

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Summary of Annual Results <sup>(1)</sup>

(All references to \$ are United States dollars unless otherwise noted)

	2007	2006	2005
<b>Financial</b>			
(\$000s, except where noted)			
Crude oil revenue	121,802	43,676	16,671
Funds flow from operations <sup>(2)</sup>	85,883	28,789	8,020
Per share – basic (\$) <sup>(3)</sup>	0.89	0.33	0.10
– diluted (\$) <sup>(3)</sup>	0.88	0.33	0.10
Net income	47,551	14,798	2,253
Per share – basic and diluted (\$) <sup>(3)</sup>	0.49	0.17	0.03
Capital expenditures	143,022	73,365	32,206
Total assets	441,462	181,407	88,317
Working capital (net debt) <sup>(2)</sup>	106,691	11,469	(15,225)
Common shares outstanding, end of year (000s)			
Basic	100,289	95,000	79,000
Diluted <sup>(4)</sup>	108,854	98,051	79,000
<b>Operations</b>			
Operating netback (\$/bbl) <sup>(2)</sup>			
Crude oil revenue	70.00	54.54	44.30
Royalties	6.55	4.38	3.54
Production expenses	7.16	6.87	7.84
Operating netback	56.29	43.29	32.92
Average daily crude oil production (bbls)	4,767	2,194	1,031

(1) Amounts in the periods ending on or before June 30, 2006 have been translated and restated in United States dollars from the previously reported Canadian dollar amounts. See "Changes in Accounting Policies" within Management's Discussion and Analysis ("MD&A").

(2) Non-GAAP measure. See "Non-GAAP Measures" section within MD&A.

(3) Assumed weighted average number of basic and diluted shares totalled 78,999,900 prior to incorporation on April 20, 2006. See "Formation of the Company" within MD&A.

(4) Assumes 3,656,508 common shares will be issued upon conversion of the Company's convertible debentures which were issued in December 2007.

The following MD&A is dated February 28, 2008 and should be read in conjunction with the consolidated financial statements and accompanying notes of Petrominerales Ltd. ("Petrominerales" or the "Company") as at and for the years ended December 31, 2007 and 2006. Additional information for the Company, including the Annual Information Form ("AIF") can be found on SEDAR at [www.sedar.com](http://www.sedar.com) or at [www.petrominerales.com](http://www.petrominerales.com). All amounts are in United States dollars, unless otherwise stated and all tabular amounts are in thousands of United States dollars, except share amounts or as otherwise noted.

## Forward-Looking Statements

In addition to historical information, the MD&A contains forward-looking statements that are generally identifiable as any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events of performance (often, but not always, through the use of words or phrases such as "will likely result," "expected," "is anticipated," "believes," "estimated," "intends," "plans," "projection" and "outlook"). These statements are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such forward-looking statements. Actual results achieved during the forecast period will vary from the information provided herein as a result of numerous known and unknown risks and uncertainties and other factors. Such factors include, but are not limited to: general economic, market and business conditions; fluctuations in oil and gas prices; the results of exploration and development of drilling and related activities; fluctuation in foreign currency exchange rates; the uncertainty of reserve estimates; changes in environmental and other regulations; risks associated with oil and gas operations and other factors, many of which are beyond the control of the Company. Accordingly, there is no representation by Petrominerales that actual results achieved during the forecast period will be the same in whole or in part as those forecast. All subsequent forward-looking statements, whether written or oral, attributable to Petrominerales or persons acting on the Company's behalf, are qualified in their entirety by these cautionary statements.

## Non-GAAP Measures

This report contains financial terms that are not considered measures under Canadian generally accepted accounting principles ("GAAP"), such as funds flow from operations, funds flow per share, net debt and operating netback. These measures are commonly utilized in the oil and gas industry and are considered informative for management and shareholders. Specifically, funds flow from operations and funds flow per share reflect cash generated from operating activities before changes in non-cash working capital. Management considers funds flow from operations and funds flow per share important as they help evaluate performance and demonstrate the Company's ability to generate sufficient cash to fund future growth opportunities and repay debt. Net debt includes bank debt plus accounts payable and accrued liabilities less current assets, and is used to evaluate the Company's financial leverage. Profitability relative to crude oil prices per barrel of production is demonstrated by an operating netback. Funds flow from operations, funds flow per share, net debt and operating netbacks may not be comparable to those reported by other companies nor should they be viewed as an alternative to cash flow from operations, net income or other measures of financial performance calculated in accordance with GAAP.

## Highlights and Significant Transactions

- Crude oil production increased by 117 percent, averaging 4,767 barrels per day ("bopd") in 2007, mainly due to production from our Corcel discovery.
- Production averaged 9,575 bopd in the fourth quarter of 2007.
- Operating netbacks increased by 30 percent to \$56.29 per barrel in 2007.
- Funds flow from operations increased by 198 percent to \$85.9 million in 2007.
- Net income increased by 221 percent to \$47.6 million in 2007.
- On September 13, 2007 the Company issued 5.1 million common shares at a price of Cdn\$12.05 per share for gross proceeds of \$58.1 million.
- On December 6, 2007, the Company issued \$100 million of convertible debentures due December 2010. The debentures are convertible into common shares of the Company at a conversion price of \$27.3485 per share and have an annual coupon of 3.375 percent.

## Formation of the Company

Petrominerales is involved in the exploration, development and production of crude oil in the country of Colombia through its 100-percent-owned subsidiary Petrominerales Colombia Ltd. Petrominerales was incorporated in the Bahamas in 2006 for the purpose of acquiring all of the issued and outstanding shares of Petrominerales Colombia Ltd., an indirect wholly-owned subsidiary of Petrobank Energy and Resources Ltd. ("Petrobank"). On June 29, 2006, an initial public offering (the "IPO") of Petrominerales' common shares was completed on the Toronto Stock Exchange. Petrobank currently owns 76.5 percent of Petrominerales.

In conjunction with the completion of the IPO, Petrominerales acquired all of the issued and outstanding common shares of Petrominerales Colombia Ltd. The acquisition of Petrominerales Colombia Ltd. by the Company was a non-arms length transaction and as such has been recorded by the Company at carrying value. The Company's financial statements presented for comparative purposes reflect the financial position, results of operations and cash flows as if Petrominerales had been combined with Petrominerales Colombia Ltd. since inception.

### Average Daily Crude Oil Production

	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Orito	2,601	2,091	24%	2,454	1,875	31%
Corcel	6,545	-	-	1,925	-	-
Neiva & Others	429	281	53%	388	319	22%
Total (bopd)	9,575	2,372	304%	4,767	2,194	117%

The average daily production increases were mainly due to the Corcel-1 well that began production late in the third quarter of 2007 and the Corcel-2 well that began production in November while the Orito-122 and 125 wells began production late in the first quarter of 2007.

### Average Benchmark Crude Oil Price and Realized Prices

	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
WTI (\$/bbl)	90.50	60.17	50%	72.41	66.25	9%
Realized price per bbl (\$/bbl)	77.87	50.58	54%	70.00	54.54	28%
Discount as a percent of WTI	14%	16%	-13%	3%	18%	-83%

In December 2006, the Company negotiated a new sales contract for Orito production resulting in an increase in realized prices relative to WTI. The average 2007 per barrel discount also decreased dramatically as the majority of Corcel revenue was realized during the fourth quarter, coinciding with the period representing the highest WTI prices of 2007.

Revenue	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Revenue	68,600	11,038	521%	121,802	43,676	179%
\$ per bbl	77.87	50.58	54%	70.00	54.54	28%

Crude oil revenue increased by 179 percent to \$121.8 million in 2007 from \$43.7 million in 2006. Related oil production increased by 117 percent in 2007 to 4,767 barrels per day (“bopd”), while the average sales price increased by 28 percent in 2007 to \$70.00 per barrel.

### Commodity Price Risk Management

The Company had the following risk management contracts outstanding at December 31, 2007:

Term	Volume (Bopd)	Price (\$/bbl)	Benchmark
Jan. 1, 2008 – Dec. 31, 2008	500	65.00 floor / 80.00 ceiling	WTI
Jan. 1, 2008 – Dec. 31, 2008	500	75.25 fixed	WTI

For the year ended December 31, 2007, the Company recorded a mark-to-market loss of \$5.8 million (2006 – \$nil) which also represents the fair value of these risk management liabilities at December 31, 2007.

Royalties	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Royalties	6,940	883	686%	11,402	3,503	225%
\$ per bbl	7.88	4.05	95%	6.55	4.38	50%
Royalties as a percent of revenue	10%	8%	25%	9%	8%	13%

Colombian government royalties are fixed at a rate of eight percent until the Company’s net production per pool exceeds 5,000 bopd. In addition, the Company pays a three percent overriding royalty on Corcel production that converts to an eight percent net profits interest after payout.

Production Expenses	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Production expenses	6,600	1,604	311%	12,463	5,503	126%
\$ per bbl	7.49	7.35	2%	7.16	6.87	4%

Production expenses increased in 2007 mainly due to higher third and fourth quarter costs associated with Corcel production, which is being produced at a higher cost through temporary production facilities. The Colombian national oil company, Ecopetrol is responsible for primary production operations at Orito and Neiva at a cost (subject to annual inflation, currency, and other adjustments) of \$4.39 per barrel and \$2.39 per barrel, respectively, in 2007.

General and Administrative Expenses	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
General and administrative expenses	2,145	1,344	60%	6,443	4,312	49%

The increase in general and administrative expenses in 2007 were primarily due to additional personnel, management fees paid to Petrobank, and the impact of the appreciation of the Colombian peso relative to the U.S. dollar.

Stock-Based Compensation Expenses	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Stock-based compensation expenses	413	194	113%	1,381	531	160%

Stock-based compensation expenses relate to stock options and deferred common shares granted. Before completion of the IPO in June, 2006, there were no stock options or deferred common shares outstanding. The calculation of this non-cash expense is determined based on the fair value of stock options and deferred common shares granted amortized over the vesting period of the option, or immediately upon grant of the deferred common shares.

Interest Expense	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Interest expense	1,233	–	–	2,826	115	2,357%

Interest expense includes interest on bank debt, fees on letters of credit, amortization of deferred financing costs, and interest on the convertible debentures issued in December of 2007. Interest expense was higher in 2007 as the Company had drawn balances up to \$40.0 million on its secured credit facility and no senior bank debt was drawn in 2006. In December 2007 the Company also issued \$100 million of convertible debentures.

Depletion, Depreciation and Accretion Expense	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Depletion, depreciation and accretion expense	17,214	3,874	344%	31,695	13,460	135%
\$ per bbl	19.54	17.75	10%	18.22	16.81	8%

Depletion, depreciation and accretion expense increased significantly over 2006 as a consequence of higher production mainly from the Corcel block. The rate increased by eight percent despite an increase in gross working interest total proved reserves of 20.6 million barrels (52 percent increase), due to capital expenditures of \$143.0 million, and \$187.8 million of future development costs associated with proved undeveloped reserves.

Taxes	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Current taxes	887	428	107%	3,533	1,887	87%
Future income taxes (recovery)	5,029	-	-	(1,079)	-	-
Taxes	5,916	428	1,282%	2,454	1,887	30%

Current taxes consist of equity and presumptive income taxes in Colombia which are based on equity capitalization levels. The increase in 2007 was primarily due to the growth in the Company's equity base. Presumptive income taxes paid in excess of ordinary income taxes owing can be recovered against income taxes in future periods, and can be carried forward for five years. An independent reserve evaluation effective December 31, 2007, anticipates an ordinary cash income tax liability commencing in 2008.

The Company also recorded a \$1.1 million future income tax recovery in 2007 as the Company recognized previously unrecognized future income tax assets.

Based on tax reforms enacted on December 27, 2006 which became effective January 1, 2007, tax losses may be carried forward without limitations to offset to taxable income; the presumptive income rate was reduced from six percent to three percent on the prior tax year's net tax equity; the seven percent remittance tax was eliminated; a 1.2 percent equity tax was introduced, the income tax rate was reduced from 38.5 percent to 34 percent in 2007, and to 33 percent for subsequent years; and, the special deduction for the acquisition or construction of real fixed assets was increased to 40 percent from 30 percent.

Net Income	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Net income	23,491	2,677	778%	47,551	14,798	221%
\$ per share, diluted	0.23	0.03	667%	0.49	0.17	188%

The significant increases in net income and net income per share in both 2007 and the fourth quarter of 2007 were due to substantially higher production and crude oil sales prices, partially offset by higher royalties, loss on risk management contracts, production expenses, general and administrative expenses, stock-based compensation costs, interest expense, depletion, depreciation and accretion expense and equity taxes.

## Funds Flow From Operations

	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Funds flow from operations	<b>51,778</b>	6,745	668%	<b>85,883</b>	28,789	198%
\$ per share, diluted	<b>0.50</b>	0.07	614%	<b>0.88</b>	0.33	167%

The increases in 2007 funds flow from operations were primarily due to increased crude oil revenues offset by higher production expenses, general and administrative expenses, interest expense and equity taxes.

The following table shows the reconciliation of funds flow from operations to cash flow from operating activities for the periods noted:

	Three months ended December 31,			Years ended December 31,		
	2007	2006	Change	2007	2006	Change
Funds flow from operations: Non-GAAP	<b>51,778</b>	6,745	668%	<b>85,883</b>	28,789	198%
Changes in non-cash working capital	<b>30,719</b>	7,624	303%	<b>18,724</b>	1,226	1,427%
Cash flow from operating activities: GAAP	<b>82,497</b>	14,369	474%	<b>104,607</b>	30,015	249%

## Capital Expenditures

	2007	2006	Change
Drilling and completions	<b>100,226</b>	37,966	164%
Workovers	<b>6,001</b>	16,743	-64%
Seismic	<b>6,561</b>	6,285	4%
Facilities, civil work, health safety and environment	<b>28,862</b>	4,997	78%
Other	<b>1,372</b>	2,836	-52%
Capital expenditure before change in reporting currency	<b>143,022</b>	68,827	108%
Effect of change in reporting currency	-	4,538	-
<b>Total</b>	<b>143,022</b>	73,365	95%

Capital expenditures in 2007 were focused on continuing field development at Orito and work commitments on the Company's exploration blocks. Activity at Orito included drilling seven wells, two sidetracks and various workovers. Exploration block activity included drilling seven wells, four of which were completed as successful oil wells (Joropo, Conga and two at Corcel), two wells were abandoned (Casimena and Casanare Este), and drilling commenced on the Corcel-3 well in November. The Company also acquired 91 square kilometres of 3D seismic in 2007.

## Transactions with Related Parties

The Company pays Petrobank a monthly fee of Cdn\$75,000 pursuant to a Management Services Agreement effective May 1, 2006 providing for the services of the President and Chief Executive Officer and Vice-President Finance and Chief Financial Officer as well as other services, including corporate, administrative, financial, treasury, accounting, information technology and human resources support. The fee is based on a negotiated value of services provided. Costs under this agreement totalled \$0.8 million for the year ended December 31, 2007 (2006 – \$0.5 million) and were recorded as general and administrative expense.

On June 29, 2006, the Company repaid a loan outstanding to Petrobank using a portion of the proceeds from the IPO. The loan was only available from April 1, 2006 until the closing of the IPO and the outstanding balance ranged from \$nil to \$8.6 million. Interest expense was incurred at a rate equal to Petrobank's cost of borrowing of nine percent and totalled \$0.1 million.

## SUMMARY OF QUARTERLY RESULTS

	2007				2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>Financial</b> (\$'000s except where noted)								
Crude oil revenue	68,600	29,058	14,977	9,167	11,038	12,818	13,581	6,239
Funds flow from operations	51,778	20,201	8,708	5,196	6,745	8,202	10,479	3,363
Per share – basic (\$)	0.52	0.21	0.09	0.05	0.07	0.09	0.13	0.04
– diluted (\$)	0.50	0.20	0.09	0.05	0.07	0.09	0.13	0.04
Net income	23,491	10,242	12,143	1,675	2,677	4,252	6,462	1,407
Per share – basic (\$)	0.23	0.11	0.13	0.02	0.03	0.04	0.08	0.02
– diluted (\$)	0.23	0.10	0.13	0.02	0.03	0.04	0.08	0.02
Capital expenditures	37,216	39,895	38,342	27,569	23,617	21,696	9,110	18,942
<b>Operations</b>								
Operating netback (\$/bbl)								
WTI benchmark price	90.50	75.15	65.02	58.23	60.17	70.54	70.72	63.48
Crude oil sales price	77.87	69.85	57.79	49.88	50.58	57.57	57.14	51.12
Royalties	7.88	6.07	4.64	3.99	4.05	4.60	4.61	4.09
Production expenses	7.49	7.16	6.15	7.04	7.35	6.97	5.59	8.36
Operating netback	62.50	56.62	47.00	38.85	39.18	46.00	46.94	38.67
Average daily crude oil production (bbls)	9,575	4,522	2,848	2,042	2,372	2,420	2,612	1,356

Significant factors influencing quarterly results were:

- Completion of the Orito-117 and 118 wells late in the first quarter of 2006 resulting in a substantial increase in production in 2007.
- Completion of the Orito-122 and 125 wells late in the first quarter of 2007 increased production in the second quarter of 2007.
- The Corcel-1 discovery well commenced production in the third quarter of 2007 and the follow up Corcel-2 well commenced production in the fourth quarter resulting in substantial increases in production.
- Appreciation of the Colombian peso during 2007 contributed to higher production expenses and general and administrative expenses.
- Future income tax recovery of \$8.3 million was recognized in the second quarter of 2007.
- Historically high world crude oil prices over the past two years.

### Commitments

Pursuant to current exploration contracts, the Company has work commitments, to be completed by March 31, 2009, totalling \$35.4 million. The work commitments are normal course of business exploration activities that include acquisition and processing of seismic data and drilling of exploration wells. The Company has secured five drilling rigs and two completion rigs with contract terms expiring April 2008 through November 2009 in order to fulfill those exploration work commitments and future development plans. At December 31, 2007 the costs remaining on these contracts totalled \$64.3 million, a significant portion which will be used to satisfy exploration work commitments. Petrominerales plans to fund these costs with existing cash balances, cash flow from operations, and available credit facilities. The Company has issued letters of credit totalling \$5.5 million to guarantee the obligations on these exploration contracts.

The following is a summary of the estimated costs required to fulfill the Company's remaining contractual commitments as at December 31, 2007:

Type of Obligation	Total	< 1 Year	1-3 Years
Convertible debentures	100,000	–	100,000
Bank debt	10,000	–	10,000
Exploration contracts	35,400	33,000	2,400
Drilling rigs <sup>(1)</sup>	64,300	42,900	21,400
<b>Total</b>	<b>209,700</b>	<b>75,900</b>	<b>133,800</b>

(1) A significant portion of these contractual commitments will be used to satisfy work commitments on the Company's exploration contracts.

## Liquidity and Capital Resources

During the year the Company completed the following share issuance:

Date Of Issue	# Issued	Price Per Share	Gross Proceeds	Use Of Proceeds
September 13, 2007	5,060,000	Cdn\$12.05	\$58.1 million	\$30 million was used to temporarily reduce bank debt and the remainder was used to accelerate exploration and delineation drilling on the Corcel block.

On December 6, 2007, the Company issued \$100 million of convertible debentures due December 2010. The debentures are convertible into common shares of the Company at a conversion price of \$27.3485 per share, which represented a 38 percent premium to the share price when initially priced, and have an annual coupon of 3.375 percent. Interest on the debentures is payable semi-annually. The debentures have been classified as a liability net of the fair value of the conversion feature which has been classified as shareholders' equity. On issuance, this resulted in \$83.4 million being classified as a liability and \$12.7 million being classified as equity. The proceeds were used to repay outstanding bank debt and to fund exploration and development.

At December 31, 2007 the Company had cash and cash equivalents of \$171.1 million, offset by \$9.3 million of bank debt and by accounts payable and accrued liabilities in excess of accounts receivable and other current assets of \$55.1 million, resulting in net working capital of \$106.7 million.

Sources of additional funds include the following:

- Funds flow from operations, which is expected to continue increasing with anticipated increases in production.
- The Company's borrowing base under its revolving credit facility as at December 31, 2007 was \$50 million and subsequent to year end is being increased to \$80 million. The facility bears interest at a rate equal to the LIBOR (London Interbank Offered Rate) plus three percent per annum. The borrowing base is reviewed semi-annually.
- The Company could raise funds through the issuance of additional common shares.
- Petrominerales may sell producing or non-producing assets to raise funds in the short term. Incremental cash resources generated as a result would be reduced by any resulting decreases in future cash flows and any required debt payments.
- An alternative financing vehicle is pre-export financing or a pre-sale of a portion of future crude oil production in Colombia. Petrominerales' currently sells the majority of its production to the national oil company, Ecopetrol, but can elect to export the crude oil directly. There is no requirement for such crude oil revenues to be remitted back to Colombia.
- The Company expects to satisfy ongoing working capital requirements with funds flow from operations, cash and available credit facilities.

Petrominerales does not anticipate cash flows to exceed capital expenditures over the next 12 months. Currently, there are no legal restrictions on repatriating funds to the Bahamas or to shareholders once excess net cash flows are achieved.

## Outstanding Share Data

The number of Petrominerales shares outstanding at December 31, 2007 of 100,288,775 was unchanged at the date of this MD&A.

## Risks and Uncertainties

Petrominerales is exposed to a variety of risks including, but not limited to competitive, operational, political, environmental and financial risks.

The oil and gas industry is intensely competitive. Competition is particularly intense in the acquisition of prospective oil properties and oil and gas reserves. Petrominerales' competitive position depends on its geological, geophysical and engineering expertise, its financial resources, its ability to develop its properties and its ability to acquire and develop reserves. Petrominerales competes with a substantial number of other companies having larger technical staffs and greater financial and operational resources. Many such companies not only engage in the acquisition, exploration, development and production of oil reserves, but also carry on refining operations and market refined products. Petrominerales also competes with state oil and other major and independent oil companies and other industries supplying energy and fuel in the marketing and sale of oil to transporters, distributors and end users, including industrial, commercial and individual consumers. Petrominerales also competes with other oil companies in attempting to secure drilling rigs and other equipment necessary for drilling and completion of wells. Such equipment may be in short supply from time to time, and has been in particularly short supply recently due to the increase in the market price of oil and activity levels in Colombia. In addition, equipment and other materials necessary to construct production and transmission facilities may be in short supply from time to time. Finally, companies not previously investing in the oil industry may choose to acquire reserves to establish a firm supply or simply as an investment. Such companies will also provide competition for Petrominerales.

Petrominerales is exposed to a number of operational risks inherent in the industry including accidents, well blowouts, uncontrolled flows and environmental risks. Operational risks are managed using prudent field operating procedures. The Company has a detailed emergency response plan to deal with potential incidents and maintains a comprehensive insurance program to reduce the risk of significant economic loss; however, not all risks can be eliminated. Losses resulting from the occurrence of these risks could have a material adverse impact on the Company's operations.

Petrominerales currently has operations in Colombia and from time to time may evaluate additional projects internationally. To help mitigate the risks associated with operating in foreign jurisdictions, the Company seeks to operate in regions where the petroleum industry is a key component of the economy. Petrominerales believes that management's experience operating both in Colombia and in other international jurisdictions helps reduce these risks. Some countries in which the Company may operate may be considered politically and economically unstable. In Colombia, the government has a long history of democracy and an established legal framework that, in Petrominerales' opinion, minimizes political risks.

Colombia has a publicized history of security problems associated with certain narco-terrorist groups. The Company and its personnel are subject to these risks, but through effective security and social programs, Petrominerales believes these risks can be effectively managed. It is difficult to obtain insurance coverage to protect against terrorist incidents and as a result the Company's insurance program excludes this coverage. Consequently, incidents like this in the future could have a material adverse impact on the Company's operations.

The Company is subject to extensive governmental and environmental approvals and regulations in its operating jurisdictions. Delays in obtaining regulatory approvals could result in project delays. Changes to these regulations could increase the costs of conducting business in these jurisdictions. Environmental risks inherent in the oil and gas industry are subject to increasingly stringent legislation and regulation. The Company operates in accordance with all relevant environmental legislation and strives to minimize the environmental impact of its operations by providing for safety and environmental issues in all of its business plans.

The Company is exposed to normal financial risks inherent within the oil and gas industry, including commodity price risk, exchange rate risk, interest rate risk and credit risk. Management believes it is neither appropriate nor possible to eliminate 100 percent of the Company's exposure to these risks. As described in Note 11 to the Company's 2007 consolidated financial statements, the Company monitors market conditions and may periodically utilize derivative instruments to mitigate these risks.

Crude oil prices are the Company's most significant financial risk. Crude oil prices are influenced by global supply and demand, OPEC policy and worldwide political events. Fluctuations in crude oil prices not only affect the Company's cash flows, but may also result in changes to the borrowing capacity under the Company's credit facilities. Management believes it is neither appropriate nor possible to eliminate 100 percent of the Company's exposure to fluctuations in crude oil prices. The Company monitors market conditions and may selectively utilize derivative instruments to reduce exposure to crude oil price movements.

Portions of the Company's expenditures are denominated in Colombian pesos and Canadian dollars. To the extent revenues and expenditures denominated in or strongly linked to the United States dollar are not equivalent; the Company is exposed to exchange rate risk. The Company is not currently using exchange rate derivatives to manage exchange rate risks.

Petrominerales is exposed to fluctuations in short-term interest rates on amounts drawn under its secured credit facilities and its Colombian peso-based bank facility, as well as any additional future floating rate debt. The Company has not hedged these rates given the need to remain flexible in borrowing and repaying outstanding balances, if any.

## Sensitivities

The Company's earnings and cash flow are sensitive to changes in the price of crude oil.

The following factors demonstrate the expected impact on annualized before tax cash flow:

Change of:	(millions)
<b>Crude oil</b>	
\$1.00/bbl WTI reference price (assuming 10,000 bopd)	<b>\$2.5</b>
100 bopd of production @ \$85/bbl WTI	<b>\$2.3</b>

## Critical Accounting Policies and Estimates

The Company's financial statements are prepared in accordance with Canadian GAAP, which require management to make judgements, estimates and assumptions, which may have a significant impact on the financial statements. A summary of the Company's significant accounting policies can be found in Note 2 to the Company's 2007 consolidated financial statements. The following is a discussion of those accounting policies and estimates that are considered critical in the determination of the Company's financial results.

### Capital Assets — Full Cost Accounting

The Company follows the full cost method of accounting and alternatively, could follow the successful efforts method of accounting whereby all costs related to non-productive wells are expensed in the period in which they are incurred.

Under the full cost method of accounting, capitalized costs are subject to a country-by-country cost centre impairment test. Under the successful efforts method of accounting, the costs are aggregated on a property-by-property basis and the carrying value of each property is subject to an impairment test. These policies may result in a different carrying value for capital assets and a different net income. The full cost method is the method most commonly followed by Petrominerales' peer group of companies.

Under full cost accounting, a limit is placed on the carrying value of the net capitalized costs in each cost centre in order to test impairment. Impairment exists when the carrying value of developed properties of a cost centre exceeds the estimated undiscounted future net cash flows associated with the cost centre's proved reserves. Costs relating to undeveloped properties are subject to individual impairment assessments until it can be determined whether or not proved reserves exist. If impairment is determined to exist, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the cost centre's proved plus probable reserves are charged to income.

## **Reserve Estimates**

Reserve estimates can have a significant impact on net income and the carrying value of capital assets. The process of estimating reserves requires significant judgement based on available geological, geophysical, engineering, and economic data, projected rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to interpretation and uncertainty. Reserve estimates impact net income through depletion expense and the application of impairment tests. Revisions or changes in reserve estimates can have either a positive or a negative impact on net income and can impact the carrying amount of capital assets.

Creditors also use reserve estimates to assess the allowable borrowing base under secured credit facilities. Changes to the reserve estimates can result in borrowing base increases or decreases, which could impact the Company's financial position.

## **Changes in Accounting Policies**

### **Change in Reporting Currency**

On July 1, 2006, the Company changed its reporting currency from Canadian dollars (Cdn\$) to United States dollars (\$), as this currency is more appropriate for the Company's investors and other users of the financial statements. In making this change, the Company has followed recommendations of the Emerging Issues Committee ("EIC") of the Canadian Institute of Chartered Accountants ("CICA"), set out in EIC-130, "Translation Method When The Reporting Currency Differs From The Measurement Currency Or There Is A Change In The Reporting Currency."

Financial statements for all periods presented have been translated from Canadian dollars into United States dollars using the current rate method, based on EIC-130 recommendations. Using this method, all consolidated assets and liabilities have been translated using the exchange rate at the balance-sheet dates, while shareholders' equity has been translated using the historical rates of exchange in effect on the dates of the corresponding transactions. The consolidated statements of operations and consolidated statements of cash flow have been translated using the prevailing average exchange rates for the period, except for financing transactions which have been translated using the historical rates of exchange. Any resulting exchange rate differences due to this translation were included in shareholders' equity as cumulative translation adjustment. All comparative financial information being presented has been restated to reflect the Company's financial statements as if they have been historically reported in United States dollars and the effect on the consolidated financial statements resulted in a cumulative translation adjustment and corresponding increase in capital assets of \$16.0 million as at July 1, 2006. Prospectively, this balance is not expected to change.

### **New Accounting Policies**

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Section 1530, "Comprehensive Income," Section 3855, "Financial Instruments – Recognition and Measurement," Section 3861, "Financial Instruments – Disclosure and Presentation" and Section 3865, "Hedges." The Company has adopted these standards prospectively and the comparative interim consolidated financial statements have not been restated, except for cumulative translation adjustment which was reclassified as accumulated other comprehensive income.

Upon adoption of Section 3855, all financial instruments are classified into one of the following five categories: held-for-trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets or other financial liabilities. Subsequent measurement of the financial instruments is based on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. All risk management contracts are recorded in the balance sheet at fair value unless they qualify for the normal sale and normal purchase exemption. All changes in their fair value are recorded in net income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income until the underlying hedged transaction is recognized in net income. Any hedge ineffectiveness is immediately recognized in net income. The company has elected not to use cash flow hedge accounting on its risk management contracts with financial counterparties resulting in all changes in fair value being recorded in net income. The other categories of financial instruments are recognized at amortized cost using the effective interest rate method.

Upon adoption of these standards, the Company classified its cash and cash equivalents as held-for-trading, which are measured at fair value which equals the carrying value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and bank debt are classified as other financial liabilities, which are measured at amortized cost.

Upon issuance, the Company's convertible debentures are classified into equity and financial liability components on the balance sheet at their fair value. The convertible debentures are classified as other financial liabilities. The financial liability, net of issuance costs, is accreted, which is included within interest expense over the maturity of the debentures using the effective interest rate method.

For financial assets and financial liabilities that are not classified as held-for-trading, the transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are adjusted to the fair value initially recognized for that financial instrument. These costs are expensed using the effective interest rate method and are recorded within interest expense.

Section 1530 establishes standards for reporting and presenting comprehensive income which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with GAAP. Other comprehensive income includes any change in fair value of the effective portion of the risk management contracts used as hedging items in a cash flow hedge, the change in fair value of any available for sale financial instruments and foreign exchange gains and losses arising from the translation of self-sustaining foreign operations. Upon adoption of Section 1530, amounts previously recognized on the balance sheet as cumulative translation adjustment have been reclassified as accumulated other comprehensive income.

These standards adopted effective January 1, 2007 had no impact on the Company's retained earnings as at January 1, 2007.

The Company also adopted Section 3251, "Equity" and Section 1506, "Accounting Changes." Section 3251 replaces Section 3250, "Surplus," and describes standards for the presentation of equity and changes in equity for reporting period as a result of the application of Section 1530, "Comprehensive Income." Section 1506, "Accounting Changes," requires entities to provide disclosure when an entity has not applied a new source of GAAP that has been issued but is not yet effective. This is the case with Section 3862, "Financial Instruments Disclosures" and Section 3863, "Financial Instruments Presentations" which are required to be adopted for fiscal years beginning on or after October 1, 2007. The Company adopted these standards

effective January 1, 2008 and it is expected the only effect on the Company will be additional disclosures regarding the significance of financial instruments for the entity's financial position and performance; and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

Section 1535, "Capital Disclosures" is effective for annual periods beginning on or after October 1, 2007 and establishes standards for disclosing information about the Company's capital and how it is managed. It requires disclosures of the Company's objectives, policies and processes for managing capital, the quantitative data about what the Company regards as capital, whether the Company has complied with any capital requirements and if it has not complied, the consequences of such non-compliance. The Company adopted this standard effective January 1, 2008 and expects the only effect will be incremental disclosures on the Company's capital and how it is managed.

### ***Recent Accounting Pronouncements***

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets," replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs." Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements .

### ***International Financial Reporting Standards***

The Accounting Standards Board has confirmed the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") will be effective January 1, 2011. The Company will continue to monitor the transition process but due to the extended period of time until implementation, the Company cannot assess the impact of IFRS at this time.

## **Regulatory Policies**

### ***Certification of Disclosures in Annual and Interim Filings***

In accordance with Multilateral Instrument 52-109 of the Canadian Securities Administrators, the Company annually issues a "Certification of Annual Filings" ("Certification"). The Certification requires certifying officers to state that they are responsible for establishing and maintaining disclosure controls and procedures, have designed such procedures and evaluated their effectiveness as of the end of the period covered by these annual filings. In addition, the Certification requires certifying officers to state that they have designed such internal control over financial reporting, or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements. The Company has continually had in place systems relating to internal control over financial reporting and will continue to monitor internal controls as the Company's business evolves.

The certifying officers have evaluated the effectiveness of the Company's disclosure controls and procedures and, based on such evaluation, believe that the disclosure controls and procedures provide a reasonable assurance that information required to be disclosed by the Company in these annual filings is recorded, processed, summarized and reported within the time periods specified and the controls and procedures ensure that the information required to be disclosed by the Company is accumulated and communicated to Petrominerales' management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

## **Outlook**

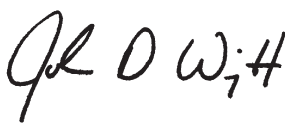
In addition to the plans discussed in this MD&A, please see the Company's 2007 Annual Report.

## MANAGEMENT'S REPORT

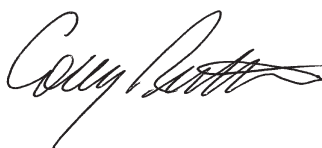
Management is responsible for the integrity and objectivity of the information contained in this report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in this report. The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Company's financial position, results of operations and changes in financial position, within Canadian generally accepted accounting principles. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The Company's external auditors, Deloitte & Touche LLP, have examined the consolidated financial statements. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported financial results and the financial condition of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The Board of Directors on the recommendation of the Audit Committee has approved the consolidated financial statements.



John D. Wright  
President & Chief Executive Officer  
Calgary, Canada  
February 18, 2008



Corey C. Ruttan  
Vice-President Finance & Chief Financial Officer

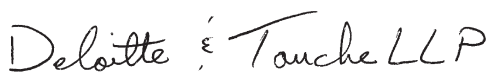
## AUDITORS' REPORT

TO THE SHAREHOLDERS OF PETROMINERALES LTD.:

We have audited the consolidated balance sheets of Petrominerales Ltd. (the "Company") as at December 31, 2007 and 2006 and the consolidated statements of operations and retained earnings, comprehensive income and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements presents fairly, in all material respects, the financial position of Petrominerales Ltd. as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Deloitte & Touche LLP  
Chartered Accountants  
Calgary, Canada  
February 18, 2008

# CONSOLIDATED BALANCE SHEETS

(Thousands of United States dollars)

As at December 31,	2007	2006
		(Note 3)
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 171,096	\$ 28,634
Accounts receivable and other current assets	7,011	2,009
	<b>178,107</b>	30,643
Capital assets (Note 4)	262,276	150,764
Future income tax assets (Note 9)	1,079	-
<b>Total assets</b>	<b>\$ 441,462</b>	<b>\$ 181,407</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 62,107	\$ 19,174
Risk management liability (Note 11)	5,797	-
	<b>67,904</b>	19,174
Bank debt (Note 6)	9,309	-
Convertible debentures (Note 7)	83,700	-
Asset retirement obligations (Note 8)	1,482	930
	<b>162,395</b>	20,104
Shareholders' equity		
Convertible debentures (Note 7)	12,738	-
Common shares (Note 5)	195,214	138,906
Contributed surplus (Note 5)	1,698	531
Accumulated other comprehensive income (Note 3)	16,024	16,024
Retained earnings	53,393	5,842
	<b>279,067</b>	161,303
<b>Total liabilities and shareholders' equity</b>	<b>\$ 441,462</b>	<b>\$ 181,407</b>

Commitments and contingencies (Note 13)

See accompanying notes to these consolidated financial statements.

Signed on behalf of the Board:



Jerald L. Oaks  
Chairman



Kenneth R. McKinnon  
Director

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Thousands of United States dollars, except per share amounts)

Years ended December 31,	2007	2006
		(Note 3)
<b>Revenues</b>		
Oil	\$ 121,802	\$ 43,676
Interest income	656	635
Royalties	(11,402)	(3,503)
Loss on risk management contracts (Note 11)	(5,797)	-
	<b>105,259</b>	<b>40,808</b>
<b>Expenses</b>		
Production	12,463	5,503
General and administrative	6,443	4,312
Stock-based compensation (Note 5)	1,381	531
Interest	2,826	115
Foreign exchange loss	446	202
Depletion, depreciation and accretion	31,695	13,460
	<b>55,254</b>	<b>24,123</b>
<b>Income before taxes</b>	<b>50,005</b>	<b>16,685</b>
Tax expense (Note 9)	2,454	1,887
<b>Net income</b>	<b>47,551</b>	<b>14,798</b>
<b>Retained earnings (deficit), beginning of year</b>	<b>5,842</b>	<b>(8,956)</b>
<b>Retained earnings, end of year</b>	<b>\$ 53,393</b>	<b>\$ 5,842</b>
<b>Basic and diluted earnings per share (Note 5)</b>	<b>\$ 0.49</b>	<b>\$ 0.17</b>

See accompanying notes to these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Thousands of United States dollars)

Years ended December 31,	2007	2006
		(Note 3)
<b>Net income</b>	<b>\$ 47,551</b>	<b>\$ 14,798</b>
Other comprehensive income	-	-
<b>Comprehensive income</b>	<b>\$ 47,551</b>	<b>\$ 14,798</b>

See accompanying notes to these consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOW

(Thousands of United States dollars)

Years ended December 31,	2007	2006
		(Note 3)
<b>Operating Activities</b>		
Net income	\$ 47,551	\$ 14,798
Depletion, depreciation and accretion	31,695	13,460
Amortization of deferred financing costs	218	-
Stock-based compensation	1,381	531
Unrealized loss on risk management contracts	5,797	-
Accretion on convertible debentures	320	-
Future income tax recovery	(1,079)	-
	85,883	28,789
Changes in non-cash working capital (Note 12)	18,724	1,226
	104,607	30,015
<b>Financing Activities</b>		
Issuance of convertible debentures – net of issuance costs	96,118	-
Issuance of common shares – net of issuance costs	56,094	49,782
Issuance of bank debt	10,000	-
Financing costs	(909)	-
Equity contributed by majority shareholder (Note 5)	-	21,816
	161,303	71,598
<b>Investing Activities</b>		
Expenditures on capital assets	(143,022)	(73,365)
Changes in non-cash working capital (Note 12)	19,574	170
	(123,448)	(73,195)
Net effect of foreign exchange on cash denominated in foreign currencies	-	103
<b>Net change in cash and cash equivalents</b>	<b>142,462</b>	<b>28,521</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>28,634</b>	<b>113</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 171,096</b>	<b>\$ 28,634</b>
Cash and cash equivalents consist of:		
Cash	\$ 955	\$ 1,035
Cash equivalents	\$ 170,141	\$ 27,599
Other cash flow information:		
Cash taxes paid	\$ 3,361	\$ 1,589
Cash interest paid	\$ 1,867	\$ 115
Cash interest received	\$ 250	\$ 635

See accompanying notes to these consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended December 31, 2007 and 2006

(All tabular amounts are expressed in thousands of United States dollars, except share amounts or as otherwise noted)

## NOTE 1 – FORMATION OF THE COMPANY AND BASIS OF PRESENTATION

Petrominerales Ltd. (“Petrominerales” or the “Company”) is involved in the exploration, development and production of crude oil in the country of Colombia through its 100-percent-owned subsidiary Petrominerales Colombia Ltd. Petrominerales was incorporated in the Bahamas on April 20, 2006 for the purpose of acquiring all of the issued and outstanding shares of Petrominerales Colombia Ltd., an indirect wholly-owned subsidiary of Petrobank Energy and Resources Ltd. (“Petrobank”). On June 29, 2006, an initial public offering (the “IPO”) of Petrominerales’ common shares was completed on the Toronto Stock Exchange, reducing the percentage owned by Petrobank from 100 percent to 80.7 percent. The percentage owned by Petrobank has been subsequently reduced to 76.5 percent.

In conjunction with the completion of the IPO, Petrominerales acquired all of the issued and outstanding common shares of Petrominerales Colombia Ltd. The acquisition of Petrominerales Colombia Ltd. by the Company was a non-arms length transaction and as such has been recorded by the Company at carrying value. The Company’s financial statements presented for comparative purposes reflect the financial position, results of operations and cash flows as if Petrominerales had been combined with Petrominerales Colombia Ltd. since inception.

## NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements are presented in accordance with Canadian generally accepted accounting principles (“GAAP”) and include the accounts of the Company and its subsidiaries as at and for the years ended December 31, 2007 and 2006. Certain prior year amounts have been reclassified to conform with current presentation. Inter-company transactions and balances are eliminated upon consolidation.

### Measurement Uncertainty

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the balance sheets as well as the reported amounts of revenues, expenses, and cash flows during the periods presented. Such estimates relate primarily to unsettled transactions and events as of the date of the financial statements. Actual results could differ materially from estimated amounts.

Amounts recorded for depletion, depreciation and accretion costs and amounts used for ceiling test calculations are based on estimates of crude oil reserves and future costs required to develop those reserves that are subject to measurement uncertainty. Stock-based compensation is based upon volatility and expected life estimates that are also subject to measurement uncertainty. Changes in these estimates could materially impact the financial statements of future periods.

### Capital Assets

All costs related to the acquisition of crude oil properties are capitalized. Such costs include land and lease acquisition costs, annual charges on non-producing properties, geological and geophysical costs, and costs of drilling and equipping productive and non-productive wells.

Gains and losses are not recognized upon disposition of crude oil properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of more than 20 percent.

Capitalized costs are accumulated in cost centres on a country-by-country basis and are depleted and depreciated using the unit-of-production method based upon estimated proved reserves before royalties as determined by independent engineers. The Company has one cost centre, Colombia. Included in costs subject to depletion are estimated costs to develop proved reserves. Costs relating to undeveloped properties are excluded from the depletion base until it is determined whether or not proved reserves exist or if impairment of such costs has occurred. These properties are assessed at least annually to determine whether impairment has occurred.

Depreciation of corporate and other fixed assets is calculated using the straight-line method over the estimated life of the asset.

A limit is placed on the carrying value of the net capitalized costs in each cost centre in order to test impairment. The Company is required to perform this impairment test at least annually. An impairment loss exists when the carrying value of a cost centre exceeds the estimated undiscounted future net cash flows associated with the cost centre’s proved reserves. If an impairment loss is determined to exist, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the cost centre’s proved plus probable reserves are charged to income. Reserves are determined pursuant to the Canadian Securities Administrators’ National Instrument 51-101 “Standards of Disclosure for Oil and Gas Activities”.

The Company does not capitalize general and administrative overhead or interest costs.

### Asset Retirement Obligations

The Company recognizes the estimated fair value of future retirement obligations associated with capital assets as a liability in the period in which they are incurred, normally when the asset is purchased or developed. The fair value is capitalized and amortized over the same period as the underlying asset. The Company estimates the liability based on the estimated costs to abandon and reclaim the wells and well sites that are either expected to be inactive upon expiration of the Incremental Production Contract’s (“IPC’s”) on June 6, 2023, or are required to be abandoned under the terms of the exploration contracts. Only wells and well sites that the Company has constructed, drilled, completed workovers on, or performed enhancements to, are included in the estimate. This estimate is evaluated on a periodic basis and any adjustment to the estimate is applied prospectively. The change in net present value of the future retirement obligation due to the passage of time is expensed as accretion. Actual retirement obligations settled during the period reduce the asset retirement liability.

## Joint Operations

The majority of the Company's crude oil operations are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

## Revenue Recognition

Revenues from the sale of crude oil are recognized when title passes to the customer.

## Foreign Currency Translation

The Company translates foreign currency denominated monetary assets and liabilities at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated at historical exchange rates. Revenues and expenses are translated at transaction date exchange rates except depletion and depreciation expense, which is translated at the same historical exchange rates as the related assets. Exchange gains or losses are included in the determination of net income as foreign exchange loss.

## Earnings Per Share

The Company computes basic earnings per share using net income divided by the weighted-average number of common shares outstanding. The Company computes diluted earnings per share using net income adjusted for interest expense on the convertible debentures divided by the weighted-average number of diluted common shares outstanding. The Company uses the treasury stock method in computing the weighted-average number of diluted common shares outstanding. This method assumes that the proceeds on exercise of in-the-money stock options are used to repurchase the Company's common shares at the average market price during the relevant period. The number of diluted common shares outstanding also reflects the potential dilution that would occur if the convertible debentures were converted into common shares at the beginning of the period, or when they were issued.

## Stock-Based Compensation

The Company accounts for stock-based compensation using the fair-value method of accounting for stock options and deferred common shares (collectively referred to as "Rights") granted to employees, officers and directors using the Black-Scholes option-pricing model. Stock-based compensation expense is recorded and reflected as stock-based compensation expense over the vesting period with a corresponding amount reflected in contributed surplus. Stock-based compensation expense is calculated as the estimated fair value for the related Rights at the time of grant, amortized over their vesting period. When Rights are exercised, the associated amounts previously recorded as contributed surplus are reclassified to common share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest, rather, the Company accounts for actual forfeitures as they occur.

## Income Taxes

The Company accounts for income taxes using the liability method. Under this method, the Company records a future income tax asset or liability to reflect any difference between the accounting and tax bases of assets and liabilities. The effect on future tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the change occurs. Future income tax assets are only recognized to the extent it is more likely than not that sufficient future taxable income will be available to allow the future income tax asset to be realized.

## Risk Management Contracts

The Company is exposed to market risks resulting from fluctuations in crude oil prices, foreign currency exchange rates and interest rates in the normal course of its business. The Company may use a variety of instruments to manage these exposures. For transactions where hedge accounting is not applied, the Company accounts for such instruments using the fair value method by initially recording an asset or liability, and recognizing changes in the fair value of the instruments in income as gains or losses on risk management contracts. Fair values of financial instruments are determined from third party quotes or valuations provided by independent third parties. Any realized gains or losses on risk management contracts are recognized in income in the period they occur.

The Company may elect to use hedge accounting when there is a high degree of correlation between the price movements in the financial instruments and the items designated as being hedged and has documented the relationship between the instruments and the hedged item as well as its risk management objective and strategy for undertaking hedge transactions. At December 31, 2007 the Company had not designated any of its outstanding financial instruments as hedges.

## Convertible Debentures

The Company presents outstanding convertible debentures in their debt and equity component parts on the consolidated balance sheet. The debt component represents the total discounted present value of the semi-annual interest obligations to be satisfied by cash and the principal payment due at maturity, using the rate of interest that would have been applicable to a non-convertible debt instrument of comparable term and risk at the date of issue. This results in an accounting value assigned to the debt component of the convertible debentures which is less than the principal amount due at maturity. The debt component presented on the balance sheet increases over the term of the debenture to the full face value of the outstanding debentures at maturity. The difference, accretion on convertible debentures, is reflected as increased interest expense with the result that adjusted interest expense reflects the effective yield of the debt component of the convertible debentures.

The equity component of the convertible debentures is presented under shareholders' equity in the consolidated balance sheet. The equity component represents the fair value of the conversion right granted to the holder, which remains a fixed amount over the term of the related debentures. Upon conversion of the debentures into common shares by the holders, the debt and equity components are transferred to common share capital.

## Cash and Cash Equivalents

Cash and cash equivalents include investments and deposits with a maturity of three months or less when purchased.

## NOTE 3 – CHANGES IN ACCOUNTING POLICIES

### Change in Reporting Currency

On July 1, 2006, the Company changed its reporting currency from Canadian dollars (Cdn\$) to United States dollars (\$), as this currency is considered more appropriate for the Company's investors and other users of the financial statements. In making this change, the Company has followed recommendations of the Emerging Issues Committee ("EIC") of the Canadian Institute of Chartered Accountants ("CICA"), set out in EIC-130, "Translation Method When The Reporting Currency Differs From The Measurement Currency Or There Is A Change In The Reporting Currency."

Financial statements for all periods presented have been translated from Canadian dollars into United States dollars using the current rate method, based on EIC-130 recommendations. Using this method, all consolidated assets and liabilities have been translated using the exchange rate at the balance-sheet dates, while shareholders' equity has been translated using the historical rates of exchange in effect on the dates of the corresponding transactions. The consolidated statements of operations and retained earnings and cash flow have been translated using the prevailing average exchange rates for the period, except for financing transactions which have been translated using the historical rates of exchange. Any resulting exchange rate differences due to this translation are included in shareholders' equity as cumulative translation adjustment. All comparative financial information being presented has been restated to reflect the Company's financial statements as if they have been historically reported in United States dollars and the effect on the consolidated financial statements resulted in a cumulative translation adjustment and corresponding increase in capital assets of \$16.0 million as at July 1, 2006.

### New Accounting Policies

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Section 1530, "Comprehensive Income," Section 3855, "Financial Instruments – Recognition and Measurement," Section 3861, "Financial Instruments – Disclosure and Presentation" and Section 3865, "Hedges." The Company has adopted these standards prospectively and the comparative interim consolidated financial statements have not been restated, except for cumulative translation adjustment which was reclassified as accumulated other comprehensive income.

Upon adoption of Section 3855, all financial instruments are classified into one of the following five categories: held-for-trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets or other financial liabilities. Subsequent measurement of the financial instruments is based on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. All risk management contracts are recorded in the balance sheet at fair value unless they qualify for the normal sale and normal purchase exemption. All changes in their fair value are recorded in net income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income until the underlying hedged transaction is recognized in net income. Any hedge ineffectiveness is immediately recognized in net income. The company has elected not to use cash flow hedge accounting on its risk management contracts with financial counterparties resulting in all changes in fair value being recorded in net income. The other categories of financial instruments are recognized at amortized cost using the effective interest rate method.

Upon adoption of these standards, the Company classified its cash and cash equivalents as held-for-trading, which are measured at fair value which equals the carrying value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and bank debt are classified as other financial liabilities, which are measured at amortized cost.

Upon issuance, the Company's convertible debentures are classified into equity and financial liability components on the balance sheet at their fair value. The convertible debentures are classified as other financial liabilities. The financial liability, net of issuance costs, is accreted, which is included within interest expense over the maturity of the debentures using the effective interest rate method.

For financial assets and financial liabilities that are not classified as held-for-trading, the transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are adjusted to the fair value initially recognized for that financial instrument. These costs are expensed using the effective interest rate method and are recorded within interest expense.

Section 1530 establishes standards for reporting and presenting comprehensive income which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with GAAP. Other comprehensive income includes any change in fair value of the effective portion of the risk management contracts used as hedging items in a cash flow hedge, the change in fair value of any available for sale financial instruments and foreign exchange gains and losses arising from the translation of self-sustaining foreign operations. Upon adoption of Section 1530, amounts previously recognized on the balance sheet as cumulative translation adjustment have been reclassified as accumulated other comprehensive income.

These new standards adopted effective January 1, 2007 had no impact on the Company's retained earnings as at January 1, 2007.

The Company also adopted Section 3251, "Equity" and Section 1506, "Accounting Changes." Section 3251 replaces Section 3250, "Surplus," and describes standards for the presentation of equity and changes in equity for reporting period as a result of the application of Section 1530, "Comprehensive Income." Section 1506, "Accounting Changes," requires entities to provide disclosure when an entity has not applied a new source of GAAP that has been issued but is not yet effective. This is the case with Section 3862, "Financial Instruments Disclosures" and Section 3863, "Financial Instruments Presentations" which are required to be adopted for fiscal years beginning on or after October 1, 2007. The Company adopted these standards effective January 1, 2008 and it is expected the only effect on the Company will be additional disclosures regarding the significance of financial instruments for the entity's financial position and performance; and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

Section 1535, "Capital Disclosures" is effective for annual periods beginning on or after October 1, 2007 and establishes standards for disclosing information about the Company's capital and how it is managed. It requires disclosures of the Company's objectives, policies and processes for managing capital, the quantitative data about what the Company regards as capital, whether the Company has complied with any capital requirements

and if it has not complied, the consequences of such non-compliance. The Company adopted this standard effective January 1, 2008 and expects the only effect will be incremental disclosures on the Company's capital and how it is managed.

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets," replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs." Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

The Accounting Standards Board has confirmed the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") will be effective January 1, 2011. The Company will continue to monitor the transition process but due to the extended period of time until implementation, the Company cannot assess the impact of IFRS at this time.

#### NOTE 4 – CAPITAL ASSETS

December 31, 2007	Cost	Accumulated Depletion and Depreciation	Net Book Value
Crude oil assets	\$ 340,818	\$ 79,402	\$ 261,416
Corporate and other	2,539	1,679	860
	\$ 343,357	\$ 81,081	\$ 262,276

December 31, 2006	Cost	Accumulated Depletion and Depreciation	Net Book Value
Crude oil assets	\$ 197,797	\$ 47,836	\$ 149,961
Corporate and other	2,090	1,287	803
	\$ 199,887	\$ 49,123	\$ 150,764

At December 31, 2007, crude oil assets included \$44.3 million (2006 – \$14.4 million) relating to unproved properties that have been excluded from the depletion calculation.

An impairment test calculation was performed for the Colombian cost centre at December 31, 2007 in which the estimated undiscounted future net cash flows associated with the proved reserves exceeded the carrying amounts. In determining the undiscounted future net cash flow the Company utilized the following benchmark prices:

Year	WTI Crude Oil <sup>(1)</sup> – \$/bbl
2008	90.00
2009	86.52
2010	84.87
2011	83.32
2012	82.78
Thereafter inflation % change	2%

(1) Actual prices used in the impairment tests were adjusted for crude oil quality differentials, transportation and marketing costs specific to the Company's operations.

## NOTE 5 – SHARE CAPITAL

### Authorized

The Company has authorized capital of 200,000,000 common shares, with a par value of \$1.00 per common share.

### Common Shares

Common Share Continuity	Number	Amount
Balance at December 31, 2005 <sup>(1)</sup>	78,999,900	\$ 67,308
Equity contributed by Petrobank	-	21,816
Incorporation on April 20, 2006	100	-
Issued pursuant to IPO	16,000,000	53,766
Share issue costs	-	(3,984)
Balance at December 31, 2006	95,000,000	\$ 138,906
Issued <sup>(2)</sup>	5,060,000	58,137
Share issue costs	-	(2,903)
Exercise of stock options	228,775	860
Transfer from contributed surplus related to stock options exercised	-	214
<b>Balance at December 31, 2007</b>	<b>100,288,775</b>	<b>\$ 195,214</b>

(1) In connection with the IPO, the Company issued 78,999,900 common shares in exchange for all of the issued and outstanding common shares of Petrominerales Colombia Ltd. and includes common shares and contributed surplus of Petrominerales Colombia Ltd. representing the historical equity contributed indirectly by Petrobank as if the Company and Petrominerales Colombia Ltd. had been combined since inception.

(2) In September 2007, the Company issued 5,060,000 common shares at a price of Cdn\$12.05 per common share for gross proceeds of Cdn\$61.0 million (\$58.1 million).

### Contributed Surplus

Changes in Contributed Surplus	Amount
Balance at December 31, 2005	\$ -
Stock-based compensation	531
Balance at December 31, 2006	\$ 531
Stock-based compensation	1,381
Transfer to common shares related to stock options exercised	(214)
<b>Balance at December 31, 2007</b>	<b>\$ 1,698</b>

### Accumulated Other Comprehensive Income

Changes in Accumulated Other Comprehensive Income	Amount
Balance at December 31, 2005	\$ -
Cumulative translation adjustment (Note 3)	16,024
Balance at December 31, 2006	\$ 16,024
Other comprehensive income	-
<b>Balance at December 31, 2007</b>	<b>\$ 16,024</b>

### Stock Options

The Company has established a stock option plan for directors, officers, employees and consultants. The plan allows for the issuance of up to 10 percent of the outstanding shares of the Company, less shares reserved under other Company stock-based compensation plans such as the deferred common share compensation plan. The exercise price is no less than the market price of the Company's stock on the date of the grant. Stock option terms are determined by the Company's Board of Directors but typically, options vest evenly over a period of four years from the date of grant and expire between five and 10 years after the date of grant.

The following is a continuity of stock options outstanding:

	2007		2006	
	Stock Options	Weighted-Average Exercise Price (Cdn\$)	Stock Options	Weighted-Average Exercise Price (Cdn\$)
Opening	3,051,126	3.78	-	-
Granted	2,307,183	6.33	3,138,626	3.78
Exercised	(228,775)	3.78	-	-
Cancelled	(258,750)	3.79	(87,500)	3.75
Closing	4,870,784	4.99	3,051,126	3.78

The following summarizes information about stock options outstanding as at December 31, 2007:

Stock Options Outstanding				Stock Options Exercisable	
Range of Exercise Prices (Cdn\$)	Number	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price (Cdn\$)	Number	Weighted-Average Exercise Price (Cdn\$)
3.11 – 3.99	2,608,101	5.7	3.74	422,100	3.75
4.00 – 7.49	1,799,400	7.1	4.44	28,775	4.31
7.50 – 14.99	247,500	5.0	10.92	-	-
15.00 – 21.57	215,783	7.3	17.93	41,196	17.32
	<b>4,870,784</b>	<b>6.2</b>	<b>4.99</b>	<b>492,071</b>	<b>4.92</b>

### Deferred Common Share Compensation Plan

At December 31, 2007, there were 37,500 (2006 – nil) deferred common shares outstanding under the Company's deferred share compensation plan whereby the Company may grant deferred common shares to its directors, officers and employees. The plan allows holders to receive one common share upon payment of \$0.05 per share. The deferred common shares vest after three years and expire 10 years from the date of grant. Up to 0.5 million deferred common shares have been approved for issuance under this plan.

### Stock-Based Compensation

The fair value of stock options and deferred common shares granted have been estimated on their respective grant dates using the Black-Scholes option-pricing model using the following assumptions:

Years ended December 31,	2007	2006
Risk free interest rate	4.0% – 4.5%	4.5%
Dividend rate	0%	0%
Expected life – options (years)	3.3	3.3
Expected life – deferred common shares (years)	8	n/a
Expected volatility	30% – 37.5%	30%

The average fair value per stock option granted during the year was \$1.74 (2006 – \$0.93) as at the date of grant. The average fair value per deferred common share granted during the year was \$3.58 (2006 – \$nil) as at the date of grant.

Stock-based compensation expense for the year ended December 31, 2007 totalled \$1.4 million (2006 – \$0.5 million).

## Earnings Per Share

The following tables summarize the net income and weighted average number of common shares used in calculating basic and diluted earnings per share.

Years ended December 31,	2007	2006
<b>Net income adjustments</b>		
Net income, basic	\$ 47,551	\$ 14,798
Interest expense on convertible debentures	551	-
Net income, diluted	\$ 48,102	\$ 14,798
<b>Weighted average common share adjustments</b>		
Weighted average common shares outstanding, basic	96,561,235	87,153,395
Effect of convertible debentures	250,446	-
Effect of stock options and deferred common shares	1,506,140	-
Weighted average common shares outstanding, diluted	98,317,821	87,153,395

## NOTE 6 – BANK DEBT

At December 31, 2007, the Company had drawn \$10.0 million on its secured credit facility (\$9.3 million – net of financing costs). The Company's borrowing base under this facility as at December 31, 2007 was \$50.0 million and subsequent to year end is being increased to \$80.0 million. The facility bears interest at a rate equal to LIBOR (London Interbank Offered Rate) plus three percent per annum. The facility is secured by a pledge over all property of the Company. The borrowing base is reviewed semi-annually.

The Company has a \$7.2 million operating line of credit under which the Company can borrow at the fixed term deposit rate set by the Central Bank of Colombia plus six percent. Advances under the facility are collateralized by a promissory note provided by the Company. The Company has used \$5.5 million of its Colombian operating lines of credit for letters of credit to guarantee work commitments under exploration blocks.

## NOTE 7 – CONVERTIBLE DEBENTURES

On December 6, 2007, the Company issued \$100 million of convertible debentures due December 6, 2010. The debentures are convertible into common shares of the Company at a conversion price of \$27.3485 per share, which represented a 38 percent premium to the share price when initially priced, and have an annual coupon of 3.375 percent. Interest on the debentures is payable semi-annually. Upon conversion, a total of 3,656,508 common shares may be issued, subject to normal provisions for adjustments of the conversion price such as a special distribution to shareholders or upon a change of control of the Company. Petrominerales has an option to force conversion of the debentures at the prevailing conversion price after December 6, 2009, should the price of the Company's common shares exceed 130 percent of the prevailing conversion price of the debentures over a specified period.

The debentures have been classified into their debt and equity components based on fair values. On issuance, this resulted in \$83.4 million being classified as a liability and \$12.7 million being classified as equity. The liability portion will accrete up to the principal balance over the term of the debentures. The accretion, and the interest paid are expensed as interest expense in the consolidated statement of operations, creating an effective yield of 9.7 percent. If the debentures are converted to common shares, the relative portion of the value of the conversion feature under shareholders' equity will be reclassified to common share capital along with the principal amounts converted.

The following table summarizes the accumulated accretion and the debentures' liability and equity components at December 31, 2007:

	Amount
Gross proceeds	\$ 100,000
Costs	(3,882)
Net proceeds	\$ 96,118
Fair value of equity component on issuance	12,738
Value attributed to liability component on issuance	83,380
Accretion to December 31, 2007	320
<b>Balance of liability component, December 31, 2007</b>	<b>\$ 83,700</b>

## NOTE 8 – ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations were estimated by management based on the estimated costs to reclaim and abandon the wells and well sites based on the Company's contractual requirements.

Changes to asset retirement obligations were as follows:

	2007	2006
Asset retirement obligations, beginning of year	\$ 930	\$ 539
Obligations incurred	352	341
Accretion expense	104	50
Changes in estimate	96	-
Asset retirement obligations, end of year	\$ 1,482	\$ 930

The obligations have been calculated using an inflation rate of four percent and discounted using a credit-adjusted risk free rate of nine percent per annum. The majority of these obligations are expected to be paid before the end of the related IPC, approximately 15 years in the future, and are expected to be funded from the Company's general resources available at the time of settlement. The total undiscounted amount of estimated cash flows required to settle the obligations at December 31, 2007 is \$6.5 million (2006 – \$3.1 million).

## NOTE 9 – TAXES

The provision for income taxes differs from the amount that would have been expected by applying expected statutory corporate income tax rates to income before taxes. The Company does not pay tax in the Bahamas. The principal reasons for this difference are as follows:

Years ended December 31,	2007	2006
Income before taxes	\$ 50,005	\$ 16,685
Statutory income tax rate	34.0%	38.5%
Expected tax expense	\$ 17,002	\$ 6,424
Increase (decrease) in income tax provision resulting from:		
Non-deductible expenses	2,951	240
Enhanced tax allowances	(13,282)	(6,975)
Changes in tax rates	-	834
Stock-based compensation	470	204
Future tax asset recognized and other	(8,220)	(727)
Future income tax expense (recovery)	(1,079)	-
Presumptive income and equity taxes	3,533	1,887
Tax expense	\$ 2,454	\$ 1,887

Presumptive income and equity taxes are based on equity levels in Colombia and can be recovered against income taxes in future periods, and can be carried forward for five years.

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

As at December 31,	2007		2006	
	Future Income Tax Assets	Future Income Tax Liabilities	Future Income Tax Assets	Future Income Tax Liabilities
Loss carry forwards	\$ 6,326	\$ -	\$ 7,822	\$ -
Excess presumptive tax	-	-	3,748	-
Capital assets	3,945	-	2,373	-
Asset retirement obligations	489	-	307	-
	10,760	-	14,250	-
Valuation allowance	(9,681)	-	(14,250)	-
	\$ 1,079	\$ -	\$ -	\$ -

As at December 31, 2007 non-capital losses totalled \$19.2 million and expire between 2008 and 2011.

Based on tax reforms enacted on December 27, 2006 which became effective January 1, 2007, tax losses may be carried forward without limitations to offset to taxable income; the presumptive income rate was reduced from six percent to three percent on the prior tax year's net tax equity; the seven percent remittance tax was eliminated; a 1.2 percent equity tax was introduced, the income tax rate was reduced from 38.5 percent to 34 percent in 2007, and to 33 percent for subsequent years; and, the special deduction for the acquisition or construction of real fixed assets was increased to 40 percent from 30 percent.

#### NOTE 10 – RELATED PARTY TRANSACTIONS

The Company pays Petrobank a monthly fee of Cdn\$75,000 pursuant to a Management Services Agreement made effective May 1, 2006. The fee is based on a negotiated value of services provided. Costs under this agreement totalled \$0.8 million for the year ended December 31, 2007 (2006 – \$0.5 million) and were recorded as general and administrative expense.

On June 29, 2006, the Company repaid a loan outstanding to Petrobank using a portion of the proceeds from the IPO (see Notes 1 and 5). The loan was only available from April 1, 2006 until the closing of the IPO and the outstanding balance ranged from \$nil to \$8.6 million. Interest expense was incurred at a rate equal to Petrobank's cost of borrowing of nine percent and totalled \$0.1 million.

#### NOTE 11 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The nature of the crude oil operations and the issuance of debt expose the Company to fluctuations in commodity prices, foreign currency exchange rates and interest rates. The Company manages these risks through periodic use of derivative instruments. The Board of Directors periodically reviews the results of all risk management activities and all outstanding positions.

##### Credit Risk

A substantial portion of the Company's accounts receivable are with customers in the oil industry and are subject to normal industry credit risks. The carrying amount of accounts receivable reflects management's assessment of the credit risk associated with these customers. Crude oil production is sold, as determined by market based prices adjusted for quality differentials, to two counterparties, the Colombian state oil company, Ecopetrol, and a large international oil company. Typically, the Company's maximum credit exposure to customers is revenue from two months' sales. While counterparties to risk management contracts expose the Company to losses in the event of non-performance, the Company currently deals with one large credit-worthy institution, who is also the Company's senior lender, and does not anticipate non-performance by this counterparty.

##### Interest Rate Risk

The Company is exposed to interest rate cash flow risk on floating interest rate bank debt due to fluctuations in market interest rates. The remainder of the Company's financial assets and liabilities are not exposed to interest rate risk.

##### Foreign Currency Exchange Risk

The Company is exposed to foreign currency fluctuations as certain expenditures are denominated in Colombian pesos and Canadian dollars.

## Fair Value of Financial Instruments

The Company's financial instruments are classified as cash and cash equivalents, accounts receivable and other current assets, accounts payable and accrued liabilities, risk management liabilities, bank debt and convertible debentures on the balance sheet. The carrying value and fair value of these financial instruments at December 31, 2007 is disclosed below by financial instrument category, as well as any related loss and interest expense for the year ended December 31, 2007:

Financial Instrument	Carrying Value	Fair Value	Loss	Interest Expense
<i>Assets Held For Trading</i>				
Cash and cash equivalents	171,096	171,096	-	-
<i>Loans and Receivables</i>				
Accounts receivable and other current assets	7,011	7,011	-	-
<i>Liabilities Held For Trading</i>				
Risk management contracts	5,797	5,797	5,797 <sup>(1)</sup>	-
<i>Other Liabilities</i>				
Accounts payable and accrued liabilities	62,107	62,107	-	-
Bank debt	9,309	10,000	-	2,275 <sup>(2)</sup>
Convertible debentures	83,700	n/a <sup>(3)</sup>	-	551 <sup>(4)</sup>

(1) Included in loss on risk management contracts on the statement of operations and retained earnings, statement of comprehensive income and statement of cash flow.

(2) Included in interest expense on the statement of operations and retained earnings and statement of comprehensive income. The amortization of deferred financing costs of \$0.2 million in relation to the Company's bank debt is included on the statement of cash flow.

(3) The fair value of the convertible debentures cannot be measured reliably due to the lack of trading information and further cannot be separated in a manner that is comparable to the carrying value of the liability component of the convertible debentures.

(4) Included in interest expense on the statement of operations and retained earnings and statement of comprehensive income. The non-cash interest expense relating to the accretion of the initial discount and transaction costs that are netted against this liability are included in accretion on convertible debentures on the statement of cash flow.

The risk management contracts are recorded at their fair value based on quoted market prices on the balance sheet date; accordingly, there is no difference between fair value and carrying value. Bank debt is recorded on the balance sheet net of deferred financing costs which results in a difference between carrying value and the fair value. Due to the short term nature of cash and cash equivalents, accounts receivable and other current assets, accounts payable and accrued liabilities, their carrying values approximate their fair values.

The Company had the following risk management contracts outstanding at December 31, 2007:

Term	Volume (Bopd)	Price (\$/bbl)	Benchmark
Jan. 1, 2008 – Dec. 31, 2008	500	65.00 floor / 80.00 ceiling	WTI
Jan. 1, 2008 – Dec. 31, 2008	500	75.25 fixed	WTI

For the year ended December 31, 2007, the mark-to-market loss recognized in net income was \$5.8 million (2006 – \$nil) which also represents the carrying amount and fair value of these risk management liabilities at December 31, 2007.

## NOTE 12 – CHANGES IN NON-CASH WORKING CAPITAL

Years ended December 31,	2007	2006
Change in:		
Accounts receivable and other current assets	\$ (5,002)	\$ 265
Accounts payable and accrued liabilities	42,933	1,562
Depletion related to other current assets	367	-
Reporting currency (Note 3)	-	(431)
	\$ 38,298	\$ 1,396
Changes relating to:		
Attributable to operating activities	\$ 18,724	\$ 1,226
Attributable to investing activities	\$ 19,574	\$ 170

**NOTE 13 – COMMITMENTS AND CONTINGENCIES**

Pursuant to current exploration contracts, the Company has work commitments, to be completed by March 31, 2009, totalling \$35.4 million. The work commitments are normal course of business exploration activities that include acquisition and processing of seismic data and drilling of exploration wells. The Company has secured five drilling rigs and two completion rigs with contract terms expiring April 2008 through November 2009 in order to fulfill those exploration work commitments and future development plans. At December 31, 2007 the costs remaining on these contracts totalled \$64.3 million, a significant portion which will be used to satisfy exploration work commitments. Petrominerales plans to fund these costs with existing cash balances, cash flow from operations, and available credit facilities. The Company has issued letters of credit totalling \$5.5 million to guarantee the obligations on these exploration contracts.