



**CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012 and 2011  
(Stated in Canadian Dollars)**



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## **INDEPENDENT AUDITORS' REPORT**

To the Shareholders of LNG Energy Ltd.

We have audited the accompanying consolidated financial statements of LNG Energy Ltd. ("the Company"), which comprise the consolidated statements of financial position as at September 30, 2012, September 30, 2011 and October 1, 2010, the consolidated statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years ended September 30, 2012 and 2011, and notes, comprising a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

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

### *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our 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, we 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 consolidated financial position of the Company as at September 30, 2012, September 30, 2011 and October 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended September 30, 2012 and 2011 in accordance with International Financial Reporting Standards.

### *Emphasis of Matter*

Without modifying our opinion, we draw attention to Note 2 (c) in the consolidated financial statements which describes that the Company incurred a net loss of \$59.8 million during the year ended September 30, 2012 and has negative working capital of \$4.5 million at September 30, 2012. The Company does not have sufficient funds to meet either its ongoing operations or its oil and gas work commitments. As such the Company's going concern assumption is dependent upon its ability to obtain significant immediate



funding in order to meet its working capital obligations and to continue to fund its oil and gas work commitments. These conditions, along with other matters as set forth in Note 2 (c), indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

*KPMG LLP*

Chartered Accountants  
January 25, 2013  
Calgary, Canada

# LNG Energy Ltd.

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| (in Canadian dollars)                             | <b>September 30,<br/>2012</b> | As at<br>September 30,<br>2011 | October 1,<br>2010   |
|---|-------------------------------|--------------------------------|----------------------|
| <b>ASSETS</b>                                     |                               | (Note 19)                      | (Note 19)            |
| <b>Current</b>                                    |                               |                                |                      |
| Cash and cash equivalents                         | \$ 798,327                    | \$ 20,510,667                  | \$ 10,036,105        |
| Short term investments                            | -                             | -                              | 9,015,750            |
| Amounts receivable                                | 337,149                       | 409,267                        | 314,242              |
| Prepaid expenses, advances and other deposits     | 452,267                       | 462,530                        | 423,467              |
|   | <b>1,587,743</b>              | 21,382,464                     | 19,789,564           |
| Investment  | -                             | 5,243                          | 6,176                |
| Exploration and evaluation assets (Note 6)        | 23,217,868                    | 60,826,781                     | 32,198,880           |
| Property, plant and equipment (Note 7)            | 194,732                       | 201,904                        | 17,704,204           |
| <b>Total Assets</b>                               | <b>\$ 25,000,343</b>          | <b>\$ 82,416,392</b>           | <b>\$ 69,698,824</b> |
| <b>LIABILITIES</b>                                |                               |                                |                      |
| <b>Current</b>                                    |                               |                                |                      |
| Accounts payable and accrued liabilities          | \$ 947,764                    | \$ 6,685,214                   | \$ 1,442,148         |
| Loans payable (Note 10)                           | 5,122,848                     | -                              | -                    |
|   | <b>6,070,612</b>              | 6,685,214                      | 1,442,148            |
| Decommissioning obligations (Note 9)              | 38,186                        | 37,820                         | 3,019                |
| <b>Total Liabilities</b>                          | <b>6,108,798</b>              | <b>6,723,034</b>               | <b>1,445,167</b>     |
| <b>SHAREHOLDERS' EQUITY</b>                       |                               |                                |                      |
| Share capital (Note 11)                           | 103,211,241                   | 103,055,103                    | 84,033,523           |
| Contributed surplus                               | 12,397,169                    | 12,073,436                     | 7,143,351            |
| Accumulated other comprehensive income            | 7,455,396                     | 4,984,841                      | -                    |
| Deficit   | (104,172,261)                 | (44,420,022)                   | (22,923,217)         |
| <b>Total Shareholders' Equity</b>                 | <b>18,891,545</b>             | <b>75,693,358</b>              | <b>68,253,657</b>    |
| <b>Total Liabilities and Shareholders' Equity</b> | <b>\$ 25,000,343</b>          | <b>\$ 82,416,392</b>           | <b>\$ 69,698,824</b> |

Going Concern (Note 2); Subsequent events (Note 18)

These consolidated financial statements were approved for issue by the Board of Directors on January 25, 2013 and are signed on its behalf by:

(Signed) "Paul Larkin"  
Director

(Signed) "David Cohen"  
Director

See accompanying notes to these consolidated financial statements.

# LNG Energy Ltd.

## CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

| (in Canadian dollars)                                    | For the Years Ended<br>September 30, |                    |
|--|--------------------------------------|--------------------|
|  | 2012                                 | 2011<br>(Note 19)  |
| <b>Expenses</b>  |                                      |                    |
| Depletion and depreciation                               | \$ 46,245                            | \$ 60,854          |
| General and administrative expenses                      | 2,161,126                            | 2,274,263          |
| Professional fees  | 1,925,217                            | 2,309,769          |
| Stock based compensation (Note 11)                       | 138,831                              | 3,526,918          |
| Travel and business development                          | 474,874                              | 648,763            |
| Loss on disposal of asset                                | -                                    | 20,914             |
| Unrealized loss on investment                            | 5,243                                | 933                |
| Write-down of exploration and evaluation assets (Note 6) | 54,548,680                           | 24,122             |
|  | <b>(59,300,216)</b>                  | <b>(8,866,536)</b> |
| <b>Finance income (expenses):</b>                        |                                      |                    |
| Accretion expense  | (366)                                | -                  |
| Interest expense (Note 10)                               | (181,955)                            | -                  |
| Foreign exchange loss                                    | (174,461)                            | (104,557)          |
| Write-down of advances                                   | (27,996)                             | -                  |
| Interest income  | 36,766                               | 114,835            |
|  | <b>(348,012)</b>                     | <b>10,278</b>      |
| Loss for the year before tax and discontinued operations | \$ (59,648,228)                      | \$ (8,856,258)     |
| Income tax expense                                       | (33,039)                             | -                  |
| Loss from continuing operations                          | (59,681,267)                         | (8,856,258)        |
| Loss from discontinued operations (Note 5)               | (70,972)                             | (12,640,547)       |
| Net loss for the year                                    | \$ (59,752,239)                      | \$ (21,496,805)    |
| Other comprehensive income                               |                                      |                    |
| Foreign currency translation gain (loss)                 | 2,470,555                            | 4,984,841          |
| Comprehensive loss for the year                          | \$ (57,281,684)                      | \$ (16,511,964)    |
| <b>Loss per share: (Note 11)</b>                         |                                      |                    |
| Basic and diluted from continuing operations             | (0.18)                               | (0.03)             |
| Basic and diluted from discontinued operations           | (0.00)                               | (0.05)             |
| Basic and diluted  | (0.18)                               | (0.08)             |

See accompanying notes to these consolidated financial statements.

# LNG Energy Ltd.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| (in Canadian dollars)                            | Number of<br>shares | Share Capital         | Contributed<br>Surplus | Deficit                 | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Shareholders'<br>Equity |
|--|---------------------|-----------------------|------------------------|-------------------------|---|----------------------------------|
| <b>Balance, October 1,<br/>2010 (Note 19)</b>    | <b>257,234,365</b>  | <b>\$ 84,033,523</b>  | <b>\$ 7,143,351</b>    | <b>\$ (22,923,217)</b>  | <b>\$ -</b>                                     | <b>\$ 68,253,657</b>             |
| Stock based<br>compensation                      | -                   | -                     | 5,120,369              | -                       | -   | 5,120,369                        |
| Shares issued upon<br>exercise of options        | 825,000             | 380,742               | (190,284)              | -                       | -   | 190,458                          |
| Shares issued upon<br>financing                  | 80,460,000          | 20,115,000            | -                      | -                       | -   | 20,115,000                       |
| Share issue costs                                | -                   | (1,474,162)           | -                      | -                       | -   | (1,474,162)                      |
| Net loss for the period                          | -                   | -                     | -                      | (21,496,805)            | -   | (21,496,805)                     |
| Foreign currency<br>translation                  | -                   | -                     | -                      | -                       | 4,984,841                                       | 4,984,841                        |
| <b>Balance, September<br/>30, 2011 (Note 19)</b> | <b>338,519,365</b>  | <b>\$ 103,055,103</b> | <b>\$ 12,073,436</b>   | <b>\$ (44,420,022)</b>  | <b>\$ 4,984,841</b>                             | <b>\$ 75,693,358</b>             |
| Stock based<br>compensation                      | -                   | -                     | 459,104                | -                       | -   | 459,104                          |
| Shares issued upon<br>exercise of options        | 200,000             | 155,371               | (135,371)              | -                       | -   | 20,000                           |
| Share issue costs                                | -                   | 767                   | -                      | -                       | -   | 767                              |
| Net loss for the period                          | -                   | -                     | -                      | (59,752,239)            | -   | (59,752,239)                     |
| Foreign currency<br>translation                  | -                   | -                     | -                      | -                       | 2,470,555                                       | 2,470,555                        |
| <b>Balance, September<br/>30, 2012</b>           | <b>338,719,365</b>  | <b>\$ 103,211,241</b> | <b>\$ 12,397,169</b>   | <b>\$ (104,172,261)</b> | <b>\$ 7,455,396</b>                             | <b>\$ 18,891,545</b>             |

See accompanying notes to these consolidated financial statements.

# LNG Energy Ltd.

## CONSOLIDATED STATEMENT OF CASH FLOWS

| (in Canadian dollars)  | For the Years Ended |                      |
|--|---------------------|----------------------|
|  | 2012                | 2011                 |
| <b>September 30,</b>   |                     |                      |
| <b>Operating activities:</b>                                   |                     |                      |
| Net loss   | \$ (59,752,239)     | \$ (21,496,805)      |
| Items not affecting cash:                                      |                     |                      |
| Depletion and depreciation (Note 5 and 7)                      | 46,245              | 60,854               |
| Accretion expense  | 366                 | -                    |
| Stock based compensation                                       | 138,831             | 3,526,918            |
| Interest expense (Note 10)                                     | 181,955             | -                    |
| Interest income  | (36,766)            | (114,835)            |
| Tax expense  | 33,039              | -                    |
| Loss on disposal of asset                                      | -                   | 20,914               |
| Write-down of exploration and evaluation assets (Note 5 and 6) | 54,548,680          | 11,400,394           |
| Unrealized foreign exchange loss                               | 52,571              | 268,933              |
| Unrealized loss on investment                                  | 5,243               | -                    |
| Write-down of advances   | 27,996              | 24,122               |
|  | <b>(4,754,079)</b>  | <b>(6,309,505)</b>   |
| Changes in non-cash working capital<br>(Notes 5 and 13)        | <b>(738,230)</b>    | 1,584,438            |
| Interest received  | 36,766              | 114,835              |
| Taxes paid   | (33,039)            | -                    |
|  | <b>(5,488,582)</b>  | <b>(4,610,232)</b>   |
| <b>Financing activities:</b>                                   |                     |                      |
| Proceeds from stock option exercises                           | 20,000              | 190,750              |
| Proceeds from equity financing                                 | -                   | 18,640,838           |
| Proceeds from loan   | 4,992,500           | -                    |
|  | <b>5,012,500</b>    | <b>18,831,588</b>    |
| <b>Investing activities:</b>                                   |                     |                      |
| Acquisition of joint interests (Note 8)                        | -                   | (3,878,400)          |
| Exploration and evaluation expenditures                        | (14,303,708)        | (17,786,180)         |
| Property, plant and equipment expenditures                     | (4,798)             | (51,759)             |
| Short term investments   | -                   | 9,015,750            |
| Proceeds from sale of US assets (Note 5)                       | -                   | 4,960,188            |
| Change in non-cash working capital (Note 13)                   | (4,916,839)         | 3,524,540            |
|  | <b>(19,225,345)</b> | <b>(4,215,861)</b>   |
| Foreign exchange effect on cash and cash equivalents           | <b>(10,913)</b>     | 469,067              |
| <b>Net increase (decrease) in cash and cash equivalents</b>    | <b>(19,712,340)</b> | 10,474,562           |
| <b>Cash and cash equivalents, beginning of year</b>            | <b>20,510,667</b>   | 10,036,105           |
| <b>Cash and cash equivalents, end of year</b>                  | <b>\$ 798,327</b>   | <b>\$ 20,510,667</b> |

See accompanying notes to these consolidated financial statements.

# LNG Energy Ltd.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
As of and for the Years Ended September 30, 2012 and 2011  
(in Canadian dollars, except otherwise stated)

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## 1. NATURE OF OPERATIONS

LNG Energy Ltd. (the "Company" or "LNG") was incorporated on February 24, 2000 in the Province of British Columbia and changed its name to "LNG Energy Ltd." on March 28, 2008. The Company's common shares began trading under the symbol "LNG" on the TSX Venture Exchange on March 28, 2008. The Company is engaged in exploration activities on its oil and gas properties in Papua New Guinea, Poland and Bulgaria. The address of LNG's registered office is 250, 1075 West Georgia Street, Vancouver, British Columbia.

## 2. BASIS OF PRESENTATION

### a) Statement of compliance

These consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). This is the first time the Company has prepared its consolidated financial statements in accordance with IFRS, having previously prepared its financial statements in accordance with pre-changeover Canadian Generally Accepted Accounting Principles ("pre-changeover Canadian GAAP").

Pre-changeover Canadian GAAP differs in some respects from IFRS. In preparing these consolidated financial statements, management has amended certain accounting and valuation methods previously applied in the Canadian GAAP financial statements to comply with IFRS. The comparative figures for 2011 were restated to reflect these adjustments. Note 19 presents a reconciliation and description of the effects, if any, of the transition from Canadian GAAP and IFRS on the statements of financial position as at October 1, 2010 and September 30, 2011, statements of cash flows and statements of loss and comprehensive loss for the year ended September 30, 2011.

These consolidated financial statements were authorized for issuance by the Board of Directors on January 25, 2013.

### b) Basis of measurement

These consolidated financial statements have been prepared on a historical cost basis, and are presented in Canadian dollars, unless otherwise indicated.

The preparation of these consolidated financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment of complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.



# LNG Energy Ltd.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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## 2. BASIS OF PRESENTATION (continued)

### c) Going concern

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which presumes the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company is in the exploration stage and as such, the Company does not generate cash inflows from operations. To date, expenditures have been financed by way of equity and debt issuances. The recoverability of the Company's assets is uncertain and dependent upon achieving significant commercial production.

During the year ended September 30, 2012, the Company used cash in operations totaling \$5,488,582 and incurred a net loss totaling \$59,752,239, primarily as a result of impairments to the exploration and evaluation assets totaling \$54,548,680. As at September 30, 2012, the Company had negative working capital of \$(4,482,869). The Company's working capital is not sufficient to meet either its ongoing operations or its oil and gas work program commitments. As such, the Company requires significant immediate funding in order to meet its working capital obligations and to continue to fund its oil and gas work program commitments. In the longer term, the Company's ability to continue as a going concern will be dependent upon the ability to obtain funding to finance ongoing exploration, development and production activities, the discovery of economically recoverable reserves and the achievement of profitable operations.

Management believes the going concern assumption to be appropriate for these consolidated financial statements. The Company is considering various alternatives to remedy its existing liquidity shortfall (see subsequent event Note 18) including but not limited to the sale of assets, debt or equity issuances and/or farm-out arrangements. There is no assurance that the Company will be successful in these endeavors or in securing the financing necessary and significant doubt exists about the Company's ability to continue as a going concern. Should the going concern assumption not be appropriate and the Company is not able to realize its assets and settle its liabilities and commitments (as described in Note 6), these consolidated financial statements would require adjustments to the amounts and classifications of assets and liabilities, and these adjustments could be significant.

## 3. SIGNIFICANT ACCOUNTING PRINCIPLES

The accounting policies set out below have been applied consistently to all years in these financial statements and in preparing the opening IFRS Statement of Financial Position at October 1, 2010 for the purpose of transition to IFRS.

### a) Consolidation principles

Assets, liabilities, revenues and expenses of the subsidiaries are recognized in accordance with the Company's accounting policies. Intercompany transactions are eliminated upon consolidation.

# LNG Energy Ltd.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### b) Details of the group

#### i) Subsidiaries and jointly controlled entities

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

These financial statements presented are those of LNG Energy Ltd. ("LNG") and the financial statements of its 100% owned subsidiaries LNG Energy US Inc. ("LNG US"), LNG Energy (BC) Ltd. ("LNG BC"), Kunagu Real Estate ("Kunagu"), Kaynes Capital S.a.r.l. ("Kaynes"), Telemu No. 18 Ltd. ("Telemu"), LNG Energy (PNG) Limited, ("LNG PNG"), LNG Energy No. 2 Limited ("LNG No. 2), Basin Tishomingo Holdings Inc. ("BTH"), and BWB Exploration, LLC ("BWB"). These consolidated financial statements also include a proportionate consolidation of LNG's 50% owned subsidiaries Joyce Podlasie LLC ("Joyce") and Maryani Podlasie LLC ("Maryani") which each own 100% of Joyce Investment Sp. z.o.o. ("Joyce Investments") and Maryani Investments Sp z.o.o. ("Maryani Investments") respectively. Also, Kaynes holds a 20.18% interest in Saponis Investments Sp. z.o.o. ("Saponis") in which the Company also proportionately consolidates. All intercompany balances and transactions have been eliminated on consolidation.

#### (ii) Jointly controlled operations and jointly controlled assets

Many of the Company's oil and natural gas activities involve jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

### c) Financial instruments

#### **Financial Assets**

Financial Assets are classified into one of the following categories based on the purpose for which the asset was acquired:

- fair value through profit or loss ("FVTPL");
- held-to-maturity ("HTM");
- available for sale ("AFS"); and,
- loans and receivable

All transactions related to financial instruments are recorded on a trade date basis. The Company has no assets classified as FVTPL or HTM.

# LNG Energy Ltd.

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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### c) Financial instruments (continued)

The Company's accounting policy for each category is as follows:

#### **AFS Investments**

Non-derivative financial assets that do not meet the definition of loans and receivables are classified as AFS and comprise principally the Company's strategic investments in entities not qualifying as subsidiaries or associates.

AFS investments are carried at fair value with changes in fair value recognized in other comprehensive loss/income. Where there is a significant or prolonged decline in the fair value of an available-for-sale financial asset (which constitutes objective evidence of impairment), the full amount of the impairment, including any amount previously recognized in other comprehensive loss/income, is recognized in profit or loss. If there is no quoted market price in an active market and fair value cannot be readily determined, available-for-sale investments are carried at cost.

On sale or impairment, the cumulative amount recognized in other comprehensive loss/income is reclassified from accumulated other comprehensive loss/income to profit or loss.

At September 30, 2012, the Company has an investment in a management service entity classified as AFS. This investment was determined to have a fair value of \$nil as at September 30, 2012.

#### **Loans and Receivables**

These assets are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on specified dates, or on demand.

They are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition or issue and subsequently carried at amortized cost, using the effective interest rate method, less any impairment losses.

Amortized cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Cash, short term investments and receivables are classified as loans and receivables.

# LNG Energy Ltd.

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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### c) Financial instruments (continued)

#### ***Financial Liabilities***

All financial liabilities are initially recorded at fair value (net of transaction costs) and designated upon inception as FVTPL or other financial liabilities.

Financial liabilities are classified as other financial liabilities, based on the purpose for which the liability was incurred, and comprise of accounts payables and accrued liabilities.

At September 30, 2012 the Company has not classified any financial liabilities as fair value through profit or loss.

### d) Foreign and presentation currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency. Several of LNG's subsidiaries transact in currencies other than the Canadian dollar and accordingly have functional currencies other than the Canadian dollar. The functional currency of a subsidiary is the currency of the primary economic environment in which the subsidiary operates. The Company has subsidiaries whereby the functional currency has been determined to be the Papua New Guinea Kina and the Polish Zloty. Translation of all assets and liabilities from the respective functional currencies to the reporting currency is performed using the rates prevailing at the balance sheet date. The differences arising upon translation from the functional currency to the reporting currency are recorded as foreign currency translation adjustments in other comprehensive income ("AOCI") and are held within AOCI until a disposal or partial disposal of a subsidiary. A disposal or partial disposal will then give rise to a realized foreign exchange gain or loss which is recorded in profit or loss.

Transactions denominated in a currency other than the functional currency are translated at the rates on the date of the transaction. Any monetary items held in a currency other than the functional currency of the subsidiary are translated to the functional currency at the prevailing rate as at the date of the balance sheet. All exchange differences arising as a result of the translation to the functional currency are recorded in profit or loss.

### e) Cash and cash equivalents

Cash and cash equivalents consists of cash bank deposits, interest bearing savings accounts and short term investments which, on acquisition have a maturity of less than ninety days.

# LNG Energy Ltd.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### f) Exploration and evaluation assets and property, plant and equipment

Exploration and evaluation assets includes capitalized costs related to our exploration and evaluation expenditures, assets under construction and capitalized costs related to our oil and gas licenses.

#### ***Exploration and evaluation assets***

##### *Pre-license expenditures*

Pre-license expenditures are expensed in the period in which they are incurred.

##### *License and property acquisition expenditures*

Exploration license and leasehold property acquisition expenditures are intangible assets that are capitalized as exploration and evaluation costs and are reviewed at each reporting date for indications of potential impairment. Once proved reserves are discovered, technical feasibility and commercial viability are established and it has been decided to proceed with development, the remaining capitalized expenditure is transferred to developed and producing assets under property, plant and equipment. If indicators of impairment are present, the asset's recoverable amount is estimated. If the carrying value exceeds recoverable amount, an impairment is recorded.

##### *Other exploration and evaluation expenditures*

Other exploration and evaluation costs, including drilling costs directly attributable to an identifiable well, are initially capitalized as an intangible asset until evaluation activities of the exploration play are completed. If hydrocarbons are found, or not found in commercial quantities, the costs are expensed. If hydrocarbons are found and are likely to be capable of commercial development, the costs continue to be capitalized. These costs are reviewed periodically for indications of potential impairment. Capitalized costs are transferred to developed and producing assets within property, plant and equipment after assessing the estimated fair value of the property and recognizing any potential impairment loss. Geological and geophysical costs and annual lease rental costs are expensed as incurred.

#### ***Producing oil and gas properties***

##### *Depreciation, depletion, amortization and impairment*

Unproven property costs and major projects under construction or development are not depreciated or depleted until commercial production commences.

The Company reviews the useful lives of capitalized costs for producing oil and gas properties to determine the appropriated method of amortization. The Company depletes oil and gas capitalized costs using the unit-of-production method. Development drilling, equipping costs and other facility costs are depleted over remaining proved developed reserves. Other facilities, plant and equipment which have significantly different useful lives than the associated proved reserves are depreciated in accordance with the asset's future use.

Depreciation methods, useful lives and residual values are reviewed annually, with any amendments considered to be a change in estimate and accounted for prospectively.

# LNG Energy Ltd.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
As of and for the Years Ended September 30, 2012 and 2011  
(in Canadian dollars, except otherwise stated)

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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### f) Exploration and evaluation of assets (continued)

#### ***Impairment***

Each reporting date, the Company assesses whether there is an indication that an asset may be impaired. If any indication exists, the Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating units ("CGU") fair value less any costs to sell or value-in-use. Where an asset does not generate separately identifiable cash flows, we perform an impairment test on CGUs which are the smallest grouping of assets that generate independent, identifiable cash inflows. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and written down to its recoverable amount. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by external valuation metrics or other available fair value indicators wherever possible.

In assessing the carrying values of our unproved properties, the Company takes into account future plans for those properties, the remaining terms of the leases and any other factors that may be indicators of potential impairment.

For assets, an assessment is made each reporting date as to whether there is an indication that previously recognized impairment losses no longer exist or have decreased. If such indication exists, an estimate of the asset's or CGU's recoverable amount is reviewed. A previously recognized impairment loss is reversed to the extent that the events or circumstances that triggered the original impairment have changed. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of DD&A, had no impairment loss been recognized for the asset in prior years.

#### ***Property, plant and equipment***

Computer equipment and office furniture are stated at historical cost less depreciation and, where necessary, write-downs for impairment. Depreciation is calculated using the double declining balance method at the following rates:

|                                 |                             |
|---------------------------------|-----------------------------|
| Office furniture and equipment  | 15%                         |
| Vehicles                        | 30%                         |
| Computer equipment and software | 15% - 50%                   |
| Technical licenses              | Straight line over 10 years |

### g) Other provisions

Provisions are recognized for liabilities of uncertain timing or an amount that have been arisen as a result of past transactions, including legal or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle the obligation at the reporting date.

#### ***Decommissioning obligations***

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of the site restoration and capitalized in the relevant asset category. Decommissioning obligations are measured at the

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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### g) Other provisions (continued)

#### Decommissioning obligations (continued)

present value of management's best estimate of expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

### h) Income taxes

Income tax expense is comprised of current and deferred income taxes. Current and deferred income taxes are recognized in profit and loss, except for income taxes relating to items recognized directly in equity or other comprehensive income.

Current income tax, if any, is the expected amount payable or receivable on the taxable income or loss for the year, calculated in accordance with applicable taxation laws and regulations, using income tax rates enacted or substantively enacted at the end of the reporting period and any adjustments to amounts payable or receivable relating to previous years.

Deferred income taxes are provided using the liability method based on temporary differences arising between the income tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using income tax rates and income tax laws and regulations that have been enacted or substantively enacted at the end of the reporting period and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized. To the extent that the Company does not consider it probable that a deferred tax asset will be recovered, the deferred tax asset is reduced.

The following temporary differences do not result in deferred tax assets or liabilities:

- the initial recognition of assets or liabilities, not arising in a business combination, that do not affect accounting or taxable profit.
- goodwill
- investment in subsidiaries, associates and jointly controlled entities where the timing of reversal of the temporary differences can be controlled and reversal in the foreseeable future is not probable.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### i) Basic and diluted income or loss per share

Basic loss per share is computed by dividing the loss for the year by the weighted average number of common shares outstanding during the year. Diluted income per share reflects the potential dilution that could occur if potentially dilutive securities were exercised or converted to common stock. Fully diluted amounts are not presented when the effect of the computations are anti-dilutive due to the losses incurred. Accordingly, there is no difference in the amounts presented for the basic and diluted loss per share.

### j) Comprehensive income (loss)

Comprehensive income (loss) is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income (loss) that are excluded from net earnings (loss).

### k) Share-based payments

The fair value, at the grant date, of equity-settled share awards is charged to income or loss over the period for which the benefits of employee and others providing similar services are expected to be received. The corresponding accrued entitlement is recorded in contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. The fair value of awards is calculated using Black-Scholes option pricing model which considers the following factors:

- Exercise price
- Expected life of the award
- Expected volatility
- Current market price of the underlying shares
- Risk-free interest rate
- Expected forfeitures

### l) Revenue recognition

Revenue associated with sales of oil, natural gas and natural gas liquids will be recognized when title passes to the purchaser.

### m) New standards and interpretations not yet adopted

Certain pronouncements have been issued by the IASB, or the IFRS Interpretations Committee that are mandatory for accounting years beginning on or after January 1, 2012 or later years.

- (i) Effective for annual periods beginning on or after July 1, 2012

**IAS 1 Presentation of Financial Statements (effective January 1, 2013).**

This standard has been amended to revise the presentation of other comprehensive income.

- (ii) Effective for annual periods beginning on or after January 1, 2013

**IFRS 7 Financial Instruments: Disclosures.**

The amendment to IFRS 7 enhances the disclosure required when offsetting financial assets and liabilities. The Company is currently assessing the impact that the adoption of these standards may have on its financial statements.



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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### m) New standards and interpretations not yet adopted (continued)

#### **IFRS 10 Consolidated Financial Statements (effective January 1, 2013).**

IFRS 10 replaces the consolidation guidance in IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation — Special Purpose Entities by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee, that is whether an entity is controlled through voting rights of investors or through other contractual arrangements as is common in special purpose entities. This standard is applicable for annual periods beginning on or after January 1, 2013 but is available for early adoption so long as IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, IAS 27 Separate Financial Statements (2011) and IAS 28 Investments in Associates and Joint Ventures (2011) are also early applied. The Company is currently assessing the impact that the adoption of these standards may have on its financial statements.

#### **IFRS 11 Joint Arrangements (effective January 1, 2013).**

IFRS 11 introduces new accounting requirements for joint arrangements, replacing IAS 31 Interests in Joint Ventures. The option to apply the proportional consolidation method when accounting for jointly controlled entities is removed. Additionally, IFRS 11 eliminates jointly controlled assets to now only differentiate between joint operations and joint ventures. A joint operation is a joint arrangement whereby the parties that have joint control have rights to the assets and obligations for the liabilities. A joint venture is a joint arrangement whereby the parties that have joint control have rights to the net assets. This standard is applicable for annual periods beginning on or after January 1, 2013 but is available for early adoption so long as IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities, IAS 27 Separate Financial Statements (2011) and IAS 28 Investments in Associates and Joint Ventures (2011) are also early applied. The Company is currently assessing the impact that the adoption of these standards may have on its financial statements.

#### **IFRS 12 Disclosure of Interests in Other Entities (effective January 1, 2013).**

IFRS 12 requires enhanced disclosures about both consolidated entities and unconsolidated entities in which an entity has involvement. The objective of IFRS 12 is to require information so that financial statement users may evaluate the basis of control, any restrictions on consolidated assets and liabilities, risk exposures arising from involvements with unconsolidated structured entities and non-controlling interest holders' involvement in the activities of consolidated entities. This standard is applicable for annual periods beginning on or after January 1, 2013 but is available for early adoption. IFRS 12 disclosure is encouraged prior to adoption of the standard. This early disclosure does not require the entity to apply IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements (2011) and IAS 28 Investments in Associates and Joint Ventures (2011). The Company is currently assessing the impact that the adoption of these standards may have on its financial statements.

#### **IFRS 13 Fair Value Measurement (effective January 1, 2013).**

The main provisions of IFRS 13 includes defining fair value, setting out in a single standard framework for measuring fair value, and specifying certain disclosure requirements about fair value measurements.

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## 3. SIGNIFICANT ACCOUNTING PRINCIPLES (continued)

### m) New standards and interpretations not yet adopted (continued)

#### **IAS 27 Separate Financial Statements (2011) (effective January 1, 2013).**

The requirements relating to separate financial statements are unchanged and are included in the amended IAS 27. The other portions of IAS 27 are replaced by IFRS 10. These amendments are applicable for annual periods beginning on or after January 1, 2013 but are available for early adoption so long as IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, and IAS 28 Investments in Associates and Joint Ventures (2011) are also early applied. The Company is currently assessing the impact that the adoption of these standards may have on its financial statements.

#### **IAS 28 Investments in Associates and Joint Ventures (2011) (effective January 1, 2013).**

IAS 28 is amended for conforming changes based on the issuance of IFRS 10, IFRS 11 and IFRS 12. These amendments are applicable for annual periods beginning on or after January 1, 2013 but are available for early adoption so long as IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, and IAS 27 Separate Financial Statements (2011) are also early applied. The Company is currently assessing the impact that the adoption of these standards may have on its financial statements.

(iii) Effective for annual periods beginning on or after January 1, 2014

#### **IAS 32 Financial Instruments: Presentation (effective January 1, 2015).**

The amendments to IAS 32 pertained to the application guidance on the offsetting of financial assets and financial liabilities, focused on four main areas: the meaning of 'currently has a legally enforceable right of set-off', the application of simultaneous realization and settlement, the offsetting of collateral amounts and the unit of account for applying the offsetting requirements. The Company is currently assessing the impact that the adoption of these standards may have on its financial statements.

#### **IFRS 9, Financial Instruments (effective January 1, 2015).**

The standard is the first step in the process to replace IAS 39, Financial instruments: recognition and measurement. IFRS 9 introduces new requirements for classifying and measuring financial assets and liabilities and carries over from the requirements of IAS 39, Financial instruments: recognition and measurement, derecognition of financial assets and financial liabilities. This standard is not applicable until January 1, 2015 but is available for early adoption. The Company is currently assessing the impact that the adoption of IFRS 9 may have on its financial statements.

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## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and assumptions are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the year of the change, if the change affects that year only, or in the year of the change and future years, if the change affects both.

Information about critical assumptions in applying accounting policies that have the most significant risk of causing material adjustment to the carrying amounts of assets and liabilities recognized in the consolidated financial statements within the next financial year are discussed below:

### ***Exploration and evaluation expenditures***

The application of the Company's accounting policy for exploration and evaluation expenditures requires judgment in determining whether it is likely that future economic benefits will flow to the Company, which may be based on assumptions about future events or circumstances. Estimates and assumptions made may change if new information becomes available. If, after the expenditure is capitalized, information becomes available suggesting that the recovery of the expenditure is unlikely, the amount capitalized is written off in the profit or loss in the year the new information becomes available.

### ***Title of mineral property interest***

Although the Company has taken steps to verify title to mineral properties in which it has an interest, these procedures do not guarantee the Company's title. Such properties may be subject to prior agreements or transfers and title may be affected by undetected defects.

### ***Income taxes***

Significant judgment is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The Company recognizes liabilities and contingencies for anticipated tax audit issues based on the Company's current understanding of the applicable tax laws in the jurisdictions in which the Company operates. For matters where it is probable that an adjustment will be made, the Company records its best estimate of the tax liability including the related interest and penalties in the current tax provision. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

### ***Provision for site restoration (Rehabilitation provisions)***

Rehabilitation provisions will be created based on the Company's internal estimates. Assumptions, based on the current economic environment, have been made which management believes are a reasonable basis upon which to estimate the future liability. These estimates are reviewed annually and are based on current regulatory requirements. Significant changes in estimates of contamination, restoration standards and techniques will result in changes to provisions from year to year. Actual rehabilitation costs will ultimately depend on future market prices for the rehabilitation costs which will reflect the market conditions at the time the rehabilitation costs are actually incurred.

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## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (continued)

### *Share-based payment transactions*

The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the stock option, volatility and dividend yield and making assumptions about them. The assumption models used for estimating fair value for share-based payment transactions are disclosed in Note 11.

## 5. DISCONTINUED OPERATIONS

The Company sold all of its working interest in oil and gas leases in Oklahoma for cash proceeds of \$4,960,188 (US\$5,207,000) in May 2011 and thereby exiting its operations and activities in the United States.

The following table presents summarized financial information related to the discontinued operation of the US assets:

| <b>Statement of operations</b>      | <b>Year Ended<br/>September 30,</b> |                 |
|-------------------------------------|-------------------------------------|-----------------|
|                                     | <b>2012</b>                         | <b>2011</b>     |
| Depletion and depreciation          | \$ -                                | \$ 46,348       |
| General and administration expenses | 3,244                               | 263,887         |
| Foreign exchange loss               | 13,286                              | 889,648         |
| Professional fees                   | 30,791                              | 114,105         |
| Total expenses                      | (47,321)                            | (1,313,988)     |
| Oil and gas revenue                 | -                                   | 79,724          |
| Impairment                          | -                                   | (11,406,283)    |
| Tax recovery (expense)              | (23,651)                            | -               |
| Loss from discontinued operations   | \$ (70,972)                         | \$ (12,640,547) |

| <b>Statement of cash flows</b>       | <b>Year Ended<br/>September 30,</b> |              |
|--------------------------------------|-------------------------------------|--------------|
|                                      | <b>2012</b>                         | <b>2011</b>  |
| <b>Operating activities</b>          |                                     |              |
| General and administration expenses  | \$ 3,244                            | \$ 263,887   |
| Income tax expense                   | 23,651                              | -            |
| Professional fees                    | 30,791                              | 114,105      |
| Oil and gas revenue                  | -                                   | (79,724)     |
| Cash used in discontinued operations | \$ 57,686                           | \$ 298,268   |
| <b>Investing activities</b>          |                                     |              |
| Proceeds on the sale of US assets    | \$ -                                | \$ 4,960,188 |

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## 6. EXPLORATION AND EVALUATION ASSETS

|                                       | <b>Total</b>         |
|---------------------------------------|----------------------|
| <hr/>                                 |                      |
| Cost or deemed cost                   |                      |
| <hr/>                                 |                      |
| Balance, October 1, 2010              | \$ 32,198,880        |
| Additions                             | 17,786,180           |
| Acquisition                           | 3,907,743            |
| Change in decommissioning obligations | 37,820               |
| Capitalized stock-based compensation  | 1,593,451            |
| Write-down of assets                  | 24,122               |
| Foreign currency translation          | 5,278,585            |
| <hr/>                                 |                      |
| Balance, September 30, 2011           | \$ 60,826,781        |
| Additions                             | 14,303,708           |
| Capitalized stock-based compensation  | 320,273              |
| Write-down of assets                  | (54,548,680)         |
| Foreign currency translation          | 2,315,786            |
| <hr/>                                 |                      |
| <b>Balance, September 30, 2012</b>    | <b>\$ 23,217,868</b> |

### Papua New Guinea

The Company holds a 100% working interests in four Petroleum Prospecting Licenses ("PPL") through permits received from the Minister of Petroleum and Energy for Papua New Guinea on November 20, 2008.

The licenses are subject to a 22.5% back-in participation right in favour of the government, which the government may exercise upon payment of 22.5% of the costs incurred in the development of the property. The government also has a 2% royalty over any oil and natural gas production that may occur with respect to these licenses.

The PPL licenses have a six year term along with various work requirements for each license. As required by the licenses, the Company has submitted proposed work programs for years 5 and 6 of the PPLs including the acquisition of a minimum of 100km of seismic as well as the drilling of an exploration well conditional on the seismic results showing a drillable target for PPL 319. The proposed work programs for the other 3 PPLs include various geological studies and seismic reprocessing. The Company has not yet received formal notification on approval of these proposed work programs. A delay or rejection of the proposed work programs may result in an impairment of the costs associated with these 4 PPLs.

The Company also holds a 100% working interest in one Petroleum Retention License ("PRL"). The Company applied for a renewal of PRL 13 and is yet to receive formal notification from the Minister as to the grant of an extension. A delay or rejection of the renewal may result in an impairment of the costs associated with this PRL. The Register maintained by the Department of Petroleum and Energy records PRL 13 as having been extended until January 29, 2015. The current work program includes the acquisition of 10km of seismic data, additional geological work and the further acquisition of seismic or the drilling of a well conditional upon the results of previous elements of the work program.

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## 6. EXPLORATION AND EVALUATION ASSETS (continued)

On January 24, 2013, the Company has entered into an investment agreement where a third party acquired 31.5% of the shares of the Company's subsidiary, Telemu, in consideration for funding of US\$4,000,000 (Cdn \$3,932,800) (see Note 18).

As a result, the Company reduced the carrying values of its properties in Papua New Guinea and recorded an impairment loss of \$46,978,245 during the year ended September 30, 2012.

During the year ended September 30, 2012, \$53,348 of stock based compensation expense was capitalized (\$1,049,607 for the year ended September 30, 2011). During the year ended September 30, 2012, \$252,147 of general and administrative costs were capitalized (\$2,241,195 for the year ended September 30, 2011).

### Poland

The Company has a 20.18% net working interest in three concessions (Slupsk, Starogard and Slawno) in Poland. The other partners are BNK Petroleum Inc., Sorgenia E&P S.p.A., and Rohol-Aufsuchungs Aktiengesellschaft. The terms of participation require the Company to fund its proportionate 20.18% share of all operational costs. The terms include the drilling, completing and testing of second wells in each of the three concessions by June 2014.

The Company, through its wholly owned subsidiary, Kaynes Capital S.a.r.l. ("Kaynes"), has a 50% interest in Joyce Podlasie LLC ("Joyce") and a 50% interest in Maryani Podlasie LLC ("Maryani"). Joyce and Maryani each hold 100% interests in two oil and gas exploration concessions (Ilawa and Wegrow) in Poland.

The terms of both the Ilawa and Wegrow concessions include the requirement to reprocess existing seismic data and the acquisition of 50km of new 2D seismic in each concession by June 2012. These commitments were fully met. The Wegrow concession terms also include the requirement to drill a well to a depth of 2,750m by December 2013. In June 2012, the Company filed and received a renewal for the Ilawa concession extending the term to maximum of 5 years. This extension carries a commitment to commence drilling a well in Ilawa no later than June 2014.

If the Company does not fund its proportionate share of expenditures in Poland, the Company's working interest may be reduced through dilution to the other partners.

During the year ended September 30, 2012, \$266,925 of stock based compensation costs were capitalized in Poland (\$542,030 for the year ended September 30, 2011). \$364,248 in general and administrative costs were capitalized during the year September 30, 2012 (\$311,175 for the year ended September 30, 2011). Recovery of costs in the Polish properties is uncertain and is dependent upon achieving commercial production or sale.

### Bulgaria

In September 2011, the Company entered into a farm-in transaction with a wholly owned subsidiary of TransAtlantic Petroleum Ltd. ("TransAtlantic"), to earn a 50% interest in a future production concession ("Etropole concession") in Bulgaria. LNG is expected to fund up to US\$15 million of drilling and completion costs for a 50% undivided interest in the Etropole concession. The application for the Etropole concession has been submitted. The Company has funded a total of \$7,570,435 as of September 30, 2012 towards the drilling of a 3,190m (10,466ft) exploration well on the A-Lovech exploration license in Bulgaria targeting the Middle Jurassic Etropole formation.

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## 6. EXPLORATION AND EVALUATION ASSETS (continued)

If the Etropole concession is granted, an additional US\$5 million is payable if the Etropole concession covers not less than an aggregate of 300,000 acres. This 300,000 acre requirement will be reduced by the amount of acreage covered by a production concession that TransAtlantic has applied for up to a maximum reduction of 100,000 acres if the production concession is granted prior to the Etropole concession. The remaining US\$7.5 million is expected to be used to drill a second well or for other exploration activities on the Etropole concession after it has been granted.

In January 2012, the Bulgarian Parliament enacted legislation which among other things, bans fracture stimulation in Bulgaria. Since the legislation creates uncertainty with respect to the ultimate cost recovery of the Company's assets in Bulgaria, the Company recorded an impairment loss of \$7,570,435 for the year ended September 30, 2012 as the recovery of costs in the Bulgarian property is uncertain.

## 7. PROPERTY, PLANT AND EQUIPMENT

|   | Oil and natural<br>gas assets |              | Other             | Total             |
|---|-------------------------------|--------------|-------------------|-------------------|
| <b>Cost or deemed cost</b>                    |                               |              |                   |                   |
| Balance, October 1, 2010                      | \$                            | 17,683,108   | \$ 369,152        | \$ 18,052,260     |
| Additions                                     |                               | 260,112      | 74,139            | 334,251           |
| Dispositions                                  |                               | (5,460,188)  | (53,277)          | (5,513,465)       |
| Write-off                                     |                               | (11,653,693) | -                 | (11,653,693)      |
| Foreign currency translation                  |                               | (829,339)    | (49,316)          | (878,655)         |
| Balance, September 30, 2011                   | \$                            | -            | \$ 340,698        | \$ 340,698        |
| Additions                                     |                               | -            | 4,798             | 4,798             |
| Foreign currency translation                  |                               | -            | 56,245            | 56,245            |
| <b>Balance, September 30, 2012</b>            | <b>\$</b>                     | <b>-</b>     | <b>\$ 401,741</b> | <b>\$ 401,741</b> |
| <b>Accumulated depletion and depreciation</b> |                               |              |                   |                   |
| Balance, October 1, 2010                      | \$                            | 201,062      | \$ 146,994        | \$ 348,056        |
| Depletion and depreciation                    |                               | 46,348       | 41,094            | 87,442            |
| Disposition                                   |                               | -            | (30,108)          | (30,108)          |
| Impairment                                    |                               | 11,406,283   | -                 | 11,406,283        |
| Write-off                                     |                               | (11,653,693) | -                 | (11,653,693)      |
| Foreign currency translation                  |                               | -            | (19,186)          | (19,186)          |
| Balance, September 30, 2011                   | \$                            | -            | \$ 138,794        | \$ 138,794        |
| Depreciation                                  |                               | -            | 46,245            | 46,245            |
| Foreign currency translation                  |                               | -            | 21,970            | 21,970            |
| <b>Balance, September 30, 2012</b>            | <b>\$</b>                     | <b>-</b>     | <b>\$ 207,009</b> | <b>\$ 207,009</b> |
| <b>Net book value</b>                         |                               |              |                   |                   |
| Balance, October 1, 2010                      |                               |              |                   | \$ 17,704,204     |
| Balance, September 30, 2011                   |                               |              |                   | \$ 201,904        |
| <b>Balance, September 30, 2012</b>            |                               |              |                   | <b>\$ 194,732</b> |

In May 2011, through its subsidiary, the Company completed the sale all of its working interest in oil and gas leases in Carter County, Oklahoma for \$4,960,188 (US\$5,207,000) in cash (see Note 5).

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## 8. JOINT VENTURES

### Saponis Investments Sp z.o.o.

Saponis holds 3 oil and gas concessions in Poland: Starogard, Slupsk and Slawno. The terms and conditions of participation require the Company to fund 20.18% of all costs related to the concessions. The other partners are BNK, Sorgenia E&P S.p.A., and Rohol-Aufsuchungs Aktiengesellschaft. The Company's net interest in Saponis is accounted for on a proportionate consolidation basis.

For the years ended September 30, 2012 and 2011 and October 1, 2010, the Company's net share of amounts attributed to it by the joint venture was as follows:

|   | September 30,<br>2012 | September 30,<br>2011 | October 1,<br>2010 |
|---|-----------------------|-----------------------|--------------------|
| <b>Balance sheet:</b>                         |                       |                       |                    |
| Cash and cash equivalents                     | \$ 541,583            | \$ 3,131,857          | \$ 26,524          |
| Amounts receivable                            | 87,043                | 266,499               | 82,603             |
| Prepaid expenses, advances and other deposits | 27,831                | 14,494                | -                  |
| Exploration and evaluation assets             | 8,541,017             | 6,577,456             | 668,128            |
| Accounts payable and accrued liabilities      | (248,114)             | (5,327,345)           | (818,561)          |
| Decommissioning obligations                   | (38,186)              | (37,820)              | (3,019)            |
|   | \$ 8,911,174          | \$ 4,625,141          | \$ (44,325)        |
| <b>For the Year Ended<br/>September 30,</b>   |                       |                       |                    |
|   | <b>2012</b>           | <b>2011</b>           |                    |
| <b>Income statement:</b>                      |                       |                       |                    |
| Interest income                               |                       | \$ 15,117             | \$ 5,489           |
| Expenses                                      |                       | (369,375)             | (69,864)           |
| Foreign exchange loss                         |                       | (24,765)              | -                  |
| Net loss                                      |                       | \$ (379,023)          | \$ (64,375)        |

### Joyce Podlasie, LLC and Maryani Podlasie, LLC

In February 2011, the Company, through its subsidiary, Kaynes, acquired a 50% interest in Joyce and a 50% interest in Maryani for a total purchase price of US\$4,000,000.

The terms and conditions of participation requires the Company to fund 50% of all costs related to the concessions. The other partner is San Leon Energy Plc ("San Leon"). The Company's net interest in Joyce and Maryani is accounted for on a proportionate consolidation basis. The Company is the operator for both concessions.



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## 8. JOINT VENTURES (continued)

For the years ended September 30, 2012 and 2011, the Company's net share of amounts attributed to it by the joint venture was as follows:

|   | September 30,       |                     |
|---|---------------------|---------------------|
|   | 2012                | 2011                |
| <b>Balance sheet:</b>                       |                     |                     |
| Cash and cash equivalents                   | \$ 31,289           | \$ 3,241            |
| Amounts receivable                          | 135,752             | 12,040              |
| Exploration and evaluation assets           | 4,676,910           | 3,968,317           |
| Accounts payable and accrued liabilities    | (134,030)           | 1,176               |
| <b>Net contribution from Joint Ventures</b> | <b>\$ 4,709,921</b> | <b>\$ 3,984,774</b> |
| <b>Income statement:</b>                    |                     |                     |
| Expenses                                    | (50,595)            | (60,024)            |
| <b>Net loss</b>                             | <b>\$ (50,595)</b>  | <b>\$ (60,024)</b>  |

## 9. DECOMMISSIONING OBLIGATIONS

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with asset retirement costs of the Wytowno, Starogard and Lebork wells in Poland:

|                             | September 30,    |                  |
|-----------------------------|------------------|------------------|
|                             | 2012             | 2011             |
| Balance, beginning of year  | \$ 37,820        | \$ 3,019         |
| Addition                    | -                | 41,970           |
| Disposition                 | -                | (3,067)          |
| Change in estimates         | -                | (4,234)          |
| Accretion expense           | 366              | 132              |
| <b>Balance, end of year</b> | <b>\$ 38,186</b> | <b>\$ 37,820</b> |

The undiscounted cash flow required to settle the obligation for the Wytowno, Starogard and Lebork wells in Poland is approximately \$180,516, representing the Company's 20.18% working interest, with an estimated abandonment date of 2026. The calculation was assessed using a risk-free rate of 10.90% and an assumed inflation rate of 1.02% per annum.

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## 10. LOANS PAYABLE

On February 27, 2012, the Company's wholly owned subsidiary, Kaynes, completed non-revolving credit facilities totaling US\$5,000,000 ("the Loans"). The Loans are repayable within one year on or before February 27, 2013. Funds drawn under the credit facility are secured against all of the shares of Kaynes. Interest is accrued at a fixed rate of 7% per annum. In the event that Kaynes disposes of certain assets prior to February 27, 2016, Kaynes will be required to pay the lenders a contingent bonus of 12.5% of the proceeds arising from the disposition of such assets. For the year ended September 30, 2012, the interest expense related to the Loans was \$181,955.

On January 24, 2013, an extension to the credit facility was agreed to (See Subsequent Event Note 18).

## 11. SHARE CAPITAL

### a) Authorized

Unlimited common shares without par value.

On September 14, 2011, the Company completed a public offering of 80,460,000 common shares at a price of \$0.25 per common share for gross proceeds of \$20,115,000. Total share issuance costs were \$1,474,162.

### b) Per share amounts

Per share amounts have been calculated using the weighted average number of common shares outstanding. The weighted average number of common shares outstanding for the year ended September 30, 2012 is 338,702,972 (261,493,776 for the year ended September 30, 2011). The average number of common shares outstanding was not increased for outstanding stock options as the effect would be anti-dilutive.

### c) Stock Options

The following table summarizes information about stock option transactions:

|                             | <b>Number of<br/>Options</b> | <b>Average<br/>Exercise Price</b> |
|-----------------------------|------------------------------|-----------------------------------|
| Balance, October 1, 2010    | 13,395,000                   | \$0.46                            |
| Granted                     | 12,580,000                   | \$0.52                            |
| Exercised                   | (825,000)                    | \$0.23                            |
| Forfeited                   | (4,700,000)                  | \$0.53                            |
| Balance, September 30, 2011 | 20,450,000                   | \$0.49                            |
| Granted                     | 9,065,000                    | \$0.15                            |
| Exercised                   | (200,000)                    | \$0.10                            |
| Forfeited                   | (6,040,000)                  | \$0.44                            |
| Balance, September 30, 2012 | 23,275,000                   | \$0.37                            |

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## 11. SHARE CAPITAL (continued)

The following table summarizes information about the stock options outstanding at September 30, 2012:

| <b>Exercise Price</b> | <b>Outstanding Options</b> | <b>Options Exercisable</b> | <b>Expiry Date</b> |
|-----------------------|----------------------------|----------------------------|--------------------|
| \$0.58                | 3,000,000                  | 3,000,000                  | November 27, 2013* |
| \$0.56                | 750,000                    | 750,000                    | February 1, 2013   |
| \$0.275               | 1,490,000                  | 1,490,000                  | May 1, 2013        |
| \$0.19                | 1,260,000                  | 1,260,000                  | May 14, 2014       |
| \$0.35                | 500,000                    | 500,000                    | November 23, 2015  |
| \$0.59                | 5,910,000                  | 5,910,000                  | April 18, 2016     |
| \$0.53                | 1,800,000                  | 1,200,000                  | June 07, 2016      |
| \$0.25                | 150,000                    | 100,000                    | October 19, 2016   |
| \$0.15                | 8,415,000                  | -                          | April 24, 2017     |
|                       | <b>23,275,000</b>          | <b>14,210,000</b>          |                    |

\*subsequent to year ended September 30, 2012, these options expired without exercise

Assumptions used to value options in the Black-Scholes option-pricing model are as follows:

|                          | <b>For the year ended September 30,</b> |                   |
|--------------------------|---|-------------------|
|                          | <b>2012</b>                             | <b>2011</b>       |
| Risk-free interest rate  | 1.40% - 1.52%                           | 2.05% - 2.17%     |
| Expected life            | 5 years                                 | 5 years           |
| Expected volatility      | 108.32% - 112.18%                       | 107.08% - 126.91% |
| Expected dividends       | Nil                                     | Nil               |
| Average value per option | \$0.05 - \$0.14                         | \$0.44            |

A forfeiture rate of 12% (2011 - 3%) is used when recording stock based compensation. This estimate is adjusted to the actual forfeiture rate. The stock based compensation expense for the year ended September 30, 2012 of \$138,831 (\$3,526,918 for year ended September 30, 2011) was expensed during 2012. The Company capitalized \$320,273 of stock compensation expense for the year ended September 30, 2012 (\$1,593,451 for the year ended September 30, 2011). This resulted in a change within contributed surplus of \$459,104 for the year ended September 30, 2012 (\$5,120,369 for the year ended September 30, 2011).

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## 12. COMPENSATION OF KEY MANAGEMENT PERSONNEL

The remuneration of members of key management personnel during the year ended September 30, 2012 and 2011 were as follows:

|                 | For the Year Ended September 30, |            |
|-----------------|----------------------------------|------------|
|                 | 2012                             | 2011       |
| Consulting fees | \$ 386,385                       | \$ 751,980 |

Consulting fees relate to amounts paid to the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") and directors.

During the year ended September 30, 2012, there were \$115,908 (September 30, 2011 - \$2,330,132) of share-based payments to key management personnel consisting of the CEO, CFO and directors of the Company.

Key management personnel were not paid post-employment benefits, termination benefits or other long-term benefits during the years ended September 30, 2012 and 2011.

## 13. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Changes in non-cash working capital are as follows:

|   | For the Year Ended<br>September 30, |              |
|---|-------------------------------------|--------------|
|   | 2012                                | 2011         |
| Amounts receivable                                    | \$ 72,118                           | \$ (95,025)  |
| Prepaid expenses, advances and<br>other term deposits | 10,263                              | (39,063)     |
| Accounts payable and accrued<br>liabilities           | (5,737,450)                         | 5,243,066    |
| Change in non-cash working capital                    | \$ (5,655,069)                      | \$ 5,108,978 |
| Relating to:  |                                     |              |
| Operating activities                                  | \$ (738,230)                        | \$ 1,584,438 |
| Investing activities                                  | (4,916,839)                         | 3,524,540    |
| Change in non-cash working capital                    | \$ (5,655,069)                      | \$ 5,108,978 |

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## 14. INCOME TAXES

The Company's provision for income taxes differs from the amounts computed by applying the statutory tax rates to the loss from continuing operations as a result of the following:

|  | September 30,   |                |
|--|-----------------|----------------|
|  | 2012            | 2011           |
| Loss from continuing operations  | \$ (59,648,228) | \$ (8,856,258) |
| Statutory rates  | 25%             | 28%            |
|  | (14,912,057)    | (2,479,752)    |
| Differences in tax rates between foreign jurisdictions                             | (302,571)       | (138,766)      |
| Writedown relating to assets with no tax base due to initial recognition exemption | 799,000         | -              |
| Share-based payments   | 34,708          | 1,163,556      |
| Other  | 22,037          | (15,421)       |
| Change in unrecognized tax benefit   | 14,448,830      | 1,557,478      |
| Unrealized foreign exchange  | (56,908)        | (87,095)       |
|  | \$ 33,039       | \$ (0)         |

The statutory rate decreased to 25% in 2012 from 28% as a result of tax legislation previously enacted by the Canadian federal government.

Deferred tax liabilities and assets are attributable to the following:

|   | September 30, |                |
|---|---------------|----------------|
|   | 2012          | 2011           |
| Deferred income tax liabilities:                                |               |                |
| Property, plant and equipment/exploration and evaluation assets | \$ -          | \$ (2,451,143) |
| Deferred income tax assets:                                     |               |                |
| Non-capital loss carry forward                                  | -             | 2,451,143      |
|   | \$ -          | \$ -           |

Unrecognized deferred income tax assets:

Deferred tax assets have been not recognized for the following deductible temporary differences:

|   | September 30, |               |
|---|---------------|---------------|
|   | 2012          | 2011          |
| Non-capital loss carry forward                                  | \$ 36,239,997 | \$ 30,567,953 |
| Unrealized foreign exchange                                     | 4,511,341     | 4,310,295     |
| Capital loss carry forward                                      | 156,000       | 156,000       |
| Decommissioning obligation                                      | 38,174        | 37,808        |
| Share issue costs   | 2,656,767     | 2,656,000     |
| Property, plant and equipment/exploration and evaluation assets | 30,687,545    | -             |
|   | \$ 74,289,824 | \$ 37,728,056 |

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## 14. INCOME TAXES (continued)

Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profits will be available against which they can be utilized.

The Company had non-operating losses in all jurisdictions. The Company has total non-operating losses carried forward of approximately \$36.2 million which may be available to offset future income for tax purposes expiring over the periods 2013 to 2032.

The Company has temporary differences associated with its investments in its foreign subsidiaries and partnerships. The Company has no deferred tax liabilities in respect of these temporary differences.

## 15. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, short term investments, receivables, investment, and accounts payable and accrued liabilities.

### ***Fair value of financial assets and liabilities***

Fair value have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

The carrying amount for cash, short term investment, receivables, and accounts payable and accrued liabilities on the balance sheet approximate their fair value because of the limited term of these instruments. Investment is carried at cost as it is not traded on an active market.

### ***Fair value hierarchy***

Financial instruments that are measured subsequent to initial recognition at fair value are grouped in Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities; and
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable marker data (unobservable inputs).

The Company did not have any financial instruments in Level 1, 2 and 3.

### ***Financial risk management objectives and policies***

The Company has exposure to the following risks from its use of financial instruments

- Credit risk
- Liquidity and funding risk
- Market risk

In common with all other businesses, the Company is exposed to risks that arise from its use of financial instruments. This note describes the Company's objectives, policies and processes for managing those risks and the methods used to measure them. Further quantitative information in respect of these risks is presented throughout these consolidated financial statements.

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## 15. FINANCIAL INSTRUMENTS (continued)

There have been no substantive changes in the Company's exposure to financial instrument risk, its objectives, policies and processes for managing those risks or the methods used to measure them from previous years unless otherwise stated in these notes.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The overall objective of the Board is to set policies that seek to reduce as far as possible without unduly affecting the Company's competitiveness and flexibility. Further details regarding these policies are set out below.

### ***Credit risk***

Credit risk is the risk of an unexpected loss if a counterparty to a financial instrument fails to meet its contractual obligations. The credit risk associated with cash and receivables is believed to be minimal.

Cash consists of cash on deposit in major banks that are believed to be creditworthy.

Receivables are comprised primarily of amounts due from VAT receivables from local government in Poland. The Company does not believe it is exposed to significant credit risk and counterparty risks.

### ***Liquidity and funding risk***

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company ensures that there is sufficient capital in order to meet short-term business requirements, after taking into account the Company's holding of cash. The Company's cash is invested in business accounts and are available on demand. Funding risk is the risk that the Company may not be able to raise equity financing in a timely manner and on terms acceptable to management. There are no assurances that such financing will be available when, and if, the Company requires additional equity financing. See Note 2.

In the normal course of business, the Company enters into contracts and performs business activities that give rise to commitments for future minimum payments.

The following table summarizes the Company's significant remaining contractual maturities for financial liabilities at September 30, 2012 and 2011 and October 1, 2010.

### **Contractual maturity analysis as at September 30, 2012**

|                     | Less than<br>3 months | 3 - 12<br>months | 1 - 5<br>years | Longer than<br>5 years | Total        |
|---------------------|-----------------------|------------------|----------------|------------------------|--------------|
| Accounts payable    | \$ 470,663            | \$ -             | \$ -           | \$ -                   | \$ 470,663   |
| Accrued liabilities | \$ 133,227            | \$ 343,874       | \$ -           | \$ -                   | \$ 477,101   |
| Loans payable       | \$ -                  | \$ 5,122,848     | \$ -           | \$ -                   | \$ 5,122,848 |

### ***Market risk***

The Company is subject to normal market risks including fluctuations in foreign exchange rates and interest rates. Interest rate risk is the risk arising from the effect of changes in prevailing interest rates on the Company's financial instruments. While the Company manages its operations in order to minimize exposure to these risks, the Company has not entered into any derivatives or contracts to hedge or otherwise mitigate this exposure.

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## 15. FINANCIAL INSTRUMENTS (continued)

### a. Interest rate risk

The Company has minimal exposure to interest rate fluctuations on its cash and short term investment balances due to current low market interest rates. Based on 2012 cash balances, a 1% increase or decrease in the prime interest rates would result in approximately a \$8,000 increase or decrease in the Company's after-tax net earnings and comprehensive income.

### b. Foreign currency risk

The Company's exploration expenditures, certain acquisition costs and other operating expenses are denominated in US dollars, Papua New Guinea kina and Polish zloty. The Company's exposure to foreign currency risk arises primarily on fluctuations between the Canadian dollar and the US dollars, Papua New Guinea kina and Polish zloty. The Company has not entered into any derivative instruments to manage foreign exchange fluctuations.

The Company is exposed to currency risk through the following financial assets and liabilities denominated in currencies other than the Canadian dollar at September 30, 2012 and 2011:

|  | September 30, 2012 |              |              |           |
|--|--------------------|--------------|--------------|-----------|
|  | US Dollars         | PNG Kina     | Polish Zloty | Euro      |
| Cash                                     | \$ 123,626         | \$ 21,674    | \$ 548,671   | \$ 97,221 |
| Amounts receivable                       | 57,763             | 27,001       | 221,702      | -         |
| Deposits                                 | -                  | 10,870       | 5,620        | -         |
| Accounts payable and accrued liabilities | (14,131)           | (195,374)    | (387,467)    | -         |
|  | \$ 167,258         | \$ (135,829) | \$ 388,526   | \$ 97,221 |

  

|  | September 30, 2011 |              |              |            |
|--|--------------------|--------------|--------------|------------|
|  | US Dollars         | PNG Kina     | Polish Zloty | Euro       |
| Cash                                     | \$ 6,321,482       | \$ 57,915    | \$ 3,082,930 | \$ 968     |
| Amounts receivable                       | 783                | 42,124       | 273,425      | -          |
| Deposits                                 | -                  | 10,366       | -            | -          |
| Accounts payable and accrued liabilities | (530,229)          | (222,935)    | (1,770,856)  | (10,187)   |
|  | \$ 5,792,036       | \$ (112,530) | \$ 1,585,499 | \$ (9,219) |



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## 16. CAPITAL MANAGEMENT

The Company manages, as capital, the components of shareholders' equity. The Company's objectives, when managing capital, are to safeguard its ability to continue as a going concern in order to explore its oil and gas interests and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk.

The Company manages its capital structure, and makes adjustments to it, in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may issue new equity if available on favorable terms, option its oil and gas properties for cash and/or expenditure commitments from optionees, enter into joint venture arrangements, borrow, acquire or dispose of assets.

The Company's policy is to invest its cash in highly liquid, short term, interest-bearing investments with maturities of a year or less from the date of acquisition. The Company is not subject to externally imposed capital requirements. The Company is currently reviewing alternatives to remedy its shortfall in capital to meet its ongoing obligations (see Note 2).

## 17. SEGMENT INFORMATION

Geographic Information:

The Company operates in one reportable operating segment, being the exploration of oil and gas properties in Papua New Guinea, Bulgaria and Poland. The geographical information is as follows:

| <b>As at<br/>September 30, 2012</b> | <b>Papua New<br/>Guinea</b> | <b>Bulgaria</b> | <b>Poland</b>        | <b>Canada</b>     | <b>Total</b>         |
|-------------------------------------|-----------------------------|-----------------|----------------------|-------------------|----------------------|
| Current assets                      | \$ 399,540                  | \$ -            | \$ 888,165           | \$ 300,038        | \$ 1,587,743         |
| E&E assets                          | 8,644,595                   | -               | 14,573,273           | -                 | 23,217,868           |
| Property, plant and<br>equipment    | 101,808                     | -               | -                    | 92,924            | 194,732              |
|                                     | <b>\$ 9,145,943</b>         | <b>\$ -</b>     | <b>\$ 15,461,438</b> | <b>\$ 392,962</b> | <b>\$ 25,000,343</b> |

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## 17. SEGMENT INFORMATION (continued)

| As at September 30,<br>2011      | Papua New<br>Guinea | Bulgaria     | Poland        | Canada        | Total         |
|----------------------------------|---------------------|--------------|---------------|---------------|---------------|
| Current assets                   | \$ 1,028,724        | \$ -         | \$ 8,410,348  | \$ 11,943,392 | \$ 21,382,464 |
| Investments                      | -                   | -            | -             | 5,243         | 5,243         |
| E&E assets                       | 45,199,902          | 5,055,250    | 10,571,629    | -             | 60,826,781    |
| Property, plant and<br>equipment | 96,295              | -            | -             | 105,609       | 201,904       |
|                                  | \$ 46,324,921       | \$ 5,055,250 | \$ 18,981,977 | \$ 12,054,244 | \$ 82,416,392 |

| Year Ended<br>September 30, 2012 | Papua New<br>Guinea | United<br>States | Poland | Canada | Total |
|----------------------------------|---------------------|------------------|--------|--------|-------|
| Oil and gas revenue              | \$ -                | \$ -             | \$ -   | \$ -   | \$ -  |

| Year Ended<br>September 30, 2011 | Papua New<br>Guinea | United<br>States | Poland | Canada | Total     |
|----------------------------------|---------------------|------------------|--------|--------|-----------|
| Oil and gas revenue*             | \$ -                | \$ 79,724        | \$ -   | \$ -   | \$ 79,724 |

\* disclosed as discontinued operation (see Note 5)

## 18. SUBSEQUENT EVENTS

- a) On January 24, 2013, the Company entered into an investment agreement with EERL Holdings (BVI) Ltd. ("EERL") under which EERL contributed US\$4,000,000 towards a 22km 2D seismic program as well as past costs in Telemu's PPL 319 in Papua New Guinea for a 31.5% equity interest in Telemu. EERL is a British Virgin Islands company that is owned as to 50% by Enterprise Energy Ltd. ("Enterprise") and 50% by an undisclosed third party. There is a common director between the Company and Enterprise.
- b) On January 24, 2013, with regards to the credit facilities that LNG's subsidiary, Kaynes Capital S.á.r.l. had entered into on February 27, 2012, there have been amendments to extend the maturity date from the first anniversary to the third anniversary. The Credit Agreement has been further amended to increase the contingency bonus payments from 3.125% to 6.25% and 9.375% to 18.75% for the US \$1.25 million and US 3.75 million portions of the facilities respectively.

# LNG Energy Ltd.

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## 19. TRANSITION TO IFRS

The Company's consolidated financial statements for the year ended September 30, 2012 are the first annual consolidated financial statements that comply with IFRS and these consolidated statements were prepared as described in Note 2, including the application of IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

The adoption of IFRS requires the application of IFRS 1. IFRS 1 generally requires that an entity retrospectively apply all IFRS effective at the end of its first IFRS reporting period; however IFRS 1 provides certain mandatory exceptions and permits limited optional exemptions. Certain IFRS 1 optional exemptions have been applied including:

- Deemed cost exemption for full cost oil and gas entities whereby exploration and evaluation assets were classified from the full cost pool to E&E.
- Decommissioning obligation exemption that allows any changes in decommissioning obligations on transition to IFRS to be adjusted through opening retained earnings.
- Stock-based compensation exemption that allows a company to only have to evaluate share based compensation awards that were unvested as of the date of transition.
- Business combination exemption that allows a company to not have to restate any business combination that occurred prior to the date of transition.
- Cumulative translation differences exemption which eliminated the cumulative translation differences and adjusted deficit by the same amount at the date of transition to IFRS.

The accounting policies in Note 3 have been applied in preparing the consolidated financial statements for the year ended September 30, 2012, the comparative information for the year ended September 30, 2011 and the preparation of the opening IFRS statement of financial position at October 1, 2010, the Company's date of transition to IFRS.

In preparing its opening IFRS statement of financial position, comparative information of the consolidated financial statements for the year ended September 30, 2011, the Company adjusted amounts previously reported in financial statements prepared in accordance with former previous GAAP. An explanation of how the transition from former previous GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and notes accompanying the tables.

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## 19. TRANSITION TO IFRS (continued)

Reconciliation of the Consolidated Statements of Financial Position:

|   | Note | As at October 1, 2010 |                              |                   | As at September 30, 2011 |                              |                   |
|---|------|-----------------------|------------------------------|-------------------|--------------------------|------------------------------|-------------------|
|   |      | Canadian GAAP         | Effect of transition to IFRS | IFRS              | Canadian GAAP            | Effect of transition to IFRS | IFRS              |
| <b>ASSETS</b>                                     |      |                       |                              |                   |                          |                              |                   |
| <b>Current</b>                                    |      |                       |                              |                   |                          |                              |                   |
| Cash and cash equivalents                         |      | \$ 10,036,105         | \$ -                         | \$ 10,036,105     | \$ 20,510,667            | \$ -                         | \$ 20,510,667     |
| Short term investments                            |      | 9,015,750             | -                            | 9,015,750         | -                        | -                            | -                 |
| Amounts receivable                                |      | 314,242               | -                            | 314,242           | 409,267                  | -                            | 409,267           |
| Prepaid expenses, advances and other deposits     |      | 423,467               | -                            | 423,467           | 462,530                  | -                            | 462,530           |
|   |      | 19,789,564            | -                            | 19,789,564        | 21,382,464               | -                            | 21,382,464        |
| Investments                                       |      | 6,176                 | -                            | 6,176             | 5,243                    | -                            | 5,243             |
| Exploration and evaluation assets                 | A, E | -                     | 32,198,880                   | 32,198,880        | -                        | 60,826,781                   | 60,826,781        |
| Property, plant and equipment                     | E    | 51,050,573            | (33,346,369)                 | 17,704,204        | 56,475,427               | (56,273,523)                 | 201,904           |
| Total Assets                                      |      | \$ 70,846,313         | \$ (1,147,489)               | \$ 69,698,824     | \$ 77,863,134            | \$ 4,553,258                 | \$ 82,416,392     |
| <b>LIABILITIES</b>                                |      |                       |                              |                   |                          |                              |                   |
| <b>Current</b>                                    |      |                       |                              |                   |                          |                              |                   |
| Accounts payable and accrued liabilities          |      | \$ 1,442,148          | \$ -                         | \$ 1,442,148      | \$ 6,685,214             | \$ -                         | \$ 6,685,214      |
|   |      | 1,442,148             | -                            | 1,442,148         | 6,685,214                | -                            | 6,685,214         |
| Deferred tax liabilities                          | D    | 3,065,151             | (3,065,151)                  | -                 | 1,775,587                | (1,775,587)                  | -                 |
| Decommissioning obligations                       | C    | 3,119                 | (100)                        | 3,019             | 42,117                   | (4,297)                      | 37,820            |
| Total Liabilities                                 |      | 4,510,418             | (3,065,251)                  | 1,445,167         | 8,502,918                | (1,779,884)                  | 6,723,034         |
| <b>SHAREHOLDERS' EQUITY</b>                       |      |                       |                              |                   |                          |                              |                   |
| Share capital                                     |      | 84,033,523            | -                            | 84,033,523        | 103,055,103              | -                            | 103,055,103       |
| Contributed surplus                               | B    | 7,155,373             | (12,022)                     | 7,143,351         | 11,996,847               | 76,589                       | 12,073,436        |
| Accumulated other comprehensive income            | A    | (987,772)             | 987,772                      | -                 | 71,866                   | 4,912,975                    | 4,984,841         |
| Deficit   |      | (23,865,229)          | 942,012                      | (22,923,217)      | (45,763,600)             | 1,343,578                    | (44,420,022)      |
| Total Shareholders' Equity                        |      | 66,335,895            | 1,917,762                    | 68,253,657        | 69,360,216               | 6,333,142                    | 75,693,358        |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> |      | <b>\$ 70,846,313</b>  | <b>\$ (1,147,489)</b>        | <b>69,698,824</b> | <b>\$ 77,863,134</b>     | <b>\$ 4,553,258</b>          | <b>82,416,392</b> |

# LNG Energy Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
As of and for the Years Ended September 30, 2012 and 2011  
(in Canadian dollars, except otherwise stated)

## 19. TRANSITION TO IFRS (continued)

Reconciliation of the Consolidated Statement of Loss and Comprehensive Loss:

|  | Note | For the year ended<br>September 30, 2011 |                                    |                 |
|--|------|--|------------------------------------|-----------------|
|  |      | Canadian<br>GAAP                         | Effect of<br>transition<br>to IFRS | IFRS            |
| <b>Expenses</b>                        |      |  |                                    |                 |
| Depletion and depreciation             |      | \$ 60,854                                | \$ -                               | \$ 60,854       |
| General and administrative expenses    |      | 2,274,263                                | -                                  | 2,274,263       |
| Loss on disposal of asset              |      | 20,914                                   | -                                  | 20,914          |
| Unrealized loss (gain) on investment   |      | 933                                      | -                                  | 933             |
| Professional fees                      |      | 2,309,769                                | -                                  | 2,309,769       |
| Stock based compensation (Note 12)     | B    | 3,596,361                                | (69,443)                           | 3,526,918       |
| Travel and business development        |      | 648,763                                  | -                                  | 648,763         |
| Write-down of asset                    |      | 24,122                                   | -                                  | 24,122          |
| Results from operating activities      |      | (8,935,979)                              | 69,443                             | (8,866,536)     |
| Foreign exchange gain (loss)           | A    | (436,680)                                | 332,123                            | (104,557)       |
| Other income                           |      | 114,835                                  | -                                  | 114,835         |
|  |      | (321,845)                                | 332,123                            | 10,278          |
| <b>Loss from continuing operations</b> |      | (9,257,824)                              | 401,566                            | (8,856,258)     |
| Loss from discontinued operations      |      | (12,640,547)                             | -                                  | (12,640,547)    |
| <b>Net loss</b>                        |      | \$ (21,898,371)                          | \$ 401,566                         | (21,496,805)    |
| Cumulative translation adjustment      | A    | 1,059,638                                | 3,925,203                          | 4,984,841       |
| <b>Comprehensive loss</b>              |      | \$ (20,838,733)                          | \$ 4,326,769                       | \$ (16,511,964) |

# LNG Energy Ltd.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
As of and for the Years Ended September 30, 2012 and 2011  
(in Canadian dollars, except otherwise stated)

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## 19. TRANSITION TO IFRS (continued)

Impact of Transition to IFRS on previous year results.

- A. Foreign Currency Translation - Under previous GAAP, LNG concluded that the functional currency of its foreign operating subsidiaries in PNG is the Canadian dollar. As a result of differences in the guidance for functional currency determination, LNG has concluded that under IFRS, the functional currency of PNG subsidiaries will be their respective local currencies, which is the Kina. As a consequence of this change, gains and losses related to the translation of the financial statements of these subsidiaries are recorded through other comprehensive income and do not impact net income until a disposal or partial disposal of a foreign operation. In addition, the capital asset accounts of LNG's PNG subsidiaries are translated to Canadian dollars at the foreign exchange rates in effect at the balance sheet date whereas under previous GAAP, these capital asset accounts were translated at historical rates of exchange. The translation of all balances denominated in foreign currencies resulted in an adjustment at each period from net earnings to other comprehensive income.
- B. Share-based payments - Under previous GAAP, the Company revalued all unvested options to its consultants at the end of each reporting period. Under IFRS, share-based payments are expensed based on a graded vesting schedule without revaluation of all LNG consultants. The Company also incorporated a forfeiture multiplier rather than accounting for forfeitures as they occur. The adjustment to contributed surplus to account for the forfeiture was a decrease of \$69,443 for the twelve months ended September 30, 2011 with the offset being charged to deficit.
- C. Decommissioning obligations - Under previous GAAP, the Company treated decommissioning obligations by discounting the estimated decommissioning amount based on a credit adjusted risk-free rate. Under IFRS, the Company is required to revalue its obligation at each balance sheet date using a current liability-specific discount rate. At transition date, there were no significant adjustments to decommissioning obligations.
- D. Deferred income tax - Under previous GAAP, the Company recorded deferred tax liabilities which arise from asset acquisitions due to the temporary differences between accounting and tax. Under IFRS, the Company is to recognize a deferred tax liability for all temporary differences except for transactions which are not considered business combinations. At transition date, the Company reversed \$3,065,151 in deferred tax liabilities in connection with previous asset acquisitions.
- E. Exploration and Evaluation assets - As required under IFRS 6, the Company reclassified \$17,482,046 at October 1, 2010 to Property, plant and equipment. See Note 7.
- F. Cash flow statements - Upon transition to IFRS, there were no significant changes to operating, investing or financing cash flows for the year ended September 30, 2011.