



LOON ENERGY CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007
(Reported in US \$'s)



Management's Report

The Consolidated Financial Statements of Loon Energy Corporation and related financial information were prepared by, and are the responsibility of Management. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles. The Consolidated Financial Statements and related financial information reflect amounts which must of necessity be based upon informed estimates and judgments of Management with appropriate consideration to materiality. The Company has developed and maintains systems of controls, policies and procedures in order to provide reasonable assurance that assets are properly safeguarded, and that the financial records and systems are appropriately designed and maintained, and provide relevant, timely and reliable financial information to Management.

KPMG LLP are the external auditors appointed by the shareholders, and they have conducted an independent examination of the corporate and accounting records in order to express an Auditors' Opinion on these Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the Consolidated Financial Statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim financial statements prior to their release, as well as annually to review the Company's annual Consolidated Financial Statements and Management's Discussion and Analysis and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.

"Signed"

Norman W. Holton
Chief Executive Officer

"Signed"

Paul H. Rose, CA
Chief Financial Officer

March 18, 2009



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Loon Energy Corporation as at December 31, 2008 and 2007, and the consolidated statements of operations, deficit, other comprehensive loss, accumulated other comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada
March 18, 2009

Loon Energy Corporation
Consolidated Balance Sheets
 US\$

		December 31,	
		2008	2007
Assets			
Current			
Cash and cash equivalents (note 5)		\$ 3,103,592	\$ 138,047
Accounts receivable		143,975	1,230,246
		3,247,567	1,368,293
Restricted cash (note 6)		-	2,250,000
Property and equipment (note 7)		1,029,761	963,111
		\$ 4,277,328	\$ 4,581,404
Liabilities			
Current			
Accounts payable and accrued liabilities		\$ 350,280	\$ 57,554
Income taxes payable		100,000	-
		450,280	57,554
Asset retirement obligation (note 8)		111,293	101,621
		561,573	159,175
Shareholders' Equity			
Share capital (note 9)		15,139,980	12,241,368
Contributed surplus (note 11)		1,291,873	1,131,908
Deficit		(12,779,744)	(9,489,338)
Accumulated other comprehensive income		63,646	538,291
		3,715,755	4,422,229
		\$ 4,277,328	\$ 4,581,404
Future operations (note 2)			
Commitments (note 13)			
Subsequent event (note 17)			

Loon Energy Corporation

Consolidated Statements of Deficit, Other Comprehensive Loss and Accumulated Other Comprehensive Income US\$

	Years ended December 31,	
	2008	2007
Deficit		
Balance, beginning of year	\$ (9,489,338)	\$ (6,853,142)
Net loss	<u>(3,290,406)</u>	<u>(2,636,196)</u>
Balance, end of year	<u>\$ (12,779,744)</u>	<u>\$ (9,489,338)</u>
Accumulated Other Comprehensive Income		
Balance, beginning of year	\$ 538,291	\$ 128,621
Unrealized gain (loss) on translation of financial statements into reporting currency (note 4)	<u>(474,645)</u>	<u>409,670</u>
Balance, end of year	<u>\$ 63,646</u>	<u>\$ 538,291</u>
Total of Deficit and Accumulated Other Comprehensive Income		
Balance, end of year	<u>\$ (12,716,098)</u>	<u>\$ (8,951,047)</u>
Other Comprehensive Loss		
Net loss being other comprehensive loss	<u>\$ (3,290,406)</u>	<u>\$ (2,636,196)</u>

Loon Energy Corporation
Consolidated Statements of Operations
 US\$

	Years ended December 31,	
	2008	2007
Petroleum and natural gas sales	\$ 499,133	\$ 402,682
Less: Royalties	(24,768)	(19,175)
	474,365	383,507
 Expenses		
Operating	194,992	95,286
General and administrative	2,374,523	1,131,513
Stock based compensation (note 10)	159,965	469,929
Unrealized (gain) loss on foreign exchange	(673,031)	274,373
Realized loss on foreign exchange	(14,131)	113,907
Depletion, depreciation and accretion	399,067	555,447
Impairment of petroleum and natural gas properties	1,223,386	379,248
	3,664,771	3,019,703
 Loss before income taxes	(3,190,406)	(2,636,196)
 Current income tax (note 16)	100,000	-
	\$ (3,290,406)	\$ (2,636,196)
 Net loss		
 Net loss per share		
Basic and diluted	\$ (0.03)	\$ (0.03)

Loon Energy Corporation
Consolidated Statements of Cash Flows
 US\$

	Years ended December 31,	
	2008	2007
Operating activities		
Net loss	\$ (3,290,406)	\$ (2,636,196)
Items not involving cash:		
Depletion, depreciation and accretion, and impairment	1,622,453	934,695
Stock based compensation expense	159,965	469,929
Unrealized foreign exchange loss (gain)	(673,031)	274,373
	(2,181,019)	(957,199)
Changes in non-cash working capital	137,819	(415,905)
	(2,043,200)	(1,373,104)
 Financing		
Proceeds on allocation of share capital (note 1 and 4)	2,898,612	5,690,887
 Investing		
Restricted cash	2,250,000	(2,250,000)
Property and equipment expenditures	(1,591,261)	(1,001,159)
Changes in working capital related to capital expenditures	1,341,178	(1,091,443)
	1,999,917	(4,342,602)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	110,216	120,833
Change in cash and cash equivalents	2,965,545	96,014
Cash and cash equivalents, beginning of year	138,047	42,033
Cash and cash equivalents, end of year	\$ 3,103,592	\$ 138,047

Loon Energy Corporation
Notes to Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

1. Basis of preparation

Loon Energy Corporation was incorporated pursuant to the provisions of the *Business Corporation Act* (Alberta) on October 30, 2008 in conjunction with the reorganization of Loon Energy Inc. (“**Loon**”). The consolidated financial statements of the Loon Energy Corporation are based on the Plan of Arrangement (“**Arrangement**”) prepared by Loon and approved by its securityholders on December 9, 2008 and by the Court of Queen’s Bench of Alberta on December 10, 2008. The Arrangement was implemented on December 10, 2008, and resulted in the division of all of the net assets and operations of Loon into Loon Energy Corporation (the “**Company**”, or if referring to periods prior to December 10, 2008, the operations conducted by Loon which are now held by Loon Energy Corporation) and Kulczyk Oil Ventures Inc. (“**Kulczyk Oil**”) as more fully explained in note 4. The Company’s consolidated financial statements have been prepared by management following continuity of interest guidelines, are presented in United States dollars and are in accordance with accounting principles generally accepted in Canada.

Under the terms of the Arrangement, Loon shareholders received one Company share for each share of Loon owned and therefore retain their same proportionate interest in the Company as they had in Loon. The Company obtained the net assets associated with the resource properties located in Colombia and Peru, where operations commenced in 2005 and 2007 respectively. The Arrangement stated that the Company would receive at a minimum, \$3.0 million of cash as at December 9, 2008 (\$3,150,000 received upon closing the Arrangement). Upon implementation of the Arrangement, Loon’s name was changed to Kulczyk Oil Ventures Inc.

2. Future operations

The Company’s exploration activities and overhead costs are financed by way of equity issuances and by farm-out agreements through which third parties pay for all or a portion of the Company’s expenditures to earn a portion of the Company’s ownership interest. It is anticipated that cash resources at December 31, 2008 together with the funding to be provided by the Company’s joint venture partner in Peru should be sufficient to fund existing capital commitments for the next twelve months. Additional capital or further commitment from farm-in partners will be required to complete the full exploration and development programs as presently contemplated under the Company’s current agreements. Should capital or farm-in partners not be available in the future when planned expenditures on oil and gas properties are required, operations may have to be suspended or re-evaluated. The uncertainty in the global capital markets that is currently being experienced could have a negative impact on the Company’s ability to access capital in the future.

3. International operations

Colombia

Abanico Association Contract

In 2005, the Company committed to expend \$6.0 million on exploration and development expenditures to earn 49% of the interest of Kappa Resources Colombia Ltd. (“**Kappa**”) in the area covered by the Abanico Association Contract. The Company funded the drilling of a gas discovery well in the third quarter of 2005 at Ventilador-2 and drilled dry holes at Aleli-1 later that year and at Duna-1 in the first quarter of 2006. The Company fulfilled its expenditure commitment of \$6.0 million during 2007. In March 2007, the Ventilador-2 natural gas well was put on-stream and production from the well continued until it was suspended in October, 2008.

Buganviles Association Contract

On December 9, 2007, drilling commenced on the Delta-1 well, which is located within a 60,817 hectare block of lands covered by the Buganviles Association Contract between Holywell Resources S.A. (“**Holywell**”) and Empresa Colombiana de Petróleo (“**Ecopetrol**”), the Colombian national oil company. Holywell farmed a portion of its interest in the Association contract out to Kappa. Through a subsequent farm-in agreement with Kappa, the Company earned a 20% participating interest in the well and surrounding lands by paying \$1.0 million of the estimated \$3.4 million “dry-hole” cost of the Delta-1 well plus 20% of costs incurred thereafter.

The Delta-1 well came on production late in September 2008. Subsequent to year-end, the operator submitted a Commerciality Application to Ecopetrol for which a decision remains outstanding. In the event the well is deemed to be commercially productive, fifty percent of the lands, or approximately 75,000 acres, will be retained for a period of two years. If the well is not capable of commercial production, the lands will expire.

Loon Energy Corporation
Notes to Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

3. International operations (continued)

Peru

On August 21, 2007, the Company announced that its wholly-owned subsidiary, Loon Peru Limited (“**Loon Peru**”), signed an exploration license contract with PERUPETRO S.A. granting Loon Peru the right to explore for and produce hydrocarbons from Block 127 in the Marañón Basin area of northeast Peru. Block 127 is approximately 2.4 million acres (approximately 9,675 square kilometres) in size and is located in the Amazon Basin area of northeast Peru.

Under the terms of the agreement, Loon Peru committed to a minimum work program to acquire, process and interpret 390 kilometres of 2D seismic and reprocess another 2,000 kilometres of 2D seismic during the first two-year exploration period. The Company posted a performance guarantee amounting to \$2.25 million with the Government of Peru in accordance with the agreement.

Much of the Company’s existing commitments for the first two exploration periods are expected to be funded by CEPSA Peru S.A. (“**CEPSA Peru**”) under the terms of a farmout agreement dated October 29, 2007 which was approved by the Government of Peru during the second quarter of 2008. Under the terms of the farmout agreement, CEPSA Peru earned 80% of Loon Peru’s interest in the block in return for consideration consisting of a payment of \$700,000 to Loon Peru for past costs, replacement of the \$2.25 million performance guarantee that was previously funded by the Company, and payment of the first \$10.75 million of expenditures incurred in fulfilling the minimum work commitment for the first exploration period that ends in August, 2009. In the event CEPSA Peru agrees to proceed to the second exploration period of 18 months, they will fund 100% of the first \$15.0 million of expenditures incurred in fulfilling the group’s work commitments which includes the drilling of one exploratory well.

4. Significant accounting policies

Continuity of interest financial statements

The consolidated financial information presented herein has been extracted from the books and records of Loon until December 10, 2008, the date the Arrangement was implemented. Certain financial statement items were maintained at a corporate rather than on a property-by-property basis by Loon and accordingly, it was necessary to make allocations of amounts reported in the consolidated financial statements of Loon in order to prepare these consolidated financial statements for the Company. The allocations that were made include:

Share capital and related share issuance expenses were allocated based on the expenditure requirements of Kulczyk Oil and the Company.

General and administrative expense, stock based compensation, unrealized loss/(gain) on foreign exchange and realized loss/(gain) on foreign exchange were allocated based on the ratio of capital expenditures in the respective entity to the total capital expenditures of Loon.

Future income taxes were estimated on the basis that each entity was a separate legal entity.

As the determination of certain assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these consolidated financial statements requires the use of estimates and assumptions which have been made using careful judgement. In the opinion of management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

Change in reporting currency and foreign currency translation

Effective December 10, 2008, the Company changed its reporting currency from Canadian dollars (CAD \$) to United States dollars (US\$ or \$) as the Company anticipates that the majority of its future income streams and the basis of evaluation of new projects will be denominated in US\$. The Company has restated prior period’s comparative information.

Effective December 10, 2008 the Company re-classified the subsidiaries and the parent Company from integrated to self-sustaining operations. This re-classification was made as it is anticipated that all future income streams and the majority of expenditures will be denominated in US\$. Accordingly, all entities now use the US\$ as their functional currency. The Company has prospectively adopted the current rate method of foreign currency translation. Under this method revenues and expenses are

Loon Energy Corporation
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For the years ended December 31, 2008 and 2007

4. Significant accounting policies (continued)

translated using the average exchange rates for the applicable period, assets and liabilities are translated using the exchange rates in effect on the balance sheet dates, and shareholder's equity is translated using historical rates in effect at the date of each transaction. Resulting exchange differences are reported as a separate component of other comprehensive income.

For the year ended December 31, 2008, the Company recorded \$474,645 in accumulated other comprehensive loss with this amount arising from the prospective adoption of the current rate method for foreign currency translation. Upon adoption of the US\$ as reporting currency, the Company recorded a gain of \$538,291 in other comprehensive income in the prior year. All comparative information has been translated and restated as if the US\$ had been used as the Company's reporting currency but the subsidiaries remain classified as integrated.

New accounting policies

The Company adopted new accounting standards effective as of January 1, 2008. These standards have been adopted prospectively, and did not have an effect on the amounts recorded in the consolidated financial statements.

Financial instruments – disclosure and presentation

The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. They also enhance the disclosures about concentrations of risk, credit risk, liquidity risk and price risk. The new presentation standard carries forward former presentation requirements.

Capital disclosures

This new standard requires additional disclosure of objectives, policies and processes for managing capital plus disclosure as to whether companies have complied with externally imposed capital requirements.

Future Accounting Policy Changes

International Financial Reporting Standards

The Canadian Accounting Standards Board confirmed that publicly accountable profit-oriented enterprises will be required to use International Financial Reporting Standards (“IFRS”) in interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Over the next two years, Canadian GAAP will be modified, to a certain extent, to converge with IFRS.

An evaluation of IFRS conversion requirements that pertain to the Company will be conducted throughout the first half of 2009, which will then lead to the development of an implementation plan to transition the Company's financial reporting process, including internal controls and information systems to IFRS.

Summary of significant accounting policies

(a) Basis of presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries.

(b) Property and equipment

The Company follows the full-cost method of accounting for its resource activities, and accordingly all costs related to the exploration for and development of petroleum and natural gas reserves are accumulated in one cost centre for each country. Capitalized costs include: land, lease acquisition and concession costs, geological and geophysical expenditures, the carrying costs associated with undeveloped and non-producing properties, drilling and completion costs of productive and non-productive properties, and related production, gathering and plant equipment costs. A portion of overhead charges directly related to acquisition, exploration and development activities are capitalized. Proceeds received from the disposition of properties are normally credited to the cost centre without recognition of a gain or loss unless such treatment would result in a change of 20% or more to the depletion rate.

The Company performs a cost recovery test for each cost centre at least annually to evaluate and if appropriate, recognize impairment when the carrying value of property and equipment exceeds the undiscounted future cash flows from proven reserves using estimated future commodity prices. The amount of any impairment to be recognized is determined as the excess of the carrying value over fair value. Fair value is determined using proven and probable reserves together with undeveloped land, and is based on the present value of expected future cash flows discounted at a risk-free rate of interest. The Company also completes an analysis of the carrying value of undeveloped properties, at least annually, to ensure there are no indicators of impairment.

Loon Energy Corporation
Notes to Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

4. Significant accounting policies (continued)

These indicators would include, but are not limited to, results of seismic reprocessing and acquisition, licence expirations and if management determines a project or property is no longer economically feasible.

(c) Depletion and depreciation

Depletion and depreciation of petroleum and natural gas properties and equipment is provided using the unit-of-production method and proved reserves. Expenditures on undeveloped properties are excluded from the depletion provision until related reserves are proven or impairment is recognized. Volumes are converted to equivalent units on the basis that one barrel of oil is equivalent to six thousand cubic feet of natural gas.

(d) Cash and cash equivalents

Cash and cash equivalents include cash on hand and short-term, highly liquid investments with original maturities of three months or less.

(e) Asset retirement obligations

The Company recognizes the fair value of its asset retirement obligation as a liability at the time it incurs an obligation for the future abandonment and reclamation costs resulting from its resource operations. The asset retirement obligation is initially measured at its estimated fair value, which is the discounted future value of the liability, with the liability then accreting each subsequent period until the obligation is settled. The estimated fair value of the asset retirement obligation is capitalized to the petroleum and natural gas properties and equipment accounts, and is depleted over the estimated useful life of these assets.

(f) Joint operations

The Company conducts all of its exploration, development and production activities with partners, and accordingly these consolidated financial statements reflect only the Company's proportionate interest in such activities.

(g) Financial instruments

All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities as defined by the standard. The Company's policy prior to the adoption of this standard on January 1, 2007, was to record these items at cost and reduce to fair value if the decline was other than temporary.

Financial assets and financial liabilities held-for-trading are measured at fair value with changes in those fair values recognized in net earnings or loss. Financial assets available-for-sale are measured at fair value, with changes in those fair values recognized in other comprehensive income. Financial assets held-to-maturity, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization.

Cash including short-term deposits and restricted cash are designated as held-for-trading and are measured at carrying value which approximates fair value due to the short-term nature of these instruments. Accounts receivable are designated as loans and receivables. Accounts payable and accrued liabilities are designated as other financial liabilities.

(h) Revenue recognition

Revenue derived from the sale of the Company's petroleum and natural gas products is recognized when title to the product passes from the Company to its customer and when collection is reasonably assured.

(i) Income taxes

Income taxes are calculated using the asset and liability method of tax accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income taxes and liabilities. Future income tax assets and liabilities are calculated using tax rates that are substantively enacted and are expected to apply in the periods that the temporary differences are expected to reverse. To the extent that management does not consider it more likely than not that a future income tax asset will be realized, a valuation allowance is provided.

(j) Stock based compensation

Compensation costs arising from share purchase options issued by Loon have been allocated to the Company. These options are accounted for using the fair value method which estimates the value of the options at the date of grant using the Black-Scholes option pricing model. The fair value thus established is recognized as an expense over the life of the options with a corresponding increase to contributed surplus. When options were exercised, the proceeds received and the applicable amount in contributed

Loon Energy Corporation
Notes to Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

4. Significant accounting policies (continued)

surplus will be credited to share capital. If options were forfeited, the amount of compensation expense relating to unvested options will be credited against the contributed surplus account. Should the Company issue options under the option plan approved under the Arrangement, the same policy as described above will be applied to such grants.

(k) Loss per share

Basic loss per share is calculated by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted loss per share, when appropriate, is calculated using the treasury stock method which adjusts the weighted average shares outstanding to recognize the effect, if any, of in-the-money stock options.

(l) Measurement uncertainty

In preparing the Company's consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the measurement and disclosure of contingent assets and liabilities at the date of the consolidated financial statements together with the reported amounts of revenues and expenses for the reporting periods then ended. Actual results could differ from these estimates. Estimates and judgements used are based on management's experience and the assumptions used are believed to be reasonable given the circumstances that exist at the time the consolidated financial statements are prepared. Predicting the outcome of future events cannot be done with certainty however, and therefore estimates used may change as new events occur, additional experience is acquired or the Company's operating environment changes.

5. Cash and cash equivalents

In accordance with the terms of the Arrangement, on December 10, 2008, the Company was allocated cash and cash equivalents of \$3,150,000. The Company did not yet have its own bank account at December 31, 2008 and accordingly these funds are held by Kulczyk Oil in the form of cash plus investments in short-term HSBC Bank Canada, Bankers Acceptances.

6. Restricted cash

In August 2007, pursuant to the terms of a petroleum exploration license for Peru, the Company posted a performance guarantee in the amount of \$2,250,000 that was to be released upon completion of the work commitment required under the agreement. The Company was entitled to earn interest on these funds being held on deposit.

During 2008 the performance guarantee for Peru was assumed by the new operator of the concession and the \$2,250,000 that had been pledged by the Company as security for the performance guarantee was released, and thus made available for general corporate purposes.

7. Property and equipment

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
	US\$	US\$
Petroleum and natural gas properties	\$ 8,365,072	\$ 8,556,884
Accumulated depletion and depreciation	(7,335,311)	(7,593,773)
	<u>\$ 1,029,761</u>	<u>\$ 963,111</u>

For the year ended December 31, 2008, the Company spent \$1.8 million on the Delta-1 well located within the Buganviles Association Contract area in Colombia. The well began producing minor quantities of oil late in the third quarter however no sales were made until the fourth quarter of 2008. During the fourth quarter of 2008, the natural gas well Ventilador 2 located in the Abanico Association Contract area of Colombia was suspended.

The Company recorded impairment of \$1,223,386 on its Colombian cost centre during 2008 based on a third party engineering report dated October 1, 2008 prepared for the Buganviles Association Contract area, and the suspension of the Ventilador 2 well.

Loon Energy Corporation
Notes to Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

7. Property and equipment (continued)

At December 31, 2008, the Company performed a ceiling test on the Colombian cost centre test based on a third party engineering report prepared for the Baganviles Association Contract area dated January 1, 2009. This test indicated that no additional impairment needed to be recorded against the Colombian cost centre for the year ended December 31, 2008. The following oil prices were used in the third party reserve evaluation:

West Texas Intermediate	Year				
	2009	2010	2011	2012	2013
US\$/STB	\$57	\$70	\$80	\$90	\$100

Costs incurred in Peru of \$30,126 at December 31, 2008 (December 31, 2007 - \$589,085) have been excluded from depletion as this cost centre is in a pre-production phase and does not yet have any proven reserves attributable to it.

During the year ended December 31, 2008, the Company collected \$700,000 from CEPSA Peru S.A. in accordance with the terms of the farmout agreement dated October 29, 2007. These funds reduced the Company's capitalized costs recorded to date for the acquisition of the Block 127 concession in Peru.

For the year ending December 31, 2007, the Company recorded impairment on its Colombian cost centre of \$379,248. The impairment charge was based on an annual reserve evaluation prepared by an independent engineering consultant.

8. Asset retirement obligation

The Company's asset retirement obligations result from its working interest ownership in petroleum and natural gas properties, including well sites, gathering systems and processing facilities. The Company's estimate of the total undiscounted cash flows required to settle the asset retirement obligations is \$174,287 (December 31, 2007 - \$133,255) which is expected to be incurred between 2012 and 2016. A credit-adjusted risk-free rate of 9.0 percent and inflation at a rate of 2.0 percent were used to calculate the fair value of the asset retirement obligations.

	December 31, 2008	December 31, 2007
	US\$	US\$
Balance beginning of year	\$ 101,621	\$ 74,896
Obligations incurred	12,213	25,296
Accretion	7,623	1,429
Adoption of change in foreign currency translation (note 3)	(10,164)	-
Balance, end of year	<u>\$ 111,293</u>	<u>\$ 101,621</u>

9. Share capital

In accordance with the Arrangement described in notes 1 and 4, Loon Energy Corporation issued 95,991,364 common shares which represent all of its issued and outstanding share capital. The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. The carrying amount of these shares is based on the allocation of share capital raised by Loon Energy Inc. that was deployed for operations in Colombia and Peru that commenced in 2005 and 2007 respectively.

Loon Energy Corporation
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9. Share capital (continued)

	<i>Number of Shares</i>	Carrying amount
		US\$
Balance, December 31, 2006	-	\$ 6,550,481
Allocation pursuant to Plan of Arrangement (notes 1 and 4)	-	5,690,887
Balance, December 31, 2007	-	12,241,368
Allocation pursuant to Plan of Arrangement (notes 1 and 4)	-	2,898,612
Balance, December 31, 2008	<u>95,991,364</u>	<u>\$ 15,139,980</u>

Under the Arrangement, each existing shareholder of Loon received the same number of shares in Loon Energy Corporation as they owned in Loon, therefore the weighted number of shares outstanding for the Company remains unchanged for the years presented.

	Year ended December 31,	
	2008	2007
Weighted average number of shares outstanding	95,991,364	82,566,706

As the Company is in a loss position in 2008 and 2007, the effect of any potentially dilutive instruments is anti-dilutive to the net loss per share.

10. Stock based compensation expense

The stock based compensation of Loon Energy Inc. was allocated between the Company and Kulczyk Oil. as detailed in note 4. As part of the Arrangement, a stock option plan was approved for the Company but as at December 31, 2008 there were no stock options granted under the plan.

	Year ended December 31,	
	2008	2007
	US\$	US\$
Total stock based compensation - Loon Energy Inc	\$ 341,642	\$ 1,189,247
Allocated to Kulczyk Oil	(181,677)	(719,318)
Allocated to Loon Energy Corporation	<u>\$ 159,965</u>	<u>\$ 469,929</u>

The fair value of the options granted in the above years was based on the Black-Scholes option pricing model using the following assumptions:

	Year ended December 31,	
	2008	2007
Fair value per option (\$CAD)	\$ 0.70	\$ 0.40
Volatility	86.0%	90.0%
Interest rate	3.34%	4.30%
Expected life (years)	4	4
Dividends	Nil	Nil

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11. Contributed surplus

	Carrying amount US\$
Balance, December 31, 2006	\$ 661,979
Stock based compensation	469,929
Balance, December 31, 2007	1,131,908
Stock based compensation	159,965
Balance, December 31, 2008	\$ 1,291,873

12. Capital management

The Company's total capital resources at December 31, 2008 are \$3,715,755 (December 31, 2007 – \$4,422,229) with this amount comprised entirely of shareholder's equity. As at December 31, 2008, the Company had no debt. Consistent with prior periods, the Company manages its capital structure to maximize financial flexibility making adjustments in light of changes in economic conditions and risk characteristics of the underlying assets. Further, each potential acquisition and investment opportunity is assessed to determine the nature and total amount of capital required together with the relative proportions of debt and equity to be deployed. The Company does not presently utilize any quantitative measures to monitor its capital and there are no external restrictions on the Company's capital.

13. Commitments

Peru

The Company has committed to a minimum work program under the terms of an exploration license contract covering Block 127 in the Marañon Basin area of northeast Peru which is presently expected to cost \$10.75 million. Much of the Company's existing commitments for the first two exploration periods is to be funded by CEPSA Peru S.A under the terms of a farmout agreement dated October 29, 2007. Under the terms of the farmout agreement, CEPSA Peru S.A. is to pay the first \$10.75 million of expenditures incurred in fulfilling the group's minimum work commitment for the first exploration period that ends in August, 2009. In the event CEPSA Peru agrees to proceed to the second exploration period of 18 months, they will fund 100% of the first \$15.0 million of expenditures incurred in fulfilling the work commitments which includes the drilling of one exploratory well.

The Company has a commitment to a third party geophysical company relating to its Peru concession which requires the Company to pay \$250,000 to the geophysical company when commerciality is first declared, a further \$500,000 when third party proven reserves are assessed at 50 million barrels of oil equivalent and an additional \$250,000 when 75 million barrels of oil equivalent are assessed as proven reserves.

14. Financial instruments

Financial risk management

The Company as part of its operations carries a number of financial instruments including cash and short-term deposits, accounts receivable and accounts payable and accrued liabilities. The Company is exposed to the following risks related to its financial assets and liabilities:

(a) Interest rate risk

The Company maintains its cash and cash equivalents and restricted cash in instruments that are redeemable at any time without penalty, thereby reducing its exposure to interest rate fluctuations thereon.

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14. Financial instruments (continued)

(b) Credit risk

The Company's cash and cash equivalents are held by Kulczyk Oil in major financial institutions. Management monitors credit risk by reviewing the credit quality of the financial institutions that hold the cash and cash equivalents.

The Company's accounts receivable are comprised of net operating revenue and cash calls, and are due from its joint venture partner in Colombia. The Company does not consider the credit risk relating to the outstanding amounts to be significant as it anticipates owing the joint venture partner funds in excess of the amounts receivable due to planned capital expenditures in Colombia.

(c) Market risk

The Company is exposed to risks arising from fluctuations in currency exchange rates between the Canadian dollar and the United States dollar. At December 31, 2008 the Company's primary exposure relates to Canadian dollar accounts payable and accrued liabilities in Canada in the amount of C\$57,452.

At December 31, 2008, if the Canadian dollar had strengthened by 10% compared to the U.S. dollar and all other variables were held constant, after tax net loss would have been approximately \$7,000 higher. Conversely, if the Canadian dollar had weakened by 10%, an equal decrease of approximately \$7,000 to after tax net loss would have resulted.

(d) Fair value

The carrying value of the Company's financial assets and liabilities approximate their fair values due to their demand nature or because of their relatively short term to maturity.

(e) Liquidity risk

The Company monitors its liquidity position regularly to ensure that it has funds necessary to complete planned exploration commitments on its petroleum and natural gas properties or that viable options are available to fund such commitments from new equity issuances or alternative sources of financing such as farm-out agreements. However, as an exploration company at an early stage of development and without significant internally generated cash flow, there are inherent liquidity risks, including the possibility that additional financing may not be available to the Company, or that actual exploration expenditures may exceed those planned. Alternatives available to the Company to manage its liquidity risk include deferring planned capital expenditures that exceed amounts required by work programmes to retain concession licences, farm-out arrangements and seeking new equity capital.

15. Related party transactions

All of the amounts to December 9, 2008 reported by the Company as related party transactions are allocated amounts as described in the continuity of interest financial statements section of note 4.

Jura Energy Corporation ("**Jura**"), a public company in which Kulczyk Oil owns 6.4% of the outstanding common shares, commenced providing financial and accounting services to Kulczyk Oil in May 2007. For the year ended December 31, 2008, the fees totalled \$107,816 (December 31, 2007: \$59,639). Timothy M. Elliott, director of the Company, and Norman W. Holton officer and director of the Company, are directors of Jura. Paul H. Rose, Chief Financial Officer of the Company is also Chief Financial Officer of Jura.

Nemmoco Petroleum Corporation ("**Nemmoco**"), a private company of which 25% is owned by Timothy M. Elliott, a director of the Company, provides certain personnel and general, accounting and administrative services to the Company at its offices in Dubai on a cost sharing basis. For the year ended December 31, 2008, the fees totalled \$118,160 (December 31, 2007: \$28,602).

All of the Kulczyk Oil shares issued in the CAD\$25,000,000 private placement completed on July 13, 2007 were bought by Kulczyk Investment House, a private company which had a prior ownership interest in and a representative on the Kulczyk Oil board of directors at the time the shares were issued. Portions of the proceeds of this share issuance were allocated to the

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15. Related party transactions (continued)

Company. At December 31, 2008, Kulczyk Investment House owns approximately 39% of the outstanding common shares of the Company.

The Company has no employees, and management and administrative services are provided by the management and staff of Kulczyk Oil pursuant to a shared services structure. This structure was implemented on December 10, 2008, the date the Arrangement was implemented. Administrative costs incurred by Kulczyk Oil for the benefit of the Company are allocated to the Company based on specific identification and an allocation of administrative costs that relate to both Kulczyk Oil and the Company. The Company owes Kulczyk Oil \$56,813 as at December 31, 2008.

Prior to May 2007, when its 12,279,763 shares of Kulczyk Oil were acquired by Kulczyk Investment House, TUSK Energy Corporation (“TUSK”) purchased shares through the open market, by private placement and the exercise of share purchase warrants. Norman W. Holton, an officer and director of the Company, was then a director of TUSK. TUSK, a related party during the relevant period because of its ownership of Kulczyk Oil shares, supplied certain personnel and general, accounting and administrative services to the Company until May 31, 2007 when the arrangement was terminated. For the year ending December 31, 2007, their monthly fees totalled \$6,518.

The above related party transactions were at exchange amounts agreed to by both parties which approximate fair value.

16. Income Taxes

Current tax expense is provided for the year ending December 31, 2008 because there are insufficient income tax deductions available in Colombia to offset the net taxable production revenues earned within the Colombian tax jurisdiction.

Differences between income tax provisions calculated using statutory rates and the reported income tax provisions are as follows:

	Years ended December 31,	
	2008	2007
	US\$	US\$
Loss before income taxes	\$ (3,190,406)	\$ (2,636,196)
<i>Federal and provincial statutory rate</i>	<i>29.50%</i>	<i>32.12%</i>
Expected income tax recovery	\$ (941,170)	\$ (846,746)
Stock based compensation	47,190	150,941
Tax rate differences and change in valuation allowance	993,980	695,805
Current income tax expense	<u>\$ 100,000</u>	<u>\$ -</u>

The tax effects of temporary differences that give rise to future tax balances are:

	Years ended December 31,	
	2008	2007
	US\$	US\$
Property and equipment	\$ (15,749)	\$ 1,486,286
Asset retirement obligations	27,835	32,083
Non-capital losses (expire up until 2028)	33,602	1,084,510
	<u>45,688</u>	<u>2,602,878</u>
Less: valuation allowance	(45,688)	(2,602,878)
Future income tax asset/(liability)	<u>\$ -</u>	<u>\$ -</u>

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17. Subsequent event

On February 23, 2009, the Company announced it had entered into a Letter of Intent (“**LOI**”) with respect to a proposed business combination which, if completed, would result in Petro Vista Energy Corporation (“**Petro Vista**”) acquiring the Company in a stock transaction.

The LOI contemplates the acquisition by Petro Vista of all the issued and outstanding shares of the Company on the basis of one Unit of Petro Vista for each five shares of the Company. Each Unit of Petro Vista will consist of one common share plus one-third of a share purchase warrant. In the event that Petro Vista’s daily average production volume for the first three months of 2010 is less than 500 barrels per day of oil equivalent from its existing assets, each whole warrant will be exchangeable for an additional Petro Vista common share. The Company and Petro Vista are engaged in ongoing discussions to negotiate and agree upon the final terms of a potential business acquisition. There is presently no assurance that such agreement will be reached and that the proposed business combination will be concluded or that it will be concluded on the terms specified in the LOI. The completion of the proposed business combination is also subject to regulatory approval and the approval of shareholders at a special meeting that would be held to consider the business combination with Petro Vista. It is presently anticipated that the proposed business combination will be completed in May 2009.

Upon completion of satisfactory due diligence and subject to other conditions, the Company has agreed to advance Petro Vista \$2,000,000 (the “**Loan**”), repayable with interest at 10% per annum in the event the business combination is not completed on or before June 30, 2009. The Loan will be secured by a pledge of shares of certain of Petro Vista’s operating subsidiaries and will be governed by a formal loan agreement to be negotiated between the Company and Petro Vista. The granting of the loan is subject to written consent of shareholders representing more than 50% of the common shares of the Company. The Loan proceeds are expected to be advanced to Petro Vista by the end of March, 2009.

18. Segmented information

The Company’s reportable segments are organized by geographical areas and consist of Colombia, Peru and Corporate.

Colombia

	Year ended December 31,	
	2008	2007
	US\$	US\$
Petroleum and natural gas sales	\$ 499,133	\$ 402,682
Royalties	(24,768)	(19,175)
Operating expenses	(194,992)	(95,286)
General and administrative	-	-
Stock based compensation expense	-	-
Depletion, depreciation and accretion	(399,067)	(555,447)
Impairment of oil and gas assets	(1,223,386)	(379,248)
Unrealized loss on foreign exchange	-	-
Realized loss on foreign exchange	-	-
Loss before income taxes and discontinued operations	<u>\$ (1,343,080)</u>	<u>\$ (646,474)</u>
Capital expenditures	<u>\$ 1,894,670</u>	<u>\$ 436,984</u>
Total assets	<u>\$ 1,080,486</u>	<u>\$ 1,371,015</u>

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18. Segmented information (continued)

Peru

	Year ended December 31,	
	2008	2007
	US\$	US\$
Petroleum and natural gas sales	\$ -	\$ -
Royalties	-	-
Operating expenses	-	-
General and administrative	-	-
Stock based compensation expense	-	-
Depletion, depreciation and accretion	-	-
Impairment of oil and gas assets	-	-
Unrealized loss on foreign exchange	-	-
Realized loss on foreign exchange	-	-
Loss before income taxes and discontinued operations	<u>\$ -</u>	<u>\$ -</u>
Capital expenditures	<u>\$ (303,409)</u>	<u>\$ 564,175</u>
Total assets	<u>\$ 30,126</u>	<u>\$ 3,072,342</u>

Corporate

	Year ended December 31,	
	2008	2007
	US\$	US\$
Petroleum and natural gas sales	\$ -	\$ -
Royalties	-	-
Operating expenses	-	-
General and administrative	(2,374,523)	(1,131,513)
Stock based compensation expense	(159,965)	(469,929)
Depletion, depreciation and accretion	-	-
Impairment of oil and gas assets	-	-
Unrealized loss on foreign exchange	673,031	(274,373)
Realized loss on foreign exchange	14,131	(113,907)
Loss before income taxes and discontinued operations	<u>\$ (1,847,326)</u>	<u>\$ (1,989,722)</u>
Capital expenditures	<u>\$ -</u>	<u>\$ -</u>
Total assets	<u>\$ 3,166,716</u>	<u>\$ 138,047</u>