PetroKamchatka Plc

Condensed Interim Financial Statements (Unaudited)

For the three months ended August 31, 2011

PetroKamchatka Plc

Condensed Consolidated Statements of Financial Position
(United States Dollars)
(Unaudited)

	Note	August 31, 2011	May 31, 2011	June 1, 2010
			note 3	
Assets				
Exploration and evaluation assets	5	$ -	$ -	$16,294,709
Property and equipment	6	4,599,853	5,133,198	4,447,941
Investment in drilling rig	7	-	4,434,210	4,137,260
Non-current assets		4,599,853	9,567,408	24,879,910
Cash and cash equivalents		2,981,169	4,045,212	7,915,415
Accounts receivable		332,270	252,667	2,758,064
Prepaid expenses		48,896	27,071	27,958
Investment in drilling rig	7	4,434,210	-	-
Current assets		7,796,545	4,324,950	10,701,437
Total assets		$12,396,398	$13,892,358	$35,581,347
Equity				
Share capital	9	$91,806,942	$91,806,942	$91,755,940
Share purchase warrants	9	1,186,971	1,186,971	1,186,971
Contributed surplus	9	4,563,590	4,540,190	4,247,572
Foreign currency translation reserve		97,252	304,987	-
Revaluation reserve	6	1,433,622	1,433,622	-
Deficit		(87,143,624)	(85,752,561)	(64,859,159)
Equity attributable to owners of the Corporation		11,944,753	13,520,151	32,331,324
Non-controlling interest		(2,011,498)	(1,960,873)	-
Total equity		9,933,255	11,559,278	32,331,324
Liabilities				
Provisions	8	62,274	-	-
Warrants	9	-	-	443
Non-current liabilities		62,274	-	443
Accounts payable and accrued liabilities		1,779,253	1,537,629	3,249,580
Provisions	8	621,616	795,451	-
Current liabilities		2,400,869	2,333,080	3,249,580
Total liabilities		2,463,143	2,333,080	3,250,023
Going concern (note 2)				
Subsequent events (note 13)				
Commitments (note 14)				
Total equity and liabilities		$12,396,398	$13,892,358	$35,581,347

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

PetroKamchatka Plc

Condensed Consolidated Statements of Comprehensive Loss
For the three month periods ended August 31
(United States Dollars, except share amounts or unless otherwise stated)
(Unaudited)

	Note	2011	2010
Expenses:			
Equipment operating expenses and other		$ 51,764	$ 163,440
General and administrative expenses		826,192	597,055
Other expenses	8	137,640	-
Share-based compensation	9	23,400	175,890
Depreciation	6	394,669	223,876
Loss before interest and income taxes		1,433,665	1,160,261
Finance income		(8,412)	(2,425)
Finance costs		-	-
Net finance costs (income)		(8,412)	(2,425)
Income tax	10	-	-
Net loss		**1,425,253**	**1,157,836**
Other comprehensive (income) loss			
Foreign exchange differences on translation of foreign operations		224,170	(24,893)
Net comprehensive (income) loss		**224,170**	**(24,893)**
Total comprehensive loss for the period		**$ 1,649,423**	**$ 1,132,943**
Net loss attributable to:			
Shareholders of the corporation		$ 1,391,063	$ 1,127,559
Non-controlling interest in subsidiary		$ 34,190	$ 30,277
Net loss for the period		$ 1,425,253	$ 1,157,836
Total comprehensive loss attributable to:			
Shareholders of the corporation		$ 1,598,798	$ 1,126,958
Non-controlling interest in subsidiary		$ 50,625	$ 5,985
Net comprehensive loss for the period		$ 1,649,423	$ 1,132,943
Net loss per share:			
Basic		$ 0.00	$ 0.00
Diluted		$ 0.00	$ 0.00
Weighted average number of common shares outstanding			
Basic	11	490,396,137	489,475,067
Diluted	11	490,396,137	489,475,067

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

PetroKamchatka Plc

Condensed Consolidated Statements of Changes in Equity
For the three month periods ended August 31, 2011 and 2010
(United States Dollars)
(Unaudited)

	Note	Share Capital	Share Purchase Warrants	Contributed Surplus	Foreign Currency Translation Difference	Revaluation Reserve	Deficit	Total Attributable To Owners Of the Corporation	Non-Controlling Interest	Total Equity
Balance at June 1, 2010 Transition Date under IFRS		**$91,755,940**	**$1,186,971**	**$ 4,247,572**	**$ -**	**$ -**	**$(64,859,159)**	**$32,331,324**	**$ -**	**$32,331,324**
Net loss for the period		-	-	-	-	-	(1,127,559)	(1,127,559)	(30,277)	(1,157,836)
Net comprehensive loss		-	-	-	601	-	-	601	24,292	24,893
Total comprehensive income loss		-	-	-	601		(1,127,559)	(1,126,958)	(5,985)	(1,132,943)
Share-based compensation	9	31,875	-	144,015	-	-	-	175,890	-	175,890
Balance at August 31, 2010		**$91,787,815**	**$1,186,971**	**$ 4,391,587**	**$ 601**	**$ -**	**$(65,986,718)**	**$31,380,256**	**$ (5,985)**	**$ 31,374,271**
Balance at May 31, 2011		**$91,806,942**	**$1,186,971**	**$ 4,540,190**	**$ 304,987**	**$ 1,433,622**	**$(85,752,561)**	**$13,520,151**	**$(1,960,873)**	**$11,559,278**
Net loss for the period		-	-	-	-	-	(1,391,063)	(1,391,063)	(34,190)	(1,425,253)
Net comprehensive loss		-	-	-	(207,735)	-	-	(207,735)	(16,435)	(224,170)
Total comprehensive income loss					(207,735)		(1,391,063)	(1,598,798)	(50,625)	(1,649,423)
Share-based compensation	9	-	-	23,400	-	-	-	23,400	-	23,400
Balance at August 31, 2011		**$91,806,942**	**$1,186,971**	**$ 4,563,590**	**$ 97,252**	**$ 1,433,622**	**$(87,143,624)**	**$11,944,753**	**$(2,011,498)**	**$ 9,933,255**

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

PetroKamchatka Plc

Condensed Consolidated Statements of Cash Flows
For the three month periods ended August 31
(United States Dollars, unless otherwise stated)
(Unaudited)

	Note	2011	2010
Cash flows from operating activities:			
Loss for the period		$(1,425,253)	$(1,157,836)
Adjustments for:			
Depreciation	7	394,669	223,876
Share-based compensation	9	23,400	175,890
Finance income		8,412	2,425
Provisions	8	137,640	-
		(861,132)	(755,645)
Change in:			
Accounts receivable		(79,603)	2,144,328
Prepaid expenses		(21,825)	(28,399)
Accounts payable and accrued liabilities		163,816	(1,585,230)
Provisions		(249,201)	-
Net cash (used in) operating activities		(1,047,945)	(224,946)
Cash flows from investing activities:			
Additions to exploration and evaluation assets		-	(755,612)
Net cash from (used in) investing activities		-	(755,612)
Net decrease in cash and cash equivalents		(1,047,945)	(980,558)
Cash and cash equivalents beginning of period		4,045,212	7,915,415
Effect of exchange rate fluctuations on cash held		(16,098)	19,080
Cash and cash equivalents end of period		$ 2,981,169	$ 6,953,937

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

1. Reporting entity:

PetroKamchatka Plc (the "Corporation" or "PKP") was incorporated on December 23, 2008 under the Companies (Jersey) Law 1991. The head office of the Corporation is located at 9 Esplanade, St. Helier, Jersey, JE23QA. It is principally engaged in exploration for oil and natural gas in the Kamchatka Peninsula of Russia which activity is conducted pursuant to exploration licenses granted to Russian subsidiaries and affiliates of its wholly-owned Cyprus subsidiary, PetroKamchatka Resources Ltd. ("PKR").

The Corporation has the following subsidiaries and affiliates:

		Percentage of Ownership		
Name of Subsidiary or Affiliate	Country of Incorporation	August 31, 2011	May 31, 2011	June 1, 2010
PetroKamchatka Resources Ltd.	Cyprus	100%	100%	100%
OJSC LukinCholot	Russia	90%	90%	90%
CJSC Unetmelgin	Russia	Wound up	90%	90%
CJSC Kehta-Exploration	Russia	100%	100%	100%
CJSC Kingi-Exploration	Russia	100%	100%	100%
CJSC Palana-Exploration	Russia	100%	100%	100%
CJSC Tvayan-Exploration	Russia	100%	100%	100%
CJSC Tigil Exploration (affiliate)	Russia	50%	50%	50%
CJSC Icha Exploration (affiliate)	Russia	50%	50%	50%
PetroKamchatka Services Inc.	Canada	100%	100%	100%
Nabesche River Exploration Ltd.	Canada	100%	100%	100%
Bluerock Acquisition Corp.	Canada	Wound up	100%	100%

PKR is a wholly-owned subsidiary of the Corporation. PKR owns 90% of OJSC LukinCholot ("LukinCholot") which in turn owned 100% of Unetmelgin and owns 50% of the shares of CJSC Tigil Exploration and CJSC Icha Exploration (the "joint interest entities"). PKR is the direct owner of the other subsidiaries. KNOC Kamchatka Petroleum Limited ("KKPL"), a company owned 55% by Korea National Oil Corporation ("KNOC"), owns the other 50% of the joint interest entities. This effectively provides the Corporation with an indirect, net 45% interest in the joint interest entities. The other 10% of LukinCholot is owned by the Koryakia Property Fund, an investment agency of the Koryakia Okrug Administration, Kamchatka. That entity's indirect beneficial interest in the joint interest entities is 5%, being 10% of 50%. LukinCholot and KKPL split the cost to carry the 5% interest of the Koryakia Okrug Administration, which means that the Corporation pays 47.5% of costs and KKPL pays 52.5%. On August 11, 2009, PKR increased its percentage ownership in

1. Reporting entity (continued):

LukinCholot from 85% to 90%. This effectively increased the Corporation's indirect share of costs from 46.25% prior to August 2009 to 47.5% after July 2009.

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 5). It could therefore lose all or part of its interests in the licenses. The drilling of two dry holes in fiscal 2010 has negatively impacted the ability of the Corporation to raise additional capital. The Corporation did not raise additional equity in the three month period ended August 31, 2011 or in the fiscal year ended May 31, 2011. At August 31, 2011, the Corporation's working capital was $5,395,676 which includes an investment in a drilling rig of $4,434,210 which was reclassified from non-current to current assets in the first quarter of fiscal 2012 as it is an asset available for immediate sale and expected to sell within the next twelve months. 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 (notes 5, 13 and 14).

3. Basis of preparation and adoption of International Financial Reporting Standards:

The Corporation prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS") and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Corporation commenced reporting on this basis in these interim consolidated financial statements. In the consolidated financial statements, the term "Canadian GAAP" or "Previous GAAP" refers to "Canadian GAAP" before the adoption of IFRS.

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standards ("IAS") 34 - "Interim Financial Reporting". Subject to certain transition elections and mandatory exemptions as disclosed in note 15, the Corporation has consistently applied the same accounting policies in its opening IFRS statement of financial position at June 1, 2010 (the "Transition Date") and throughout the periods presented, as if these policies had always been in effect. As these are the Corporation's first interim condensed consolidated financial statements for part of the period covered by the first IFRS annual financial statements, IFRS 1 - "First- time Adoption of International Financial Reporting Standards" has

1. Basis of preparation and adoption of International Financial Reporting Standards (continued):

been applied. Note 15 discloses the impact of the transition to IFRS on the Corporation's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Corporation's Canadian GAAP consolidated financial statements for the year ended May 31, 2011.

The policies adopted in these interim consolidated financial statements are based on IFRS issued and outstanding as at November 29, 2011, the date the Corporation's Board of Directors approved the interim consolidated financial statements. Any subsequent changes to IFRS that are given effect in the Corporation's annual consolidated financial statements for the reporting period ending May 31, 2012 could result in a restatement of these interim consolidated financial statements, including the transition adjustments recognized on the initial adoption of IFRS.

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the Corporation's reporting period ended May 31, 2011.

Functional and Presentation Currency

The consolidated financial statements are presented in United States dollars. The functional currency is the United States dollar for the Jersey parent company and its Cyprus subsidiary. For the Russian subsidiaries and affiliates, the functional currency is the Russian Rouble. For the subsidiaries located in Canada, the functional currency is the Canadian dollar.

Use of Assumptions, Judgments and Estimates

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized at the time the estimates are revised. Estimates of recoverable quantities of proven and probable reserves, if any, including estimates and assumptions regarding future commodity prices, exchange rates, discount rates, production volumes and timing of production, production and transportation costs can affect various calculations including: the impairment of assets; decommissioning obligations; the economic feasibility of exploration and evaluation assets; and the amounts reported for depletion (if any), depreciation and amortization of property and equipment and exploration and evaluation assets.

3. Basis of preparation and adoption of International Financial Reporting Standards (continued):

Use of Assumptions, Judgments and Estimates (continued):

In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of future reserves, production rates, oil and natural gas prices, costs, discount rates and other relevant assumptions. The Corporation would, if applicable in the future, estimate decommissioning obligations for oil and natural gas wells and associated production facilities and pipelines. Usually, the removal of assets and remediation occurs many years into the future. Amounts recorded for decommissioning obligations and related accretion expense require judgmental assumptions regarding removal date, future environmental legislation, the extent of reclamation activities that will be required, the engineering methodology and future removal technologies for estimating cost, and liability specific discount rates to determine the present value of these cash flows.

Accounting for exploration and evaluation assets requires management to make certain estimates and assumptions as to future events and circumstances as to whether economic quantities of reserves have been found, if any.

The amounts recorded for share-based compensation are based on share price and estimates of expected volatility, forfeiture rates, performance factors and risk-free interest rates.

The Corporation is subject to income taxes in a number of tax jurisdictions. The tax amount expected to be settled and the actual amount can change over time, depending on the facts and circumstances. The recognition of deferred tax assets, if any, is based on assumptions about future taxable profits.

By their nature, these estimates and assumptions are subject to measurement uncertainty. The effect on the consolidated financial statements of changes in such estimates in future periods could be material.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following notes:

- Note 4(c) – valuation of financial instruments
- Note 4(d) – valuation of exploration and evaluation assets
- Note 4(e) – valuation of equipment
- Note 8 – provisions and contingencies
- Note 10(d) – measurement of share-based payments
- Note 11 – valuation and utilization of tax losses

4. Significant accounting policies:

(a) Basis of Measurement

These interim consolidated financial statements have been prepared on a historical cost basis except as noted below.

(b) Basis of consolidation:

(i) Subsidiaries

These interim consolidated financial statements include the accounts of PetroKamchatka Plc and its subsidiaries which are wholly-owned, except for OJSC LukinCholot ("LukinCholot"), a Russian entity which is 90% owned, through PKR (note 1). Losses applicable to the non-controlling interests in a subsidiary since the Transition Date are allocated to the non-controlling interests even if doing so caused the non-controlling interests to have a deficit balance.

(ii) Joint-interest entities:

In Russia, exploration licenses are granted to Russian entities only. Some of the Corporation's exploration activities are conducted on a joint venture basis with an unrelated joint venture partner. LukinCholot owns 50% of the shares of two Russian entities. The unrelated joint venture partner owns the other 50%. The consolidated financial statements include the Corporation's proportionate share of the accounts of the joint-interest entities.

(iii) Transactions eliminated on consolidation:

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(iv) Non-controlling interest

Subsidiaries are entities controlled by the Corporation. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(c) Financial instruments:

Financial Assets

Financial assets include cash and cash equivalents and accounts receivable. The Corporation does not have any derivative financial instruments.

4. Significant accounting policies (continued):

(c) Financial instruments (continued):

Financial Assets (continued):

At the time of initial recognition, financial assets are recognized at fair value, normally being the transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

The subsequent measurement of financial assets depends on their classification as follows:

- Loans and receivables – these financial assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such financial assets are carried at 'amortized cost' using the effective interest rate method if the time value of money is significant. Gains and losses are recognized in income when the loans and receivables are derecognized or impaired as well as through the amortization process.

A financial asset is classified and measured at amortized cost if it is held with the objective of holding in order to collect contractual cash flows and the contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest.

Financial assets other than those qualifying for amortized cost measurement are classified as fair value through profit or loss and measured at fair value with all changes in fair value recognized in profit or loss.

Financial assets measured at amortized cost are assessed for impairment at the end of each reporting period. Financial assets are considered impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the asset have been negatively affected.

Financial Liabilities

At the time of initial recognition, financial liabilities are classified at fair value measured at 'amortized cost or as financial liabilities' through profit or loss.

Financial liabilities are measured depending on their classification as follows:

- Financ*ial liabilities measured at 'amortized cost'* – This category of financial liabilities includes accounts payable and accrued liabilities and other liabilities, if any.

(d) Property and Equipment and Exploration and Evaluation Assets

Pre-license costs

Pre-license costs incurred prior to receiving the legal rights to explore an area are expensed when incurred.

4. Significant accounting policies (continued):

(d) Property and Equipment and Exploration and Evaluation Assets (continued):

Exploration and evaluation assets *("E&E")*

Exploration license and unproved property acquisition costs, geological and geophysical costs and costs directly associated with exploration and appraisal activities are capitalized within E&E assets. The Corporation aggregates its costs in cash generating units ("CGU") based on exploration licenses granted by the Russian Federal Ministry of Natural Resources ("MNRF") pending determination of technical feasibility and commercial viability.

The Corporation's CGUs at the Transition Date included: 'Icha'; 'Ichinskaya'; and 'Vorovskaya'. Each of these is located in the Peninsula of Kamchatka, Russia. (note 5).

The technical feasibility and commercial viability is considered to be determinable when proven plus probable reserves are determined to exist. A review of each CGU is carried out, at least annually, to ascertain whether proven plus probable reserves have been discovered. Upon determination of proven plus probable reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to property and equipment.

Property and equipment

Property and equipment includes a mobile drilling rig; drill pipe and collars; spare parts and other drilling rig equipment; other oilfield service equipment; materials and other. These assets are measured at fair value less accumulated depletion, depreciation and amortization and accumulated impairment losses. Capitalized costs include the purchase price or construction cost of the asset, any costs directly attributable to bringing the asset into operation, the initial estimate of decommissioning obligations, if any, and borrowing costs for qualifying assets, if any. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalized value of a finance lease, if any, is also included in property and equipment.

Any gain arising on remeasurement is recognized in profit or loss to the extent the gain reverses a previous impairment loss on the specific equipment, with any remaining gain recognized in other comprehensive income and presented in the revaluation reserve in equity. Any loss is recognized in other comprehensive income and presented in the revaluation reserve in equity to the extent that an amount had previously been included in the revaluation reserve relating to the specific equipment, with any remaining loss recognized immediately in profit or loss.

4. Significant accounting policies (continued):

(d) Property and Equipment and Exploration and Evaluation Assets (continued):

Property and equipment (continued):

The gain or loss from the divestiture of property and equipment is recognized in profit or loss. In addition, risk-sharing arrangements such as farm-outs, where the Corporation cedes a portion of its working interest to a third-party are generally considered to be disposals of property and equipment, potentially resulting in a gain or loss on disposition.

Exchanges of assets within property and equipment are measured at fair value unless the exchange transaction lacks commercial substance; or at historical cost if the fair value of neither the asset received nor the asset given up is reliably measurable. Unless the fair value of the asset received is more clearly evident, the cost of the acquired asset is measured at the fair value of the asset given up. Where the fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. The gain or loss on de-recognition of the asset given up is recognized in profit or loss.

An asset within 'property and equipment' is de-recognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the item is derecognized.

Depreciation of equipment is based on the estimated useful lives of the assets as follows:

Asset class	Expected Life	Method	Residual
Mobile drilling rig	7 years	Straight-line	20%
Drill pipe and collars	5 years	Straight-line	-
Spare parts and other drilling rig equipment	5 years	Straight-line	-
Other oilfield service equipment	5 years	Straight-line	10%
Materials and other	2 years	Straight-line	-
Office furniture and equipment	3 years	Straight-line	-

The calculation of depreciation includes assumptions regarding useful lives and residual values and is subject to change as new information becomes available.

Equipment is reviewed for impairment when events or changes in circumstances indicate that its carrying value may not be recoverable. The Corporation's operations and business environment are routinely monitored and judgment and assessments are made to determine if an event has occurred that indicates a possible impairment.

4. Significant accounting policies (continued):

(d) Property and Equipment and Exploration and Evaluation Assets (continued):

Property and equipment (continued):

Corporate assets primarily consist of office furniture and equipment which are stated at cost less accumulated depreciation where depreciation is determined on a straight-line basis over three years and assumes no residual value.

Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing components of equipment are recognized as property and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are expensed as incurred. Such capitalized amounts generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Depletion, depreciation and amortization

The Corporation presently has no reserves, no production and no cash inflows from the sale of oil or natural gas. The Corporation has no development or production assets as at Transition Date or at the end of the reporting period which would otherwise be included in 'property and equipment'.

(e) Investment in Drilling Rig

Non-current assets, or disposal groups consisting of assets and liabilities, are classified as 'held for sale' if their carrying amounts are expected to be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition.

In the interim consolidated financial statements for the current reporting period, the Corporation's 46.25% investment in a 'new' drilling rig, delivered in November 2008 and presently stored in a bonded facility in Shanghai, was reclassified to current assets (note 7).

4. Significant accounting policies (continued):

(e) Investment in Drilling Rig (continued):

Non-current assets classified as ‘held for sale’ are measured at the lower of the carrying amount and fair value less estimated costs to sell, with impairments recognized in profit or loss in the period measured. Current assets ‘held for sale’ are presented in current assets within the consolidated statement of financial position. Assets ‘held for resale’ are not depreciated, depleted or amortized.

(f) Impairment

Non-financial assets

The carrying amounts of the Corporation’s non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset’s recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property and equipment; and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount (such as: unsuccessful drilling results; surrendered or expired exploration licenses; and/or failure to achieve work commitment bench marks within time limits established by the exploration license).

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generate cash flows from continuing use that are largely independent of the cash inflows of other assets or groups of assets or CGUs. The recoverable amount of an asset or a CGU is the greater of its value-in-use and its fair value less estimated costs to sell.

In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value-in-use is generally computed by references to the present value of the future cash flows expected to be derived. For the purpose of impairment testing, goodwill acquired in a business combination, if any, is allocated to the CGUs that are expected to benefit from the synergies of the combination.

E&E assets are combined with all CGUs when they are assessed for impairment, both at the time of any triggering event as well as upon their eventual reclassification to property and equipment. An impairment loss is recognized in profit or loss if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit or group of units on a pro rata basis.

4. Significant accounting policies (continued):

(f) Impairment (continued):

Non-financial assets (continued)

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion, depreciation and amortization, if no impairment loss had been recognized.

Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at 'amortized cost' is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics. All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

(g) Foreign currency translation and operations

The assets and liabilities of foreign operations are translated to United States dollars at exchange rates at the reporting dates.

Transactions in foreign currencies are translated to United States dollars at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to United States dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies are measured at fair value and translated to the functional currency at the exchange rate at the date that the fair value was determined. Realized foreign currency differences are recognized in profit or loss.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to USD at exchange rates at the reporting date. The income and expenses of foreign operations are translated to USD at exchange rates at the dates of the transactions.

4. Significant accounting policies (continued):

(g) Foreign currency translation and operations (continued):

Foreign currency differences are recognized in other comprehensive income, and presented in the foreign currency translation reserve ("Translation Reserve") in equity. However, if the operation is a non-wholly-owned subsidiary, then the relevant proportionate share of the translation difference is allocated to the non-controlling interests. When a foreign operation is disposed of such that control, significant influence or joint control is lost, the cumulative amount in the Translation Reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal. When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognized in other comprehensive income, and presented in the Translation Reserve in equity.

(h) Share-based compensation

All share-based transactions are settled with equity instruments. Transactions with non-employees are measured at the fair value of goods or services received unless such cannot be estimated reliably in which case, the measurement is based upon the fair value of the equity instruments granted. For transactions with parties other than employees the measurement date is the date the Corporation received the goods or services.

The Corporation has a share option plan for employees, consultants, officers and directors.

Fair value is determined using the Black-Scholes option pricing model. The cost is recognized as 'share-based compensation' expense with a corresponding increase in equity (contributed surplus) over the vesting period which ends on the date on which the recipient becomes fully entitled to the stock option awarded.

The expense is recognized over the vesting period based on the best available estimate of the number of equity instruments expected to vest. The estimate is revised, if necessary, if subsequent information in the number of equity instruments expected to vest differs from previous estimates.

(i) Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present obligation (legal or constructive) that can be estimated reliably, and it is probable that an outflow of economic resources will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

4. Significant accounting policies (continued):

(i) Provisions

The Corporation's activities could give rise to decommissioning obligations for dismantling, decommissioning and site restoration activities. Provision would be made, if applicable, for the estimated cost and capitalized in the relevant asset category unless it arises from the normal course of production activities in which case it is recognized in profit or loss.

Contingent liabilities are possible obligations whose existence will only be confirmed by future events not wholly within the control of the Corporation, or present obligations where it is not probable that an outflow of resources will be required or the amount of the obligation cannot be measured with sufficient reliability. Contingent liabilities are not recognized in the financial statements but are disclosed unless the possibility of an outflow of economic resources is remote.

A provision for onerous contracts is recognized when the expected benefits to be derived by the Corporation from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract.

(j) Income Taxes

The Corporation is subject to income taxes in a number of tax jurisdictions. Income tax expense comprises current and deferred portions. Current tax is expected tax payable on taxable income for the reporting period, using tax rates enacted or substantively enacted at the reporting date and any adjustments to the tax payable in respect of previous years. Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Deferred tax liabilities are recognized for taxable temporary differences. Deferred tax assets are recognized for deductible temporary differences, unused tax losses and unused tax credits only if it is probable that sufficient future taxable income will be available to utilize those temporary differences and losses.

Such deferred tax liabilities and assets are not recognized if the temporary differences arises from goodwill or from the initial recognition of assets and liabilities (other than in a business combination) in a transaction that affects neither the taxable net income nor the accounting profit or from investments in subsidiaries, associates and interest in joint ventures to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on laws that have been enacted or substantively enacted at the reporting date.

4. Significant accounting policies (continued):

(j) Income Taxes (continued):

The effect of a change in income tax rates on deferred tax assets and liabilities is recognized in profit or loss in the period the change occurs.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

Income tax expense is recognized in profit or loss except to the extent it relates to a business combination, or items recognized directly in equity or other comprehensive income.

(k) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares, warrants and share options are recognized as a deduction from equity, net of any tax effects.

(l) Earnings per share

The Corporation presents basic and fully diluted earnings per share data for its common shares. Basic earnings per share is calculated by dividing the net income attributable to common shareholders of the Corporation by the weighted average number of common shares outstanding during the reporting period. Diluted per share amounts are calculated using the treasury stock method for equity based compensation arrangements. The treasury stock method assumes that any proceeds obtained on exercise of equity based compensation arrangements would be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the difference between the number of shares issued from the exercise of equity based compensation arrangements and shares repurchased from the related proceeds.

5. Exploration and Evaluation Assets

Exploration and evaluation assets consist of the Corporation's exploration projects which are pending the determination of proven or probable reserves.

	Icha	Ichinskaya	Vorovskaya	Total
Balance at June 1, 2010	$ 16,267,828	$ 15,688	$ 11,193	$ 16,294,709
Additions to May 31, 2011	746,104	28,320	19,844	794,268
Impairments to May 31, 2011	(17,013,932)	(44,008)	(31,037)	(17,088,977)
Balance at May 31, 2011	-	-	-	-
Additions to August 31, 2011	-	-	-	-
Balance at August 31, 2011	$ -	$ -	$ -	$ -

The Corporation elected to measure its E&E assets at the Transition Date at the amount previously capitalized under Canadian GAAP.

Under the exemption provisions, the Corporation continued to aggregate its costs in CGUs. More specifically, the Corporation recognizes cost centers based on exploration licenses granted by the Russian Federal Ministry of Natural Resources ("MNRF"). The Corporation's cost centers at the Transition Date were: 'Icha'; 'Ichinskaya'; and ''Vorovskaya'. Each of these is located in Kamchatka, Russia.

At the Transition Date, the E&E assets were tested for impairment in accordance with IFRS 6 "Exploration for and Evaluation of Mineral Resources", IFRS 1 and IAS 36. No impairment charge was required. The E&E assets were also subsequently tested for impairment during the third and fourth quarters of the prior fiscal year and found to be fully impaired as a result of evaluation of drilling to date.

Exploration licenses in Russia are issued by the federal Ministry of Natural Resources ("MNRF") and conditionally 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 license holder has the right to convert parts of the exploration license into a production license. Exploration licenses have an associated license agreement, which specify the required geological and geophysical work program required to retain the license. The licenses were granted based on successful bids detailing work commitments, with no cash bonus required at time of bid or grant. Exploration licenses are granted to Russian entities only. At the reporting date, the exploration licenses held by Russian subsidiaries of the Corporation's wholly-owned Cyprus subsidiary include:

5. Exploration and Evaluation Assets (continued):

(a) Ichinskaya Exploration License – geological license PTR 14752 NP was issued by the Federal Agency for Subsoil Use of the Russian Federation (“FASU”) and bears State Registration on September 24, 2009. The exploration license expires on September 1, 2014 and covers an area of 567,200 gross hectares (6,050 km^2). The work commitment requires the approval of the Exploration Program within one year of State Registration; the shooting of 600 kilometers of 2D seismic within two years of State Registration; and the commencement of drilling of an exploration well within three years of State Registration. The Corporation has not met these conditions at the reporting date and it is more probable than not that it will be unable to do so. Although time extensions are sometimes granted, there is discretion in such matters and there is no certainty that an extension will be granted. As a result, the Corporation recognized a full impairment of the carrying costs of this license as at May 31, 2011.

(b) Vorovskaya Exploration License – geological license PTR 14748 NP was issued by the FASU and bears State Registration on September 21, 2009. The exploration license expires on September 1, 2014 and covers an area of 399,900 gross hectares (4,320 km^2). The work commitment requires the approval of the Exploration Program within one year of State Registration; the shooting of 500 kilometers of 2D seismic within two years of State Registration; and the commencement of drilling of an exploration well within three years of State Registration. The Corporation has not met these conditions at the reporting date and it is more probable than not that it will be unable to do so. As a result, the Corporation recognized a full impairment of the carrying costs of this license as at May 31, 2011.

The Corporation expected to develop detailed exploration work plans for the Ichinskaya and Vorovskaya Blocks based on success and information derived from previously-held Tigil and Icha licenses. However, the Tigil license expired in December 2010 after the Corporation and its joint venture partner drilled two unsuccessful wells on that Block; and the Icha license was surrendered back to MNFR in March 2011, after the Corporation and its joint venture partner agreed that the mapped prospects on that Block were non-commercial on a fully risked basis. The Corporation’s share of E&E costs at the Transition Date relating to the Icha exploration license amounted to US $16,267,828. The cumulative E&E costs for Icha, were fully impaired in the reporting year ended May 31, 2011, amounted to US $17,013,932. In addition to subsoil taxes, a license holder is required to pay other license fees and taxes for surface rights, permits or forestry, fishery and environmental charges. Upon expiration of a license, the license holder must, at its expense, re-cultivate the land and return it to a condition acceptable to the authorities.

The Corporation estimates expenditures of approximately $49 million will be required to meet the seismic and drilling work commitments of the Ichinskaya and Vorovskaya exploration licenses.

Subsequent to the reporting date, a new exploration license, the Tigilskaya Exploration License, in Tigil, Kamchatka was granted to a wholly-owned Russian subsidiary of the Corporation (note 13).

6. Property and equipment:

	Oil and Natural Gas Interests	Development and Production Equipment	Mobile Drilling Rig and Other Exploration Equipment	Corporate	Total
Fair value at June 1, 2010	-	-	4,357,830	90,111	4,447,941
Depreciation to May 31, 2011	-	-	(807,285)	(88,221)	(895,506)
Foreign currency translation difference	-	-	317,794	-	317,794
Fair value adjustments	-	-	1,262,969	-	1,262,969
Balance at May 31, 2011	-	-	5,131,308	1,890	5,133,198
Depreciation to August 31, 2011	-	-	(394,669)	-	(394,669)
Foreign currency translation difference	-	-	(138,676)	-	(138,676)
Balance at August 31, 2011	$ -	$ -	$ 4,597,963	$ 1,890	$ 4,599,853

As the Corporation has not discovered proved or probable reserves to the Transition Date and the reporting date, there has not been a reclassification or transfer of E&E costs to 'property and equipment' nor were there any amounts capitalized for development and production assets. In accordance with IAS 16, the Corporation elected to use fair value for equipment at the Transition Date and thereafter. Fair value is based on independent appraisals at the Transition Date and May 31, 2011.

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 equipment to a third party. The Corporation presently does not have sufficient cash to fund all expenditure commitments under the terms of its Russian exploration licenses (note 2 and 5). 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.

6. Property and equipment (continued):

Under IFRS, depreciation is recognized even during periods when assets are idle unless the assets are being held-for-sale. During the three month reporting period ended August 31, 2011 depreciation amounted to $394,669 compared to $223,876 in the first three months ended August 31, 2010.

'Corporate' property and equipment is comprised of office furniture and equipment.

As a result of applying fair value, the carrying value under previous Canadian GAAP was reduced by $2,495,456 at the Transition Date to fair value of $4,357,830 (note 15).

The revaluation reserve at August 31, 2011 and May 31, 2011 of $1,559,919 is comprised of an adjustment to the fair value of the equipment at May 31, 2011 of $1,262,969 (net of foreign exchange translation effects) and an adjustment to the fair value of the Corporation's investment in a drilling rig of $296,950 (note 7).

7. Investment in Drilling Rig:

This asset is carried at fair value as determined by independent appraisal. The Corporation owns a 46.25% interest in a drilling rig, delivered new in November 2008 and stored since delivery in a bonded export facility in Shanghai, China. It was determined that this rig was not suited for the Russian drilling program for which it was originally intended. At the reporting date, the rig is available for immediate sale which sale is expected to occur within the twelve month period following the reporting date.

At the Transition Date and May 31, 2011, the investment was considered as a non-current asset of the Corporation. 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 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 rig. Accordingly, the investment in the drilling rig was reclassified to current assets as an asset held for sale. The investment in the drilling rig is recorded at fair value as indicated by independent appraisals less estimated costs to sell.

8. Provisions:

	Onerous Contracts	Joint Venture Wind-up	Total
Balance at June 1, 2010	$ -	$ -	$ -
Provisions made during the year	-	795,451	795,451
Provisions used during the year	-	-	-
Balance at May 31, 2011	$ -	$ 795,451	$ 795,451
Provisions made during the period	137,640	-	137,640
Provisions used during the period	-	(249,201)	(249,201)
Balance at August 31, 2011	$ 137,640	$ 546,250	$ 683,890

	Onerous Contracts	Joint Venture Wind-up	Total
Balance at August 31, 2011			
Non-current	$ 62,274	$ -	$ 62,274
Current	75,366	546,250	621,616
	$ 137,640	$ 546,250	$ 683,890

(a) Onerous contracts:

In 2008, the Corporation entered into two non-cancellable leases for office space in Canada. Due to changes in its activities, the Corporation has ceased to completely use this office space as at the reporting date. The leases expire on June 30, 2013. Management estimates that 75% of the office space is surplus to its needs. The obligation for 75% of the discounted future payments has been provided for as ‘onerous contract.’ The provision is net of an estimate of probable sublease income.

Undiscounted future net minimum lease payments for these leases before recoveries, if any, by fiscal year are as follows:

Fiscal year 2012	$ 198,000
Fiscal year 2013	264,000
Fiscal year 2014	22,000
	$ 484,000

(b) Joint Venture Wind-up:

The Operating Agreement with the Corporation’s Joint Venture partner expired with the early relinquishment of the Icha exploration license in March 2011. The estimate of the Corporation’s share of costs to wind-up the Joint Venture was $795,451 at May 31, 2011. In

8. Provisions (continued):

the three months ended August 31, 2011, the provision for wind-up costs decreased by $249,201 to $546,250.

(c) Legal:

There are no outstanding claims against the Corporation and thus no provision for legal costs is required at August 31, 2011.

9. Share capital:

(a) Authorized:

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

(b) Common shares issued and outstanding:

	August 31, 2011		May 31, 2011	
	Number issued	Amount	Number issued	Amount
Share capital, beginning of period	490,396,137	$ 91,806,942	489,063,510	$ 91,755,940
Issued for services (note 9 (b) (i) and (ii))	–	–	1,332,627	51,002
Share capital, end of period	490,396,137	$ 91,806,942	490,396,137	$ 91,806,942

(i) 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.

(ii) 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 Venture 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:

There were 20,882,774 warrants outstanding at August 31, 2011 and May 31, 2011 which are recognized in equity in the amount of $1,186,971. There were no warrants issued during the period ended August 31, 2011 or the fiscal year ended May 31, 2011 (notes 13(d) and 5).

(d) Stock options:

There were no stock options granted or exercised during the period ended August 31, 2011 or the fiscal year ended May 31, 2011. At August 31, 2011, there were 16,581,000 stock options outstanding at exercise prices ranging from $0.10 to $0.50.

The Corporation recognized share-based compensation expense for the three month period ended August 31, 2011 of $23,400 (August 31, 2010 - $175,890).

(e) Contributed surplus:

Changes in contributed surplus are as follows:

	August 31, 2011	May 31, 2011
Balance, beginning of period	$ 4,540,190	$ 4,396,175
Share-based compensation (note 10(d))	23,400	144,015
Balance, end of period	$ 4,563,590	$ 4,540,190

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 is expected to offset any current income tax expense. Deferred tax assets are not recognized as the Corporation and its subsidiaries and affiliates have no history of generating taxable earnings.

11. Loss per share:

Basic and diluted loss per share for the first three months of the fiscal year was calculated as follows:

	August 31, 2011	August 31, 2010
Net loss for the period	$(1,425,253)	$(1,157,836)
Weighted average number of common shares (basic):		
Issued common shares at beginning of period	490,396,137	489,063,510
Share options exercised	-	-
Effects of shares issued	-	411,557
Weighted average number of common shares - basic	490,396,137	489,475,067

As the exercise prices of all options and warrants are significantly out-of-the-money compared to market prices, a determination of diluted earnings per share is not relevant as their effect is anti-dilutive.

12. 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, stress the need for greater conservation of capital and careful monitoring of the Corporation's rate of spending on capital projects in Russia and to fund general and administrative costs, especially given the absence of adequate financing at August 31, 2011 (note 2).

There are no external restrictions on the Corporation's capital.

12. 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 August 31, 2011 and May 31, 2011 and June 1, 2010.

(c) Financial instrument 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, exchange rates and interest 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 periods ended August 31, 2011 and 2010, or thereafter.

(iii) Foreign currency risk:

The Corporation is exposed to foreign currency fluctuations as it holds cash and incurs expenditures in foreign currencies. The Corporation incurs expenditures 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 periods ended August 31, 2011 or 2010, or thereafter.

A 1% change in foreign exchange rates between the Russian rouble and the U.S. dollar would have resulted in a $3,000 change in net loss for the period ended August 31, 2011.

12. 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 which consist of Russian Value Added Taxes and accounts receivable from the Corporation's joint ventures. At August 31, 2011 and 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. The Corporation's financial liabilities consist of accounts payable and accrued liabilities. Accounts payable consists primarily of invoices payable to trade suppliers or professionals for services rendered.

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

13. Subsequent events:

(a) On September 10, 2011, a wholly-owned Russian subsidiary of the Corporation received a new 5 year exploration license in Kamchatka from the Russian Federal Agency for Subsoil Use. The license, named 'Tigilskaya', is effectively the previously-held Tigil License, but with additional 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: the first by September 10, 2015; and the second by September 10, 2016 (note 14).

(b) As part of an ongoing process to wind-up the joint venture between PKR, OJSC LukinCholot and Korea Kamchatka Petroleum Ltd. ("KKPL") (note 8), the equipment that was owned in the joint interest entities and located in Russia was sold by auction in accordance with an auction process pre-approved by KKPL and OJSC LukinCholot. The auction was held in Petropavlovsk-Kamchatsky, Russia on October 4, 2011. As the Corporation seeks to continue its exploration in Kamchatka on a farm-out basis, it placed the winning bid, through a pre-registered wholly-owned Russian subsidiary, of RUR 2,010,000 (approx. US $67,000 gross; $35,175 net). This secured a 100% interest in the equipment. The winning auction price was the result of a liquidation process.

13. Subsequent events (continued):

(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 and for the Corporation to complete a financing of a minimum of $30 million. As at November 29, 2011, a definitive binding agreement has not been reached with Advastor and discussions are ongoing.

(d) On November 19, 2011, there ware1,365,834 share purchase warrants, exercisable at US $0.15 which expired.

14. Commitments

The Corporation estimates expenditures of approximately $49 million will be required to meet the seismic and drilling work commitments of the Ichinskaya and Vorovskaya exploration licenses (note 5).

Subsequent to the reporting date, a new exploration license, the Tigilskaya exploration license, in Tigil, Kamchatka was granted to a wholly-owned Russian subsidiary of the Corporation (note 13). The Corporation estimates expenditures of approximately $51 million will be required to meet the work commitments of the Tigilskaya exploration license. The Corporation is seeking partners to farm-in on its aggregate Kamchatka acreage.

15. Reconciliation of statement of financial position from Canadian GAAP to IFRS:

These interim consolidated financial statements for the period ended August 31, 2011 represent the Corporation's first financial statements prepared in accordance with IAS 34.

Certain disclosures that are normally required to be included in the notes to the annual audited consolidated financial statements have been condensed. The accounting policies adopted by the Corporation under IFRS are set out in note 4 and are based on IFRS issued and outstanding as at November 29, 2011.

In accordance with IFRS, the Corporation has provided statements of financial position as at the reporting date of August 31, 2011 compared to May 31, 2011 and June 1, 2010, the Transition Date. It has also provided results of operations and cash flows under IFRS for the three month reporting periods ended August 31, 2011 compared to August 31, 2010.

The adoption of IFRS requires the application of IFRS 1. IFRS generally require that an entity retrospectively apply all IFRS except where IFRS 1 mandates exceptions to restrict retroactive application; or where IFRS 1 permits limited optional exemptions from the general requirement of retrospective application.

The only mandatory exception in IFRS 1 that restricts retrospective application that is relevant to the Corporation relates to non-controlling interests. There is a 10% non-controlling interest in one of the Corporation's Russian subsidiaries to which the mandatory exception applies. The non-controlling interest is recognized prospectively from the Transition Date. Under Canadian GAAP, no minority interest in the Russian subsidiary's history of accumulated losses was recognized. The non-controlling interest's share of the Russian subsidiary's losses under IFRS, after the Transition Date, is recognized.

The Corporation has made the following **optional elections** to avoid retrospective application of IFRS. The Corporation utilized these elections after considering the cost/benefit and/or practicality of a retrospective application:

A. Measurement of exploration and evaluation ("E&E") assets upon transition for companies using full cost accounting

The Corporation elected to measure its E&E assets at the Transition Date at the amount previously capitalized under previous Canadian GAAP.

The Corporation has no 'development or production assets' at the end of the reporting period because exploration to date has been unsuccessful. The Corporation presently has no reserves, no production and no positive cash inflows from the sale of oil or natural gas.

15. Reconciliation of Net Loss and Comprehensive Loss from previous Canadian GAAP to IFRS (continued):

Reconciliation of statement of financial position from Canadian GAAP to IFRS (continued):

B. Measurement of exploration and evaluation ("E&E") assets upon transition for companies using full cost accounting (continued):

At the Transition Date, the E&E assets were tested for impairment in accordance with IFRS 6 "Exploration for and Evaluation of Mineral Resources", IFRS 1 and IAS 36. No impairment charge was required.

Under the exemption provisions, the Corporation continued to aggregate its costs in CGUs. More specifically, the Corporation recognizes cost centers based on exploration licenses granted by the Russian Federal Ministry of Natural Resources ("MNRF"). The Corporation's cost centers at the Transition Date included: 'Icha'; 'Ichinskaya'; and 'Vorovskaya'. Each of these is located in Kamchatka, Russia. A new exploration license in Kamchatka was granted to a wholly-owned, indirectly-held Russian subsidiary of the Corporation subsequent to the reporting date (note 13).

C. Cost of equipment at Fair Value

In accordance with IFRS transitional provisions, the Corporation elected to use fair value for equipment presented in the Corporation's statement of financial position at the Transition Date. Fair value is based on independent appraisals of fair value.

Depreciation after the Transition Date is based on deemed cost and revised estimates of useful lives and residual values on a smaller component-by-component basis.

D. Share-based compensation

Under Canadian GAAP, the Corporation recognized an expense related to its share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture multiple. Under IFRS, the Company recognizes the expense over the individual vesting periods for the graded vesting awards and estimates a forfeiture rate.

IFRS 2 was not applied to equity instruments which vested before the Transition Date.

15. Reconciliation of Net Loss and Comprehensive Loss from previous Canadian GAAP to IFRS (continued):

Reconciliation of statement of financial position from Canadian GAAP to IFRS (continued):

E. Cumulative translation adjustment

In accordance with IFRS transitional provisions, the Corporation elected to reset the cumulative translation adjustment account, which includes gains and losses from the translation of foreign operations, to $nil. This reclassification resulted in a reduction of the Corporation's deficit as at the Transition Date of $1,018,864.

F. Business combinations and goodwill

There were no business combinations prior to the Transition Date which required adjustments under IFRS. To the reporting date, the Corporation has not entered into any business combinations. The corporate transactions that were completed in earlier years were accounted for as capital transactions.

In November 2009, the Corporation acquired its wholly-owned Cyprus subsidiary. The Corporation followed the '*continuity of interest basis of accounting'* whereby the Corporation is considered a continuation of the subsidiary. The consolidated financial statements reflect the assets, liabilities and results of operations of the subsidiary for periods prior to the acquisition. As the Corporation 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.

Also in November 2009, the Corporation completed an Arrangement with Bluerock Acquisition Corp. ("Bluerock") to achieve a public listing of its common shares on the TSX Venture Exchange ("TSXV"). Bluerock was a capital pool corporation listed on the TSXV that 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.

15. Reconciliation of statement of financial position from previous Canadian GAAP to IFRS

As at the IFRS Transition Date – June 1, 2010:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Non-current assets:			
Exploration and evaluation assets	$ -	$ 16,294,709	$16,294,709
Property and equipment	27,375,366	(22,927,425)	4,447,941
Investment in drilling rig	-	4,137,260	4,137,260
Non-current assets	27,375,366	(2,495,456)	24,879,910
Current assets:			
Cash and cash equivalents	7,915,415	-	7,915,415
Accounts receivable	2,758,064	-	2,758,064
Prepaid expenses	27,958	-	27,958
Current assets	10,701,437	-	10,701,437
Total Assets	$38,076,803	$ (2,495,456)	$35,581,347
Equity			
Share capital	$91,755,940	$ -	$91,755,940
Share purchase warrants	7,038,779	(5,851,808)	1,186,971
Contributed surplus	3,903,396	344,176	4,247,572
Cumulative translation adjustment	1,018,864	(1,018,864)	-
Foreign currency translation reserve	-	-	-
Revaluation reserve	-	-	-
Deficit	(68,889,756)	4,030,597	(64,859,159)
Equity attributable to owners of Corporation	34,827,223	(2,495,899)	32,331,324
Non-controlling interests	-	-	-
Total equity	34,827,223	(2,495,899)	32,331,324
Liabilities			
Non-current liabilities:			
Provisions		-	-
Warrants	-	443	443
Non-current liabilities	-	443	443
Current liabilities:			
Accounts payable and accrued liabilities	3,249,580	-	3,249,580
Provisions	-	-	-
Current liabilities	3,249,580	-	3,249,580
Total Liabilities	3,249,580	443	3,250,023
Total Equity and Liabilities	$38,076,803	$ (2,495,456)	$35,581,347

15. Reconciliation of statement of financial position from previous Canadian GAAP to IFRS (continued):

As at the end of the first quarter of the prior reporting period - August 31, 2010:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Non-current assets:			
Exploration and evaluation assets	$ -	$ 17,050,321	$17,050,321
Property and equipment	27,883,613	(23,659,548)	4,224,065
Investment in drilling rig	-	4,137,260	4,137,260
Non-current assets	27,883,613	(2,471,967)	25,411,646
Current assets:			
Cash and cash equivalents	6,953,937	-	6,953,937
Accounts receivable	613,736	-	613,736
Prepaid expenses	56,357	-	56,357
Current assets	7,624,030	-	7,624,030
Total Assets	$35,507,643	$(2,471,967)	$33,035,676
Equity			
Share capital	$91,787,815	$ -	$91,787,815
Share purchase warrants	7,038,779	(5,851,808)	1,186,971
Contributed surplus	4,072,396	319,191	4,391,587
Cumulative translation adjustment	1,018,864	(1,018,864)	-
Foreign currency translation reserve	-	601	601
Revaluation reserve	-	-	-
Deficit	(70,071,616)	4,084,898	(65,986,718)
Equity attributable to owners of Corporation	33,846,238	(2,465,982)	31,380,256
Non-controlling interest	-	(5,985)	(5,985)
Total equity	33,846,238	(2,471,967)	31,374,271
Liabilities			
Non-current liabilities:			
Warrants	-	-	-
Provisions	-	-	-
Non-current liabilities	-	-	-
Current liabilities:			
Accounts payable and accrued liabilities	1,661,405	-	1,661,405
Provisions	-	-	-
Current liabilities	1,661,405	-	1,661,405
Total Liabilities	1,661,405	-	1,661,405
Total Equity and Liabilities	$35,507,643	$(2,471,967)	$33,035,676

15. Reconciliation of statement of financial position from previous Canadian GAAP to IFRS (continued):

As at the end of the last reporting year under Canadian GAAP – May 31, 2011:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Non-current assets:			
Exploration and evaluation assets	$ -	$ -	$ -
Property and equipment	10,816,759	(5,683,561)	5,133,198
Investment in drilling rig	-	4,434,210	4,434,210
Non-current assets	10,816,759	(1,249,351)	9,567,408
Current assets:			
Cash and cash equivalents	4,045,212	-	4,045,212
Accounts receivable	252,667	-	252,667
Prepaid expenses	27,071	-	27,071
Current assets	4,324,950	-	4,324,950
Total Assets	$15,141,709	$(1,249,351)	$13,892,358
Equity			
Share capital	91,806,942	-	91,806,942
Share purchase warrants	7,038,779	(5,851,808)	1,186,971
Contributed surplus	4,289,815	250,375	4,540,190
Cumulative translation adjustment	1,018,864	(1,018,864)	-
Foreign currency translation reserve	-	304,987	304,987
Revaluation reserve	-	1,433,622	1,433,622
Deficit	(91,345,771)	5,593,210	(85,752,561)
Equity attributable to owners of Corporation	12,808,629	711,522	13,520,151
Non-controlling interest	-	(1,960,873)	(1,960,873)
Total equity	12,808,629	(1,249,351)	11,559,278
Liabilities			
Non-current liabilities:			
Warrants	$ -	$ -	$ -
Provisions	-	-	-
Non-current liabilities	-	-	-
Current liabilities:			
Accounts payable and accrued liabilities	1,537,629	-	1,537,629
Provisions	795,451	-	795,451
Current liabilities	2,333,080	-	2,333,080
Total Liabilities	2,333,080	-	2,333,080
Total Equity and Liabilities	$15,141,709	$(1,249,351)	$13,892,358

15. Reconciliation of Net Loss and Comprehensive Loss from previous Canadian GAAP to IFRS (continued):

For the three months ended August 31, 2010:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
Expenses:				
Exploration and evaluation expenditures		$ -	$ -	$ -
Equipment operating expenses and other		163,440	-	163,440
General and administrative expenses		628,930	(31,875)	597,055
Share-based compensation		169,000	(6,890	175,890
Depreciation		247,365	(23,489)	223,876
Loss before interest and income taxes		1,208,735	(48,474)	1,160,261
Finance income		(26,875)	24,450	(2,425)
Finance expenses		-	-	-
Net finance income (loss)		(26,875)	24,450	(2,425)
Income tax		-	-	-
Net loss		1,181,860	(24,024)	1,157,836
Other comprehensive loss (income)				
Foreign exchange differences on translation of foreign operations		-	(24,893)	(24,893)
Net comprehensive income		-	(24,893)	(24,893)
Net loss and comprehensive loss for the period		$ 1,181,860	$ (48,917)	$ 1,132,943
Net loss attributable to:				
Shareholders of the corporation		$ 1,181,860	$ (54,301)	$ 1,127,559
Non-controlling interest in subsidiary		$ -	$ 30,277	$ 30,277
Net loss for the period		$ 1,181,860	$ (24,024)	$ 1,157,836
Total comprehensive loss attributable to:				
Shareholders of the corporation		$ 1,181,860	$ (54,902)	$ 1,126,958
Non-controlling interest in subsidiary		$ -	$ 5,985	$ 5,985
Net comprehensive loss for the period		$ 1,181,860	$ (45,917)	$ 1,132,943
Net loss per share:				
Basic		$ (0.00)	$ 0.00	$ (0.00)
Diluted		$ (0.00)	$ 0.00	$ (0.00)
Weighted average number of common shares outstanding				
Basic		489,475,067	-	489,475,067
Diluted		489,475,067	-	489,475,067

15. Reconciliation of Net Loss and Comprehensive Loss from previous Canadian GAAP to IFRS (continued):

For the year ended May 31, 2011:

	Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
Expenses:				
Equipment operating expenses and other		$ 2,350,579	$ -	$ 2,350,579
General and administrative expenses		2,376,413	-	2,376,413
Share-based compensation		386,419	(93,801)	292,618
Depreciation		263,898	631,608	895,506
Write down of property and equipment		17,088,976	-	17,088,976
Loss before interest and income taxes		22,466,285	537,807	23,004,092
Finance income		(10,270)	-	(10,270)
Finance expenses		-	-	-
Net finance income (loss)		(10,270)	-	(10,270)
Income tax expense (reduction)		-	-	-
Net loss		22,456,015	537,807	22,993,822
Other comprehensive loss				
Foreign exchange differences on translation of foreign operations		-	(318,237)	(318,237)
Revaluation of property and equipment		-	(1,559,919)	(1,559,919)
Net comprehensive income		-	(1,878,156)	(1,878,156)
Net loss and comprehensive loss for the year		$22,456,015	$(1,340,349)	$21,115,666
Net loss attributable to:				
Shareholders of the corporation		$22,456,015	$ (1,562,613)	$20,893,402
Non-controlling interest in subsidiary		-	2,100,420	2,100,420
Net loss for the year		$22,456,015	$ 537,807	$22,993,822
Total comprehensive loss attributable to:				
Shareholders of the corporation		$22,456,015	$ (3,301,222)	$19,154,793
Non-controlling interest in subsidiary		-	1,960,873	1,960,873
Net comprehensive loss for the year		$22,456,015	$ (1,340,349)	$21,115,666
Net loss per share:				
Basic		$ (0.05)	$ 0.01	$ (0.04)
Diluted		$ (0.05)	$ 0.01	$ (0.04)
Weighted average number of common shares outstanding				
Basic		489,987,712	-	489,987,712
Diluted		489,987,712	-	489,987,712

15. Reconciliation of Net Loss and Comprehensive Loss from previous Canadian GAAP to IFRS (continued):

Transition from Canadian GAAP to IFRS – Notes to Reconciliations

(a) **Property and equipment and exploration and evaluation assets**

(i) The Corporation elected an IFRS 1 exemption whereby exploration and evaluation assets were reclassified from the full cost pool under Canadian GAAP to exploration and evaluation assets at the amount that was recorded under Canadian GAAP. As exploration efforts were unsuccessful to the Transition Date, the Corporation had no reserves and no producing or development assets.

This resulted in a $16,294,709 increase in exploration and evaluation assets at the Transition Date and a corresponding decrease in 'property and equipment' presented under Canadian GAAP.

(ii) IFRS 1 also provides an optional exemption to measure assets using the estimated fair value on the Transition Date and applied IAS 16 as the fair value measurement. The Corporation elected this exemption such that equipment costs were adjusted to the independently appraised fair value at the Transition Date of $4,447,941 compared to carrying value of $6,853,286 under Canadian GAAP.

(iii) In addition, depreciation is measured on a more detailed component-by-component basis under IFRS. This change in approach resulted in differences in the estimates of expected life and residual values of some components of the Corporation's equipment.

(b) **Decommissioning obligations**:

There was no need for the Corporation to record any increase in decommissioning obligations at the Transition Date which would have been offset by a corresponding decrease in retained earnings under transition to IFRS.

Under Canadian GAAP, because the Corporation's exploration drilling efforts were unsuccessful to the Transition Date, there were no long-term asset retirement obligations required for producing or development assets as there were no such assets. Accounts payable and accrued liabilities at the Transition Date include an accrual of $156,700 for estimated site reclamations and other environmental impact damages relating to exploration licenses that either expired subsequent to the Transition Date or were surrendered back to the MNFR early. These liabilities are not discounted to a present value because settlement is required in the current period.

(c) Share-based payments:

Under Canadian GAAP, the Company recognized an expense related to their share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture multiple. Under IFRS, the Company is required to recognize the expense over the

15. Reconciliation of Net Loss and Comprehensive Loss from previous Canadian GAAP to IFRS (continued):

Transition from Canadian GAAP to IFRS – Notes to Reconciliations (continued):

(c) Share-based payments (continued):

individual vesting periods for graded vesting awards and estimate a forfeiture rate. Accordingly, a $344,176 increase to accumulated deficit was recorded upon transition to IFRS, offset by a $24,985 decrease for the three months ended August 31, 2010 and a $93,801 decrease for the fiscal year May 31, 2011.

(d) Foreign currency translation adjustment:

The Effects of Changes in Foreign Exchange Rates (“IAS 21”) requires the functional currency of each entity of the consolidated group to be determined separately based on primary and secondary indicators. For the three months ended August 31, 2010, the Corporation recorded $24,893 gain on changes in foreign exchange rates and a $318,237 gain for the fiscal year ended May 31, 2011.

In addition, IFRS 1 provides an optional exemption to set accumulated foreign currency translation balances reported in other comprehensive income to ‘nil’. Upon transition to IFRS, the Corporation elected to use this exemption. The cumulative translation balance at June 1, 2010 of $1,018,864 was set to nil and offset to retained earnings.

(e) Investment in drilling rig – held for resale

The Corporation owns a 46.25% interest in a drilling rig currently stored since delivery in a bonded export facility in Shanghai, China. At August 31, 2011, the rig is available for immediate sale which sale is expected to occur within the twelve month period following the reporting date and therefore has been included in current assets.

(f) Warrants

Under Canadian GAAP the Corporation classified warrants previously issued to purchase common shares with exercise prices in Canadian dollars and British pounds as equity instruments. Under IFRS, warrants issued to purchase common shares for a fixed price, in a currency other than the functional currency of the parent and not offered pro rata to all existing shareholders of the same class at the time issuance are considered derivative financial liabilities. Such warrants are required to be measured and recognized at fair value with changes subsequent to the initial recognition charged to profit or loss. The fair value of the warrants at August 31, 2011 was not material. The Corporation used the Black-Scholes pricing model to determine the fair value.

(g) Cash Flow Statement

The transition from Canadian GAAP to IFRS had no material effect upon the reported cash flows generated by the Corporation.