

## **Brownstone Energy Inc.**

### **Management's Discussion and Analysis**

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**For the year ended:            June 30, 2014**

**Date of report:                October 24, 2014**

This management's discussion and analysis of the financial condition and results of operation ("MD&A") of Brownstone Energy Inc. ("Brownstone" or the "Company") should be read in conjunction with Brownstone's annual audited consolidated financial statements and notes thereto as at and for the years ended June 30, 2014 and 2013.

Unless indicated otherwise, all financial data in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). All dollar amounts in this MD&A are reported in Canadian dollars unless otherwise indicated.

#### **Caution Regarding Forward-Looking Information:**

Certain information contained in this MD&A constitutes forward-looking information, which is information relating to future events or the Company's future performance and which is inherently uncertain. All information other than statements of historical fact may be forward-looking information. Forward-looking information is often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar words or phrases (including negative variations) suggesting future outcomes or statements regarding an outlook. Forward-looking information contained in this MD&A includes, but is not limited to the Company's expectations regarding its exploration and development activities, including expectations regarding drilling and other activities, receipt of regulatory and governmental approvals, the Company's future working capital requirements, including its ability to satisfy such requirements, the exposure of its financial instruments to various risks and its ability to manage those risks, the Company's ability to use tax resource pools and loss carry-forwards and changes in accounting policies.

Forward-looking information involves known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information. The Company believes the expectations reflected in the forward-looking information are reasonable but no assurance can be given that these expectations will prove to be correct and readers are cautioned not to place undue reliance on forward-looking information contained in this MD&A. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking information contained in this MD&A include, but are not limited to: risks relating to oil and gas exploration activities generally, including the availability and cost of seismic, drilling and other equipment; our ability to complete our capital programs; geological, technical, drilling and processing problems, including the availability of equipment and access to properties; our ability to secure adequate transportation for our products; potential losses which would stem from any disruptions in production, including work stoppages or other labour difficulties, or disruptions in the

transportation network on which we are reliant; potential delays or changes in plans with respect to exploration or development projects or capital expenditures; our ability and the ability of our partners to attract and retain the necessary labour required to explore and develop our projects; potential conflicting interests with our joint operating partners; our failure or the failure of the holder(s) of licenses or leases to meet specific requirements of such licenses or leases; the failure by counterparties to make payments or perform their operational or other obligations in compliance with the terms of contractual arrangements between us and such counterparties; adverse claims made in respect of our properties or assets; operating hazards and other difficulties inherent in the exploration for and production and sale of crude oil and natural gas; political and economic conditions in the countries in which our property interests are located; obtaining the necessary financing for operations, our ability to generate taxable income from operations, fluctuations in the value of our portfolio investments due to market conditions and/or company-specific factors, fluctuations in prices of commodities underlying our interests and portfolio investments, and other risks included elsewhere in this MD&A under the heading "Risks" and in the Company's public disclosure documents filed with certain Canadian securities regulatory authorities and available under the Company's profile at [www.sedar.com](http://www.sedar.com).

Readers are cautioned that the foregoing lists of factors are not exhaustive. Although the Company has attempted to identify important factors that could cause actual events and results to differ materially from those described in the forward-looking information, there may be other factors that cause events or results to differ from those intended, anticipated or estimated. The forward-looking information contained in this MD&A are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as otherwise required by law. All of the forward-looking information contained in this MD&A is expressly qualified by this cautionary statement.

### **Nature of the Business:**

Brownstone Energy Inc. ("Brownstone" or the "Company") is a Canadian-based, energy-focused company with direct and indirect interests in oil and gas exploration projects. By owning and managing a diversified portfolio of energy-based projects, Brownstone provides shareholders with a unique energy alternative. Its common shares are publicly-traded on the TSX Venture Exchange ("TSXV") under the symbol "BWN" and on the OTCQX under the symbol "BWSOF".

### **Summary:**

- As at June 30, 2014, the Company has working capital of \$9,172,740 as compared to working capital of \$8,992,430 as at June 30, 2013, an increase primarily due to the increase in the fair value of the Company's investment portfolio and the release of restricted cash offset by expenditures on exploration and evaluation assets and the purchases of new investments during the year ended June 30, 2014.
- As at June 30, 2014, exploration and evaluation assets decreased to \$4,911,743 as compared to \$17,274,483 as at June 30, 2013. The decrease was due to impairment charges of \$11,839,435, offset by expenditures on the exploration and evaluation assets net of oil, natural gas, and natural gas liquids sales from production testing. See the Exploration and evaluation assets section.
- In June 2014, the Company closed the sale of 13% of its 28.57% working interest in its Kokopelli project in Colorado, USA, for cash proceeds of \$211,190 with a possible reduction to 10% upon

completion of an earn-in by the purchaser in a US\$16,000,000 drilling and completion program, which commenced in September 2014.

- The Company assigned its private participating interests in Block 27 and Block 36 in Colombia to the operator of each Block during the current year for no consideration. The Blocks were the Company's remaining oil and gas projects in Colombia.
- On September 1, 2014, the Gabriella license (in Israel) expired without further extension being granted, due to the milestones in the work program not being achieved. The Company and the joint operating partners of the Gabriella Block are evaluating the options available to them, including the filing of an appeal with the Israeli Ministry.
- On October 15, 2014, the Yitzhak license (in Israel) expired. The Company and its joint operating partners of the Yitzhak Block are awaiting for formal notice from the Israeli Ministry and evaluating the options available to them, including the filing of an extension with the Israeli Ministry.

### **Going concern uncertainty:**

The Company has incurred a loss in the year ended June 30, 2014 of \$13,355,875 (2013 - \$40,860,181) and has an accumulated deficit of \$107,338,393 (June 30, 2013 - \$93,982,518). The Company is in the early exploration and development stage and is subject to risks and challenges similar to other companies in a comparable stage of exploration. These risks include, but are not limited to, dependence on key individuals, successful exploration and the ability to secure adequate financing to meet the minimum capital required to successfully complete the projects, political risk relating to maintaining property licenses in good standing and continuing as a going concern. Management estimates that the funds available as at June 30, 2014 will not be sufficient to meet the Company's potential capital expenditures through June 30, 2015. The Company will have to raise additional funds to continue operations. Although the Company has been successful in raising funds to date, there can be no assurance that adequate funding will be available in the future, or available on terms acceptable to the Company. Failure to meet its funding commitments with its partners may result in the loss of the Company's exploration and evaluation interests.

The challenges of securing requisite funding beyond June 30, 2014 and the continued estimated operating losses cast significant doubt on the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts or classification of liabilities that might be necessary should the Company not be able to continue as a going concern.

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

All of the Company's oil and gas activities are conducted jointly with others. The Company enters into exploration agreements with other parties, pursuant to which Brownstone may earn interests in the underlying exploration and evaluation assets by issuing common shares and/or making cash payments and/or incurring expenditures in varying amounts by varying dates. Failure by the Company to issue such shares, make such cash payments or incur such expenditures can result in a reduction or loss of the Company's interests.

The Company's accounts reflect only its interests in its oil and gas activities. The following is a summary of the Company's exploration and evaluation assets:

	Colombia (a)	Israel (b)	USA (c)	Canada (d)	Argentina (e)	Total
	\$	\$	\$	\$	\$	\$
<b>Balance at July 1, 2012</b>	34,745,055	4,614,117	3,646,119	1,116,757	1,019,100	45,141,148
Net additions <sup>1</sup>	6,255,290	6,067,145	1,148,394	13,711	111,334	13,595,874
Disposals	(6,140,400)	-	-	-	-	(6,140,400)
Impairment of exploration and evaluation assets	(34,313,636)	(1,380,604)	(588,818)	-	(111,334)	(36,394,392)
Foreign currency translation	504,891	364,260	171,002	-	32,100	1,072,253
<b>Balance at June 30, 2013</b>	1,051,200	9,664,918	4,376,697	1,130,468	1,051,200	17,274,483
Net additions <sup>1</sup>	306,317	(706,143)	(126,018)	12,689	(112,956)	(626,111)
Disposals	-	-	(270,170)	-	-	(270,170)
Impairment of exploration and evaluation assets	(1,372,310)	(9,236,915)	-	(1,143,154)	(87,056)	(11,839,435)
Foreign currency translation	14,793	278,140	71,247	-	8,796	372,976
<b>Balance at June 30, 2014</b>	-	-	4,051,756	3	859,984	4,911,743

<sup>1</sup> Net additions reflects expenditures on exploration and evaluation assets less revenue received from sales of oil, natural gas, and natural gas liquids generated during long-term production testing (if any) and reversals of outstanding cash calls previously capitalized.

(a) Colombia:

For the year ended June 30, 2014, included in net additions was \$1,489,106 (2013 - \$7,917,608) of revenue from the sales of oil generated from long-term production testing on Block 27 (2013 includes the Canaguaro Block) in the Llanos Basin of Central Colombia up to December 31, 2013, the day when the Block was impaired to nil. Additionally, the Company also received \$432,706 of revenue from the sales of oil generated from long-term production testing on Block 27 for the period from when the Block was impaired up to the day of the assignment of the Block to the operator, which was offset against exploration and evaluation expense in the consolidated statement of comprehensive loss. The Canaguaro Block was sold in June 2013 for total gross proceeds of \$6,140,400 (US\$6,000,000) and included in the consolidated statements of comprehensive loss for the year ended June 30, 2013 as other income was a gain of \$77,567 from the sale of the Canaguaro Block. Included in the statements of cash flows is the cash spent on expenditures and evaluation, net of oil sales from long-term production testing.

- (i) Block 27: In December 2013, the Company recorded an impairment charge on Block 27 of \$1,372,310 (2013 - \$19,219,802) to its estimated recoverable amount of \$0. The impairment was recognized upon a review of the Company's private participating interest in the Block. The Company believed there was a low probability of realization of the asset from the continued development of the Block. In February 2014, the Company's 34.25% private participating interest in Block 27 was assigned to the operator of the Block for nil proceeds. As at June 30, 2014, the Company had net liabilities of \$134,959 (US\$126,413) owing to the operator of the Block which were paid subsequent to June 30, 2014.
- (ii) Block 36: In October 2013, the Company assigned its 14% private participating interest in Block 36 to the operator of the Block for no consideration. As at June 30, 2014, the Company had no further obligations or liabilities in respect of the Block.
- (iii) Block 21: Following the satisfaction of the Company's obligations to pay an aggregate of US\$3,875,000 towards the drilling of two wells in fiscal 2013, both of which were subsequently abandoned, Brownstone allowed its interest in Block 21 to terminate.

In October 2013, the Agencia Nacional de Hidrocarburos ("ANH"), a Colombian government agency, the oil and gas agency of the Colombian government, called and Brownstone paid US\$567,027 of the US\$2,700,000 letter of guarantee on Block 21 provided by the Company's bank in support of its share of the operator's obligations on the Block. The ANH informed the Company that the operator of the Block breached its commitment to the ANH by not delivering certain information when required. The balance of the \$2,700,000 letter of guarantee on the Block expired on November 1, 2013.

In September 2014, the operator of the Block reimbursed the Company the full amount (US\$567,027 plus interest) of the letter of guarantee that was paid to the ANH.

The Blocks were the Company's remaining oil and gas projects in Colombia.

(b) Israel:

As at June 30, 2014, the Company has the following participating interests in Israel and is required to fund its share of the participating interests:

	<b>Gabriella Block (i)</b>	<b>Yitzhak Block (ii)</b>
Participating Interest	15%	15%

- (i) Gabriella Block: To date Brownstone has fund its share of costs incurred in connection with the attempted drilling of the exploration well.

On June 30, 2013, the Company and its license partners entered into a settlement and release agreement. Brownstone's net share of the costs totaled US\$3,504,579 pursuant to the agreement, and was recorded in exploration and evaluation assets on the consolidated statements of financial position as at June 30, 2013. During the year ended June 30, 2014, the Company reversed US\$665,956 of these costs as a result of the sale of certain assets by the operator and a reduction in liabilities owed to creditors. The costs are Brownstone's proportionate share of all costs associated with the Gabriella Block that have been incurred in connection with the drilling of the first well.

On June 30, 2013, the Operator of the Gabriella Block had applied to the Ministry of Energy and Water of the State of Israel ("Ministry") for an extension of the milestone dates and approval was received in October 2013 with a new expiry date of the license of September 1, 2014. The following table sets out the work program that must be completed in order to maintain the Gabriella Block:

<b>Gabriella Work Program</b>	<b>Milestone Dates</b>
Submitting a request for approving an operator	February 28, 2014
Signing a rig contract	April 30, 2014
Submitting the results of an Anisotropic PSDM and coherent sub surface model	July 31, 2014
Spud the first well	August 31, 2014

Brownstone and its partners have missed all of the work program milestones and have suspended their operations on the Gabriella license. For the year ended June 30, 2014, the Company recorded an impairment charge on the Gabriella Block of \$8,315,788 to its estimated recoverable value of nil. The impairment was recognized upon a review of the Company's participating interests in the exploration licenses in

Israel. The Company believes there is a low probability of realization of the asset from the successful development and the milestones have not been met.

The Gabriella license expired on September 1, 2014 without further extension being granted by the Ministry, due to the milestones in the work program not being achieved. The Company and the joint operating partners of the Gabriella Block are evaluating the options available to them, including the filing of an appeal of the Ministry's decision not to extend the license.

- (ii) Yitzhak Block: On June 30, 2013, the Operator had applied to the Ministry for an extension of the milestone dates and approval was received in October 2013 with a new expiry date of the license on October 15, 2014.

The following table sets out the current work program that must be completed in order to maintain the Yitzhak Block:

<b>Yitzhak Work Program</b>	<b>Milestone Dates</b>
Execute a contract with a drilling contractor	September 30, 2014
Spud the first well	September 30, 2014

Brownstone and its partners have missed the milestones and the license expired on October 15, 2014. The Company and its partners are evaluating their options to further extend the milestone dates. Until such extensions are obtained (if at all), the consortium is at risk of the Ministry retracting the Yitzhak license. Brownstone has funded its proportionate share of costs incurred and there are currently no outstanding liabilities in respect to the Yitzhak Block.

For the year ended June 30, 2014, the Company recorded an impairment charge on the Yitzhak Block of \$921,127 to its estimated recoverable value of nil. The impairment was recognized upon a review of the Company's participating interests in the exploration licenses in Israel. The Company believes there is a low probability of realization of the asset from the successful development.

- (iii) Samuel Block: During the year ended June 30, 2013, the milestone dates for certain work on the Samuel license were not met and the Company recorded an impairment charge on the Samuel Block of \$1,380,604 to its estimated recoverable amount of nil. The impairment was recognized upon a review of the Company's participating interests in the exploration licenses in Israel. The Company believed there was a low probability of realization of the asset from the successful development and, together with its partners, decided not to proceed with the development of the license.

The Samuel license expired on July 31, 2013 and Brownstone and the other license holders relinquished their interests in the license back to the Ministry in October 2013.

- (c) USA:

The Company has participating interests of between 10% to 28.57% in various acreages in the Piceance/Uinta basin in the USA and is required to fund its share of the costs in proportion to its participating interests.

On June 30, 2014, the Company closed the sale of 13% of its 28.57% interests in two oil and gas leases comprising the Kokopelli project in Colorado (and 65% of its 28.57% working interest in the initial well drilled in 2013), together with certain related production facilities, for \$211,190 (US\$194,987) cash with a further 52% of the Company's 28.57% interests subject to an earn-in by the purchaser. The Company now has a 24.85% carried working interest in a US\$16,000,000 drilling and completion program planned for 2014-2015 to be funded 100% by the purchaser of the assets. If the earn-in conditions are satisfied, the Company will have a 10% working interest in the Kokopelli project. During the year ended June 30, 2014, the Company also sold some of its other USA interests for total proceeds of \$58,980 (US\$55,840) and received \$153,184 (US\$144,038) in net revenue from the sale of natural gas, natural gas liquids, and oil generated during long-term production testing.

For the year ended June 30, 2013, the Company recorded an impairment charge of \$588,818 on certain of its USA properties upon the abandonment of certain of its leases. The Company has satisfied its financial obligations in respect of the USA properties.

As at June 30, 2014, the Company has determined that there were no further indicators of impairment or reversal of impairments.

(d) Canada:

- (i) In fiscal year 2005, the Company entered into an agreement with Marksmen Energy Limited ("Marksmen") to acquire a 7.0% working interest in a certain petroleum and natural gas well (the "13-22 Re-Drill Well") located in the Namao South Area of Alberta, Canada, close to the town site of St. Albert, just outside of Edmonton.

During the year ended June 30, 2014, the Company recorded an impairment charge of \$122,703 upon a review of the Company's interest in the 13-22 Re-Drill Well and its estimated recoverable amount which is nil. The Company believes there is a low probability of realization of the asset from the successful development of the property. The well has been shut-in for the past several years and the Company expects the well to remain shut-in until the operator and partners have the available funds to complete needed repairs, do additional engineering and operational reviews, and until economic conditions improve.

- (ii) The Company has a 50% interest in the exploration licenses of the Rimouski, Rimouski North, Trois-Pistoles and Shawinigan properties in the St. Laurent Lowlands, Quebec. The Company is required to fund its share of the costs incurred on the properties. During the year ended June 30, 2014, the Company spent \$12,689 (2013 - \$13,711) to maintain these properties in good standing.

During the year ended June 30, 2014, the Company concluded that it would not commit capital in the foreseeable future to exploration and evaluation activities on the Quebec properties due to the lack of market activity and the continued uncertainty regarding the drilling moratorium on shale gas exploration and production. Accordingly, the Company recorded an impairment charge of \$1,020,451 on its Quebec exploration licenses. The Company intends to keep the exploration licenses in good standing but does not believe the interest can be sold for any value at this time until the moratorium is lifted.

The Company in conjunction with its Canadian partners may in the future re-evaluate the potential of the Canadian interests and (in the case of the Alberta interest) bring back the well to production, at which time, the Company may reverse the impairment charges.

(e) Argentina:

The Company has a 25% interest in the Vaca Mahuida Block in the Province of Rio Negro, Argentina. Under the terms of the participation agreement governing Brownstone's interest, the Company is required to fund 50% of the costs to be incurred in the conduct of the work program on the property.

During the year ended June 30, 2014, the Company agreed to relinquish its 25% working interest to Petrolifera Petroleum (Americas) Limited Sucursal Argentina, the operator of the Block for net cash consideration of US\$805,530. The net cash consideration settled all outstanding liabilities and no further liabilities will occur in respect of the Block. As a result, the Company reversed accruals of \$112,956 that were recorded as at June 30, 2013 in respect of the Block and recorded an impairment charge of \$87,056. The impairment was recognized upon a review of the Company's interest in the Block and its recoverable amount of US\$805,530. As at June 30, 2014, the value of the 25% working interest in Argentina was \$859,984. The relinquishment is conditional upon granting by the Province of Rio Negro of an exploitation concession on the Vaca Mahuida Block to Petrolifera. As at the filing date of these consolidated financial statements, the concession has not been awarded by the Province and there is no certainty that it will be awarded.

During the year ended June 30, 2013, the Company considered a reserve report prepared by an independent engineering firm, GLJ Petroleum Consultants. Based upon the information contained in the report, management determined the recoverable amount of the Company's interest in Argentina to be approximately US\$1,000,000 as at June 30, 2013. The future cash flows were discounted using a pre-tax discount rate of 10% that reflects current market assessments of the time value of money and the risk specific to the Company's asset in Argentina. The future cash flows at a pre-tax discount rate of 5% and 15% was US\$1,266,000 and US\$786,000, respectively, with an average of US\$1,026,000. As a result, for the year ended June 30, 2013, the Company recorded an impairment charge of \$111,334 on its Argentinean exploration and evaluation assets to its estimated recoverable amount of \$1,051,200. The recoverable amount was determined based on the amount for which management believed the assets could be sold in a comparable arm's length transaction, less estimated costs to sell.

**Investments:**

The fair value and cost of investments are as follows:

	Fair Value	Cost
2014	\$ 3,707,817	\$ 9,746,424
2013	1,667,208	13,750,659

As at June 30, 2014, the original cost of investments exceeded fair value by \$6,038,607 as compared to \$12,083,451 as at June 30, 2013. The decrease for the year ended June 30, 2014 was primarily



due to the net change in unrealized gains on investments of \$6,043,813 offset by the disposal of investments, realizing a loss of \$5,155,874.

For details of the Company's accounting policies for investments, see (b) under "Significant Accounting Policies" elsewhere in this MD&A. The fair value of the Company's investments as reflected in its consolidated financial statements and calculated in accordance with IFRS and its accounting policies may differ from the actual proceeds of disposition that would be realized by the Company. For example, the amounts at which the Company's publicly-traded investments could be disposed of currently may differ from fair values based on market quotes, as the value at which significant ownership positions are sold is often different than the quoted market price due to a variety of factors such as premiums paid for large blocks or discounts due to illiquidity.

## Results of Operations

Selected financial information for the Company for its three most recently completed financial years as at and for the years ending June 30 is provided below:

	2014	2013	2012
Net investment gains (losses), interest and other income	\$ 920,617	\$ (1,390,480)	\$ (5,315,869)
Comprehensive loss for the year	<b>(12,988,974)</b>	(40,010,523)	(24,817,623)
Loss per common share – basic and diluted	<b>(0.10)</b>	(0.31)	(0.21)
Exploration and evaluation assets	\$ 4,911,743	\$ 17,274,483	\$ 45,141,148
Total assets	<b>15,115,615</b>	30,452,958	67,650,272
Total liabilities	<b>1,031,132</b>	3,551,120	1,150,868
Equity	<b>14,084,483</b>	26,901,838	66,499,404

No dividends were declared by the Company during any of the years indicated.

The Company's selected quarterly results for the eight most recently completed interim financial periods are as follows:.

	Quarter ended			
	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013
Net investment gains (losses)	\$ 290,489	\$ 249,270	\$ (81,206)	\$ 429,186
Net profit (loss) for the period	<b>(10,943,929)</b>	201,169	(2,095,191)	(517,924)
Total comprehensive income (loss) for the period	<b>(11,296,308)</b>	755,342	(1,604,098)	(843,909)
Earnings (loss) per share based on loss for the period – basic and diluted	<b>(0.08)</b>	0.00	(0.02)	(0.00)

	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
Net investment losses	\$ (231,949)	\$ (410,312)	\$ (674,534)	\$ (287,466)
Net loss for the period	(32,396,668)	(1,327,113)	(6,040,709)	(1,095,691)
Total comprehensive loss for the period	(31,404,339)	(380,017)	(5,488,984)	(2,737,183)
Loss per share based on loss for the period – basic and diluted	(0.25)	(0.01)	(0.05)	(0.01)

No dividends were declared by the Company during any of the periods indicated.

### Three months ended June 30, 2014 and 2013:

For the three months ended June 30, 2014, the Company generated net realized losses on disposal of investments of \$3,094,980, as compared to nil for the three months ended June 30, 2013. The net realized losses in the current quarter was a result of the disposition of six of the Company's investments.

For the three months ended June 30, 2014, the Company recorded a net change in unrealized gains on investments of \$3,385,469 as compared to a net change in unrealized losses on investments of \$231,949 for the three months ended June 30, 2013. The net change in unrealized gains on investments in the current year related to the reversal of previously recognized net unrealized losses on disposal of investments and the net write-up to market on the Company's investments. In the prior year, the net change in unrealized losses on investments related to the net write-down to market on the Company's investments.

For the three months ended June 30, 2014, the Company recorded interest and other income of \$834 as compared to \$85,396 for the three months ended June 30, 2013. In the prior year period, other income included \$77,567 from the sale of the Canaguaro Block (Colombia). Interest income is primarily composed of interest income earned on investments in banker's acceptances and cash deposits. In the current year, the cash deposits were much lower which decreases the interest earned.

For the three months ended June 30, 2014, operating, general and administrative expenses increased by \$320,940 to \$838,794 from \$517,854 for the three months ended June 30, 2013. The increase was primarily due to an increase in foreign exchange loss as discussed below.

The following is the breakdown of the Company's operating, general and administrative expenses for the indicated three month periods ended June 30. Details of the changes follow the table:

	2014	2013
Salaries, consulting and administrative fees (a)	\$ 449,496	\$ 359,907
Foreign exchange loss (gain) (b)	224,277	(247,560)
Professional fees	120,330	137,863
Other office and general (c)	37,892	94,466
Stock-based compensation expense (d)	20,807	63,204
Travel and promotion (e)	15,276	89,943
Other employment benefits	6,517	5,783
Transaction costs	5,900	-
Shareholder relations, transfer agent and filing fees	2,034	14,248
Exploration and evaluation expenses (f)	(43,735)	-
	\$ 838,794	\$ 517,854

- (a) Salaries, consulting and administrative fees increased by \$89,589 for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013. The increase was due to a payment of \$100,000 to the Company's former President and Chief Operating Officer from the cessation of his employment. The increase during the current quarter was offset by a reduction of consultants during the period compared to the prior year period.
- (b) Foreign exchange loss increased by \$471,837 for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013. The foreign exchange loss during the current quarter was due to the increase in the value of the Canadian dollar versus the U.S. dollar during the quarter, which decreased the Canadian dollar value of the Company's U.S. dollar denominated monetary assets.
- (c) Other office and general expenses decreased by \$56,574 for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013, primarily due to a reduction in business activities in the Company's foreign subsidiaries.
- (d) Stock-based compensation expense decreased by \$42,397 for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013. The decrease was due to a decrease in the value of stock options, which vested during the current period as compared to the prior year period. Stock options granted during the current and prior year vest at three-month intervals over 18 months and are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of these options is estimated at the date of grant using the Black-Scholes option pricing model, and expensed over the vesting periods based on the graded method. Unvested forfeited stock options are not expensed during the period.
- (e) Travel and promotion decreased by \$74,667 for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013, due to a decrease in traveling related to the Company's oil and gas activities in Colombia and Israel in the current period.
- (f) Exploration and evaluation expense decreased by \$43,735 for the three months ended June 30, 2014, primarily due a reversal of \$104,811 (US\$97,899) in accrued liabilities relating to a cash call for the Canaguaro Block in Colombia that has been settled with the former operator of the Block.

For the three months ended June 30, 2014, the Company recorded an impairment on exploration and evaluation assets totalling \$10,380,069 as compared to \$31,653,915 for the three months ended June 30, 2013. During the year ended June 30, 2014, the Company recorded impairments on its Colombia, Israel, and Canadian properties. See "Exploration and evaluation assets" section.

For the three months ended June 30, 2014, the Company recorded an income tax expense of \$16,389 as compared to \$78,346 for the three months ended June 30, 2013. The income tax expense in the current period is due to the recording of an alternative minimum income tax in Colombia. In the prior year period, the income tax expense included an alternative minimum income tax in Colombia and a reassessment of income tax in Argentina of US\$69,104.

Loss for the three months ended June 30, 2014 was \$10,943,929 (\$0.08 per share) as compared to \$32,396,668 (\$0.25 per share) for the three months ended June 30, 2013. The loss in the both periods were primarily due to the impairments recorded against its exploration and evaluation assets.

For the three months ended June 30, 2014, the Company recorded a loss from the exchange differences on translation of foreign operations of \$352,379 resulting in total comprehensive loss for the period of \$11,296,308. The loss from the exchange differences on translation of foreign operations was primarily

due to the increase in the value of the Canadian dollar versus the U.S. dollar during the quarter, which decreased the Canadian dollar value of the Company's U.S. dollar denominated exploration and evaluation assets held by foreign subsidiaries. For the three months ended June 30, 2013, the Company recorded a gain from the exchange differences on translation of foreign operations of \$992,329 resulting in total comprehensive loss for the period of \$31,404,339.

### Year ended June 30, 2014 and 2013:

For the year ended June 30, 2014, the Company generated net realized losses on disposal of investments of \$5,155,874, as compared to nil for the year ended June 30, 2013. The net realized losses in the current year was a result of the disposition of seven of the Company's investments.

For the year ended June 30, 2014, the Company recorded a net change in unrealized gains on investments of \$6,043,813 as compared to a net change in unrealized losses on investments of \$1,604,261 in the year ended June 30, 2013. The net change in unrealized gains on investments in the current year related to the reversal of previously recognized net unrealized losses on disposal of investments and the net write-up to market of \$1,063,300 on the Company's investments. The net change in unrealized losses on investments in the prior year period related to the net write-down to market on the Company's investments.

For the year ended June 30, 2014, the Company recorded interest and other income of \$32,678 as compared to \$213,781 for the year ended June 30, 2013. In the prior year, other income included \$94,428 from the sale of the Canaguaro Block (Colombia) and other USA properties. Interest income is primarily composed of interest income earned on investments in banker's acceptances and cash deposits. In the current year, the cash deposits were much lower which decreases the interest earned.

For the year ended June 30, 2014, operating, general and administrative expenses decreased by \$235,923 to \$2,455,295 from \$2,691,218 for the year ended June 30, 2013, primarily from the decreased in stock-based compensation expense, travel and promotion, and office and general expenses.

The following is the breakdown of the Company's operating, general and administrative expenses for the year ended June 30.

Details of the changes follow the table:

	2014	2013
Salaries, consulting and administrative fees (a)	\$ 1,626,359	\$ 1,485,341
Professional fees	266,824	327,553
Other office and general (b)	198,318	414,176
Stock-based compensation expense (c)	171,619	412,957
Exploration and evaluation expenses (d)	95,036	-
Shareholder relations, transfer agent and filing fees	77,952	113,902
Travel and promotion (e)	57,313	286,373
Other employment benefits	40,301	28,654
Transaction costs	5,900	-
Foreign exchange gain (f)	(84,327)	(377,738)
	<b>\$ 2,455,295</b>	<b>\$ 2,691,218</b>

- (a) Salaries, consulting and administrative fees increased by \$141,018 for the year ended June 30, 2014 as compared to the year ended June 30, 2013. The increase was due to a one-time increase of \$100,000 each to the Chairman and Chief Executive Officer, Chief Financial Officer and Vice President, Corporate & Legal Affairs and the payment of \$100,000 to the Company's former President and Chief Operating Officer from the cessation of his employment. The increase during the current year was offset by a reduction of consultants during the 2014 year compared to the prior year.
- (b) Other office and general decreased by \$215,858 for the year ended June 30, 2014 as compared to the year ended June 30, 2013. The decrease was primarily due to a decrease of bank service charges and fees relating to the Company's outstanding letters of guarantee for its Colombian properties.
- (c) Stock-based compensation expense decreased by \$241,338 for the year ended June 30, 2014 as compared to the year ended June 30, 2013. The decrease was due to a decrease in the value of stock options, which vested during the current period as compared to the prior year period. Stock options granted during the current and prior year vest at three-month intervals over 18 months and are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value of these options is estimated at the date of grant using the Black-Scholes option pricing model, and expensed over the vesting periods based on the graded method. Unvested forfeited stock options are not expensed during the period.
- (d) Exploration and evaluation expenses increased by \$95,036 for the year ended June 30, 2014, primarily due to accrued cash calls in Israel and on Block 36 in Colombia, which were expensed. The increase for the current year includes a reversal of \$104,811 in accrued liabilities relating to a cash call for the Canaguaro Block that has been settled with the former operator of the Block. In prior year periods, the cash calls were capitalized.
- (e) Travel and promotion decreased by \$229,060 for the year ended June 30, 2014 as compared to the year ended June 30, 2013, due to a decrease in traveling related to the Company's oil and gas activities in Colombia and Israel in the current year.
- (f) Foreign exchange gain decreased by \$293,411 for the year ended June 30, 2014 as compared to the year ended June 30, 2013. The foreign exchange gain was due to the decrease in the value of the Canadian dollar versus the U.S. dollar during the quarter, which increased the Canadian dollar value of the Company's U.S. dollar denominated monetary assets.

For the year ended June 30, 2014, the Company recorded an impairment on exploration and evaluation assets totalling \$11,839,435 as compared to \$36,394,392 for the year ended June 30, 2013. The Company recorded impairments on its properties in Colombia, Israel, and Canada. See "Exploration and evaluation assets" section.

For the year ended June 30, 2013, the Company recorded an income tax recovery of \$18,238 as compared to income tax expense of \$384,091 for the year ended June 30, 2013. The income tax recovery in the current year is due to taxes withheld in Colombia, which is greater than the alternative minimum tax.

Loss for the year ended June 30, 2014 was \$13,355,875 (\$0.10 per share) as compared to \$40,860,181 (\$0.31 per share). The loss in the current and prior year was primarily due to the impairment of exploration and evaluation assets.

For the year ended June 30, 2014, the Company recorded a gain from the exchange differences on translation of foreign operations of \$366,901 resulting in total comprehensive loss for the year of \$12,988,974. The gain from the exchange differences on translation of foreign operations was primarily due to the decrease in the value of the Canadian dollar versus the U.S. dollar during the year, which increased the Canadian dollar value of the Company's U.S. dollar denominated exploration and evaluation assets held by foreign subsidiaries. For the year ended June 30, 2013, the Company recorded a gain from the exchange differences on translation of foreign operations of \$849,658 resulting in total comprehensive loss for the year of \$40,010,523.

## **Cash Flows**

### **Year ended June 30, 2014 and 2013:**

During the year ended June 30, 2014, the Company used cash of \$2,375,674 in operating activities as compared to \$3,030,281 in the year ended June 30, 2013.

During the year ended June 30, 2014, net cash used in investing activities was \$1,836,032 as compared to \$5,349,066 during the year ended June 30, 2013. During the year ended June 30, 2014, the Company spent cash on expenditures on exploration and evaluation assets of \$1,588,457 as compared to cash expenditures of \$10,935,983 during the year ended June 30, 2013, net of oil revenues. In the year ended June 30, 2014, the Company had proceeds of \$270,170 from the sale of exploration and evaluation assets as compared to \$6,157,261 during the year end June 30, 2013. During the year ended June 30, 2014, the Company had proceeds from dispositions of investments of \$212,496 as compared to nil during the year ended June 30, 2013. During the year ended June 30, 2014, the Company purchased \$1,365,166 of investments as compared to \$500,000 during the year ended June 30, 2013. During the year ended June 30, 2014, \$634,925 of restricted cash was released when the Company assigned its 14% private participating interest in Block 36.

For the year ended June 30, 2014, the Company had a net decrease in cash and cash equivalents of \$4,211,706 as compared to \$8,379,347 for the year ended June 30, 2013. For the year ended June 30, 2014, the Company also had a loss from the exchange rate changes on its foreign operations' cash balances of \$6,075, leaving a cash and cash equivalents balance of \$5,377,283 as at June 30, 2014 as compared to an exchange loss of \$222,595, leaving a cash and cash equivalents balance of \$9,595,064 as at June 30, 2013.

## **Segmented information:**

Reporting segments are defined as components of an enterprise about which separate financial information is available, that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. All of the Company's operations relate to direct and indirect investments in the oil and gas sector. The Company's significant segments include six distinct geographic areas: Colombia, Israel, Canada, United States, Argentina and Brazil. There were no changes in the reportable segments during the year ended June 30, 2014.

The accounting policies applied to Brownstone's operating segments are the same as those described in the summary of significant accounting policies, except that certain expenses and other items are not allocated to the individual operating segments when determining income or loss, but are attributed to the Canadian operations where the corporate head office is located.

The following is segmented information as at and for the year ended June 30, 2014:

	Year ended June 30, 2014		As at June 30, 2014		
	Interest and other income	Net loss for the year	Exploration and evaluation assets	Other assets	Total assets
Canada and other	\$ 2,047	\$ 2,291,086	\$ 3	\$ 9,570,543	\$ 9,570,546
Israel	1,524	9,179,073	-	17,458	17,458
United States	-	1,189	4,051,756	66,235	4,117,991
Colombia	29,107	1,759,047	-	407,888	407,888
Argentina	-	125,480	859,984	5,471	865,455
Brazil	-	-	-	136,277	136,277
	\$ 32,678	\$ 13,355,875	\$ 4,911,743	\$ 10,203,872	\$ 15,115,615

The following is segmented information as at and for the year ended June 30, 2013:

	Year ended June 30, 2013		As at June 30, 2013		
	Interest and other income	Net loss for the year	Exploration and evaluation assets	Other assets	Total assets
Canada and other	\$ 73,819	\$ 3,768,674	\$ 1,130,468	\$ 11,443,473	\$ 12,573,941
Israel	-	1,529,724	9,664,918	78,918	9,743,836
United States	16,861	571,957	4,376,697	18,814	4,395,511
Colombia	123,101	34,829,460	1,051,200	1,488,705	2,539,905
Argentina	-	160,366	1,051,200	14,622	1,065,822
Brazil	-	-	-	133,943	133,943
	\$ 213,781	\$ 40,860,181	\$ 17,274,483	\$ 13,178,475	\$ 30,452,958

### Liquidity and capital resources:

#### Consolidated statements of financial position highlights

	June 30, 2014	June 30, 2013
Cash and cash equivalents	\$ 5,377,283	\$ 9,595,064
Investments, at fair value	3,707,817	1,667,208
Exploration and evaluation assets	4,911,743	17,274,483
Total assets	15,115,615	30,452,958
Total liabilities	1,031,132	3,551,120
Share capital, warrants and broker warrants, contributed surplus	121,135,056	120,963,437
Foreign currency translation reserve	287,820	(79,081)
Deficit	(107,338,393)	(93,982,518)
Working Capital	9,172,740	8,992,430

Accounts payable and accrued liabilities decreased by \$2,447,346 to \$1,031,132 as at June 30, 2014 as compared to \$3,478,478 as at June 30, 2013. The decrease was primarily due to the timing of the accrual of liabilities of \$841,989 for exploration and evaluation cash calls as compared to \$2,907,683 as at June 30, 2013. As at June 30, 2014, included in accounts payable and accrued liabilities is \$83,456 for a Colombian equity tax as compared to \$240,501 as at June 30, 2013. Brownstone is required to pay an equity tax based on the net equity of its Colombian branch office, subject to certain adjustments. Subsequent to June 30, 2014, the Company paid the balance of the Colombian equity tax.

The Company has committed and is required to meet all of its drilling and related expenditures as they become due to maintain the Company's interests in its oil and gas properties (see "Exploration and evaluation assets" section). These exploration and evaluation assets' obligations are not fixed and cannot be pre-determined with certainty. Failure to meet the obligations may result in the dilution or loss of the Company's interests.

The Company's cash and cash equivalents and investments as at June 30, 2014 would be sufficient to meet the Company's current liabilities. As at June 30, 2014, the Company had working capital of \$9,172,740 as compared to working capital of \$8,992,430 as at June 30, 2013. The working capital since June 30, 2013 did not significantly change, primarily due to the increase in the fair value of the Company's investment portfolio and the release of restricted cash, offset primarily by new purchases of investments and expenditures.

The Company continues to have no long-term debt. In order to meet its operating and capital expenditure obligations as they become due, Brownstone will have to rely on external sources of capital. The Company expects to have to raise additional funds through debt and/or equity financings to meet its future exploration obligations and will continue to consider, where warranted, strategic dispositions of certain of its interests in order to raise funds and/or reduce its capital expenditure requirements. The Company's ability to access the debt and equity markets and sell property interests when required will depend upon factors beyond its control, such as economic and political conditions that may affect the capital markets generally and the oil and gas industry specifically, including conditions pertaining to the countries in which it operates. The Company's inability to raise sufficient capital to fund its operations and growth may result in the loss of some or all of the Company's interests and, accordingly, could have a material adverse effect on the Company's business, financial condition, and results of operations, and its ability to continue as a going concern.

#### Related party transactions:

All transactions with related parties have occurred in the normal course of operations and are recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

- (a) Compensation to key management personnel and directors during the years ended June 30 were as follows:

Type of expense	2014	2013
Salaries and consulting fees	\$ 1,160,080	\$ 776,750
Other short-term benefits	32,537	22,536
Stock-based compensation expense	144,119	305,607
	\$ 1,336,736	\$ 1,104,893

Key management personnel are the Chairman and Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer and Vice President, Corporate & Legal Affairs.

- (b) During the year ended June 30, 2014, the Company granted 2,550,000 options to directors and officers of the Company, with an exercise price of \$0.10 per share expiring on September 9, 2018.



- (c) During the year ended June 30, 2013, the Company granted 1,950,000 options to directors and officers of the Company, with an exercise price of \$0.17 per share expiring on November 28, 2017.

### Off-Balance sheet arrangements:

As at June 30, 2014, the Company does not have any off-balance sheet arrangements that have, or are reasonable likely to have, a current or future effect on the results of operations or financials condition of Brownstone.

### Management of capital:

The Company includes the following in its capital as at June 30:

	2014	2013
Equity comprising:		
Share capital	\$ 96,597,845	\$ 96,597,845
Contributed surplus	24,537,211	21,806,275
Warrants	-	2,559,317
Foreign currency translation reserve	287,820	(79,081)
Deficit	(107,338,393)	(93,982,518)
	<b>\$ 14,084,483</b>	<b>\$ 26,901,838</b>

The Company's objectives when managing capital are:

- (a) to ensure that the Company maintains the level of capital necessary to meet the requirements of cash calls for the exploration of properties and from operators in joint venture properties;
- (b) to ensure that the Company maintains the level of capital necessary to meet the requirements of its broker;
- (c) to allow the Company to respond to changes in economic and/or marketplace conditions by maintaining the Company's ability to purchase new investments and acquisitions of exploration properties;
- (d) to give shareholders sustained growth in shareholder value by increasing shareholders' equity; and
- (e) to maintain a flexible capital structure that optimizes the cost of capital at acceptable levels of risk.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its underlying assets. The Company maintains or adjusts its capital level to enable it to meet its objectives by:

- (a) realizing proceeds from the disposition of its investments; and
- (b) raising capital through equity or debt financings.

The Company is not subject to any capital requirements imposed by any regulator.

There were no changes in the Company's approach to capital management during the year ended June 30, 2014. To date, the Company has not declared any cash dividends to its shareholders as part of its capital management program. The Company's current working capital is sufficient to discharge its liabilities as at June 30, 2014.

### Risk management:

The investments operation of Brownstone's business involves the purchase and sale of securities and, accordingly, a significant portion of the Company's assets are currently comprised of financial instruments. The use of financial instruments can expose the Company to several risks, including market, credit, and liquidity risks. A discussion of the Company's use of financial instruments and their associated risks is provided below.

(a) Market risk:

Market risk is the risk that the fair value of or future cash flows from, the Company's financial instruments will significantly fluctuate because of changes in market prices. The value of the financial instruments can be affected by changes in interest rates, foreign exchange rates, and equity and commodity prices. The Company is exposed to market risk in trading its investments and unfavourable market conditions could result in dispositions of investments at less than favourable prices. Additionally, the Company adjusts its investments to fair value at the end of each reporting period. This process could result in significant write-downs of the Company's investments over one or more reporting periods, particularly during periods of overall market instability, which would have a significant unfavourable effect on Brownstone's financial position.

There were no changes to the way the Company manages market risk during the year ended June 30, 2014. The Company manages market risk by having a portfolio that is not singularly exposed to any one issuer; however, its investment activities are currently concentrated primarily in the oil and gas resource industry.

The following table shows the estimated sensitivity of the Company's after-tax net loss for the year ended June 30, 2014 from a change in the closing trade price of the Company's investments with all other variables held constant as at June 30, 2014:

Percentage of change in closing trade price	Decrease in net after-tax loss from % increase in closing trade price	Increase in net after-tax loss from % decrease in closing trade price
2%	\$ 64,311	\$ (64,311)
4%	128,661	(128,661)
6%	192,992	(192,992)
8%	257,322	(257,322)
10%	321,653	(321,653)

The following table shows the estimated sensitivity of the Company's after-tax net loss for the year ended June 30, 2013 from a change in the closing bid price of the Company's investments with all other variables held constant as at June 30, 2013:

Percentage of change in closing bid price	Decrease in net after-tax loss from % increase in closing bid price	Increase in net after-tax loss from % decrease in closing bid price
2%	\$ 28,926	\$ (28,926)
4%	57,852	(57,852)
6%	86,778	(86,778)
8%	115,704	(115,704)
10%	144,630	(144,630)

(b) Credit risk:

Credit risk is the risk of loss associated with the inability of a third party to fulfill its payment obligations. The Company is exposed to the risk that third parties owing it money or securities will not perform their underlying obligations and for funds held with banks for cash and cash equivalents. The Company may, from time to time, invest in debt obligations. As at June 30, 2014 and 2013, the Company did not hold any debt obligations. All funds in cash and cash equivalents are held in financial institutions that have a credit rating above AA and the Company believes it is not exposed to any significant loss.

There were no changes to the way the Company manages credit risk during the year ended June 30, 2014. The Company is also exposed in the normal course of business to credit risk from the sale of its investments and advances to investee and joint arrangements.

The following is the Company's maximum exposure to credit risk as at June 30:

	2014	2013
Cash and cash equivalents	\$ 5,377,283	\$ 9,595,064
Restricted cash	-	634,925
Receivables	838,450	1,117,211
Income taxes receivable	242,537	144,471
	<b>\$ 6,458,270</b>	<b>\$ 11,491,671</b>

As at June 30, 2014 and 2013, the Company had the following significant receivables:

- (i) As at June 30, 2014, included in receivables is \$605,358 (US\$567,027) relating to a letter of guarantee on Block 21 (Colombia) that was called by the ANH (see Note 8) in October 2013. The ANH informed the Company that the operator of the Block breached its commitment to the ANH by not delivering certain information when required. Brownstone is seeking reimbursement from the operator in accordance with the operator's contractual obligations.

The Company is exposed to this credit risk, however, subsequent to June 30, 2014, the Company received the balance in full from the operator of the Block.

- (ii) As at June 30, 2014, included in receivables is \$163,501 (2013 - \$1,047,044) relating to oil sales revenue. The Company is exposed to this credit risk since the amount is due from three counterparties.
- (iii) As at June 30, 2014, included in receivables is \$41,541 (2013 - \$35,026) relating to Goods and Services Tax and Harmonized Sales Tax input sales tax refunds. The Company believes it is not exposed to credit risk since the amount is fully collectible from the Canadian government.

(c) Liquidity risk:

Liquidity risk is the risk that the Company will have sufficient cash resources to meet its financial obligations as they become due. The Company's liquidity and operating results may be adversely affected if the Company's access to the capital markets is hindered, whether as a result of a downturn in stock market conditions generally or related to matters specific to the Company, or if the value of the Company's investments declines, resulting in losses upon disposition. The Company generates cash flow primarily from its financing activities and proceeds from the disposition of its investments, in addition to interest earned on its investments.

There were no changes to the way that the Company manages liquidity risk during the year ended June 30, 2014. The Company manages liquidity risk by reviewing the amount of margin available on a daily basis and managing its cash flow. The Company holds investments that can be converted into cash when required.

As at June 30, 2014 and 2013, the Company was not using any margin.

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at June 30, 2014:

Liabilities and obligations	Payments due by period				
	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Accounts payable and accrued liabilities	\$ 1,031,132	\$ 1,031,132	\$ -	\$ -	\$ -
	\$ 1,031,132	\$ 1,031,132	\$ -	\$ -	\$ -

The following table shows the Company's liabilities and potential due dates related to liquidity risk as at June 30, 2013:

Liabilities and obligations	Payments due by period				
	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Accounts payable and accrued liabilities	\$ 3,478,478	\$ 3,478,478	\$ -	\$ -	\$ -
Income taxes payable	72,642	72,642			
	\$ 3,551,120	\$ 3,551,120	\$ -	\$ -	\$ -

The following table shows the Company's source of liquidity by assets as at June 30, 2014:

Assets	Liquidity by period				Non-liquid assets
	Total	Less than 1 year	1 – 3 years	After 4 years	
Cash and cash equivalents	\$ 5,377,283	\$ 5,377,283	\$ -	\$ -	\$ -
Prepays and receivables	876,235	876,235	-	-	-
Investments, at fair value	3,707,817	3,707,817	-	-	-
Income taxes receivable	242,537	242,537	-	-	-
Exploration and evaluation assets	4,911,743	-	-	-	4,911,743
	<b>\$ 15,115,615</b>	<b>\$ 10,203,872</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 4,911,743</b>

The following table shows the Company's source of liquidity by assets as at June 30, 2013:

Assets	Liquidity by period				Non-liquid assets
	Total	Less than 1 year	1 – 3 years	After 4 years	
Cash and cash equivalents	\$ 9,595,064	\$ 9,595,064	\$ -	\$ -	\$ -
Prepays and receivables	1,136,807	1,136,807	-	-	-
Investments, at fair value	1,667,208	1,667,208	-	-	-
Income taxes receivable	144,471	144,471	-	-	-
Restricted cash	634,925	-	634,925	-	-
Exploration and evaluation assets	17,274,483	-	-	-	17,274,483
	<b>\$ 30,452,958</b>	<b>\$ 12,543,550</b>	<b>\$ 634,925</b>	<b>\$ -</b>	<b>\$ 17,274,483</b>

(d) Interest risk:

Interest risk is the impact that changes in interest rates could have on the Company's earnings and liabilities. As at June 30, 2014 and 2013, the Company did not have any interest rate risk liabilities. The Company holds a significant portion of cash equivalents in interest-bearing instruments and is exposed to the risk of changing interest rates.

The primary objective of the Company's investment activities is to preserve principal while at the same time maximizing the income it receives from its investments without significantly increasing risk. To minimize interest rate risk, the Company maintains its portfolio of cash equivalents in GICs and bankers' acceptances with maturities of less than one year. The Company does not use any derivative instruments to reduce exposure to interest rate fluctuations.

(e) Currency risk:

Currency risk is the risk that the fair value of or future cash flows from the Company's financial instruments will fluctuate because of changes in foreign exchange rates. The Company's operations are exposed to foreign exchange fluctuations, which could have a significant adverse effect on its consolidated results of operations from time to time.

The Company presently holds funds in Canadian dollars but a significant amount of its costs are denominated in U.S. dollars, Colombian pesos, and Argentinean pesos. The Company does not engage in any hedging activities to mitigate its foreign exchange risk. A change in the foreign exchange rate of the Canadian dollar versus another currency may increase or decrease the value of the Company's financial instruments. The Company does not hedge its foreign currency exposure.

The following assets and liabilities were denominated in foreign currencies as at June 30:

	2014	2013
Denominated in U.S. dollars:		
Cash and cash equivalents	\$ 5,163,293	\$ 8,014,927
Restricted cash	-	634,925
Prepays and receivables	221,862	1,089,282
Income tax receivable	242,537	144,471
Exploration and evaluation assets	4,911,740	16,144,015
Accounts payable and accrued liabilities	(966,052)	(3,338,441)
Net assets denominated in U.S. dollars	<u>9,573,380</u>	<u>22,689,179</u>
Denominated in Brazilian reals:		
Cash and cash equivalents	<u>136,277</u>	133,943
Net assets denominated in Brazilian reals	<u>136,277</u>	<u>133,943</u>
Denominated in Argentinean pesos:		
Cash and cash equivalents	5,471	14,622
Accounts payable and accrued liabilities	-	(53,469)
Income taxes payable	-	(72,642)
Net assets denominated in Argentinean pesos	<u>5,471</u>	<u>(111,489)</u>
Denominated in Colombian pesos:		
Cash and cash equivalents	<u>6,407</u>	282,773
Net assets denominated in Colombian pesos	<u>6,407</u>	<u>282,773</u>

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2014 from a change in the U.S. dollar exchange rate in which the Company has significant exposure with all other variables held constant as at June 30, 2014:

Percentage change in U.S. dollar exchange rate	Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate	Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate
2%	\$ 140,729	\$ (140,729)
4%	281,457	(281,457)
6%	422,186	(422,186)
8%	562,915	(562,915)
10%	<u>703,643</u>	<u>(703,643)</u>

The following table shows the estimated sensitivity of the Company's total comprehensive loss for the year ended June 30, 2013 from a change in the U.S. dollar exchange rate in which the Company has significant exposure with all other variables held constant as at June 30, 2013:

Percentage change in U.S. dollar exchange rate	Decrease in total comprehensive loss from an increase in % in the U.S. dollar exchange rate	Increase in total comprehensive loss from a decrease in % in the U.S. dollar exchange rate
2%	\$ 333,531	\$ (333,531)
4%	667,062	(667,062)
6%	1,000,593	(1,000,593)
8%	1,334,124	(1,334,124)
10%	1,667,655	(1,667,655)

### Risks:

Brownstone's financial condition, results of operation and business are subject to certain risks, which may negatively affect them. Certain of these risks are described below in addition to elsewhere in this MD&A.

#### (a) Exploration and Development

The business of exploring for, developing and producing oil and gas involves a high degree of risk. Oil and gas reserves may never be found or, if discovered, may not be result in production at reasonable costs or profitability. The business of exploring, developing and producing is also capital intensive and, to the extent that cash flows from operating activities and external sources become limited or unavailable, the ability of Brownstone and of its operating partners to meet their respective financial obligations which are necessary to maintain their interests in the underlying properties could be impaired, resulting in those of the interests.

#### (b) Investment Risks:

The Company acquires securities of public and private companies from time to time, which are primarily junior or small-cap resource companies. The market values of these securities can experience significant fluctuations in the short and long term due to factors beyond the Company's control. Market value can be reflective of the actual or anticipated operating results of the companies and/or the general market conditions that affect the oil & gas sector as a whole, such as fluctuations in commodity prices and global political and economical conditions. The Company's investments are carried at fair value, and unrealized gains/losses on the securities and realized losses on the securities sold could have a material adverse impact on the Company's operating results. The recent decline in stock prices of the types of companies in which the Company invests have been very significant and such prices might take an extended time, to recover if they do at all.

#### (c) Dependence Upon Operating Partners:

Brownstone's oil and gas activities are conducted through partners in respect of which the Company is not the operator. Brownstone is dependent upon its operating partners for the financial and technical support, which they contribute to the Company's oil and gas properties. If Brownstone's operating partners are unable to fulfill their own contractual obligations, the

Company's interests could be jeopardized, resulting in project delays, additional costs and loss of the interests.

(d) Environmental:

The Company's oil and gas operations are subject to environmental regulations in the jurisdictions in which it operates. Environmental legislation is evolving in a manner which will likely require stricter standards and enforcement, increased costs, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist on the properties in which the Company holds interests which are presently unknown to the Company and which have been caused by previous or existing owners or operators of the properties or by illegal mining activities.

(e) Governmental:

Government approvals and permits are often generally required in connection with the Company's operations. To the extent such approvals are required and not obtained, the Company may be delayed or prohibited from proceeding with planned exploration or development of properties. Amendments to current laws, regulations and permits governing operations and activities of oil and gas companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in capital expenditures or require abandonment or delays in development of new properties. Although the governments of the various countries in which Brownstone operates have been stable recently, there is no assurance that political and economic conditions will remain stable. Political and economic instability may impede the Company's ability to continue its exploration activities in the manner currently contemplated.

(f) Foreign Operations:

The Company is exposed to risks of political instability and changes in government policies, laws and regulations in every country in which the Company has oil & gas interests. The Company holds interests in Argentina and Israel and in other jurisdictions that may be affected in varying degrees by political stability, government regulations relating to the oil & gas industry and foreign investment therein. Any changes in regulations or shifts in political conditions are beyond the Company's control and may adversely affect the Company's business. The Company's operations may be affected in varying degrees by government regulations, including those with respect to restrictions on production, price controls, export controls, income taxes, expropriation of property, employment, land use, water use, environmental legislation and mine safety. There is no assurance that permits can be obtained, or that delays will not occur in obtaining all necessary permits or renewals of such permits for existing properties or additional permits required in connection with future exploration and development programs. In the event of a dispute arising at the Company's foreign operations, the Company may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons to the jurisdiction of courts in Canada. The Company may also be hindered or prevented from enforcing its rights with respect to a government entity or instrumentality because of the doctrine of sovereign immunity.

(g) Fluctuations in Crude Oil, Natural Gas, and Natural Gas Liquid Prices:

The price of the Company's common shares, and consolidated financial results and exploration, development and other oil and gas activities may in the future be significantly and adversely



affected by declines in the price of crude oil, natural gas, and/or natural gas liquid (collectively "oil and gas"). The price of oil and gas fluctuates widely and is affected by numerous factors beyond the Company's control, such as interest rates, exchange rates, inflation or deflation, fluctuation in the value of the US dollar and foreign currencies, global and regional supply and demand, the political and economic conditions and production costs of major oil and gas - producing countries throughout the world, and the cost of substitutes, inventory levels and carrying charges. Future material price declines could cause continued development of and commercial production from the properties in which the Company holds an interest to be impracticable. Depending on the price of oil and gas, cash flow from the Company's operations may not be sufficient and the Company could be forced to discontinue production and may lose the Company's interest in, or may be forced to sell, some of the Company's properties. Future production from the Company's properties is dependent upon the price of oil and gas being adequate to make these properties economic.

### **Significant Accounting Policies:**

Refer to Note 2 of the Notes to the consolidated financial statements as at and for the year ended June 30, 2014 for details of the Company's basis of preparation of the consolidated financial statements.

Some significant accounting policies used in the presentation of the consolidated financial statements are as follows.

(a) Oil and gas properties and exploration and evaluation assets:

(i) Exploration and evaluation assets:

Amounts included under exploration and evaluation assets relate to properties that are in preproduction and are undergoing exploration and evaluation.

All costs incurred in connection with the Company's exploration and evaluation assets (acquisition and exploration for oil and gas reserves) including overhead and dry-holes are capitalized less accumulated impairment losses. Such amounts include land acquisition costs, geological and geophysical expenditures, cost of drilling both productive and non-productive wells, gathering production facilities and equipment, and overhead expenses directly related to exploration and development activities. The Company capitalizes carrying costs directly attributable to its acquisition, exploration and development activities, such as interest costs.

Capitalized exploration and evaluation assets are assessed to determine whether it is likely such net costs may be recovered in the future. Assets that are unlikely to be recovered are written down to their recoverable amount. Impairment reviews take place where there is an indication of impairment or when an exploration and evaluation asset has been transferred into oil and gas properties. The Company considers both qualitative and quantitative factors when determining whether an exploration and evaluation asset may be impaired. Impairment reviews are based on each specific license or block. Each specific license or block has an operator (which may be similar) with different joint partners.

Management may consider the following when reviewing an exploration and evaluation asset for impairment:

1. failure to receive approvals of or extensions of environmental/ drilling permits, aboriginal or similar approvals that allow the Company and its partners to proceed with a project;
2. valuations based on reserve or resource reports prepared by an independent engineering firm;
3. political changes in a country which the Company owns the exploration or evaluation asset;
4. seismic testing or drilling results;
5. the Company's intention of participating in a project;
6. management's estimate of the recoverable amount (fair value less costs to sell);
7. long-term oil and gas prices (considering current and historical prices, price trends and related factors);
8. operating costs;
9. future capital requirements; and
10. the financial capability of a partner.

A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount nor exceeds the carrying amount that would have been determined net of amortization had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statements of comprehensive loss.

(ii) Joint oil and gas activities:

All of the Company's oil and gas activities are conducted jointly with others. The Company's accounts reflect only the Company's share of assets, liabilities, revenue and expenses in the joint operations.

For interests in joint operations, the Company's share of the jointly controlled assets are classified according to the nature of the assets, the Company's share of any liabilities incurred jointly with the other parties, and the Company's share of any income and expenses incurred jointly with the partners are recognized in the consolidated financial statements.

(b) Financial investments:

(i) Classification:

All investments are classified upon initial recognition at fair value through profit or loss, with changes in fair value reported in income (loss).

(ii) Recognition, de-recognition and measurement:

Regular purchases and sales of investments are recognized on the settlement date.

Investments at fair value through profit or loss are initially recognized at fair value where a reliable basis for determination exists. Transaction costs are expensed as incurred in the statements of comprehensive loss. Investments are derecognized when the rights to receive cash flows from the investments have expired or the Company has transferred substantially all risks and rewards of ownership.

Subsequent to initial recognition, all investments at fair value through profit or loss are measured at fair value. Gains and losses arising from changes in the fair value of the investments at fair value through profit or loss category are presented in the consolidated statements of comprehensive loss within unrealized gains or losses on investments in the period in which they arise.

(iii) Reclassification of investments:

The Company only reclassifies any financial assets when the Company changes its business model for managing the financial asset. Reclassifications are recorded at fair value at the date of reclassification, which becomes the new carrying value.

(iv) Determination of fair value:

The determination of fair value requires judgment and is based on market information where available and appropriate. At the end of each financial reporting period, the Company's management estimates the fair value of investments based on the criteria below and reflects such valuations in the consolidated financial statements.

The Company is also required to present its investments (and other financial assets and liabilities reported at fair value) into three hierarchy levels (Level 1, 2, or 3) based on the transparency of inputs used in measuring the fair value, and to provide additional disclosure in connection therewith.

1. Publicly-traded investments (i.e., securities of issuers that are public companies):

- a. Securities, including shares, options, and warrants that are traded on a recognized securities exchange and for which no sales restrictions apply are presented at fair value based on quoted closing trade prices at the consolidated statements of financial position date or the closing trade price on the last day the security traded if there were no trades at the consolidated statements of financial position date.

- b. Securities that are traded on a recognized securities exchange but which are escrowed or otherwise restricted as to sale or transfer are recorded at amounts discounted from market value to a maximum of 10%. In determining the discount for such investments, the Company considers the nature and length of the restriction.
  - c. For options and warrants that are not traded on a recognized securities exchange, no market value is readily available. When there are sufficient and reliable observable market inputs, a valuation technique is used; if no such market inputs are available, the warrants and options are valued at intrinsic value, which is equal to the higher of the closing trade price at the consolidated statement of financial position date of the underlying security less the exercise price of the warrant or option, and zero, which approximates fair value.
2. Private company investments (securities of issuers that are not public companies):

All privately-held investments (other than options and warrants) are initially recorded at the transaction price, being the fair value at the time of acquisition. Thereafter, at each reporting period, the fair value of an investment may, depending upon the circumstances, be adjusted using one or more of the valuation indicators described below.

The determinations of fair value of the Company's privately-held investments at other than initial cost are subject to certain limitations. Financial information for private companies in which the Company has investments may not be available and, even if available, that information may be limited and/or unreliable.

Use of the valuation approach described below may involve uncertainties and determinations based on the Company's judgment and any value estimated from these techniques may not be realized or realizable.

The following circumstances are used to determine if the fair value of a privately-held investment should be adjusted upward or downward at the end of each reporting period. In addition to the events described below which may affect a specific investment, the Company will take into account general market conditions when valuing the privately-held investments in its portfolio.

Absent the occurrence of any of these events or any significant change in general market conditions indicates generally that the fair value of the investment has not materially changed.

The fair value of a privately-held investment may be adjusted upward if:

- a. there has been a significant subsequent equity financing provided by outside investors at a valuation above the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place; or
- b. there have been significant corporate, political or operating events affecting the investee company that, in management's opinion, have a positive impact on the investee company's prospects and therefore its fair value. In these

circumstances, the adjustment to the fair value of the investment will be based on management's judgment and any value estimated may not be realized or realizable.

Such events include, without limitation:

- i. political changes in a country in which the investee company operates which, for example, reduce the corporate tax burden, permit drilling where or to an extent that it was not previously allowed, or reduce or eliminate the need for permitting or approvals;
- ii. receipt by the investee company of environmental, drilling, aboriginal or similar approvals that allow the investee company to proceed with its project(s);
- iii. filing by the investee company of a National Instrument 51-101 technical report in respect of a previously non-compliant resource;
- iv. release by the investee company of positive exploration results, which either proves or expands their resource prospects; and
- v. important positive management changes by the investee company that the Company's management believes will have a very positive impact on the investee company's ability to achieve its objectives and build value for shareholders.

In the circumstances described above under (i) through (v), or in circumstances where general market conditions so warrant it, an adjustment to the fair value of an investment will be based upon management's judgment and any value estimated may not be realized or realizable.

The fair value of a privately-held investment may be adjusted downward if:

- a. there has been a significant subsequent equity financing provided by outside investors, at a valuation below the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place;
- b. the investee company is placed into receivership or bankruptcy;
- c. based on financial information received from the investee company, it is apparent to the Company that the investee company is unlikely to be able to continue as a going concern; or
- d. there have been significant corporate, political or operating events affecting the investee company that, in management's opinion, have a negative impact on the investee company's prospects and therefore its fair value. The amount of the change to the fair value of the investment is based on management's judgment and any value estimated may not be realized or realizable.

Such events include, without limitation:

- i. political changes in a country in which the investee company operates that increase the tax burden on companies that prohibit drilling where it was previously allowed, that increase the need for permitting or approvals, etc.;
- ii. denial of the investee company's application for environmental, drilling, aboriginal or similar approvals that prohibit the investee company from proceeding with its projects;
- iii. the investee company releases negative exploration results; and
- iv. changes to the management of the investee company take place that the Company believes will have a negative impact on the investee company's ability to achieve its objectives and build value for shareholders.

In the circumstances described above under (i) through (iv), or in circumstances where general market conditions so warrant it, an adjustment to the fair value of an investment will be based upon management's judgment and any value estimated may not be realized or realizable.

The resulting values for non-publicly-traded investments may differ from values that would be realized if a ready market existed. In addition, the amounts at which the Company's privately-held investments could be disposed of currently may differ from the carrying value assigned.

(c) Cash and cash equivalents:

Cash and cash equivalents include cash on hand and short-term investments with remaining maturities of less than three months at the date of acquisition. Cash and cash equivalents include accrued interest on short-term investments.

(d) Restricted cash:

Restricted cash represents cash in the form of GICs deposited with the Company's bank as collateral for letters of guarantee provided by the bank. The restricted cash underlying a GIC (or part thereof) is classified as current if the GIC (or part thereof) is expected to be released within one year otherwise the restricted cash is classified as non-current.

(e) Revenue recognition:

Purchases and sales of investments are recognized on the settlement date. Realized gains and losses on disposal of investments and unrealized gains and losses in the value of investments are reflected in the consolidated statements of comprehensive loss.

Upon disposal of an investment, previously recognized unrealized gains or losses are reversed so as to recognize the full realized gain or loss in the period of disposition. All transaction costs associated with the acquisition and disposition of investments are expensed to the consolidated statements of comprehensive loss as incurred. Dividend income is recorded on the ex-dividend date and when the right to receive the dividend has been established.

Interest income, other income, and income from securities lending are recorded on an accrual basis.

Oil revenue:

The Company recognizes revenue from petroleum and natural gas production at the fair value of the consideration received or receivable when the significant risks and rewards of ownership are transferred to the buyer and it can be reliably measured and only at such time as a project becomes commercially viable and development approval is received.

Prior to this stage, any production is considered test production and the related revenue is capitalized, net of applicable costs.

(f) Segment reporting:

Reportable segments are defined as components of an enterprise about which separate financial information is available, that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company has the following reportable geographic segments: Colombia, Israel, Canada, United States, Argentina and Brazil.

(g) Foreign currency translation:

(i) Functional currency:

These consolidated financial statements are presented in Canadian dollars, which is the parent's functional currency. Each entity in the group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

(ii) Transactions and balances:

Transactions in foreign currencies are initially recorded in the functional currency at the rate in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange in effect at the reporting date.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction.

(iii) Translation of foreign operations:

The results and financial position of Brownstone's subsidiaries that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

1. Assets and liabilities for each consolidated statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
2. Share capital is translated using the exchange rate at the date of the transaction;

3. Revenue and expenses for each consolidated statement of comprehensive loss are translated at average exchange rates; and
4. All resulting exchange differences are recognized as a separate component of equity and as an exchange difference on translation of foreign operations in other comprehensive loss in the consolidated statements of comprehensive loss.

The Company treats specific inter-company loan balances that are not intended to be repaid in the foreseeable future as part of its net investment in a foreign operation which is recorded as an exchange difference on translation of foreign operations in other comprehensive loss in the consolidated statements of comprehensive loss. When a foreign entity is sold, such exchange differences are reclassified to income or loss in the consolidated statements of comprehensive loss as part of the gain or loss on sale. Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

(h) Non-monetary transactions:

Transactions in which shares or other non-cash consideration are exchanged for assets or services are valued at the fair value of the assets or services involved.

(i) Income taxes:

(i) Current income tax:

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the end of the reporting period. Current tax assets and current tax liabilities are only offset if a legally enforceable right exists to set off the amounts, and the intention is to settle on a net basis, or to realize the asset and settle the liability simultaneously. Current income tax relating to items recognized directly in equity is recognized in equity and not through profit or loss.

(ii) Deferred tax:

Deferred tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable income will be available against which the deductible temporary difference and the carry forward of unused tax credits and unused tax losses can be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the consolidated statement of financial position date. Deferred tax relating to items recognized directly in equity is also recognized in equity and not in the consolidated statements of comprehensive loss. Deferred tax assets and deferred tax liabilities are not offset unless a legally enforceable right exists



to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

The carrying amount of deferred tax assets is reviewed at each consolidated statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each consolidated statement of financial position date and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered. The Company does not record deferred tax assets to the extent that it considers deductible temporary differences, the carry-forward of unused tax credits and unused tax losses cannot be utilized.

(j) Stock-based compensation plan:

The Company has a stock option plan that is described in Note 10(b) of the Company's consolidated financial statements as at and for the year ended June 30, 2013. Employees (including officers), directors, and consultants of the Company receive remuneration in the form of stock options granted under the plan for rendering services to the Company. Any consideration received by Brownstone on the exercise of stock options is credited to share capital. The cost of options is recognized, together with a corresponding increase in contributed surplus, over the period in which the corresponding performance and/or service conditions are fulfilled, ending on the date on which the relevant optionee becomes fully entitled to the award ("the vesting date"). The cumulative expense recognized for option grants at each reporting date until the vesting date reflects the portion of the vesting period that passed and the Company's best estimate of the number of options that will ultimately vest on the vesting date. The Company records compensation expense and credits contributed surplus for all stock options granted, which represents the movement in cumulative expense recognized as at the beginning and end of that period.

Stock options granted during the period are accounted for in accordance with the fair value method of accounting for stock-based compensation. The fair value for these options is estimated at the date of grant using the Black-Scholes option pricing model. The Company is also required to estimate the expected future forfeiture rate of options in its calculation of stock-based compensation expense.

Where the terms of a stock option award are modified, the minimum expense recognized in compensation expense is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the option or is otherwise beneficial to the optionee as measured at the date of modification.

Where an option is cancelled it is treated as if it had vested on the date of cancellation and any expense not yet recognized for the award is recognized immediately.

However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

(k) Earnings (loss) per share:

Basic earnings (loss) per common share is determined by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during

the period, excluding shares securing employee share purchase loans and shares in escrow. Diluted earnings (loss) per common share is calculated in accordance with the treasury stock method and based on the weighted average number of common shares and dilutive common share equivalents outstanding.

#### **Future changes in accounting policies:**

At the date of authorization of this MD&A, the IASB and the International Financial Reporting Interpretations Committee has issued the following new and revised Standards and Interpretations that are not yet effective for the relevant reporting periods and the Company has not early adopted these standards, amendments and interpretations. However, the Company is currently assessing what impact the application of these standards or amendments will have on the consolidated financial statements of the Company. The Company intends to adopt these standards, if applicable, when the standards become effective:

- (a) *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27) - These amendments are effective for annual periods beginning on or after January 1, 2014 and provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. The Company has assessed and determined that the amendments to IFRS 10, IFRS 12 and IAS 27 did not result in any change in the accounting or disclosures for its subsidiaries.
- (b) IFRS 15, *Revenue from Contracts with Customers* ("IFRS 15"), was issued in May 2014, which replaced IAS 11, *Construction Contracts*, IAS 18, *Revenue Recognition*, IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue – Barter Transactions Involving Advertising Services*. IFRS 15 provides a single, principles based five-step model that will apply to all contracts with customers with limited exceptions, including, but not limited to, leases within the scope of IAS 17; financial instruments and other contractual rights or obligations within the scope of IFRS 9, IFRS 10, *Consolidated Financial Statements* and IFRS 11, *Joint Arrangements*. In addition to the five-step model, the standard specifies how to account for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. The incremental costs of obtaining a contract must be recognized as an asset if the entity expects to recover these costs. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some nonfinancial assets that are not an output of the entity's ordinary activities. IFRS 15 is required for annual periods beginning on or after January 1, 2017. Earlier adoption is permitted. The Company is in the process of assessing the impact of IFRS 15 on its consolidated financial statements.
- (c) In July 2014, the IASB issued the final amendments to IFRS 9, *Financial Instruments* ("IFRS 9") which provides guidance on the classification and measurement of financial assets and liabilities, impairment of financial assets, and general hedge accounting. The Classification and measurement portion of the standard determines how financial assets and financial liabilities are accounted for in financial statements and, in particular, how they are measured on an ongoing basis. The amended IFRS 9 introduced a new, expected-loss impairment model that will require more timely recognition of expected credit losses. In addition, the amended IFRS 9 includes a substantially-reformed model for hedge accounting, with enhanced disclosures about risk management activity. The new standard is effective for annual periods beginning on or after

January 1, 2018, with earlier adoption permitted. The Company is in the process of evaluating the impact of adopting these amendments on the Company's consolidated financial statements.

### Changes in Accounting Policies:

Effective July 1, 2013, the Company has adopted the following new and revised standards, along with any consequential amendments. These changes were made in accordance with the applicable transitional provisions.

- (a) IFRS 7, *Financial Instruments, Disclosures*, amended to provide more extensive quantitative disclosures for financial instruments that are offset in the consolidated statements of financial position or that are subject to enforceable master netting similar arrangements. The Company has assessed and determined that the amendments to IFRS 7 did not result in any change in its disclosures for financial instruments.
- (b) IFRS 10, *Consolidated Financial Statements*, requires consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. Detailed guidance is provided on applying the definition of control. The Company has assessed its consolidation conclusions on July 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries and investees.
- (c) IFRS 11, *Joint Arrangements*, supersedes IAS 31, *Interests in Joint Ventures*, and requires joint arrangements to be classified either as joint operations or joint ventures depending on the contractual rights and obligations of each investor that jointly controls the arrangement. For joint operations, a company recognizes its share of assets, liabilities, revenues and expenses of the joint operation. An investment in a joint venture is accounted for using the equity method as set out in IAS 28, *Investments in Associates and Joint Ventures* (amended in 2011). The other amendments to IAS 28 did not affect the Company. The Company has concluded that the adoption of IFRS 11 did not result in any changes in the accounting.
- (d) IFRS 12, *Disclosure of Interests in Other Entities*, requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with an entity's interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The Company does not have any material subsidiaries (outside of those disclosed in Note 2(c) of the Notes to the consolidated financial statements) that requires additional disclosures. The Company does not have any associates that are individually material nor any associates that are accounted for using the equity method that requires additional disclosures. The Company has interests in joint arrangements or interest in unconsolidated structured entities. The Company has assessed and determined that the adoption of IFRS 12 did not result in any significant change in its disclosures of interests in other entities.
- (e) IFRS 13, *Fair Value Measurement*, provides the guidance on the measurement of fair value and related disclosures through a fair value hierarchy. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. As a result of the guidance in IFRS 13, the Company re-assessed its policies for measuring fair value.

The Company has fair valued its investments in publicly-traded investments (securities of issuers that are public companies) based on the closing trade price at the consolidated statement of

financial position date or the closing trade price on the last day the security traded if there were no trades at the consolidated statement financial position date. Management views that this policy provides a more indicative fair value price to sell its publicly-traded investments in an orderly transaction in the principal market at the consolidated statement of financial position date. In prior periods, publicly-traded investments were fair valued based on quoted closing bid prices at the consolidated statement of financial position date or the closing bid price on the last day the security traded if there were no trades at the consolidated statement of financial position date.

As permitted under the transitional provision, IFRS 13 was applied on a prospective basis and, accordingly, the adoption of the new policy had no effect on prior years. The effect on the current period is to increase investments as at July 1, 2013 by \$48,504.

IFRS 13 also requires additional disclosures. Additional disclosures where required are provided in the individual notes relating to the assets and liabilities whose fair values were determined. Fair value hierarchy is provided in Note 5(b) of the Notes to the consolidated financial statements.

- (f) IAS 19R, *Employee Benefits*, includes a number of amendments to the accounting for defined benefit plans, including actuarial gains and losses that are now recognized in other comprehensive income and permanently excluded from profit and loss; expected returns on plan assets that are no longer recognised in profit or loss, instead, there is a requirement to recognize interest on the net defined benefit liability (asset) in profit or loss, calculated using the discount rate used to measure the defined benefit obligation; and unvested past service costs are now recognised in profit or loss at the earlier of when the amendment occurs or when the rated restructuring or termination costs are recognized. Other amendments include new disclosures, such as, quantitative sensitivity disclosures. The Company has assessed its employee benefits and determined that the amendments to IAS 19R did not have any impact on the consolidated financial statements.
- (g) IAS 27, *Separate Financial Statements*, as a result of the issue of the new consolidation suite of standards, IAS 27 has been reissued, as the consolidation guidance will now be included in IFRS 10. IAS 27 now only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The Company does not prepare separate financial statements, therefore, IAS 27 does not impact the Company.
- (h) IAS 28, *Investments in Associates and Joint Ventures*, as a consequence of the issue of IFRS 10, IFRS 11 and IFRS 12 has been amended and will provide the accounting guidance for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. The amended IAS 28 is applied by all entities that are investors with joint control of, or significant influence over, an investee. The Company accounts for its investments in associates at fair value (as permitted by IAS 28) and does not have any investments accounted for using the equity method. Therefore, the amendments to IAS 28 did not have an impact on the consolidated financial statements.
- (i) IAS 32, *Financial Instruments, Presentation* was amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right of offset must be available on the current date and cannot be contingent on a future date. The Company has early adopted IAS 32 effective on July 1, 2013 and determined that there was no significant impact on the consolidated financial statements.

## **Critical accounting estimates:**

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Critical accounting estimates used in the preparation of the Company's consolidated financial statements include the Company's valuation of its privately-held investments, estimate of recoverable fair value on exploration assets, the valuation related to the Company's deferred tax assets ("DTA") and deferred tax liabilities ("DTL"), and the Company's estimate of inputs for the calculation of the fair value of stock-based compensation expense, the Company's own warrants and broker warrants, and unlisted warrants of public companies held by Brownstone.

### Valuation of privately-held investments:

The valuation of these investments ("private investments") requires management to assess the current financial status and prospects of private investments based upon potentially incomplete or unaudited financial information provided by the investee company, on management's general knowledge of the private investment's activities, and on any political or economic events that may impact upon the private investment specifically, and to attempt to quantify the impact of such events on the fair value of the investment. In addition to any events or circumstances that may affect the fair value of a particular private investment, management can consider general market conditions that may affect the fair value of either a particular private investment or of a group, segment or complete portfolio of private investments.

Changes in the fair value of our private investments for company-specific reasons have tended to be infrequent. Changes as a result of general market conditions may be more frequent from period to period during times of significant volatility, however, given the relatively small size of our private investment portfolio, such changes are not expected to have a material impact on our financial condition or operating results. For the year ended June 30, 2014, the Company had a change in unrealized losses on investments of \$250,000 (2013 - \$275,000) relating to its private company investments.

### Estimate of recoverable fair value on exploration and evaluation assets:

The costs of acquiring interests in exploration and evaluation assets are carried at cost until they are brought into production, at which time they are depleted on a unit-of-production method based on estimated recoverable proven oil and gas reserves. The Company's recorded value of exploration assets is based on historical costs that it expects to be recoverable in the future. The Company operates in an industry that is exposed to a number of risks and uncertainties, including exploration risk, development risk, commodity price risk, operating risk, political, ownership, funding, and currency risks, as well as environmental risk and overall economic conditions. All of these factors are potentially subject to significant change, out of the Company's control, and such changes are not determinable. Additionally, failure to conduct additional work on the Company's exploration properties may result in their loss. Accordingly, there is always the potential for a material adjustment to the value assigned to exploration assets.

At each reporting period, the Company's management reviews the status of all of its exploration properties, taking into account all of the factors noted above, in order to make an estimate of the recoverable value of each property. When management believes that the value of a property has been

impaired, the Company will write down the value of the property to management's estimate of its recoverable value. As well, if the Company determines that an exploration project is not viable due to the risks described above or to unsatisfactory drill results, the Company will write-off the carrying value of the property. During the year ended June 30, 2014, the Company recorded an impairment of exploration and evaluation assets of \$11,839,435 (2013 – \$36,394,392) on its exploration and evaluation assets.

Deferred tax assets:

Deferred tax is provided using the statement of financial position method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

DTL are recognized for all taxable temporary differences and DTA are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses. The Company does not record DTA to the extent that it considers it is not more likely than not that deductible temporary differences, the carry forward of unused tax credits and unused tax losses can be utilized.

Management determined, based upon expectations for future taxable income that it believes that it is not more likely than not it will realize the tax benefits of the DTA during the next several years.

Stock-based Compensation Expense/Warrants and Broker Warrants:

The Company uses the Black-Scholes option pricing model to calculate stock-based compensation expense and the fair value of the warrants and broker warrants issued under the Company's private placements. The model requires six key inputs: exercise price, market price at date of issue, risk free interest rate, expected dividend yield, expected life and expected volatility. The first two inputs are facts rather than estimates, while the risk free interest rate, expected life, expected volatility and expected dividend yield (estimated at 0% based on the Company's history of not paying any dividends) are based on the Company's estimates. A shorter expected life of the option, lower volatility number or higher dividend yield used would result in a decrease in stock-based compensation expense. A longer expected life of the option or a higher volatility number used would result in an increase in stock-based compensation expense. The Company is also required to estimate the future forfeiture rate of options based on historical information in its calculation of stock-based compensation expense. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of the Company's control.

During the year ended June 30, 2014, the Company granted 2,980,000 stock options exercisable at \$0.10 per share expiring on September 9, 2018.

During the year ended June 30, 2013, the Company granted 2,390,000 options exercisable at \$0.17 per share expiring on November 28, 2017.

The fair value of the options granted during the year ended June 30, 2014 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

Black-Scholes option valuation model assumptions used (weighted average)	
Expected volatility	<b>111.4%</b>
Expected dividend yield	<b>0%</b>
Risk-free interest rate	<b>1.8%</b>
Expected option life in years	<b>3.8 years</b>

Expected forfeiture rate	<b>4.9%</b>
Fair value per stock option granted on September 10, 2013	<b>\$ 0.04</b>

The fair value of the options granted during the year ended June 30, 2013 was estimated at the date of grant using the Black-Scholes option valuation model with the following assumptions:

Black-Scholes option valuation model assumptions used (weighted average)	
Expected volatility	104.7%
Expected dividend yield	0%
Risk-free interest rate	1.2%
Expected option life in years	3.7 years
Expected forfeiture rate	5.5%
Fair value per stock option granted on November 29, 2012	<b>\$ 0.12</b>

The expected volatility is based on the historical volatility over the life of the option at Brownstone's share price. The Company has not paid any cash dividends historically and has no plans to pay cash dividends in the foreseeable future. The risk-free interest rate is based on the yield of Canadian Benchmark Bonds with equivalent terms. The expected option life in years represents the period of time that options granted are expected to be outstanding based on historical options granted.

Valuation of Unlisted Warrants of Public Companies:

The Company uses the Black-Scholes option pricing model to calculate the fair value of unlisted warrants of public companies if there are sufficient and reliable observable market inputs; if no such market inputs are available, the warrants are valued at intrinsic value. The model requires six key inputs: risk free interest rate, exercise price, market price at date of issue, expected dividend yield, expected life and expected volatility. The first four inputs are facts rather than estimates, while the expected life, expected volatility and expected dividend yield (estimated at 0% based on the Company's history of not paying any dividends) are based on the Company's estimates. A shorter expected life of the warrant, lower volatility number or higher dividend yield used would result in a decrease in the fair value of the warrant. A longer expected life of the warrant or a higher volatility number used would result in an increase in the fair value of the warrant. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of the Company's control. As at June 30, 2014 and June 30, 2013, there were not sufficient reliable observable market inputs and thus, the Company valued the warrants in its portfolio using their intrinsic value.

**Outstanding Share Data:**

Subsequent to June 30, 2014, 1,538,400 options at a weighted average exercise price of \$0.51 per share expired unexercised.

As at October 24, 2014, the number of common shares of the Company outstanding and the number of common shares issuable pursuant to other outstanding securities of Brownstone are as follows:

<b>Common shares</b>	<b>Number</b>
Outstanding	<b>129,794,289</b>
Issuable under options	<b>11,221,680</b>
<b>Total diluted common shares</b>	<b>141,015,969</b>

Refer to Note 10 of the Notes to the consolidated financial statements as at and for the year ended June 30, 2014 for details of the Company's share capital as at June 30, 2014.

**Additional Information:**

Additional information relating to Brownstone may be found on the Company's website at [www.brownstoneenergy.com](http://www.brownstoneenergy.com) or under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).