Consolidated Financial Statements of

PetroKamchatka Plc

As at May 31, 2011 and 2010
and for the years ended May 31, 2011 and 2010
(United States Dollars)

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of PetroKamchatka Plc

We have audited the accompanying consolidated financial statements of PetroKamchatka Plc (the "Company"), which comprise the consolidated balance sheets as at May 31, 2011 and 2010, the consolidated statements of operations, comprehensive loss and deficit and changes in cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at May 31, 2011 and 2010, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.
KPMG Canada provides services to KPMG LLP.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 2 in the consolidated financial statements which describes that the Company does not have sufficient funds to meet all of its exploration and drilling commitments and therefore could lose all or part of its interests in its oil and gas properties. This condition indicates the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

Sincerely,

KPMG LLP

Chartered Accountants

Calgary, Canada
September 28, 2011

PetroKamchatka Plc

Consolidated Balance Sheets

As at May 31, 2011 and 2010
(United States Dollars)

	2011	2010
Assets		
Current assets:		
Cash and cash equivalents	$ 4,045,212	$ 7,915,415
Accounts receivable (note 5)	252,667	2,758,064
Prepaid expenses	27,071	27,958
	4,324,950	10,701,437
Property and equipment (note 6)	10,816,759	27,375,366
	$ 15,141,709	$ 38,076,803
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities (note 8)	$ 2,333,080	$ 3,249,580
Shareholders' equity:		
Share capital (note 9(b))	91,806,942	91,755,940
Share purchase warrants (note 9(c))	7,038,779	7,038,779
Contributed surplus (notes 9(d) and 9(e))	4,289,815	3,903,396
Currency translation adjustment	1,018,864	1,018,864
Deficit	(91,345,771)	(68,889,756)
	12,808,629	34,827,223
Going concern (note 2)		
Commitments and contingencies (notes 6 and 13)		
Subsequent events (note 14)		
	$ 15,141,709	$ 38,076,803

See accompanying notes to financial statements

(*signed*) "*Jonathan Morley-Kirk*"
Director

(signed)"Graeme Phipps"
Director

PetroKamchatka Plc

Consolidated Statements of Operations, Comprehensive Loss and Deficit

Years ended May 31, 2011 and 2010
(United States Dollars)

	2011	2010
Interest income	$ –	$ 88,364
Expenses:		
Equipment operating costs and other (note 3(k))	2,350,579	–
General and administration	2,376,413	4,525,263
Reorganization and listing costs (note 1)	–	1,173,750
Financing and other costs	–	(425,303)
Foreign exchange gain	(10,270)	(94,071)
Stock-based compensation (note 9(e))	386,419	679,000
Depreciation (note 6)	263,898	734,972
Write down of property and equipment (note 6(a))	17,088,976	31,948,499
	22,456,015	38,542,110
Loss before income taxes	(22,456,015)	(38,453,746)
Income taxes (note 10)	–	–
Net loss and comprehensive loss for the year	(22,456,015)	(38,453,746)
Deficit, beginning of year	(68,889,756)	(30,264,850)
Transaction costs (note 1)	–	(171,160)
Deficit, end of year	$(91,345,771)	$(68,889,756)
Net loss per share	$ (0.05)	$ (0.09)
Weighted average number of common shares outstanding:		
Basic and diluted	489,987,712	430,392,239

See accompanying notes to financial statements

PetroKamchatka Plc

Consolidated Statements of Changes in Cash Flows

Years ended May 31, 2011 and 2010
(United States Dollars, unless otherwise stated)

	2011	2010
Cash provided by (used in):		
Operations:		
Net loss and comprehensive loss for the year	$(22,456,015)	$(38,453,746)
Items not involving cash:		
Write down of property and equipment (note 6)	17,088,976	31,948,499
Depreciation (note 6)	263,898	734,972
Stock-based compensation (note 9(e))	386,419	679,000
Shares issued for services (notes 9(b)(viii), (ix), (x) and (xi))	51,002	174,773
Shares issued for bonuses and other	–	543,334
Unrealized foreign exchange (gain) loss	13,778	(169,463)
	(4,651,942)	(4,542,631)
Change in non-cash working capital (note 12)	999,273	(78,188)
	(3,652,669)	(4,620,819)
Investing:		
Property and equipment expenditures (note 6)	(794,267)	(5,657,906)
Change in non-cash working capital (note 12)	582,944	(3,156,896)
	(211,323)	(8,814,802)
Financing:		
Issue of shares and warrants for cash, net (notes 9(b)(i), (ii) and (vii))	–	19,812,264
Shareholder loan repayment (note 8)	–	(395,051)
	–	19,417,213
Foreign exchange loss on cash held in foreign currencies	(6,211)	(174,999)
Increase (decrease) in cash and cash equivalents	(3,870,203)	5,806,593
Cash and cash equivalents, beginning of year	7,915,415	2,108,822
Cash and cash equivalents, end of year	$ 4,045,212	$ 7,915,415

See accompanying notes to financial statements

1. General:

(a) PetroKamchatka Plc (the “Corporation” or “PKP”) was incorporated on December 23, 2008 under the Companies (Jersey) Law 1991 by directors and officers of PetroKamchatka Resources Ltd. with the intent to have it acquire all of the shares of PetroKamchatka Resources Ltd. (“PKR”). PKR was incorporated on November 23, 1998 under the Business Corporations Act (Yukon, Canada) and was re-domiciled to Cyprus on August 25, 2009. PKR is principally engaged in the exploration and development of petroleum and natural gas resources in the Kamchatka Peninsula of Russia pursuant to exploration licenses (note 6). To date, the Corporation has received no revenue from these operations.

(b) In October 2009, PKP issued a Take-Over Bid Circular to the shareholders of PKR, to acquire all of the issued and outstanding Class A Common Shares of PKR including any that would become outstanding upon the conversion of warrants of PKR or exercise of options of PKR and to acquire all of the issued and outstanding warrants of PKR (the “Offer”). The shareholders of PKR received one share of PKP for each PKR share held. The warrant holders of PKR received one warrant of PKP for each warrant of PKR held. The PKP warrants and options were issued on substantially similar terms and conditions as the PKR warrants and options. Under this Offer, PKP acquired PKR effective November 23, 2009 (note 9(b)(ii)).

(c) The Corporation followed the continuity of interest basis of accounting whereby the Corporation is considered a continuation of PKR. These consolidated financial statements reflect the assets, liabilities and results of operations of PKR for periods prior to the acquisition by PKP. PKR is consolidated as a 100% owned subsidiary of PKP. As PKP had no significant assets, liabilities, capital, income or expense prior to the acquisition, the transaction had no significant impact on the consolidated financial statements, except for transaction costs, which were included in expense as part of reorganization and listing costs.

(d) On October 2, 2009, the Corporation entered into an Arrangement Agreement to complete a business combination with Bluerock Acquisition Corp. (“Bluerock”) a capital pool corporation listed on the TSX Venture Exchange. The arrangement was approved at a special meeting of the Bluerock shareholders and by the Court of Queen’s Bench of Alberta, Canada on November 25, 2009 resulting in the Corporation issuing 6,626,501 common shares, on the basis of 0.46837 of a common share for each Bluerock common share outstanding and 187,348 warrants. The warrants expired unexercised (note 9(c)). Bluerock had no operating assets and limited working capital. As a result, the transaction was not recorded as a business combination, but rather as a capital transaction (note 9(b)(vi)).

1. General (continued):

Details of the acquisition were as follows:

	Number of shares		Amount
Working capital (including cash of $171,160)	–	$	98,840
Common shares issued to Bluerock shareholders (note 9(b)(vi))	6,626,501	$	98,840

Transaction costs of $171,160, incurred by Bluerock relating to the acquisition, were recorded as a charge to deficit to the extent of cash available in Bluerock. Additional costs related to the Bluerock transaction, the PKP acquisition of PKR and the listing of the common shares of PKP for trading on the TSX Venture Exchange were expensed as reorganization and listing costs.

2. Going concern:

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Corporation will realize its assets and discharge its liabilities in the normal course of operations. If the going concern assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary to adjust the carrying value of assets and liabilities, reported expenses and to revise the balance sheet classifications used.

The Corporation presently does not have sufficient funds to meet all of its exploration and drilling commitments on its licenses in Kamchatka, Russia (note 6). It could therefore lose all or part of its interests in the remaining Russian properties. The drilling of two dry holes has negatively impacted the ability of the Corporation to raise additional capital.

The Corporation did not raise additional equity in the year ended May 31, 2011. During the year ended May 31, 2010, the Corporation raised net cash proceeds of $19,812,264 through private placements and became a listed public Corporation (notes 1, 9(b)(ii) and 9(b)(vii)). At May 31, 2011, the Corporation's working capital was $1,991,870. Management believes the going concern assumption to be appropriate for these consolidated financial statements as the Corporation has positive working capital, no debt and is able to meet its current obligations (note 14).

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3. Significant accounting policies:

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

(a) Basis of presentation:

The consolidated financial statements include the accounts of the Corporation and its subsidiaries and the Corporation's proportionate share of the accounts of its joint interest corporations. The Corporation conducts certain of its oil and gas exploration activities on a joint interest basis (note 7).

All consolidated financial statement amounts are stated in United States dollar.

(b) Petroleum and natural gas properties:

At present, all activities of the Corporation are in the exploration stage. The Corporation follows the full cost method of accounting for oil and gas properties whereby all costs of exploring for and developing oil and natural gas resources or reserves are capitalized in cost centers, on an exploration-by-exploration license basis. Such costs include exploration license acquisition costs and geological, geophysical and drilling costs. All general and administrative costs are expensed as incurred. Carrying costs directly attributable to property and equipment under construction are capitalized.

Upon the commencement of commercial production, capitalized costs net of impairments, less the carrying value of unevaluated properties, will be depleted within each cost centre using the unit-of-production method based upon estimated proven reserves before royalties, as determined by independent reservoir engineers. For the purposes of this calculation, natural gas will be converted to oil on an energy equivalent basis. The cost of acquiring and evaluating unproven properties are initially excluded from the depletion calculation. These properties are assessed periodically for impairment. When proved reserves are assigned, the costs of the property are added to the costs subject to depletion. Proceeds from the sale of petroleum and natural gas properties will be applied against capitalized costs, with no gain or loss recognized, unless such adjustment would alter the rate of depletion and depreciation by more than 20%.

3. Significant accounting policies (continued):

(b) Petroleum and natural gas properties (continued):

In applying the full cost method, the Corporation completes a ceiling test calculation, by exploration license, whereby the carrying amount of property and equipment, less unproved properties, is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of the carrying amount, the Corporation would then measure the amount of impairment by comparing the carrying amounts of property and equipment, less unproved properties, to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves. The Corporation's risk-free interest rate will be used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a write down impairment.

(c) Asset retirement obligations:

The Corporation recognizes the fair value of an asset retirement obligation in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated obligation is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is expensed to income in the period. Actual costs incurred upon the settlement of the obligation are charged against the liability.

(d) Drilling rig and related equipment - Russia:

Depreciation of the drilling rig and related equipment is calculated using the straight-line method over the estimated useful life of the assets of seven years. No depreciation is provided for when the rig is not in use and held in storage. The cost of normal maintenance and repairs is charged to expense as incurred. Material expenditures that increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset. The cost of equipment sold, or otherwise disposed of, and the related accumulated depreciation is removed from the accounts and any gain or loss is reflected in current operations. The Corporation began using and depreciating the drilling rig and related equipment in October, 2009. At May 31, 2011, the drilling rig and related equipment were held in storage for future use.

3. Significant accounting policies (continued):

(e) Office furniture and equipment:

Office furniture and equipment is recorded at cost upon acquisition. Depreciation is calculated over their useful life on a straight-line basis with rates ranging from 30% to 100% per annum. Additions during the period are depreciated at 50% of the assigned rate.

(f) Stock-based compensation:

The Corporation uses the fair value method for accounting for all stock and other stock-based payments, which requires the use of the fair value method of valuing all stock options granted and other stock-based payments whether they be to employees, directors or non-employees. The fair value is recognized in earnings over the vesting period of the options as stock-based compensation expense with a corresponding increase to contributed surplus. Stock-based compensation for options granted to directors and employees is based on the estimated fair value at the time of the grant. Stock-based compensation for options granted to consultants is based on the estimated fair value at each balance sheet date until the related options are fully vested. Upon the exercise of the stock options, consideration paid together with the amount previously recognized as contributed surplus is recorded as an increase to share capital.

(g) Foreign currency translation:

The Corporation determined, effective June 1, 2006, that its functional currency is the United States dollar. Foreign currency amounts of subsidiaries are expressed in United States dollars using the temporal method. Under this method, monetary assets and liabilities are translated at the rates of exchange at the balance sheet date; non-monetary assets and related depreciation, amortization and write downs are translated at historic rates; revenues and expenses are translated at rates in effect as they have occurred. Foreign exchange gains and losses are recognized in earnings.

(h) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and highly liquid investments with original maturities of three months or less.

3. Significant accounting policies (continued):

(i) Future income taxes:

The Corporation uses the asset and liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the consolidated financial statements and their respective tax basis, using income tax rates substantively enacted at the balance sheet date. The effect of a change in rates on future income tax liabilities and assets is recognized in the period in which the change occurs. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

Under Russia foreign currency legislation, foreign currency liabilities are adjusted at the end of each calendar quarter to reflect the current exchange rate. The revaluation may result in a foreign exchange gain or loss. Losses are accumulated and applied to future foreign currency gains. When a foreign currency gain is calculated, available accumulated foreign currency losses are applied against the gain, and the remaining gain is subject to a 20% profit tax.

At May 31, 2011 and 2010, there were no profit tax liabilities.

(j) Revenue recognition:

Revenues associated with the sale of crude oil, natural gas and natural gas liquids will be recorded when title passes to the customer. Revenues from properties in which the Corporation has an interest with other producers will be recognized on the basis of the Corporation's net working interest.

(k) Equipment operating costs and other:

The joint interest entities own a mobile drilling rig and other equipment located in Russia. In periods when the drilling rig and equipment are idle and not assigned to a specific drilling location, certain costs are expensed when incurred and included in 'equipment operating costs and other'. Such costs include rig and equipment mobilization expenditures, storage expenditures and other amounts. The Corporation also owns a 46.25% interest in another drilling rig (the "HighKelly rig"). The Corporation's share of storage, legal, inspection and other costs are also included in 'equipment operating costs and other'.

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3. Significant accounting policies (continued):

(l) Per share data:

Basic per share amounts are computed by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments.

(m) Measurement uncertainty:

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make assumptions and estimates that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from and affect the results reported in these consolidated financial statements. The most significant estimates relate to the valuation of the Russian petroleum and natural gas properties and other property and equipment including the HighKelly drilling rig (note 6(a) and (b)).

(n) Financial instruments:

Cash and short-term investments are held-for-trading investments and the fair values approximate their carrying value due to their short-term nature. The fair values of accounts receivable and accounts payable and accrued liabilities approximate their carrying values due to the short-term nature of these receivables and other liabilities. The Company has not designated any financial instruments as available for-sale or held-to-maturity.

PetroKamchatka is exposed to foreign currency fluctuations as it holds cash in Russian roubles, Euros, Pounds Sterling and Canadian Dollars and is exposed to fluctuations in exchange rates of these currencies relative to the US dollar.

4. Changes in accounting policies:

In January 2009, the CICA Accounting Standards Board (“AcSB”) issued CICA Handbook 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. Section 1582 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 1, 2011 with earlier application permitted. The adoption of section 1582 will affect the accounting for business combinations by the Corporation on or after June 1, 2011.

4. Changes in accounting policies (continued):

In January 2009, the AcSB issued CICA Handbook Sections 1601, "Consolidated Financial Statements", and Section 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 1, 2011. Early adoption is permitted provided the new standards are adopted simultaneously with Section 1582 "Business Combinations". Section 1582 requires equity instruments issued as part of the purchase consideration to be measured at the fair value of the shares at the acquisition date. In addition, guidance generally requires all acquisition costs to be expensed whereas such amounts could be capitalized as part of the purchase price under the previous standard. The adoption of these recommendations may have a material impact on any future business combinations or future investments reported in the Corporation's consolidated financial statements. The Corporation is currently assessing the impact that the adoption of these Sections may have on its results of operations or financial position. There is a 10% non-controlling interest in one of the Corporation's Russian subsidiaries.

Effective for fiscal years beginning on or after January 1, 2011, the Corporation will be required to report under IFRS, which will become the generally accepted accounting principles in Canada. The adoption date for the Corporation of June 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Corporation for the year ended May 31, 2011, including the opening balance sheet as at June 1, 2010. The transition impact from Canadian GAAP to IFRS will be significant with differences affecting the financial position and results of operations. Subsequent to the year ended May 31, 2011, the Corporation continued its work to finalize the impact on its financial statements of the convergence of Canadian GAAP with IFRS and this process is expected to be completed in time for the first IFRS compliant reporting required for the interim three month period ending August 31, 2011.

5. Accounts receivable:

Accounts receivable include the Corporation's proportionate share of refunds of Russian Value Added Taxes ("VAT") of $224,478 (May 31, 2009 - $1,338,504) and other amounts.

6. Property and equipment:

May 31, 2011	Cost	Accumulated depreciation	Accumulated impairment	Net book value
Petroleum and natural gas properties:				
Russia	$ 46,848,625	$ –	$ (46,848,625)	$ –
Canada	5,184,840	–	(5,184,840)	–
	52,033,465	–	(52,033,465)	–
Drilling rig and equipment - Russia	7,498,228	(886,795)	-	6,611,433
Joint interest in drilling rig - Russia	8,567,260	–	(4,430,000)	4,137,260
Office furniture and equipment	376,613	(308,547)	–	68,066
	$ 68,475,566	$ (1,195,342)	$ (56,463,465)	$ 10,816,759

May 31, 2010	Cost	Accumulated depreciation	Accumulated impairment	Net book value
Petroleum and natural gas properties:				
Russia	$ 46,054,358	$ –	$ (29,759,649)	$ 16,294,709
Canada	5,184,840	–	(5,184,840)	–
	51,239,198	–	(34,944,489)	16,294,709
Drilling rig and equipment - Russia	7,498,228	(644,942)	–	6,853,286
Joint interest in drilling rig – Russia	8,567,260	–	(4,430,000)	4,137,260
Office furniture and equipment	376,613	(286,502)	–	90,111
	$ 67,681,299	$ (931,444)	$ (39,374,489)	$ 27,375,366

6. Property and equipment (continued):

(a) Russia:

The ultimate recovery of property and equipment costs is dependent upon the existence and commercial exploitation of petroleum and natural gas reserves or a sale of property and equipment to a third party. The Corporation presently does not have sufficient cash to fund all expenditure commitments embedded in the terms of its Russian exploration licenses (note 2). Uncertainties regarding the political, legal, tax or regulatory environment, including the potential for adverse and retroactive changes with respect to the Corporation's operations in Russia could significantly affect the Corporation and the ultimate cost recovery of its assets.

Exploration licenses in Russia are issued by the Federal Ministry of Natural Resources ("MNRF") and grant the holder of the license the right to explore for oil and natural gas reserves within the area specified in the license. In the event of a commercial discovery, the Corporation has the right to convert parts of the exploration license into a production license. Exploration licenses have an associated license agreement, which specifies a required geological and geophysical work program to be completed.

(i) Exploration licenses:

In September 2009, the Corporation acquired 100% interest in the Pustaretskaya, Palanskaya, Ichinskaya and Vorovksaya exploration licenses. The licenses, each with a five year term, require minimum seismic, drilling and completion programs in the first two to three years of the license term. In August 2010, the Corporation surrendered the Pustaretskaya and Palanskaya exploration licenses back to the MNFR along with the Urginskaya license, which was acquired in February 2008. The accumulated impairment includes a write down at May 31, 2010 of $18,012, $34,617 and $237,873 of the Pustaretskaya, Palanskaya and Urginskaya licenses respectively. Upon reviewing the drilling results of two unsuccessful wells and further evaluation of the remaining prospects on the Tigil license, a write down of the cost of the Tigil exploration license of $29,469,147 was recorded at May 31, 2010. On December 31, 2010, the Tigil exploration license expired and reverted back to the MNRF (note 14(a)).

Upon further evaluation of the existing prospects on the Icha license, the Corporation and its Joint Venture Partner determined that the mapped prospects were non-commercial on a fully risked basis. As a result, it was determined not to drill an exploration well on the Icha license and effective February 28, 2011, the Corporation recorded a write down of the carrying value of its full cost pool relating to the Icha license of $17,013,932. On March 24, 2011, the Corporation and KKPL agreed to seek an early relinquishment of the Icha exploration license. On April 29, 2011, the Corporation received approval for the early relinquishment of the Icha exploration license from MNFR effective March 28, 2011.

6. Property and equipment (continued):

(a) Russia – Exploration licenses (continued):

At May 31, 2011, the Corporation held interests in exploration licenses in the Ichinskaya and Vorovskaya areas of Kamchatka. The licenses, valid until September 2014, each required minimum seismic, drilling and completion programs in the first two to three years of the license term. The Corporation has determined that it does not currently have sufficient capital to complete its minimum commitments under the terms of the Ichinskaya and Vorovskaya licenses. Effective May 31, 2011, the Corporation recorded a write down of its carrying value relating to these licenses of $75,044.

The following is a summary of the impairments of property and equipment recorded in the years ended May 31, 2011 and 2010:

	May 31, 2011	May 31, 2010
Russia full cost pool		
Icha – (note 7)	$ 17,013,932	$ –
Tigil – (note 7)	–	29,469,147
Ichinskaya	44,007	–
Vorovskaya	31,037	–
Urginskaya	–	237,873
Palanskaya	–	34,617
Pustaretskaya	–	18,012
	17,088,976	29,759,649
Canadian full cost pool – (note 6(c))	–	165,850
Joint interest in drilling rig – (note 6(b))	–	2,023,000
Total impairments in the year	$ 17,088,976	$ 31,948,499

(ii) Mobile drilling rig and other equipment:

The Russian joint interest entities own a mobile drilling rig and other equipment located in Russia (note 14(b)). In periods when the drilling rig and equipment are idle and not assigned to a specific drilling location, certain costs are expensed when incurred and included in 'equipment operating costs and other'. Such costs include rig and equipment mobilization expenditures, storage expenditures and other amounts. No depreciation is provided for when the rig is not in use and held in storage.

6. Property and equipment (continued):

(b) Joint interest in drilling rig:

The aggregate cost of $8,567,260 (May 31, 2010 - $8,567,260) represents the Corporation's 46.25% share of the original purchase price for a new drilling rig and tubulars (the "HighKelly rig") of $17,533,000 plus the Corporation's share of other costs. The Corporation and its Joint Venture Partner determined that this rig, which is currently stored in a secure facility in Shanghai, China, was not suitable for the Russian drilling program and purchased a separate mobile rig and other ancillary equipment to drill in Russia (note 6(a)(ii)).

The estimated fair market value of the HighKelly rig as at August 1, 2010, as indicated by an independent appraisal, was $9,223,200 gross. On that basis, the carrying value of the Corporation's 46.25% interest was written down, in the fiscal year ended May 31, 2010, by $2,023,000 (May 31, 2009 - $2,407,000) to $4,137,260, which is net of estimated selling costs. A subsequent independent appraisal indicated a fair market value of the HighKelly rig, as at May 31, 2011, greater than that of the prior year reflecting a general increase in demand for drilling rigs and a general improvement in market conditions.

On August 18, 2009, the Corporation's Joint Venture Partner initiated an arbitration proceeding in The International Court of Arbitration against the manufacturer of the rig in respect of an alleged claim that the manufacturer failed to comply fully with certain contractual obligations to manufacture and deliver a customized rig in compliance with specific contracted requirements. Pursuant to the arbitration, the Joint Venture Partner is seeking damages for the alleged breach. The Joint Venture Partner has agreed to suspend arbitration proceedings against the manufacturer until December 31, 2011, in order for it and the Corporation to work towards a sale of the HighKelly rig.

(c) Canada:

The Corporation is not active in Canada and its British Columbia properties, held by a Canadian subsidiary, have been fully written down.

7. Joint ventures:

The Corporation's net interests in Tigil and Icha are accounted for on a proportionate consolidation basis.

For the year ended May 31, 2011, the Corporation's net share of amounts contributed to the joint ventures were:

	Tigil	Icha	Total
Balance Sheet:			
Cash	282,064	45,169	327,233
Accounts receivable	108,239	116,239	224,478
Property and equipment, cost (note 6)	29,469,147	17,013,932	46,483,079
Accumulated impairment (note 6)	(29,469,147)	(17,013,932)	(46,483,079)
Drilling rig and related equipment	5,955,102	–	5,955,102
Accounts payable	(29,182)	(82,951)	(112,133)
Net contribution to joint venture	6,316,223	78,457	6,394,680
Income Statement:			
Revenues	–	–	–
Expenses	1,017,929	18,307,992	19,325,921
Proportionate share of net loss	(1,017,929)	(18,307,992)	(19,325,921)
Cash flows:			
Operating activities	(345,815)	(835,997)	(1,181,812)
Financing activities	(1,605,358)	1,278,063	(327,295)
Investing activities	732,905	(746,104)	(13,199)
Proportionate share of decrease in cash	(1,218,268)	(304,038)	(1,522,306)

7. Joint ventures (continued):

For the year ended May 31, 2010, the Corporation's net share of amounts contributed to the joint ventures were:

	Tigil	Icha	Total
Balance Sheet:			
Cash	1,500,332	349,206	1,849,538
Accounts receivable	1,428,262	–	1,428,262
Property and equipment, cost (note 6)	29,469,147	16,267,828	45,736,975
Accumulated impairment (note 6)	(29,469,147)	–	(29,469,147)
Drilling rig and related equipment	6,196,956	–	6,196,956
Accounts payable	(186,039)	(5,778)	(191,817)
Net contribution to joint venture	8,939,511	16,611,256	25,550,767
Income Statement:			
Revenues	–	–	–
Expenses (recovery)	29,994,918	(1,779)	29,993,139
Proportionate share of net loss	(29,994,918)	1,779	(29,993,139)
Cash flows:			
Operating activities	77,229	850	78,079
Financing activities	4,570,096	(1,326,307)	3,243,789
Investing activities	(3,803,826)	1,671,048	(2,132,778)
Proportionate share of increase in cash	843,499	345,591	1,189,090

8. Related party transactions and balances:

At May 31, 2011 and 2010, there were no amounts receivable from directors or officers. The Corporation's aggregate liabilities owing to directors and officers for services performed and expenses incurred in the normal course of operations as at May 31, 2011 amounted to $127,800 (May 31, 2010 - $67,500).

A portion of the fees paid to directors for services performed for the fiscal years ended May 31, 2011 and 2010 was by way of common shares of the Corporation. (See notes 9(b)(viii), (ix), (x), and (xi)).

On July 8, 2009, the Corporation repaid loans to a person who is a shareholder, officer and director of the Corporation. The aggregate amounts repaid included principal of $390,000 and interest of $5,051. The loans were made to the Corporation during the fiscal year ended May 31, 2009.

9. Share capital:

(a) Authorized:

An unlimited number of common shares and an unlimited number of preferred shares.

(b) Common shares issued and outstanding – (note 1 and note 9(b)(i) to 9(b)(xi)):

	May 31, 2011		May 31, 2010	
	Number issued	Amount	Number issued	Amount
Share capital, beginning of year	489,063,510	$ 91,755,940	158,119,627	$ 69,731,912
PKP shares upon incorporation (note 9(b)(i))	–	–	2	3
Issued for cash (note 9(b)(ii)	–	–	228,505,044	11,477,980
Share issue costs (note 9(b)(ii))	–	–	–	(89,401)
Issued for settlement of liabilities (note 9(b)(iii))	–	–	17,600,000	880,000
Issued for bonus (note 9(b)(iv))	–	–	8,766,666	876,667
Issued for shares of subsidiary (note 9(b)(v))	–	–	5,200,000	260,000
Issued to acquire Bluerock (note 1 and 9(b)(vi))	–	–	6,626,501	98,840
Issued for cash (note 9(b)(vii)	–	–	61,828,486	9,274,273
Share issue costs (note 9(b)(vii))	–	–	–	(850,591)
Less portion representing warrant value (note 9(b)(vii))	–	–	–	(78,516)
Issued for services (note 9(b) (viii), (ix), (x) and (xi))	1,332,627	51,002	2,417,184	174,773
	490,396,137	$ 91,806,942	489,063,510	$ 91,755,940

9. Share capital (continued):

(b) Common shares issued and outstanding (continued):

(i) On December 23, 2008, upon incorporation of the Corporation under the Companies (Jersey) Law 1991, two directors of PKR (note 1) subscribed for two common shares of the Corporation for $3.

(ii) From June 2009 through August 2009, the Corporation issued, through an offering to shareholders and others closely associated with the Corporation, 217,959,590 common shares at $0.05 per share and the right to acquire 10,545,454 common shares at $0.055 per share. The Corporation acquired the obligation to the rightsholders and converted these to common shares of the Corporation when it completed its reorganization and financing transactions in November 2009. This offering generated gross proceeds of $10,897,980 and $580,000 respectively, before issue costs of $89,401.

(iii) On June 22, 2009, the Corporation issued 17,600,000 common shares at $0.05 per share to one of the Corporation's vendors to settle aggregate outstanding invoices of approximately $880,000.

(iv) On October 1, 2009, the Corporation declared a bonus of $1,155,000 payable to officers, employees and contractors, comprised of $278,333 in cash and indicated that the remaining portion of $876,667 would be in the form of 8,766,666 common shares at a price of $0.10 per share when issuable. The shares were issued in November 2009, upon the completion of its reorganization and financing transactions.

(v) On August 11, 2009, the Corporation issued 5,200,000 common shares and paid additional costs to acquire an additional 5% equity ownership of its Russian subsidiary from a minority shareholder. After this acquisition, PetroKamchatka owns 90% of its Russian subsidiary. This increased the Corporation's beneficial ownership of the Tigil and Icha licenses to 45%.

(vi) On November 26, 2009, the Corporation issued 6,626,501 common shares and 187,348 warrants to acquire common shares of the Corporation pursuant to an Arrangement Agreement dated October 2, 2009 to complete a business combination with Bluerock (note 1(d)). The warrants expired unexercised on May 14, 2010 (note 9(c)).

9. Share capital (continued):

(b) Common shares issued and outstanding (continued):

(vii) On November 26, 2009, the Corporation issued 61,828,486 common shares to convert subscription receipts, which were issued by a wholly-owned subsidiary pursuant to a brokered private placement financing at a price of $0.15 per subscription receipt, into common shares, which financing generated gross proceeds of $9,274,273, before costs related to the issue of $850,591. Under the financing, 1,365,834 warrants were issued to brokers to purchase the same number of common shares of the Corporation for $0.15 per share until November 19, 2011. The warrants were ascribed a fair value of $78,516 using the Black-Scholes pricing model, assuming a risk-free interest rate of 2.28%; life of 2 years; dividend yield of nil; and expected volatility rates of 69%.

(viii) In November, 2009, upon the completion of its reorganization and financing transactions, the Corporation issued 1,851,715 common shares to directors, officers and contractors for services rendered in the amount of $111,023.

(ix) On May 31, 2010, the Corporation issued 565,469 common shares to directors at a price of CAD $0.115 per share for services rendered for the three months ended March 31, 2010 in the amount of $63,750, representing one-half of the fees owed.

(x) On July 7, 2010, the Corporation issued 676,130 common shares to directors at a price of CAD $0.05 per share for services rendered for the three months ended June 30, 2010 in the amount of $31,875, representing a portion of the fees owed.

(xi) On December 8, 2010, the Corporation issued 656,497 common shares to directors at a 'deemed price' of CAD $0.05 per share pursuant to the rules and regulations of The Toronto Stock Exchange, which was approximately CAD $0.02 per share higher than the 'actual trading price' at the time of issue. The shares were issued for services rendered for the three months ended September 30, 2010 in the amount of $19,127, representing only a portion of the fees owed.

9. Share capital (continued):

(c) Warrants:

The following is a continuity of warrants issued to investors and brokers:

	May 31, 2011		May 31, 2010	
	Number issued	Amount	Number issued	Amount
Balance, beginning of year	20,882,774	$ 7,038,779	19,516,940	$ 6,960,263
Issued to brokers (note 9(b)(vii))	–	–	1,365,834	78,516
Issued to investors (notes 1(d) and 9(b)(vi))	–	–	187,348	–
Expired	–	–	(187,348)	–
Balance, end of year	20,882,774	$ 7,038,779	20,882,774	$ 7,038,779

The following summarizes information on warrants issued to investors to purchase common shares that were outstanding as at May 31, 2011:

Exercise Price $	£	Outstanding and exercisable	Contractual life
	£0.525	5,760,809	December 10, 2011
CAD 1.25		7,590,000	December 10, 2011
Outstanding, end of year		13,350,809	

On March 15, 2010, the Corporation received approval from investor warrant holders of the £0.525 and CAD $1.25 warrants to amend the existing term of the warrants. The warrants were exchanged for warrants with substantially similar terms and conditions except that the contractual life was amended to expire on December 10, 2011, two years after the Corporation's listing on the TSX Venture Exchange. The original warrants expired fifteen days following the listing of the Corporation on a recognized public stock exchange and the TSXV was not considered to be a recognized exchange under the original warrant agreement.

9. Share capital (continued):

(c) Warrants (continued):

The following summarizes information about warrants issued to brokers to purchase common shares that were outstanding as at May 31, 2011:

Exercise price		Outstanding and	
$	£	exercisable	Contractual life
CAD 050		28,800	December 10, 2011
	0.42	614,105	December 10, 2011
CAD 1.00		607,200	December 10, 2011
USD 0.50		4,916,026	December 10, 2011
USD 0.15		1,365,834	November 19, 2011
Outstanding, end of year		7,531,965	

(d) Stock options:

The Corporation has a stock option plan for employees, consultants, officers and directors. On October 16, 2009, the Board of Directors of the Corporation adopted a new stock option plan. Under the terms of the option plan, the Corporation may grant options up to 10% of the aggregate number of common shares outstanding, with no one optionee permitted to hold more than 5% of the total options outstanding in any 12 month period. The options granted may not be for a term exceeding five years and vest one-third each year from the date of grant. The exercise price of options is approved by the Board and cannot be less than the market price of its common shares on the day the option is granted.

The following is a summary of options outstanding and exercisable:

	May 31, 2011	May 31, 2010
Outstanding, beginning of year	21,625,000	6,225,000
Granted	–	15,400,000
Expired	(200,000)	–
Forfeited	(3,697,000)	–
Outstanding, end of year	17,728,000	21,625,000
Exercisable, end of year	8,556,960	3,941,667

9. Share capital (continued):

(d) Stock options (continued):

There were no stock options granted or warrants issued during the year ended May 31, 2011. The fair value of stock options granted and warrants issued during the year ended May 31, 2010 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Warrants	Options
Fair value of stock options granted in the year ended May 31, 2010 (per option)		$ 0.06
Fair value of warrants granted in the period ended May 31, 2010 (per warrant)	$ 0.06	
Expected volatility	84%	69%
Risk free rate of return	3.2% to 4.3%	2.9% to 4%
Expected option life	2 to 5 years	5 years
Forfeiture rate	nil%	nil%
Expected Dividends	nil	nil

The following table summarizes stock options outstanding and exercisable at May 31, 2011:

	Stock options outstanding			Stock options exercisable	
Exercise price	Number outstanding	Weighted-average remaining contractual life	Weighted-average exercise price	Number exercisable	Weighted average exercise price
$ 0.50	4,693,000	1.76	$ 0.50	4,212,003	$ 0.50
$ 0.10	12,810,000	3.33	$ 0.10	4,269,957	$ 0.10
$ 0.11	225,000	3.92	$ 0.11	75,000	$ 0.11
	17,728,000	2.55		8,556,960	

Based on the vesting terms of the options, the Corporation recognized stock-based compensation expense for the fiscal year ended May 31, 2011 of $386,419 (May 31, 2010 - $679,000) with an equal and offsetting amount recognized as contributed surplus.

9. Share capital (continued):

(e) Contributed surplus:

Changes in contributed surplus are as follows:

	May 31, 2011	May 31, 2010
Beginning of year	$ 3,903,396	$ 3,224,396
Stock-based compensation (note 9(d))	386,419	679,000
Expired warrants	–	–
	$ 4,289,815	$ 3,903,396

10. Income taxes:

The Corporation has no history of generating taxable income. The Corporation carries on business in Jersey, Cyprus, Russia and Canada. In these jurisdictions where corporate income taxes apply, the allocations of loss carry forwards and valuation allowances would offset any tax expense.

The income tax provision differs from the amount that would be obtained by applying the Corporation's income tax rate of 0% (May 31, 2010 - 0%). The main differences between expected and actual tax provisions are as follows:

	May 31, 2011	May 31, 2010
Net loss	$(22,456,015)	$ (38,453,746)
Tax rate	0%	0%
Computed income tax recovery	–	–
Re-domiciled from Canada to Cyprus	–	6,911,174
Change in tax rate due to operating jurisdiction and other	(1,202,273)	(197,880)
Change in valuation allowance	1,202,273	(6,713,294)
	$ –	$ –

On August 25, 2009, PKR continued out of Canada into Cyprus and the Corporation believes its estimated value was below its tax basis at that time. PKR is considered to have disposed of all its assets at fair value on the date of re-domiciliation (note 1) and the Canadian tax pools were utilized or expired as part of the re-domiciliation process.

10. Income taxes (continued):

The components of future income taxes are approximately as follows:

	May 31, 2011	May 31, 2010
Future income tax assets:		
Non-capital loss carried forward	$ 2,633,951	$ 1,420,365
Property and equipment	505,963	517,276
	3,139,914	1,937,641
Less valuation allowance	(3,139,914)	(1,937,641)
	$ –	$ –

The Corporation has Russian tax losses of approximately $12.6 million (2010 - $6.6 million) expiring between 2015 and 2020. The Corporation also has Canadian non-capital losses of approximately $426,000 (2010 - $426,000) expiring between 2027 and 2031. The tax losses are based on client prepared tax filings, which are subject to audit and potential reassessment. The final results are not reasonably determinable at this time and management believes that it has adequately provided for current and future income taxes.

11. Financial instruments and risk management:

(a) Capital management:

As an exploration company, the Corporation's operations are financed principally through shareholders' equity. The Corporation's objectives when managing capital are to: finance planned exploration activities; continue as a going concern; maximize returns for shareholders; provide benefits for other stakeholders; and provide resources to facilitate growth.

The Corporation manages the capital structure and responds to changes in economic conditions and planned requirements. It will continue to use cash from equity offerings to fund operations and invest in its capital expenditure program. Future capital strategies may include debt financing and obtaining strategic partners to fund a portion of its projects.

Current economic conditions continue to affect capital markets and the allocation of capital. This situation, together with the impact of unsuccessful drilling results, stresses the need for greater conservation of capital and careful monitoring of the Corporation's rate of spending on capital projects in Russia and general and administrative costs, especially given the absence of adequate financing at May 31, 2011 (note 2). There are no external restrictions on the Corporation's capital.

11. Financial instruments and risk management (continued):

(b) Fair values:

The fair value of the Corporation's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximated their carrying values as at May 31, 2011 and May 31, 2010.

(c) Risk exposure and management:

The Corporation is exposed to various risks associated with its financial instruments. These risks are categorized as market risk, credit risk and liquidity risk.

(i) Market risk:

Market risk is the risk that changes in market conditions, such as commodity prices and exchange rates, will affect the Corporation's net earnings or the value of its financial instruments. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns.

(ii) Commodity risk:

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Significant changes in commodity prices can also reduce the Corporation's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. In the future, the Corporation may attempt to mitigate commodity price risk through the use of financial derivatives. The Corporation does not have any oil or gas production and did not have any risk management contracts in place as at or during the years ended May 31, 2010 and 2011, or thereafter.

(iii) Foreign currency risk:

The Corporation is exposed to foreign currency fluctuations as it holds cash and incurs capital expenditures and expenses in foreign currencies. The Corporation incurs expenditures and expenses in Russian rubles, Pound sterling, Euros and Canadian dollars and is exposed to fluctuations in exchange rates in these currencies. There are no exchange rate contracts in place as at or during the years ended May 31, 2010 or 2011, or thereafter.

A 1% change in foreign exchange rates between the Russian ruble and the U.S. dollar would have resulted in a change in net loss of approximately $10,000 for the year ended May 31, 2011.

11. Financial instruments and risk management (continued):

(c) Financial instrument risk exposure and management (continued):

(iv) Credit risk:

Financial instruments that potentially subject the Corporation to concentration of credit risk consist of accounts receivable. There is low credit risk on accounts receivable. Accounts receivable consists of recoverable VAT in Russia (note 5), goods and services tax recoveries in Canada and other accounts receivable from the Corporation's joint ventures relating to the portion allocable to its Joint Venture Partner. At May 31, 2011 the Corporation's receivables were current.

(v) Liquidity Risk:

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due (note 2). The Corporation's financial liabilities consist of accounts payable and accrued liabilities and consist primarily of invoices payable to trade suppliers or professionals for capital expenditures and services rendered.

The Corporation prepares budgets for its corporate operations and capital expenditure programs which are regularly monitored and updated as considered necessary.

12. Supplemental cash flow disclosures:

Change in non-cash working capital:

	Years ended May 31,	
	2011	2010
Accounts receivable	$ 2,505,397	$ (1,243,322)
Prepaid expenses	887	118,569
Accounts payable and accrued liabilities	(916,500)	(3,312,473)
	1,589,784	(4,437,226)
Unrealized foreign exchange loss on working capital	(7,567)	345,496
Less non-cash working capital acquired from Bluerock (note 1)	–	(72,320)
Add shares issued for accounts payable	–	928,966
	1,582,217	(3,235,084)
Less changes in non-cash working capital related to investing	(582,944)	3,156,896
Less changes in non-cash working capital related to financing	–	–
Changes in non-cash working capital related to operations	$ 999,273	$ (78,188)

Cash interest of $nil was paid during the year ended May 31, 2011 (2010 - $5,051).

13. Commitments and contingencies:

Under the terms and conditions of its Russian exploration licenses, the Corporation is committed to completion of seismic work programs and the drilling of exploration wells by certain dates in order to retain its rights under the licenses (note 6).

The Corporation is committed to making payments with respect to its office leases in Canada which expire on June 30, 2013. Future net minimum lease payments for these leases by fiscal year are as follows:

Fiscal year 2012	$ 273,000
Fiscal year 2013	273,000
Fiscal year 2014	23,000
	$ 569,000

14. Subsequent events:

Subsequent to May 31, 2011, the following subsequent events occurred:

(a) On September 10, 2011, a wholly-owned Russian subsidiary of the Corporation received a new 5 year exploration license, granted by the Russian Federal Agency for Subsoil Use, Kamchatka, named ‘Tigilskaya’. This license is effectively an expanded version of the previously held Tigil License but with expanded acreage to the east. In total, the license covers 4,164 km^2. It was granted on the basis of a work commitment to acquire 500 km of 2-D seismic prior to September 10, 2014 of which 200 km must be acquired prior to September 10, 2013. The work commitment also requires the drilling of two exploration wells, one by September 10, 2015 and second by September 10, 2016. The Corporation is seeking partners to farm-in on its aggregate Kamchatka acreage.

(b) The Corporation and its Joint Venture Partner agreed to auction the equipment located in Russia. Both the Corporation and its Joint Venture Partner are eligible to bid at the auction.

(c) In May, 2011, the Corporation announced it had signed a non-binding Letter of Intent whereby the Corporation would issue common shares in exchange for the outstanding shares of Advastor Services Ltd. (“Advastor”), a Cyprus entity. Advastor owns 100% of four Russian entities which in turn hold six exploration licenses in northern European Russia, an established oil and gas producing region close to existing production and transportation infrastructure. The transaction is subject to due diligence, which is ongoing, and for the Corporation to complete a financing of a minimum of $30 million. As at September 28, 2011, a definitive binding agreement has not been reached with Advastor and discussions are ongoing.