19, 2008, the Company entered into companion agreements with Petrominerales Peru S.A.. ("Petrominerales Peru") whereby it agreed to sell half of its 90% interest in Block 126 (a 45% participating interest) to Petrominerales Peru for initial consideration of US \$500,000 and contingent consideration resulting from the condition that Petrominerales Peru provide the Company a noninterest bearing, non-revolving term loan in the amount of US \$9,000,000 (the "Loan"). As described in Note 4(c) below, the Loan includes a term that if Petrominerales Peru requires the Loan to be repaid, the Company could repurchase the 45% participating interest (together with a 10% participating interest Petrominerales Peru acquired from a third-party) for \$1. During the year ended December 31, 2008, the Company received a US \$100,000 (CDN \$121,800) deposit as an advance on the purchase.

On December 4, 2009 the Peruvian Government approved the transfer of the 45% interest to Petrominerales Peru. The remaining US \$400,000 of the purchase price was paid to the Company and the Loan was provided thereby completing the sale of the 45% working interest in the Block. The proceeds from the sale of the 45% interest in the Block were applied as a reduction of the Company's oil and natural gas property.

- (c) In conjunction with the agreement described above, Petrominerales Peru agreed to fund a portion of the Company's exploration program through a non-interest bearing, non-revolving term loan facility of US \$9,000,000. Until the approval of the transaction by the Peruvian Government on December 4, 2009, funds advanced to the Company were done so as an interest bearing promissory note. Subsequent to the approval of the transaction, the outstanding promissory note was converted to the Loan as described above and as March 24, 2010, the Company had received all US \$9,000,000 under the loan facility.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

4. Property and equipment (continued)

On March 24, 2010, Petrominerales Peru elected to forgive the Loan in its entirety. The Loan forgiveness was treated as contingent sale proceeds, with the Company allocating the proceeds between the value of the unproven oil and natural gas property sold and the value of the unproven oil and natural gas property retained. As the Company sold 50% of its interest in the Block (representing a 45% working interest), the Company's oil and gas properties as at March 24, 2010 were reduced by 50% of the value on that date. The balance of the contingent sale proceeds was treated as a gain on disposition of the 50% interest in the Company's unproven oil and natural gas property.

- (d) On October 13, 2010, the Company entered into several companion agreements with Petrominerales Peru whereby the Company agreed to sell an additional 25% participating interest in Block 126 to Petrominerales Peru, where upon completion of the transaction, the Company would retain a 20% participating interest in Block 126. In exchange for the interest in Block 126, Petrominerales Peru paid the Company a finder's fee of US \$2,250,000 and agreed to a carried interest for expenditures whereby Petrominerales will pay the first US \$4,500,000 of expenditures on behalf of the Company on Block 126. Petrominerales Peru also agreed to incremental bonus payments of US \$2,000,000 per 4 million gross barrels produced from Block 126 to a maximum of US \$8,000,000. Lastly Petrominerales Peru granted the Company a 20% participating interest in Blocks 161 and 141 located in the Ucayali and Titicaca Basins, Peru, respectively. Proceeds from the finder's fee of US \$2,250,000 were applied as a reduction of the Company's oil and natural gas property.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

5. Share capital

(a) Common Shares

Authorized:

Unlimited number of common shares without par value

Issued and outstanding:

	2010		2009	
	Shares	Amount	Shares	Amount
Balance, beginning of year	32,523,580	\$ 9,786,106	32,523,580	\$ 9,791,539
Issued during the year	21,000,000	13,350,010	-	-
Share issue costs	-	(1,233,941)	-	(5,433)
Balance, end of year	53,523,580	\$ 21,902,175	32,523,580	\$ 9,786,106

On November 30, 2010, the Company completed a bought deal financing of 21,000,000 units ("Units") at a price of \$0.73 per Unit for gross proceeds of \$15,330,000. Each Unit consists of one common share and one-half of one common share purchase warrant ("Warrant") of the Company, with each whole Warrant entitling the holder thereof to acquire one common share at a purchase price of \$1.10 until May 30, 2012; providing the Company may accelerate the expiry date in the event that the common shares trade at a volume weighted average trading price of not less than \$1.65 per share for a period of 20 consecutive trading days.

(b) Warrants

	Warrants	Amount	Exercise Price
Balance, December 31, 2009	-	-	
Issued during the year	10,500,000	\$ 1,979,990	\$ 1.10
Balance, December 31, 2010	10,500,000	\$ 1,979,990	\$ 1.10

The fair value of the warrants at the issue date was estimated using the Black-Scholes option pricing model with the following assumptions: Risk-free interest rate – 1.4%; expected life – 18 months; expected volatility – 145%; expected dividend yield – nil.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

5. Share capital (continued)

(c) Per share amounts

The weighted average number of common shares issued and outstanding for the period are as follows:

	<u>2010</u>	<u>2009</u>
Basic	34,307,142	32,523,580
Diluted	37,492,142	32,523,580

6. Option plans

(a) Stock options

The Company has a stock option plan whereby up to 10% of the issued and outstanding common shares may be granted to employees, directors and other persons who provide ongoing management or consulting services to the Company. Stock options are granted for a term of five years and vest over three years from the date granted. The exercise price of each option equals the market price of the Company's common shares on the date of the grant.

As at December 31, 2010, the following options have been issued and remain outstanding:

	<u>2010</u>		<u>2009</u>	
	<u>Options Outstanding</u>	<u>Weighted average exercise price per share</u>	<u>Options Outstanding</u>	<u>Weighted average exercise price per share</u>
Balance, beginning of year	3,185,000	\$0.40	2,570,000	\$ 0.35
Granted	-	-	635,000	0.61
Forfeited	-	-	(20,000)	0.35
Balance, end of year	3,185,000	\$0.40	3,185,000	\$ 0.40
Options exercisable, end of year	1,911,667	\$0.38	850,000	\$ 0.35

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

6. Option plans (continued)

The following table summarizes information about the stock options outstanding at December 31, 2010:

Range of Exercise price	Options outstanding			Options exercisable	
	Number outstanding	Weighted average exercise price	Weighted average Remaining contractual life (years)	Number exercisable	Weighted average exercise price
\$0.15-0.65	635,000	\$0.61	3.8	211,677	\$0.61
\$0.35	2,550,000	\$0.35	2.9	1,700,000	\$0.35
	3,185,000	\$0.40	3.1	1,911,677	\$0.38

(b) Stock-based compensation

The Company accounts for its stock-based compensation plan using the fair value method. Under this method stock-based compensation is charged to contributed surplus over the vesting period of the options granted.

The fair values of options granted during the period have been estimated based on the following assumptions:

	2009
Fair value	\$0.56
Average risk-free interest rate	2.0%
Expected life	3 years
Expected volatility	119%
Expected dividend	\$NIL

(c) Contributed surplus

	2010	2009
Balance, beginning of year	\$ 2,087,839	\$ 1,859,568
Stock-based compensation expense	295,800	228,271
Balance, end of year	<u>\$ 2,383,639</u>	<u>\$ 2,087,839</u>

Veraz Petroleum Ltd.
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7. Income taxes

A reconciliation of income taxes at statutory rates with the reported taxes is as follows:

	<u>2010</u>	<u>2009</u>
Statutory rate – Canada	28%	29%
Statutory rate – Barbados	2.5%	
Statutory rate – Peru	30%	0%
Expected current income tax recovery	\$ (408,648)	\$ (448,721)
Stock-based compensation	82,824	66,199
Non-taxable portion of capital gain	(5,339)	(13,854)
Non-capital losses expired	40,298	41,876
Taxable finders fees	630,000	-
Effective of reduction in statutory rate & other	88,041	(397,684)
Change in valuation allowance	(427,176)	752,184
Income tax provision	<u>\$ -</u>	<u>\$ -</u>

The significant components of the Company's future tax assets as of December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Property and equipment	\$ (61,812)	\$ (1,371,994)
Operating losses – Canadian	478,541	1,067,535
Operating losses – Peru	2,251,592	2,107,814
Unrealized foreign exchange gain	(8,823)	(40,321)
Other	248,277	1,748
Less: Valuation allowance	(2,908,315)	(1,764,782)
	<u>\$ -</u>	<u>\$ -</u>

The Company has accumulated non-capital losses and share issuance costs of approximately \$2,134,164 and \$990,413, which may be used to reduce future years' Canadian taxable income. The non-capital losses expire at various times from 2011 to 2030 and the share issuance costs may be deducted against Canadian taxable income until 2014.

The Company has accumulated losses of approximately \$7,505,306, which may be used to reduce future years' Peruvian taxable income. These losses are available indefinitely.

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8. Commitments

(a) Work commitments

- (i) During the period ended December 31, 2007, the Company entered into a License Contract to explore Ucayali Block 126, located in east central Peru, South America (the "Exploration Agreement"). The license is comprised of a four stage, seven - year work commitment where the Company has the right to withdraw from the license at the end of each period associated with the term of the license. The Company has completed the first two stages of the work commitment and is currently in the third stage.

Stage	Duration	Activity	Letter of Guarantee Required, gross (net to Company)
Third Stage	24 months from completion of the second stage	Drilling of one exploratory well	US \$ 1,125,000 (\$225,000)
Fourth Stage	24 months from completion of the third stage	Drilling of one exploratory well	US \$ 1,125,000 (\$225,000)

During December 2010, the Company issued a letter of guarantee of US \$225,000 for its proportionate share of the third stage work commitment, replacing the letter of guarantee previously issued for the second stage work commitment.

Under the Exploration Agreement, the Company is responsible to make an annual education and technology contribution, which contribution is based on commercial daily production and is described as follows:

		Gross	Net
From commencement until commercial production	US	\$50,000	\$10,000
From commercial production of 0-30,000 barrels per day	US	\$80,000	\$16,000
From commercial production of 30,001-50,000 barrels per day	US	\$120,000	\$24,000
Over 50,000 barrels per day	US	\$180,000	\$36,000

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8. Commitments (continued)

- (ii) Pursuant to the transaction described in note 4(d), the Company entered into License Contracts with Petrominerales Peru to explore Titicaca Block 141 located in south eastern Peru and Ucayali Block 161, located in east central Peru. The Company has the right to withdraw from the license at the end of each period associated with the term of the licenses. The Company's joint venture partner, Petrominerales Peru SA has completed the first stage of the work commitment for Block 141 and 161 and has posted the required Letters of Guarantee for the second stage of each work commitment. The commitments for the Licenses are described as follows:

Block 141 – Titicaca Basin

Stage	Duration	Activity	Letter of Guarantee Required, gross (net to Company)
Second Stage	12 months from completion of the first stage	150 Exploration Work Units ("EWU"s) or 300km 2D seismic	
Third Stage	18 months from completion of the second stage	150 EWU or drilling of one exploratory well	US \$ 750,000 (\$150,000)
Fourth Stage	18 months from completion of the third stage	150 EWU or drilling of one exploratory well	US \$ 750,000 (\$150,000)
Fifth Stage	18 months from completion of the fourth stage	150 EWU or drilling of one exploratory well	US \$ 750,000 (\$150,000)

Block 161 – Ucayali Basin

Stage	Duration	Activity	Letter of Guarantee Required, gross (net to Company)
Second Stage	18 months from completion of the first stage	476 EWU or drilling one exploratory well	US \$ 1,428,000 (\$ 285,600)
Third Stage	18 months from completion of the second stage	476 EWU or drilling of one exploratory well	US \$ 1,428,000 (\$ 285,600)
Fourth Stage	18 months from completion of the third stage	476 EWU or drilling of one exploratory well	US \$ 1,428,000 (\$ 285,600)

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8. Commitments (continued)

(b) Lease commitments

The Company has entered into several lease agreements for office space. The Company's financial commitments under the agreements are as follows:

2011	\$ 42,438
2012	\$ NIL

9. Capital management

The Company's objective is to maintain a strong capital position in order to be able to fund its proportionate share of the work commitments under the Exploration Agreements.

Given that the Company's activities are in the exploration stage, the Company's capital structure includes common share capital, and working capital (current assets minus current liabilities) or net debt. From time to time, in order to maintain or adjust the capital structure, the Company may issue common shares or other securities, sell assets or adjust its capital spending to manage current and projected debt levels and required work commitments.

The Board of Directors has established that the Company maintains sufficient capital such that working capital is positive and is sufficient to meet budgeted general and administrative expenses plus the Company's proportionate share of required work commitments for the next 12 months. As at December 31, 2010, the Company had working capital of \$15,558,352 not including the US \$4,500,000 carry for expenditures (see note 4(d)) which amounts are sufficient to meet the criteria established by the Board.

The Company is not subject to any externally imposed capital requirements.

10. Financial instruments and risk management

The Company is exposed to various risks that arise from its business environment and the financial instruments it holds. The Audit Committee and the Board of Directors of the Company review the adequacy of the risk management framework in relation to these risks. The following outlines the Company's risk exposures, quantifies these risks, and explains how these risks are managed.

(a) Credit risk

The Company is exposed to credit risk in relation to its cash and accounts receivable. The Company maintains cash with highly rated international banks and therefore considers these assets to have negligible credit risk.

The Company's accounts receivable is comprised mostly of recoverable taxes and joint interest receivables.

The Company was owed \$33,725 from the Government of Canada related to refundable goods and services tax as at year end which amount has negligible credit risk.

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10. Financial instruments and risk management (continued)

The majority of the remaining accounts receivable balance relates to amounts owing to the Company from its joint venture partner in the oil and gas industry. Management does not believe that this concentration of credit risk will result in any loss to the Company based on past payment experience. The Company's policy to mitigate credit risk associated with these balances is to establish relationships with large and reputable joint venture partners. However, the receivables are from participants in the oil and gas sector and collection of the outstanding balances is dependent on industry factors and therefore subject to credit risk.

The Company does not have an allowance for doubtful accounts as at December 31, 2010 and 2009, and did not provide for any doubtful accounts nor was it required to write-off any accounts receivable during the years ended December 31, 2010 and 2009.

(b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking harm to the Company's reputation. The Company continuously monitors forecast and actual cash flows to ensure that it has sufficient funds available to meet current and foreseeable financial requirements at a reasonable cost.

Management believes that future cash flows from proposed financings and borrowings will be adequate to support these financial liabilities. See note 10 for further details.

(c) Market risks

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. Given that the current oil and gas activities are in the exploration stage and that no oil and gas reserves have been identified, the Company does not use financial derivatives or physical delivery sales contracts and accordingly, commodity price risk is negligible.

(i) 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 Company is exposed to foreign currency fluctuations as the Company transacts business in both Canada and Peru and purchases goods and services denominated in Canadian Dollars, Peruvian Neuvos Soles and US Dollars. As a result, the Company has both foreign exchange transaction and translation exposure.

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10. Financial instruments and risk management (continued)

(ii) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is currently not exposed to interest rate risk.

(d) Fair values of financial instruments

The Company's financial instruments as at December 31, 2010 include cash and accounts receivable, accounts payable and accrued liabilities, notes payable and loans payable.

Financial instrument	Category	Measurement method
Cash	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Financial liabilities	Amortized cost
Notes payable	Financial liabilities	Amortized cost

The fair value of cash, accounts receivable, accounts payable and accrued liabilities and notes payable approximate their carrying amounts due to their short terms to maturity.