PACIFIC RUBIALES ENERGY CORP.

Annual Consolidated Financial Statements

For the years ended December 31, 2010 and 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 10, 2011

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Pacific Rubiales Energy Corp.

We have audited the accompanying consolidated financial statements of **Pacific Rubiales Energy Corp.**, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Pacific Rubiales Energy Corp.** as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada,
March 10, 2011.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

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

(In thousands of U.S. dollars)		2010		2009
				(restated - note 1 s)
ASSETS				
Current				
Cash and cash equivalents	$	608,344	$	438,117
Restricted cash		6,706		8,712
Accounts receivable (note 15 a)		300,836		159,049
Inventories (note 4)		56,050		38,228
Risk management assets (note 15 c)		1,066		-
Income tax receivable		2,324		5,048
Prepaid expenses		6,398		4,449
Future income tax (note 17)		2,669		2,693
		984,393		656,296
Property, plant and equipment (note 3)		2,383,628		1,985,361
Intangible assets (note 10)		170,967		-
Restricted cash		-		2,059
Investments and other assets (note 5)		215,462		74,758
Goodwill		100,636		100,636
	$	3,855,086	$	2,819,110
LIABILITIES				
Current				
Accounts payable and accrued liabilities	$	540,292	$	208,603
Risk management liability (note 15 e)		53,647		23,538
Income tax payable		109,982		2,721
Current portion of long-term debt (note 7)		90,091		13,310
Current portion of obligations under capital lease (note 8)		4,304		1,920
Future income tax (note 17)		3,396		846
		801,712		250,938
Long-term debt (note 7)		434,350		442,159
Obligations under capital lease (note 8)		34,383		38,521
Convertible debentures (note 9)		186,416		165,611
Risk management liability (note 15 e)		-		1,720
Future income tax (note 17)		344,810		382,625
Asset retirement obligation (note 6)		18,343		8,778
		1,820,014		1,290,352
SHAREHOLDERS' EQUITY				
Common shares (note 11 a)		1,691,838		1,364,687
Contributed surplus		112,339		136,934
Equity component of convertible debentures (note 9)		65,826		66,130
Accumulated other comprehensive income		11,806		229
Retained earnings (deficit)		153,263		(39,222)
		2,035,072		1,528,758
	$	3,855,086	$	2,819,110

See accompanying notes to the consolidated financial statements

On behalf of the Board:

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

PACIFIC RUBIALES ENERGY CORP.
Consolidated Statements of Operations
For the years ended December 31

(In thousands of U.S. dollars, except per share amounts)		2010		2009
				(restated - note 1 s)
Revenues				
Oil and gas sales	$	1,661,544	$	639,201
Cost of operations				
Operating		607,939		271,687
Overlift (underlift)		18,833		(2,149)
Depletion, depreciation and amortization		298,567		196,138
		925,339		465,676
Earnings before undernoted		736,205		173,525
Expenses				
General and administrative		111,919		71,831
Stock-based compensation (note 11 b)		73,327		28,361
		185,246		100,192
Operating income		550,959		73,333
Other (expenses) income				
Foreign exchange loss		(11,092)		(59,896)
(Loss) income from equity investment (note 5)		(1,634)		1,657
Interest expense		(76,447)		(48,150)
Loss on risk management contracts (note 15 e)		(40,230)		(21,525)
Other expense		(951)		(25,160)
		(130,354)		(153,074)
Net income (loss) before income taxes		420,605		(79,741)
Income tax expense (note 17)				
Current		171,235		30,089
Future		31,764		15,963
		202,999		46,052
Net income (loss)	$	217,606	$	(125,793)
Net income (loss) per share (note 16)				
Basic	$	0.83	$	(0.59)
Diluted	$	0.75	$	(0.59)

See accompanying notes to the consolidated financial statements

PACIFIC RUBIALES ENERGY CORP.
Consolidated Statements of Comprehensive Income
For the years ended December 31

(In thousands of U.S. dollars)		**2010**		**2009**
				(restated - note 1 s)
Net income (loss)	$	217,606	$	(125,793)
Other comprehensive income				
Unrealized foreign currency translation adjustment - net of nil tax (note 5)		11,577		-
Unrealized gain on cash flow hedges - net of nil tax (note 15 c)		21,721		-
Realized gain on cash flow hedges transferred to net income (note 15 c)		(21,721)		-
		11,577		-
Comprehensive income (loss)	$	229,183	$	(125,793)

See accompanying notes to the consolidated financial statements

PACIFIC RUBIALES ENERGY CORP.
Consolidated Statements of Changes in Shareholders' Equity
For the years ended December 31

(In thousands of U.S. dollars)	2010	2009
		(restated - note 1 s)
Common shares		
Balance, beginning of year	$ 1,364,687	$ 1,187,925
Issued on Pacific Stratus acquisition	-	3,262
Issued on exercise of warrants	223,109	133,520
Issued on exercise of options	102,860	39,980
Issued on conversion of convertible debentures (note 9)	1,182	-
Balance, end of year	1,691,838	1,364,687
Contributed surplus		
Balance, beginning of year	136,934	158,660
Exercise of warrants	(62,328)	(36,663)
Exercise of options	(35,594)	(13,424)
Stock-based compensation	73,327	28,361
Balance, end of year	112,339	136,934
Equity component of convertible debentures		
Balance, beginning of year	66,130	66,130
Conversion to common shares (note 9)	(304)	-
Balance, end of year	65,826	66,130
Accumulated other comprehensive income		
Balance, beginning of year	229	229
Other comprehensive income	11,577	-
Balance, end of year	11,806	229
Retained earnings (deficit)		
Balance, beginning of year	(39,222)	86,571
Net income (loss)	217,606	(125,793)
Dividends	(25,121)	-
Balance, end of year	153,263	(39,222)
Total shareholders' equity	$ 2,035,072	$ 1,528,758

See accompanying notes to the consolidated financial statements

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

(In thousands of U.S. dollars)	2010	2009
		(restated - note 1 s)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 217,606	$ (125,793)
Items not affecting cash:		
Depletion, depreciation and amortization	298,567	196,138
Asset retirement obligation accretion (note 6)	1,174	1,701
Unrealized loss on risk management contracts (note 15 e)	28,389	18,684
Accretion on convertible debentures (note 9)	13,028	10,470
Stock-based compensation	73,327	28,361
Future income tax	31,764	15,963
Unrealized foreign exchange loss	2,344	62,331
Acquisition of non-controlling interest	-	10,730
Loss (income) from equity investments (note 5)	1,634	(1,657)
Other	(5,840)	8,958
Changes in non-cash working capital (note 13)	166,810	(82,228)
Net cash provided by operating activities	828,803	143,658
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to oil and gas properties and equipment	(721,007)	(386,610)
Acquisition of Kappa	-	(1,050)
Additions to intangible assets (note 10)	(190,000)	-
Decrease in restricted cash	4,065	7,894
Reduction of capital in ODL (note 5)	-	41,219
Acquisition of non-controlling interest	-	(12,000)
(Investment in) disposition of investments and other assets (note 5)	(31,579)	6,451
Net cash used in investing activities	(938,521)	(344,096)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances from long-term debt	84,693	772,381
Repayment of long-term debt	(15,064)	(346,117)
Proceeds from the exercise of warrants and options	228,047	123,413
Dividends	(25,121)	-
Net cash provided by financing activities	272,555	549,677
Effect of exchange rate changes on cash and cash equivalents	7,390	(1,513)
Change in cash and cash equivalents during the year	170,227	347,726
Cash and cash equivalents, beginning of the year	438,117	90,391
Cash and cash equivalents, end of the year	$ 608,344	$ 438,117

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, Peru, and Guatemala.

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, as at and for the years ended December 31, 2010 and 2009. 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, 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, which 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.

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

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.

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

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-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 three cost centres, which are Colombia, Peru, and Guatemala. 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) Intangible assets

Intangible assets are recorded at their fair value on the date of acquisition. Intangible assets with finite useful lives are amortized over their useful lives. The Company's intangible asset consists of rights to the available capacity of a pipeline system in Colombia. The intangible asset is amortized based on the usage

of the 160 million barrel capacity over the term of the agreement. The Company does not have intangible assets with an infinite life which would not be subject to amortization. The Company applies an impairment test to the carrying value of the intangible asset to ensure that such costs do not exceed the estimated amount ultimately recoverable. Any reduction in the carrying value, as a result of the impairment test, is included in depletion, depreciation and amortization.

f) 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 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.

g) 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.

h) 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.

i) 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

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

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.

j) 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.

k) 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 scientific research and development and oil and gas properties are eligible for an additional special tax deduction (25% or 30% depending on the type of eligible expenditures), 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.

l) Joint operations

Substantially all of the Company's operations are conducted jointly with others. For those operations where the Company is the operator, the gross working capital has been included in the Company's consolidated financial statements. For all other joint operations, these consolidated financial statements only reflect the Company's proportionate interest in such activities.

m) 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 3 and note 8).

The Company has a 32.9% interest in Oleoducto Bicentenario de Colombia ("OBC"), an entity established by a consortium of oil producers to build and operate a private-use oil pipeline in Colombia. The Company has determined that OBC is a variable interest entity and the Company is not its primary beneficiary. OBC has been accounted for as an investment using the equity method (note 5).

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

n) 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 crude oil and foreign currency derivatives.

Level 3 – Valuations in this level are those with inputs which are less observable, unavailable or where the observable data does not support the majority of the instrument's fair value. Level 3 instruments may include items based on pricing services or broker quotes where 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, 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 in 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.

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

o) 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 the cost to produce the product and overliftings are recorded in accounts payable and accrued liabilities at the cost to sell 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.

p) 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.

q) 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.

r) 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 fair value.

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

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

s) Comparative financial statements

i) Reclassification of comparative financial statements

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

For all joint operations where the Company is the operator, the Company has reclassified the working capital of its joint operations on a gross basis from the proportionate consolidation basis in prior periods. As a result, the Company has reclassified its cash, accounts receivable, income tax receivable, inventory, accounts payable, income tax payable and current portion of long-term debt related to its joint operations to their gross amounts.

ii) Restatement of comparative financial statements

The Company has restated its 2009 consolidated financial statements to correct an error that resulted in an overstatement of accounts payable and accrued liabilities at December 31, 2009. This occurred in the fourth quarter of 2009 as a result of the amalgamation of several operating subsidiaries of the Company and enterprise resource planning system conversion.

The impact of the above reclassification and restatement on the 2009 consolidated financial statements is as follows:

As at December 31, 2009	Previously Reported	Reclassification	Restatement Adjustment	Restated
Cash	$ 398,849	$ 39,268	$ -	$ 438,117
Accounts receivable	134,968	24,081	-	159,049
Income tax receivable	5,116	(68)	-	5,048
Inventory	38,996	(768)	-	38,228
Property, plant and equipment	1,991,425	-	(6,064)	1,985,361
Total assets	2,762,661	62,513	(6,064)	2,819,110
Accounts payable and accrued liabilities	180,153	62,295	(33,845)	208,603
Income tax payable	2,685	36	-	2,721
Current portion of long-term debt	13,128	182	-	13,310
Deficit	(67,003)	-	27,781	(39,222)
Total liabilities and shareholders' equity	2,762,661	62,513	(6,064)	2,819,110
Operating costs	293,992	-	(22,305)	271,687
Foreign exchange gain (loss)	(65,372)	-	5,476	(59,896)
Net loss	$ (153,574)	$ -	$ 27,781	$ (125,793)
Net loss per share - Basic and Diluted	$ (0.72)	$ -	$ 0.13	$ (0.59)

2. CHANGES IN AND ADOPTION OF ACCOUNTING POLICIES

a) 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

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

2. C
HANGES IN AND ADOPTION OF ACCOUNTING POLICIES (continued)

statements relating to fiscal years beginning on or after January 1, 2011, with early adoption permitted. An entity must adopt Section 1582, 1601 and 1602 at the same time. The Company has adopted these standards effective January 1, 2010 and the adoption did not have a material impact on the results of operations or financial position.

b) International Financial Reporting Standards ("IFRS")

The Company will be required to prepare financial statements in accordance with IFRS starting with the interim financial statements for the quarter ended March 31, 2011. These statements will require 2010 comparatives in accordance with IFRS. As a result, the financial statements that are prepared under Canadian GAAP for 2010 will need to be restated to conform to IFRS for comparative purposes. The Company's transition date is January 1, 2010.

3. PROPERTY, PLANT AND EQUIPMENT

	December 31, 2010		
	Cost	Accumulated DD & A	Net Book Value
Oil and gas properties and equipment	$ 2,911,479	$ 581,036	$ 2,330,443
Corporate and other	32,325	12,677	19,648
Power generation unit under capital lease	38,783	5,246	33,537
	$ 2,982,587	$ 598,959	$ 2,383,628

	December 31, 2009		
	Cost	Accumulated DD & A	Net Book Value
Oil and gas properties and equipment	$ 2,245,610	$ 309,724	$ 1,935,886
Corporate and other	20,393	8,092	12,301
Power generation unit under capital lease	38,783	1,609	37,174
	$ 2,304,786	$ 319,425	$ 1,985,361

As of December 31, 2010, $1.6 billion (December 31, 2009 – $1.1 billion) in future capital expenditures has been included in the calculation of depletion, depreciation and amortization. The cost of oil and gas properties and equipment was reduced by the tax benefit of $166 million (December 31, 2009 - $100.3 million) arising from the 30% (40% before 2010) special tax deduction on qualified expenditures in Colombia.

During 2009 the Company entered into a power generation arrangement to supply electricity to 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. For the year ended December 31, 2010, amortization expense of $3.6 million (2009 - $1.6 million) related to the leased property is charged to depletion, depreciation and amortization.

Included in oil and gas properties and equipment is $312 million (2009 – $236.9 million) of unproved properties that were excluded from the depletion, depreciation and amortization calculation.

A recoverable amount calculation was performed at December 31, 2010 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 2011 to 2019 are outlined in the following table:

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

3. PROPERTY, PLANT AND EQUIPMENT (continued)

Year	WTI Crude Oil - $/bbl	Gas - $/MMCF
2011	100.25	4.12
2012	100.92	4.75
2013	98.96	5.13
2014	98.36	5.44
2015	98.71	5.74
2016	99.48	6.00
2017	100.60	6.25
2018	101.62	6.50
2019	102.71	6.71
Thereafter	2% escalation	2% escalation

Prices above are West Texas Intermediate (WTI) for crude and Henry Hub for gas, 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.

4. INVENTORIES

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

	2010	2009
Crude oil and gas	$ 51,159	$ 34,869
Materials and supplies	4,891	3,359
	$ 56,050	$ 38,228

Inventory included in operating costs for the year ended December 31, 2010 was $597.3 million (2009 - $234.8 million).

5. INVESTMENTS AND OTHER ASSETS

Investments and other assets consist of the following:

	ODL (1)	Ronter (2)	PII (3)	Pacific Coal (4)	OBC (5)	Other	Total
As at January 1, 2009	$ 105,323	$ 8,427	$ -	$ -	$ -	$ 7,021	$ 120,771
Disposition	-	-	-	-	-	(6,451)	(6,451)
Income (loss) from equity investment	141	1,516	-	-	-	-	1,657
Reduction of capital in ODL	(41,219)	-	-	-	-	-	(41,219)
As at December 31, 2009	$ 64,245	$ 9,943	$ -	$ -	$ -	$ 570	$ 74,758
Acquisition (disposition)	-	-	10,500	24,000	95,682	579	130,761
Income (loss) from equity investment	(2,881)	1,470	(342)	119	-	-	(1,634)
Distribution of PII common shares	-	(6,412)	6,412	-	-	-	-
Foreign currency translation	11,577	-	-	-	-	-	11,577
As at December 31, 2010	$ 72,941	$ 5,001	$ 16,570	$ 24,119	$ 95,682	$ 1,149	$ 215,462

(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 from 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. ODL's functional currency is the Colombian peso and is accounted for as a self-sustaining operation. The currency translation adjustment upon conversion to US dollars has been recorded in other comprehensive income as at December 31, 2010. As at December 31, 2009 ODL was accounted for as an integrated operation. Subsequently, ODL's operations became self-sustaining when the pipeline became fully operational upon the completion of phase two of the construction of the pipeline.

5. INVESTMENTS AND OTHER ASSETS (continued)

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 $336 million from 2009 to 2016.

(2) The investment in Ronter Inc. (“Ronter”) represents a 17.7% 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. The Company’s interest in Ronter was 21.7% as of December 31, 2009. During 2010, Ronter’s convertible debentures, with a face value of $8 million, were fully converted to its common shares. The conversion resulted in a decrease in the Company’s interest in Ronter to 17.7%. The investment in Ronter is accounted for using the equity method.

On December 31, 2010 Ronter distributed the Pacific Infrastructure Inc. (“PII”, previously Lando) common shares it held to Ronter’s shareholders, including the Company. The distribution represented a dividend payment in kind with a fair value of $6.4 million. The Company recorded a decrease of $6.4 million to the carrying amount of its investment in Ronter with a corresponding increase to its investment in PII as of December 31, 2010. (See note 5(3) below).

(3) In April 2010 the Company acquired a 9.4% interest in PII,,a Panamanian company established for the purpose of developing an export seaport, an industrial park, and a free trade zone in Cartagena, Colombia. Prior to the transaction, PII was fully owned by Ronter. The consideration consisted of a $3.5 million deposit previously advanced to PII to acquire land. In September 2010, the Company acquired a 4% interest for $2 million from a shareholder of PII that was not related to the Company. In November 2010, the Company invested an additional $5 million in PII as part of a private placement offering. Subsequent to the private placement offering, Ronter distributed its holding in PII common shares to Ronter’s shareholders. This distribution resulted in a reduction to the Company’s investment in Ronter and a corresponding increase in the investment in PII. As of December 31, 2010, PII is 16.8% owned by the Company, 38.1% owned by Blue Pacific Assets Corp. (“Blue Pacific”, see note 19 a), 7.6% owned by Orinoquia Holdings Corp., a company that two directors of the Company control or provide advice to, and 37.5% owned by unrelated parties. The investment in PII is accounted for using the equity method.

(4) During year ended December 31, 2010, the Company acquired a 19.05% interest in Pacific Coal S.A. (“Pacific Coal”), a private company incorporated in Panama, for $24 million. Pacific Coal is engaged in the acquisition and development of coal mining assets and related businesses in Colombia. Four directors and one officer of the Company are also directors of Pacific Coal. The investment is accounted for using the equity method.

(5) During the year ended December 31, 2010, the Company acquired a 32.9% interest in OBC for $95.7 million to be paid in 2011. OBC is a corporation established and owned by a consortium of oil producers operating in Colombia, led by Ecopetrol. OBC will build and operate a private-use oil pipeline in Colombia between Casanare and Coveñas with an ultimate capacity of 450,000 barrels per day. The investment in OBC is accounted for using the equity method. (See note 14)

The shareholders of OBC are obliged to execute a transport agreement before the completion of the first phase of the project, for the transport of crude at a set rate per barrel.

6. ASSET RETIREMENT OBLIGATION

The amount required to settle the future asset retirement obligation is 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 $18.3 million (December 31, 2009 - $8.8 million) based on a total undiscounted future liability of $51.9 million as of December 31, 2010 (December 31, 2009 - $39.4 million), and annual inflation rates ranging from 2.9% to 4.7% 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 in 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 9% to 15% as of December 31, 2010 (December 31, 2009 – 12% to 15%).

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

6. ASSET RETIREMENT OBLIGATION (continued)

Changes to the asset retirement obligation during the period were:

	2010	2009
Balance, beginning of the year	$ 8,778	$ 14,191
Obligation incurred during the year	8,051	201
Increase (decrease) in liability	340	(7,315)
Accretion expense	1,174	1,701
Balance, end of the year	$ 18,343	$ 8,778

7. LONG-TERM DEBT

	Maturity	Currency	Interest Rate	December 31 2010	December 31 2009
Prommisory note (1)	December 24, 2010	COP	10.00%	$ -	$ 7,338
Prommisory note (1)	November 30, 2010	COP	9.70%	-	3,812
Prommisory note (1)	March 30, 2010	COP	9.70%	-	773
Prommisory note (1)	January 24, 2011	COP	3.50%	6,232	-
Prommisory note (1)	January 28, 2011	COP	3.50%	31,969	-
Prommisory note (1)	January 28, 2011	COP	3.60%	9,076	-
Prommisory note (1)	January 17, 2011	COP	3.60%	20,361	-
Prommisory note (1)	January 21, 2011	COP	3.60%	16,307	-
Prommisory note (1)	January 14, 2011	COP	3.80%	5,341	-
Prommisory note (1)	September 3, 2012	COP	10.48%	805	1,205
Bank overdraft		COP		-	182
Senior notes(2)		USD	8.75%	436,946	442,159
Deferred transaction cost (3)				(2,596)	-
				$ 524,441	$ 455,469
Current portion				$ 90,091	$ 13,310
Long-term debt				434,350	442,159
				$ 524,441	$ 455,469
Convertible debenture (note 8)				186,416	165,611
				$ 710,857	$ 621,080

(1) Unsecured, repayable in equal monthly instalments.

(2) November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%).

(3) Deferred transaction costs related to revolving credit facility.

Senior notes

The Company has outstanding senior notes 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. 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. Under the terms of the notes, the Company is required to maintain (1) an interest coverage ratio of greater than 2.5; and (2) a debt to EBITDA ratio of less than 3.5. The covenants do not apply during any period of time when the notes have an investment grade rating from at least two rating agencies. The Company was compliant with the covenants during the period.

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

7. LONG-TERM DEBT (continued)

The senior notes are carried at amortized cost using the effective interest rate method with note discount and transaction costs netted against the principal of the revolving credit facility. For the year ended December 31, 2010, $36.3 million (2009 – $5.5 million) in interest expense related to the senior notes has been recorded in the statements of operations.

On June 30, 2010 the Company solicited consents to amend the indenture relating to its senior notes to provide the Company with needed flexibility to invest in minority equity investments, and provide guarantees for joint venture entities. This solicitation was approved by a majority of the noteholders on July 15, 2010.

Revolving credit facility

During April 2010, the Company closed the syndication of a $250 million unsecured revolving credit facility. As of December 31, 2010, no borrowing has been made on the facility. The interest rate for the facility is determined in accordance with the ratings assigned to the Company's senior debt securities by Standard & Poor's Ratings Group and Fitch Inc. Based on the Company's rating as of December 31, 2010, the interest rate would be LIBOR plus 3.25%. In addition, the Company is required to pay commitment fees of 1% on the unutilized portion of any outstanding commitments under the facility. Subject to customary acceleration events set out in the credit agreement, or unless terminated earlier by the Company without penalty, repayment of the outstanding principal on the facility will be made in full on April 26, 2012. Under the terms of the credit facility, the Company is required to maintain (1) a debt to EBITDA ratio of less than 3.5; and (2) an EBITDA to interest expense ratio of greater than 3. The Company was compliant with the covenants during the period.

8. OBLIGATIONS UNDER CAPITAL LEASE

The Company has entered into a power generation arrangement to supply electricity for three of its oil fields in Colombia until 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:

		December 31 2010
Within 1 year	$	11,306
Year 2		11,337
Year 3		11,306
Year 4		11,306
Year 5		11,306
Thereafter		5,638
Total minimum lease payments	$	62,199
Amounts representing interest		(23,512)
Present value of net minimum lease payments		38,687
Current portion		4,304
Long-term portion		34,383
Total obligations under capital lease	$	38,687

For the year ended December 31, 2010, interest expense of $7.6 million (2009 – $3.1 million) was incurred on the capital lease.

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

9. 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 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 million 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%.

	2010	2009
Balance, beginning of the year	$ 165,611	$ 132,001
Conversion to common shares (1)	(880)	-
Accretion expense	13,028	10,470
Foreign exchange loss	8,657	23,140
Balance, end of the year	$ 186,416	$ 165,611

(1) During the year ended December 31, 2010, $1.1 million (2009 – nil) of the convertible debentures ($0.9 million in amortized cost) were converted to 84,998 common shares of the Company. The debt component of $0.9 million and the equity component of $0.3 million for the debentures converted in the year were reclassified to common shares.

10. INTANGIBLE ASSETS

	2010	2009
Balance, beginning of the period	$ -	$ -
Additions	190,000	-
Amortization	(19,033)	-
Balance, end of the period	$ 170,967	$ -

In January 2010, the Company entered into an agreement with Oleoducto Central S.A. ("OCENSA") whereby the Company acquired preferential rights to the 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, for a one-time payment of $190 million. The intangible asset is amortized based on the usage of the barrel capacity over the term of the agreement. The amortization is included in depletion, depreciation and amortization.

11. SHARE CAPITAL

(a) Authorized, issued and fully paid common shares

Unlimited number of common shares with no par value.

Continuity schedule of share capital:

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

11. SHARE CAPITAL (continued)

	Number of Shares		Amount
Balance, January 1, 2009	210,566,340	$	1,187,925
Issued on the Pacific Stratus Acquisition	538,334		3,262
Issued on exercise of warrants	16,893,209		133,520
Issued on exercise of options	4,906,889		39,980
Balance, December 31, 2009	232,904,772	$	1,364,687
Issued on exercise of warrants	27,109,081		223,109
Issued on exercise of options	7,550,002		102,860
Issued on conversion of convertible debentures	84,998		1,182
Balance, December 31, 2010	267,648,853	$	1,691,838

(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:

	Outstanding	Weighted average exercise price
Balance, January 1, 2009	19,747,748	C$5.94
Granted during the period	4,596,500	C$12.81
Canceled during the period	(214,228)	C$5.70
Exercised during the period	(4,906,889)	C$5.88
Balance, December 31, 2009	19,223,131	C$7.60
Granted during the period	9,551,000	C$16.37
Exercised during the period	(7,550,002)	C$9.18
Balance, December 31, 2010	21,224,129	C$10.98

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

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

11. SHARE CAPITAL (continued)

Outstanding & Exercisable	Exercise price	Expiry date	Remaining contractual life
1,137,253	C$ 2.22	August 21, 2011	0.6
2,339,206	C$ 4.70	October 23, 2013	2.8
166,667	C$ 5.70	May 9, 2017	6.4
352,001	C$ 6.30	July 10, 2017	6.5
946,042	C$ 6.78	April 20, 2012	1.3
5,497,835	C$ 7.38	February 11, 2013	2.1
10,000	C$ 10.86	July 30, 2014	3.6
2,896,000	C$ 13.09	October 12, 2014	3.8
7,500	C$ 14.57	January 6, 2015	4.0
4,812,500	C$ 14.08	February 9, 2015	4.1
18,000	C$ 19.00	March 16, 2015	4.2
5,000	C$ 19.47	April 14, 2015	4.3
2,907,125	C$ 20.56	April 23, 2015	4.3
21,000	C$ 20.09	May 17, 2015	4.4
52,000	C$ 24.41	June 22, 2015	4.5
56,000	C$ 27.58	September 30, 2015	4.7
21,224,129	C$ 10.98		3.2

The following stock options with a 5 year life were granted to employees, directors and consultants during the year ended December 31, 2010:

Number of options granted	Weighted average exercise price	Weighted average fair value
9,551,000	C$16.37	C$7.97

The fair values of the stock options issued during the year ended December 31, 2010 have been calculated using the Black-Scholes option pricing model, based on the following assumptions:

Weighted average risk-free interest rate:	1.35%
Expected life:	2.5 years
Weighted expected volatility:	77%
Expected dividend yield:	0%

(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, 2010:

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

11. SHARE CAPITAL (continued)

Outstanding & exercisable	Exercise price	Expiry date
611,682	C$7.80	July 12, 2012

A summary of the changes in warrants is presented below:

	Outstanding & exercisable	Weighted average exercise price
Balance on January 1, 2009	44,803,552	C$7.72
Exercised during the year	(16,893,209)	C$6.14
Balance on December 31, 2009	27,910,343	C$7.80
Exercised during the year	(27,298,661)	C$6.30
Balance on December 31, 2010	611,682	C$7.80

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 original 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.

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 early exercise transaction. As a result of reaching the 66 2/3% threshold, each warrant that had not been so exercised during the 30-day early exercise period was 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 Company 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. Warrants that were held by U.S. warrantholders were not subject to the automatic exchange. In total, 27,295,661 warrants were exchanged after December 31, 2009 under the early exercise program, for C$170 million in cash and 27,106,081 common shares of the Company.

12. 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. 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.

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

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

12. CAPITAL DISCLOSURES (continued)

The Company defines its capital as follows:

	2010	2009
Shareholders' equity	$ 2,035,072	$ 1,528,758
Long-term debt	524,441	455,469
Convertible debentures	186,416	165,611
Working capital surplus	(272,772)	(418,668)
	$ 2,473,157	$ 1,731,170

13. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Changes in non-cash working capital, net of foreign exchange gains or losses, were as follows.

	2010	2009
Increase in accounts receivable	$ (143,795)	$ (88,558)
Decrease (increase) in income taxes receivable	2,724	(5,048)
Increase in accounts payable and accrued liabilities	214,718	40,219
Increase in inventory	(17,054)	(14,750)
Increase (decrease) in income taxes payable	112,166	(16,761)
(Increase) decrease in prepaid expenses and other	(1,949)	2,670
	$ 166,810	$ (82,228)

Included in accounts payable and accrued liabilities are amounts related to additions to property, plant, and equipment of $102.4 million as at December 31, 2010 (December 31, 2009 - $91.3 million).

Non-cash investing activities for the year ended December 31, 2010 included the acquisition of a 9.4% interest in PII (note 5) in exchange for a $3.5 million deposit that had been previously advanced to PII.

Non-cash financing activities for the year ended December 31, 2010 included the conversion of $1.1 million of convertible debentures to 84,998 of the Company's common shares.

Other cash flow information:

	2010	2009
Cash income taxes paid	$ 57,610	$ 28,539
Cash interest paid	59,528	29,189
Cash interest received	2,530	1,599

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

14. CONTINGENCIES AND COMMITMENTS

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

	2011	2012	2013	2014	2015	Subsequent to 2015	Total
Operating leases	$ 7,441	$ 5,605	$ 4,948	$ 4,948	$ 4,948	$ 24,318	$ 52,208
Transportation and processing commitments	46,980	46,980	46,980	46,980	41,580	83,160	312,660
Minimum work commitments	82,046	83,058	-	-	-	-	165,104
Accounts payable	540,292	-	-	-	-	-	540,292
OBC investment commitment (Note 5)	243,318	-	-	-	-	-	243,318
Abandonment obligations	1,220	815	106	2,402	377	46,996	51,916
Long-term debt and bank indebtedness	90,091	-	-	149,985	149,985	150,030	540,091
Convertible debentures - principal	-	-	240,192	-	-	-	240,192
Obligations under capital lease	11,306	11,337	11,306	11,306	11,306	5,638	62,199
Total	$ 1,022,694	$ 147,795	$ 303,532	$ 215,621	$ 208,196	$ 310,142	$ 2,207,980

The Company has various guarantees in place in the normal course of business. As at December 31, 2010, the Company has issued letters of credit and guarantees for exploration and operational commitments for a total of $304 million (2009 – $110.3 million).

Association contracts

Certain association contracts signed before 2003 with Ecopetrol include clauses in which Ecopetrol may commence participating in the operation of new discoveries made by the Company at any time, without prejudice to the Company's right to be reimbursed for the investments made on their sole account and risk (back-in right). The contract provides that if Ecopetrol decides to declare the commerciality of the field and participate in the commercial phase of the association contract, the Company shall have the right to be reimbursed for 200% of the total costs incurred during the exploration phase of the contract. Once the reimbursement has been made, Ecopetrol is entitled to acquire a 50% share of the oil production of the fields. The back-in rights were not exercised as at December 31, 2010.

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 2011-2012:

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

14. CONTINGENCIES AND COMMITMENTS (continued)

		2011		2012	
Client	*Contract*	Quantity (MMBTUD)	Price (1) ($/MMBTU)	Quantity (MMBTUD)	Price (1) ($/MMBTU)
GECELCA	take or pay	34,807	RMP + 28%	45,000	RMP + 28%
PROELECTRICA	Firm (2)	14,000	RMP + 12%	6,312	RMP + 84% +$ 0.10/MBTU
Interruptible supply		11,193	RMP	8,688	RMP - 21%
Total		60,000	RMP + 19%	60,000	RMP + 27%

15. FINANCIAL RISK MANAGEMENT

The nature of oil and natural gas operations and the related 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.

(a) 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 (December 31, 2009 – two) of the Company's customers had accounts receivable that were greater than 10% of total trade accounts receivable. The Company's credit exposure to these customers was $56.9 million and $56.2 million or 38% and 37% of trade accounts receivable, respectively (December 31, 2009 - two customers at $30.9 million and $10.5 million or 50% and 17% respectively). Revenues from these customers were $91.3 million and $56.2 million or 5% and 3% of net revenue, respectively (December 31, 2009 - $65.5 million and $17.5 million or 10.2% and 2.7% respectively).

The Company's accounts receivables are as follows:

	2010	2009
Trade accounts receivable		
Not past due (less than 45 days)	$ 150,484	$ 35,458
Past due (0-30 days)	-	26,641
Past due (31-120 days)	563	-
Past due (over 120 days)	-	-
Allowance for doubtful accounts	(966)	(1,225)
Total trade accounts receivable	150,081	60,874
VAT and withholding taxes recoverable	99,001	47,079
Advances and deposits	21,441	30,654
Joint ventures partners	16,480	11,722
Other	13,833	8,720
	$ 300,836	$ 159,049

(b) Interest rate risk

The Company is exposed to interest rate risk on its outstanding variable rate revolving credit borrowings due to fluctuations in market interest rates. The Company monitors its exposure to interest rates. As of December 31, 2010 the Company does not have outstanding borrowings under the variable rate revolving credit.

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

15. FINANCIAL RISK MANAGEMENT (continued)

(c) Foreign currency exchange risk

The Company is exposed to foreign currency fluctuations in Colombian pesos (COP) and Canadian dollars relative to US dollars.

In addition, as of December 31, 2010, the Company has COP 776.5 billion, or $390.2 million, of future income tax liabilities related to proved and unproved properties arising from the Rubiales, Pacific Stratus, and Kappa acquisitions in 2007 and 2008 (2009 – COP 845.2 billion, or $413.5 million). The future income tax liabilities are denominated in COP as the assets to which the future income tax liabilities relate are located in Colombia. The future income tax liabilities are monetary items, which are revalued each period end at the current exchange rates, with the unrealized foreign exchange gain or loss recorded in net income (loss) in the period. Based on the net exposure and foreign exchange rates at December 31, 2010, a 10% depreciation or appreciation of the Colombian Peso against the US dollar would result in a $35.4 million (2009 - $41.4 million) increase or decrease in the Company's after-tax net income.

The Company has convertible debentures outstanding with a face amount of C$238,895 as at December 31, 2010. 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 unrealized foreign exchange gain or loss recorded in net income (loss). Based on the debt balance and foreign exchange rates as of December 31, 2010, a 10% depreciation or appreciation of the Canadian dollar against the US dollar would result in a $16.9 million (2009 - $16.5 million) increase or decrease in the Company's after-tax net income.

To reduce its foreign currency exposure associated with operating expense incurred in COP, the Company may enter into currency risk management contracts such as foreign exchange forwards, options, and costless collars. The Company has the following currency risk management contracts outstanding as at December 31, 2010 that qualify for cash flow hedge accounting:

Instrument	Settlement date	Notional amount ($)	Floor-ceiling (COP/$)	Fair value ($)
Currency collars	January 2011	$ 20,000	1900-1928 & 1900-1930	$ 105
Currency collars	February 2011	20,000	1900-1928 & 1900-1930	166
Currency collars	March 2011	20,000	1900-1928 & 1900-1930	166
Currency collars	April 2011	20,000	1900-1928 & 1900-1930	164
Currency collars	May 2011	20,000	1900-1928 & 1900-1930	149
Currency collars	June 2011	20,000	1900-1928 & 1900-1930	122
Currency collars	July 2011	20,000	1900-1928 & 1900-1930	95
Currency collars	August 2011	20,000	1900-1928 & 1900-1930	70
Currency collars	September 2011	20,000	1900-1928 & 1900-1930	40
Currency collars	October 2011	20,000	1900-1928 & 1900-1930	16
Currency collars	November 2011	20,000	1900-1928 & 1900-1930	(3)
Currency collars	December 2011	20,000	1900-1928 & 1900-1930	(24)
	Total	**$ 240,000**		**$ 1,066**

The effective portion of the change in the fair value of the above currency hedges is recognized in other comprehensive income as unrealized gains or losses on cash flow hedges. The effective portion is reclassified as operating expenses in net income in the same period as the hedged operating expenses are incurred. During the year ended December 31, 2010, $21.7 million (2009 - nil) of unrealized gains were recorded in other comprehensive income, and subsequently recorded against operating cost when the gains became realized. The Company excludes changes in fair value due to the time value of options and records these amounts along with hedge ineffectiveness in foreign exchange gains or losses in the period that they arise. During the year ended December 31, 2010, $8 million of ineffectiveness was recorded as foreign exchange loss (2009 - $nil).

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

15. FINANCIAL RISK MANAGEMENT (continued)

(d) Liquidity risk

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

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

Financial liability due in	2011	2012	2013	2014	2015	Subsequent to 2015	Total
Accounts payable and accrued liabilities	$ 540,292	$ -	$ -	$ -	$ -	$ -	$ 540,292
Long-term debt and bank indebtedness	90,091	-	-	149,985	149,985	150,030	540,091
Convertible debentures - principal (1)	-	-	240,192	-	-	-	240,192
Obligations under capital lease (2)	11,306	11,337	11,306	11,306	11,306	5,638	62,199
Total	$ 641,689	$ 11,337	$ 251,498	$ 161,291	$ 161,291	$ 155,668	$ 1,382,774

(1) The principal of C$238,895 of convertible debentures is due on August 29, 2013. The balance due is converted to US dollars using the exchange rate on December 31, 2010.

(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.

(e) 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 commodity price derivates currently qualify as fair value hedges or cash flow hedges, and accordingly, changes in their fair value are recognized in net income.

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

15. FINANCIAL RISK MANAGEMENT (continued)

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

Liabilities as of December 31, 2010

Type of Instrm.	Term	Volume (bbl)	Floor/Ceiling ($/bbl)	Benchmark		Fair value
Zero cost collars	Jan 1, 2011 - Dec 31, 2011	1,842,000	70/98	WTI	$	(8,003)
Zero cost collars	Jan 1, 2011 - Dec 31, 2011	1,842,000	70/98	WTI		(7,949)
Zero cost collars	Jan 1, 2011 - Dec 31, 2011	1,842,000	70/98	WTI		(8,073)
Zero cost collars	Jan 1, 2011 - Mar 31, 2011	525,000	75/100	WTI		(400)
Zero cost collars	Apr 1, 2011 - Dec 31, 2011	2,070,000	75/102	WTI		(9,220)
Zero cost collars	Apr 1, 2011 - Dec 31, 2011	2,739,000	70/98	WTI		(14,192)
Zero cost collars	Jan 1, 2011 - Jun 30, 2011	540,000	70/98	WTI		(1,014)
Zero cost collars	Jan 1, 2011 - Jun 30, 2011	750,000	70/98	WTI		(1,967)
	Total	**12,150,000**				**(50,819)**

Type of Instrm.	Term	Volume (bbl)	Strike Price ($/bbl)	Premium ($/bbl)		Fair value
Put option	Jan 1, 2011 - Jul 31, 2011	700,000	40	2.45		(1,712)
Put option	Jan 1, 2011 - Jun 30, 2011	585,000	40	1.91		(1,116)
	Total	**1,285,000**				**(2,828)**
	Total				**$**	**(53,647)**
	Short-term					(53,647)
	Long-term					-
	Total				**$**	**(53,647)**

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

15. FINANCIAL RISK MANAGEMENT (continued)

As of December 31, 2009

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

For the year ended December 31, 2010, the Company recorded a loss of $40.2 million (2009 - $21.5 million) on commodity price risk management contracts in net income. Included in these amounts were $28.4 million of unrealized loss (2009 – $18.7 million) representing the change in the fair value of the contracts, and $11.8 million of realized loss (2009 - $2.8 million).

If the forward WTI crude oil price estimated at December 31, 2010 had been $1/bbl higher or lower, the unrealized loss on these contracts would change by approximately $2.7 million (2009 – $1.3 million) and would be reflected in the statement of operations of the Company.

(f) Fair value risk

The Company's financial instruments are cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued liabilities, risk management assets and liabilities, bank debt and convertible debentures on the balance sheet. The carrying value and fair value of these financial instruments is disclosed below by financial instrument category, as well as any related gain (loss) and interest income (expense).

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

15. FINANCIAL RISK MANAGEMENT (continued)

	2010				2009			
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	$ 608,344	$ 608,344	$ -	$ 2,984	$ 438,117	$ 438,117	$ -	$ 1,599
Restricted cash	6,706	6,706	-	-	10,771	10,771	-	-
Loans and receivables								
Accounts receivable and other current assets	300,836	300,836	-	-	159,049	159,049	-	-
Derivative assets designated as cash flow hedges								
Foreign currency (1)	1,066	1,066	21,721	-	-	-	-	-
Liabilities held for trading								
Commodity price derivatives (2)	53,647	53,647	(40,230)	-	25,258	25,258	(21,525)	-
Other Liabilities								
Accounts payable and accrued liabilities	540,292	540,292	-	-	208,603	208,603	-	-
Long-term debt	524,441	580,908	-	(37,201)	455,469	455,469	-	(5,483)
Convertible debtentures (3)	186,416	523,829	-	(32,417)	165,611	328,549	-	(27,332)
Obligations under capital lease	38,687	40,621	-	(7,513)	40,441	40,441	-	(3,107)

(1) Gain represents the amount recorded against operating cost when the gains were realized.

(2) Loss for the year includes $28.4 million of unrealized loss (2009 - $18.7 million), representing the change in the fair value of the contracts, and $11.8 million realized loss (2009 - $2.8 million)

(3) The closing price of the convertible debenture (PRE.DB – TSX) at December 31, 2010 represented 281% of the face value of the convertible debenture (December 31, 2009 – 144%). The fair value of the convertible debenture includes both the fair value of the conversion feature as well as the debt itself.

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

The following table summarizes the Company's financial instruments that are carried at fair value, in accordance with the classification of fair value input hierarchy included in CICA Handbook Section 3862, *Financial Instruments – Disclosures*.

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

Fair value as at December 31, 2009	**Level 1**	**Level 2**	**Level 3**	**Total**
Risk management liabilities	$ -	$ (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 discounted cash flows based on quoted forward prices and quotes obtained from counterparties, taking into account the creditworthiness of those counterparties.

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

16. WEIGHTED AVERAGE SHARES AND FULLY DILUTED SHARES OUTSTANDING

	2010	2009
Weighted average number of shares - basic	262,945,271	213,294,237
Dilution effect from dilutive securities	26,890,920	-
Weighted average number of shares - diluted	289,836,191	213,294,237

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

17. INCOME TAX

Years ended December 31,		2010		2009
				(restated - note 1 s)
(Loss) income before income taxes and non-controlling interests	$	420,605	$	(79,741)
Canadian statutory income tax rate		31%		33%
Income tax (recovery) expense at statutory rate	$	130,388	$	(26,315)
Increase (decrease) in income tax provision resulting from:				
Non-deductible expenses	$	16,976	$	17,093
Effect of foreign exchange not taxable or deductible		(9,503)		28,304
Losses of foreign jurisdictions		26		7,896
Recovery of prior period non-deductible expenses		897		(2,084)
Stock-based compensation		22,731		9,378
Differences in tax rates in foreign jurisdictions		12,642		93
Losses for which no tax benefit is recorded		29,762		11,074
Others		(920)		613
Income tax expense	$	202,999	$	46,052
Current income tax expense		171,235		30,089
Future income tax expense		31,764		15,963
Income tax expense	$	202,999	$	46,052

The tax rate in Canada decreased to 31% from 33% and Colombia remained at 33% of taxable income. The special tax benefit in Colombia for acquisition of qualified assets has been reduced from 40% in 2009 to 30% in 2010. The Colombian Congress passed a tax reform on December 29, 2010 eliminating the 30% special tax benefit starting January 2011. However, the new law allows certain tax payers which had submitted a tax stabilization contract prior to November 1, 2010, to maintain this benefit for another three years once it has been approved by the applicable governmental authority. The Company is in the process of having its stabilization contracts reviewed and the Company expects to have a positive outcome before the end of 2011.

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

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

17. INCOME TAX (continued)

Years ended December 31,		2010		2009
Future income tax assets:				
Tax loss carry forwards	$	48,216	$	21,042
Share/debt issue costs		1,921		4,382
Risk management contracts		3,435		-
Net foreign exchange		3,189		-
Valuation allowance		(54,092)		(22,731)
	$	2,669	$	2,693
Current		2,669		2,693
Non-current		-		-
	$	2,669	$	2,693
Future income tax liabilties:				
Oil and gas properties and equipment	$	342,435	$	373,513
Income not currently taxable		-		8,158
Other		5,771		1,800
	$	348,206	$	383,471
Current		3,396		846
Non-current		344,810		382,625
	$	348,206	$	383,471

As at December 31, 2010 non-capital losses totalled $177.4 million (2009 - $72 million) in Canada and expire between 2011 and 2030. In Colombia, non-capital losses totalled $8.1 million (2008 – $8.2 million).

18. SEGMENT DISCLOSURES

The Company currently has one reportable segment as at December 31, 2010, being the exploration, development and production of heavy crude oil and gas in Colombia. As at December 31, 2010 all of the Company's assets are located in Colombia except for $149 million (2009 - $224.6 million) in cash and cash equivalents which are held in Canada and the United States and $5.3 million (2009 - $3.2 million) of property, plant and equipment in Peru.

The Company's revenue based on the geographic location of customers were as follows:

		2010		2009
North America	$	800,891	$	498,900
Colombia		196,975		140,301
South America (excluding Colombia)		193,879		-
Asia		179,883		-
Europe		159,851		-
Africa		130,065		-
	$	1,661,544	$	639,201

19. RELATED-PARTY TRANSACTIONS

a) In June 2007, the Company entered into a 5-year lease agreement with Blue Pacific for administrative office space in one of its Bogota, Colombia locations. Monthly rent expense of $57 is payable to Blue Pacific under this agreement. Three directors and officers of the Company control, or provide investment advice to the holders of, 67.2% of the shares of Blue Pacific. The Company also has accounts receivable of $773 from Blue Pacific related to certain administrative costs paid by the Company on behalf of Blue Pacific. In addition, the Company paid $500 to Blue Pacific during the year for air transportation services received.

b) As at December 31, 2010, the Company had trade accounts receivable of $1.7 million (2009 - $10.5 million) from Proelectrica, in which the Company has a 17.7% indirect interest and which is 31.49% owned by Blue Pacific. The Company's and Blue Pacific's indirect interests are held through Ronter (note 5 a). Revenue

19. RELATED-PARTY TRANSACTIONS (continued)

from Proelectrica in the normal course of the Company's business was $12.5 million (2009 - $17.5 million) for the year ended December 31, 2010.

c) During the year ended December 31, 2010, Transportadora Del Meta S.A. ("Transmeta"), a variable interest entity indirectly 100% owned by a director of the Company, paid a dividend of $3.5 million respectively to its shareholder. The Company does not own any shares in Transmeta, but is the primary beneficiary and therefore consolidates Transmeta. The Transmeta dividend is included in other expense on the statement of operations.

d) During the year ended December 31, 2010, the Company received $565 (2009 - $374) from companies related by way of a number of directors in common, for reimbursement of general and administrative support expenses for the office premises in Canada. As at December 31, 2010, the Company has accounts receivable of $215 (2009 - $173) from the above companies, which was repaid in January 2011.

e) Loans receivable from related parties in the aggregate of $524 (2009 – $290) are due from two directors and four officers (2009 – two officers) of the Company. The loans are non-interest bearing and payable in equal monthly payments over a 48-month term. The loans were issued by the Company to these individuals in connection with costs incurred by these individual as a result of their relocation.

f) On April 19, 2010, the Company acquired a 9.4% interest in PII, a company that was previously wholly owned by Ronter, for $3.5 million. In September 2010, the Company acquired an additional 4% interest in PII for $2 million from an unrelated party. The Company invested a further $5 million in PII during a private placement offering in November 2010 (see note 5).

g) During the year ended December 31, 2010, the Company acquired a 19.05% interest in Pacific Coal, a company controlled by Blue Pacific, for $24 million. Four directors and one officer of the Company are also directors of Pacific Coal (see note 5).

h) The Company has entered into aircraft transportation agreements with Petroleum Aviation Services S.A.S., a company controlled by a director of the Company. During the year, the Company paid $7.7 million (2009 - $1.6 million) in fees as set out under the agreements.

i) The Company received $5.3 million from ODL during 2010 (2009 - nil) with respect to certain administrative services and rental equipment and machinery. The Company has accounts receivable of $0.6 million from ODL with respect to these charges as at December 31, 2010 (2009 - nil).

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

20. SUBSEQUENT EVENTS

a) Subsequent to December 31, 2010, the Company issued letters of credit and guarantees for exploration and operational commitments for a total of $304 million.

b) On December 29, 2010 the Colombian Congress passed a law imposing a surcharge on the current equity tax levied on Colombian companies. This surcharge has the effect of increasing the equity tax rate for the Company from 4.8% to 6%, and is applied on the net taxable equity as at January 1, 2011, the date which the amount becomes payable. The Company's equity tax for 2011 is $83.4 million and will be paid in eight equal semi-annual installments.

c) On March 10, 2011 the Company's Board of Directors approved a cash dividend in the aggregate of $25 million, or $0.093 per common share. The dividend is payable on March 30, 2011 to shareholders of record as of March 16, 2011; the ex-dividend date is March 14, 2011.

d) Subsequent to December 31, 2010, the Company invested $30.3 million in Pacific Coal as part of Pacific Coal's second round private placement offering. The Company's interest in Pacific Coal decreased from 19.05% to 15% after this private placement.

e) The Company entered into the following foreign currency derivative contracts subsequent to December 31, 2010:

(U.S. $ thousands, except share and per share amounts or unless otherwise stated)

20. SUBSEQUENT EVENTS (continued)

Instrument	Settlement date	Notional amount ($)	Floor-ceiling (COP/$)
Currency collars	February 2011	$ 20,000	1860-1900 & 1870-1900
Currency collars	March 2011	25,000	1860-1900 & 1870-1900
Currency collars	April 2011	25,000	1860-1900 & 1870-1900
Currency collars	May 2011	25,000	1860-1900 & 1870-1900
Currency collars	June 2011	25,000	1860-1900 & 1870-1900
Currency collars	July 2011	25,000	1860-1900 & 1870-1900
Currency collars	August 2011	25,000	1860-1900 & 1870-1900
Currency collars	September 2011	25,000	1860-1900 & 1870-1900
Currency collars	October 2011	25,000	1860-1900 & 1870-1900
Currency collars	November 2011	25,000	1860-1900 & 1870-1900
Currency collars	December 2011	25,000	1860-1900 & 1870-1900
	Total	**$ 270,000**	

f) The Company granted the following employee stock options under the rolling Plan after December 31, 2010:

Number of options granted	Exercise price	Fair value
250,000	C$34.43	C$9.55