PACIFIC RUBIALES ENERGY CORP.

Annual Consolidated Financial Statements

For the year ended December 31, 2009
(In United States dollars)

Management's Responsibility for Financial Statements

Management is responsible for the integrity and objectivity of the information contained in this report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in this report. The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Company's financial position, results of operations and changes in financial position, within Canadian generally accepted accounting principles. 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 the financial information is reliable and accurate. 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 12, 2010

AUDITORS' REPORT

To the Shareholders of
Pacific Rubiales Energy Corp.

We have audited the consolidated balance sheets of **Pacific Rubiales Energy Corp.** as at December 31, 2009 and 2008 and the consolidated statements of operations, comprehensive income (loss) and retained earnings (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
March 12, 2010

PACIFIC RUBIALES ENERGY CORP.
Consolidated Balance Sheets
As at December 31,

(In thousands of U.S. dollars)	2009	2008
ASSETS		
Current		
Cash and cash equivalents	$ 398,849	$ 90,391
Restricted cash (note 17)	8,712	7,224
Accounts receivable (note 4)	134,968	70,491
Inventories (note 5)	38,996	13,873
Income tax receivable	5,116	-
Prepaid expenses	4,449	7,119
Future income tax (note 15)	2,693	1,119
	593,783	190,217
Property, plant and equipment (note 6)	1,991,425	1,907,504
Restricted cash (note 17)	2,059	11,441
Future income tax (note 15)	-	8,431
Investments and other assets (note 7)	74,758	120,771
Goodwill (note 3)	100,636	60,744
	$ 2,762,661	$ 2,299,108
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$ 180,153	$ 173,911
Risk management liability (note 18)	23,538	6,574
Income tax payable	2,685	19,482
Current portion of long-term debt (note 9)	13,128	18,392
Current portion of obligations under capital lease (note 10)	1,920	-
Future income tax (note 15)	846	1,144
	222,270	219,503
Long-term debt (note 9)	442,159	11,646
Obligations under capital lease (note 10)	38,521	-
Convertible debentures (note 11)	165,611	132,001
Risk management liability (note 18)	1,720	-
Future income tax (note 15)	382,625	420,502
Asset retirement obligation (note 8)	8,778	14,671
	1,261,684	798,323
Non-controlling interest (note 12)	-	1,270
SHAREHOLDERS' EQUITY		
Equity component of convertible debentures (note 11)	66,130	66,130
Common shares (note 13)	1,364,687	1,187,925
Contributed surplus (note 13)	136,934	158,660
Accumulated other comprehensive income (note 13)	229	229
(Deficit) retained earnings	(67,003)	86,571
	1,500,977	1,499,515
	$ 2,762,661	$ 2,299,108

See accompanying notes to the consolidated financial statements

On behalf of the Board:

Ronald Pantin (signed)

Jose Francisco Arata (signed)

PACIFIC RUBIALES ENERGY CORP.
Consolidated Statements of Operations, Comprehensive Income (Loss) and Retained Earnings (Deficit)
For the year ended December 31,

(In thousands of U.S. dollars, except share and per share amounts)	**2009**	**2008**
Revenues		
Net sales	$ 639,201	$ 579,064
Cost of operations		
Operating	293,992	253,240
(Underlift) overlift	(2,149)	12,272
Depletion, depreciation and amortization	196,138	104,671
	487,981	370,183
Earnings before undernoted	151,220	208,881
Expenses		
General and administrative	71,831	45,487
Stock-based compensation (note 13)	28,361	38,573
	100,192	84,060
Operating income	51,028	124,821
Other (expenses) income		
Foreign exchange (loss) gain	(65,372)	31,736
Income (loss) from equity investment (note 7)	1,657	(573)
Interest expense	(48,150)	(11,826)
Realized and unrealized loss on risk management contracts (note 18)	(21,525)	(6,574)
Other (expense) income	(25,160)	9,034
	(158,550)	21,797
Net (loss) income before non-controlling interest and income taxes	(107,522)	146,618
Income tax expense (note 15)		
Current	30,089	11,943
Future	15,963	57,040
	46,052	68,983
Non-controlling interest	-	937
Net (loss) income and comprehensive (loss) income	(153,574)	76,698
Retained earnings, beginning of year	86,571	9,873
(Deficit) retained earnings, end of year	$ (67,003)	$ 86,571
Net (loss) income per share (note 19)		
- Basic	$ (0.72)	$ 0.38
- Diluted	$ (0.72)	$ 0.36

See accompanying notes to the consolidated financial statements

PACIFIC RUBIALES ENERGY CORP.
Consolidated Statements of Cash Flows
For the year ended December 31,

(In thousands of U.S. dollars)	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$ (153,574)	$ 76,698
Items not affecting cash:		
Depletion, depreciation and amortization	196,138	104,671
Asset retirement obligation accretion (note 8)	1,701	698
Unrealized loss on risk management contracts (note 18)	18,684	6,574
Accretion expense on convertible debentures (note 11)	10,470	3,954
Non-cash interest expense on capital lease obligation	1,658	-
Stock-based compensation (note 13)	28,361	38,573
Future income tax (note 15)	15,963	57,040
Unrealized foreign exchange loss (gain)	62,331	(31,736)
Acquisition of non-controlling interest (note 3)	10,730	-
Other	5,643	1,510
Changes in non-cash working capital (note 16)	(87,468)	13,664
Net cash provided by operating activities	110,637	271,646
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to oil and gas properties and equipment	(392,675)	(280,838)
Acquisition of Pacific Stratus	-	
cash acquired less acquisition costs (note 3)	-	19,490
Acquisition of Kappa net of cash acquired (note 3)	(1,050)	(167,747)
Decrease (increase) in restricted cash	7,894	(4,735)
Reduction of capital (investment) in ODL Finance S.A. (note 7)	41,219	(105,323)
Acquisition of non-controlling interest (note 3)	(12,000)	-
Disposition (purchase) of other assets	6,451	(5,799)
Net cash used in investing activities	(350,161)	(544,952)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances from long-term debt	772,199	36,427
Repayment of debt	(346,117)	(39,484)
Proceeds from the exercise of warrants and options (note 13)	123,413	40,941
Issuance of convertible debt (note 11)	-	215,843
Net cash provided by financing activities	549,495	253,727
Effect of exchange rate changes on cash and cash equivalents	(1,513)	(30,538)
Change in cash and cash equivalents during the year	308,458	(50,117)
Cash and cash equivalents, beginning of the year	90,391	140,508
Cash and cash equivalents, end of the year	$ 398,849	$ 90,391
Cash and cash equivalents are comprised of:		
Cash	$ 288,344	$ 61,849
Short-term money market instruments	110,505	28,542
	$ 398,849	$ 90,391

Supplemental disclosure with respect to cash flows (note 16)

See accompanying notes to the consolidated financial statements

1. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Pacific Rubiales Energy Corp. (the "Company"), is a publicly traded oil and gas company engaged in the exploration, development and production of heavy crude oil and natural gas in Colombia and Peru.

These consolidated financial statements have been prepared in U.S dollars and are presented in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of the Company and its subsidiaries, from the date of acquisition, as at and for the years ended December 31, 2009 and 2008. Inter-company transactions and balances are eliminated upon consolidation.

a) Measurement uncertainty and use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the consolidated balance sheets as well as the reported amounts of revenues, expenses and cash flow during the periods presented. Such estimates relate primarily to unsettled transactions and events as of the date of the consolidated financial statements. Actual results could differ materially from estimated amounts.

Amounts recorded for depreciation, depletion, amortization and accretion costs and amounts used for impairment calculations are based on estimates of crude oil and natural gas reserves and commodity prices and capital costs required to develop those reserves. By their nature, reserves estimates and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

Inherent in the fair value calculation of the asset retirement obligation are assumptions and judgments which are subject to measurement uncertainty, including the inflation factor, the ultimate settlement amount, the credit-adjusted risk-free interest rate and the timing of settlement. To the extent future revisions to these assumptions impact the fair value of the existing asset retirement obligation, a corresponding adjustment is made to the oil and gas properties balance.

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

The measurement of the fair value allocation of the convertible debenture between its debt and equity components is based on estimated stock volatility and expected life of the equity component while the debt component is determined by deducting the amount of the equity component from the fair value of the convertible debenture as a whole upon issuance. These estimates are subject to measurement uncertainty.

b) 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.

c) Inventories

Oil and gas inventory and operating supplies are valued at the lower of average cost and net realizable value. Cost is determined using the weighted average basis. Cost consists of materials, 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 operating costs.

d) Property, plant and equipment

Oil and gas properties and equipment

The Company follows the full cost method of accounting for oil and gas operations whereby all costs incurred in connection with the acquisition, exploration for and development of oil and gas reserves, including certain overheads and dry-holes are capitalized and accumulated by cost centres on a country-by-

1. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)

country basis. Such amounts include land acquisition costs, geological and geophysical expenditures, cost of drilling both productive and non-productive wells, gathering production facilities and equipment, and overhead expenses directly related to exploration and development activities. The Company capitalizes carrying costs directly attributable to the acquisition, exploration, or development activities such as interest costs. The Company has two cost centres, which are Colombia and Peru. Costs related to operating and administrative activities during the development of large capital projects are capitalized until commercial production has commenced.

Capitalized oil and gas property costs are depleted using the unit-of-production method based on net proved reserves for each cost centre. Reserves and production are converted to equivalent units on the basis of 6 Mcf – 1 bbl, reflecting the approximate relative energy content. Costs subject to depletion include both the estimated costs required to develop proved undeveloped reserves and the associated addition to the asset retirement obligations. Costs of acquiring and evaluating significant unproved oil and gas properties are initially excluded from the depletion base. When it is determined that proved oil and gas reserves are attributable to such property, or the property is considered to be impaired, the cost of the property or the impairment is added to the depletion base.

The Company applies an impairment test to the net carrying value of oil and gas properties and equipment designed to ensure that such costs do not exceed the estimated amount ultimately recoverable. This amount is the aggregate of estimated undiscounted future net cash-flows from production of proved reserves and the cost of unproved oil and gas properties less impairments. Future cash-flows are estimated using future prices and costs without discounting. Should the net carrying value of oil and gas properties and equipment exceed the amount ultimately recoverable, the amount of the impairment is determined by deducting the discounted estimated future cash-flows from proved and probable reserves based on the future prices plus the cost of unproved properties, net of impairment allowances, from the carrying value of the related assets. Any reduction in the net carrying value, as a result of the impairment test, is included in depletion, depreciation and amortization expense.

Corporate and other

Corporate and other fixed assets are stated at cost, net of accumulated depreciation. Maintenance and repairs are charged to expense as incurred. When assets are retired or otherwise disposed of, the cost is removed from the asset account and the corresponding accumulated depreciation is removed from the related reserve account. Any gain or loss resulting from such retirement or disposal is charged to income for the year.

Depreciation is calculated using the straight-line method based on the estimated useful life of the assets. Office furniture and equipment is depreciated using a ten-year useful life, computer equipment is depreciated over a three-year period, vehicles are depreciated over five years and leasehold improvements are depreciated over the life of the lease. Assets under construction are not depreciated until construction has been completed and the related asset is placed into service.

An impairment loss is recognized when the carrying value of a long-lived asset is not recoverable. Testing for recoverability uses the undiscounted cash flows expected from the asset's use and disposition. To test for and measure impairment, long-lived assets are grouped at the lowest level for which identifiable cash flows are largely independent.

e) Investments

When the Company determines that it has significant influence in 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

1. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)

investment to ensure it does not exceed the higher of the present value of cash flows expected to be generated and the amount that could be realized by selling the investment. 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.

f) Goodwill

Goodwill represents the excess purchase price over the fair value of identifiable assets and liabilities acquired in business combinations. Goodwill is not amortized but is subject to annual impairment reviews on December 31 of each year, or more frequently as economic events dictate based on the fair value of the reporting units. The fair value of each reporting unit is determined and compared to the book value of the reporting unit. If the fair value of the reporting unit is less than the book value, then a second test is performed to determine the amount of the goodwill impairment. The amount of the impairment is determined by deducting the fair value of the reporting unit's individual assets and liabilities from the fair value of the reporting unit to determine the implied fair value of goodwill and comparing that amount to the book value of the reporting unit's goodwill. Any excess of the book value of goodwill over the implied fair value of goodwill is recorded as impairment in net income.

g) Asset retirement obligations

The Company recognizes the fair value of an asset retirement obligation in the period in which it is incurred and when a reasonable estimate of the fair value can be made. Asset retirement obligations are provided for estimated costs to abandon and reclaim the Company's net ownership interest in all wells and facilities and is capitalized as part of the cost of oil and gas properties and depleted on the same basis. The accumulated asset retirement obligation is adjusted for the passage of time, which is recognized in the consolidated statement of operations under general and administrative costs, and for revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Actual costs incurred upon settlement of the asset retirement obligation reduce the asset retirement obligation to the extent of the liability recorded. Any difference between the recorded asset retirement obligation and the actual retirement costs incurred is recorded as a gain or loss in the settlement period.

h) 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 equity component of the convertible debenture is valued using the Black-Scholes option pricing model. The debt component is determined by deducting the amount of the equity component from the fair value of the compound instrument as a whole. The debt component presented on the balance sheet 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 increased interest expense 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 balance sheet. 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.

i) Leases

Leases are classified as either capital or operating. Assets that are held by the Company under leases, which transfer to the Company substantially all the benefits and risks of ownership, are accounted for as assets acquired under capital leases. The capitalized lease obligations reflect the present value of future lease payments, discounted at an appropriate interest rate. Leases that are not classified as capital leases are accounted for as operating leases with payments included in operating expenses in the year incurred.

1. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)

j) Income taxes

The Company accounts for income taxes using the liability method. Under this method, the Company records a future income tax asset or liability to reflect any difference between the accounting and tax basis of assets and liabilities using the substantively enacted income tax rates in the respective jurisdictions that will be in effect when the difference are expected to reverse. The effect on the future tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the related legalisation is substantively enacted. Future income tax assets are only recognized to the extent that income tax asset will be realized. To the extent that the Company does not consider it more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess. Certain expenditures in oil and gas properties are eligible for an additional 40% special tax deduction which results in tax deductions being eligible to be claimed in excess of the cost of the expenditure. For these expenditures, the cost base of the expenditure is reduced by the recognition of a future tax asset associated with this additional deduction.

k) Joint operations

Substantially all of the Company's operations are conducted jointly with others and accordingly these consolidated financial statements reflect only the Company's proportionate interest in such activities.

l) Variable interest entity

The Company consolidates Transportadora del Meta S.A, a crude oil transportation service company which transports oil to the Company's customers. The Company does not own any shares in Transportadora del Meta S.A but is the primary beneficiary.

The Company has entered into an agreement with a third party to supply electricity for the Rubiales, Piriri, and Quifa fields up to June 2016. Under the agreement, the contractor was required to build, operate, maintain, and transfer to the Company the power generation plant. A variable interest entity Termorubiales Corp., unrelated to the Company, was set up to act as the power generation contractor. The Company has determined that it is not the primary beneficiary of Termorubiales Corp. The power generation contract has been accounted for as a capital lease (note 6 and note 10).

m) Financial instruments

The Company classifies all financial instruments into one of the following categories: held-to-maturity, available-for-sale, held for trading, loans and receivables, or other financial liabilities. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held for trading are measured at amortized cost using the effective interest rate method. Available for sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income, net of income tax, until sold or derecognized. Instruments classified as held for trading are measured at fair value with unrealized gains and losses recognized in consolidated statement of income.

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 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 oil collars.

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 we are 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,

1. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)

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.

Transaction costs are classified as part of the carrying value of long-term debt and amortized to income using the effective interest method over the life of the related debt. Transaction costs for acquiring or issuing other financial assets or liabilities are recognized to income.

The Company may utilize derivative financial instruments in its management of exposures to fluctuations in crude oil and natural gas prices, foreign exchange rates and interest rates. The Company does not enter into derivative financial instruments for trading or speculative purposes. For transactions where hedge accounting is applied, the Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Gains and losses on contracts that constitute effective cash flow hedges to the extent of the effective portion are deferred in other comprehensive income and recognized in income when the related transactions occur. The ineffective portion of a hedge is recognized in income in the period it occurs.

For transactions where hedge accounting is not applied, the Company accounts for such instruments using the fair value method by initially recording an asset or liability, and recognizing changes in the fair value of the instruments in net income as unrealized gains or losses on risk management contracts. Fair values of such instruments are determined from Level 1 inputs where available, such as quoted market prices of identical instruments, and Level 2 inputs including models and valuations utilizing observable market data. Any realized gains or losses are recognized in net income as realized gains or losses on risk management contracts in the period they occur.

n) Revenue recognition

The Company recognizes revenues on the sale of oil and gas when these are delivered and the title passes to the buyers and collection is reasonably assured.

Royalties on production represent the entitlement of the respective governments to a portion of the Company's share of oil and gas production and are recorded using rates in effect under the terms of contracts at the time of production. The Company records revenue net of royalties.

The Company employs the entitlement method in accounting when the share of production of a joint interest partner is above or below the proportionate interest. Under this method, oil produced and sold below or above the Company's working interest share, results in production underlifting, or overlifting. Underliftings are recorded as inventory at cost to produce the product and overliftings are recorded in accounts payable and accrued liabilities at the cost to purchase oil. Underliftings are reversed from inventory when the oil is lifted and sold, with the sales proceeds recorded as revenue and the cost of the inventory expensed. Overliftings are reversed from accounts payable and accrued liabilities and recorded as revenue when sufficient volumes are produced to make up the overlifted volume.

o) Foreign currency translation

Subsidiaries who maintain their accounting records in a currency other than the U.S. dollar translate their financial statements to U.S. dollars using the temporal method. Under this method, monetary assets and liabilities are translated into U.S. dollars at the balance sheet date exchange rate, while non-monetary assets and liabilities are translated into U.S. dollars at their historical rate. All non-US dollar transactions, including revenues, expenses, and gains or losses, are measured and recorded in U.S. dollars using the exchange rate in effect on the date of the transaction, except for depletion, depreciation and amortization expense which is translated at the same historical rates as the related asset. Exchange gains and losses arising from translation of non U.S. dollar amounts at the balance sheet date are recognized in income for the year.

1. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)

p) Earnings per share

The Company computes basic earnings per share using net income divided by the weighted-average number of the common shares outstanding. The Company computes diluted earnings per share using net income adjusted for interest expense on the convertible debentures and the impact of the potential dilution if the stock options, warrants and the convertible debt as if they 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.

On May 9, 2008 the Company consolidated its issued and outstanding common shares on a 1 for 6 basis by issuing one common share for every six common shares outstanding. All references in these consolidated financial statements to earnings per share, weighted average number of common shares outstanding, common shares issued and outstanding and authorized common shares have been adjusted to reflect the share consolidation.

q) Stock-based compensation

The Company accounts for stock-based compensation using the fair-value method of accounting for stock options granted to directors, officers, employees and consultants using the Black-Scholes option-pricing model. Stock-based compensation expense is recorded and reflected as stock-based compensation for options granted, with a corresponding amount reflected in contributed surplus. Stock-based compensation expense is calculated as the estimated fair value of stock-options at the time of the grant, amortized over their 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.

r) Cash and cash equivalents

Cash and cash equivalents include cash on deposit with banks and short-term investments with an original maturity, when acquired, of three months or less. Cash and cash equivalents are stated at cost, which approximates market value.

2. CHANGES IN ACCOUNTING POLICIES

New accounting changes

a) Financial Instruments - Disclosures

In May 2009, the CICA amended Section 3862, “Financial Instruments – Disclosures”, to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. These amendments are effective for the Company on December 31, 2009. The adoption of this standard does not impact the amounts reported in the Company’s consolidated balance sheets, statements of operations, comprehensive income (loss) and retained earnings (deficit), and statements of cash flows, as it relates to disclosure.

b) Goodwill and intangible assets

In February 2008, the CICA issued Section 3064, “Goodwill and Intangible Assets”, replacing Section 3062, “Goodwill and Other Intangible Assets” and Section 3450, “Research and Development Costs”. The changes are applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company has adopted the new standards for its fiscal year beginning January 1, 2009. The new standard establishes the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. This new guidance requires recognizing all goodwill and intangible assets in accordance with CICA Section 1000, “Financial Statement Concepts.” Section 3064 has eliminated the practice of recognizing items as assets that do not meet the Section 1000 definition and recognition criteria. Under this new guidance, fewer items meet the criteria for capitalization. The adoption of this standard had no significant impact on the Company’s consolidated financial statements.

2. CHANGES IN ACCOUNTING POLICIES (continued)

c) Credit Risk and Fair Value of Financial Assets and Liabilities

On January 1, 2009, the Company retrospectively adopted the CICA's EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This abstract provides guidance on how to take into account credit risk of an entity and its counterparty when determining the fair value of the financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not have a significant impact on the Company's consolidated financial statements as at December 31, 2009.

Future accounting changes

a) International Financial Reporting Standards – ("IFRS")

The Accounting Standards Board confirmed recently that public companies will be required to report under IFRS effective January 1, 2011. The Company is currently assessing the impact of adopting IFRS, including an examination of recognition, measurement and disclosure differences. The Company has performed an initial scoping process and will complete a transition plan in order to ensure successful implementation within the required time frame. Key information will be disclosed as it becomes available during the transition period.

b) Business Combinations/Consolidated Financial Statements/Non-Controlling Interests

In January 2009, the CICA issued Handbook Sections 1582, "Business Combinations" ("Section 1582"), 1601, "Consolidated Financial Statements" ("Section 1601") and 1602, "Non-controlling Interests" ("Section 1602"). Section 1582 replaces CICA Handbook Section 1581, "Business Combinations", and establishes standards for the accounting for business combinations that are equivalent to the business combination accounting standard under IFRS. Section 1582 is applicable prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011, with early adoption permitted. Section 1601 together with Section 1602 replaces CICA Handbook Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements and Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Sections 1601 and 1602 are applicable for interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011, with early adoption permitted. An entity must adopt Section 1582, 1601 or 1602 at the same time. The Company plans to adopt these standards effective January 1, 2010 and does not expect the adoption will have a material impact on the results of operations or financial position.

3. BUSINESS ACQUISITIONS

2009 acquisition

On February 11, 2009, the Company acquired for $12.0 million cash the remaining 34% of the outstanding shares of Pacific Rubiales Energy Trading S.A. ("PRET") that it did not own, increasing its ownership from 66% to 100%. The acquisition represented a settlement of a pre-existing relationship between the Company and PRET, and the consideration paid less non-controlling interest of $1.3 million was recognized as an expense in other (expense) income.

2008 acquisitions

Kappa

On September 3, 2008, the Company acquired all outstanding common shares of Kappa Energy Holdings Ltd. ("Kappa Acquisition"), an oil and gas exploration and production company, for $170.4 million cash and acquisition costs of $3.7 million (included was $1 million paid in 2009).

The above acquisition has been accounted for using the purchase method with the Company being identified as the acquirer and Kappa as the acquiree. Therefore the results of operations for Kappa commencing September 3, 2008 are included in the Company's results. The purchase price allocation was finalized in September 2009 and resulted in an adjustment to the preliminary purchase price allocation. The adjustment to the preliminary purchase price is attributable to the final valuation for the proved, probable, possible and exploration properties acquired in

3. BUSINESS ACQUISITIONS (continued)

the transaction. The final valuation for oil and gas properties was $240.6 million compared to $292.9 million previously estimated. Also included in this final valuation is goodwill of $36.6 million compared to previously estimated balance of nil. The difference from the preliminary estimate was due to the finalization of the fair market valuation including an independent valuation of reserves acquired.

Pacific Stratus

On January 23, 2008, the Company completed the acquisition of Pacific Stratus Energy Ltd. (the "Pacific Stratus Acquisition") through an amalgamation with a wholly-owned subsidiary of the Company. Consideration for the acquisition was the issuance of 79.3 million (475.5 million pre-consolidation) shares of the Company to Pacific Stratus Energy Ltd. ("Pacific Stratus") shareholders at a fair value of C$8.34 (C$1.39 pre-consolidation) per each share issued for a total amount of $648.9 million in exchange for all the shares of Pacific Stratus that were outstanding at closing, at a ratio of 9.5 pre-consolidation shares of the Company for every Pacific Stratus share. In addition 5.1 million (30.4 million pre-consolidation) Company warrants with a fair value of $28.5 million and 6.0 million (35.8 million pre-consolidation) Company incentive stock options with a fair value of $29.6 million were issued to existing Pacific Stratus warrant and option-holders upon closing based on the same exchange ratio. Acquisition costs amounted to $8.8 million.

The above acquisition has been accounted for using the purchase method with the Company being identified as the acquirer and Pacific Stratus as the acquiree. Therefore the results of operations for Pacific Stratus commencing January 23, 2008 are included in the Company's results. The purchase price allocation was finalized at December 31, 2008 and the fair value of the assets acquired and liabilities assumed are based on management's best estimate and an independent valuation. The adjustment to the preliminary purchase price is attributed to the final independent valuation of the proved, probable and exploration properties in the acquisition. The final valuation for oil and gas properties was $837 million compared to $913 million previously estimated. Also included in this final valuation is goodwill of $64 million compared to previously estimated balance of nil. The difference from the preliminary estimate was due to the finalization of the independent valuation of the fair market valuation of properties acquired.

Pursuant to the acquisition of La Creciente by Pacific Stratus in 2004 the Company issued 538,334 common shares to the sellers of the La Creciente properties upon achieving certain cash flow targets. In March 2009 these targets were met, accordingly a liability of $3.3 million to recognize the issuance of the common shares was recorded with a corresponding increase to goodwill.

A summary of the purchase price allocations for the acquisitions is found in the following table:

	2008 Acquisitions		
	Kappa	Pacific Stratus	Total
Purchase price:			
Cash	$ 170,399	$ -	$ 170,399
Accounts payable	-	-	-
Common shares, warrants and stock options	-	707,041	707,041
Acquisition costs	3,747	8,780	12,527
	$ 174,146	$ 715,821	$ 889,967
Net assets acquired:			
Cash	$ 5,349	$ 28,270	$ 33,619
Non-cash working capital deficiency	(27,676)	(24,838)	(52,514)
Oil and gas properties	240,611	836,568	1,077,179
Goodwill	36,630	64,006	100,636
Restricted cash	-	13,930	13,930
Investments	471	3,919	4,390
Asset retirement obligation	(566)	(3,497)	(4,063)
Long-term debt	(10,000)	-	(10,000)
Future income tax liability	(70,673)	(202,537)	(273,210)
	$ 174,146	$ 715,821	$ 889,967

3. BUSINESS ACQUISITIONS (continued)

Goodwill

A summary of the changes in the carrying amount of the Company's goodwill is provided in the table below:

	2009	2008
Balance at January 1	$ 60,744	$ -
Pacific Stratus Acquisition	-	60,744
Final payment for Pacific Stratus Acquisition	3,262	-
Final purchase price allocation for Kappa Acquisition	36,630	-
Balance at December 31	$ 100,636	$ 60,744

4. ACCOUNTS RECEIVABLE

	2009	2008
Trade (note 18)	$ 60,529	$ 17,195
VAT and withholding taxes recoverable	46,988	37,866
Advances and deposits	21,340	6,914
Others	7,336	8,721
Allowance for doubtful accounts	(1,225)	(205)
	$ 134,968	$ 70,491

5. INVENTORIES

Inventory is comprised of crude oil held in storage at the Company's facilities and in trucks not yet delivered to customers, and operating supplies.

	2009	2008
Crude oil and gas	$ 34,869	$ 4,658
Materials and supplies	4,127	9,215
	$ 38,996	$ 13,873

Inventory included in cost of operations as operating cost was $257,098 (2008 - $212,847).

6. PROPERTY, PLANT AND EQUIPMENT

	December 31, 2009		
	Cost	Accumulated DD & A	Net Book Value
Oil and gas properties and equipment	$ 2,251,675	$ 309,725	$ 1,941,950
Corporate and other	20,393	8,092	12,301
Power generation unit under capital lease	38,783	1,609	37,174
	$ 2,310,851	$ 319,426	$ 1,991,425

	December 31, 2008		
	Cost	Accumulated DD & A	Net Book Value
Oil and gas properties and equipment	$ 2,011,069	$ 121,790	$ 1,889,279
Corporate and other	19,723	1,498	18,225
	$ 2,030,792	$ 123,288	$ 1,907,504

6. PROPERTY, PLANT AND EQUIPMENT (continued)

$1.1 billion (December 31, 2008 - $1.4 billion) in future capital expenditures has been included in the calculation of depletion, depreciation and amortization. The Company has capitalized interest of $2.9 million (December 31, 2008 - $nil) related to financing on acquisition of oil and gas properties. The cost of oil and gas properties and equipment was reduced by the tax benefit of $56.7 million (2008 - $10.4 million) arising from the 40% special tax deduction on qualified expenditures in Colombia.

During 2009 the Company entered into a power generation arrangement to supply electricity for three of its oil fields in Colombia. The arrangement is accounted for as a capital lease. Under this accounting treatment, the Company has recorded its proportionate share of the leased asset and obligation. The asset is amortized using the unit of production method over the term of the lease. Amortization expense of $1.6 million (December 31, 2008 - $ nil) related to the leased property is charged to depletion, depreciation and amortization.

Included in oil and gas properties and equipment is $191,438 (2008 – $404,843) of unproved properties that were excluded from depletion, depreciation and amortization calculation.

A recoverable amount calculation was performed at December 31, 2009 in which the estimated undiscounted future net cash flows associated with the proved reserves exceeded the carrying amounts. The benchmark prices used to determine the estimated undiscounted future net cash flows for the years from 2010 to 2017 are outlined in the following table:

Year	WTI Crude Oil - $/bbl	Gas - $/MMCF
2010	78.00	6.00
2011	85.00	6.50
2012	95.00	6.75
2013	86.00	7.00
2014	87.72	7.14
Thereafter	2% escalation	2% escalation

Prices above are West Texas Intermediate (WTI) and were taken from the New York Mercantile Exchange (NYMEX) based on the average of the monthly futures prices. Actual prices used in the impairment tests were adjusted for price differentials specific to the Company's operations.

7. INVESTMENTS AND OTHER ASSETS

The investments and other assets consist of the following:

	ODL (1)	Ronter (2)	Other	Total
As at January 1, 2007	$ -	$ -	$ 977	$ 977
Investments and other assets acquired	105,323	9,000	6,044	120,367
Loss from investment	-	(573)	-	(573)
As at December 31, 2008	$ 105,323	$ 8,427	$ 7,021	$ 120,771
Reduction of capital in ODL	(41,219)	-	-	(41,219)
Disposition of other assets	-	-	(6,451)	(6,451)
Income from equity investment	141	1,516	-	1,657
As at December 31, 2009	$ 64,245	$ 9,943	$ 570	$ 74,758

(1) The investment represents a 35% interest in ODL Finance S.A. ("ODL"), a special purpose Panamanian company with a Colombian branch that has constructed an oil pipeline for the transportation of heavy crude oil produced out of the Rubiales field. The remaining 65% interest is owned by Ecopetrol S.A., the national oil company of Colombia. The investment is accounted for using the equity method and the Company's share of net income is included as income (loss) from equity investment. The Company's investment in ODL was reduced by $14.2 million and $27 million in February and November of 2009 respectively through returns of capital approved by the ODL board of directors.

7. INVESTMENTS AND OTHER ASSETS (continued)

On March 12, 2009, ODL completed a debt facility for approximately $200 million, equivalent to COP520,000,000. The loan is provided by Grupo Aval, a Colombian banking group led by Banco de Bogota. The facility has an interest rate of DTF (Colombia base for fixed rate deposits over three months) + 5%, a maturity of five years with a one year grace period and blended quarterly payments. The loan is non-recourse to the sponsors. The second tranche of financing was closed on October 2009. This second tranche included a structured debt instrument of $260 million issued in the Colombian capital market. This is a seven years debt instrument with a coupon of IPC + 4.88% (IPC = Official Colombian Consumer Price Index).

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 $452.3 million over a seven-year period.

(2) The investment in Ronter Inc. represents a 21.7% 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. This investment is accounted for using the equity method and the Company's share of Proelectrica's net income or loss is included as income (loss) from equity investment.

8. ASSET RETIREMENT OBLIGATION

The amount required to settle the future asset retirement obligation was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim those wells and facilities and estimated timing of the costs to be incurred in future periods. The Company has estimated its total asset retirement obligations to be $8.8 million (2008 - $14.7 million) based on a total undiscounted future liability of $39.4 million (2008 - $53.9 million), and annual inflation rates ranging from 3.2% to 6.0% until the time the liability is settled. The obligation is expected to be settled at the end of the useful lives of the underlying assets determined by the expiration date on concession agreements which is expected to be incurred subsequent to 2016. The obligation has been discounted using credit adjusted risk free interest rates ranging from 12% to 15% (2008 – 15%).

Changes to the asset retirement obligation during the year were:

	2009	2008
Balance, January 1	$ 14,671	$ 1,498
Assumed on the Pacific Stratus Acquisition	-	3,497
Assumed on the Kappa Acquisition (1)	(480)	1,046
Obligations incurred during the year	201	7,932
Revisions to estimated cash flows and timing	(7,315)	-
Accretion expense	1,701	698
Balance, December 31	$ 8,778	$ 14,671

(1) Adjustment in 2009 resulting from the finalization of the purchase price allocation.

9. LONG-TERM DEBT

	Maturity	Currency	Interest Rate	December 31, 2009	December 31, 2008
Bank overdrafts				$ -	$ 212
Bilateral Credit Facility	April 23, 2010 (1)	COP	DTF + 3.5 (2)	-	6,583
Promissory note (3)	March 10, 2009	COP	DTF + 3.5 (2)	-	319
Promissory note (3)	April 3, 2009	COP	17.32%	-	2,227
Promissory note (3)	June 4, 2009	COP	16.50%	-	10,697
Promissory note (4)	October 15, 2012	USD	Libor +3.0%	-	10,000
Promissory note (3)	September, 2010	COP	10.48%	1,205	-
Promissory note (3)	December 24, 2010	COP	10.00%	7,338	-
Promissory note (3)	November 30, 2010	COP	9.70%	3,812	-
Promissory note (3)	March 30, 2010	COP	9.70%	773	-
Senior notes	(5)	USD	8.75%	442,159	-
				$ 455,287	$ 30,038
Current portion				$ 13,128	$ 18,392
Long-term debt				442,159	11,646
				$ 455,287	$ 30,038
Convertible debenture (note 11)				165,611	132,001
				$ 620,898	$ 162,039

(1) Subject to the bank's right to demand payment
(2) DTF = fixed- term-deposit rate in Colombia
(3) Unsecured, repayable in equal monthly instalments
(4) Secured by up to 51% of the common shares of Kappa Resources Colombia Limited.
Interest is paid semi-annually on April 15 and October 15
(5) November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%)

On November 10, 2009, the Company completed a senior notes offering with an aggregate principal amount of $450 million and maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%). The interest rate on the notes is 8.75%, payable on May 10 and November 10 of each year, beginning on May 10, 2010. 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 notes are senior unsecured and will rank equal in right of payment with all of the Company's existing and future senior unsecured debt. The notes are on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. As a condition of closing, the proceeds from the offering were used to repay the outstanding amount under the $250 million revolving credit facility. The senior notes are carried at amortized cost using the effective interest rate method with note discount and transaction costs of $13.3 million (2008 - $nil) netted against the principal of the revolving credit facility.

On May 5, 2009, the Company completed a syndicated $250 million extendible revolving credit facility with a stated term date of June 30, 2013. The revolving credit facility was secured by a first floating charge over the Company's reserve base and its assets. The facility was available on a revolving basis for a period of 24 months. Under the terms of the revolving credit facility, the Company was required to maintain (1) a debt to EBITDA ratio of less than 3.5; (2) a guaranteed debt to EBITDA ratio of less than 2.5; (3) current ratio of greater than 1.0; (4) a reserve tail ratio, which is defined as net present value of proved reserve divided by total debt, of less than 1.4; and (5) at least $5 million in cash or banking commitments. The facility was repaid and cancelled during the year resulting in transaction cost of $12.4 million recorded in net income as other expense.

The Company also has a non-revolving bilateral credit facility for up to $18.7 million. Subject to the bank's right to demand payment, the repayment terms are monthly repayments of principal and interest maturing on April 23, 2010. Under the terms of the non-revolving bilateral credit facility, the Company is required to maintain a debt to cash flow ratio of less than 3.5. As of December 31, 2009, the amount outstanding on the facility was nil (2008 - $6.6 million). The Company was fully compliant with this financial covenant at December 31, 2009. The non-revolving bilateral credit facility is unsecured.

9. LONG-TERM DEBT (continued)

The contractual aggregate repayment of the long-term debt is as follows:

		Amount
2010	$	13,128
2011		-
2012		-
2013		228,159
2014 and after		450,000
	$	691,287

10. OBLIGATIONS UNDER CAPITAL LEASE

The Company has entered into a power generation arrangement to supply electricity for three of its oil fields in Colombia from August 2009 to June 2016. The arrangement has been accounted for as a capital lease with an effective interest rate of 18.9%. Under this arrangement, the Company's proportionate share of annual minimum lease payments is as follows:

		Minimum lease payment
2010	$	9,524
2011		11,306
2012		11,337
2013		11,306
2014		11,306
Thereafter		16,944
Total minimum lease payments	$	71,723
Amounts representing interest		(31,282)
Present value of net minimum lease payments		40,441
Less current portion		(1,920)
Long-term portion of obligations under capital lease	$	38,521

Interest expense of $3.1 million (2008 – $nil) was incurred on the capital leases.

11. CONVERTIBLE DEBENTURES

On August 28, 2008, the Company issued $228.2 million (C$240 million) of convertible unsecured subordinated debentures due August 29, 2013 and convertible into common shares of the Company at C$13 per share. The debentures bear interest at 8% annually and are payable semi-annually in arrears on June 30 and December 31.

The debentures have been classified into their debt and equity components. The fair value of the equity component was valued using the Black-Scholes option pricing model using the a risk free rate of 3.65%, no dividends paid, expected life of 5 years and an expected volatility of 50% with the residual of the cash received allocated to the debt component. As a result, on the issuance of the debentures, $149.7 million (net of $8.5 million issuance costs) was classified as the debt component and $66.1 million (net of $3.8 issuance costs) was classified as the equity component. The debt component will accrete 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%.

		Amount
Gross proceeds due on maturity (C$240 million)	$	228,159
Costs		12,316
	$	215,843
Fair value of equity component (net of $3,773 issuance costs)		66,130
Value attributed to liability component on issuance (net of $8,543 issuance costs)		149,713
Accretion expense		3,954
Foreign exchange gain upon conversion to US$		(21,666)
Balance as at December 31, 2008	$	132,001
Accretion expense		10,470
Foreign exchange loss upon conversion to US$		23,140
Balance as at December 31, 2009	$	165,611

12. NON-CONTROLLING INTEREST

Up until February 11, 2009, the Company had a 66% controlling interest in PRET. On February 11, 2009, the Company acquired the remaining 34% of PRET (note 3). PRET's earnings are reflected in the Company's net income and adjusted to reflect the portion attributable to the non-controlling interest in 2008.

13. SHARE CAPITAL

(a) Authorized, issued and fully paid common shares

Unlimited number of common shares with no par value.

Continuity schedule of share capital and contributed surplus:

	Number of Shares	Share Capital	Contributed surplus	Accumulated Comprehensive Income
Balance, January 1, 2008	118,993,149	$ 453,321	$ 106,710	$ 229
Issued on the Pacific Stratus Acquisition				
- Common shares issued	79,251,491	648,901	-	-
- Warrants and options issued	-	-	58,139	-
Issued on the exercise of warrants	8,833,254	45,198	(24,540)	-
Issued on the exercise of options	3,488,446	40,505	(20,222)	-
Stock-based compensation	-	-	38,573	-
Balance, December 31, 2008	210,566,340	$ 1,187,925	$ 158,660	$ 229
Issued on Pacific Stratus Acquisition	538,334	3,262	-	-
Issued on the exercise of warrants	16,893,209	133,520	(36,663)	-
Issued on the exercise of options	4,906,889	39,980	(13,424)	-
Stock-based compensation	-	-	28,361	-
Balance, December 31, 2009	232,904,772	$ 1,364,687	$ 136,934	$ 229

On May 9, 2008 the Company consolidated its issued and outstanding common shares on a 1:6 basis by issuing one common share for every six common shares outstanding. All references in these consolidated financial statements to earnings per share, weighted average number of common shares outstanding, common shares issued and outstanding and authorized common shares have been adjusted to reflect the share consolidation.

On January 23, 2008, pursuant to the Pacific Stratus Acquisition (note 3), the Company issued 79,251,491 shares at a fair value of C$8.34 per share for all Pacific Stratus' shares held at closing of the transaction on January 23, 2008, pursuant to an exchange ratio of 9.5 pre-consolidation shares of the Company for every Pacific Stratus share. Pursuant to the acquisition of La Creciente by Pacific Stratus in 2004, the Company was required to issue a further 538,334 common shares to one of the sellers of the La Creciente properties as settlement for achieving certain cash flow targets. These shares were issued on April 16, 2009.

(b) Stock options

The Company has established a "rolling" Stock Option Plan (the "Plan") in compliance with the 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 TSX Policy) of the Company's stock at the date of grant.

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

13. SHARE CAPITAL (continued)

	Outstanding	Weighted average exercise price
Balance, January 1, 2008	2,357,500	C$ 6.06
Granted during the year	14,907,944	C$ 6.54
Granted on the Pacific Stratus Acquisition	5,970,750	C$ 4.26
Exercised during the year	(3,488,446)	C$ 5.74
Balance, December 31, 2008	19,747,748	C$ 5.94
Granted during the year	4,596,500	C$ 12.81
Cancelled during the period	(214,228)	C$ 5.70
Exercised during the year	(4,906,889)	C$ 5.88
Balance, December 31, 2009	19,223,131	C$ 7.60

The following table summarizes information about the stock options outstanding and exercisable (2008 - 19,747,748):

Outstanding & Exercisable	Exercise price	Expiry date	Remaining contractual life
227,426	C$ 1.92	May 2, 2010	0.3
10,075	C$ 1.92	October 16, 2011	1.8
1,757,502	C$ 2.22	August 21, 2011	1.6
25,000	C$2.79	February 11, 2014	4.1
2,923,570	C$ 4.70	October 23, 2013	3.8
293,335	C$ 5.70	May 9, 2017	7.4
781,669	C$ 6.30	July 10, 2017	7.5
1,114,460	C$ 6.78	April 20, 2012	2.3
7,802,760	C$ 7.38	February 11, 2013	3.1
6,251	C$ 8.46	May 3, 2012	2.3
9,583	C$ 8.46	April 16, 2013	3.3
15,000	C$ 10.86	July 30, 2014	4.6
4,185,000	C$ 13.09	October 12, 2014	4.8
71,500	C$ 14.31	October 12, 2014	4.8
19,223,131	C$ 7.60		3.7

The following stock options with a 5 year life were granted to employees, directors, consultants and institutions during the years ended 2009 and 2008:

Stock options granted in 2009

Date of stock option grant	Granted	Exercise price	Fair value
February 11, 2009	50,000	C$2.79	C$1.59
April 14, 2009	100,000	C$5.72	C$3.00
July 30, 2009	65,000	C$10.86	C$5.86
October 12, 2009	4,310,000	C$13.09	C$6.60
November 9, 2009	71,500	C$14.31	C$6.77
	4,596,500	C$12.81	C$6.46

13. SHARE CAPITAL (continued)

Stock options granted in 2008

Date of stock option grant	Granted	Exercise price	Fair value
January 23, 2008	5,970,750	C$4.26	C$5.04
February 11, 2008	10,202,498	C$7.38	C$3.05
April 9, 2008	9,583	C$8.46	C$3.60
October 23, 2008	4,695,863	C$4.70	C$1.77
	20,878,694	C$5.89	C$3.33

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

	2009	2008
Risk-free interest rate:	1.31% - 1.39%	2.63% - 3.84%
Expected life:	2.5 years	2.5 years
Weighted expected volatility:	80%	50% - 67%
Expected dividend yield:	0	0

On July 4, 2008 the Company waived the vesting period on 435,070 options which had vesting periods and as a result 435,070 options became exercisable. The unamortized value of the options of $0.3 million was expensed at the date of modification.

(c) Warrants

Each warrant outstanding is exercisable into one common share.

The following table summarizes information about the warrants outstanding and exercisable at December 31, 2009:

Outstanding & exercisable	Exercise price	Expiry date
27,910,343	C$ 7.80	July 12, 2012

A summary of the changes in warrants is presented below:

	Outstanding & exercisable	Weighted average exercise price
Balance, January 1, 2008	48,479,098	C$ 7.26
Issued on the Pacific Stratus Acquisition	5,157,708	C$ 2.52
Exercised during the year	(8,833,254)	C$ 2.39
Balance, December 31, 2008	44,803,552	C$7.72
Exercised during the year	(16,893,209)	C$7.59
Balance, December 31, 2009	27,910,343	C$7.80

2009

On December 14, 2009, the Company's proposed offer of a cash payment of C$1.50 per warrant as an incentive for holders of the warrants to exercise their warrants during an early exercise period was approved by shareholders and warrantholders. The period commenced on December 14, 2009 and expired January 20, 2010. Warrantholders were able to exercise their warrants within this period to acquire one common share of the Company per warrant at an exercise price of C$6.30 instead of the C$7.80 exercise price. As of December 31, 2009, 16,361,293 warrants had been exchanged for common shares under the early exercise program.

13. SHARE CAPITAL (continued)

2008

On January 23, 2008, with the Pacific Stratus Acquisition, 5.2 million warrants with a fair value of C$5.64 were issued to Pacific Stratus warrant holders upon closing in exchange for Pacific Stratus warrants outstanding at the date of acquisition. The fair value of the options was capitalized as part of the purchase price.

The fair value of the warrants issued during the year ended December 31, 2008 has been calculated using the Black-Scholes pricing model, based on the following assumptions:

Risk-free interest rate:	3.84%
Expected life:	0.5 years
Expected volatility:	69%
Expected dividend yield:	Nil

14. CAPITAL DISCLOSURES

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. The Company considers its capital structure to include shareholders' equity, debt, convertible debt and working capital. 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 GAAP 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; however the Company's debt is subject to the financial covenants details in note 9. The Company was fully compliant with the covenants throughout 2008 and 2009.

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

	2009	2008
Shareholders' equity	$ 1,500,977	$ 1,499,515
Long-term debt	455,287	30,038
Convertible debt	165,611	132,001
Working capital (surplus) deficit	(384,641)	10,894
	1,737,234	$ 1,672,448

15. INCOME TAXES

The provision for income taxes differs from the amount that would have been expected by applying expected statutory corporate income tax rates to income before income taxes and non-controlling interests. The principal reasons for this difference are as follows:

15. INCOME TAXES (continued)

Years ended December 31,		2009		2008
(Loss) income before income taxes and non-controlling interests	$	(107,522)	$	146,618
Canadian statutory income tax rate		33.00%		33.50%
Income tax (recovery) expense at statutory rate	$	(35,482)	$	49,117
Increase (decrease) in income tax provision resulting from:				
Non-deductible expenses	$	10,927	$	4,056
Effect of foreign exchange not taxable or deductible		30,111		(4,990)
Losses of foreign jurisdictions		15,257		-
Non-deductible unrealized risk management loss		6,166		(2,022)
Recovery of prior period non-deductible exppenses		(2,084)		-
Stock-based compensation		9,378		12,729
Differences in tax rates in foreign jurisdictions		93		(932)
Non-capital losses for which no tax benefit is removed		11,074		4,705
Others		612		2,276
Income tax expense	$	46,052	$	64,939
Current income tax expense		30,089		11,943
Future income tax expense		15,963		57,040
Income tax expense	$	46,052	$	68,983

Based on Colombian tax reforms enacted on December 27, 2006, tax losses may be carried forward without limitations to offset to taxable income; the presumptive income tax rate was reduced from six percent to three percent on the prior tax year's net equity tax; the seven percent remittance tax was eliminated; a 1.2 percent equity tax was introduced, the income tax rate was reduced from 38.5 percent to 34 percent in 2007, and to 33 percent for subsequent years; and the special deduction for the acquisition or construction of real fixed assets was reduced from 40 percent to 30 percent starting 2010 onwards.

The components of the Company's future income tax assets and liabilities arising from temporary differences are as follows:

Years ended December 31,		2009		2008
Future income tax assets:				
Tax loss carry forwards	$	21,042	$	16,651
Share/debt issue costs		4,382		7,141
Valuation allowance		(22,731)		(19,971)
Other		-		5,729
	$	2,693	$	9,550
Current		2,693		1,119
Non-current		-		8,431
	$	2,693	$	9,550
Future income tax liabilties:				
Oil and gas properties and equipment	$	373,513	$	421,646
Income not currently taxable	$	8,158	$	-
Other		1,800		-
	$	383,471	$	421,646
Current		846		1,144
Non-current		382,625		420,502
	$	383,471	$	421,646

15. INCOME TAXES (continued)

As at December 31, 2009 non-capital losses totalled $72 million (2008 - $19.6 million) in Canada and expire between 2010 and 2029. In Colombia, non-capital losses totalled $8.2 million (2008 – $11.6 million) and expire between 2010 and 2012.

16. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Changes in non-cash working capital items for the year ended:

	2009	2008
Increase in accounts receivable	$ (64,477)	$ (28,188)
(Increase) decrease in income taxes receivable	(5,116)	-
Increase in accounts payable and accrued liabilities	12,054	15,839
(Increase) decrease in inventory	(15,802)	10,808
(Decrease) increase in income taxes payable	(16,797)	16,120
Increase (decrease) in prepaid expenses and other	2,670	(915)
	$ (87,468)	$ 13,664

The significant non-cash investing transaction for the year ended December 31, 2009 included the issuance of 538,334 common shares at a fair value of C$6.06 per share as settlement of a contingent consideration on acquisition of La Creciente by Pacific Stratus in 2004.

The significant non-cash investing and financing transactions for the year ended December 31, 2008 consisted of the Company issuing 79,251,490 common shares at a fair value of C$8.34 per share, 6.0 million stock options with a fair value of C$5.04 and 5.0 million warrants with a fair value of C$5.64 for a total of $707 million, pursuant to the Pacific Stratus acquisition.

Other cash flow information:

	2009	2008
Cash income taxes paid	28,539	7,423
Cash interest paid	29,189	3,359
Cash interest received	1,599	3,707

17. CONTINGENCIES AND COMMITMENTS

Estimated future minimum commitments

	2010	2011	2012	2013	2014	subsequent to 2014	Total
Operating leases	$ 1,486	$ 40	$ -	$ -	$ -	$ -	$ 1,526
Transportation and processing commitments	62,062	61,949	61,949	61,949	61,949	169,646	479,504
Minimum work commitments	120,737	35,771	13,598	-	-	-	170,106
Abandonment obligations	2,331	1,180	393	106	2,402	32,758	39,170
Repayment of debt and convertible debenture	13,128	-	-	228,159	149,985	300,015	691,287
BOMT contract (power generation unit)	9,524	11,306	11,337	11,306	11,306	16,944	71,723
Total	$209,268	$110,246	$ 87,277	$ 301,520	$ 225,642	$ 519,363	$1,453,316

The Company has various guarantees in place in the ordinary course of business.

The Company has issued letters of credit and guarantees for exploration and operational commitments for a total of $110.3 million (2008 - $38.6 million) of which $10.8 million (2008-$18.7 million) are secured by restricted cash.

17. CONTINGENCIES AND COMMITMENTS (continued)

Association contracts

Certain association contracts signed before 2003 with Ecopetrol include a clause in which at any time Ecopetrol may commence participating in the operation of the new discovery made by the Company, without prejudice to the Associate'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, then the Associate shall have the right to be reimbursed 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.

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 favor. 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 60 MMBTU per day for the period 2010-2011:

		2010		2011	
		Quantity	Price	Quantity	Price
Client	*Contract*	(MMBTUD)	($/MMBTU)	(MMBTUD)	($/MMBTU)
GECELCA	Take or pay	34,807	PMR + 34%	34,807	PMR + 34 %
GECELCA	Take or pay	10,193	PMR + 7.5%	10,193	PMR + 7.5 %
PROELÉCTRICA	OCG	14,000	PMR + 38%	14,000	PMR
Interruptible supply		1,000	PMR	1,000	PMR
Total		60,000	PMR + 30%	60,000	PMR + 21%

PMR represents the Colombian Regulated Market Price.

The Company anticipates having sufficient production to meet all future delivery commitments.

18. FINANCIAL RISK MANAGEMENT

The nature of the oil and natural gas operations and the issuance of debt expose the Company to fluctuations in commodity prices, foreign currency exchange rates and interest rates. The Company manages these risks through periodic use of derivative instruments. The Board of Directors periodically reviews the results of all risk management activities and all outstanding positions.

Credit Risk

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 (2008 – one) of the Company's customers had accounts receivable that were greater than 10% of total trade accounts receivable. The Company's credit exposure in accounts receivable to these customers was $30.9 and $10.5 million or 50% and 17% of trade accounts receivable, respectively (2008 – one customer, with accounts receivable of $12.7 million or 75%). Revenue from these customers were $65.5 and $17.5 million or 10.2% and 2.7% of net revenue, respectively (2008 - $45.7 million or 7.9%).

The Company's trade accounts receivables are aged as follows:

	2009	2008
Not past due (less than 45 days)	$ 33,888	$ 17,190
Past due (0-30 days)	26,641	5
Past due (31-120 days)	-	-
Past due (over 120 days)	-	-
Allowance for doubtful accounts	(1,225)	(205)
Total trade accounts receivable	59,304	16,990

Interest Rate Risk

The Company is exposed to interest rate risk on its outstanding borrowings and short-term investments. The Company monitors its ongoing exposure to interest rates. The Company is exposed to interest rate price risk on fixed interest rate bank debt and debentures. As at year end, a 1% hypothetical change in the market interest rate would increase/decrease net income by $3.6 million (2008 - $0.1 million) on its fixed-interest-rate bank debt and debentures. The remainder of the Company's financial assets and liabilities are not exposed to interest rate risk.

Foreign Currency Exchange Risk

The Company is exposed to foreign currency fluctuations as certain expenditures are incurred in Colombian pesos (COP) and Canadian dollars.

In addition, as of December 31, 2009, the Company has recorded COP845.2 billion, or $413.5 million of future income tax liabilities on proved and unproved properties arising from the Rubiales, Pacific Stratus, and Kappa acquisitions in 2007 and 2008, respectively (2008 – COP926.1 billion, or $390.9 million). The future income tax liabilities are denominated in Colombian Pesos as the assets to which the future income tax liabilities relate to are in Colombia. The future income tax liabilities are monetary items, which are revalued each period end at the current exchange rates, with the gain or loss recorded in net income as unrealized foreign gain (loss) in the period. Based on the net exposure and foreign exchange rates at December 31, 2009, a 10% depreciation or appreciation of the Colombian Peso against the US dollar would result in a $41.4 million (2008 - $45 million) increase or decrease in the Company's after-tax net earnings.

The Company has convertible debentures outstanding with a face amount of C$240 million. The debentures have been classified into debt and equity components, with the debt component being revalued each period end at the current exchange rates and the gain or loss recorded in net earnings. Based on the debt balance and foreign exchange rates as of December 31, 2009, a 10% depreciation or appreciation of the Canadian dollar against the US dollar would result in a $16.5 million (2008 - $13.2 million) increase or decrease in the Company's after-tax net earnings.

18. FINANCIAL RISK MANAGEMENT (continued)

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 processes for managing liquidity risk include 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.

The following are the contractual maturities of financial liabilities:

Financial liability	2010	2011	2012	2013	2014	Subsequent to 2014	Total
Accounts payable and accrued liabilites	$ 180,153	$ -	$ -	$ -	$ -	$ -	$ 180,153
Long-term debt and bank indebtedness	13,128	-	-	-	149,985	300,015	463,128
Convertible debentures - principal (1)	-	-	-	228,354	-	-	228,354
Obligations under capital lease (2)	9,524	11,306	11,337	11,306	11,306	16,944	71,723
Total	$ 202,805	$ 11,306	$ 11,337	$ 239,660	$ 161,291	$ 316,959	$ 943,358

(1) The convertible debentures are due August 29, 2013 in the principal amount of C$240 million. The balance due is converted to US$ using the exchange rate of 1.0510 on December 31, 2009.

(2) Obligations arising from the power generation arrangement to supply electricity to the Company from August 2009 to June 2016. The arrangement has been accounted for as a capital lease.

Commodity Price Risk Management

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 balance sheet. None of the Company's derivative instruments currently qualify as fair value hedges or cash flow hedges, and accordingly, changes in fair value of the derivative instruments are recognized as income or expense in the consolidated statement of operations with a corresponding adjustment to the fair value of derivative instruments recorded on the balance sheet.

The Company had the following derivative instruments (risk management contracts) outstanding:

As of December 31, 2009

18. FINANCIAL RISK MANAGEMENT (continued)

Type of Instrm.	Term	Volume	Strike Price ($/bbl)	Benchmark	Fair value
Written call option	Jan 1, 2010 - Feb 28, 2010	300,000	80.0	WTI	$ (805)
Written call option	Mar 1, 2010 - Apr 30, 2010	300,000	76.1	WTI	(2,577)
Written call option	May 1, 2010 - May 31, 2010	152,000	80.0	WTI	(1,238)
Written call option	Jun 1, 2010 - Aug 31, 2010	504,000	90.0	WTI	(2,844)
Written call option	Sep 1, 2010 - Nov 30, 2010	500,001	89.5	WTI	(4,022)
Written call option	Jan 1, 2010 - May 31, 2010	785,000	80.0	WTI	(4,111)
Written call option	Jun 1, 2010 - Jul 30, 2010	304,000	80.0	WTI	(2,956)
	Total	**2,845,001**			**(18,553)**

Type of Instrm.	Term	Volume	Strike Price ($/bbl)	Premium ($/bbl)	Fair value
Put option	Jan 1, 2010 - Apr 30, 2010	600,000	40	$1.16	$ 1
Put option	May 1, 2010 - Jun 30, 2010	300,000	40	$1.95	(547)
Put option	Jul 1, 2010 - Dec 31, 2010	600,000	40	$2.45	(1,228)
Put option	Jan 1, 2010 - Jun 30, 2010	900,000	40	$1.41	(1,223)
Put option	Jan 1, 2010 - Jun 30, 2010	900,000	40	$1.28	(1,106)
Put option	Jul 1, 2010 - Dec 30, 2010	585,000	40	$1.91	(882)
Put option	Jan 1, 2011 - Jul 30, 2011	700,000	40	$2.45	(1,097)
Put option	Jan 1, 2011 - Jun 30, 2011	585,000	40	$1.91	(623)
	Total	**5,170,000**			**(6,705)**
	Total				**$ (25,258)**
	Short-term				(23,538)
	Long-term				(1,720)
	Total				**$ (25,258)**

As of December 31, 2008

Type of Instrm.	Term	Volume	Strike Price ($/bbl)	Benchmark	Fair value
Oil collar	Dec 4, 2008 - Jun 30, 2009	2,100,000	$40.00 floor / $59.00 ceiling	WTI	$ 1,468
Oil collar	May 1, 2009 - Jun 30, 2009	600,000	$40.00 floor / $65.00 ceiling	WTI	1,374
Oil collar	Jan 1, 2009 - April 30, 2009	1,200,000	$40.00 floor / $58.25 ceiling	WTI	3,732
	Total				**$ 6,574**
	Short-term				6,574
	Long-term				-
	Total				**$ 6,574**

For the year ended December 31, 2009, the Company recorded a realized loss of $2.8 million (2008 – nil) on these contracts included in net income as realized gain (loss) on risk management contracts. The unrealized loss on risk management contracts represents the change in the fair value of the contracts, which totaled $18.7 million in loss (2008 - $6.6 million). The unrealized loss was recorded in net income as realized and unrealized loss on risk management contracts.

If the forward WTI crude oil price estimated at December 31, 2009 had been $1/bbl higher or lower, the unrealized loss on these contracts would change by approximately $1.3 million (2008 - $0.3 million) and would be reflected in the statement of operations of the Company.

18. FINANCIAL RISK MANAGEMENT (continued)

Fair Value Risk

The Company's financial instruments are cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued liabilities, commodity risk management liabilities, bank debt and convertible debentures on the balance sheet. The carrying value and fair value of these financial instruments at December 31, 2009 and 2008 is disclosed below by financial instrument category, as well as any related gain and interest expense for the year ended December 31, 2009 and 2008:

	2009				2008			
Financial Instrument	**Carrying value**	**Fair value**	**Gain (loss)**	**Interest income (expense)**	Carrying value	Fair value	Gain (loss)	Interest income (expense)
Assets held for trading								
Cash and cash equivalents	398,849	398,849	-	1,599	90,391	90,391	-	-
Restricted cash	10,771	10,771	-	-	18,665	18,665	-	-
Loans and receivables								
Accounts receivable and other current assets	134,968	134,968	-	-	96,065	96,065	-	-
Liabilities held for trading								
Risk management contracts (1)	25,258	25,258	(21,525)	-	6,574	6,574	(6,574)	-
Other Liabilities								
Accounts payable and accrued liabilities	180,153	180,153	-	-	173,911	173,911	-	-
Long-term debt	455,287	455,287	-	(5,483)	30,038	30,038	-	(7,248)
Convertible debtentures (2)	165,611	328,549	-	(27,332)	132,001	75,900	-	(9,624)
Obligations under capital lease	40,441	40,441	-	(3,107)	-	-	-	-

(1) An unrealized loss of $18.7 million representing the change in fair value of the contracts is included on the statement of operations, comprehensive income (loss), and retained earnings (deficit), and the statement of cash flow.
(2) The closing price of the convertible debenture (PRE.DB – TSX) at December 31, 2009 represented 144% of the face value of the convertible debenture.

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 as at December 21, 2009, in accordance with the classification of fair value input hierarchy included in CICA Handbook Section 3862, *Financial Instruments – Disclosures*.

	Liabilities at fair value as at December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total**
Risk management contracts	$ -	$ 25,258	$ -	$ 25,258
Total	$ -	$ 25,258	$ -	$ 25,258

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 commodity price curves and quote obtained from counterparties to the contracts taking into account the credit worthiness of those counterparties.

19. WEIGHTED AVERAGE SHARES AND FULLY DILUTED SHARES OUTSTANDING

(in thousands)	2009	2008
Weighted average number of shares - basic	213,294,237	200,574,170
Dilution effect of stock options, warrants and convertible debt	-	11,151,911
Weighted average number of shares - diluted	213,294,237	211,726,081

All options, warrants and convertible debt that are anti-dilutive are excluded from the calculation of diluted weighted average number of shares.

20. SEGMENTED INFORMATION

The Company currently operates in one reporting segment, being the exploration, development and production of heavy crude oil and gas in Colombia. As at December 31, 2009 all of the Company's assets are located in Colombia except for $224.6 million (2008 - $18.1 million) in cash and cash equivalents which are held in Canada and the United States and $3.2 million (2008 - $2.7 million) of property, plant and equipment in Peru.

For the year ended December 31, 2009 the Company's revenues were from Colombia except for $498.9 million which were export sales to refineries in the United States.

21. RELATED-PARTY TRANSACTIONS

a) On April 16, 2009, 538,334 common shares ($3.3 million) of the Company were issued to a director of the Company as settlement of a contingent consideration on acquisition of La Creciente by Pacific Stratus in 2004.

b) The Company paid Endeavour Financial Corp. ("Endeavour"), a company related by way of a director in common, $180 in retainer fees. The Company also paid Endeavour financing fees of $3 million (2008 – $nil) for ODL pursuant to an advisory agreement dated November 8, 2007.

c) On May 5, 2009 the Company closed on initial commitments totaling $180 million of a senior secured revolving credit facility of up to $250 million. The facility consisted of $50 million commitments from each of BP Paribas, Calyon and Banco Davivienda S.A. and $30 million from West LB A.G. In June 2009, the Company paid Endeavour an amount of $2.6 million in retainer and advisory fees for the arrangement of this revolving credit facility. The Company received an additional $45 million under the revolving credit facility and paid Endeavour an amount of $1.2 million in advisory fees related to the additional credit.

d) As at December 31, 2009, the Company had trade accounts receivable of $10.5 million (2008 - nil) from Proelectrica, in which the Company has a 21.4% indirect interest. Revenue from Proelectrica in the normal course of the Company's business was $17.5 million for 2009 (2008 - $2.7 million).

e) In June 2007, the Company entered into a 5-year lease agreement with Blue Pacific Assets Corp. ("Blue Pacific"), a British Virgin Islands corporation, for administrative office space in one of its Bogota, Colombia locations. Monthly rent expense of $55 is payable to Blue Pacific under this agreement. Three directors and officers of the Company control, or provide investment advice to the holders of, 75% of the shares of Blue Pacific. In addition, the Company has a receivable of $16 from Blue Pacific related to certain administrative costs paid by the Company on behalf of Blue Pacific.

f) The Company has an accounts receivable in the amount of $173 (2008 - $13) from Medoro Resources Ltd., a company related by way of a director and two officers in common. The receivable balance is related to the Company's share of general and office expenses, including administrative support and office premises in Canada. The receivable was repaid in full in January 2010.

g) Loans receivable from related parties in the aggregate amount of $290 (2008 – nil) are due from one director and two officers of the Company. The loans are non-interest bearing and payable in equal monthly payments over a 48-month terms.

All these transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

22. SUBSEQUENT EVENTS

a) The Company issued standby and letters of credit and guarantees for exploration and operational commitments for a total of $11.5 million. Most of these bank guarantees are related to naphtha and light oil purchases.

b) The Company granted the following employee stock options under the rolling Plan after December 31, 2009.

Date of stock option grant	Granted	Exercise price	Fair value
January 6, 2010	30,000	C$14.57	C$7.27
February 9, 2010	6,248,500	C$14.08	C$6.93
	6,278,500	C$14.08	C$6.93

The options vested immediately and expire in five years from the date of grant. The fair value of the options was calculated using the Black-Scholes option pricing model. The above stock option grants will result in the recognition of $40.8 million of stock-based compensation expense in the statement of operations in the first quarter of 2010.

c) On January 12, 2010, the Company announced that greater than 66 2/3% of its publicly-traded warrants outstanding as of December 14, 2009 had been exercised pursuant to the announced early exercise transaction. Under this transaction, warrantholders were able to exercise their warrants within the 30 day period ended January 13, 2010 to acquire one common share of the Company per warrant at an exercise price of C$6.30 instead of the C$7.80 exercise price. In the event that at least 66 2/3% of the warrants outstanding as of December 14, 2009 have been exercised on or before January 13, 2010, each warrant that had not been so exercised during the 30-day early exercise period would be deemed automatically exchanged by the warrantholder, without any further action or payment of additional consideration on the part of the warrantholder (including payment of the exercise price thereof), for consideration payable by the Corporation of C$0.75 (the "Exchange Payment") plus a fraction of a common share (collectively, the "Exchange Shares") equal to: (A) the volume weighted average trading price of the common shares on the TSX for the five trading days immediately prior to the early exercise expiry date (the "Market Price") minus (B) current exercise price, divided by (C) the Market Price.

The Company also announced that, despite having reached the required threshold number of warrant exercises, the early exercise period was extended from January 13, 2010 to January 20, 2010 in order to provide warrantholders with sufficient time to comply with the procedural aspects of the early exercise. In total, 27,295,661 warrants were exchanged after December 31, 2009, for C$170 million in cash and 27,108,081 common shares of the Company.

d) On January 7, 2010, the Company announced that it had entered into an agreement with Oleoducto Central S.A. ("OCENSA") to acquire preferential rights to the use of available capacity on the OCENSA pipeline system for up to 160 million barrels of its oil for a 10 year period beginning February 1, 2010, in consideration for a one-time payment of $190 million. Under the terms of the agreement, the transport capacity of the contract is specified as follows:

1. 50 thousand barrels of oil per day ("kbopd") from the first business day of February 2010, until December 31, 2010;
2. 60 kbopd commencing January 1, 2011, for seven years starting on February 1, 2010;
3. 20 kbopd commencing on the day after the seven year period noted above has elapsed for a period of up to three additional years, or until the total volume of capacity pursuant to the agreement has reached 160 million barrels.

In parallel with this agreement, the two companies executed a related transportation contract to regulate the operating aspects of transporting oil through the OCENSA system. These volumes will be delivered by the company to OCENSA at either the Cusiana station or the El Porvenir station and will be pumped through to the Coveñas terminal for which the Company will pay the transportation tariff as set by the Ministry of Mines and Energy of Colombia for each segment of the OCENSA pipeline. In addition to this agreement, the Company also purchased 10 kbopd capacity in the OCENSA system to be accessed through the new truck unloading facility, currently under construction in the Cusiana station. All together, the Company secured a capacity of 60 kbopd in the OCENSA system for most of 2010 and 70 kbopd starting in January 2011.

22. SUBSEQUENT EVENTS (continued)

e) On February 17, 2010, the Company engaged Banc of America Securities LLC as lead arranger for a two-year syndicated senior unsecured credit facility of up to $200 million. The closing is expected to occur on or before March 31, 2010. Pricing of the new facility will depend on the rating assigned to the Company's senior debt securities by Standard & Poor's Ratings Group and Fitch Inc. The Company will pay commitment fees on the unutilized portion of any outstanding commitments under the facility and regular spread over any disbursed amounts. Subject to customary acceleration events set out in the credit agreement to be executed between the parties, or unless terminated earlier by the Company without penalty, repayment of outstanding principal on the facility will be made in full on the second anniversary of the closing date.

f) Subsequent to December 31, 2009, the Company has entered into the following derivative contracts to manage its exposures to fluctuations in commodity prices and foreign exchange rates.

Commodity price derivatives

Call options	Term	Volume	Strike Price ($/bbl)	Benchmark
Written Call Option	Dec 01, 2010 - Dec 31, 2010	300,000	95.30	WTI
Bought Call Option	Feb 1, 2010 - March 31, 2010	464,000	80.00	WTI
Bought Call Option	March 1, 2010 - April 30, 2010	300,000	76.10	WTI
	Total	**1,064,000**		

Put options	Term	Volume	Strike Price ($/bbl)	Premium ($/bbl)
Put Option	March 01, 2010 - March 31, 2010	150,000	65.00	0.88
Put Option	April 01, 2010 - April 30, 2010	150,000	65.00	1.38
Put Option	March 01, 2010 - April 30, 2010	300,000	65.00	0.86
Put Option	May 01, 2010 - May 31, 2010	150,000	65.00	0.92
Put Option	June 01, 2010 - June 30, 2010	150,000	65.00	0.94
Put Option	May 1, 2010 - May 31, 2010	150,000	65.00	0.90
Put Option	June 1, 2010 - June 30, 2010	150,000	65.00	0.95
	Total	**1,200,000**		

Foreign currency derivatives

Currency collars	Expiration Date	Amount ($)	Floor / Ceiling (COP/$)
	March 15, 2010	22,302,000	2000-2050 and 2000-2060
	April 15, 2010	20,445,000	2000-2050 and 2000-2060
	April 30, 2010	20,894,000	2000-2050 and 2000-2060
	May 25, 2010	17,691,000	2000-2050 and 2000-2060
	June 25, 2010	19,288,000	2000-2050 and 2000-2060
	July 26, 2010	22,531,000	2000-2050 and 2000-2060
	August 25, 2010	24,887,000	2000-2050 and 2000-2060
	September 27, 2010	28,291,000	2000-2050 and 2000-2060
	October 25, 2010	38,825,000	2000-2050 and 2000-2060
	November 26, 2010	40,131,000	2000-2050 and 2000-2060
	December 23, 2010	41,653,000	2000-2050 and 2000-2060
	December 23, 2010	44,366,000	2000-2050 and 2000-2060
	Total	**341,304,000**	

23. COMPARATIVE FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the current consolidated financial statements.