TERRACE ENERGY CORP
(formerly Terrace Resources Inc.)

CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in Canadian dollars, unless otherwise stated)

JANUARY 31, 2012 AND 2011

SmytheRatcliffe
CHARTERED ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF TERRACE ENERGY CORP.
(formerly Terrace Resources Inc.)

We have audited the accompanying consolidated financial statements of Terrace Energy Corp., which comprise the consolidated statements of financial position as at January 31, 2012, January 31, 2011 and February 1, 2010, and the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years ended January 31, 2012 and January 31, 2011, 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 auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our 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 Terrace Energy Corp. as at January 31, 2012, January 31, 2011 and February 1, 2010, and its financial performance and its cash flows for the years ended January 31, 2012 and January 31, 2011 in accordance with International Financial Reporting Standards.

Smythe Ratcliffe LLP

Chartered Accountants

Vancouver, British Columbia
May 28, 2012

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TERRACE ENERGY CORP
(formerly Terrace Resources Inc.)
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in Canadian Dollars)

	January 31 2012	January 31 2011 (Note 8)	February 1 2010 (Note 8)
ASSETS			
Current			
Cash	$ 2,590,292	$ 219,701	$ 290,796
Receivables	5,148	1,232	-
	2,595,440	220,933	290,796
Long-Term			
Oil and gas properties (Note 3)	2,997,236	-	-
Restricted cash	-	2,523,771	2,502,262
	$ 5,592,676	$ 2,744,704	$ 2,793,058

	January 31 2012	January 31 2011 (Note 8)	February 1 2010 (Note 8)
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	$ 167,113	$ 18,953	$ 6,098
Shareholders' Equity			
Capital stock (Note 4)	6,272,512	2,880,589	2,880,589
Reserves (Note 4)	517,235	-	-
Deficit	(1,364,184)	(154,838)	(93,629)
	5,425,563	2,725,751	2,786,960
	$ 5,592,676	$ 2,744,704	$ 2,793,058

Approved on behalf of the Board:

"Eric Boehnke"	"William McCartney"
Eric Boehnke, Director	William McCartney, Director

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

TERRACE ENERGY CORP
(formerly Terrace Resources Inc.)
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(Expressed in Canadian Dollars)
For the Years Ended January 31

	2012	2011
		(Note 8)
EXPENSES		
Administrative	$ 125,611	$ 5,562
Business investigation costs (Note 7)	93,557	14,828
Consulting (Note 7)	91,511	-
Foreign exchange loss	6,916	-
Impairment of oil and gas properties (Note 3)	234,564	-
Interest income	(10,746)	(21,509)
Professional (Note 7)	177,990	44,362
Project investigation costs (Note 7)	118,787	-
Share-based payments (Note 7)	277,672	-
Transfer agent and filing fees	69,916	17,966
Travel	23,568	-
Net loss and comprehensive loss for the year	$ 1,209,346	$ 61,209
Loss per share - basic and diluted	$ 0.03	$ 0.00
Weighted average number of common shares outstanding	38,741,924	30,881,821

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

TERRACE ENERGY CORP
(formerly Terrace Resources Inc.)
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Expressed in Canadian Dollars)

	Capital Stock				Total
	Shares	Amount	Reserves	Deficit	Shareholders' Equity
Balance, February 1, 2010 (Note 8)	30,881,821	$ 2,880,589	$ -	$ (93,629)	$ 2,786,960
Loss and comprehensive loss	-	-	-	(61,209)	(61,209)
Balance, January 31, 2011 (Note 8)	30,881,821	2,880,589	-	(154,838)	2,725,751
Private placements	19,000,000	2,794,200	355,800	-	3,150,000
Share issue costs	-	(56,264)	-	-	(56,264)
Exercise of warrants	2,887,500	519,750	-	-	519,750
Exercise of options	150,000	18,000	-	-	18,000
Share-based payments	-	-	277,672	-	277,672
Fair value of options exercised	-	13,500	(13,500)	-	-
Fair value of warrants exercised	-	102,737	(102,737)	-	-
Loss and comprehensive loss	-	-	-	(1,209,346)	(1,209,346)
Balance, January 31, 2012	52,919,321	$ 6,272,512	$ 517,235	$ (1,364,184)	$ 5,425,563

TERRACE ENERGY CORP
(formerly Terrace Resources Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in Canadian Dollars)
For the Years Ended January 31

	2012	2011
CASH FLOW FROM OPERATING ACTIVITIES		
Net loss for the year	$ (1,209,346)	$ (61,209)
Items not involving cash:		
Share-based payments	277,672	-
Impairment of oil and gas properties	234,564	-
Changes in non-cash working capital items:		
Receivables	(3,916)	(1,232)
Accounts payable and accrued liabilities	45,919	12,855
Net cash used in operating activities	(655,107)	(49,586)
CASH FLOWS FROM INVESTING ACTIVITIES		
Restricted cash	2,523,771	(21,509)
Oil and gas properties	(3,129,559)	-
Net cash used in investing activities	(605,788)	(21,509)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of shares	3,687,750	-
Share issue costs	(56,264)	-
Net cash provided by financing activities	3,631,486	-
Change in cash for the year	2,370,591	(71,095)
Cash, beginning of year	219,701	290,796
Cash, end of year	$ 2,590,292	$ 219,701
Cash paid during the year for interest	$ -	$ -
Cash paid during the year for taxes	$ -	$ -

Non-cash financing activities:

During the year ended January 31, 2012, the Company:

a) Allocated proceeds of $355,800 in connection with a private placement to the value of warrants.
b) Reallocated $13,500 of reserves to capital stock on the exercise of 150,000 stock options.
c) Reallocated $102,737 of reserves to capital stock on the exercise of 2,887,500 warrants.
d) Had accounts payable of $102,241 related to Oil & Gas properties.

1. NATURE AND CONTINUANCE OF OPERATIONS

Terrace Energy Corp. (the "Company") was incorporated on July 6, 2006 under the *Business Corporations Act* (British Columbia) and previously named Terrace Resources Inc.

The Company's head office is located at 270 – 666 Burrard Street, Vancouver, BC, Canada V6C 2X8.

The Company was classified as a "capital pool corporation" until June 2011 at which time it completed a "qualifying transaction" and became a "Tier 2 Oil and Gas Issuer", as those terms are defined in TSX Venture Exchange (the "Exchange") policies. Its common shares trade on the Exchange under the symbol "TZR".

These consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. The Company has no history of revenues or operating cash flows. The continuing operations of the Company are therefore dependent upon its ability to raise additional capital as required and achieving future profitable operations, neither of which is assured. These financial statements do not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue operations.

The financial statements of the Company are presented in Canadian dollars, unless otherwise stated, which is the functional currency.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of January 31, 2012. These consolidated financial statements were approved for issuance by the Board on May 28, 2012.

These consolidated financial statements for the year ended January 31, 2012 are the Company's first IFRS annual financial statements. Previously, the Company prepared its annual financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") and comparative figures for 2011 have been restated as necessary to conform to IFRS (Note 8).

As this is the first year in which the Company's consolidated financial statements are prepared in accordance with IFRS, disclosure of the elected transition exemptions and reconciliation and explanation of accounting policy differences compared to Canadian GAAP have been provided in Note 8.

Estimates, risks and uncertainties

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported expenses during the period. Actual results could differ from these estimates and, as such, estimates and underlying assumptions are reviewed on an ongoing basis. Revisions are recognized in the period in which the estimates are revised and in any future period affected.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of the reporting period that could result in a material adjustment to the carrying amounts of assets and liabilities in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

i) The inputs used in calculating the fair value for share-based payments included in operations.
ii) The inputs used in calculating the fair value of warrants included in units issued in private placements.
iii) The valuation of shares issued in non-cash transactions.
iv) The recoverability of amounts recorded as oil and gas properties.

Principles of consolidation

The consolidated financial statements include the financial statements of the Company and its controlled subsidiaries. All inter-company transactions, balances, income and expenses are eliminated in full on consolidation.

Name of subsidiary	Place of Incorporation	Percentage ownership
Terrace US Holdings Inc.	USA	100%
Terrace Operating LLC	USA	100%
Terrace Cutlass LLC	USA	100%
Terrace STS LLC	USA	100%

Financial instruments

All financial instruments are classified as one of the following: held-to-maturity, loans and receivables, fair value through profit or loss ("FVTPL"), available-for-sale or other financial liabilities. Financial assets and liabilities at FVTPL are measured at fair value with gains and losses recognized in income or loss. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) and reported in shareholders' equity.

Transaction costs that are directly attributable to the acquisition or issue of financial instruments that are classified as other than FVTPL, which are expensed as incurred, are included in the initial carrying value of such instruments.

Foreign currency translation

The Company's subsidiaries are integrated foreign operations and are translated into Canadian dollars using the temporal method. Monetary items are translated at the exchange rate in effect at the statement of financial position date and non-monetary items are translated at historical exchange rates. Income and expense items are translated at rates approximating those in effect at the time of the transactions. Translation gains and losses are reflected in the results of operations.

Oil and gas properties

Pre-exploration ("Project Investigation Costs") expenditures

Expenditures made by the Company before acquiring the legal right to explore in a specific area do not meet the definition of an asset and therefore are expensed by the Company as incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Oil and gas properties (continued)

Exploration and evaluation expenditures

Costs incurred once the legal right to explore has been acquired are capitalized as oil and gas properties. These assets include, but are not limited to, exploration license expenditures, leasehold property acquisition costs, evaluation costs, including drilling costs directly attributable to an identifiable well and directly attributable general and administrative costs. These costs are accumulated in cost centers by property and are not subject to depletion until technical feasibility and commercial viability has been determined.

Oil and gas properties are assessed for impairment when facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting petroleum resources is considered to be determinable when proved and probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved and probable reserves have been discovered. Upon determination of proved and probable reserves, oil and gas properties attributable to these reserves are tested for impairment and reclassified from exploration and evaluation assets to oil and gas properties.

Development and production costs

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped in cash-generating units ("CGU") for impairment testing. A CGU's recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of a CGU exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount.

Gains and losses on disposal of an item of property and equipment, including oil and gas properties, are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized within net loss.

Subsequent costs

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Asset retirement obligations

The Company recognizes the fair value of a provision for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability. Changes in the liability for an asset retirement obligation due to the passage of time will be measured by applying an interest method of allocation. The amount will be recognized as an increase in the liability and an accretion expense in the statement of operations. Changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows are recognized as an increase or a decrease to the carrying amount of the liability and the related long-lived asset.

As of January 31, 2012 and 2011, the Company does not have any asset retirement obligations.

Share-based payments

Share-based payments to employees are measured at the fair value of the instruments issued and recognized over the vesting periods. Share-based payments to non-employees are measured at the fair value of the goods or services received or the fair value of the equity instruments issued, if it is determined the fair value of the goods or services cannot be reliably measured, and are recorded at the date the goods or services are received. The offset to the recorded cost is to share-based payments reserve. Consideration received on the exercise of stock options is recorded as capital stock and the related amount originally recorded in share-based payments reserve is transferred to capital stock. Upon expiry, related fair value calculated is transferred from share-based payments reserve to deficit.

Income taxes

The Company uses the asset and liability method for accounting for income taxes. Under this method of tax allocation, deferred income tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax basis (temporary differences). Deferred income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on deferred income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantially assured. The amount of deferred income tax assets recognized is limited to the amount of the benefit that is more likely than not to be realized.

Capital stock

Proceeds from the issue of units is allocated between common shares and share purchase warrants on a relative fair value basis, based on the fair value of common shares being the market value on the date of announcement of the placement and the value of share purchase warrants as determined using the Black Scholes option pricing model.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basic and diluted loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is calculated presuming the exercise of outstanding options, warrants and similar instruments.

It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the year. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

Shares held in escrow, other than where their release is subject to the passage of time, are not included in the calculation of the weighted average number of common shares outstanding.

Revenue recognition

Interest income is recognized as earned.

New accounting pronouncements

Certain new accounting standards and interpretations have been published that are not mandatory for the year ended January 31, 2012:

IFRS 9 *Financial Instruments* is effective for accounting periods commencing on or after January 1, 2015.

Amendments to IFRS 7 *Financial Instruments: Disclosures* are effective for annual periods beginning on or after July 1, 2011 and introduce enhanced disclosure around transfer of financial assets and associated risks. These amendments are not anticipated to impact the disclosures made by the Company.

Amendments to IAS 1 *Presentation of Financial Statements* (effective for annual periods beginning on or after July 1, 2012) require that elements of other comprehensive income that may subsequently be reclassified through profit and loss be differentiated from those items that will not be reclassified.

IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, and consequential revisions to IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (all effective January 1, 2013) provide revised guidance on the accounting treatment and associated disclosure requirements for joint arrangements and associates, and a revised definition of “control” for identifying entities that are to be consolidated.

IFRS 13 *Fair Value Measurement* (effective January 1, 2013) provides new guidance on fair value measurement and disclosure requirements.

The Company is currently evaluating the impact of these new and amended standards on its consolidated financial statements.

(Expressed in Canadian Dollars)

3. OIL AND GAS PROPERTIES

	Los Patos	STS Olmos	Cutlass	Total
Balance, February 1, 2010 and January 31, 2011	$ -	$ -	$ -	$ -
Acquisition costs	-	1,014,100	376,508	1,390,608
Bond	23,710	-	-	23,710
Exploration and evaluation	380,242	66,422	198,507	645,171
Advances for future exploration	-	1,185,168		1,185,168
Impairment charge	(234,564)	-	-	(234,564)
Incidental sales	(5,678)	(7,179)	-	(12,857)
Balance, January 31, 2012	**$ 163,710**	**$ 2,258,511**	**$ 575,015**	**$ 2,997,236**

Los Patos

In June 2011, the Company entered into an agreement to earn, through a wholly-owned subsidiary, an 87.5% working interest and a 65.187% net revenue interest in certain leases and farm-out lands covering 320 acres in Wharton County, Texas, by funding all costs associated with the re-fracture, stimulation and completion of an existing, primarily gas, well. The Company fulfilled its obligations under the agreement in 2011 and earned its interests. The well was deemed not successful and since the Company has no further exploration plans at this time it has reduced the carrying value of Los Patos to the approximate current market cost of leasing comparable acreage on similar terms plus the estimated refundable bond. The Company may choose to explore, joint venture, sell, lease or abandon Los Patos in the future.

STS Olmos

In November 2011, the Company entered into an agreement, through a wholly-owned subsidiary, to acquire varying working and net revenue interests, which average 26.88% and 20.16%, respectively, in approximately 14,400 gross acres (3,875 net acres) in LaSalle and McMullen Counties, Texas. The purchase price was US$1.0 million (C$1,014,100) with an effective date of October 1, 2011. The Company's share of the estimated costs to drill and complete an initial test well is C$1,185,168, which was advanced to the project's operator by January 31, 2012. The well was completed and brought into production in February 2012.

Cutlass

In November 2011, the Company entered into an agreement, through a wholly-owned subsidiary, to earn a 25% working interest and an 18.75% net revenue interest in certain leases covering 3,395 net acres in Dimmit and LaSalle counties, Texas. In February 2012, the Company acquired an additional 5% working interest and 3.75% net revenue interest for US$234,096. The percentages and dollar amounts below are based on the 30% working interest obtained after the year-end.

In order to earn the net revenue interests (22.5% in aggregate), the Company agreed to pay 33.33% of all costs, including acreage leases, prospect fees, site preparation and drilling, until the completion of three wells, and thereafter 30% of all costs relating to the lease payments, prospect fees and infrastructure costs covering 1,342 net acres (the "Dimmit County Acreage") plus its share of the drilling costs for the first well on the Dimmit County Acreage. The Company advanced US$2,178,476 in March 2012 representing the operator's estimate of the Company's share of costs to drill, but not complete, the first well.

The operator has estimated the Company's share of costs to complete and place the first well into production to be approximately US$854,000. The Company is also required to pay its share of the drilling and completion costs of a

3. OIL AND GAS PROPERTIES (Continued)

Cutlass (continued)

second well, at an estimated cost to the Company of US$2,333,000, in order to earn its interest in the balance of the Dimmit County Acreage.

In addition, after the drilling and technical evaluation of the first well on the Dimmit County Acreage, the Company will have the right to exercise its option to earn a 22.5% net revenue interest in the remaining 2,053 acres (the "LaSalle County Acreage") at a cost of approximately US$739,000, representing the operator's estimate of its share of lease payments, site preparation and drilling costs of two wells.

4. CAPITAL STOCK

On January 31, 2012, the Company had unlimited authorized common shares, without par value and 52,919,321 shares outstanding.

Share issues

In June 2011, the Company completed a private placement of 10,000,000 units at a purchase price of $0.09 per unit for gross proceeds of $900,000. Each unit consisted of one common share and one common share purchase warrant, which entitles the holder to acquire one additional common share for a period of five years at an exercise price of $0.18.

The Company allocated $544,200 of the subscription proceeds to capital stock and $355,800 to reserves based on their relative fair values as of the placement announcement date. The valuation of the warrants was estimated using the Black-Scholes valuation model with a weighted expected volatility of 100%, risk-free interest rate of 2.19%, expected life of 5 years and a dividend yield of 0%. The Company paid $56,264 of share issue costs in relation to the private placement.

In December 2011, the Company completed a private placement of 9,000,000 shares at a purchase price of $0.25 per share.

Stock options

The Company has an incentive stock option plan, which provides that the Board of Directors of the Company may from time to time, in its discretion, and in accordance with Exchange requirements, grant to directors, officers, employees and technical consultants to the Company, non-transferable options to purchase common shares, provided that the number of common shares reserved for issuance will not exceed 10% of the issued and outstanding common shares. The number of common share reserves for issuance pursuant to options granted to all technical consultants will not exceed 2% of the issued and outstanding common shares. The number of options granted to any one person cannot exceed 5% of the issued and outstanding common shares. Such options will be exercisable for a period of up to 10 years from the date of grant. Vesting terms will be determined at the time of grant by the Board of Directors.

(Expressed in Canadian Dollars)

4. CAPITAL STOCK (Continued)

Share-based payments

The Company uses a fair value method of accounting for all share-based payments. Under this method, the Company recorded a share-based payments expense of $277,672 for the year ended January 31, 2012, with a corresponding credit to reserves. The fair value of stock options is estimated at the date of the grant using the Black-Scholes option pricing model assuming the following weighted average assumptions:

Risk-free interest rate	1.18% - 2.19%
Expected life	5 years
Annualized volatility	100%
Pre-vest forfeiture rate	2%
Dividend rate	0.00%

During the year ended January 31, 2012, the Company granted 3,050,000 options with a fair value of $589,170, which is being recognized over the vesting periods of the options.

Escrow shares and warrants

Of the common shares issued, 22,143,693 are subject to an escrow agreement and may not be transferred without the consent of the Exchange. The escrow agreement provides, among other things, that a total of 3,690,605 common shares were released from escrow on December 23, 2011 and the same amount will be released every six months thereafter.

Of the 10,000,000 common shares underlying the outstanding warrants, 5,400,000 would be subject to an escrow agreement and could not be transferred without the consent of the Exchange and 3,600,000 are subject to a voluntary pooling agreement. The escrow and voluntary pooling agreements provide, among other things, that warrants to purchase a total of 1,500,000 common shares at $0.18 each were released from trading restrictions on December 23, 2011 and the same amount will be released every six months thereafter.

(Expressed in Canadian Dollars)

4. CAPITAL STOCK (Continued)

Outstanding stock options and warrants

Stock option transactions and the number of stock options outstanding are summarized as follows:

	Number	Weighted Average Exercise Price
Balance, February 1, 2010 and January 31, 2011	-	$ -
Granted	3,050,000	$ 0.20
Exercised	(150,000)	$ 0.12
Balance, January 31, 2012	2,900,000	$ 0.20

The following stock options were outstanding as at January 31, 2012:

Number of options	Number of options exercisable	Exercise price	Weighted average remaining contractual life (years)
1,800,000	1,800,000	$ 0.12	4.39
250,000	62,500	$ 0.19	4.45
250,000	25,000	$ 0.21	4.60
250,000	25,000	$ 0.19	4.72
100,000	20,000	$ 0.53	4.82
250,000	25,000	$ 0.67	4.88
2,900,000	1,957,500		4.50

Warrant transactions and the number of warrants outstanding are summarized as follows:

	Number of Warrants	Weighted Average Exercise Price	Expiry Date
Balance, February 1, 2010 and January 31, 2011	-	-	-
Granted	10,000,000	$ 0.18	June 21, 2016
Exercised	(2,887,500)	$ 0.18	
Balance, January 31, 2012	7,112,500	$ 0.18	

5. FINANCIAL INSTRUMENTS

The Company has classified its financial instruments as follows:

- Cash and restricted cash - as FVTPL; and
- Accounts payable and accrued liabilities - as other financial liabilities.

The Company's risk exposure and the impact on the Company's financial instruments are summarized below:

Fair value

The carrying values of cash, restricted cash, and accounts payable and accrued liabilities approximate their fair values due to the short-term maturity of these financial instruments.

Credit risk

Credit risk is the risk of potential loss to the Company if the counterparty to a financial instrument fails to meet its contractual obligations.

The Company's credit risk is primarily attributable to its cash and receivables. The Company manages exposure to credit risk on liquid financial assets through maintaining its cash with major Canadian financial institutions, for which management believes the risk of loss to be minimal.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in the market prices. Market risk is comprised of three types of risk: interest rate risk, foreign currency risk and other price risk.

(i) Interest rate risk

To the extent that payments made or received on the Company's monetary assets and liabilities are affected by changes in prevailing market interest rates, the Company is exposed to interest rate cash flow risk.

To the extent that changes in prevailing market interest rates differ from the interest rates in the Company's monetary assets and liabilities, the Company is exposed to interest rate price risk.

The Company's exposure to interest rate risk is minimal.

(ii) Foreign currency risk

The Company's principal asset is located in the United States. As at the date of this report, the majority of the Company's cash was held in Canadian dollars and was therefore subject to fluctuation against the United States dollar. Based on the balances as at January 31, 2012, if the US dollar had weakened (strengthened) against the Canadian dollar, with all other variables held constant, by 1%, the change to net loss would be approximately $1,000. There would be no effect on other comprehensive loss. The Company does not use derivatives or similar instruments to manage currency risk.

(iii) Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in the market prices, other than those arising from interest rate risk or foreign currency risk. The Company is not exposed to significant other price risk.

5. FINANCIAL INSTRUMENTS (Continued)

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in satisfying financial obligations as they become due. The Company manages liquidity risk through maintaining sufficient cash on hand to meet its obligations as they become due. As at January 31, 2012, the Company had cash of $2,590,292 and accounts payable and accrued liabilities of $167,113 due within three months of the period-end.

6. CAPITAL DISCLOSURES

The Company considers its capital under management to be shareholders' equity. The Company's capital management objectives are to ensure the Company continues as a going concern, as well as to maintain optimal returns to shareholders and benefits for other stakeholders. The Board of Directors does not establish quantitative criteria for management, but rather relies on management expertise to sustain future development. Management will adjust the capital structure as necessary to achieve the objectives.

The Company's capital management strategy has not changed from January 31, 2011. At January 31, 2012, the Company is not subject to any externally imposed capital requirements.

7. RELATED PARTY TRANSACTIONS

During the year, the Company:

(i) Paid or accrued $91,511 (2011 - $nil) for consulting fees, $19,989 (2011 - $nil) for project investigation costs, $20,025 (2011 - $nil) for business investigation costs to a director of the Company, and fees of $40,402 were included in oil & gas properties;

(ii) Paid or accrued $119,451 (2011 - $18,592) for legal fees and $54,902 (2011 - $nil) for share issue costs to a law firm of which the corporate secretary of the Company is a principal;

(iii) Paid or accrued $3,000 (2011 - $nil) for accounting fees to a firm where an officer of the Company is a partner; and

(iv) Paid or accrued $11,000 (2011 - $12,000) for accounting fees to a former officer of the Company.

Total compensation paid to key management personnel was $311,661 (2011: $12,000), which included short term benefits of $33,989 (2011: $12,000) and share-based payments of $277,672 (2011: nil). Share-based payments are the fair value of the options granted to directors and other key management personnel."

8. TRANSITION TO IFRS

The Company adopted IFRS on February 1, 2011 with a transition date of February 1, 2010. Under IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the IFRS are applied retrospectively at the transition date with all adjustments to assets and liabilities as stated under GAAP taken to deficit unless certain exemptions are applied.

The Company elected to take the following IFRS 1 transition elections and accounting policy choices:

Share-based payments

IFRS 1 allows a first-time adopter to not apply IFRS 2 *Share-based Payment* to share-based payments granted after November 7, 2002 that vested before the later of the date of transition to IFRS and January 1, 2005. The Company has elected not to apply IFRS 2 to awards that vested prior to February 1, 2010.

Under Canadian GAAP, amounts in contributed surplus relating to expired share-based payments remain there indefinitely. The Company has elected to change its accounting policy to transfer the value of the unexercised expired options to deficit as allowed under IFRS.

IFRS employs a conceptual framework that is similar to Canadian GAAP. The following represents the reconciliations from Canadian GAAP to IFRS for the respective periods noted for equity, earnings and comprehensive loss. The effects on the statements of cash flows would not have been material and, therefore, have not been presented.

(Expressed in Canadian Dollars)

8. TRANSITION TO IFRS (Continued)

The February 1, 2010 Canadian GAAP statement of financial position has been reconciled to IFRS as follows:

	February 1, 2010		
	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Current			
Cash	$ 290,796	$ -	$ 290,796
Receivables	-	-	-
	290,796	-	290,796
Long-Term			
Restricted cash	2,502,262	-	2,502,262
	$ 2,793,058	$ -	$ 2,793,058
Liabilities			
Current			
Accounts payable and accrued liabilities	$ 6,098	$ -	$ 6,098
Shareholders' Equity			
Capital stock	2,880,589	-	2,880,589
Reserves	87,950	(87,950)	-
Deficit	(181,579)	87,950	(93,629)
	2,786,960	-	2,786,960
	$ 2,793,058	$ -	$ 2,793,058

(Expressed in Canadian Dollars)

8. TRANSITION TO IFRS (Continued)

The January 31, 2011 Canadian GAAP statement of financial position has been reconciled to IFRS as follows:

	January 31, 2011		
	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Current			
Cash	$ 219,701	$ -	$ 219,701
Receivables	1,232	-	1,232
	220,933	-	220,933
Long-Term			
Restricted cash	2,523,771	-	2,523,771
	$ 2,744,704	$ -	$ 2,744,704
Liabilities			
Current			
Accounts payable and accrued liabilities	$ 18,953	$ -	$ 18,953
Shareholders' Equity			
Capital stock	2,880,589	-	2,880,589
Reserves	87,950	(87,950)	-
Deficit	(242,788)	87,950	(154,838)
	2,725,751	-	2,725,751
	$ 2,744,704	$ -	$ 2,744,704

(Expressed in Canadian Dollars)

8. TRANSITION TO IFRS (Continued)

The statement of operations and comprehensive loss under Canadian GAAP for the year ended January 31, 2011 has been reconciled to IFRS as follows:

	January 31, 2011		
	Canadian GAAP	Effect of transition to IFRS	IFRS
Expenses			
Administrative	$ 5,562	$ -	$ 5,562
Business investigation costs	14,828	-	14,828
Professional fees	44,362	-	44,362
Transfer agent and filing fees	17,966	-	17,966
Loss before other item	82,718	-	82,718
Other Item			
Interest income	(21,509)	-	(21,509)
Net Loss and Comprehensive Loss	$ 61,209	$ -	$ 61,209

9. INCOME TAXES

(i) Income tax expense differs from the amount that would be computed by applying the Canadian statutory income tax rate of 26.5% (2011 - 26.5%) to income before income taxes. The reasons for the differences are as follows:

	2012	**2011**
Loss before tax	$ (1,209,346)	$ (61,209)
Statutory income tax rate	26.50%	26.50%
Expected income tax	(320,477)	(16,220)
Share-based payments	73,583	-
Temporary differences	(25,297)	-
Unused tax loss not recognized in tax assets	272,191	15,303
Change in deferred income taxes resulting from enacted tax rate reduction	-	917
	$ -	$ -

(Expressed in Canadian Dollars)

9. INCOME TAXES (Continued)

(ii) The Company recognizes tax benefits on losses or other deductible amounts generated in countries where the probable criteria for the recognition of deferred tax assets has been met.

The Company's unrecognized deductible temporary differences include share issuance costs of $146,409 and unused tax losses for which no deferred tax asset is recognized of the following amounts and expiry dates:

2027	$	10,168
2028		29,809
2029		75,177
2030		120,644
2031		145,418
2032		792,571
	$	1,173,787

10. SUBSEQUENT EVENTS

Except as disclosed elsewhere in these consolidated financial statements, the Company had the following subsequent event:

In May 2012, the Company completed a non-brokered private placement and issued 10,000,000 shares at a price of $1.00 per share for aggregate gross proceeds of $10,000,000. No commissions or finders' fees were paid by the Company in respect of the private placement.