

**Veraz Petroleum Ltd.**  
**Condensed Interim Consolidated Financial Statements**  
**For the three and six months ended June 30, 2011**  
*(unaudited)*

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## **Veraz Petroleum Ltd.**

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### **Notice of No Auditor Review of Interim Consolidated Financial Statements**

Pursuant to subsection 4.3(3)(a) of Part 4 of National Instrument 51-102 Continuous Disclosure Obligations, if an auditor has not performed a review of interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been so reviewed.

The accompanying unaudited interim consolidated financial statements of Veraz Petroleum Ltd. (the "Company") for the three and six month period as at and ending June 30, 2011 have been prepared by and are the responsibility of the Company's management.

The Company's independent auditors have not performed a review of these financial statements.

(Signed) "Oppe Cosijn"  
President and Chief Executive Officer

August 26, 2011

**Veraz Petroleum Ltd.**  
**Condensed Consolidated Balance Sheets**  
*(unaudited)*

	Notes	June 30, 2011	December 31, 2010
<b>Assets</b>			
Current assets			
Cash and cash equivalents		<b>\$ 14,645,558</b>	\$ 16,048,388
Accounts receivable	4(c)	<b>236,654</b>	191,571
Prepaid expenses		<u><b>23,221</b></u>	<u>48,408</u>
		<b>14,905,433</b>	16,288,367
Exploration and evaluation assets	6	<b>2,749,962</b>	2,412,632
Equipment	7	<u><b>92,722</b></u>	<u>101,561</u>
		<u><b>\$ 17,748,117</b></u>	<u>\$ 18,802,560</u>
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities	4(d)	<b>\$ 468,992</b>	\$ 730,015
<b>Shareholders' Equity</b>			
Share capital	8	<b>21,902,175</b>	21,902,175
Warrants	8	<b>1,979,990</b>	1,979,990
Contributed surplus		<b>2,673,063</b>	2,543,463
Deficit		<b>(8,650,728)</b>	(7,752,731)
Accumulated other comprehensive loss		<u><b>(625,375)</b></u>	<u>(600,352)</u>
		<u><b>17,279,125</b></u>	<u>18,072,545</u>
		<u><b>\$ 17,748,117</b></u>	<u>\$ 18,802,560</u>
Commitments	12		

See accompanying notes to the condensed interim consolidated financial statements.

## Veraz Petroleum Ltd.

### Condensed Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

(unaudited)

	Notes	Three months ended June 30		Six months ended June 30	
		2011	2010	2011	2010
<b>Expenses</b>					
General and administrative expense		\$ 430,120	\$ 436,019	\$ 760,117	\$ 809,625
Foreign exchange (gain) loss		(6,428)	(13,452)	46,389	(101,553)
Stock-based compensation	9(b)	95,096	82,203	129,600	164,406
Depreciation	7	<u>3,428</u>	<u>3,527</u>	<u>6,979</u>	<u>7,102</u>
		<b>522,216</b>	<b>508,297</b>	<b>973,085</b>	<b>879,580</b>
Finance income	10	9,975	18	45,088	33
Finance expense	10	-	-	-	(194,966)
Net finance income (expenses)		<u>9,975</u>	<u>18</u>	<u>45,088</u>	<u>(194,933)</u>
Gain on disposition of unproven properties		-	-	-	4,518,625
Net income (loss)		<b>(512,241)</b>	<b>(508,279)</b>	<b>(897,997)</b>	<b>3,444,112</b>
<b>Other comprehensive income (loss)</b>					
Cumulative translation adjustment		<u>(730)</u>	<u>160,692</u>	<u>(25,023)</u>	<u>148,301</u>
Comprehensive income (loss) for the period		<b><u>\$ (512,971)</u></b>	<b><u>\$ (347,587)</u></b>	<b><u>\$ (923,020)</u></b>	<b><u>\$ 3,592,413</u></b>
<b>Earnings (loss) per Share</b>					
	11				
Basic		<u>\$ (0.01)</u>	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>	<u>\$ 0.11</u>
Diluted		<u>\$ (0.01)</u>	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>	<u>\$ 0.10</u>

See accompanying notes to the condensed interim consolidated financial statements.

# Veraz Petroleum Ltd.

## Condensed Consolidated Statements of Changes in Shareholders' Equity

(unaudited)

	Notes	Number of common Shares	Common Shares stated value	Number of Warrants	Warrants stated value	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total equity
Balance at January 1, 2010		32,523,580	\$ 9,786,106	-	\$ -	\$ 2,214,652	\$ (9,936,390)	\$ (522,041)	\$ 1,542,327
Net income							3,444,112	-	3,444,112
Stock-based compensation related to stock options	9(b)	-	-	-	-	164,406	-	-	164,406
Cumulative translation adjustment		-	-	-	-	-	-	148,301	148,301
<b>Balance at June 30, 2010</b>		<b><u>32,523,580</u></b>	<b><u>\$ 9,786,106</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>\$ 2,379,058</u></b>	<b><u>\$ (6,492,278)</u></b>	<b><u>\$ (373,740)</u></b>	<b><u>\$ 5,299,146</u></b>
Balance at January 1, 2011		53,523,580	\$ 21,902,175	10,500,000	\$ 1,979,990	\$ 2,543,463	\$ (7,752,731)	\$ (600,352)	\$ 18,072,545
Net loss							(897,997)		(897,997)
Stock-based compensation related to stock options	9(b)	-	-	-	-	129,600	-	-	129,600
Cumulative translation adjustment		-	-	-	-	-	-	(25,023)	(25,023)
<b>Balance at June 30, 2011</b>		<b><u>52,523,580</u></b>	<b><u>\$ 21,902,175</u></b>	<b><u>10,500,000</u></b>	<b><u>\$ 1,979,990</u></b>	<b><u>\$ 2,673,063</u></b>	<b><u>\$ (8,650,728)</u></b>	<b><u>\$ (625,375)</u></b>	<b><u>\$ 17,279,125</u></b>

See accompanying notes to the interim condensed consolidated financial statements.

# Veraz Petroleum Ltd.

## Condensed Consolidated Statements of Cash Flows

(unaudited)

		Six months ended June 30	
	Notes	2011	2010
Cash provided by (used in):			
Cash flows from operating activities			
Net income (loss) for the period		\$ (897,997)	\$ 3,444,112
Adjustments for:			
Gain on disposition of unproven property		-	(4,518,625)
Depreciation	7	6,979	7,102
Stock-based compensation	9(b)	129,600	164,406
Unrealized foreign exchange (gain) loss	4(e)	46,389	(74,868)
Net finance (income) expenses	10	(45,088)	194,933
Changes in non-cash working capital	5	<u>(400,787)</u>	<u>(7,451,445)</u>
Net cash used in operating activities		<b>(1,160,904)</b>	(8,234,385)
Cash flows from investing activities			
Additions to exploration and evaluation assets	6	(385,139)	(153,393)
Interest received	10	45,088	34
Change in non-cash working capital	5	<u>237,522</u>	<u>3,875,547</u>
Net cash used in investing activities		<b>(102,529)</b>	3,722,188
Cash flows from financing activities			
Proceeds from loan payable		<u>-</u>	<u>979,647</u>
Net cash used in financing activities		-	979,647
Effect of exchange rate changes on cash and cash equivalents		<u>(139,397)</u>	<u>(46,112)</u>
Change in cash and cash equivalents		<b>(1,402,830)</b>	(3,578,662)
Cash and cash equivalents, beginning of period		<u>16,048,388</u>	<u>3,937,687</u>
Cash and cash equivalents, end of period		<b><u>\$ 14,645,558</u></b>	<b><u>\$ 359,025</u></b>

See accompanying notes to the condensed interim consolidated financial statements.

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

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#### 1. Reporting entity

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.

The Company has experienced recurring losses, has not generated profitable operations and as at June 30, 2011, has accumulated losses of \$8,650,728 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.

Veraz Petroleum Ltd. is a publicly traded company, incorporated and domiciled in Canada. The address of business of the Company is Suite 200, 209 8th Avenue SW, Calgary, Alberta, Canada, T2P 1B8. These condensed interim consolidated financial statements were approved and authorized for issuance by the Board of Directors on August 25, 2011.

#### 2. Basis of preparation

##### (a) Statement of compliance

The condensed interim consolidated financial statements for the three and six month periods ended June 30, 2011 were prepared in accordance with IAS 34, Interim Financial Reporting. The same accounting policies and methods of computation were followed in the preparation of these condensed interim consolidated financial statements as were followed in the preparation of the condensed interim consolidated financial statements for the three month period ended March 31, 2011. In addition, the condensed interim consolidated financial statements for the three month period ended March 31, 2011 contain certain incremental annual IFRS disclosures not included in the annual financial statements for the year ended December 31, 2010 prepared in accordance with previous Canadian GAAP. Accordingly, these condensed interim consolidated financial statements for the three and six month periods ended June 30, 2011 should be read together with the annual consolidated financial statements for the year ended December 31, 2010 prepared in accordance with previous Canadian GAAP as well as the condensed interim consolidated financial statements for the three month period ended March 31, 2011.

##### (b) Basis of measurement

The condensed interim consolidated financial statements have been prepared on the historical cost basis except for certain financial assets and financial liabilities, which are measured at fair value as disclosed in note 4.

##### (c) Functional and presentation currency

These condensed interim consolidated financial statements are presented in Canadian dollars, which is the functional currency of the Canadian parent company. The functional currency of the Company's two wholly-owned subsidiaries is the US dollar.

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

For the Three and Six months ended June 30, 2011 and 2010

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(d) Use of estimates and judgments

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

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting estimates will, by definition, seldom equal the actual results. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected.

The following discussion sets forth management's most critical estimates and assumptions in determining the value of assets, liabilities and equity:

*Valuation of exploration and evaluation assets*

The value of exploration and evaluation assets are dependent upon the discovery of economically recoverable reserves which in turn is dependent on future oil and natural gas prices, future capital expenditures and environmental and regulatory restrictions.

*Valuation of accounts receivable*

The valuation of accounts receivable is based on management's best estimate of the provision for doubtful accounts.

*Income taxes*

The amounts recorded for deferred income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. They are also based on estimates of the probability of the Company utilizing certain tax pools and assets. The availability of tax pools is subject to audit and interpretation by taxation authorities.

*Stock-based compensation*

The amounts recorded relating to the fair value of stock options issued are based on estimates of the risk-free rate, forfeiture rate, future volatility of the Company's Stock price, estimated market price of the Company's Stocks at grant date, expected lives of the options, expected dividends and other relevant assumptions as at the date of grant.

3. Significant accounting policies

The Company's accounting policies have not changed from those previously disclosed in the condensed interim consolidated financial statements for the quarter ended March 31, 2011 note 3.

(a) Recent accounting pronouncements

On May 12, 2011 the IASB issued three new standards: IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interest in Other Entities*. These new standards are effective for annual periods beginning on or after January 1, 2013. IFRS 10 replaces the consolidation requirements in SIC-12 Consolidation – Special Purpose

# Veraz Petroleum Ltd.

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Entities and a portion of IAS 27 Consolidated and Separate Financial Statements. IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess. IFRS 11 *Joint Arrangements* provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case) and requires a single method to account for interests in jointly controlled entities (equity method). IFRS 12 *Disclosure of Interests in Other Entities* is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet. The Company has not yet assessed for the potential impact on the adoption of these new standards.

#### 4. Financial instruments and risk management

##### (a) Risk management overview

The Company's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk. This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these condensed interim consolidated financial statements. The Company employs risk management strategies and policies to ensure that any exposure to risk are in compliance with the Company's business objectives and risk tolerance levels. While the Board of Directors has the overall responsibility for the Company's risk management framework, Veraz's management has the responsibility to administer and monitor these risks.

##### (b) Fair value of financial instruments

The fair values of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their carrying value due to the short-term maturity of those instruments.

The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly, and are based on valuation models and techniques where the inputs are derived from quoted indices. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

Cash and cash equivalents are measured at fair value based on their Level 1 designation.

##### (c) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company's accounts receivable are comprised of recoverable taxes and joint interest receivables.

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

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The majority of the 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 June 30, 2011, and did not provide for any doubtful accounts nor was it required to write-off any accounts receivable during the three and six month periods ended June 30, 2011 and 2010.

As at June 30, 2011 and December 31, 2010 the Company's accounts receivable were comprised of the following:

	<b>June 30, 2011</b>	<b>Dec 31, 2010</b>
Joint interest partners and other	\$ 195,490	\$ 157,846
GST	41,164	33,725
	<b>\$ 236,654</b>	<b>\$ 191,571</b>

The Company manages the credit exposure related to cash and cash equivalents by selecting financial institutions with high credit ratings and monitors all short term deposits to ensure an adequate rate of return. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

(d) 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 6 for further details.

The Company's accounts payable and accrued liabilities as at June 30, 2011, December 31, 2010 are comprised of the following:

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

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	June 30, 2011	Dec 31, 2010
Accruals	\$ 55,750	\$ 406,753
Joint Venture	266,288	-
Other	146,954	23,262
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	\$ 468,992	\$ 730,015

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(e) Market risk

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.

*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.

*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.

(f) 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 Stock 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 Stocks 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 Stock of required work commitments for the next 12 months. As at June 30, 2011, the Company had working capital of \$14,436,441 not including the US \$4,500,000 carry for expenditures which amounts are sufficient to meet the criteria established by the Board.

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

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

There were no changes in the Company's approach to capital management during the three months ended June 30, 2011.

### 5. Supplemental cash flows information

Changes in non-cash working capital is comprised of:

	Six months ended June 30,	
	2011	2010
Source (use) of cash:		
Accounts receivable	\$ (36,205)	\$ 3,864,876
Prepaid expenses and deposits	20,792	3,698
Accounts payable and accrued liabilities	(147,852)	(7,444,472)
	\$ (163,265)	\$ (3,575,898)
Related to operating activities	\$ (400,787)	\$ (7,451,445)
Related to investing activities	237,522	3,875,547
Related to financing activities	-	-
Changes in non-cash working capital	\$ 163,265	\$ (3,575,898)

### 6. Exploration and evaluation assets

Balance at December 31, 2010	\$ 2,412,632
Additions	407,139
Exchange Difference	(69,809)
Balance at June 30, 2011	\$ 2,749,962

- (a) During the three months ended June 30, 2011, the Company capitalized general and administrative expenses in the amount of \$14,824 (\$30,251 - three months ended June 30, 2010).

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 non-interest bearing, non-revolving term loan in the amount of US \$9,000,000 (the "Loan"). As described in note 6(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

## Veraz Petroleum Ltd.

### Notes to the Condensed Interim Consolidated Financial Statements

#### For the Three and Six months ended June 30, 2011 and 2010

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\$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.

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 Peru 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 the Condensed Interim Consolidated Financial Statements

For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

### 7. Equipment

Cost at December 31, 2010	\$ 133,467
Additions for the period	-
Exchange difference	(3,407)
<b>Balance at June 30, 2011</b>	<b>\$ 130,060</b>
<b>Accumulated depreciation</b>	
Balance at December 31, 2010	31,906
Depreciation for the period	6,979
Exchange difference	(1,547)
<b>Balance at June 30, 2011</b>	<b>\$ 37,338</b>

### 8. Stock capital

#### (a) Authorized

Unlimited number of voting common shares without par value

#### (b) Issued

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.

#### (c) Warrants

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.

### 9. Stock-based compensation

#### (a) Stock option plan

The Company has a stock option plan whereby up to 10% of the issued and outstanding common Stocks 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 Stocks on the date of the grant.

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

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The following options have been awarded under the stock option plan:

	As at June 30, 2011		As at December 31, 2010	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding, beginning of period	3,185,000	\$ 0.40	3,185,000	\$ 0.40
Granted	970,000	0.78	-	-
Forfeited	-	-	-	-
Outstanding at June 30	4,155,000	\$ 0.46	3,185,000	\$ 0.40
Exercisable at June 30	1,998,334	\$ 0.40	1,911,667	\$ 0.40

The following table summarizes the expiry terms and exercise prices of the Company's outstanding stock options as at June 30, 2011:

Date of grant	Outstanding Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number of Stock Options Exercisable
November 2008	2,550,000	\$ 0.35	2.4	1,700,000
November 2009	635,000	0.61	3.4	228,334
April 2011	970,000	0.78	4.8	NIL
	4,155,000	\$ 0.46	3.1	1,998,334

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## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

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(b) Stock-based compensation expense

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. During the three months ended June 30, 2011, the Company awarded 970,000 stock options to employees of the Company. The fair values of options granted during the period have been estimated based on the following assumptions:

	2011
Fair value	\$0.49
Average risk-free interest rate	2.43%
Expected life	3
Expected volatility	75%
Expected dividend	\$NIL

Compensation costs of \$95,096 for the three months ended June 30, 2011 (2010 - \$82,203) have been expensed and have resulted in a corresponding increase in contributed surplus.

10. Finance income and expense

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Finance income				
Interest income on cash and cash equivalents	\$ 9,975	\$ 18	\$ 45,088	\$ 33
Finance expenses				
Interest expense on loan payable	-	-	-	194,966
Net finance income (expense)	\$ 9,975	\$ 18	\$ 45,088	\$ 194,933

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

#### 11. Earnings per Share

The following table summarizes the common shares used in calculating earnings per share:

Weighted Average Common Shares Outstanding	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Basic	53,523,580	32,523,580	53,523,580	32,523,580
Diluted	53,523,580	32,523,580	53,523,580	35,708,580

#### 12. 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)

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## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

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During December 2010, the Company issued a letter of guarantee of US \$225,000 for its proportionate Stock 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:

			<b>Gross</b>	<b>Net</b>
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

- (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 commitments for the Licenses are described as follows:

#### Block 141 - Titicaca Basin

<b>Stage</b>	<b>Duration</b>	<b>Activity</b>	<b>Letter of Guarantee Required, gross (net to Company)</b>
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)

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

### 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)

(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	\$ 33,524
2012	\$ NIL

13. Reconciliation of Canadian GAAP to IFRS

As disclosed in note 2, these interim condensed consolidated financial statements represent the Company's initial presentation of the financial results of operations and financial position under IFRS for the period ended June 30, 2011 in conjunction with the Company's annual audited consolidated financial statements to be issued under IFRS as at and for the year ended December 31, 2011. As a result, these interim condensed consolidated financial statements have been prepared in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards" and with IAS 34, "Interim Financial Reporting", as issued by the IASB. Previously, the Company prepared its interim and annual consolidated financial statements in accordance with Canadian GAAP.

The following reconciliations present the adjustments made to the Company's previous GAAP financial results of operations and financial position to comply with IFRS 1. Reconciliations include the Company's condensed consolidated statements of income (loss) and comprehensive income (loss) for the three and six months ended June 30, 2010, condensed consolidated statements of cash flows for the three and six months ended June 30, 2010 and Shareholder's equity reconciliation as at June 30, 2010.

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

Reconciliation of consolidated statement of income and comprehensive income for the three month period ended June 30, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
<b>Expenses</b>				
General and administrative expenses		\$ 436,019	\$ -	\$ 436,019
Foreign exchange gain	4(e)	(13,452)	-	(13,452)
Stock-based compensation	9(b)	73,950	8,253	82,203
Depreciation	7	3,527	-	3,527
		500,044	8,253	508,297
Finance income	10	18	-	18
Finance expense	10	-	-	-
Net finance income (expense)		18	-	18
Gain on disposition of unproven properties		-	-	-
Net income		(500,026)	(8,253)	(508,279)
<b>Other comprehensive loss</b>				
Cumulative translation adjustment		160,692	-	160,692
Comprehensive income for the period		\$ (339,334)	\$ (8,253)	\$ (347,587)
<b>Income per Share</b>				
Basic	11	\$ (0.02)		\$ (0.02)
Diluted	11	\$ (0.02)		\$ (0.02)

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

Reconciliation of consolidated statement of income and comprehensive income for the six month period ended June 30, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
<b>Expenses</b>				
General and administrative expenses		\$ 809,625	\$ -	\$ 809,625
Foreign exchange gain	4(e)	(101,553)	-	(101,553)
Stock-based compensation	9(b)	147,900	16,506	164,406
Depreciation	7	7,102	-	7,102
		863,074	16,506	879,580
Finance income	10	33	-	33
Finance expense	10	(194,966)	-	(194,966)
Net finance income (expense)		(194,933)	-	(194,933)
Gain on disposition of unproven properties		4,518,625	-	4,518,625
Net income (loss)		3,460,618	(16,506)	3,444,112
<b>Other comprehensive loss</b>				
Cumulative translation adjustment		148,301	-	148,301
Comprehensive income for the year		\$3,608,919	\$ (16,506)	\$ 3,592,413
<b>Earnings per Share</b>				
Basic	11	\$ 0.11		\$ 0.11
Diluted	11	\$ 0.10		\$ 0.10

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

### For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

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Reconciliation of Shareholders' equity as at June 30, 2010 from Canadian GAAP to IFRS:

	<u>June 30, 2010</u>
Total Shareholders' equity under Canadian GAAP	<u>\$ 5,299,146</u>
Increase to contributed surplus due to Stock-based compensation adjustments	143,319
Decrease in deficit due to Stock-based compensation adjustments	<u>(143,319)</u>
Total Shareholders' equity under IFRS	<u>\$ 5,299,146</u>

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

Reconciliation of consolidated cash flows statement for the three month period ended June 30, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
Cash provided by (used in):				
Operating activities				
Income for the period		\$ (500,026)	\$ (8,253)	\$ (508,279)
Adjustments for:				
Unrealized foreign exchange gain	4(e)	63	-	63
Stock based compensation	9(b)	73,950	8,253	82,203
Net finance expense		(18)	-	(18)
Depreciation	7	3,527	-	3,527
		(422,504)	-	(422,504)
Changes in non-cash working capital	5	(94,911)	-	(94,911)
Net cash used in operating activities		(517,415)	-	(517,415)
Investing activities				
Exploration and evaluation expenditures	6	(48,236)	-	(48,236)
Interest received	10	18	-	18
Changes in non-cash working capital	5	9,681	-	9,681
		(38,537)	-	(38,537)
Effect of exchange rate changes on cash and cash equivalents		13,578	-	13,578
Increase (decrease) in cash and cash equivalents		(542,374)	-	(542,374)
Cash and cash equivalents, beginning of period		901,399	-	901,399
Cash and cash equivalents, end of period		\$ 359,025	\$ -	\$ 359,025

# Veraz Petroleum Ltd.

## Notes to the Condensed Interim Consolidated Financial Statements

For the Three and Six months ended June 30, 2011 and 2010

(unaudited)

Reconciliation of consolidated cash flows statement for the six month period ended June 30, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
Cash provided by (used in):				
Operating activities				
Income for the year		\$ 3,460,618	\$ (16,506)	\$ 3,444,112
Adjustments for:				
Gain on disposition of unproven property		(4,518,625)	-	(4,518,625)
Unrealized foreign exchange gain	4(d)	(74,868)	-	(74,868)
Stock-based compensation	9(b)	147,900	16,506	164,406
Net finance expense	10	194,933	-	194,933
Depreciation	7	7,102	-	7,102
		(782,940)	-	(782,940)
Changes in non-cash working capital	5	(7,451,445)	-	(7,451,445)
Net cash used in operating activities		(8,234,385)	-	(8,234,385)
Investing activities				
Exploration and evaluation expenditures	6	(153,393)	-	(153,393)
Interest received	10	34	-	34
Changes in non-cash working capital	5	3,875,547	-	3,875,547
		3,722,188	-	3,722,188
Financing activities				
Proceeds from note payable		979,647	-	979,647
Effect of exchange rate changes on cash and cash equivalents				
		(46,112)	-	(46,112)
Increase (decrease) in cash and cash equivalents		(3,578,662)	-	(3,578,662)
Cash and cash equivalents, beginning of year		3,937,687	-	3,937,687
Cash and cash equivalents, end of period		\$ 359,025	\$ -	\$ 359,025