ShaMaran Petroleum Corp

Consolidated Financial Statements

For the years ended December 31, 2010 and 2009

Prepared by Management

Independent Auditor's report

7 April 2011

To the Shareholders of ShaMaran Petroleum Corporation

We have audited the accompanying consolidated financial statements of ShaMaran Petroleum Corporation, which comprise the consolidated balance sheet as at 31 December 2010, the consolidated statements of operations and deficit, comprehensive income and cash flows for the year then ended, and the related notes including a summary of significant accounting policies.

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 policies, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

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

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

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Opinion

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

Other matter

The financial statements of ShaMaran Petroleum Corporation for the year ended 31 December 2009 were audited by another auditor who expressed an unmodified opinion on those statements on 26 March 2010.

(signed) PricewaterhouseCoopers LLP
Chartered Accountants, Licensed Public Accountants
London

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SHAMARAN PETROLEUM CORP.
Consolidated Balance Sheets
(Expressed in thousands of United States Dollars)

	Note	As at December 31, 2010	2009
ASSETS			
Current assets			
Cash and cash equivalents	6	58,684	63,565
Accounts receivable		124	31
Inventory	8	2,656	-
Prepaid expenses and other assets		447	376
Discontinued operations	4	74	847
		61,985	**64,819**
Non-current assets			
Investment in company	7	44,282	-
Property, plant and equipment	9	150,222	185,180
		194,504	**185,180**
		256,489	**249,999**
LIABILITIES			
Current liabilities			
Accounts payable and accrued expenses		5,142	2,050
Net payable to joint venture partner		14	37
Income taxes payable		103	12
Deferred consideration	7	12,643	-
Discontinued operations	4	2,719	2,817
		20,621	**4,916**
Non-current liabilities			
Other long-term liabilities		-	170
Discontinued operations	4	350	350
		350	**520**
		20,971	**5,436**
SHAREHOLDERS' EQUITY			
Share capital	10	432,506	379,673
Shares to be issued	10	-	61,349
Contributed surplus	10	3,867	3,360
Accumulated other comprehensive income	5	5	4
Deficit		(200,860)	(199,823)
		235,518	**244,563**
		256,489	**249,999**

Commitments and contingencies (note 15)

See accompanying notes to the Consolidated Financial Statements.

Approved on behalf of the Board:

Cameron Bailey, Director

Keith Hill, Director

SHAMARAN PETROLEUM CORP.
Consolidated Statement of Operations and Deficit
(Expressed in thousands of United States Dollars, except for per share data)

	Note	For the year ended December 31, 2010	2009
Expenses			
Depreciation		139	6
General and administrative		594	2,378
Stock-based compensation	10	514	546
		1,247	**2,930**
Other expenses/(income)			
Guarantee fees	12	1,353	636
Interest income		(416)	(310)
Loss from investment in company	7	27	-
Foreign exchange gain		(2,215)	(4,943)
		(1,251)	**(4,617)**
Net income before income taxes		**4**	**1,687**
Income tax expense	11	81	12
Net (loss)/income from continuing operations		**(77)**	**1,675**
Discontinued operations			
Loss from operations	4	(1,037)	(359)
Gain on asset disposal	4	77	1,600
		(960)	**1,241**
Net (loss)/income		**(1,037)**	**2,916**
Deficit, beginning of the year		**(199,823)**	**(202,739)**
Deficit, end of the year		**(200,860)**	**(199,823)**
Basic income per share:			
Continuing operations		0.00	0.005
Discontinued operations		0.00	0.005
		0.00	**0.01**
Diluted income per share:			
Continuing operations		0.00	0.005
Discontinued operations		0.00	0.005
		0.00	**0.01**
Weighted average number of common shares:			
Continuing operations		536,164	346,639
Discontinued operations		536,164	346,639

See accompanying notes to the Consolidated Financial Statements.

SHAMARAN PETROLEUM CORP.

Consolidated Statement of Comprehensive Income

(Expressed in thousands of United States Dollars)

	For the year ended December 31,	
	2010	**2009**
Net (loss)/income	**(1,037)**	**2,916**
Other comprehensive income:		
Exchange gains arising from translation of the financial statements of a foreign operation	1	4
Comprehensive (loss)/income	**(1,036)**	**2,920**

See accompanying notes to the Consolidated Financial Statements.

SHAMARAN PETROLEUM CORP.
Consolidated Statement of Cash Flows
(Expressed in thousands of United States Dollars)

	Note	For the year ended December 31, 2010	2009
Operating activities of continuing operations			
Net (loss)/income from continuing operations		(77)	1,675
Adjustments for non-cash items:			
Depreciation		139	6
Stock-based compensation		514	546
Loss from investment in company		27	-
Exchange gains		(2,215)	(4,943)
Changes in working capital:			
Accounts receivable		(93)	(31)
Short term investments		-	(358)
Prepaid expenses and other assets		(71)	-
Accounts receivable from joint venture partner		-	(126)
Inventories		(2,656)	-
Accounts payable and accrued expenses		3,092	1,850
Net payable to joint venture partner		(23)	-
Income taxes payable		91	12
		(1,272)	**(1,369)**
Investment activities of continuing operations			
Property, plant and equipment		(26,900)	(91,230)
Investment in company		(26,666)	-
		(53,566)	**(91,230)**
Financing activities of continuing operations			
Proceeds net of costs on issuance of shares		47,826	96,598
		47,826	**96,598**
Effect of exchange rate changes on cash and cash equivalents		2,216	4,947
Cash flows from/(used in) continuing operations		**(4,796)**	**8,946**
Cash flows from/(used in) discontinued operations	4	(85)	9,337
Change in cash and cash equivalents		**(4,881)**	**18,283**
Cash and cash equivalents, beginning of the year		63,565	45,282
Cash and cash equivalents, end of the year		**58,684**	**63,565**

See accompanying notes to the Consolidated Financial Statements.

1. NATURE OF OPERATIONS

ShaMaran Petroleum Corp. ("ShaMaran" and formerly Bayou Bend Petroleum Ltd., together with its subsidiaries the "Company") is incorporated under the British Columbia Business Corporations Act.

On October 16, 2009, the Company changed its name to ShaMaran Petroleum Corp. from Bayou Bend Petroleum Ltd. with an effective date of October 21, 2009. The Company's shares trade on the TSX Venture Exchange under the symbol of "SNM" (formerly "BBP").

The Company is engaged in the business of oil and gas exploration and development, and is currently in the pre-production stages of an exploration and development campaign in respect of petroleum properties located in the Kurdistan Region of Iraq ("Kurdistan"). The Company conducts its operations through wholly owned subsidiary entities.

Oil and gas operations are subject to extensive controls and regulations imposed by various levels of government that may be amended from time to time. The Company's operations may require licenses and permits from various governmental authorities in the countries in which it operates. Under the production sharing contracts the Company has entered into, the Kurdish Regional Government is required to assist in obtaining all permits and licenses from any government agencies in the Kurdistan Region and from any other government administration in Iraq. There can be no assurance that the Company will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development of its projects.

The political and security situation in Iraq is not settled. Issues relating to federalism and the autonomy of the various regions of Iraq could adversely impact the Company's interest in the Kurdistan Region, including the ability to export any hydrocarbons as a result of our activities.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

These Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries and its proportionate interest in joint ventures, and have been prepared in accordance with generally accepted accounting principles in Canada.

On May 28, 2009, the Company sold to a third party substantially all of its oil and gas properties located in the United States in the Gulf of Mexico. The financial results relating to these properties have been reported as discontinued operations. Refer to note 4.

The significant accounting policies followed by the Company have been applied consistently in the preparation of these consolidated financial statements. These accounting policies are summarized below.

(b) Going concern

These Consolidated Financial Statements have been prepared assuming that the Company will into the foreseeable future be able to realize its assets and liabilities as they come due in the normal course of business. The ability of the Company to continue as a going concern and to successfully carry out its business plan is primarily dependent upon the continued support of its shareholders, the discovery of economically recoverable reserves, the resolution of remaining political uncertainties in Iraq, and the ability of the Company to obtain financing to develop reserves.

In the absence of current production revenues, the Company is currently dependent upon its existing financial resources which include approximately $58.7 million of cash and cash equivalents as at December 31, 2010 to satisfy its obligations and finance its exploration and evaluation programme in Kurdistan. Failure to meet these exploration and evaluation commitments could put the related licence interests at risk of forfeiture.

The Directors believe that based on the forecasts and projections they have prepared, the resources available will be sufficient for the Company and its subsidiaries to satisfy its contractual obligations and commitments and to continue as a going concern for the foreseeable future, being at least the next 12 months. Due to high levels of planned expenditure as a result of the significant exploration campaign over the next 12 months, the Company may require additional financing. The Company has a number of financing possibilities which it believes it would be able to pursue if and when required. Nevertheless, the possibility remains that the Company's operations and the availability of additional finance could be significantly affected by adverse exploration and appraisal results, geopolitical events in the region, macroeconomic conditions or other risks.

(c) Cash and Cash Equivalents

The Company considers cash and cash equivalents to include amounts held in banks and highly liquid investments with remaining maturities at point of purchase of 90 days or less. The Company places its excess cash and cash equivalents with institutions of high-credit worthiness.

(d) Short-term investments

Short-term investments are accounted for at fair market value and consist of securities backed by the full credit of the United States Government with maturities of less than one year.

(e) Investment

The Company uses the equity method to account for its 33.5% investment in General Exploration Partners Inc on the basis that it has significant influence in the operating, financing, and investing decisions of this company.

(f) Inventories

Inventories of drilling equipment and consumable materials are stated at the lower of cost or net realizable value, cost being determined on a first-in, first-out ("FIFO") method. Net realizable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(g) Property Plant and Equipment (PP&E)

i. Petroleum Properties

Exploration well costs are initially capitalized and, if subsequently determined to have not found sufficient reserves to justify commercial production, are charged to dry hole expense. Exploration well costs that have found sufficient reserves to justify commercial production, but those reserves cannot be classified as proved, continue to be capitalized as long as sufficient progress is being made to assess the reserves and economic viability of the well or related project.

Expenses incurred which are recoverable as Petroleum Costs under the terms of the Company's Production Sharing Contracts are capitalized with a resulting reduction to general and administrative expense. In the current year the Company has capitalized such expenses in the amount of $4,823 (2009: $426).

Producing properties and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. Any impairment loss is the difference between the carrying value of the asset and its fair value. Fair value is calculated as the present value of estimated expected future cash flows from proved, probable and, as appropriate, possible reserves.

The Company engages independent reserve evaluators in order to determine the extent to which it has reserves.

The Company is currently engaged in exploration operations in Kurdistan, as described in note 9. The Company has no reserves to form the basis for an estimate of future net cash flow from the corresponding petroleum properties. The Company has considered the conditions in CICA Accounting Guideline 11 for impairment which includes significant unfavorable economic, legal, regulatory, environmental, political and other factors. In addition, the Company's continued execution of its business plan is a key factor considered as part of the assessment of the recoverability of the carrying amount of the properties. Whenever events or changes in circumstances indicate that the carrying amount of a property in the development stage may be impaired, capitalized costs are written down to the estimated recoverable amount. As at December 31, 2010 the Company has capitalized $149,692 (2009: $184,953) related to this project. No revenues have been generated from this project to date and no impairment was identified at December 31, 2010.

ii. Corporate PP&E

Corporate PP&E includes office equipment, furniture and other assets not used directly in petroleum operations, which are stated at historical cost less accumulated depreciation.

iii. Depreciation, Depletion and Amortization (DD&A)

Capitalized costs of proved oil and gas properties are depleted using the unit of production method. For purposes of these calculations, production and reserves of oil are converted to cubic feet of natural gas on an energy equivalent basis at a ratio of one barrel (bbl) of oil to six thousand cubic feet (mcf) of natural gas.

Successful exploratory wells and development costs are depleted over proved developed reserves. However, to the extent significant development costs are incurred in connection with proved undeveloped reserves, such costs are excluded from depletion until the reserves are developed. Acquired resource properties with proved reserves are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs are transferred to depletable costs as proved reserves are recognized. Costs associated with significant development projects are not depleted until commercial production commences.

Corporate PP&E are depreciated using the straight-line method as follows:

- Computer and information technology assets over 3 years
- Furniture and fixtures over 5 years.

(h) Asset Retirement Obligations

The fair value of the statutory, contractual or legal liability associated with the retirement and reclamation of oil and gas properties is recorded when incurred, with a corresponding increase to the carrying amount of the related petroleum properties. The increase to capitalized costs is depleted to earnings on a unit of production basis over the life of the proved reserves for each property. Subsequent changes in the estimated fair value of the asset retirement obligation (ARO) are capitalized and depleted over the remaining useful life of the underlying petroleum properties.

ARO liabilities are carried at their discounted present value and are accreted over time for the change in their present value. Actual expenditures incurred are charged against the accumulated obligation.

(i) Revenue Recognition

Revenues from the sale of petroleum and natural gas are recorded when title passes to an external party and collection is reasonably assured.

(j) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method current income taxes are recognized for the estimated income taxes payable for the current year. Future income taxes are recognized for temporary differences between the tax and accounting basis of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are likely to be realized.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of future tax assets and liabilities of a change in tax rates is recognized in income in the period that included the date of enactment or substantive enactment.

(k) Stock-Based Compensation

All stock-based awards made to employees and non-employees are measured and recognized using a fair value based method. Accordingly, the fair value of the options at the date of the grant is determined and charged to operations, with the offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

(l) Loss per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price for the reporting period.

(m) Joint Interests

Substantially all of the Company's exploration and development activities are conducted jointly with others. Accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(n) Use of Estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

In the accounting for oil and gas interests, amounts recorded for depletion and amounts used for impairment test calculations are based on estimates of oil and gas reserves and future cash flows, including development costs. By their nature, the estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material.

(o) Foreign Currency Translation

Activities denominated in currencies other than the U.S. dollar are translated using the temporal method. Under this method, monetary assets and liabilities denominated in other currencies are translated into U.S. dollars at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities denominated in other currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates approximating exchange rates in effect at the time of the transactions. Gains and losses on translation are reflected in the Statement of Operations and Deficit.

The accounts of the Company's self-sustaining foreign operations are translated into U.S. dollars using the current rate method. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenue and expenses are translated at exchange rates which approximate those prevailing at the transaction dates. Gains or losses arising from the translation of the financial statements of the self-sustaining foreign operations are deferred in the accumulated other comprehensive income account in shareholders' equity.

(p) Changes in Accounting Standards

i. Financial instruments:

Effective for fiscal years ending on or after September 30, 2009, the Company has adopted the enhanced disclosure requirements of amended CICA Section 3862, Financial Instruments - Disclosures. Refer to note 13 for fair value measurement disclosures using a fair value hierarchy that reflects the significance of the inputs in making the measurements.

ii. Goodwill and intangible assets:

On January 1, 2009, the Company adopted the new requirements of the CICA Handbook Section 3064, Goodwill and Intangible Assets. This new accounting standard, which applies to fiscal years beginning on or after October 1, 2008, replaces Section 3062, Goodwill and Other Intangible Assets. Section 3064 expands on the standards for recognition, measurement, and disclosure of goodwill and intangible assets. The adoption of this new standard did not have any impact on the Company's financial statements, disclosures, or results of operations.

iii. Credit risk and the fair value of financial assets and liabilities:

On January 23, 2009, the CICA Emerging Issues Committee (EIC) issued EIC-173, Credit Risk and the Fair Value of Financial Assets and Liabilities. EIC-173 is effective for interim and annual financial statements ending on or after January 20, 2009. EIC-173 provides guidance which requires that an entity consider its own credit risk and the credit risk of counterparties when determining the fair value of financial assets and liabilities. Adoption of this guidance is to be applied retrospectively without restatement to prior periods. The Company has evaluated the impact of this new standard and concluded that it does not have a material impact on its financial statements.

(q) Comparability

Certain prior year information and amounts has been reclassified to conform with the current year's presentation.

3. FUTURE ACCOUNTING STANDARDS

International Financial Reporting Standards

In February 2008 the Canadian Accounting Standards Board confirmed that Canadian generally accepted accounting principles ("Canadian GAAP") will be converged with International Financial Reporting Standards ("IFRS") for fiscal years commencing January 1, 2011. The transition from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative financial information using IFRS. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences on recognition, measurement and disclosures. While the effects of IFRS have not yet been fully determined, the Company has identified key areas which are likely to be impacted by changes in accounting policy and disclosures, including the accounting for petroleum properties, income taxes, and asset retirement obligations.

4. DISCONTINUED OPERATIONS

On May 28, 2009, the Company sold to a third party substantially all of its petroleum properties located in the United States in the Gulf of Mexico. The financial position of discontinued operations included within the Consolidated Balance Sheet is as follows:

	As at December 31,	
	2010	**2009**
ASSETS		
Current assets		
Short-term investments	-	79
Accounts receivable	59	535
Prepaid expenses and other assets	15	233
	74	**847**
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	1,378	1,816
Asset retirement obligation	1,341	1,001
	2,719	**2,817**
Non-current liabilities		
Asset retirement obligation	350	350
	3,069	**3,167**
NET LIABILITIES	**2,995**	**2,320**

The current and non-current portion of the Company's asset retirement obligation ("ARO") pertaining to discontinued operations relate to the remaining interests the Company holds in petroleum properties located in the United States. The liability was determined based on the Company's remaining net ownership interest in the corresponding wells and facilities, agreed and estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. In the year 2010 the Company agreed to a program to decommission and remediate a property which has resulted in an increase by $340 in the ARO included as a current liability.

4. DISCONTINUED OPERATIONS (continued)

The results of discontinued operations included in the Consolidated Statement of Operations and Deficit are as follows:

	For the year ended December 31,	
	2010	**2009**
Revenue		
Oil and gas sales	-	2,089
Royalties	-	(431)
Net revenues	**-**	**1,658**
Expenses		
Operating	-	761
Exploration	-	810
Dry hole costs	-	21
Asset retirement obligation	340	200
Accretion	-	12
Depletion, depreciation and amortization	-	447
Foreign exchange gain	-	(3,282)
General and administrative	704	3,072
	1,044	**2,041**
Other income		
Interest income	7	24
Net loss	**(1,037)**	**(359)**
Discontinued operations		
Loss from operations	**(1,037)**	**(359)**
Gain on asset disposals	77	1,600
Net income / (loss)	**(960)**	**1,241**

During the year ended December 31, 2010 the remaining inventories in the United States from discontinued operations were sold for gross proceeds of $277, and a resulting gain of $77. In the comparable period in 2009 the Company sold substantially all of its oil and gas properties located in the United States for gross proceeds of $12,487 and a resulting gain on asset disposals of $1,600.

4. DISCONTINUED OPERATIONS (continued)

The cash flows relating to discontinued operations in the Consolidated Statement of Cash Flows are as follows:

	For the year ended December 31,	
	2010	**2009**
Operating activities of discontinued operations		
Income / (loss) from discontinued operations	(960)	1,241
Adjustments for non-cash items:		
Depletion, depreciation and amortization	-	447
Impairment of properties	-	200
Dry hole costs	-	21
Accretion	-	12
Gain on asset disposals	(77)	(1,600)
Unrealized foreign exchange gain	-	(3,282)
Changes in working capital:		
Accounts receivable	476	1,377
Accounts receivable from joint venture partner	-	163
Short term investments	79	1,295
Prepaid expenses	218	-
Accounts payable and accrued expenses	(438)	(2,151)
Asset retirement obligation	340	426
	(362)	**(1,851)**
Investing activities of discontinued operations		
Property, plant & equipment	-	(1,299)
Proceeds from sale of assets	277	12,487
	277	**11,188**
Cash flows from/(used in) discontinued operations	**(85)**	**9,337**

5. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income is comprised as follows:

As at December 31, 2008	**3,282**
Reclassification of cumulative foreign currency translation gain	(3,282)
Gain on currency translation of the financial statements of a foreign operation during the year	4
As at December 31, 2009	**4**
Gain on currency translation of the financial statements of a foreign operation during the year	1
As at December 31, 2010	**5**

The financial statements of the Swiss entity of the Company have been translated from Swiss Francs into the reporting currency of the Company with a resulting currency translation gain of $1 for year ended December 31, 2010 (2009: gain of $4).

5. ACCUMULATED OTHER COMPREHENSIVE INCOME (continued)

Consistent with the sale during 2009 of substantially all of the Company's petroleum properties located in the United States, the cumulative foreign currency translation gain of $3,282 which originated in 2007 was reclassified. Accordingly, the amount was reflected in the loss from discontinued operations for the year ended December 31, 2009.

6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist primarily of cash deposits held in Canadian dollars.

7. INVESTMENT IN COMPANY

On August 27, 2010, ShaMaran Ventures BV, a wholly owned subsidiary of the Company entered into a Subscription Agreement and a Shareholders Agreement with Aspect Energy International, LLC ("Aspect") to acquire 33.5% of the fully-diluted share capital of General Exploration Partners Inc ("GEP"), a wholly owned subsidiary of Aspect. GEP holds an 80% working interest in the Production Sharing Contract ("PSC") in respect of the Atrush Block Oil and Gas Exploration Area located in Kurdistan.

The total consideration exchanged for the investment in GEP was $45.1 million comprised of cash payments totaling $24.3 million and share consideration of $5.0 million, representing 12.5 million shares of the Company, and an obligation to contribute the next $15.8 million in cash required to fund GEP's oil exploration and development operations, which will be repaid on a first in first out basis from a portion of available petroleum production in the future.

Of the $15.8 million obligation $12,643 remained at December 31, 2010 and is reported as deferred consideration under current liabilities on the balance sheet. The Company has also reported in the Consolidated Statement of Operations and Deficit a loss from investment in the amount of $27 which corresponds to 33.5% of the net loss reported by GEP over the period from August 27, 2010 to December 31, 2010 in the amount of $81.

8. INVENTORIES

Inventories were comprised as follows:

	As at December 31,	
	2010	**2009**
Drilling equipment and consumable materials	2,656	-
	2,656	**-**

9. PROPERTY PLANT AND EQUIPMENT

Property plant and equipment is comprised as follows:

	Cost	Accumulated depreciation	Net book value
As at December 31, 2009			
Petroleum properties – Kurdistan	184,953	-	184,953
Corporate PP&E	233	(6)	227
	185,186	**(6)**	**185,180**
As at December 31, 2010			
Petroleum properties – Kurdistan	149,692	-	149,692
Corporate PP&E	690	(160)	530
	150,382	**(160)**	**150,222**

No depletion has been attributed to the costs of petroleum properties located in Kurdistan, as the related operations are currently in the pre-production exploration stage and, currently, there is no corresponding production or reserves.

In August 2010 the Company executed agreements with the Kurdistan Regional Government ("KRG") to amend the Pulkhana Block 10 and the Arbat Block PSCs, waiving the Company of its previous contractual requirement to issue 150 million common shares of the Company to the KRG. Accordingly, an adjustment was made to reduce the carrying value of petroleum properties by $61,349, which represented the amount previously capitalized in respect of the previous contractual requirement. Refer also to note 10(b).

10. SHARE CAPITAL AND CONTRIBUTED SURPLUS

(a) Share capital and contributed surplus

The Company is authorized to issue an unlimited number of common shares with no par value.

Share capital and contributed surplus are comprised as follows:

	Number of shares	Share capital	Contributed surplus
Balance at December 31, 2008	**308,756,088**	**250,899**	**3,024**
Shares issued on private placement	140,000,000	96,250	-
Shares issued (acquisition)	50,000,000	31,966	-
Stock options exercised during the year	790,000	558	(210)
Stock option expense during the year	-	-	546
Balance at December 31, 2009	**499,546,088**	**379,673**	**3,360**
Shares issued (acquisition, see note 7)	12,500,000	5,000	-
Shares issued on private placement	111,111,106	47,813	-
Stock options exercised during the year	25,000	20	(7)
Stock options expense during the year	-	-	514
Balance at December 31, 2010	**623,182,194**	**432,506**	**3,867**

(b) Shares to be issued

In August 2010 the Company executed agreements with the Kurdistan Regional Government to amend the Pulkhana Block 10 and the Arbat Block PSCs. The amendments waive the Company of its previous contractual requirement to issue 150 million common shares of the Company to the KRG, which was comprised of 100 million shares due on signing of the PSCs plus a further 50 million shares due 30 days prior to the expiry of the first exploration sub-period in the Pulkhana Block, and in exchange require the Company to contribute 20% of its profit oil share (produced oil, less royalty and cost oil) from the Pulkhana Block 10 PSC and the Arbat Block PSC as capacity building payments to the Government.

The amount previously reported as shares to be issued of $61,349 has been reversed with a corresponding decrease to the cost of the Company's petroleum properties within property, plant and equipment. Refer also to note 9.

(c) Share options

The Company has an established share purchase option plan whereby a committee of the Company's board of directors may, from time to time, grant up to a total of 10% of the issued share capital to directors, officers, employees or consultants. The number of shares under option at any specific time to any one optionee shall not exceed 5% of the issued and outstanding common shares of the Company. The term of any options granted under the plan will be fixed by the Board of Directors and may not exceed five years from the date of grant. A four month hold period may be imposed by the stock exchange from the date of grant. Vesting terms are at the discretion of the Board of Directors. All issued stock options have terms of three to five years and vest over periods of up to three years. The exercise prices reflect trading values of the Company's shares at grant date.

Movement during the year in stock options issued and outstanding is as follows:

	Number of options	Weighted average exercise price (Cdn $)
Outstanding at December 31, 2009	**4,110,000**	**0.82**
Granted	1,390,000	0.51
Exercised	(25,000)	0.48
Cancelled/forfeited	(915,000)	1.20
Outstanding at December 31, 2010	**4,560,000**	**0.65**

At December 31, 2010 there were 3,155,000 options exercisable at an average exercise price of Cdn $0.69 per share with a weighted average remaining life of 2.13 years.

(c) Share options (continued)

The incentive stock options issued and outstanding are as follows:

Expiry date	Number of options outstanding at December 31, 2010	Exercise price (Cdn $)
April 24, 2011	1,210,000	0.48
January 18, 2012	300,000	1.20
March 27, 2012	150,000	2.15
September 10, 2014	875,000	0.67
September 30, 2014	710,000	0.64
January 3, 2015	600,000	0.47
March 25, 2015	100,000	0.60
May 11, 2015	75,000	0.43
August 9, 2015	75,000	0.43
September 22, 2015	315,000	0.54
October 1, 2015	125,000	0.64
October 20, 2015	25,000	0.78
	4,560,000	

The Company recognizes compensation expense on stock options granted to both employees and non-employees using the fair value method at the date of grant, which the Company records as an expense. The stock option compensation expense is calculated using the Black-Scholes option pricing model. The weighted average fair value of options granted and the assumptions used in their determination are as follows:

	As at December 31,	
	2010	**2009**
Expected dividend yield	0%	0%
Risk-free interest rate (weighted average)	3.21%	3.32%
Expected stock price volatility (weighted average)	86.95%	85.77%
Expected option life in years (weighted average)	4.11	3.98
Grant date fair value (weighted average)	Cdn $0.37	Cdn $0.48

Stock option compensation expense for the year ended December 31, 2010 was $514 (2009: $546).

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company’s stock options.

11. INCOME TAXES

(a) Income tax expense

The provision for income taxes reflects an effective tax rate which differs from Federal and Provincial statutory tax rates. The main differences are as follows:

	For the year ended December 31,	
	2010	**2009**
Income / (loss) from continuing operations before income tax	(77)	1,687
Corporate income tax rate	30.0%	30.0%
Computed income tax expense / (recovery)	(23)	506
Increase / (decrease) resulting from:		
Non-taxable foreign exchange gain	(664)	(1,482)
Share issuance costs charged to share capital	(204)	(1,402)
Non-deductible compensation expense	154	164
Foreign tax rate differences	182	12
Effect of change in tax rates	233	448
Change in valuation allowance	586	2,254
Effect of changes in foreign exchange rates	(200)	(446)
Other	17	(42)
Income tax expense from continuing operations	**81**	**12**

The components of the future income tax assets are as follows:

	As at December 31,	
	2010	**2009**
Non-capital losses	61,715	60,366
Share issue costs carried forward	1,447	2,033
Properties – tax basis over carrying value	1,279	1,160
Exploration expenses	803	764
Future income tax assets before allowance	65,244	64,323
Valuation allowance	(65,244)	(64,323)
Future income tax asset	**-**	**-**

(b) Tax losses carried forward

The Company has tax losses and costs which are available to apply to future taxable income as follows:

	For the year ended December 31,	
	2010	**2009**
Canadian losses from operations	10,774	7,401
Canadian exploration expenses	3,210	3,057
Canadian unamortized share issue costs	5,606	7,577
Dutch losses from operations	1,446	-
U.S. Federal losses from operations	167,807	167,188
U.S. Federal – tax basis in excess of carrying values of properties	3,654	3,315
Total	**192,497**	**188,538**

(b) Tax losses carried forward (continued)

The Canadian losses from operations may be used to offset future Canadian taxable income and will expire over the period from 2015 to 2030. The Canadian exploration expenses may be carried forward indefinitely to offset future taxable Canadian income. Canadian unamortized share issue costs may offset future taxable Canadian income of years 2011 to 2014. The U.S. Federal losses are available to offset future taxable income in the United States through 2030.

12. RELATED PARTY TRANSACTIONS

Namdo Management Services Ltd. ("Namdo") provides corporate administrative support and investor relation services to the Company under an agreement which commenced April 1, 2007. The Company incurred fees for these services and associated reimbursable costs during the current year of $185 (2009: $214), respectively. Namdo is a private corporation owned by a shareholder of the Company. There was no amount owing to this related party at December 31, 2010 (2009: Nil).

Mile High Holdings Ltd., a private corporation associated with a shareholder of the Company, provided transportation services to the Company relating to its fundraising activities in the amount of $152 during year ended December 31, 2010 (2009: $385). There was $12 owing to this related party at December 31, 2010 (2009: $385).

During the year ended December 31, 2010, the Company incurred legal fees of $41 (2009: $217) with a law firm in which an officer of the Company is a partner. There was no amount owing to this related party at December 31, 2010 (2009: Nil).

The Company receives services from various subsidiary companies of Lundin Petroleum AB ("Lundin"), a shareholder of the Company. Lundin charges for the year ended December 31, 2010 were $2,673 (2009: $1,245). The charges were comprised of G&G and other technical service costs of $382 (2009: $317), reimbursement for Company travel and related expenses of $601 (2009: $207), office rental, administrative and building services of $328 (2009: $86), and charges of $1,362 (2009: $635) relating to a guarantee provided to the KRG on behalf of the Company in respect of its minimum financial commitments, charged at a rate of 3% per annum through to June 30, 2010, thereafter charged at 1.5% per annum, and payable semi-annually. The amount owing to Lundin at December 31, 2010 was $214 (2009: $767).

Total amounts owing to related parties as at December 31, 2010 was $226 (2009: $1,152). The Company was owed no amounts by related parties at the reporting dates.

All transactions with related parties are recorded at amounts agreed to by the parties and are made on the same terms and conditions as with non-related parties.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments consist of cash and cash equivalents, short-term investments, accounts receivable, accounts payable, accrued expenses and advances from joint interest holders.

Cash and cash equivalents and investments are designated as held for trading and therefore carried at fair value, with unrealized gain or loss recorded in interest income.

The carrying amounts reported in the consolidated balance sheet for short term financial assets and liabilities, which includes accounts receivable, accounts payable, accrued expenses and advances from joint interest holders approximate fair values due to the immediate or short-term maturities of these financial instruments.

The following is a classification of fair value measurements recognized in the consolidated balance sheet using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

	Fair value measurement at reporting using:			
Financial assets	**December 31, 2010**	**Quoted prices in active markets identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Held for trading securities:				
Cash and cash equivalents	58,684	58,684	-	-
Total	**58,684**	**58,684**	**-**	**-**

The Company is exposed in varying degrees to a variety of financial instrument related risks.

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 manages its credit risk through its counterparty ratings and credit limits. The Company is mainly exposed to credit risk on its cash and cash equivalents and accounts receivable. To manage this risk the Company maintains its excess cash on account in instruments having a minimum credit rating of R-1 (mid) or better (as measured by Dominion Bond Rate Services) or the equivalent thereof according to a recognized bond rating service.

Accounts receivable are primarily with joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Joint venture receivables are typically collected within one to two months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project.

Liquidity Risk

Liquidity risk is the risk that the Company will incur difficulties meeting 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, without incurring unacceptable losses or risk harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operating and non-operating projects to further manage capital expenditures.

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.

The significant market risk exposures to which the Company is exposed are foreign currency, commodity price and interest rate risks.

Foreign currency risk – The Company maintains a portion of its cash in Canadian dollars. The Company's operations are conducted in U.S. dollars. The Company's operating results and cash flows are affected to varying degrees by the changes in the Canadian dollar vis-à-vis the U.S. dollar. Company expenditures are incurred predominately in U.S. dollars. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks.

At December 31, 2010, the Company had $50,364 denominated in Canadian dollars. As of December 31, 2010, with other variables unchanged, a 1% strengthening of the U.S. dollar against the Canadian dollar would increase the net loss by $500 due to this financial asset.

Commodity price risk – The prices that the Company received for its crude oil and natural gas production may have had a significant impact on its revenue and cash provided by operating activities. Any significant price decline in commodity prices would have adversely affected the amount of funds available for capital reinvestment purposes. The Company did not use derivative financial instruments to manage its exposure to this risk.

Interest rate risk – The Company's bank accounts earn interest income at variable rates. The Company's future interest income is exposed to changes in short-term rates. At December 31, 2010, the Company had $50,364 denominated in Canadian dollars. As of December 31, 2010, with other variables unchanged, a 0.25% weakening of the interest rate on Canadian funds on deposit would increase the net loss by approximately $126 due to this financial asset.

14. CAPITAL DISCLOSURE

The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern such that it can provide returns for shareholders and benefits for other stakeholders.

The Company considers its capital structure to include shareholders' equity and working capital. The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust its capital structure, the Company may issue new shares or sell assets to settle liabilities. The Company is not subject to externally imposed capital requirements.

The components of the Company's capital structure are as follows:

	As at December 31,	
	2010	**2009**
Current assets	61,985	64,819
Current liabilities	(20,621)	(4,916)
Working capital	41,364	59,903
Shareholders' equity	235,518	244,563

15. COMMITMENTS AND CONTINGENCIES

(a) Production Sharing Contracts ("PSC")

The Company entered into two PSCs during the year 2009, which govern its petroleum operations in two separate petroleum exploration and development properties, the Pulkhana Block 10 and the Arbat Block, located in the Kurdistan Region of Iraq.

Under the terms of the Pulkhana PSC, the Company holds a 60% undivided interest in the petroleum operations, Petoil Petroleum and Petroleum Products International Exploration and Production Inc ("Petoil") holds a 20% interest and the remaining 20% is held by the Kurdistan Regional Government (the "KRG"). The Company is required to pay 100% of the minimum financial commitment in respect of the first exploration sub-period, which is 36 months from the commencement of the PSC with option to extend by one year. Under the terms of the Pulkhana PSC, the Company is the operator and collectively with Petoil, represent the "Contractor".

Under the terms of the Arbat PSC, the Company holds a 60% undivided interest in the petroleum operations, the KRG holds a 20% interest and the remaining 20% is a third party interest which the KRG has the option to assign to a third party or parties. The Company is required to pay 100% of the minimum financial commitment in respect of the first exploration sub-period or until such time as the KRG's reserved 20% interest has been sold, following which the Company will pay 75% of the forward costs and receive a reimbursement for 25% of the costs incurred to that date. Under the terms of the Arbat PSC, the Company is the operator and represents the "Contractor".

(a) Production Sharing Contracts (continued)

The PSCs contemplate a minimum financial commitment of $61 million in respect of the first exploration sub-period for the Pulkhana and Arbat Blocks combined. The PSCs also require the Contractor to fund certain personnel, training, environmental, and technological assistance projects, during the period over which the contracts are in effect. As at December 31, 2010, the Company had executed $11.0 million of its minimum financial obligations through the completion of its two dimensional ("2D") seismic acquisition program in both Blocks.

All qualifying petroleum costs incurred by the Contractor shall be recovered from a portion of available petroleum production, defined under the terms of the PSCs. At any time during the exploration period the Contractor has the right to terminate the PSCs, by surrendering the entire contract area.

All modifications to the PSC's are subject to the approval of the KRG.

(b) Amendment and Novation Agreement to the Block 42 Option Agreement ("K42 Option Agreement")

During the year 2009 the Company became party to the K42 Option Agreement between the KRG and Oil Search (Iraq) Limited ("OSIL"), which allows an option to the Company and OSIL to enter into with the KRG a PSC relating to the exploration and development of petroleum resources in the Block K42 contract area located in Kurdistan Region of Iraq, the terms of which have been agreed in principle.

In accordance with the K42 Block PSC, OSIL is the operator and, collectively with the Company, represent the "Contractor". Upon exercise of the option, the Company would acquire not less than an undivided 20% interest in the petroleum operations in respect of the K42 Block contract area, with OSIL holding a 60% interest and the KRG holding the remaining 20%. If either the Company or OSIL elect not to exercise its option in respect of the Contract the other party has the option to acquire the exiting party's rights and obligations.

This K42 Option Agreement requires the Contractor to conduct certain seismic services, including the acquisition of 200 kilometers of seismic surveying, within the option period of 18 months commencing October 1, 2009, which is extendable for a further three months. Provided that the seismic services are completed prior to the expiry of the option period, the option to enter into a PSC may be exercised by providing written notice to the KRG. The Contractor is to pay 100% of all the costs incurred during the option period, 25% of which are to be paid by the Company.

The Company estimates that it has concluded its minimum commitments under the K 42 Option as at December 31, 2010.

All qualifying petroleum costs incurred by the Contractor during the option period would be recoverable from a portion of available petroleum production, defined under the terms of the PSC.

(c) Net Profit Interest

During 2009 the Company entered into a non-legally binding heads of agreement ("HOA") which offered a net profit interest to certain parties in the Pulkhana and Arbat PSC's, and if granted, the K42 PSC. This non-legally binding HOA has not been formalized into a legally binding agreement.

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