

Consolidated Financial Statements of

# Brownstone Energy Inc.

Years ended June 30, 2014 and 2013  
(Prepared in Canadian dollars)

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**Contents**

|                                                       |               |
|-------------------------------------------------------|---------------|
| <b>Independent Auditors' Report</b>                   | <b>2</b>      |
| <b>Consolidated Financial Statements:</b>             |               |
| <b>Consolidated Statements of Financial Position</b>  | <b>3</b>      |
| <b>Consolidated Statements of Comprehensive Loss</b>  | <b>4</b>      |
| <b>Consolidated Statements of Changes in Equity</b>   | <b>5</b>      |
| <b>Consolidated Statements of Cash Flows</b>          | <b>6</b>      |
| <b>Notes to the Consolidated Financial Statements</b> | <b>7 - 49</b> |

# INDEPENDENT AUDITORS' REPORT

To the Shareholders of  
**Brownstone Energy Inc.**

We have audited the accompanying consolidated financial statements of **Brownstone Energy Inc.**, which comprise the consolidated statements of financial position as at June 30, 2014 and 2013, and the consolidated statements of comprehensive loss, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

## Management's responsibility for the consolidated financial statements

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

## Auditors' responsibility

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

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

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

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Brownstone Energy Inc.** as at June 30, 2014 and 2013, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

## Emphasis of matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company has a history of operating losses. The Company has incurred a loss for the year ended June 30, 2014 of \$13,355,875 and as at June 30, 2014 the Company has an accumulated deficit of \$107,338,393. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern.

Toronto, Canada,  
October 24, 2014

The logo for Ernst & Young LLP, featuring the company name in a stylized, handwritten-style font.

Chartered Professional Accountants  
Licensed Public Accountants

**BROWNSTONE ENERGY INC.**  
**Consolidated Statements of Financial Position**  
**As at June 30,**  
**(Prepared in Canadian dollars)**

|                                          | <u>Notes</u> | <u>2014</u>          | <u>2013</u>          |
|------------------------------------------|--------------|----------------------|----------------------|
| <b>Assets</b>                            |              |                      |                      |
| <b>Current</b>                           |              |                      |                      |
| Cash and cash equivalents                | 7            | \$ 5,377,283         | \$ 9,595,064         |
| Prepays and receivables                  | 7, 15(b)     | 876,235              | 1,136,807            |
| Investments, at fair value               | 6            | 3,707,817            | 1,667,208            |
| Income taxes receivable                  |              | 242,537              | 144,471              |
|                                          |              | <u>10,203,872</u>    | <u>12,543,550</u>    |
| <b>Restricted cash</b>                   | 8            | -                    | 634,925              |
| <b>Exploration and evaluation assets</b> | 5            | 4,911,743            | 17,274,483           |
|                                          |              | <u>\$ 15,115,615</u> | <u>\$ 30,452,958</u> |
| <b>Liabilities and Equity</b>            |              |                      |                      |
| <b>Current</b>                           |              |                      |                      |
| Accounts payable and accrued liabilities | 7            | \$ 1,031,132         | \$ 3,478,478         |
| Income taxes payable                     |              | -                    | 72,642               |
|                                          |              | <u>1,031,132</u>     | <u>3,551,120</u>     |
| <b>Equity</b>                            |              |                      |                      |
| Share capital                            | 10(a)        | 96,597,845           | 96,597,845           |
| Contributed surplus                      | 10(c)        | 24,537,211           | 21,806,275           |
| Warrants                                 | 10(d)        | -                    | 2,559,317            |
| Foreign currency translation reserve     |              | 287,820              | (79,081)             |
| Deficit                                  |              | <u>(107,338,393)</u> | <u>(93,982,518)</u>  |
|                                          |              | <u>14,084,483</u>    | <u>26,901,838</u>    |
|                                          |              | <u>\$ 15,115,615</u> | <u>\$ 30,452,958</u> |

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

"Steven Mintz" Director

"Michael Sweatman" Director

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**BROWNSTONE ENERGY INC.****Consolidated Statements of Comprehensive Loss****Years Ended June 30,****(Prepared in Canadian dollars)**

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|                                                             | <u>Notes</u> | <u>2014</u>            | <u>2013</u>            |
|-------------------------------------------------------------|--------------|------------------------|------------------------|
| <b>Net investment gains (losses)</b>                        |              |                        |                        |
| Net realized losses on disposal of investments              |              | \$ (5,155,874)         | \$ -                   |
| Net change in unrealized gains (losses) on investments      |              | <u>6,043,813</u>       | <u>(1,604,261)</u>     |
|                                                             |              | 887,939                | (1,604,261)            |
| <b>Interest and other income</b>                            |              | <u>32,678</u>          | <u>213,781</u>         |
|                                                             |              | <u>920,617</u>         | <u>(1,390,480)</u>     |
| <b>Expenses</b>                                             |              |                        |                        |
| Operating, general and administrative                       | 9, 10(b), 13 | 2,455,295              | 2,691,218              |
| Impairment of exploration and evaluation assets             | 5            | <u>11,839,435</u>      | <u>36,394,392</u>      |
|                                                             |              | <u>14,294,730</u>      | <u>39,085,610</u>      |
| <b>Loss before income taxes</b>                             |              | (13,374,113)           | (40,476,090)           |
| <b>Income tax expense (recovery)</b>                        | 11 (a, b)    | <u>(18,238)</u>        | <u>384,091</u>         |
| <b>Net loss for the year</b>                                |              | (13,355,875)           | (40,860,181)           |
| <b>Other comprehensive income</b>                           |              |                        |                        |
| Exchange differences on translation of foreign operations   |              | 366,901                | 849,658                |
| <b>Total comprehensive loss for the year</b>                |              | <u>\$ (12,988,974)</u> | <u>\$ (40,010,523)</u> |
| <b>Loss per common share based on net loss for the year</b> | 10(e)        |                        |                        |
| Basic and diluted                                           |              | <u>\$ (0.10)</u>       | <u>\$ (0.31)</u>       |
| <b>Weighted average number of common shares outstanding</b> | 10(e)        |                        |                        |
| Basic and diluted                                           |              | 129,794,289            | 129,794,289            |

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See accompanying notes to the consolidated financial statements.

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**BROWNSTONE ENERGY INC.****Consolidated Statements of Changes in Equity****Years Ended June 30, 2014 and 2013****(Prepared in Canadian dollars)**

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|                                                           |              | Number of<br>shares | Share capital | Warrants     | Contributed<br>surplus | Foreign<br>currency<br>translation<br>reserve | Deficit          | Total equity  |
|-----------------------------------------------------------|--------------|---------------------|---------------|--------------|------------------------|-----------------------------------------------|------------------|---------------|
| <b>Balance at July 1, 2012</b>                            | <b>Notes</b> | 129,794,289         | \$ 96,597,845 | \$ 7,310,433 | \$ 16,642,202          | \$ (928,739)                                  | \$ (53,122,337)  | \$ 66,499,404 |
| Net loss for the year                                     |              | -                   | -             | -            | -                      | -                                             | (40,860,181)     | (40,860,181)  |
| Exchange differences on translation of foreign operations |              | -                   | -             | -            | -                      | 849,658                                       | -                | 849,658       |
| Total comprehensive loss for the year                     |              | -                   | -             | -            | -                      | 849,658                                       | (40,860,181)     | (40,010,523)  |
| Stock-based compensation expense                          | 10(b)        | -                   | -             | -            | 412,957                | -                                             | -                | 412,957       |
| Reallocation of expired warrants                          | 10(d)        | -                   | -             | (4,751,116)  | 4,751,116              | -                                             | -                | -             |
| <b>Balance at June 30, 2013</b>                           |              | 129,794,289         | \$ 96,597,845 | \$ 2,559,317 | \$ 21,806,275          | \$ (79,081)                                   | \$ (93,982,518)  | \$ 26,901,838 |
| Net loss for the year                                     |              | -                   | -             | -            | -                      | -                                             | (13,355,875)     | (13,355,875)  |
| Exchange differences on translation of foreign operations |              | -                   | -             | -            | -                      | 366,901                                       | -                | 366,901       |
| Total comprehensive loss for the year                     |              | -                   | -             | -            | -                      | 366,901                                       | (13,355,875)     | (12,988,974)  |
| Stock-based compensation expense                          | 10(b)        | -                   | -             | -            | 171,619                | -                                             | -                | 171,619       |
| Reallocation of expired warrants                          | 10(d)        | -                   | -             | (2,559,317)  | 2,559,317              | -                                             | -                | -             |
| <b>Balance at June 30, 2014</b>                           |              | 129,794,289         | \$ 96,597,845 | \$ -         | \$ 24,537,211          | \$ 287,820                                    | \$ (107,338,393) | \$ 14,084,483 |

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See accompanying notes to the consolidated financial statements.

**BROWNSTONE ENERGY INC.**  
**Consolidated Statements of Cash Flows**  
**Years Ended June 30,**  
**(Prepared in Canadian dollars)**

|                                                                    | <b>Notes</b> | <b>2014</b>            | <b>2013</b>     |
|--------------------------------------------------------------------|--------------|------------------------|-----------------|
| <b>Cash flows used in operating activities</b>                     |              |                        |                 |
| Net loss for the year                                              |              | <b>\$ (13,355,875)</b> | \$ (40,860,181) |
| Items not affecting cash                                           |              |                        |                 |
| Net realized losses on disposal of investments                     |              | <b>5,155,874</b>       | -               |
| Net change in unrealized losses (gains) on investments             |              | <b>(6,043,813)</b>     | 1,604,261       |
| Impairment of exploration and evaluation assets                    | 5            | <b>11,839,435</b>      | 36,394,392      |
| Stock-based compensation expense                                   | 10(b)        | <b>171,619</b>         | 412,957         |
|                                                                    |              | <b>(2,232,760)</b>     | (2,448,571)     |
| Changes in non-cash working capital balances                       |              |                        |                 |
| Prepays and receivables                                            |              | <b>260,572</b>         | (160,739)       |
| Income taxes receivable                                            |              | <b>(98,066)</b>        | (144,471)       |
| Accounts payable and accrued liabilities                           |              | <b>(232,778)</b>       | (349,142)       |
| Income taxes payable                                               |              | <b>(72,642)</b>        | 72,642          |
|                                                                    |              | <b>(2,375,674)</b>     | (3,030,281)     |
| <b>Cash flows used in investing activities</b>                     |              |                        |                 |
| Expenditures on exploration and evaluation assets, net             | 5            | <b>(1,588,457)</b>     | (10,935,983)    |
| Proceeds on sale of exploration and evaluation assets              | 5(c)         | <b>270,170</b>         | 6,157,261       |
| Decrease (increase) in restricted cash                             | 8            | <b>634,925</b>         | (70,344)        |
| Proceeds on disposal of investments                                |              | <b>212,496</b>         | -               |
| Purchases of investments                                           |              | <b>(1,365,166)</b>     | (500,000)       |
|                                                                    |              | <b>(1,836,032)</b>     | (5,349,066)     |
| <b>Net decrease in cash and cash equivalents during the period</b> |              | <b>(4,211,706)</b>     | (8,379,347)     |
| <b>Exchange rate changes on foreign currency cash balances</b>     |              | <b>(6,075)</b>         | (222,595)       |
| <b>Cash and cash equivalents, beginning of year</b>                |              | <b>9,595,064</b>       | 18,197,006      |
| <b>Cash and cash equivalents, end of year</b>                      |              | <b>\$ 5,377,283</b>    | \$ 9,595,064    |
| <b>Supplemental cash flow information</b>                          |              |                        |                 |
| Income taxes paid                                                  |              | <b>\$ 224,299</b>      | \$ 455,920      |
| Finance expense paid                                               |              | -                      | -               |

See accompanying notes to the consolidated financial statements.

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# **BROWNSTONE ENERGY INC.**

## **Notes to the Consolidated Financial Statements**

**June 30, 2014 and 2013**

**(Prepared in Canadian dollars)**

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### **1. Nature of business and going concern uncertainty:**

Brownstone Energy Inc. ("Brownstone" or the "Company") was continued under the Canada Business Corporations Act on December 1, 2011 and its common shares are publicly-traded on the TSX Venture Exchange under the symbol "BWN" and on the OTCQX under the symbol "BWSOF". The Company is domiciled in the Province of Ontario and its head office is located at 130 King St. West, Suite 2500, Toronto, Ontario, Canada. Brownstone 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.

These consolidated financial statements were approved for issuance by the Company's board of directors on October 24, 2014.

These consolidated financial statements have been prepared using accounting policies applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they become due. The Company has incurred a loss for the year ended June 30, 2014 of \$13,355,875 (2013 - \$40,860,181) and has an accumulated deficit of \$107,338,393 (2013 - \$93,982,518). The Company is in the 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 statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts nor to the amounts or classification of liabilities that might be necessary should the Company not be able to continue as a going concern.

### **2. Basis of preparation:**

#### **(a) Statement of compliance:**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). Significant accounting estimates, judgments and assumptions used or exercised by management in the preparation of these consolidated financial statements are presented below.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**2. Basis of preparation (continued):**

(b) Basis of presentation:

These consolidated financial statements have been prepared using the historical cost convention except for certain financial instruments which have been measured at fair value. All monetary references expressed in these notes are references to Canadian dollar amounts ("\$/").

(c) Basis of consolidation:

These consolidated financial statements include the financial statements of Brownstone and its wholly-owned subsidiaries: Brownstone Ventures (US) Inc., Brownstone Ventures (Barbados) Inc., Brownstone Comercializadora de Petroleo Ltda. and 2121197 Ontario Ltd.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. All inter-company account balances and transactions have been eliminated upon consolidation.

(d) Critical accounting judgments, estimates and assumptions:

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Uncertainty about these judgments, estimates and assumptions could result in outcomes that could require a material adjustment to the carrying amount of the asset or liability affected in future periods.

The information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements is as follows:

(i) Impairment:

At the end of each financial reporting period the carrying amounts of the Company's non-financial assets are reviewed to determine whether there is any indication that those assets have suffered an impairment loss or reversal of previous impairment. Where such an indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. Where an indicator of impairment exists, a formal estimate of the recoverable amount is made, which is considered to be the higher of the fair value less costs of disposal and value in use.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**2. Basis of preparation (continued):**

The assessments require the use of estimates and assumptions such as long-term oil prices (considering current and historical prices, price trends and related factors), discount rates, operating costs, future capital requirements, decommissioning costs, exploration potential, reserves and operating performance (which includes production and sales volumes). These estimates and assumptions are subject to risk and uncertainty. Therefore, there is a possibility that changes in circumstances will impact these projections, which may impact the recoverable amount of assets. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Refer to Note 5 for further details.

(ii) Fair value of investments in securities not quoted in an active market:

Where the fair values of financial assets and financial liabilities recorded on the consolidated statements of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgment is required to establish fair values. Changes in estimates and assumptions about these inputs could affect the reported fair value. Refer to Note 3(c)(iv) for further details.

(iii) Fair value of financial derivatives:

The Company measures financial instruments, such as derivatives, at fair value at each consolidated statement of financial position date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. Investments in warrants that are not traded on a recognized securities exchange do not have a readily available market value. When there are sufficient and reliable observable market inputs, a valuation technique is used. Changes in estimates and assumptions about these inputs could affect the reported fair value. If no such market inputs are available, the warrants and options are valued at intrinsic value that approximates fair value. Refer to Note 3(c)(iv) for further details.

(iv) Stock-based compensation expense:

The Company uses the Black-Scholes option pricing model to determine the fair value of options in order to calculate stock-based compensation expense. The Black-Scholes model involves six key inputs to determine fair value of an option: risk-free interest rate, exercise price, market price at the date of issue, expected dividend yield, expected life, and expected volatility. Certain of the inputs are estimates that involve considerable

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**2. Basis of preparation (continued):**

judgment and are or could be affected by significant factors that are out of the Company's control. 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. Refer to Note 10(b) for further details.

The information about significant areas of judgment considered by management in preparing the consolidated financial statements are as follows:

(i) Going concern:

The Company's management has made an assessment of the Company's ability to continue as a going concern and the consolidated financial statements continue to be prepared on a going concern basis. However, management does not believe the Company has sufficient funds to meet the Company's potential capital expenditures through to June 30, 2015 which may cast significant doubt upon the Company's ability to continue as a going concern. These consolidated financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. Refer to Note 1.

(ii) Exploration and evaluation expenditures:

The application of the Company's accounting policy for exploration and evaluation expenditure requires judgment to determine whether future economic benefits are likely, from future either exploitation or sale, or whether activities have not reached a stage which permits a reasonable assessment of the existence of reserves. The determination of reserves and resources is itself an estimation process that requires varying degrees of uncertainty depending on how the resources are classified. These estimates directly impact when the Company defers exploration and evaluation expenditure. The deferral policy requires management to make certain estimates and assumptions about future events and circumstances, in particular, whether an economically viable extraction operation can be established. Any such estimates and assumptions may change as new information becomes available. If, after expenditure is capitalized, information becomes available suggesting that the recovery of the expenditure is unlikely, the relevant capitalized amount is written off in the statement of profit or loss and other comprehensive income in the period when the new information becomes available.

(iii) Determination of functional currency:

The effects of Changes in Foreign Exchange Rates' (IAS 21) defines the functional currency as the currency of the primary economic environment in which an entity operates. The determination of functional currency, which is performed on an entity by entity basis, is based on various judgmental factors outlined in IAS 21.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**2. Basis of preparation (continued):**

Based on assessment of the factors in IAS 21, primarily those that influence labour, material and other costs of goods or services received by its subsidiaries, management determined that the functional currency for the parent company is Canadian dollars, the US dollar for the Company's subsidiaries located in Barbados and the United States and the Brazilian real for the Company's subsidiary located in Brazil.

(iv) Deferred tax assets:

Deferred tax assets are recognized in respect of tax losses and other temporary differences to the extent it is probable that taxable income will be available against which the losses can be utilized. Judgment is required to determine the amount of deferred tax assets that can be recognized based upon the likely timing and level of future taxable income together with future tax planning strategies. Refer to Note 11 for further details.

**3. Significant accounting policies:**

The significant accounting policies used in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

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

(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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

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) Foreign currency:

(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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

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.

(c) 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:

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 reliable basis for determination exists. Transaction costs are expensed as incurred in the consolidated statements of comprehensive loss. Investments are derecognized when the rights to receive cash flows from the investments have expired or the Company has transferred the financial asset and the transfer qualifies for derecognition in accordance with IFRS 9, *Financial Instruments* ("IFRS 9").

Subsequent to initial recognition, all investments 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 net change in unrealized gains or losses on investments in the period in which they arise.

(iii) Reclassification of investments:

The Company would only reclassify a financial asset 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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

(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 disclose details of its investments (and other financial assets and liabilities reported at fair value) within 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 (see Note 6(b)).

1. Publicly-traded investments:

- a. Securities, including shares, options, and warrants that are traded in an active market (such as 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. These investments are included in Level 1 in Note 6(b).
- 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. These investments are included in Level 2 in Note 6(b).
- 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 or reliable, 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. These investments are included in Level 2 in Note 6(b).

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

2. Private company investments:

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. These investments are included in Level 3 in Note 6(b).

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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

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

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## **BROWNSTONE ENERGY INC.**

### **Notes to the Consolidated Financial Statements**

**June 30, 2014 and 2013**

**(Prepared in Canadian dollars)**

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#### **3. Significant accounting policies (continued):**

- 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 project(s);
- 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.

#### (d) Financial assets other than investments at fair value:

Financial assets that are managed to collect contractual cash flows made up of principal and interest on specified dates are classified as subsequently measured at amortized cost. All other financial assets are designated as at fair value through profit or loss. All financial assets are recognized initially at fair value plus, in the case of financial assets classified as subsequently measured at amortized cost, directly attributable transaction costs.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

Financial assets at amortized cost are measured at initial cost plus interest calculated using the effective interest rate method less cumulative repayments and cumulative impairment losses.

A financial asset is derecognized when the rights to receive cash flows from the asset have expired or the Company has transferred substantially all the risks and rewards of the asset. The Company assesses at each reporting date whether there is any objective evidence that a financial asset is impaired. For amounts deemed to be impaired, the impairment provision is based upon the expected loss.

(e) Cash and cash equivalents:

Cash and cash equivalents consist of 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.

(f) Restricted cash:

Restricted cash represents cash in the form of Guaranteed Investment Certificates (each a "GIC") 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.

(g) 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, natural gas and natural gas liquids 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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

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

(h) Offsetting of financial instruments:

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statements of financial position if there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

(i) 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.

(j) 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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

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.

(k) Stock-based compensation plan:

The Company has a stock option plan that is described in Note 10(b). 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 that increases the total fair value of the option, or is otherwise beneficial to the optionee as measured at the date of modification.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

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 above.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of diluted earnings per share.

(l) Earnings (loss) per common 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.

(m) Financial liabilities:

Financial liabilities are presented at amortized cost except for financial derivatives and certain financial liabilities that from inception were designated at fair value through profit or loss. All financial liabilities are recognized initially at fair value net of directly attributable transaction costs, except for those designated at fair value through profit or loss. Financial liabilities at fair value through profit or loss are carried in the consolidated statements of financial position at fair value with changes in fair value recognized in the consolidated statements of comprehensive loss.

Other financial liabilities are subsequently recognized at amortized cost using the effective interest rate method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period.

(n) Financial derivatives – options and warrants:

A financial derivative such as a warrant or option that will be settled with the issuing entity's own equity instruments will be classified as an equity instrument if the derivative is used to acquire a fixed number of the entity's own equity instruments for a fixed amount of Canadian dollars.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**3. Significant accounting policies (continued):**

A financial derivative will be considered as a financial liability at fair value through profit or loss if it is used to acquire either a variable number of equity instruments or consideration in a foreign currency and the options and warrants were not offered pro rata to all existing owners of the same class of non-derivative equity instruments.

(o) Segment reporting:

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

(p) Provisions:

(i) General:

Provisions are recognized when (a) the Company has a present obligation (legal or constructive) as a result of a past event that is independent of future action by the Company, and (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

(ii) Asset retirement obligation:

Asset retirement obligation is the present value of estimated costs to restore operating locations in accordance with regulations and laws as defined by each oil and gas license.

**4. 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 additional disclosures for offset amounts.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**4. Changes in accounting policies (continued):**

- (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) 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.

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# BROWNSTONE ENERGY INC.

## Notes to the Consolidated Financial Statements

June 30, 2014 and 2013

(Prepared in Canadian dollars)

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### 4. Changes in accounting policies (continued):

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 6(b).

- (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 provide the accounting guidance for investments in associates and 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.

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**4. Changes in accounting policies (continued):**

- (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.

**5. 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 and maintain 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>                      | <b>306,317</b> | <b>(706,143)</b> | <b>(126,018)</b> | <b>12,689</b> | <b>(112,956)</b> | <b>(626,111)</b> |
| 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>                 | -              | -                | <b>4,051,756</b> | <b>3</b>      | <b>859,984</b>   | <b>4,911,743</b> |

<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

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**5. Exploration and evaluation assets (continued):**

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.

Block 27 and 36 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 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         |

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**5. Exploration and evaluation assets (continued):**

|                                                                              |                 |
|------------------------------------------------------------------------------|-----------------|
| 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 of the Block and the milestones have not been met. See Note 17(c)).

- (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. Brownstone has funded its 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. See Note 17(d)).

- (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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**5. Exploration and evaluation assets (continued):**

(c) USA:

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

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**5. Exploration and evaluation assets (continued):**

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.

(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.

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**6. Investments at fair value and financial instruments hierarchy:**

(a) The fair value and cost of investments are as follows as at June 30:

|             | Fair Value          | Cost                |
|-------------|---------------------|---------------------|
| <b>2014</b> | <b>\$ 3,707,817</b> | <b>\$ 9,746,424</b> |
| 2013        | 1,667,208           | 13,750,659          |

(b) Financial instruments hierarchy:

The fair value measurements use a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The level in the hierarchy within which the fair value measurement is categorized is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The fair value hierarchy has the following levels:

- (i) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- (ii) Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- (iii) Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

For financial instruments that are recognized at fair value on a recurring basis, the Company determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

The following table presents the Company's financial instruments, measured at fair value and categorized into levels of the fair value hierarchy on the consolidated statements of financial position as at June 30, 2014 and 2013:

| Investments, at fair value | Level 1             | Level 2                                        | Level 3                                            | Total               |
|----------------------------|---------------------|------------------------------------------------|----------------------------------------------------|---------------------|
|                            | Quoted market price | Valuation technique – observable market inputs | Valuation technique – non-observable market inputs |                     |
| <b>2014</b>                | <b>\$ 3,207,817</b> | <b>\$ -</b>                                    | <b>\$ 500,000</b>                                  | <b>\$ 3,707,817</b> |
| 2013                       | 917,208             | -                                              | 750,000                                            | 1,667,208           |

There were no transfers from Level 1 to 2 or Level 2 to 1 during the year ended June 30, 2014 or 2013.

# BROWNSTONE ENERGY INC.

## Notes to the Consolidated Financial Statements

June 30, 2014 and 2013

(Prepared in Canadian dollars)

### 6. Investments at fair value and financial instruments hierarchy (continued):

The following table presents the changes in fair value measurements of financial instruments classified as Level 3 for the years ended June 30, 2014 and 2013. These financial instruments are measured at fair value utilizing non-observable market inputs based on specific company information and general market conditions. The net change in unrealized losses are recognized in the consolidated statements of comprehensive loss.

|      | Opening<br>balance at<br>July 1, | Purchases | Net unrealized<br>losses | Net transfer<br>out of<br>Level 3 | Ending<br>balance |
|------|----------------------------------|-----------|--------------------------|-----------------------------------|-------------------|
| 2014 | \$ 750,000                       | \$ -      | \$ (250,000)             | \$ -                              | \$ 500,000        |
| 2013 | \$ 1,025,000                     | \$ -      | \$ (275,000)             | \$ -                              | \$ 750,000        |

For this investment valued based on general market conditions and specific company information, the inputs used can be highly judgmental. A +/- 25% change on the fair value of this investment will result in a corresponding +/- \$125,000 (2013 - \$187,500) change in the total fair value of the investments. While this illustrates the overall effect of changing the values of the unobservable inputs by a set percentage, the significance of the impact and the range of reasonably possible alternative assumptions may differ significantly between investments, given their different terms and circumstances. The sensitivity analysis is intended to reflect the uncertainty inherent in the valuation of these investments under current market conditions, and its results cannot be extrapolated due to non-linear effects that changes in valuation assumptions may have on the fair value of this investment.

Furthermore, the analysis does not indicate a probability of such changes occurring and it does not necessarily represent the Company's view of expected future changes in the fair value of this investment. Any management actions that may be taken to mitigate the inherent risks are not reflected in this analysis.

### 7. Financial assets (and liabilities) other than investments at fair value:

Financial assets other than investments at fair value

|                                                                        | 2014         | 2013         |
|------------------------------------------------------------------------|--------------|--------------|
| Cash and cash equivalents                                              |              |              |
| - Cash on hand                                                         | \$ 5,377,283 | \$ 8,498,195 |
| - Short-term investments with maturities of less than three months (i) | -            | 1,096,869    |
| Restricted cash                                                        | -            | 634,925      |
| Receivables                                                            | 838,450      | 1,117,211    |
| Accounts payable and accrued liabilities                               | (1,031,132)  | (3,478,478)  |
|                                                                        | \$ 5,184,601 | \$ 7,868,722 |

(i) As at June 30, 2013, short-term investments with maturities of less than three months consisted of banker's acceptance notes with an average annual yield of 1.09%.

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**7. Financial assets (and liabilities) other than investments at fair value (continued):**

The carrying values of cash and cash equivalents, restricted cash, receivables and accounts payable and accrued liabilities approximate their fair values due to the short term to maturity for these instruments.

**8. Restricted cash:**

As at June 30, 2013, the Company had restricted cash totaling \$634,925 (US\$604,000) as collateral to the Royal Bank of Canada ("RBC") for letters of guarantee issued by RBC. The restricted cash was held in GICs and were renewed on a monthly basis at the prevailing interest rate (0.02% per annum as at June 30, 2013). The GICs were held as collateral by RBC for letters of guarantee issued by RBC to Agencia Nacional de Hidrocarburos ("ANH"), a Colombian government agency, the oil and gas agency of the Colombian government. As at June 30, 2013, the Company had letters of guarantee totaling US\$5,700,000. During the year ended June 30, 2014, the letters of guarantee and the corresponding restricted cash were released.

**9. Related party transactions:**

All transactions with related parties have occurred in the normal course of operations.

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

| <b>Type of expense</b>           | <b>2014</b>         | <b>2013</b>         |
|----------------------------------|---------------------|---------------------|
| 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             |
|                                  | <b>\$ 1,336,736</b> | <b>\$ 1,104,893</b> |

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.

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**10. Equity:**

- (a) Authorized: unlimited number of common shares (no par value).
- (b) Stock options:

The Company grants stock options to eligible directors, officers, key employees and consultants under its 2006 stock option plan to enable them to purchase common shares of the Company. Under the terms of the plan, the number of common shares that may be issued pursuant to the exercise of options granted under the plan may not exceed 10% of the number of common shares outstanding at the time of grant.

The exercise price of an option granted under the plan cannot be less than the closing price of the common shares on the last day on which the common shares trade prior to the grant date of the option. An individual can receive grants of no more than 5% of the outstanding shares of the Company on a yearly basis and options are exercisable over a period not exceeding five years. Stock options granted vest at the rate of 1/6 of the grant every three months over an 18-month period.

Options granted are accounted for by the fair value method of accounting for stock-based compensation. The Company records compensation expense and credits contributed surplus for all options granted.

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>   |

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**10. Equity (continued):**

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                 | \$ 0.12   |

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.

For the year ended June 30, 2014, included in operating, general and administrative expenses was stock-based compensation expense of \$171,619 (2013 - \$412,957) relating to the stock options granted to directors, officers, employees and consultants of the Company.

A summary of the status of the Company's stock options as at June 30, 2014 and 2013 and changes during the years then ended is presented below:

|                                   | 2014         |                                 | 2013         |                                 |
|-----------------------------------|--------------|---------------------------------|--------------|---------------------------------|
|                                   | # of options | Weighted average exercise price | # of options | Weighted average exercise price |
| <b>Stock options</b>              |              |                                 |              |                                 |
| Outstanding, at beginning of year | 9,975,080    | \$ 0.52                         | 8,925,080    | \$ 0.72                         |
| Granted                           | 2,980,000    | 0.10                            | 2,390,000    | 0.17                            |
| Forfeited                         | (16,668)     | 0.17                            | (8,334)      | 0.40                            |
| Expired                           | (178,332)    | 0.53                            | (1,331,666)  | 1.25                            |
| Outstanding, at end of year       | 12,760,080   | \$ 0.42                         | 9,975,080    | \$ 0.52                         |
| Exercisable, at end of year       | 11,270,080   | \$ 0.47                         | 8,344,232    | \$ 0.59                         |

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**10. Equity (continued):**

The following table summarizes information about stock options outstanding and exercisable as at June 30, 2014:

| <b>Number of options outstanding</b> | <b>Number of options exercisable</b> | <b>Exercise price</b> | <b>Expiry date</b> |
|--------------------------------------|--------------------------------------|-----------------------|--------------------|
| 1,128,400                            | 1,128,400                            | \$ 0.52               | August 12, 2014    |
| 10,000                               | 10,000                               | 0.61                  | October 5, 2014    |
| 50,000                               | 50,000                               | 0.75                  | November 26, 2014  |
| 200,000                              | 200,000                              | 0.75                  | November 30, 2014  |
| 500,000                              | 500,000                              | 0.65                  | March 2, 2015      |
| 630,000                              | 630,000                              | 0.65                  | April 14, 2015     |
| 130,000                              | 130,000                              | 0.43                  | May 25, 2015       |
| 1,111,680                            | 1,111,680                            | 0.51                  | September 20, 2015 |
| 1,325,000                            | 1,325,000                            | 1.20                  | March 29, 2016     |
| 2,105,000                            | 2,105,000                            | 0.40                  | October 10, 2016   |
| 225,000                              | 225,000                              | 0.56                  | February 7, 2017   |
| 2,365,000                            | 2,365,000                            | 0.17                  | November 28, 2017  |
| 2,980,000                            | 1,490,000                            | 0.10                  | September 9, 2018  |
| <b>12,760,080</b>                    | <b>11,270,080</b>                    |                       |                    |

(c) Contributed surplus comprised the following as at June 30, 2014 and 2013:

|                                                              | <b>2014</b>          | <b>2013</b>          |
|--------------------------------------------------------------|----------------------|----------------------|
| Stock-based compensation                                     | \$ 10,094,627        | \$ 9,923,008         |
| Expired warrants and broker warrants                         | 14,416,320           | 11,857,003           |
| Cancellation of common shares under normal course issuer bid | 20,639               | 20,639               |
| Value of cancelled escrowed shares                           | 5,625                | 5,625                |
|                                                              | <b>\$ 24,537,211</b> | <b>\$ 21,806,275</b> |

(d) A summary of the status of the Company's warrants at the reporting dates and the changes during the years then ended are as follows:

| <b>June 30, 2014</b>              |                      |                                        |               |
|-----------------------------------|----------------------|----------------------------------------|---------------|
|                                   | <b># of warrants</b> | <b>Weighted average exercise price</b> | <b>Amount</b> |
| Outstanding, at beginning of year | 7,951,454            | \$ 0.75                                | \$ 2,559,317  |
| Expired                           | (7,951,454)          | 0.75                                   | (2,559,317)   |
| Outstanding, at end of year       | -                    | \$ -                                   | \$ -          |
| <b>June 30, 2013</b>              |                      |                                        |               |
|                                   | <b># of warrants</b> | <b>Weighted average exercise price</b> | <b>Amount</b> |
| Outstanding, at beginning of year | 25,201,454           | \$ 1.09                                | \$ 7,310,433  |
| Expired                           | (17,250,000)         | 1.25                                   | (4,751,116)   |
| Outstanding, at end of year       | 7,951,454            | \$ 0.75                                | \$ 2,559,317  |

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**10. Equity (continued):**

The following table summarizes information about warrants outstanding as at June 30, 2013:

| Number of warrants | Exercise price | Expiry date    | Warrant value |
|--------------------|----------------|----------------|---------------|
| 7,951,454          | \$ 0.75        | April 13, 2014 | \$ 2,559,317  |

(e) Basic and diluted loss per common share based on loss for the years ended June 30:

| <b>Numerator:</b>                                                 | <b>2014</b>     | <b>2013</b>     |
|-------------------------------------------------------------------|-----------------|-----------------|
| Loss for the year                                                 | \$ (13,355,875) | \$ (40,860,181) |
| <b>Denominator:</b>                                               | <b>2014</b>     | <b>2013</b>     |
| Weighted average number of common shares outstanding – basic      | 129,794,289     | 129,794,289     |
| Weighted average effect of diluted stock options and warrants (i) | -               | -               |
| Weighted average number of common shares outstanding – diluted    | 129,794,289     | 129,794,289     |
| <b>Loss per common share based on loss for the year:</b>          | <b>2014</b>     | <b>2013</b>     |
| Basic and diluted                                                 | \$ (0.10)       | \$ (0.31)       |

(i) The determination of the weighted average number of common shares outstanding – diluted excludes 12,760,080 shares related to stock options that were anti-dilutive for the year ended June 30, 2014 (2013 – 17,926,534 shares).

(f) Maximum share dilution:

The following table presents the maximum number of shares that would be outstanding if all outstanding stock options and warrants were exercised as at June 30:

|                                         | <b>2014</b> | <b>2013</b> |
|-----------------------------------------|-------------|-------------|
| Common shares outstanding               | 129,794,289 | 129,794,289 |
| Stock options to purchase common shares | 12,760,080  | 9,975,080   |
| Warrants to purchase common shares      | -           | 7,951,454   |
| Fully diluted common shares outstanding | 142,554,369 | 147,720,823 |

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**11. Income tax expense and deferred taxes:**

- (a) Income tax expense attributable to loss before income taxes differs from the amounts computed by applying the combined federal and provincial tax rate of 26.50% (2013 – 26.50%) of pre-tax income as a result of the following:

|                                                                   | 2014            | 2013            |
|-------------------------------------------------------------------|-----------------|-----------------|
| Loss before income taxes                                          | \$ (13,374,113) | \$ (40,476,090) |
| Computed "expected" income tax recovery                           | \$ (3,544,140)  | \$ (10,726,164) |
| Non-taxable portion of capital losses                             | 683,153         | -               |
| Non-taxable portion of unrealized losses (gains)                  | (800,805)       | 212,565         |
| Expenses not deductible for income tax purposes                   | 44,134          | 88,257          |
| Impairment of exploration and evaluation assets not tax benefited | 3,137,451       | 9,644,514       |
| Net deferred tax assets not recognized                            | 480,207         | 780,828         |
| Minimum tax and income tax withheld in foreign jurisdictions      | (18,238)        | 384,091         |
| Income tax expense (recovery)                                     | \$ (18,238)     | \$ 384,091      |

- (b) Significant components of the income tax expense for the years ended June 30 are as follows:

|                                                                  | 2014        | 2013         |
|------------------------------------------------------------------|-------------|--------------|
| Current income tax expense (recovery)                            |             |              |
| Tax withheld in foreign jurisdiction                             | \$ (18,238) | \$ 384,091   |
|                                                                  | (18,238)    | 384,091      |
| Deferred taxes                                                   |             |              |
| Income taxes – origination and reversal of temporary differences | (3,617,659) | (10,425,342) |
| Relating to unrecognized temporary differences                   | 3,617,659   | 10,425,342   |
|                                                                  | -           | -            |
| Income tax expense (recovery)                                    | \$ (18,238) | \$ 384,091   |

- (c) The following deferred tax assets are not recognized in the consolidated financial statements due to the unpredictability of future income.

|                                             | 2014          | 2013          |
|---------------------------------------------|---------------|---------------|
| Non-capital losses carry-forward            | \$ 11,645,340 | \$ 4,637,322  |
| Exploration and evaluation assets tax pools | 4,562,723     | 4,767,118     |
| Capital losses carry-forward                | 1,350,418     | 666,403       |
| Share issuance costs and other differences  | 883,340       | 1,039,979     |
| Investments                                 | 669,491       | 1,470,512     |
|                                             | \$ 19,111,312 | \$ 12,581,334 |

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

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**11. Income tax expense and deferred taxes (continued):**

As at June 30, 2014, the Company has approximately \$749,000 (2013 - \$821,000) of Canadian resource deductions and \$16,468,000 (2013 - \$18,298,000) of foreign resource deductions available that have an unlimited carry-forward period to reduce future years' income for tax purposes, the benefit of which has not been recorded in the accounts.

As at June 30, 2014, the Company has approximately \$10,192,000 of capital losses (2013 - \$5,029,000) and \$16,836,000 (2013 - \$12,465,000) of Canadian non-capital losses available to reduce future years' income for tax purposes, the benefit of which has not been recorded in the accounts.

The non-capital losses will expire as follows:

|      |    |            |
|------|----|------------|
| 2028 | \$ | 73,100     |
| 2031 |    | 2,327,800  |
| 2032 |    | 5,506,300  |
| 2033 |    | 4,574,500  |
| 2034 |    | 4,354,300  |
|      | \$ | 16,836,000 |

In addition, the Company has unclaimed non-capital losses of approximately US\$46,386,000 in Barbados that expires from 2017 to 2023 and US\$12,744,000 in U.S. that expires from 2015 to 2019.

**12. Segmented information:**

Reportable segments are defined as components of an enterprise about which separate financial information is available, that are 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 consist of six distinct geographic areas: Colombia, Israel, Canada, United States, Argentina and Brazil. There were no changes in the reportable segments since June 30, 2013.

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.

# BROWNSTONE ENERGY INC.

## Notes to the Consolidated Financial Statements

June 30, 2014 and 2013

(Prepared in Canadian dollars)

### 12. Segmented information (continued):

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 |

### 13. Expenses by nature:

Included in operating, general, and administrative expenses for the years ended June 30 are the following expenses:

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

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**14. 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                              | <b>(107,338,393)</b> | <b>(93,982,518)</b>  |
|                                      | <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.

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**BROWNSTONE ENERGY INC.****Notes to the Consolidated Financial Statements****June 30, 2014 and 2013****(Prepared in Canadian dollars)**

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**15. Risk management:**

The investment operations of Brownstone's business involve the purchase and sale of securities and, accordingly, a 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 in the way the Company manages market risk during the year ended June 30, 2014. The Company manages market risk by having a portfolio which 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:

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

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**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**15. Risk management (continued):**

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       |
|                           | \$ 6,458,270 | \$ 11,491,671 |

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 ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**15. Risk management (continued):**

Brownstone is seeking reimbursement from the operator in accordance with the operator's contractual obligations. The Company is exposed to this credit risk. (See Note 17(b)).

- (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     | \$ -        | \$ -        | \$ -          |

# BROWNSTONE ENERGY INC.

## Notes to the Consolidated Financial Statements

June 30, 2014 and 2013

(Prepared in Canadian dollars)

### 15. Risk management (continued):

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              | -           | -           | -             |
|                                          | <u>\$ 3,551,120</u>    | <u>\$ 3,551,120</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u>   |

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

| Assets                            | Liquidity by period  |                      |             |               |                     |
|-----------------------------------|----------------------|----------------------|-------------|---------------|---------------------|
|                                   | Total                | Less than 1 year     | 1 – 3 years | After 4 years | Non-liquid assets   |
| 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           |
|                                   | <u>\$ 15,115,615</u> | <u>\$ 10,203,872</u> | <u>\$ -</u> | <u>\$ -</u>   | <u>\$ 4,911,743</u> |

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

| Assets                            | Liquidity by period  |                      |                   |               |                      |
|-----------------------------------|----------------------|----------------------|-------------------|---------------|----------------------|
|                                   | Total                | Less than 1 year     | 1 – 3 years       | After 4 years | Non-liquid assets    |
| 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           |
|                                   | <u>\$ 30,452,958</u> | <u>\$ 12,543,550</u> | <u>\$ 634,925</u> | <u>\$ -</u>   | <u>\$ 17,274,483</u> |

#### (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.

**BROWNSTONE ENERGY INC.**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2014 and 2013**  
**(Prepared in Canadian dollars)**

**15. Risk management (continued):**

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:

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>    |

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**BROWNSTONE ENERGY INC.****Notes to the Consolidated Financial Statements**

June 30, 2014 and 2013

**(Prepared in Canadian dollars)**

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**15. Risk management (continued):**

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%                                            | 703,643                                                                                     | (703,643)                                                                                  |

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)                                                                                |

**16. Future accounting changes:**

At the date of authorization of these consolidated financial statements, 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.

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## **BROWNSTONE ENERGY INC.**

### **Notes to the Consolidated Financial Statements**

**June 30, 2014 and 2013**

**(Prepared in Canadian dollars)**

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#### **16. Future accounting changes (continued):**

The Company has assessed and determined that the amendments to IFRS 10, IFRS 12 and IAS 27 will 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.

#### **17. Subsequent events:**

- (a) Subsequent to June 30, 2014, 1,538,400 options at a weighted average exercise price of \$0.51 per share expired unexercised.
- (b) Subsequent to June 30, 2014, the Company received from the operator of Block 21 (Colombia) the full amount (US\$567,027 plus interest) of the letter of guarantee that was paid to the ANH (see Note 15(b)(i)).

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**BROWNSTONE ENERGY INC.****Notes to the Consolidated Financial Statements****June 30, 2014 and 2013****(Prepared in Canadian dollars)**

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**17. Subsequent events (continued):**

- (c) 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 (see Note 5(b)(i)).
- (d) The Yitzhak license expired on October 15, 2014. The Company and its joint operating partners of the Yitzhak Block are awaiting for formal notice from the Ministry and evaluating the options available to them, including the filing of an extension with the Ministry (see Note 5(b)(ii)). The Yitzhak Block was the Company's remaining oil and gas project in Israel.

**18. Comparative consolidated financial statements:**

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the June 30, 2014 consolidated financial statements.