Pacific
Rubiales Energy

Consolidated Financial Statements

For the years ended December 31, 2011 and 2010

PACIFIC RUBIALES ENERGY CORP.

Management's Responsibility for Financial Statements

Management is responsible for preparing the consolidated financial statements and the accompanying notes. The consolidated financial statements have been prepared by in accordance with International Financial Reporting Standards using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that accounting systems provide timely, accurate, and reliable information. The Company's external auditors, Ernst & Young LLP, have examined the consolidated financial statements. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported financial results and the financial condition of the Company.

The Audit Committee of the Board of Directors, consisting exclusively of independent directors, has reviewed in detail the consolidated financial statements with management and the external auditors. The Board of Directors on the recommendation of the Audit Committee has approved the consolidated financial statements.

"Ronald Pantin"
Chief Executive Officer

"Carlos Perez Olmedo"
Chief Financial Officer

Toronto, Canada
March 13, 2012

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Pacific Rubiales Energy Corp.

We have audited the accompanying consolidated financial statements of Pacific Rubiales Energy Corp., which comprise the consolidated statements of financial position as at December 31, 2011 and 2010 and January 1, 2010 and the consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years ended December 31, 2011 and 2010, and 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 International Financial Reporting Standards, 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 the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors 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 financial position of Pacific Rubiales Energy Corp. as at December 31, 2011 and 2010 and January 1, 2010 and the results of its financial performance and its cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

Ernst & Young LLP
Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
March 13, 2012.

Consolidated Statements of Income

(In thousands of U.S. Dollars,except per share information)		Year ended December 31	
	Notes	2011	2010
Oil and gas sales		$ 3,380,819	$ 1,661,544
Cost of operations			
Production and operating costs	5	1,245,509	630,372
Depletion, depreciation and amortization		656,474	394,308
		1,901,983	1,024,680
Earnings before undernoted		1,478,836	636,864
Expenses			
General and administrative		188,722	107,109
Share-based compensation		48,783	73,327
		237,505	180,436
Earnings from operations		1,241,331	456,428
Finance costs		(86,469)	(77,383)
Income from equity investments	15	6,829	7,770
Equity tax	6	(68,446)	(2,088)
Foreign exchange (loss) gain		(39,894)	33,851
Gain (loss) on risk management	22e	8,831	(40,230)
Incentive for early conversion of debentures	16	(46,489)	-
Other (expenses) income		(13,207)	2,718
Net earnings before income tax		1,002,486	381,066
Income tax (expense)	7	(448,150)	(115,979)
Net earnings for the year		$ 554,336	$ 265,087
Basic earnings per share	8	2.04	1.01
Diluted earnings per share	8	1.97	0.96

See accompanying notes to the consolidated financial statements

On behalf of the Board of Directors:

Miguel de la Campa (signed) José Francisco Arata (signed)

PACIFIC RUBIALES ENERGY CORP.

Consolidated Statements of Comprehensive Income

(In thousands of U.S. Dollars)	Notes	Year ended December 31 2011	2010
Net earnings for the year		$ 554,336	$ 265,087
Other comprehensive income (nil tax effect)			
Foreign currency translation		4,205	(20,637)
Fair value adjustments on investments	15	20,402	-
Unrealized (loss) gain on cash flow hedges	22c	(14,492)	21,721
Realized gain on cash flow hedges transferred to earnings	22c	(9,577)	(21,721)
		538	(20,637)
Comprehensive income		$ 554,874	$ 244,450

See accompanying notes to the consolidated financial statements

PACIFIC RUBIALES ENERGY CORP.

Consolidated Statements of Financial Position

(In thousands of U.S. Dollars)	Notes	As at December 31 2011	As at December 31 2010	As at January 1 2010
ASSETS				
Current				
Cash and cash equivalents		$ 729,671	$ 602,776	$ 428,556
Restricted cash		3,074	6,706	8,712
Accounts receivables	22a	774,759	292,659	153,919
Inventories	10	181,272	56,532	38,066
Income tax receivable		18,694	1,587	2,050
Prepaid expenses		2,462	6,398	4,449
Risk management assets	22e	-	1,066	-
		1,709,932	967,724	635,752
Non-current				
Oil and gas properties	11	2,483,153	2,294,474	2,037,397
Exploration and evaluation assets	12	437,901	150,896	38,279
Intangible assets	14	144,961	170,967	-
Plant and equipment	13	80,001	19,176	10,006
Investments in associates and other assets	15	492,221	250,256	103,209
Goodwill	14	100,636	100,636	100,636
Restricted cash		-	-	2,059
		$ 5,448,805	$ 3,954,129	$ 2,927,338
LIABILITIES				
Current				
Accounts payable and accrued liabilities		$ 702,895	$ 525,956	$ 203,332
Risk management liability	22c & e	67,387	53,647	23,538
Income tax payable	7	367,674	109,982	1,310
Current portion of long-term debt	16	4,726	90,043	12,128
Current portion of obligations under finance lease	18	17,106	4,304	1,920
		1,159,788	783,932	242,228
Non-current				
Long-term debt	16	922,418	434,350	442,159
Obligations under finance lease	18	87,782	34,383	38,521
Convertible debenture	16	2,234	186,416	165,611
Risk management liability	22c & e	5,397	-	1,720
Deferred tax liability	7	284,462	349,614	404,736
Equity tax payable	6	33,522	-	-
Asset retirement obligation	17	45,400	20,609	9,119
		2,541,003	1,809,304	1,304,094
SHAREHOLDERS' EQUITY				
Common shares	20	2,025,665	1,691,838	1,364,687
Contributed surplus		145,741	112,339	136,934
Equity component of convertible debenture		-	56,766	57,070
Accumulated other comprehensive loss		(20,099)	(20,637)	-
Retained earnings		756,495	304,519	64,553
		2,907,802	2,144,825	1,623,244
		$ 5,448,805	$ 3,954,129	$ 2,927,338

See accompanying notes to the consolidated financial statements

PACIFIC RUBIALES ENERGY CORP.

Consolidated Statements of Shareholders' Equity

(In thousands of U.S. Dollars)	Notes	Year ended December 31 2011	2010
Common shares			
Balance, beginning of year		$ 1,691,838	$ 1,364,687
Issued on exercise of warrants		6,176	223,109
Issued on exercise of options		34,420	102,860
Issued on conversion of convertible debentures	16	293,231	1,182
Balance, end of year		2,025,665	1,691,838
Contributed surplus			
Balance, beginning of year		112,339	136,934
Exercise of warrants		(1,347)	(62,328)
Exercise of options		(14,034)	(35,594)
Share-based compensation		48,783	73,327
Balance, end of year		145,741	112,339
Equity component of convertible debentures			
Balance, beginning of year		56,766	57,070
Conversion to common shares	16	(56,766)	(304)
Balance, end of year		-	56,766
Accumulated other comprehensive (loss)			
Balance, beginning of year		(20,637)	-
Other comprehensive income (loss)		538	(20,637)
Balance, end of year		(20,099)	(20,637)
Retained earnings			
Balance, beginning of year		304,519	64,553
Net earnings for the year		554,336	265,087
Dividends	9	(102,360)	(25,121)
Balance, end of year		756,495	304,519
Total shareholders' equity		$ 2,907,802	$ 2,144,825

See accompanying notes to the consolidated financial statements

PACIFIC RUBIALES ENERGY CORP.

Consolidated Statements of Cash Flows

(In thousands of U.S. Dollars)	Notes	Year ended December 31 2011	2010
OPERATING ACTIVITIES			
Net earnings for the year		$ 554,336	$ 265,087
Items not affecting cash:			
Depletion, depreciation and amortization		656,474	394,308
Asset retirement obligation accretion	17	1,082	1,969
Unrealized (gain) loss on risk management contracts	22e	(13,445)	28,389
Share-based compensation		48,783	73,327
Gain on cash flow hedges included in operating expense		(9,577)	(21,721)
Deferred income tax	7	(65,152)	(55,121)
Accretion on convertible debentures		14,870	13,028
Unrealized foreign exchange loss (gain)		51,480	(18,202)
Loss (income) from equity investments	15	(6,829)	(7,770)
Equity tax	6	68,446	-
Unwinding of equity tax discount	6	6,914	-
Incentive for early conversion and debentures	16	46,489	-
Other		14,728	(5,525)
Changes in non-cash working capital	23	(149,542)	272,160
Net cash provided by operating activities		1,219,057	939,929
INVESTING ACTIVITIES			
Additions to oil and gas properties and plant and equipment		(852,552)	(611,036)
Additions to exploration and evaluation assets		(299,988)	(119,770)
Additions to intangible assets	14	-	(190,000)
Investment in equity investments and other assets	15	(141,994)	(126,682)
Finance loan to OBC	15	(102,258)	-
Decrease in restricted cash		3,035	4,061
Net cash used in investing activities		(1,393,757)	(1,043,427)
FINANCING ACTIVITIES			
Advances from debt		4,831	97,071
Repayment of debt		(98,264)	(23,532)
Proceeds from the exercise of warrants and options		25,214	228,044
Dividends paid	9	(102,360)	(25,121)
Drawdown of revolving credit facility	16	193,000	-
Issuance of senior notes	16	300,000	-
Transaction cost - note exchange and debenture early conversion	16	(9,777)	-
Other		-	(5,398)
Net cash provided by financing activities		312,644	271,064
Effect of exchange rate changes on cash and cash equivalents		(11,049)	6,654
Change in cash and cash equivalents during the year		126,895	174,220
Cash and cash equivalents, beginning of the year		602,776	428,556
Cash and cash equivalents, end of the year		$ 729,671	$ 602,776
Cash and cash equivalents are comprised of:			
Cash		$ 728,760	$ 598,170
Short-term money market instruments		911	4,606
		$ 729,671	$ 602,776

See accompanying notes to the consolidated financial statements

1. Corporate information

Pacific Rubiales Energy Corp. (the "Company") is an oil and gas company incorporated in Canada and engaged in the exploration, development and production of crude oil and natural gas in Colombia, Peru, and Guatemala. The Company's common shares are listed and publicly traded on the Toronto Stock Exchange and the Bolsa de Valores de Colombia (or the Colombian Stock Exchange). On February 2, 2012, the Brazilian Depository Receipts representing the Company's common shares ("BDRs") commenced trading on Bolsa de Valores Mercadorias e Futuros (or the Brazilian Stock Exchange). The Company's registered office is located at Suite 650 – 1188 West Georgia Street, Vancouver, British Columbia, V6E4A2, Canada and it also has corporate offices in Toronto, Canada and Bogota, Colombia.

These consolidated financial statements of the Company were authorized for issuance by the Board of Directors on March 13, 2012.

2. Basis of preparation and significant accounting policies

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The Company adopted IFRS in 2011 with a transition date of January 1, 2010. As such, these are the Company's first consolidated financial statements prepared in accordance with IFRS. The transition to IFRS resulted in changes to the Company's previous accounting policies as applied and disclosed in the consolidated financial statements for the year ended December 31, 2010, prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). A summary of the significant changes to the Company's accounting policies is disclosed in Note 25 along with the impact of the changeover to IFRS on the comparative years.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and subsidiaries.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

All intra-Company balances, income and expenses and unrealized gains and losses resulting from intra-Company transactions are eliminated in full.

2.1. Significant accounting judgments, estimates and assumptions

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.

Critical judgments in applying accounting policies

The following critical judgments have been made by the Company in applying accounting policies which have the most significant impact on the amounts recognized in the consolidated financial statements.

Cash generating units have been identified to be the major producing fields, the lowest level at which there are identifiable cash inflows that are largely independent of cash inflows of other groups of assets. The Company prepares and reviews separate detailed budgets and forecast calculations for each of the cash generating units. Impairment assessment is generally carried out separately for each cash generating unit based on cash flow forecasts calculated based on proven reserves for each cash generating unit (value in use).

The determination of the Company's functional currency requires analyzing facts that are considered primary factors, and if the result is not conclusive, the secondary factors. The analysis requires the Company to apply significant judgment since primary and secondary factors may be mixed. In determining its functional currency the Company analyzed both the primary and secondary factors, including the currency of the Company's revenues, operating costs in both Canada and Colombia, and sources of debt and equity financing.

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

Estimation uncertainty and assumptions

Oil and gas properties are depreciated using the units-of-production method over proved developed and undeveloped oil and gas reserves for facilities and wells. The calculation of the unit-of-production rate of amortization could be impacted to the extent that actual production in the future is different from current forecast production based on proved reserves. This would generally result from significant changes in any of the factors or assumptions used in estimating reserves. These factors could include:

- Changes in proved reserves.
- The effect on proved reserves of differences between actual commodity prices and commodity price assumptions.
- Unforeseen operational issues.

The recoverable amounts of cash-generating units and individual assets have been determined based on the higher of value-in-use calculations and fair values less costs to sell. These calculations require the use of estimates and assumptions. It is reasonably possible that the oil price assumption may change which may then impact the estimated life of the field and may then require a material adjustment to the carrying value of goodwill and tangible assets. The Company monitors internal and external indicators of impairment relating to its tangible and intangible assets.

Certain association contracts in Colombia provide for an adjustment to the partner's share when certain volume thresholds are reached. As a result, from time to time the Company may be required to estimate the impact of such contract adjustments.

Decommissioning costs will be incurred by the Company at the end of the operating life of certain facilities and properties. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing and amount of expenditure can also change, for example in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the asset retirement obligation established which would affect future financial results.

Significant assumptions with respect to share-based payment expense include an estimate of the volatility of the Company's shares and the expected life of the options, which are subject to measurement uncertainty.

The fair values of financial instruments are estimated based on market and third party inputs. These estimates are subject to changes in the underlying commodity prices, interest rates, foreign exchange rates, and non-performance risk.

2.2. Summary of significant accounting policies

Interests in joint ventures

Substantially, all of the Company's operations are conducted jointly with others. Joint control is defined as contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

Jointly controlled operations and jointly controlled entities

A jointly controlled operation involves the use of assets and other resources of the Company and other venturers rather than the establishment of a corporation, partnership or other entity.

The Company recognizes in its consolidated financial statements the assets that it controls and the liabilities and the expenses it incurs, and the share of income that it earns from the sale of goods or services by the joint venture. For those operations where the Company is the operator, the gross working capital has been included in the Company's consolidated financial statements. For jointly controlled entities, these consolidated financial statements only reflect the Company's proportionate interest in such activities.

Reimbursement of the joint venture operator's costs

When the Company acting as an operator receives reimbursement of direct costs charged to the joint venture, such charges represent reimbursements of costs that the operator incurred as an agent for the joint venture and therefore have no effect on the consolidated statement of income.

In many cases, the Company also incurs certain general overhead expenses in carrying out activities on behalf of the joint venture. As these costs can often not be specifically identified, joint venture agreements allow the operator to recover the general overhead expenses incurred by charging an overhead fee that is based on a fixed percentage of the total costs incurred for the year. Although the purpose of this recharge is very similar to the reimbursement of direct costs, the Company is not acting as an agent in this case. Therefore, the general overhead expenses and the overhead fee are recognized in the consolidated statement of income as an expense and income, respectively.

Business combinations and goodwill

On the acquisition of a subsidiary, the acquisition method of accounting is used whereby the purchase consideration transferred is allocated to the identifiable assets, liabilities and contingent liabilities (identifiable net assets) on the basis of fair value at the date of acquisition. Those petroleum reserves and resources that are able to be reliably valued are recognized in the assessment of fair values on acquisition. Other potential reserves, resources and rights, for which fair values cannot be reliably determined, are not recognized.

Goodwill is initially measured at cost being the excess of the cost of the business combination over the Company's share in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

If the fair value attributable to the Company's share of the identifiable net assets exceeds the fair value of the consideration, the Company reassesses whether it has correctly identified and measured the assets acquired and liabilities assumed and recognizes any additional assets or liabilities that are identified in that review. If an excess remains after reassessment, the Company recognizes the resulting gain in profit or loss on the acquisition date.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquire are assigned to those units.

Accounts receivable

Trade accounts receivable are recorded based on the Company's revenue recognition policy. The allowance for doubtful accounts is management's best estimate of accounts receivable balances that may not be collectible.

Inventories

Oil and gas inventory and operating supplies are valued at the lower of average cost and net realizable value. Cost is determined on a weighted average basis. Cost consists of material, labour and direct overhead. Previous impairment write-downs are reversed when there is a recovery of the previously impaired inventory. Costs of diluents are included in production and operating costs.

Oil and gas properties, exploration and evaluation assets, and plant and equipment

Oil and gas properties and plant and equipment

Oil and gas properties and plant and equipment are stated at cost, less accumulated depletion and depreciation and accumulated impairment losses. The initial cost of an asset comprises its purchase price or construction cost, any cost directly attributable to bringing the asset into operation, the initial estimate of the asset retirement obligation, and for qualifying assets, borrowing costs. 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 is also included within plant and equipment.

Depletion, depreciation and amortization

Oil and gas properties are depleted on a unit-of-production basis over the proved reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. Rights and concessions are depleted on the unit-of-production basis over the total proved reserves of the relevant area. The unit-of-production rate for the depletion of field development costs takes into

account expenditures incurred to date, together with approved future development expenditure required to develop reserves.

Plant and equipment are generally depreciated on a straight-line basis over their estimated useful lives, which range from one to ten years. Major inspection costs are amortized over three to five years which represents the estimated period before the next planned major inspection. Plant and equipment held under finance leases are depreciated over the shorter of lease term and estimated useful life.

Development costs

Expenditure on the construction, installation or completion of infrastructure facilities such as pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalized in oil and gas properties.

Exploration and evaluation costs

All license acquisition, exploration and appraisal costs of technical services and studies, seismic acquisition, exploratory drilling and testing are initially capitalized by well, field, unit of account or specific exploration unit as appropriate. Expenditures incurred during the various exploration and appraisal phases are carried forward, until the existence of commercial reserves and when the technical feasibility and commercial viability are demonstrable and approved by regulator. If commercial reserves have been discovered and technical feasibility and commercial viability are demonstrable, the carrying value of the exploration and evaluation assets, after any impairment loss, is reclassified as oil and gas properties. If technical feasibility and commercial viability cannot be demonstrated upon completion of the exploration phase, the carrying value of the exploration and evaluation costs incurred are expensed in the period this determination is made.

Exploration and evaluation assets are tested for impairment when indicators of impairment are present and when exploration and evaluation assets are transferred to oil and gas properties. The Company has determined the level for assessing for impairment at the cash-generating unit level.

Pre-license costs

Costs incurred prior to having obtained the legal rights to explore an area are expensed to the consolidated statement of income as they are incurred.

Major maintenance and repairs

Expenditures on major maintenance refits or repairs comprise the cost of replacement assets or parts of assets, inspection costs and overhaul costs. Where an asset or part of an asset that was separately depreciated and is now written off is replaced and it is probable that future economic benefits associated with the item will flow to the Company, the expenditure is capitalized. Where part of the asset was not separately considered as a component, the replacement value is used to estimate the carrying amount of the replaced assets which is immediately written off. Inspection costs associated with major maintenance programs are capitalized and amortized over the period to the next inspection. All other maintenance costs are expensed as incurred.

Carried interest and farm-in arrangements

The Company recognizes its expenditures under a farm-in or carried interest arrangement for exploration and evaluation assets in respect of its interest and that retained by the other party, as and when the costs are incurred. Such expenditures are recognized in the same way as the Company's directly incurred exploration and evaluation expenditures.

Intangible assets

Intangible assets are stated at the amount initially paid, less accumulated amortization and accumulated impairment losses. Intangible assets represent rights to the available capacity of a pipeline system in Colombia. Following initial recognition, the intangible asset is amortized based on the usage of the 160 million barrel capacity over the term of the agreement. The Company does not have intangible assets with an indefinite life which would not be subject to amortization. Internally generated intangible assets are not capitalized and the expenditure is reflected in the consolidated statement of income in the year in which the expenditure is incurred.

Investments

When the Company determines that it has significant influence over an investment, the investment is accounted for using the equity method. Under the equity method the investment is initially recorded at cost and the carrying value is adjusted thereafter to include the Company's pro rata share of post-acquisition earnings of the investee, computed using the consolidation method. The amount of the adjustment is included in the determination of net income and the investment account is also increased or decreased to reflect the Company's share of capital transactions. Profit distributions received or receivable from an investee reduce the carrying value of the investment.

The Company periodically assesses its investments to determine whether there is any indication of impairment. When there is an indication of impairment, the Company tests the carrying amount of the investment to ensure it does not exceed the higher of the present value of cash flows expected to be generated (value in use) and the amount that could be realized by selling the investment (fair value less cost to sell).When a reduction to the carrying amount of an investment is required, after applying the impairment test, an impairment loss is recognized equal to the amount of the reduction.

Impairment of assets

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's fair value less costs to sell and its value-in-use. Individual assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. Where the carrying amount of an asset or cash generating unit exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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.

The Company bases its impairment calculation on detailed budgets and forecast calculations which are prepared separately for each of the Company's cash generating units to which the individual assets are allocated. These budgets and forecast calculations generally cover a period of five years. For longer periods, a long term growth rate is calculated and applied to project future cash flow after the fifth year. Impairment losses are recognized in the consolidated statement of income.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company estimates the asset's or cash generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income.

Goodwill is tested for impairment annually (as at December 31) and when circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of each cash generating unit (or group of cash generating units) to which the goodwill relates. Where the recoverable amount of the cash generating unit is less than its carrying amount an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

Financial instruments

Financial assets

Financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available for sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, transaction costs. The Company considers whether a contract contains an embedded derivative when the Company first becomes a party to the contract. Embedded derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

The Company determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial period end.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss includes financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments or a financial guarantee contract. Gains or losses on investments held for trading are recognized in profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method less impairment.

Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate. The amortization is included in finance cost in the consolidated statement of income. The losses arising from impairment are recognized in the consolidated statement of income in finance costs.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and that are not classified in any of the previous categories. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences, are recognized in other comprehensive income. When an investment is derecognized, the cumulative gain or loss in other comprehensive income is transferred to net earnings.

Cash and cash equivalents

Cash and short term deposits in the consolidated statement of financial position comprise cash at banks and at hand and short-term deposits with an original maturity of three months or less.

For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Financial liabilities

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss or other liabilities, as appropriate. The Company determines the classification of its financial liabilities at initial recognition. All financial liabilities are recognized initially at fair value and in the case of loans and borrowings, net of directly attributable transaction costs.

Interest bearing loans and borrowings

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as through the effective interest rate method amortization process. Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs. The amortization is included in finance cost in the consolidated statement of income.

Convertible debentures

The component parts of compound instruments (convertible debentures) issued by the Company are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. At the date of issue, the debt component is recognized at the fair value of a similar debt instrument that does not have a

conversion feature. The equity component of the convertible debenture is determined by deducting the amount of the debt component from the fair value of the compound instrument as a whole. The debt component presented on the consolidated statement of financial position increases over the term of the debenture to the full face value of the outstanding debentures at maturity. The difference, representing the accretion on convertible debentures, is reflected as finance cost with the result that adjusted interest expense reflects the effective yield of the debt component of the convertible debentures.

The equity component of the convertible debenture is presented under shareholders' equity in the consolidated statement of financial position. The equity component represents the fair value of the conversion right granted to the holder, which remains a fixed amount over the term of the related debentures. Upon conversion of the debentures into common shares by the holders, the debt and equity components are transferred to common share capital. Upon the repayment of the face value of the debt, the equity component of the convertible debentures not converted before or upon maturity is transferred to contributed surplus.

Transaction costs related to the issuance of the convertible debentures are allocated on a pro rata basis to the debt and equity components based on the fair values assigned to the components, respectively.

If the compound instrument is denominated in a currency different from the Company's functional currency, the equity component, being the conversion feature, is recognized as a derivative liability and measured at its fair value.

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss includes financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit and loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognized in profit or loss.

Own use exemption

Contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the Company's expected purchase, sale or usage requirements fall within the exemption from IAS 32 and IAS 39, which is known as the 'own use exemption'. These contracts are accounted for as executory contracts. The Company recognizes such contracts in its consolidated statement of financial position only when one of the parties meets its performance obligation.

Fair value hierarchy

The Company uses a three level hierarchy to categorize the significance of the inputs used in measuring the fair value of financial instruments. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 consists of financial instruments such as quoted share prices, exchange-traded oil collars and information from forward markets such as the New York Mercantile Exchange.

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value, volatility factors and broker quotations, which can be substantially observed or corroborated in the marketplace. Instruments in this category include non-exchange traded crude oil and foreign currency derivatives.

Level 3 – Valuations in this level are those with inputs which are less observable, unavailable or where the observable data does not support the majority of the instrument's fair value. Level 3 instruments may include items based on pricing services or broker quotes where the Company is unable to verify the observability of inputs into their prices. Level 3 instruments include longer-term transactions, transactions in less active markets or transactions at locations for which pricing information is not available. In these instances, internally developed methodologies are used to determine fair value which primarily includes extrapolation of observable future prices to similar location, similar instruments or later time periods.

If different levels of inputs are used to measure a financial instrument's fair value, the classification within the hierarchy is based on the lowest level input that is significant to the fair value measurement.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date: whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. All take or pay contracts are reviewed for indicators of a lease on inception.

Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognized in the consolidated statement of income.

Finance leased assets are depreciated over the useful life of the asset. However if there is no reasonable certainty that the Company will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

Operating lease payments are recognized as an expense in the consolidated statement of income on a straight-line basis.

Asset retirement obligation

An asset retirement obligation is recognized when the Company has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. A corresponding amount equivalent to the asset retirement obligation is also recognized as part of the cost of the related oil and gas properties or exploration and evaluation assets. The amount recognized is the estimated cost of decommissioning, discounted to its present value. Changes in the estimated timing or costs of decommissioning, or discount rate are recognized prospectively by recording an adjustment to the asset retirement obligation, and a corresponding adjustment to the properties. The unwinding of the discount on the decommissioning cost is included as a finance cost.

The Company does not recognize either the deferred tax asset regarding the temporary difference on the asset retirement obligation, or the corresponding deferred tax liability regarding the temporary difference on a decommissioning asset.

Taxes

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date.

Current income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statement of income. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences at the date of the consolidated statement of financial position between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- Where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting earnings nor taxable earnings or loss; and

- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable earnings will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilized except:

- Where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting earnings nor taxable earnings or loss; and

- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable earnings will be available against which the temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at each date of the consolidated statement of financial position and reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each date of the consolidated statement of financial position and are recognized to the extent that it has become probable that future taxable earnings will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the end of the reporting period.

Deferred income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statement of income.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

Production-sharing arrangements

According to production-sharing agreements, the share of the profit oil to which the government is entitled in any calendar year in accordance with production sharing contracts is deemed to include a portion representing the corporate income tax imposed upon and due by the Company, and which will be paid directly by the government on behalf of the Company to the appropriate tax authorities. This portion of income tax and revenue are presented net in the consolidated statement of income.

Revenue recognition

Revenue from sale of oil and gas is recognized when the significant risks and rewards of ownership have been transferred. This generally occurs when product is physically delivered and the title passes to the buyers and collection is reasonably assured.

Sales between the Company’s subsidiaries are based on prices generally equivalent to commercially available prices.

Revenue is stated after deducting royalties, sales taxes, excise duties and similar levies.

The Company follows the entitlements method in accounting when the share of production of a joint interest partner is above or below the proportionate interest. Under the entitlements method, revenue reflects the participant’s share of production regardless of which participant has actually made the sale and invoiced the production. This is achieved by adjusting cost of sales.

Borrowing costs

Borrowing costs directly relating to the acquisition, construction or production of a qualifying capital project under construction are capitalized and added to the project cost during construction until such time the assets are substantially ready for their intended use i.e. when they are capable of commercial production. Where funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs incurred.

Where surplus funds are available for a short term out of money borrowed specifically to finance a project, the income generated from such short term investments is also capitalized and reduced from the total capitalized borrowing cost. Where the funds used to finance a project form part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognized in the consolidated statement of income using the effective interest rate method.

Share-based compensation

The Company accounts for the granting of stock options using the fair-value method on stock options granted to directors, officers, employees and consultants. Share-based compensation is recorded in the consolidated statement of income for options granted, with a corresponding amount reflected in contributed surplus. Share-based compensation is the fair value of stock options at the time of the grant, estimated using the Black-Scholes option pricing model, and amortized over the options' vesting period. When the stock options are exercised, the associated amounts previously recorded as contributed surplus are reclassified to common share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest as all options granted are fully vested at the date of grant.

Foreign currency translation

During the last quarter of 2011, the Company's functional currency changed from the Canadian dollar to the U.S. dollar which is the functional currency of the Company's significant subsidiaries. The change in functional currency was primarily due to a shift in the currency of the Company's financing as a result of the early conversion of Canadian dollar denominated convertible debentures and the issuance of new U.S. dollar debts.

These consolidated financial statements are presented in U.S. dollars.

Transactions denominated in a foreign currency are initially recorded at the exchange rates at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the closing rates at the date of the consolidated statement of financial position. All differences are recorded in net earnings or loss. Non-monetary items are translated using the historical exchange rates as at the dates of the initial transactions.

For a foreign operation whose functional currency is not the U.S. dollar, the foreign operation's assets and liabilities are translated at the closing rate as at the date of the consolidated statement of financial position, and revenue and expenses are translated using the rate as at the time of the transaction. All exchange differences resulting from the translation are recognized in other comprehensive income.

Earnings per share

The Company computes basic earnings per share using net earnings divided by the weighted-average number of the common shares outstanding. The Company computes diluted earnings per share using net earnings adjusted for interest expense on the convertible debentures and the impact of the potential dilution if the stock options, warrants and the convertible debt were exercised and exchanged for common shares. The Company follows the treasury stock method in the calculation of diluted earnings per share. This method assumes that any proceeds received from in-the-money options and warrants would be used to buy common shares at the average market price for the period.

2.3. Standards issued but not yet effective

Standards issued but not yet effective up to the date of issuance of the Company's financial statements are listed below. This listing is of standards and interpretations issued, which the Company reasonably expects to be applicable at a future date. The Company intends to adopt those standards when they become effective.

IFRS 9 *Financial Instruments: Classification and Measurement*

In November 2009, the IASB issued IFRS 9, which covers classification and measurement as the first part of its project to replace IAS 39. In October 2010, the Board also incorporated new accounting requirements for liabilities.

The standard introduces new requirements for measurement and eliminates the current classification of loans and receivables, available-for-sale and held-to-maturity, currently in IAS 39. There are new requirements for the accounting of financial liabilities as well as carryover of requirements from IAS 39. The Company does not anticipate early adoption and will adopt the standard on the effective date of January 1, 2015. The Company has not determined the impact of the new standard on the consolidated financial statements.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 *Consolidated Financial Statements* will replace portions of IAS 27 *Consolidated and Separate Financial Statements and interpretation* SIC-12 *Consolidation – Special Purpose Entities*. The key features of IFRS 10 include consolidation using a single control model, definition of control, considerations on power, and continuous reassessment. IFRS 10 is effective for annual periods beginning on or after January 1, 2013 and early adoption is permitted. The Company has not determined the impact of the new standard on the consolidated financial statements.

IFRS 11 *Joint Arrangements*

IFRS 11 *Joint Arrangements* will apply to interests in joint arrangements where there is joint control. IFRS 11 would require joint arrangements to be classified as either joint operations or joint ventures. The structure of the joint arrangement would no longer be the most significant factor when classifying the joint arrangement as either a joint operation or a joint venture. In addition, the option to account for joint ventures using proportionate consolidation would be removed, and equity accounting would be required. Venturers would transition the accounting for joint ventures from the proportionate consolidation method to the equity method by aggregating the carrying values of the proportionately consolidated assets and liabilities into a single line item.

These amendments are effective for annual periods beginning on or after January 1, 2013 and early adoption is permitted. The Company has not determined the impact of the new standard on the consolidated financial statements.

IFRS 12 *Disclosure of Interests in Other Entities*

The IASB has issued IFRS 12 *Disclosure of Interests in Other Entities*, which includes disclosure requirements about subsidiaries, joint ventures, and associates, as well as unconsolidated structured entities and replaces existing disclosure requirements. This standard is effective for annual periods beginning on or after January 1, 2013. Entities will be permitted to apply any of the disclosure requirements in IFRS 12 before the effective date. The Company has not determined the impact of the new standard on the consolidated financial statements.

IFRS 13 *Fair Value Measurement*

IFRS 13 will generally converge the IFRS and US GAAP requirements for how to measure fair value and the related disclosures. IFRS 13 establishes a single source of guidance for fair value measurements, when fair value is required or permitted by IFRS. The key features of IFRS 13 include: a single framework for measuring fair value while requiring enhanced disclosures when fair value is applied, fair value would be defined as the ‘exit price’, and concepts of ‘highest and best use’ and ‘valuation premise’ would be relevant only for non-financial assets and liabilities. IFRS 13 is effective for annual periods beginning on or after January 1, 2013 and early adoption is permitted. The Company has not determined the impact of the new standard on the consolidated financial statements.

IAS 27 *Separate Financial Statements*

As a result of the issue of the new consolidation suite of standards, IAS 27 *Separate Financial Statements* has been reissued as the consolidation guidance will now be included in IFRS 10.IAS 27 will now only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. These amendments are effective for annual periods beginning on or after January 1, 2013 and early adoption is permitted. The Company does not believe IAS 27 will have a material impact on the Company’s consolidated financial statements.

IAS 28 *Investments in Associates and Joint Ventures*

As a consequence of the issue of IFRS 10, IFRS 11 and IFRS 12, IAS 28 has been amended and will provide the accounting guidance for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. The amended IAS 28 will be applied by all

entities that are investors with joint control of, or significant influence over, an investee. These amendments are effective for annual periods beginning on or after January 1, 2013 and early adoption is permitted. The Company has not determined the impact of the new standard on the consolidated financial statements.

3. Composition of the Company

The following table summarizes the Company's significant subsidiaries and equity associates, the location of their registered offices, the Company's interest, and the method of consolidation.

			Percentage Interest		
	Registered	Recognition	As at December		As at January 1
Company	**Office**	**Method**	**2011**	**2010**	**2010**
Pacific Rubiales Energy Corp	Canada	Parent holding company	Parent holding company		
Subsidiaries					
Pacific Stratus International Energy Ltd.	Canada	Consolidated	100%	100%	100%
Rubiales Holding Corp.	Panama	Consolidated	100%	100%	100%
Petro Rubiales Corp.	Panama	Consolidated	100%	100%	100%
Major International Oil S.A.	Panama	Consolidated	100%	100%	100%
Meta Petroleum Corp	Panama	Consolidated	100%	100%	100%
Pacific Stratus Energy Colombia Corp.	Panama	Consolidated	100%	100%	100%
Petro Eléctrica de los Llanos S.A.	Panama	Consolidated	100%	100%	100%
Tethys Petroleum Company Inc.	Panama	Consolidated	100%	100%	100%
Quifa Petroleum Corp	Panama	Consolidated	100%	100%	100%
Pacific & Rubiales Energy Trading Corp.	Panama	Consolidated	100%	100%	100%
PRE-PSIE Cooperatief U.A.	Netherlands	Consolidated	100%	-	-
Equity interests					
Pacific Coal, S.A.	Panama	Equity method	14.1%	19.1%	-
ODL Finance S.A.	Panama	Equity method	35.0%	35.0%	35.0%
Oleoducto Bicentenario de Colombia	Colombia	Equity method	32.9%	32.9%	-
Pacific Power Generation Corp	Panama	Equity method	20.2%	17.7%	17.7%
Pacific Infrastruacture, Inc	Panama	Equity method	22.6%	16.8%	-
Maurel and Prom Colombia B.V.	Netherlands	Proportionately consolidated	49.999%	-	-

4. Segmented information

The Company is organized into business units based on the main types of activities and has one reportable segment, being the exploration, development, and production of heavy crude oil and gas in Colombia. The operations in Peru and Guatemala are not significant. The Company manages its operations to reflect differences in the regulatory environments and risk factors for each country.

As at December 31, 2011, all of the Company’s assets are located in Colombia except for $297.4 million (December 31, 2010 - $149 million; January 1, 2010 – $224.6 million) in cash and cash equivalents which are held in Canada and the United States and $15.3 million (December 31, 2010 - $5.3 million; January 1, 2010 - $3.2 million) of exploration and evaluation assets in Peru.

The Company’s revenue based on the geographic location of customers is as follows:

	2011	2010
Colombia	$ 218,927	$ 196,975
North and Central America	2,155,674	800,891
Europe	466,588	159,851
Asia	423,189	179,883
Others	116,441	323,944
	$ 3,380,819	$ 1,661,544

5. Production and operating costs

	Year ended December 31			
		2011		2010
Oil and gas operating cost	$	1,239,104	$	611,539
Overlift		6,405		18,833
Total	$	1,245,509	$	630,372

6. Equity tax

On December 29, 2010, the Colombian Congress passed a law which imposes a 6% tax on the equity of the Colombian operations as at January 1, 2011. The Company's total equity tax payable for the years 2011 to 2014 is $83.4 million, to be paid in eight equal installments.

The equity tax is payable even in the event that the Company ceases to have taxable equity in subsequent years. As such, the Company recognized on January 1, 2011 the entire amount of the equity tax payable on the consolidated statement of financial position and a corresponding expense in the consolidated statement of income. The amount recognized is calculated by discounting the eight future equity tax payments using a rate of 10.8%.

As at December 31, 2010	$	-
Amount expensed during the period		68,446
Unwinding of discount		6,914
Foreign exchange		(708)
Payment		(21,510)
As at December 31, 2011	$	53,142
Current	$	19,620
Non-current		33,522
	$	53,142

The current portion of the equity tax payable is included in accounts payable and accrued liabilities on the consolidated statement of financial position.

7. Income tax

A reconciliation between income tax expense and the product of accounting profit multiplied by the Company's domestic tax rate is provided below:

	Year ended December 31	
	2011	2010
Net earnings before income taxes	$ 1,002,486	$ 381,066
Canadian statutory income tax rate	28.25%	31.00%
Income tax expense at statutory rate	283,202	118,130
Increase (decrease) in income tax provision resulting from:		
Other non-deductible (non-taxable) expenses	31,347	(24,640)
Special tax benefit	-	(54,369)
Share-based compensation	13,781	22,731
Risk management (gain) loss	(1,247)	12,471
Differences in tax rates in foreign jurisdictions	57,782	11,246
Losses for which no tax benefit is recorded	30,730	29,762
Non-deductible equity tax	19,336	648
Incentive for early conversion of debentures	13,219	
Income tax expense	$ 448,150	$ 115,979
Current income tax expense	513,302	171,101
Deferred income tax expense (recovery):		
Relating to origination and reversal of temporary differences	(65,152)	(55,122)
Income tax expense	$ 448,150	$ 115,979

The Company's deferred tax relates to the following:

	As at December 31		As at January 1	Year ended December 31	
	2011	2010	2010	2011	2010
Deferred tax assets:					
Tax loss carry forwards		9,155	10,283	$ 9,155	$ 1,128
	$ -	$ 9,155	$ 10,283		
Deferred tax liabilties:					
Oil and gas properties and equipment	301,495	346,398	397,363	(44,903)	(50,965)
Income not currently taxable		-	8,158	-	(8,158)
Convertible debenture		6,486	7,590	(6,486)	(1,104)
Other	(17,033)	5,885	1,908	(22,918)	3,977
	$ 284,462	$ 358,769	$ 415,019		
Deferred income tax recovery				(65,152)	(55,122)
Deferred tax liabilities, net	$ (284,462)	$ (349,614)	$ (404,736)		

The Canadian statutory income tax rate changed from 31% for the year ended December 31, 2010 to 28.25% for the 2011 taxation year as a result of the enacted reduction of Canadian corporate tax rates.

Deferred tax assets are recognized for the carry-forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profits will be available against which the unused tax losses/credits can be utilized.

As at December 31, 2011, non-capital losses totaled $285.3 million (December 31, 2010 - $177.4 million) in Canada and expire between 2013 and 2031. No deferred tax assets have been recognized in respect of the non-capital losses as at December 31, 2011 (2010 – deferred tax assets were recognized on $24.7 million of the non-capital losses). In Colombia, non-capital losses totaled $5.7 million (December 31, 2010 - $8.1 million) and deferred tax assets have been recognized in respect of these losses.

The temporary differences associated with investments in subsidiaries and joint ventures, for which a deferred tax liability has not been recognized, amounted to $1,786 million as at December 31, 2011 (2010 - $880.8 million).

The Company has other deductible temporary differences such as share issue costs, net foreign exchange and risk management contract losses totaling $18.2 million (December 31, 2010 - $31.9 million) for which deferred tax assets have not been recognized.

8. Earnings per share

Earnings per share amounts are calculated by dividing the net earnings for the period attributable to shareholders of the Company by the weighted average number of shares outstanding during the period.

	Year ended December 31	
	2011	2010
Net earnings	$ 554,336	$ 265,087
Adjust for interest expense on dilutive convertible debentures	32,499	-
Adjusted net earnings	$ 586,835	$ 265,087
Basic weighted average number of shares	271,985,534	262,945,271
Effects of dilution	26,285,663	11,843,526
Diluted weighted waverage number of shares	298,271,197	274,788,797
Basic earnings per share	$ 2.04	$ 1.01
Diluted earnings per share	$ 1.97	$ 0.96

All options, warrants and convertible debentures that are anti-dilutive have been excluded from the diluted weighted average number of common shares.

9. Dividends paid

	Year ended December 31	
	2011	2010
Declared and paid	$ 102,360	$ 25,121
Dividend per common share	$ 0.37	$ 0.09

10. Inventories

	As at December 31		As at January 1
	2011	2010	2010
Crude oil and gas	$ 174,959	$ 51,849	$ 34,868
Materials and supplies	6,313	4,683	3,198
	$ 181,272	$ 56,532	$ 38,066

11. Oil and gas properties

Cost		
Cost as at January 1, 2010	$	2,037,397
Additions		618,066
Change in asset retirement obligation		9,521
Cost as at December 31, 2010		2,664,984
Additions		791,744
Change in asset retirement obligation		24,516
Cost as at December 31, 2011	$	3,481,244

Accumulated depletion		
Accumulated depletion as at January 1, 2010	$	-
Charge for the year		370,510
Accumulated depletion as at December 31, 2010		370,510
Charge for the year		627,581
Accumulated depletion as at December 31, 2011	$	998,091

Net book value		
January 1, 2010	$	2,037,397
December 31, 2010		2,294,474
December 31, 2011		2,483,153

Included in the amount subject to depletion is $800 million (December 31, 2010 - $921 million; January 1, 2010 - $270 million) of estimated future development costs that are required to bring proved undeveloped reserves to production.

12. Exploration and evaluation assets

As at January 1, 2010	$	38,279
Additions		112,617
As at December 31, 2010		150,896
Additions		299,071
Impairment		(12,066)
As at December 31, 2011		437,901

In April 2011 the Company acquired a 49.999% interest in Maurel and Prom Colombia B.V. ("Maurel & Prom Colombia") from Les Establissments Maurel & Prom, for cash consideration of $63.4 million and certain exploratory commitments. Maurel & Prom Colombia holds interests in five exploration blocks located on-shore in Colombia. The Company has determined that this transaction does not constitute a business combination in accordance with IFRS 3 *Business Combinations*.

In 2011, the impairment loss of $12.1 million represented the write-down of certain exploration and evaluation assets based on an evaluation of the qualitative conditions at the field level. The impairment is recognized in consolidated statement of income as depletion, depreciation and amortization.

13. Plant and equipment

Cost	Land & buildings	Other plant & equipment	Total
Cost as at January 1, 2010	$ 4,624	$ 11,390	$ 16,014
Additions	3,029	9,119	12,148
Cost as at December 31, 2010	7,653	20,509	28,162
Additions	18,782	60,325	79,107
Disposal	-	(3,752)	(3,752)
Cost as at December 31, 2011	26,435	77,082	103,517
Accumulated depreciation			
Accumulated depreciation as at January 1, 2010	$ 1,714	$ 4,294	$ 6,008
Charge for the year	1,580	1,398	2,978
Accumulated depreciation as at December 31, 2010	3,294	5,692	8,986
Charge for the year	8,016	7,559	15,575
Disposal	-	(1,045)	(1,045)
Accumulated depreciation as at December 31, 2011	11,310	12,206	23,516
Net book value			
January 1, 2010	$ 2,910	$ 7,096	$ 10,006
December 31, 2010	4,359	14,817	19,176
December 31, 2011	15,125	64,876	80,001

Depreciation charge for plant and equipment is included in general and administrative expenses on the consolidated statement of income.

14. Intangible assets and goodwill

Cost	Goodwill	Intangible assets
Cost as at January 1, 2010	$ 100,636	$ -
Additions	-	190,000
Cost as at December 31, 2010 and 2011	$ 100,636	$ 190,000
Accumulated amortization		
Accumulated amortization as at January 1, 2010	$ -	$ -
Charge for the year	-	19,033
Accumulated depreciation as at December 31, 2010	-	19,033
Charge for the year	-	26,006
Accumulated depreciation as at December 31, 2011	$ -	$ 45,039
Net book value		
January 1, 2010	$ 100,636	$ -
December 31, 2010	100,636	170,967
December 31, 2011	100,636	144,961

Intangible assets comprise the rights to the available capacity of the OCENSA pipeline system in Colombia. The OCENSA right is amortized based on the usage of the 160 million barrel capacity over the term of the agreement.

Impairment test for goodwill

The Company assessed the goodwill for impairment as at January 1, 2010, December 31, 2010, and December 31, 2011. The Company's goodwill is tested for impairment at the group of cash-generating units level, being the operating segment of the Company. The recoverable amount for the operating segment is the sum of the value-in-use for each cash-generating unit, which is calculated based on the future cash flows of the proven reserves over reserve life, discounted by the Company’s weighted cost of capital of 10.8%. As at January 1, 2010, December 31, 2010 and December 31, 2011, the recoverable amount for the operating segment exceeded the carrying amount including goodwill and as such no impairment was recognized. No reasonably possible change in assumptions would cause goodwill to be impaired.

15. Investments in associates and other assets

The Company's investments in associates and other assets are as follows:

	Investment in associates					Other assets		
	ODL	Pacific Power	PII	Pacific Coal	OBC	CGX	Other	Total
As at January 1, 2010	$ 92,043	$ 10,675	$ -	$ -	$ -	$ -	$ 491	$ 103,209
Acquisition (disposition)	-	-	10,500	24,000	95,682	-	(56)	130,126
Income from equity investments	4,982	1,472	1,197	119	-	-	-	7,770
Distribution of PII common shares	-	(6,412)	6,412	-	-	-	-	-
Foreign currency translation	9,049	-	-	-	102	-	-	9,151
As at December 31, 2010	$ 106,074	$ 5,735	$ 18,109	$ 24,119	$ 95,784	$ -	$ 435	250,256
Acquisition	29,750	800	7,286	30,140	32,290	39,477	84,097	223,840
Fair value adjustment	-	-	-	-	-	21,147	(745)	20,402
Income (loss) from equity investments	16,059	2,372	(1,846)	(7,218)	(2,538)	-	-	6,829
Foreign currency translation	(4,879)	-	(3)	-	(4,224)	-	-	(9,106)
As at December 31, 2011	$ 147,004	$ 8,907	$ 23,546	$ 47,041	$ 121,312	$ 60,624	$ 83,787	$ 492,221

<u>*Investments in associates*</u>

Set out below are the investments made by the Company in associates during the year ended and as at December 31, 2011. Investments in associates are accounted for using the equity method, with the Company's proportionate share of the associates' net income or loss recognized in the consolidated statement of income.

ODL Finance S.A. ("ODL")

The investment represents a 35% interest in ODL, a special purpose Panamanian company with a Colombian branch that has constructed an oil pipeline for the transportation of heavy crude oil produced from the Rubiales field. The remaining 65% interest is owned by Ecopetrol, S.A. ("Ecopetrol"), the national oil company of Colombia. In September 30, 2011, additional capital was contributed by the partners to ODL, of which the Company's share was $29.8 million. The capital contribution did not change the company's equity interest percentage. ODL's functional currency is the Colombian peso and the currency translation adjustment upon conversion to U.S. dollars is recorded in other comprehensive income.

The Company has ship or pay contracts with ODL for the transportation of crude oil from the Rubiales field to Colombia´s oil transportation system, for a total commitment of $280.7 million from 2012 to 2016.

Pacific Power Generation Corp ("Pacific Power", previously Ronter)

The investment in Pacific Power represents a 20.2% indirect interest in Promotora de Energia Electrica de Cartagena & Cia, S.C.A. ESP ("Proelectrica"). Proelectrica is a private, Cartagena, Colombia-based 90 megawatt electrical utility peak demand supplier to the local Cartagena utility. The Company's interest in Pacific Power was 21.7% as at January 1, 2010. During October 2010, Pacific Power's convertible debentures were fully converted to its common shares, resulting in a decrease of the Company's interest in Pacific Power to 17.7%. On December 31, 2010 Pacific Power distributed the Pacific Infrastructure Inc. common shares it held to Pacific Power's shareholders, including the Company. The distribution represented a dividend payment in kind with a fair value of $6.4 million. The Company recorded a decrease of $6.4 million to the carrying amount of its investment in Pacific Power with a corresponding increase to its investment in PII as of December 31, 2010. In July 2011 the Company acquired an additional 2.5% equity interest in Pacific Power from an unrelated party for cash consideration of $0.8 million.

Pacific Infrastructure Inc. ("PII")

In April 2010, the Company acquired a 9.4% interest in PII, a Panamanian company established for the purpose of developing an export seaport, an industrial park, and a free trade zone in Cartagena. Prior to the transaction, PII was fully owned by Pacific Power. The consideration consisted of a $3.5 million deposit previously advanced to PII to acquire land. In September 2010, the Company acquired a 4% interest for $2 million from a shareholder of PII that was not related to the Company. In November 2010, the Company invested an additional $5 million in PII as part of a private placement offering. Subsequent to the private placement offering, Pacific Power distributed its holding in PII common shares to Pacific Power's shareholders. This distribution resulted in a reduction to the Company's investment in Pacific Power and a corresponding increase in the investment in PII. During June 2011, the Company acquired an additional 2.3% interest in PII from unrelated parties for $2.9 million in cash. In July 2011, the Company acquired an additional equity interest in PII from an unrelated party for cash consideration of $4.4 million. As at December 31, 2011, PII is 22.6% owned by the Company, 38.1% owned by Blue Pacific Assets Corp. ("Blue Pacific",

see note 22 a), 7.6% owned by Orinoquia Holdings Corp., a company that two directors of the Company control or provide advice to, and 31.7% owned by unrelated parties.

Pacific Coal Resources Ltd. ("Pacific Coal")

During August 2010, the Company acquired a 19.05% interest in Pacific Coal, a then private company incorporated in Panama, for $24 million. Pacific Coal is engaged in the acquisition and development of coal mining assets and related businesses in Colombia. The functional currency of Pacific Coal is the Canadian dollar and currency translation adjustment is recorded in the statement of other comprehensive income. In February 2011, the Company invested an additional $30.1 million in Pacific Coal as part of a private placement offering. On March 17, 2011, the common shares and warrants of Pacific Coal began trading on the TSX Venture Exchange. As at December 31, 2011, the Company's interest in Pacific Coal was 14.07% and the fair value of the investment in Pacific Coal was estimated at $20 million, based on the last traded price on the TSX of C$0.43.

The Company has determined that it holds significant influence but not control over Pacific Power, PII, and Pacific Coal as a result of the Company's equity interests and a number of common directors. As such the investments in Pacific Power, PII, and Pacific Coal are accounted for using the equity method.

Oleoducto Bicentenario de Colombia ("OBC")

During December 2010, the Company invested $95.7 million in the OBC pipeline project, representing a 32.9% interest. OBC is a corporation established and owned by a consortium of oil producers operating in Colombia, led by Ecopetrol. In December, 2011, additional capital was contributed by the partners to OBC, of which the Company's share was $32.3 million. The capital contribution did not change the Company's equity interest percentage. OBC will build and operate a private-use oil pipeline in Colombia between Casanare and Coveñas with an ultimate capacity of 450,000 barrels per day. The investment in OBC is accounted for using the equity method. OBC's functional currency is the Colombian peso and the currency translation adjustment upon conversion to U.S. dollars has been recorded in other comprehensive income. The shareholders of OBC are obliged to execute a transport agreement before the completion of the first phase of the project for the transport of crude at a set rate per barrel.

The Company did not receive any cash dividends from its equity-accounted investments during the years 2011 and 2010.

Summarized financial information

The table below summarizes the financial information for the Company's significant equity investments (figures represent 100% of the underlying entities' interest):

	ODL	OBC
As at and for the year ended December 31, 2011		
Current assets	$ 200,268	$193,799
Non-current assets	1,051,902	575,932
Total assets	1,252,170	769,731
Current liabilities	88,499	399,935
Non-current liabilities	741,019	-
Total liabilities	829,518	399,935
Equity	422,652	369,796
Total liabilities and equity	1,252,170	769,731
Revenue	297,735	170
Expenses	251,851	7,892
Net earnings (loss)	45,884	(7,722)

	ODL	OBC
As at and for the year ended December 31, 2010		
Current assets	$ 219.050	$218.997
Non-current assets	826.275	72.717
Total assets	1.045.325	291.714
Current liabilities	63.035	577
Non-current liabilities	679.213	-
Total liabilities	742.248	577
Equity	303.077	291.137
Total liabilities and equity	1.045.325	291.714
Revenue	155.095	-
Expenses	141.592	-
Net earnings	13.503	-

Available-for-sale financial assets

CGX Energy Inc. ("CGX")

On October 13, 2011, the Company purchased 58,720,000 common shares in the capital of CGX, a company listed on the TSX Venture Exchange, at a price of C$0.70 per common share for an aggregate investment of C$41.1 million. CGX is a Canadian-based oil and gas exploration company focused on the exploration for oil in the Guyana/Suriname Basin. This investment was made pursuant to CGX's bought deal financing whereby CGX issued 131,445,000 common shares at a price of C$0.70 per Common Share. The Company did not hold any common shares or other securities of CGX prior to the above purchase. As at December 31, 2011, the Company holds approximately 18% of the outstanding common shares of CGX.

The Company does not have significant influence in CGX, accordingly the investment in CGX is classified as an available-for-sale financial asset and carried at its fair value with changes in value recorded in other comprehensive income. As at December, 2011 the fair value of the investment in CGX, using the last traded price of C$1.05 per common share, was $60.6 million.

Other Assets

Included in other assets is a loan to OBC, classified as loans and receivables, as at December 31, 2011. During the fourth quarter of 2011 the Company, along with the other shareholders of OBC, entered into certain subordinated loan agreements with OBC. Pursuant to the agreement the Company will make loans to OBC for up to $237.3 million, with the principal being repaid in 10 equal semi-annual installments over a five-year term. The loans carry an annual interest rate of 7.32% with semi-annual interest payments. As at December 31, 2011 the balance of loans outstanding to the Company under the agreement is $102.3 million. $20.5 million of the total loan balance, representing the current portion, is included in accounts receivable as at December 31, 2011. No interest was paid on the loan during 2011.

16. Interest-bearing loans and borrowings

	Maturity	Currency	Interest Rate	As at December 31 2011	2010	As at January 1 2010
Prommisory note (1)	2010	COP	9.70% - 10.00%	$ -	$ -	$ 11,923
Promissory note (1)	2011	COP	3.50% - 3.80%	-	89,286	-
Promissory note (1)	2012	COP	10.48%	-	757	23
Promissory note (1)	2012	COP	6.03%	4,726	-	-
Bank overdraft		COP		-	-	182
Senior notes - 2009	2016	USD	8.75%	110,865	436,946	442,159
Senior notes - 2011	2021	USD	7.25%	620,836	-	-
Revolving credit facility (2)	2013	USD	LIBOR + 2.50%	190,717	(2,596)	-
				$ 927,144	$ 524,393	$ 454,287
Current portion				$ 4,726	$ 90,043	12,128
Non-current portion				922,418	434,350	442,159
				$ 927,144	$ 524,393	$ 454,287
Convertible debenture				2,234	186,416	165,611
				$ 929,378	$ 710,809	$ 619,898

(1) Unsecured, repayable in equal monthly installments.
(2) Amount as at December 31, 2010 represents the deferred transaction costs.

2009 Senior Notes

The 2009 Senior Notes, with maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%), are direct, unsecured subordinated obligations with interest payable in arrears at a rate of 8.75%, on May 10 and November 10 of each year. The notes may be redeemed in whole (but not in part) at any time at the discretion of the Company with a redemption price equal to the greater of (1) 100% of the principal amount of the notes to be redeemed, and (2) the sum of the present values of the remaining scheduled payments of principal and interest discounted to the date of redemption on a semi-annual basis at the applicable treasury rate plus 75 basis points, in each case plus accrued and unpaid interest on the outstanding principal amount.

The 2009 Senior Notes are on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. Under the terms of the notes, the Company is required to maintain (1) an interest coverage ratio of greater than 2.5; and (2) a debt to EBITDA ratio of less than 3.5. The covenants do not apply during any period of time when the notes have an investment grade rating from at least two rating agencies. The Company was compliant with the covenants during the year.

On December 5, 2011 the Company commenced an offer to exchange ("Exchange Offer") any and all of its 8.75% 2009 Senior Notes for newly issued 7.25% notes maturing on December 12, 2021 (“2011 Senior Notes”). Eligible holders who tendered their 2009 Senior Notes on or prior to January 3, 2012 ("Expiration Date") would receive, in exchange for each $1,000 of principal amount of 2009 Senior Notes, an aggregate principal amount of 2011 Senior Notes equal to $1,150. As at December 31, 2011, $336.4 million of principal amount of the 2009 Senior Notes have been tendered and accepted in exchange for $386.9 million of 2011 Senior Notes, representing 74.8% of the total outstanding 2009 Senior Notes.

The Company determined that the Exchange Offer did not constitute an extinguishment of the 2009 Senior Notes. As such, the carrying amount was not adjusted for the additional principal amount provided under the Exchange Offer. Instead, the additional principal amount, net of transaction costs incurred with respect to the Exchange Offer, will be amortized into the carrying amount of the 2011 Senior Notes through December 2021.

The 2009 Senior Notes are carried at amortized cost using the effective interest rate method with note discount and transaction costs netted against the principal. The principal amount outstanding on the 2009 Senior Notes as at December 31, 2011 was $113.6 million (2010 – $450 million). For the year ended December 31, 2011, $41.6 million (2010 - $36.3 million) in interest expense related to the 2009 Senior Notes have been recorded in the consolidated statement of income.

2011 Senior Notes

The 2011 Senior Notes, due December 12, 2021, are direct, unsecured, subordinated obligations with interest payable in arrears at a rate of 7.25% on each June 12 and December 12 of each year, commencing on June 12, 2012.

The 2011 Senior Notes are on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. Under the terms of the notes, the Company is required to maintain (1) an interest coverage ratio of greater than 2.5; and (2) a debt to EBITDA ratio of less than 3.5. The covenants do not apply during any period of time when the notes have an investment grade rating from at least two rating agencies. The Company was compliant with the covenants during the year.

In addition to the 2011 Senior Notes issued under the Exchange Offer, the Company closed an offering of an additional $300 million Senior Notes on December 12, 2011. Both the $300 million Senior Notes and the Senior Notes issued under the Exchange Offer (collectively, the "2011 Senior Notes") carry the same terms and covenants.

The 2011 Senior Notes are carried at amortized cost using the effective interest rate method with note discount and transaction costs netted against the principal. The principal amount outstanding on the 2011 Senior Notes as at December 31, 2011 was $686.9 million (2010 – nil).

Revolving credit facility

The Company has a $350 million unsecured revolving credit facility with an interest rate determined in accordance with the ratings assigned to the Company's senior debt securities by Standard & Poor's Ratings Group and Fitch Inc.

In December 2011, the Company drew down $193 million on the revolving credit facility. Based on the Company's credit rating as at December 31, 2011, the interest rate was LIBOR plus 2.25%. In addition, the Company is required to pay commitment fees of 0.75% on the unutilized portion of any outstanding commitments under the facility. Subject to customary acceleration events set out in the credit agreement, or unless terminated earlier by the Company without penalty, repayment of the outstanding principal drawn on the facility is required to be made by on April 26, 2013. Under the terms of the credit facility, the Company is required to maintain (1) a debt to EBITDA ratio of less than 3.5; and (2) an EBITDA to interest expense ratio of greater than 3. The Company was compliant with the covenants during the year.

Convertible debentures

On October 25, 2011 the Company provided notice to all holders of the Company's outstanding convertible unsecured subordinated debentures due August 29, 2013 (the “Debentures”) of an incentive to convert the Debentures at the current conversion rate of 77.9423 plus an additional 8.6310 common shares per C$1,000 face amount of Debentures (together, the "Incentive Conversion Rate") during a temporary period between November 9, 2011 and November 29, 2011 (the "Early Conversion Period"). The additional 8.6310 common shares was calculated by dividing the daily volume weighted average trading price of the common shares traded on the TSX during the period October 27, 2011 up to and including November 4, 2011 by C$200 for each C$1,000 face amount of the Debentures.

During the Early Conversion Period, C$236.2 million, or 98.9% of the Debentures were converted, representing an issuance of 20,450,600 common shares of the Company, of which 2,040,352 represents the incentive common shares. Debenture holders who did not convert during the Early Conversion Period were not entitled to the benefit of the Incentive Conversion Rate and to receive the additional common shares.

Included on the consolidated statement of income for the year ended December 31, 2011 was a $46.5 million expense representing the fair value of the incentive provided for the Debentures that were converted under the early conversion program.

As at December 31, 2011 the Company had outstanding Debentures of C$2.7 million (2010 – C$238.9 million) due August 29, 2013. The outstanding Debentures are convertible into common shares of the Company at the rate of C$12.83 (2010 – C$13) per share, being equivalent to 77.9423 (2010 – 76.9231) common shares per C$1,000 face amount of Debentures, subject to adjustments pursuant to the indenture. The Debentures bear interest at 8% annually and are payable semi-annually in arrears on June 30 and December 31.

The Debentures were previously classified into their debt and equity components. The debt component accretes up to the principal balance over the term of the Debenture using the effective interest method. The accretion and interest paid are expensed as interest expense yielding an effective annual rate of 18%. As a result of the change in the Company’s functional currency to the U.S. dollar, the equity component, representing the conversion feature of the Debentures, is revalued to its fair value and the change in the fair value is recorded in the consolidated statements of income.

As at January 1, 2010	$	165,611
Conversion to common shares		(880)
Accretion expense		13,028
Foreign currency translation		8,657
As at December 31, 2010	$	186,416
Accretion expense		14,870
Foreign currency translation		(6,058)
Conversion to common shares		(192,994)
As at December 31, 2011	$	2,234

17. Asset retirement obligation

The Company makes full provision for the future cost of decommissioning oil production facilities on a discounted basis on the installation of those facilities.

As at January 1, 2010	$	9,119
Arising during the year		9,521
Accretion expense		1,969
As at December 31, 2010	$	20,609
Arising during the year		24,516
Accretion expense		1,082
Derecognition		(807)
As at December 31, 2011	$	45,400

The asset retirement obligation represents the present value of decommissioning costs relating to oil and gas properties, which are expected to be incurred up to $60.2 million (December 31, 2010 - $29.8 million; January 1, 2010 - $18.1 million). The future decommissioning costs are discounted using the risk free rate of 3.6% (December 31, 2010 – 4.6%; January 1, 2010 – 7.2%) to arrive at the present value. Assumptions, based on the current economic environment, have been made which management believe are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to take into account any material changes to the assumptions. However, actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning expenditures which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain.

18. Finance lease

The Company has entered into two power generation arrangements to supply electricity for three of its oil fields in Colombia until June 2016 and August 2021. In addition, the Company has lease and take or pay arrangements for airplanes, IT equipment and a fuel transport vessel that are accounted for as finance leases. The arrangements have been accounted for as finance leases with an average effective interest rate of 12.85%. The Company's minimum lease payments are as follows:

	As at December 31		January 1
	2011	2010	2010
Within 1 year	$ 30,105	$ 11,306	$ 9,524
Year 2	29,625	11,337	11,306
Year 3	27,706	11,306	11,337
Year 4	22,386	11,306	11,306
Year 5	14,618	11,306	11,306
Thereafter	31,849	5,638	16,944
Total minimum lease payments	$ 156,289	$ 62,199	$ 71,723
Amounts representing interest	(51,401)	(23,512)	(31,282)
Present value of net minimum lease payments	104,888	38,687	40,441
Current portion	$ 17,106	$ 4,304	$ 1,920
Non-current portion	87,782	34,383	38,521
Total obligations under finance lease	104,888	38,687	40,441

For the year ended December 31, 2011, interest expense of $9.4 million (2010 - $7.7 million) was incurred on these finance leases.

19. Contingencies and commitments

A summary of the Company's commitments, undiscounted, by calendar year is presented below:

	2012	2013	2014	2015	2016	Subsequent to 2016	Total
Operating leases	$ 20,066	$ 6,447	$ 6,387	$ 6,282	$ 6,282	$ 21,675	$ 67,139
Transportation and processing commitments	51,898	63,184	59,130	54,769	50,675	14,302	293,958
Minimum work commitments	169,975	98,784	63,269	28,990	10,318	4,800	376,136
OBC investment commitment	67,566	67,566	-	-	-	-	135,132
Community obligations	1,860	-	-	-	-	-	1,860
Transmission line project	47,484	8,206	-	-	-	-	55,690
Total	$ 358,849	$ 244,187	$ 128,786	$ 90,041	$ 67,275	$ 40,777	$ 929,915

The Company has various guarantees in place in the normal course of business. As at December 31, 2011, the Company has issued letters of credit and guarantees for exploration and operational commitments for a total of $193.9 million (December 31, 2010 – $304 million; January 1, 2010 - $110.3 million).

Association contracts

Certain association contracts signed before 2003 with Ecopetrol include clauses in which Ecopetrol may commence participating in the operation of new discoveries made by the Company at any time, without prejudice to the Company's right to be reimbursed for the investments made on their sole account and risk (back-in right). The contract provides that if Ecopetrol decides to declare the commerciality of the field and participate in the commercial phase of the association contract, the Company shall have the right to be reimbursed for 200% of the total costs incurred during the exploration phase of the contract. Once the reimbursement has been made, Ecopetrol is entitled to acquire a 50% share of the oil production of the fields. The back-in rights were not exercised as at December 31, 2011.

Contingencies

The Company is involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain, there can be no assurance that such matters will be resolved in the Company's favour. The Company does not currently believe that the outcome of adverse decisions in any pending or threatened proceedings related to these and other matters or any amount which it may be required to pay by reason thereof would have a material impact on its financial position, results of operations or cash flows.

Natural gas supply agreements

Since the discovery of the La Creciente field in early 2007, the Company has focused on developing a commercial strategy to service the domestic market while concurrently exploring export opportunities. The Company has entered into the following take or pay contracts, and interruptible contracts, totaling 60MMBTU per day:

	2012		2013	
Client	Quantity (MMBTUD)	Price (1) ($/MMBTU)	Quantity (MMBTUD)	Price (1) ($/MMBTU)
FIRM*	54,000	RMP + 27%	54,000	RMP + 16%
Interruptible Supply	6,000	RMP - 30%	6,000	RMP - 30%
Total	**60,000**		**60,000**	

* Represents OCG (opción compra de gas) gas purchase option contract
RMP - Colombian Regulated Market Price

20. Issued capital

a) Authorized, issued and fully paid common shares

The Company has an unlimited number of common shares with no par value.

Continuity schedule of share capital:

	Number of Shares		Amount
As at January 1, 2010	232,904,772	$	1,364,687
Issued on exercise of warrants	27,109,081		223,109
Issued on exercise of options	7,550,002		102,860
Issued on conversion of convertible debentures	84,998		1,182
As at December 31, 2010	267,648,853	$	1,691,838
Issued on exercise of warrants	597,232		6,176
Issued on exercise of options	3,481,370		34,420
Issued on conversion of convertible debentures (1)	20,450,600		293,231
As at December 31, 2011	292,178,055	$	2,025,665

(1) In addition to the 18,410,248 shares issued upon conversion, 2,040,352 shares were issued as an incentive for early conversion.

(b) Stock options

The Company has established a "rolling" Stock Option Plan (the "Plan") in compliance with the applicable TSX policy for granting stock options. Under the Plan, the maximum number of shares reserved for issuance may not exceed 10% of the total number of issued and outstanding common shares. The exercise price of each option shall not be less than the market price (as defined under the TSX Company Manual) of the Company's stock at the date of grant.

A summary of the changes in stock options is presented below:

	Number of options outstanding		Weighted average exercise price (C$)
As at January 1, 2010	19,223,131	$	7.60
Granted during the year	9,551,000		16.37
Exercised during the year	(7,550,002)		9.18
As at December 31, 2010	21,224,129		10.98
Granted during the year	4,623,500		26.09
Forfeited during the year	(750)		20.09
Exercised during the year	(3,481,370)		5.63
As at December 31, 2011	22,365,509	$	14.93

The weighted average share price at the time when the stock options were exercised during the year ended December 31,2011 was C$22.97(2010 – C$23.97).

The following table summarizes information about the stock options outstanding and exercisable:

Options outstanding & exercisable	Exercise price (C$)		Expiry date	Remaining contratual life (year)
1,458,541	$	4.70	October 23, 2013	1.8
166,667		5.70	May 9, 2017	5.4
316,001		6.30	July 10, 2017	5.5
629,375		6.78	April 20, 2012	0.3
4,747,500		7.38	February 11, 2013	1.1
10,000		10.86	July 30, 2014	2.6
2,663,300		13.09	October 12, 2014	2.8
7,500		14.57	January 6, 2015	3.0
4,705,000		14.08	February 9, 2015	3.1
18,000		19.00	March 16, 2015	3.2
5,000		19.47	April 14, 2015	3.3
2,896,875		20.56	April 23, 2015	3.3
20,250		20.09	May 17, 2015	3.4
52,000		24.41	June 22, 2015	3.5
46,000		27.58	September 29, 2015	3.7
250,000		34.43	February 2, 2016	4.1
4,081,500		25.76	March 16, 2016	4.2
53,000		28.01	May 3, 2016	4.3
12,000		25.59	May 26, 2016	4.4
200,000		22.05	September 27, 2016	4.7
27,000		24.68	October 24, 2016	4.8
22,365,509	$	14.93		2.8

The following stock options with a 5 year life were granted to employees, directors and consultants during 2010 and 2011.

	Number of options granted	Weighted average exercise price (C$)	Weighted average fair value (C$)
During the year ended December 31, 2011	4,623,500	26.09	10.46
During the year ended December 31, 2010	9,551,000	16.37	7.97

The fair values of the stock options issued have been calculated using the Black-Scholes option pricing model, based on the following assumptions:

	As at December 31	
For options granted during the	2011	2010
Weighted average risk-free interest rate:	1.55%	1.35%
Expected life:	2.5 years	2.5 years
Weighted average expected volatility:	62%	77%
Weighted average expected dividend yield:	1.34%	0%

(c) Warrants

Each warrant outstanding is exercisable into one common share.

A summary of the changes in warrants is presented below:

	Number of warrants	Weighted average exercise price (C$)	
As at January 1, 2010	27,910,343	$	7.80
Exercised during the year	(27,298,661)		6.30
As at December 31, 2010	611,682		7.80
Exercised during the year	(597,232)		7.80
As at December 31, 2011	14,450	$	7.80

The weighted average share price at the time when the warrants were exercised during the year ended December 31, 2011 was C$26.94 (December 31, 2010 – C$15.03).

The following table summarizes information about the warrants outstanding and exercisable at December 31, 2011:

Warrants outstanding	Exercise price (C$)	Expiry date	Remaining contratual life (year)
14,450	C$ 7.80	July 12, 2012	0.5

21. Related party transactions

a) In June 2007, the Company entered into a 5-year lease agreement with Blue Pacific for administrative office space in one of its Bogota, Colombia locations. Monthly rent expense of $57 is payable to Blue Pacific under this agreement. Three directors and officers of the Company control, or provide investment advice to the holders of, 67.2% of the shares of Blue Pacific. During 2011, the lease was amended to include additional space in Bogota for a 10-year term with a monthly rent of $0.4 million, and assignment of the lessor to an entity controlled by Blue Pacific.

   The Company does not have any outstanding accounts receivable from Blue Pacific as at December 31, 2011 (December 31, 2010 - $773; January 1, 2010 - nil) related to certain administrative costs paid by the Company on behalf of Blue Pacific. In addition, the Company paid $0.4 million to Blue Pacific during the year ended December 31, 2011 (2010 - $0.5 million) for air transportation services.

b) As at December 31, 2011, the Company had trade accounts receivable of $2.4 million (December 31, 2010 - $1.7 million; January 1, 2010 - $10.5 million) from Proelectrica, in which the Company has a 20.2% indirect interest and which is 31.49% owned by Blue Pacific. The Company's and Blue Pacific's indirect interests are held through Pacific Power. Revenue from Proelectrica in the normal course of the Company's business was $25.6 million for the year ended December 31, 2011 (2010 - $12.5 million).

c) During the year ended December 31, 2011, the Company paid $47.1 million (2010 - $40.2 million) to Transportadora Del Meta S.A.S. ("Transmeta") in crude oil transportation costs. In addition the Company has accounts receivable of $3.2 million (December 31, 2010 - $4.1 million; January 1, 2010 - $5 million) from Transmeta and accounts payable of $5.5 million (December 31, 2010 - $4.6 million; January 1, 2010 - nil) to Transmeta as at December 31, 2011. Transmeta is controlled by a director of the Company.

d) Loans receivable in the aggregate amount of $490 (December 31, 2010 - $524; January 1, 2010 - $290) are due from three management directors and three officers of the Company as at December 31, 2011. The loans are non-interest bearing and payable in equal monthly payments over 48 months. The loans were issued to these individuals in connection with costs incurred by these individuals as a result of their relocation.

e) The Company has entered into aircraft transportation agreements with Petroleum Aviation Services S.A.S., a company controlled by a director of the Company. During 2011, the Company paid $9.5 million (2010 - $7.7 million) in fees as set out under the transportation agreements.

f) During the year ended, December 31, 2011 the Company paid $80.2 million to ODL (2010 - $44.6 million) for crude oil transport services under the pipeline take or pay agreement, and has accounts payable of $1 million to ODL as at December 31, 2011 (December 31, 2010 and January 1, 2010 - nil). In addition, the Company received $1.6 million from ODL during the year ended December 31, 2011 (2010 - $6.6 million) with respect to certain administrative services and rental equipment and machinery. The Company does not have any outstanding accounts receivable from ODL as at December 31, 2011 (December 31, 2010 – $3.1 million; January 1, 2010 - nil).

g) As at December 31, 2011 the Company has a short-term advance of $8 million (December 31, 2010 - nil; January 1, 2010 – nil) to OBC to fund on-going work commitments, which will be repaid upon OBC's closing of financing.

h) As at December 31, 2011 the Company has accounts receivable of $20 (December 31, 2010 and January 1, 2010 - nil) from PII for the sale of certain administrative assets.

i) As at December 31, 2011, the Company has accounts payable of $0.4 million (December 31, 2010 and January 1, 2010 - nil) due to Helicol with respect to air transportation services and paid during the year $1.3 million for this service (2010 - nil). Helicol is controlled by a director of the Company.

All related party transactions are recognized at terms equivalent to those that prevail in arm's length transactions.

Compensation of key management personnel of the Company

The Company's key management personnel include its Directors of the Board and the executive officers.

	As at December 31			
		2011		2010
Short-term employee benefits	$	9,810	$	8,608
Post-employment pension and medical benefits		1,953		701
Shared-based payments		29,435		61,238
	$	41,198	$	70,547

22. Financial risk management objectives and policies

The Company's principal financial liabilities, other than derivatives, comprise accounts payable and accrued liabilities, long-term debt, finance lease obligations and convertible debentures. The main purpose of these financial instruments is to manage short term cash flow and raise financing for the Company's capital expenditure program. The Company has various financial assets such as accounts receivable and cash and cash equivalents and restricted cash, which arise directly from its operations.

It is the Company's policy that no speculative trading in derivatives shall be undertaken.

The main risks that could adversely affect the Company's financial assets, liabilities or future cash flows are credit risk, interest rate risk, foreign currency risk, liquidity risk, and commodity price risk. Management reviews and agrees policies for managing each of these risks which are summarized below.

The following discussion also includes a sensitivity analysis that is intended to illustrate the sensitivity to changes in market variables on the Company's financial instruments and show the impact on profit or loss and shareholders' equity, where applicable. Financial instruments affected by market risk include bank loans and overdrafts, accounts receivable, accounts payable and accrued liabilities and derivative financial instruments.

The sensitivity analysis has been prepared using the amounts of debt and other financial assets and liabilities held as at those dates.

(a) Credit risk

	As at December 31				As at January 1	
		2011		2010		2010
Trade receivable		229,005	$	146,190	$	68,311
Advances / deposits		93,684		15,383		21,188
Recoverable VAT		301,169		99,004		-
Other receivables		52,797		16,568		53,823
Receivable from joint ventures		78,613		16,480		11,722
Allowance for doubtful accounts		(961)		(966)		(1,125)
OBC (current, note 15)		20,452		-		-
	$	774,759	$	292,659	$	153,919
Loan to OBC (non-current, note 15)		81,806		-		-
	$	856,565	$	292,659	$	153,919

The Company actively limits the total exposure to individual client counterparties and holds a trade credit insurance policy for indemnification for losses from non-collection of trade receivables. Two of the Company's customers had accounts receivable that were greater than 10% of total trade accounts receivable. The Company's credit exposure to these customers was $106 million and $59 million or 46% and 26% of trade accounts receivable, respectively (2010 - two customers at $56.9 million and $56.2 million or 38% and 37% of trade accounts receivable; January 1, 2010 – two customers at $30.9 million and $10.5 million or 50% and 17%, respectively). Revenues from these customers for 2011 were $407 million and $277 million or 12% and 8% of net revenue (2010 - $91.3 million and $56.2 million or 5% and 3% of net revenue, respectively).

The entire amount of the recoverable VAT as at December 31, 2011 and December 31, 2010 is due from the Colombian tax authority.

(b) Interest rate risk

The Company is exposed to interest rate risk on its outstanding variable rate revolving credit borrowings due to fluctuations in market interest rates. The Company monitors its exposure to interest rates on an ongoing basis.

(c) Foreign currency risk

The Company is exposed to foreign currency fluctuations in Colombian pesos (COP).Such exposure arises primarily from expenditures that are denominated in currencies other than the functional currency. The Company monitors its exposure to foreign currency risks. To reduce its foreign currency exposure associated with operating expenses incurred in COP, the Company may enter into foreign currency derivatives to manage such risks. The Company has the following currency risk management contracts outstanding that qualify for cash flow hedge accounting:

As at December 31, 2011

Instrument	Term	Notional amount	Floor-ceiling (COP/$)	Fair value
Currency collar	January to December 2012	650,400	1805 - 1975	(30,546)
Currency collar	January to December 2013	120,000	1870 - 1930	(2,355)
		$ 770,400		$ (32,901)
		Current		$ (27,504)
		Non-current		(5,397)
		Total		$ (32,901)

As at December 31, 2010

Instrument	Term	Notional amount	Floor-ceiling (COP/$)	Fair value
Currency collars	January to December 2011	$ 240,000	1900 - 1930	$ 1,066

The effective portion of the change in the fair value of the above currency hedges is recognized in other comprehensive income as unrealized gains or losses on cash flow hedges. The effective portion is reclassified as production and operating expenses in net earnings in the same period as the hedged operating expenses are incurred. During the year ended December 31, 2011, $14.5 million (2010 - $21.7 million) of unrealized gains were initially recorded in other comprehensive income, and $9.6 million (2010 - $21.7 million) were subsequently transferred to production and operating cost when the gains became realized. The Company excludes changes in fair value due to the time value of the investments and records these amounts along with hedge ineffectiveness in foreign exchange gains or losses in the period that they arise. During 2011, $19.5 million (2010 - $8 million) of ineffectiveness was recorded as foreign exchange loss.

(d) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's process for managing liquidity risk includes ensuring, to the extent possible, that it will have sufficient liquidity to meet its liabilities when they become due. The Company prepares annual capital expenditure budgets which are monitored and updated as required. In addition, the Company requires authorizations for expenditures on projects to assist with the management of capital. As at December 31, 2011, the Company had available $157 million of undrawn revolving credit available.

The following are the contractual maturities of financial liabilities (undiscounted):

Financial liability due in	2012	2013	2014	2015	2016	Subsequent to 2016	Total
Accounts payable and accrued liabilities	$ 702,895	$ -	$ -	$ -	$ -	$ -	$ 702,895
Long-term debt and bank indebtedness	-	193,000	37,875	37,875	37,875	686,835	993,460
Obligations under finance lease (Note 18)	30,105	29,625	27,706	22,386	14,618	31,849	156,289
Equity Tax	20,864	20,864	20,864	-	-	-	62,592
Convertible debentures - principal	-	2,717	-	-	-	-	2,717
Total	$ 753,864	$ 246,206	$ 86,445	$ 60,261	$ 52,493	$ 718,684	$ 1,917,953

(e) Commodity price risk

Commodity price risk is the risk that the cash flows and operations of the Company will fluctuate as a result of changes in commodity prices. Significant changes in commodity prices can also impact the Company's ability to raise capital or obtain additional debt financing. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. From time to time the Company may attempt to mitigate commodity price risk through the use of financial derivatives. The Company recognizes the fair value of its derivative instruments as assets or liabilities on the statement of financial position. None of the Company's commodity price derivatives currently qualify as fair value hedges or cash flow hedges, and accordingly, changes in their fair value are recognized in earnings.

The Company has the following commodity price risk management contracts outstanding:

As at December 31, 2011

Instrument	Term	Volume (bbl)	Floor/ceiling or strike price ($/bbl)	Benchmark	Fair value
Call option	February 2012 to December 2012	8,790,000	109.50 -120	WTI	$ (29,353)
Sold put	August 2012 - December 2012	5,350,000	61.5 - 64	WTI	$ (8,732)
Zero cost collars	January 2012 to December 2012	10,051,404	70-80 / 115 - 121	WTI	(1,798)
	Total				**$ (39,883)**
	Short-term				$ (39,883)
	Total				**$ (39,883)**

As at December 31, 2010

Instrument	Term	Volume (bbl)	Floor/ceiling or strike price ($/bbl)	Benchmark	Fair value
Zero cost collars	January to December 2011	12,150,000	70-75 / 98-102	WTI	$ (50,819)
Put option	January to July 2011	1,285,000	40	WTI	(2,828)
	Total				**$ (53,647)**
	Short-term				$ (53,647)
	Total				**$ (53,647)**

As at January 1, 2010

Instrument	Term	Volume (bbl)	Floor/ceiling or strike price ($/bbl)	Benchmark	Fair value
Call option	January to November 2010	2,845,001	76.10 - 90.00	WTI	(18,553)
Put option	January to December 2010	5,170,000	40	WTI	(6,705)
				Total	**$ (25,258)**
	Short-term				(23,538)
	Long-term				(1,720)
	Total				**$ (25,258)**

For the year ended December 31, 2011, the Company recorded a gain of $8.8 million (2010 – loss of $40.2 million) on commodity price risk management contracts in net earnings. Included in these amounts were $13.4 million of unrealized gain (2010 – unrealized loss of $28.4 million) representing the change in the fair value of the contracts, and $4.6 million (2010 - $11.8 million) of realized loss resulting from premiums paid.

If the forward WTI crude oil price estimated at December 31, 2011 had been $1/bbl higher or lower, the unrealized gain or loss on these contracts would change by approximately $0.7 million (2010 – $1.5 million).

(f) Fair value risk

The Company's financial instruments are cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued liabilities, risk management assets and liabilities, bank debt, finance lease obligation, Debentures and available-for-sale investments on the statement of financial position. The carrying value and fair value of these financial instruments are disclosed below by financial instrument category.

	As at December 31, 2011		As at December 31, 2010	
Financial instrument	Carrying value	Fair value	Carrying value	Fair value
Assets held for trading				
Cash and cash equivalents	$ 729,671	$ 729,671	$ 602,776	$ 602,776
Restricted cash	3,074	3,074	6,706	6,706
Loans and receivables				
Accounts receivable	774,759	774,759	292,659	292,659
Loan to OBC (Long term)	81,806	81,806	-	-
Availble for sale financial assets				
Investment in CGX and other assets	62,667	62,667	-	-
Assets (liabilities) designated as cash flow hedges				
Foreign currency derivatives	(32,901)	(32,901)	1,066	1,066
Liabilities held for trading				
Commodity price derivatives	(39,883)	(39,883)	(53,647)	(53,647)
Other Liabilities				
Accounts payable and accrued liabilities	(702,895)	(702,895)	(525,956)	(525,956)
Long-term debt (1)	(927,144)	(941,556)	(524,393)	(580,908)
Convertible debtentures (2)	(2,234)	(4,245)	(186,416)	(523,829)
Obligations under finance lease	(104,888)	(111,181)	(38,687)	(40,621)

(1) Fair value of the 2009 senior notes is estimated using the last traded price, representing 113% of the face value of the 2009 Senior Notes as at December 31, 2011. The fair value of the 2011 Senior Notes approximate their carrying amounts as they were recently issued.

(2) The closing price of the convertible debenture (PRE.DB – TSX) at December 31, 2011 represented 190% of the face value of the convertible debenture (December 31, 2010 – 281%). The fair value of the convertible debenture includes both the fair value of the conversion feature and the debt itself.

When drawn, bank debt bears interest at a floating rate and accordingly the fair value approximates the carrying value. Due to the short term nature of cash and cash equivalents, accounts receivable and other current assets, accounts payable and accrued liabilities, their carrying values approximate their fair values.

The following table summarizes the Company's financial instruments that are carried at fair value, in accordance with the classification of fair value input hierarchy in IFRS 7 *Financial Instruments– Disclosures.*

	Fair value as at December 31, 2011			
	Level 1	Level 2	Level 3	
Available-for-sale financial assets	$ 62,667	$ -	$ -	$ 62,667
Risk management liabilities	-	(72,784)	-	(72,784)
Total	$ 62,667	$ (72,784)	$ -	$ (10,117)

	Fair value as at December 31, 2010			
	Level 1	Level 2	Level 3	
Risk management assets	$ -	$ 1,066	$ -	$ 1,066
Risk management liabilities	-	(53,647)	-	(53,647)
Total	$ -	$ (52,581)	$ -	$ (52,581)

The Company uses Level 1 inputs, being the last quoted price of the traded investments, to measure the fair value of its available-for-sale financial assets.

The Company uses Level 2 inputs to measure the fair value of its risk management contracts. The fair values of these contracts are estimated using internal discounted cash flows based upon forward prices and quotes obtained

from counterparties to the contracts taking into account the credit worthiness of those counterparties or the Company's credit rating when applicable.

(g) Capital management

The Company's objectives when managing capital are: (i) to maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk; and (ii) to maintain investor, creditor and market confidence to sustain the future development of the business.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its underlying assets. To maintain or adjust the capital structure, the Company may from time to time issue shares, raise debt and/or adjust its capital spending to manage its current and projected debt levels.

The Company monitors capital based on the following non-standardized IFRS measures: current and projected ratios of debt to cash flow from operations and debt to capital employed. The Company's objective, which is currently met, is to maintain a debt to cash flow from operations ratio of less than three times. The ratio may increase at certain times as a result of acquisitions. To facilitate the management of this ratio, the Company prepares annual budgets, which are updated depending on varying factors such as general market conditions and successful capital deployment. The Company's share capital is not subject to external restrictions.

There were no changes in the Company's approach to capital management from the previous year.

The Company defines its capital as follows:

	As at December 31		As at January 1
	2011	2010	2010
Shareholders' equity	$ 2,907,802	$ 2,144,825	$ 1,623,244
Long-term debt	927,144	524,393	454,287
Convertible debentures	2,234	186,416	165,611
Working capital surplus	(554,870)	(273,835)	(405,652)
	$ 3,282,310	$ 2,581,799	$ 1,837,490

23. Supplemental disclosure on cash flows

Changes in non-cash working capital:

	As at December 31	
	2011	2010
Increase in accounts receivable	$ (472,741)	$ (136,776)
(Increase) decrease in income taxes receivable	(17,158)	463
Increase in accounts payable and accrued liabilities	176,887	315,561
(Increase) in inventories	(112,413)	(18,716)
Increase in income taxes payable	271,947	113,577
Decrease (Increase) in prepaid expenses	3,936	(1,949)
	$ (149,542)	$ 272,160

The significant non-cash financing transaction for the twelve months ended December 31, 2011 included the exchange of 2009 Senior Notes for 2011 Senior Notes and the early conversion of the Debentures into common shares of the Company (refer to Note 16). Other cash flow information:

	As at December 31	
	2011	2010
Cash income taxes paid	$ 291,540	$ 57,610
Cash interest paid	66,670	59,528
Cash interest received	2,441	2,530

24. Subsequent events

a) During the period January 1 to January 3, 2012, $22.1 million of the 2009 Senior Notes were exchanged for $25.4 million of the 2011 Senior Notes due 2021 pursuant to the Exchange Offer that commenced on December 5, 2011 (refer to Note 16). Along with the notes that were exchanged during December 2011, a

total of $358.5 million of principal amount of the 2009 Senior Notes were exchanged for $412.3 million of the 2011 Senior Notes under the Exchange Offer.

b) The Company granted the following employees stock options under the rolling Plan after December 31, 2011:

Number of options granted	Weighted average exercise price (C$)
5,894,000	$22.75

25. First time adoption of IFRS

These consolidated financial statements have been prepared in accordance with IFRS. Prior to January 1, 2011, the Company prepared its financial statements in accordance with Canadian GAAP.

The effects of the changeover to IFRS as at January 1, 2010 and for the year ended December 31, 2010 are explained below.

IFRS 1 Exemptions

The general principle to be applied on first-time adoption of IFRS is that standards in force at the first annual reporting date (December 31, 2011) should be applied as at the date of transition to IFRS (January 1, 2010) and throughout all periods presented in the first IFRS financial statements. IFRS 1 contains a number of exemptions that companies are permitted to apply. The Company has elected to apply the following exemptions:

a) To apply IFRS 3 *Business Combinations* prospectively and not restate business combinations that occurred prior to January 1, 2010.
b) To not apply IFRS 2 *Share-Based Payments* to equity awards that vested before January 1, 2010
c) To deem cumulative currency translation differences for all foreign operations to be zero as at January 1, 2010.
d) To deem the cost of oil and gas properties and exploration and evaluation assets equal to its Canadian GAAP historical property, plant and equipment net book value as at January 1, 2010.
e) To measure the changes in asset retirement obligation and the related depreciation as at January 1, 2010, with the effect recorded in retained earnings.
f) To apply the exemption to prospectively capitalize borrowing costs from January 1, 2010.

Reconciliations from Canadian GAAP to IFRS

In preparing these consolidated financial statements, the Company has adjusted amounts reported previously in its consolidated financial statements prepared under Canadian GAAP. An explanation of how the transition from Canadian GAAP to IFRS has impacted the Company’s consolidated statement of financial position, consolidated statement of income and shareholders’ equity is included in the following reconciliations and notes.

Reconciliation of Consolidated Statement of Income and Comprehensive Income for the year ended December 31, 2010

	Dec. 31, 2010 Cdn GAAP	O&G assets (25.1)	Transmeta (25.2)	ARO (25.3)	Deferred income tax (25.4)	Land acquisition (25.5)	Equity investments (25.6)	Functional currency (25.7)	Dec. 31, 2010 IFRS
Oil and gas sales	$ 1,661,544	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,661,544
Cost of operations									
Production and operating costs	626,772	(1,435)	5,035	-	-	-	-	-	630,372
Depletion, depreciation and amortization	298,567	83,083	-	-	12,658	-	-	-	394,308
	925,339	81,648	5,035	-	12,658	-	-	-	1,024,680
Earnings before undernoted	736,205	(81,648)	(5,035)	-	(12,658)	-	-	-	636,864
Expenses									
General and administrative expenses	109,831	1,253	(3,699)	(380)	104	-	-	-	107,109
Shared-based compensation	73,327	-	-	-	-	-	-	-	73,327
	183,158	1,253	(3,699)	(380)	104	-	-	-	180,436
Earnings from operations	553,047	(82,901)	(1,336)	380	(12,762)	-	-	-	456,428
Finance costs	(76,447)	(1,112)	176	-	-	-	-	-	(77,383)
Income (loss) from equity-investments	(1,634)	-	-	-	-	-	9,404	-	7,770
Equity tax	(2,088)	-	-	-	-	-	-	-	(2,088)
Foreign exchange gain (loss)	(11,092)	-	2,937	340	11,278	(266)	-	30,654	33,851
Gain (loss) on risk management	(40,230)	-	-	-	-	-	-	-	(40,230)
Other income (expenses)	(951)	2,753	1,375	-	(155)	-	(304)	-	2,718
Net earnings before income tax	420,605	(81,260)	3,152	720	(1,639)	(266)	9,100	30,654	381,066
Income tax expense	(202,999)	-	133	-	86,887	-	-	-	(115,979)
Net earnings for the year	**$ 217,606**	**$ (81,260)**	**$ 3,285**	**$ 720**	**$ 85,248**	**$ (266)**	**$ 9,100**	**$ 30,654**	**$ 265,087**
Other comprehensive income									
Foreign currency translation (nil tax effect)	11,577	-	-	-	-	-	(2,425)	(29,789)	(20,637)
Unrealized gain on cash flow hedges (nil tax effect)	21,721	-	-	-	-	-	-	-	21,721
Realized gain on cash flow hedges transferred to earnings (nil tax effect)	(21,721)	-	-	-	-	-	-	-	(21,721)
	11,577	-	-	-	-	-	(2,425)	(29,789)	(20,637)
Comprehensive income for the year	229,183	(81,260)	3,285	720	85,248	(266)	6,675	865	244,450

Reconciliation of Consolidated Statement of Financial Position as at January 1, 2010

	Jan. 1, 2010 Cdn GAAP	O&G assets (25.1)	Transmeta (25.2)	ARO (25.3)	Deferred income tax (25.4)	Land acquisition (25.5)	Equity investments (25.6)	Functional currency (25.7)	Jan. 1, 2010 IFRS
ASSETS									
Current									
Cash and cash equivalents	$ 438,117	$ -	$ (9,561)	$ -	$ -	$ -	$ -	$ -	$ 428,556
Restricted cash	8,712	-	-	-	-	-	-	-	8,712
Accounts receivables	159,049	-	(1,204)	-	-	(3,926)	-	-	153,919
Inventories	38,228	-	(162)	-	-	-	-	-	38,066
Income tax receivable	5,048	-	(2,998)	-	-	-	-	-	2,050
Prepaid expenses	4,449	-	-	-	-	-	-	-	4,449
Deferred tax asset	2,693	-	-	-	(2,693)	-	-	-	-
	656,296	**-**	**(13,925)**	**-**	**(2,693)**	**(3,926)**	**-**	**-**	**635,752**
Non-current									
Property, plant and equipment	1,985,361	(1,985,361)	-	-	-	-	-	-	-
Oil and gas properties	-	1,937,121	-	-	100,276	-	-	-	2,037,397
Exploration and evaluation assets	-	38,421	-	-	-	-	-	(142)	38,279
Plant and equipment	-	9,819	(3,823)	-	456	3,536	-	18	10,006
Investments and other assets	74,758	-	328	-	-	-	28,123	-	103,209
Restricted cash	2,059	-	-	-	-	-	-	-	2,059
Goodwill	100,636	-	-	-	-	-	-	-	100,636
	$2,819,110	**$ -**	**$ (17,420)**	**$ -**	**$ 98,039**	**$ (390)**	**$ 28,123**	**$ (124)**	**$2,927,338**
LIABILITIES									
Current									
Accounts payable and accrued liabilities	$ 208,603	$ -	$ (5,397)	$ -	$ -	$ 126	$ -	$ -	$ 203,332
Risk management liability	23,538	-	-	-	-	-	-	-	23,538
Income tax payable	2,721	-	(1,411)	-	-	-	-	-	1,310
Current portion of long-term debt	13,310	-	(1,182)	-	-	-	-	-	12,128
Current portion of obligations under finance lease	1,920	-	-	-	-	-	-	-	1,920
Deferred tax liability	846	-	-	-	(846)	-	-	-	-
	250,938	**-**	**(7,990)**	**-**	**(846)**	**126**	**-**	**-**	**242,228**
Non-current									
Long-term debt	442,159	-	-	-	-	-	-	-	442,159
Obligations under finance lease	38,521	-	-	-	-	-	-	-	38,521
Convertible debenture	165,611	-	-	-	-	-	-	-	165,611
Risk management liability	1,720	-	-	-	-	-	-	-	1,720
Deferred tax liability	382,625	-	108	(88)	22,091	-	-	-	404,736
Asset retirement obligation	8,778	-	-	341	-	-	-	-	9,119
	1,290,352	**-**	**(7,882)**	**253**	**21,245**	**126**	**-**	**-**	**1,304,094**
SHAREHOLDERS' EQUITY									
Common shares	1,364,687	-	-	-	-	-	-	-	1,364,687
Contributed surplus	136,934	-	-	-	-	-	-	-	136,934
Equity component of convertible debenture	66,130	-	-	-	(9,060)	-	-	-	57,070
Accumulated other comprehensive income	229	-	-	-	(229)	-	-	-	-
Retained earnings (deficit)	(39,222)	-	(9,538)	(253)	86,083	(516)	28,123	(124)	64,553
	1,528,758	**-**	**(9,538)**	**(253)**	**76,794**	**(516)**	**28,123**	**(124)**	**1,623,244**
	$2,819,110	**$ -**	**$ (17,420)**	**$ -**	**$ 98,039**	**$ (390)**	**$ 28,123**	**$ (124)**	**$2,927,338**

Reconciliation of Consolidated Statement of Financial Position as at December 31, 2010

	Dec. 31, 2010 Cdn GAAP	O&G assets (25.1)	Transmeta (25.2)	ARO (25.3)	Deferred income tax (25.4)	Land acquisition (25.5)	Equity investments (25.6)	Functional currency (25.7)	Dec. 31, 2010 IFRS
ASSETS									
Current									
Cash and Cash equivalents	$ 608,344	$ -	$ (5,568)	$ -	$ -	$ -	$ -	$ -	$ 602,776
Restricted Cash	6,706	-	-	-	-	-	-	-	6,706
Accounts Receivables	300,836	-	(2,853)	-	-	(5,324)	-	-	292,659
Inventories	56,050	690	(208)	-	-	-	-	-	56,532
Income tax receivable	2,324	-	(737)	-	-	-	-	-	1,587
Prepaid expenses	6,398	-	-	-	-	-	-	-	6,398
Risk Management	1,066	-	-	-	-	-	-	-	1,066
Deferred tax asset	2,669	-	-	-	(2,669)	-	-	-	-
	984,393	**690**	**(9,366)**	**-**	**(2,669)**	**(5,324)**	**-**	**-**	**967,724**
Non-current									
Property, plant and equipment	2,383,628	(2,383,628)	-	-	-	-	-	-	-
Oil and gas properties	-	2,129,081	(3,081)	2,574	165,900	-	-	-	2,294,474
Exploration and evaluation assets	-	150,252	-	70	(155)	-	-	729	150,896
Intangible assets	170,967	-	-	-	-	-	-	-	170,967
Plant and equipment	-	22,344	(8,116)	-	505	4,431	-	12	19,176
Investments and other assets	215,462	-	151	-	(155)	-	34,798	-	250,256
Goodwill	100,636	-	-	-	-	-	-	-	100,636
	$ 3,855,086	**$ (81,261)**	**$ (20,412)**	**$ 2,644**	**$ 163,426**	**$ (893)**	**$ 34,798**	**$ 741**	**$ 3,954,129**
LIABILITIES									
Current									
Accounts payable and accrued liabilities	$ 540,292	$ -	$ (14,225)	$ -	$ -	$ (111)	$ -	$ -	$ 525,956
Risk Management liability	53,647	-	-	-	-	-	-	-	53,647
Income tax payable	109,982	-	-	-	-	-	-	-	109,982
Current portion of long-term debt	90,091	-	(48)	-	-	-	-	-	90,043
Current portion of obligations under finance lease	4,304	-	-	-	-	-	-	-	4,304
Deferred tax liability	3,396	-	-	-	(3,396)	-	-	-	-
	801,712	**-**	**(14,273)**	**-**	**(3,396)**	**(111)**	**-**	**-**	**783,932**
Non-current									
Long-term debt	434,350	-	-	-	-	-	-	-	434,350
Obligations under finance lease	34,383	-	-	-	-	-	-	-	34,383
Convertible debenture	186,416	-	-	-	-	-	-	-	186,416
Deferred tax liability	344,810	-	114	(89)	4,779	-	-	-	349,614
Asset retirement obligation	18,343	-	-	2,266	-	-	-	-	20,609
	1,820,014	**-**	**(14,159)**	**2,177**	**1,383**	**(111)**	**-**	**-**	**1,809,304**
SHAREHOLDERS' EQUITY									
Common shares	1,691,838	-	-	-	-	-	-	-	1,691,838
Contributed surplus	112,339	-	-	-	-	-	-	-	112,339
Equity component of convertible debenture	65,826	-	-	-	(9,060)	-	-	-	56,766
Accumulated other comprehensive income	11,806	-	-	-	(229)	-	(2,425)	(29,789)	(20,637)
Retained earnings (deficit)	153,263	(81,261)	(6,253)	467	171,332	(782)	37,223	30,530	304,519
	2,035,072	**(81,261)**	**(6,253)**	**467**	**162,043**	**(782)**	**34,798**	**741**	**2,144,825**
	$ 3,855,086	**$ (81,261)**	**$ (20,412)**	**$ 2,644**	**$ 163,426**	**$ (893)**	**$ 34,798**	**$ 741**	**$ 3,954,129**

Notes for reconciliations from Canadian GAAP to IFRS

25.1 Oil and gas properties and exploration and evaluation assets

The Company has elected to apply the exemption under IFRS 1 to deem the cost of oil and gas properties and exploration and evaluation assets as at January 1, 2010 equal to the net book value of property, plant and equipment recorded under Canadian GAAP.

Under Canadian GAAP, depreciation, depletion and amortization of oil and gas properties is determined on a unit-of-production basis with Colombia being considered one cost centre. Under IAS 16 *Property, Plant and Equipment*, depletion, depreciation and amortization is calculated at the level of the cash generating unit, which the Company has determined to be the major producing fields.

Depreciation charged against certain administrative assets related to oil producing fields is now included under cost of operations rather than general and administrative expenses.

All oil and gas properties and exploration and evaluation assets were tested for impairment as at January 1, 2010 and no impairment was recognized.

25.2 Consolidation of Transmeta

Under Canadian GAAP, the Company consolidated Transmeta as a variable interest entity. Under SIC 12 requirements, consolidation of special purpose entities is determined based on control. The Company has concluded it does not control Transmeta as of January 1, 2010 and therefore consolidation has been reversed.

25.3 Asset retirement obligation

As the Company elected to use the full cost as deemed cost exemption as described above, the asset retirement obligation has been re-measured as at January 1, 2010 using the guidance in IAS 37. In re-measuring the asset retirement obligation, expected future cash outflows were estimated and discounted to January 1, 2010 using the risk free rate of 4% with the offset recorded to retained earnings.

25.4 Deferred income tax

a) Under Canadian GAAP the Company recognized a deferred income tax arising from the bonus depreciation "superdeduction" related to qualifying new investments in Colombia. This type of benefit is not within the scope of IAS 20 and is therefore not treated as part of the tax base. Instead, the deduction is recognized as a reduction to income tax expense in the current period.

b) Under Canadian GAAP, deferred income tax assets and liabilities were classified between current and non-current, based on the classification of the underlying assets and liabilities that gave rise to the differences. IAS 12 requires that deferred taxation amounts be classified as non-current assets and liabilities only.

c) Deferred income tax assets and liabilities have been adjusted for the changes to net book values of oil and gas properties arising as a result of the adjustments for first time adoption of IFRS as discussed in 1 above. Under Canadian GAAP, deferred tax was not recognized for temporary differences resulting from differences between the functional currency and the currency in which the Company's taxes are denominated, being the Colombian peso. Under IFRS, such temporary tax differences are recognized as part of the deferred tax expense or recovery in the consolidated statement of income.

d) Under IFRS, a temporary difference is calculated on the difference between the accounting base and the tax base of the convertible debenture. The tax effect calculated on the equity component of the convertible debenture is recorded as a deferred tax liability with a corresponding adjustment to the equity component at the time of issue. The tax effect on the subsequent change in the temporary difference related to the debt component of the convertible debenture is recognized as deferred tax expense or recovery in the consolidated statement of income.

25.5 Land acquisition

Certain advances made for the acquisition of land that were included in accounts receivable under Canadian GAAP have been reclassified to oil and gas properties, as the title of the land has been transferred to a trust that is considered to be a special purpose entity subject to consolidation pursuant to the requirements of SIC 12.

25.6 Equity-accounted investments

The Company determined that the effect of the changeover to IFRS on the financial statements of the Company's equity-accounted investments as at January 1, 2010 was an increase to the carrying amount of the investments by $28.1 million with a corresponding adjustment to retained earnings. The carrying amounts of property, plant and equipment of ODL and PII were adjusted for IFRS requirements, including the effect of the accounting for the superdeduction related to qualifying investments in Colombia.

25.7Functional currency

The Company's functional currency under Canadian GAAP was the U.S. dollar. The Company has determined that its functional currency is the Canadian dollar upon transition to IFRS. The Company's presentation currency continues to be the U.S. dollar. The effect of this change is primarily related to the translation of the Company's cash and debts on the consolidated statement of financial position and the resulting foreign exchange gains and losses on the consolidated statement of income. Unrealized gains and losses resulting from the translation to the U.S. dollar presentation currency have been included in other comprehensive income.

25.8 Reconciliation of the statement of cash flows from Canadian GAAP to IFRS

The transition from Canadian GAAP to IFRS did not materially change the underlying cash flows of the Company with the exception that the Company no longer consolidates the operating results of Transmeta as described in 25.2 above. As a result of the reversal of consolidation of Transmeta, the Company's net cash provided by operating activities was reduced by $8.3 million for the year ended December 31, 2010.