

Veraz Petroleum Ltd.
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2008 and 2007



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Veraz Petroleum Ltd. as at December 31, 2008 and 2007 and the consolidated statements of operations comprehensive loss and deficit and cash flows for the year ended December 31, 2008 and for period of 11 months from February 1, 2007 to December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the year ended December 31, 2008 and for the period of 11 months from February 1, 2007 to December 31, 2007 in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Calgary, Canada
April 24, 2009

Veraz Petroleum Ltd.
Consolidated Balance Sheets
As at December 31, 2008 and 2007

	2008	2007
Assets		
Current assets		
Cash	\$ 1,136,918	\$ 1,351,793
Accounts receivable	176,126	53,998
Prepaid expenses and deposits	37,668	9,740
	<u>1,350,712</u>	1,415,531
Property and equipment (note 4)	<u>4,618,877</u>	2,671,098
	<u>\$ 5,969,589</u>	<u>\$ 4,086,629</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 797,188	\$ 120,593
Notes payable (note 5)	1,733,200	28,000
Deposit (note 4)	121,800	-
	<u>2,652,188</u>	148,593
Shareholders' Equity		
Share capital (note 8)	9,791,539	8,538,164
Contributed surplus (note 9)	1,859,568	1,706,738
Deficit	(8,262,264)	(6,306,866)
Accumulated other comprehensive loss	(71,442)	-
	<u>(8,333,706)</u>	(6,306,866)
	<u>3,317,401</u>	3,938,036
	<u>\$ 5,969,589</u>	<u>\$ 4,086,629</u>

Going concern (note 1)
 Commitments (note 11)

Approved by the Board

_____"Trevor Mitzel"_____, Director

_____"Paul Baay"_____, Director

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

Veraz Petroleum Ltd.**Consolidated Statement of Operations, Comprehensive Loss and Deficit**

	For the year ended December 31, 2008	For the eleven months ended December 31, 2007
Interest income	<u>\$ 7,537</u>	<u>\$ 14,000</u>
Expenses		
General and administrative	1,690,410	428,663
Foreign exchange loss	15,188	-
Interest on convertible debentures (note 6)	63,375	-
Interest on notes payable (note 5)	34,365	-
Stock-based compensation (note 9)	152,830	1,403,278
Depreciation	6,767	-
	<u>1,962,935</u>	<u>1,831,941</u>
Loss from continuing operations	(1,955,398)	(1,817,941)
Loss from discontinued operations (note 15)	-	(796,660)
Net loss for the period	(1,955,398)	(2,614,601)
Other comprehensive loss		
Cumulative translation adjustment (note 3)	(71,442)	-
Comprehensive loss for the period	<u>(2,026,840)</u>	<u>(2,614,601)</u>
Deficit, beginning of period	(6,306,866)	(3,692,265)
Net loss for the period	(1,955,398)	(2,614,601)
Deficit, end of period	<u>\$ (8,262,264)</u>	<u>\$ (6,306,866)</u>
Loss per share (note 10)		
From continuing operations		
Basic and diluted	\$ (0.06)	\$ (0.07)
From discontinued operations		
Basic and diluted	-	(0.03)
Total loss per share		
Basic and diluted	\$ (0.06)	\$ (0.10)

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

Veraz Petroleum Ltd.
Consolidated Statement of Cash Flows

	For the year ended December 31, 2008	For the eleven months ended December 31, 2007
Cash provided by (used for)		
Operating activities		
Net loss for the period	\$ (1,955,398)	\$ (2,614,601)
Items not affecting cash		
Unrealized foreign exchange gains	(167,989)	-
Interest on convertible debentures (note 6)	63,375	-
Stock-based compensation (note 9)	152,830	1,403,278
Depreciation	6,767	-
Loss from discontinued operations (note 15)	-	796,660
	<u>(1,900,415)</u>	<u>(414,663)</u>
Changes in non-cash working capital	<u>(1,863)</u>	<u>56,855</u>
Cash flows used in continuing operations	<u>(1,902,278)</u>	<u>(357,808)</u>
Cash flows used in discontinued operations (note 15)	<u>-</u>	<u>(241,005)</u>
	<u>(1,902,278)</u>	<u>(598,813)</u>
Investing activities		
Property and equipment expenditures	(1,571,521)	(171,098)
Changes in non-cash working capital	385,735	-
Cash flows used in discontinued operations (note 15)	-	(420,066)
	<u>(1,185,786)</u>	<u>(591,164)</u>
Financing activities		
Proceeds on issuance of common shares	-	1,492,575
Proceeds on issuance of notes payable	1,705,200	-
Proceeds on issuance of convertible debentures	1,000,000	-
	<u>2,705,200</u>	<u>1,492,575</u>
Effect of exchange rate changes on cash	<u>167,989</u>	<u>-</u>
Increase (decrease) in cash	<u>(214,875)</u>	<u>302,598</u>
Cash, beginning of period	<u>1,351,793</u>	<u>1,049,195</u>
Cash, end of period	<u>\$ 1,136,918</u>	<u>\$ 1,351,793</u>

Non-cash transactions (notes 4, 6 and 8)

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

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

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 a formal agreement (the "Exploration Agreement") to explore Ucayali Block 126 (the "Block"), located in east central Peru, South America.

During the period ended December 31, 2007, the Company changed its year-end to December 31 from January 31. As described in note 15, during the period ended December 31, 2007, the Company refocused its business activities on international oil and gas exploration and development activities and discontinued its mining operations. As a result, the consolidated financial statements have been presented to include the results of both continuing and discontinued operations.

Going Concern

These consolidated financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of operations. The Company has experienced recurring losses, has not generated profitable operations and as at December 31, 2008, has a working capital deficiency of \$1,301,476 and has accumulated losses of \$8,262,264 since inception. Current oil and gas activities are in the exploration stage and have not identified oil and gas reserves. Current cash resources will not be sufficient to continue the exploration and development activities. These matters raise doubt about the ability of the Company to continue to meet its obligations as they become due. Continuing operations are dependent on the ability to obtain adequate funding to finance existing operations, attain commercial production from its oil and gas properties and attain future profitable operations. Management's plans to remediate are described in note 4. These consolidated financial statements do not include any adjustments for the recoverability and classification of recorded asset amounts, nor for the classification of liabilities and revenues and expenses that might be necessary should the Company be unable to continue as a going concern.

2. Significant accounting policies

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its two wholly-owned subsidiaries, North American Vanadium Peru S.A.C. ("NAVI Peru"), 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.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

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, 2008 and 2007, 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, exploration and development and administrative costs directly related to development activities. As the Company's oil and gas activities are in the development stage, any incidental revenues are netted against costs until commercial production begins. When commercial production begins, these capitalized costs will be depleted following the unit-of-production method based on proved reserves.

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	25% straight line basis

Joint 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.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Income Taxes

Income taxes are accounted for using the 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.

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, 2008 and 2007, the asset retirement obligation has been determined to be \$NIL as the Company has not commenced any exploration activities.

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 or warrant 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 or warrant; 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 or warrants, consideration paid by the option or warrant 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 or warrants that will not vest, rather, the Company accounts for actual forfeitures as they occur.

Per Share Amounts

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.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Revenue Recognition

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

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 that an entity elects to designate as being available for sale and any financial asset that does not fit into any other category (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.

Translation of Foreign Currencies

The Company's subsidiaries are accounted for as self-sustaining operations as described in note 3. Transactions of the Company originating in foreign currencies are translated at the rates in effect at the time of the transaction. Monetary items denominated in foreign currencies are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Foreign exchange gains and losses are included in income.

Use of Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles 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, 2008 and 2007

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

(a) Financial Instruments and Capital Disclosures

On January 1, 2008, the Company adopted new Canadian Institute of Chartered Accountants ("CICA") standards relating to Capital Disclosures, Financial Instruments - Disclosures and Financial Instruments - Presentation.

The Company is required to disclose its objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. These new disclosures are included in note 12 to these consolidated financial statements.

The Company is required to disclose the significance of financial instruments to an entity's financial statements, the risks associated with the financial instruments, and how those risks are managed. Additional guidance is provided on the classification of financial instruments as liabilities or equity, and when netting of financial assets and financial liabilities is appropriate. Note 13 contains further disclosure with respect to this standard.

(b) Going Concern

On January 1, 2008, the Company adopted certain amendments to Canadian accounting standards related to General Standards of Financial Statement Presentation with respect to requirements to assess and disclose the Company's ability to continue as a going concern. The adoption of these amendments did not have a significant impact on the financial statements and disclosures have been included in note 1.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

(c) Change in Foreign Currency Translation

Effective December 31, 2008, the Company designated its subsidiary NAVI Peru from integrated to self-sustaining. This change was made as it is anticipated that all future income streams and the majority of expenditures will be denominated in US\$. Accordingly, it now uses the US\$ as their functional currency. The Company has prospectively 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.

For the year ended December 31, 2008, the Company recorded \$71,442 in accumulated other comprehensive loss with this amount arising from the prospective adoption of the current rate method for foreign currency translation.

(d) Future Accounting Pronouncements

Goodwill and Intangible Assets

As of January 1, 2009, the Company will be required to adopt new standards for Goodwill and Intangible Assets. New standards have been established for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous CICA Handbook Section 3062. The adoption of these new standards is not expected to have any impact on the financial statements.

Business Combinations

In January 2009, the Accounting Standards Board of the CICA ("AcSB") issued Section 1582, *Business Combinations*, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This standard applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company plans to adopt this standard prospectively effective January 1, 2009 and does not expect the adoption of this standard to have any impact on results of operations or financial position.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Consolidated Financial Statements and Non-controlling Interests

In January 2009, the AcSB issued Sections 1601, *Consolidated Financial Statements*, and 1602, *Non-controlling Interests*, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company plans to adopt these standards effective January 1, 2009 and does not expect the adoption will have any impact on results of operations or financial position.

International Financial Reporting Standards ("IFRS")

The AcSB has confirmed the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") will be effective January 1, 2011. The Company has performed an initial scoping process in order to ensure successful implementation within the required timeframe. The impact on the Company's consolidated financial statements is not reasonably determinable at this time. Key information will be disclosed as it becomes available during the transition period.

4. Property and equipment

	2008		
	Cost	Accumulated Depreciation	Net Book Value
Oil and natural gas properties	\$ 4,480,727	\$ -	\$ 4,480,727
Equipment	144,917	6,767	138,150
	<u>\$ 4,625,644</u>	<u>\$ 6,767</u>	<u>\$ 4,618,877</u>
	2007		
	Cost	Accumulated Depreciation	Net Book Value
Oil and natural gas properties	\$ 2,671,098	\$ -	\$ 2,671,098

- (a) During the year ended December 31, 2008, the Company capitalized general and administrative expenses in the amount of \$324,670 (\$NIL - eleven months ended December 31, 2007).

During the year ended December 31, 2008, the Company issued 200,000 common shares at \$0.95 per share with respect to the payment of a finders fee related to the acquisition of Block 126.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

During the period ended December 31, 2007, the Company capitalized all costs related to the Block which included the issuance of 2,000,000 common shares valued at \$1.25 per share and cash payments of \$171,098 as a finders fee related to the acquisition of Block 126.

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. When commercial production begins, these capitalized costs will be depleted following the unit-of-production method based on proved reserves.

- (b) During November 2008, the Company entered into an agreement with Petrominerales Peru S.A.. ("Petrominerales"), to jointly explore Block 126. Under the terms of the agreement, Petrominerales will pay consideration of US \$500,000 to purchase a 45% working interest in the Block. During the year ended December 31, 2008, the Company received US \$100,000 (CDN \$121,800) deposit as an advance on the purchase. If the closing does not occur on or before April 30, 2009, Petrominerales has the right to elect by notice in writing:
- to terminate the agreement whereby the Company will be obligated to repay to Petrominerales the deposit received, plus accrued interest; or
 - to terminate the agreement and elect to close the purchase of shares of North American Vanadium Peru S.A.C. ("Veraz Peru") under which the Company agreed to sell 51% of the issued and outstanding shares of Veraz Peru to Petrominerales; or
 - to extend the date for closing beyond April 30, 2009 at the sole discretion of Petrominerales.

The agreement is effective November 1, 2008 and closing is to occur on the date of the signing of the public deed by Petrominerales and the Company and Perupetro S.A. ("Perupetro") in order to transfer the 45% working interest to Petrominerales, which is expected to occur by April 30, 2009. The signing of public deed will confirm the recognition of Petrominerales as true working interest partner by Perupetro.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

- (c) In conjunction with the agreement described above, Petrominerales Peru Ltd. has 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. US \$3,000,000 of the loan facility will be available to the Company upon the closing of the asset agreement described in note 5(a); and the balance upon the completion of the Environmental Impact Assessment ("EIA") and Perupetro's formal recognition of Petrominerales as a partner to the Exploration Agreement and will be used to fund ongoing operations and the exploration program. Once Petrominerales acknowledges in writing receipt of the final processed seismic from the Company, Petrominerales Peru Ltd. will have the option to either: (a) forgive the loan in its entirety, or (b) demand repayment of the loan. If Petrominerales Peru Ltd. chooses to demand the loan, the Company has the option to either repay the loan in its entirety or convert the loan into common shares of the Company provided that the common shares of the Company are listed on the TSX-V and conversion will not result in Petrominerales Peru Ltd. holding more than 49% of the outstanding common shares of the Company. If the Company either repays or converts the loan to common shares of the Company, Petrominerales Ltd. will transfer and convey all of its shares and interests in Petrominerales Peru Ltd. to the Company in exchange for \$1.

The loan is secured by the shares of the Company's wholly-owned subsidiary, is non-interest bearing, non-revolving, and all amounts owing shall be paid in full no later than December 31, 2009. The loan will be used to fund exploration activities and working capital requirements.

5. Notes payable

- (a) Notes payable includes an amount of \$28,000 which is non-interest bearing and due on demand.
- (b) Promissory notes payable of US \$1,400,000 (CDN \$1,705,200) relate to the loan agreement described in note 4(c). The note has an interest rate of 18% per annum and the principal sum and all unpaid interest is due and payable on the earlier of:
- (i) April 30, 2009; and
 - (ii) the date on which the Company transfers a 45% working interest in the Block and all necessary consents and approvals required in connection with such transfer are obtained.

At April 24, 2009, the latter condition has not yet occurred.

6. Convertible debentures

During the year ended December 31, 2008, the Company completed a private placement unsecured convertible debenture financing for \$1,000,000. Directors and officers of the Company purchased \$250,000 of the debentures.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

The conversion price of the debentures was contingent upon the satisfaction of certain conditions on or before December 31, 2008. In the event that these conditions were not met by December 31, 2008, the debentures were automatically convertible at \$0.50 per common share. The convertible debentures bore interest at 10% per annum with interest payable on the earlier of the date of conversion, or December 31, 2008. In the event the principal amount of the debentures was converted into common shares, all interest under the debentures would be payable through the issuance of common shares. For purposes of determining the number of common shares to be issued to satisfy the obligation to pay interest, each common share shall be deemed to have a value equal to the conversion price of the debenture.

On December 31, 2008, the convertible debentures and accrued interest were converted to common shares at \$0.50 per common share. The number of common shares issued for conversion were 2,126,749 with a stated value of \$1,063,375.

During the year ended December 31, 2008, interest expense of \$63,375 has been included in the statement of operations, of which \$15,844 relates to directors and officers of the Company.

7. Income taxes

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

	<u>2008</u>	<u>2007</u>
Statutory rate	29.5%	32.12%
Expected current income tax recovery	\$ (576,842)	\$ (839,810)
Stock-based compensation	45,085	450,733
Effect of reduction in statutory rate and other	128,489	248,798
Change in valuation allowance	403,268	140,279
	<u>Income tax provision</u>	<u>Income tax provision</u>
	\$ -	\$ -

The significant components of the Company's future tax assets as of December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Property and equipment	\$ (123,418)	\$ 139,000
Operating losses - Canadian	611,489	462,000
Operating losses - Peru	516,138	-
Less: Valuation allowance	(1,004,209)	(601,000)
	<u>\$ -</u>	<u>\$ -</u>

The Company has accumulated losses of approximately \$2,400,000, which may be used to reduce future years' Canadian taxable income. These losses expire at various times from 2009 to 2028.

The Company has accumulated losses of approximately \$1,720,000, which may be used to reduce future years' Peru taxable income. These losses are available indefinitely.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

8. Share capital

(a) Common Shares

Authorized:
 Unlimited number of common shares without par value

Issued and outstanding:

	2008		2007	
	Shares	Amount	Shares	Amount
Balance, beginning of period	30,196,831	\$ 8,538,164	26,046,731	\$ 4,148,974
Shares issued on exercise of warrants	-	-	1,950,100	1,357,575
Add: value of warrants transferred from Warrants to Share Capital	-	-	-	343,473
Shares issued on exercise of options	-	-	200,000	135,000
Add: stock option value transferred to Share Capital from Contributed Surplus	-	-	-	53,142
Issued for finders fees on oil and gas properties (note 4)	200,000	190,000	2,000,000	2,500,000
Issued on conversion of debentures (note 6)	2,126,749	1,063,375	-	-
Balance, end of period	<u>32,523,580</u>	<u>\$ 9,791,539</u>	<u>30,196,831</u>	<u>\$ 8,538,164</u>

(b) Stock Options

The Company has a rolling stock option plan under which options to acquire common shares of the Company are granted to directors, officers, employees and consultants of the Company. The maximum number of options permitted is limited to ten percent (10%) of the issued capital of the Company from time to time. As at December 31, 2008, the following options have been issued and remain outstanding:

	2008		2007	
	Options outstanding	Weighted average exercise price per share	Options outstanding	Weighted average exercise price per share
Balance, beginning of period	1,100,000	\$ 1.25	-	\$ -
Granted	1,850,000	0.35	1,750,000	1.28
Exercised	-	-	(200,000)	0.68
Cancelled/expired	(400,000)	1.25	(450,000)	1.61
Balance, end of period	<u>2,550,000</u>	<u>\$ 0.35</u>	<u>1,100,000</u>	<u>\$ 1.25</u>
Options exercisable, end of period	-	-	1,100,000	\$ 1.25

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

During November 2008, 700,000 stock options granted to an officer and director with a weighted exercise price of \$1.32 were cancelled and reissued with an exercise price of \$0.35. The cancellation of these options for which new options were subsequently issued has been accounted for as a modification of an award.

Compensation cost recognized for the year ended December 31, 2008 related to the modified options was \$5,000 which was charged to income.

During the year ended December 31, 2008, the Company granted an aggregate of 1,850,000 stock options at an exercise price of \$0.35 per share to certain directors, officers and employees to purchase common shares of the Company, vesting over a three-year period and will be exercisable over a five-year period, expiring November 21, 2013.

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

	2008	2007
Fair value	\$0.25	\$0.90
Average risk-free interest rate	2.1%	4.3%
Expected life	3 years	3.3 years
Expected volatility	139%	144%
Expected dividend	\$ NIL	\$ NIL

(c) Warrants

	Warrants outstanding	Weighted average exercise price per share
Balance, February 1, 2007	3,964,100	\$ 0.72
Exercised	(1,950,100)	0.70
Expired	(2,014,000)	0.75
Balance, December 31, 2007 and 2008	-	\$ -

(d) Escrow Shares

As at December 31, 2008, NIL (2007 - 2,105,991) shares were held in escrow. Under the terms of the Escrow Agreement, all shares were released from escrow on June 13, 2008.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

9. Contributed surplus

	<u>2008</u>	<u>2007</u>
Balance, beginning of period	\$ 1,706,738	\$ 1,875
Stock-based compensation expense	152,830	1,403,278
Transferred to share capital on exercise of options	-	(53,142)
Transferred from warrants on expiry	-	354,727
Balance, end of period	<u>\$ 1,859,568</u>	<u>\$ 1,706,738</u>

10. Per share amounts

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

	<u>2008</u>	<u>2007</u>
Basic	30,396,622	26,707,190
Diluted	30,396,622	26,707,190

All stock options and warrants for all periods have been excluded from the diluted loss per share calculation as the effect would be anti-dilutive.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

11. 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 purchased a performance bond in the amount of US \$180,000 to secure the capital expenditure requirements associated with the Company's interest in the exploration license.

Stage	Duration	Activity	Letter of Guarantee Required
First Stage	12 months from December 22, 2007	Reprocessing of 1,000 km of seismic lines and comprehensive geological study of the area	US \$ 200,000
Second Stage	24 months from completion of the first stage	Drilling of two (2) exploratory or confirmation wells	US \$ 2,500,000
Third Stage	24 months from completion of the second stage	Drilling of one (1) exploratory well	US \$ 1,250,000
Fourth Stage	24 months from completion of the third stage	Drilling of one (1) exploratory well	US \$ 1,250,000

To December 31, 2008, the Company has completed the first stage work commitment. During December 2008, the Company issued a letter of guarantee of US \$1,125,000 for their share of the second stage work commitment and replaced the letter of guarantee previously issued for the first stage work commitment.

- (ii) 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:

From commencement until commercial production	US \$ 50,000
Upon commercial production of 0 - 30,000 barrels per day	US \$ 80,000
Upon commercial production of 30,001 - 50,000 barrels per day	US \$120,000
Over 50,000 barrels per day	US \$180,000

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

(iii) During the year ended December 31, 2008, the Company executed an agreement with Servicios Geograficos y Medio Ambiente SA to complete the required environmental impact assessment ("EIA"). The commitments under this agreement total US \$700,000 with payments made on the achievement of the following milestones:

- 30% or US \$210,000, which was paid upon execution of the agreement;
- 30% or US \$210,000 due on submission of the EIA to the Minister of Energy and Mines of Peru. The Company submitted the EIA in December 2008 and the amount due has been accrued at December 31, 2008; and
- 40% or US \$280,000 due on approval of the EIA by the Minister of Energy and Mines for Peru.

In addition to the contractual commitments, the Company is also obligated to host three public workshops and consultations. The costs of hosting these public workshops and consultations have been estimated by the Company at approximately \$400,000, of which \$336,390 has been spent to December 31, 2008 and capitalized to property and equipment. As at April 24, 2009, the remaining costs have been spent.

(b) Lease commitments

During the year ended December 31, 2008, the Company entered into several lease agreements for office space. The Company's financial commitment under the agreements are as follows:

2009	\$ 155,129
2010	12,125

12. Capital disclosures

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 Agreement.

Given that the Company's activities are in the exploration stage, the Company's capital structure includes common share capital, convertible debentures 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.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

The Board of Directors has established that the Company maintain sufficient capital such that working capital is positive and that sufficient capital is available 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, 2008, the Company had negative working capital of \$1,301,476 (2007 - \$1,266,938) thereby not meeting the required positive working capital criteria established by the Board. In November 2008, the Company entered into an agreement to sell a 45% working interest in the Block, which proceeds of the loan facility as described in note 4(c) upon closing will be sufficient to fund the Company's budgeted general and administrative expenses and its proportionate share of required work commitments for 2009.

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

13. 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 the Company considers these assets to have negligible credit risk. The Company's accounts receivable is comprised of refundable consumption taxes paid and receivable from the Governments of Canada and Peru and accordingly have negligible credit risk.

(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 4 for further details.

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

(c) 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.

(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.

(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 as the notes payable described in note 5(b) are subject to a fixed interest rate.

(d) Fair values of financial instruments

The carrying and fair values of the Company's financial instruments as at December 31, 2008 are as follows:

	Carrying Value	Fair Value
<u>Financial Assets</u>		
Held-for trading:		
Cash	\$ 1,136,918	\$ 1,136,918
Loans and receivables:		
Accounts receivable	176,126	176,126
<u>Financial Liabilities</u>		
Other financial liabilities		
Accounts payable and accrued liabilities	797,188	797,188
Notes payable	1,733,200	1,733,200
Deposit	121,800	121,800

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

14. Related party transactions

The following summarizes the Company's related party transactions:

	<u>2008</u>	<u>2007</u>
General and administrative expenses		
Exploration costs included in additions to Mineral Property and Deferred Expenditures were paid to a company 50% owned by a former director	\$ -	\$ 298,239
Property investigation costs include amounts paid to a company 50% owned by a former director	-	22,633
Professional fees paid or accrued to a company controlled by the family of a former officer	-	20,130
Consulting fees paid to a company of which a former director holds a minority interest	-	30,000
	<u>2008</u>	<u>2007</u>
Notes payable		
Amount due to a company controlled by the family of a former officer	\$ -	\$ 7,000

These transactions are in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties) which approximates the arm's length equivalent value of services.

15. Discontinued operations

Due to the Company's refocusing its business activities on international oil and gas exploration and development activities, during the period ended December 31, 2007, the Company made the decision to discontinue its mining operations and accordingly wrote-off all costs on the mining property to a fair value of \$NIL.

	Balance, January 31, 2007	Additions	Accumulated Impairment	Balance, December 31, 2007
Acquisition costs	\$ 60,000	\$ -	\$ (60,000)	\$ -
Geological	80,789	415,349	(496,138)	-
Total expenditures	<u>\$ 140,789</u>	<u>\$ 415,349</u>	<u>\$ (556,138)</u>	<u>\$ -</u>

Veraz Petroleum Ltd.
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

These operations have been accounted for as discontinued operations. The following are summarized consolidated statements of operations and statements of cash flows regarding the discontinued operations:

Consolidated Statements of Operations

	<u>For the eleven months ended December 31, 2007</u>
Interest income	<u>\$ -</u>
Expenses	
Amortization	1,390
General and administrative	229,477
Stock based compensation	-
Write-off of mineral properties and deferred expenditures	556,138
Write-off of property and equipment	9,655
	<u>796,660</u>
Loss from discontinued operations	<u>\$ (796,660)</u>

Consolidated Statements of Cash Flows

	<u>For the eleven months ended December 31, 2007</u>
Cash flows used in operating activities	\$ (241,005)
Cash flows used in investing activities	(420,066)
Cash flows used in discontinued operations	<u>\$ (661,071)</u>

16. Comparative figures

Certain comparative figures have been reclassified to conform with the current year's presentation.