Consolidated Financial Statements of

MADALENA VENTURES INC.

As at and for the years ended December 31, 2011 and 2010

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Madalena Ventures Inc.

We have audited the accompanying consolidated financial statements of Madalena Ventures Inc., which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010, the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Madalena Ventures Inc. as at December 31, 2011, December 31, 2010 and January 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

[signed] "KPMG LLP"

Chartered Accountants

Calgary, Canada
April 20, 2012

MADALENA VENTURES INC.

Consolidated Balance Sheets

As at	Note	December 31, 2011	December 31, 2010 (note 20)	January 1, 2010 (note 20)
Assets				
Current assets				
Cash and cash equivalents	4	**$ 16,439,077**	$ 40,719,947	$ 10,131,040
Trade and other receivables		**712,737**	1,033,938	187,193
Prepaid expenses		**212,913**	333,688	154,972
Inventory	5	**42,876**	231,751	-
		17,407,603	42,319,324	10,473,205
Non-current assets				
Property and equipment	6	**7,120,404**	4,605,457	112,977
Exploration and evaluation assets	7	**17,338,614**	12,829,447	15,140,809
Other non-current assets		**231,166**	-	-
		24,690,184	17,434,904	15,253,786
		$ 42,097,787	$ 59,754,228	$ 25,726,991
Liabilities				
Current liabilities				
Trade and other payables		**$ 2,964,693**	$ 5,313,802	$ 1,601,212
Decommissioning provisions	8	**330,981**	602,366	256,640
		3,295,674	5,916,168	1,857,852
Shareholders' equity				
Share capital	9	**77,862,747**	75,403,123	38,345,561
Warrants	9	**-**	-	2,380,678
Contributed surplus		**10,073,672**	7,932,605	7,092,401
Accumulated other comprehensive loss		**(5,162,197)**	(1,662,102)	-
Deficit		**(43,972,109)**	(27,835,566)	(23,949,501)
		38,802,113	53,838,060	23,869,139
		$ 42,097,787	$ 59,754,228	$ 25,726,991

Commitments (note 17)
Subsequent events (note 17 and 21)

See accompanying notes to the consolidated financial statements

On behalf of the Board:

[signed] "Ray Smith"

Ray Smith
Chairman

[signed] "Keith Macdonald"

Keith Macdonald
Director

MADALENA VENTURES INC.

Consolidated Statements of Loss and Comprehensive Loss

For the years ended December 31	Note		2011		2010
					(note 20)
Revenue					
Oil and gas		**$**	**2,598,503**	$	244,235
Royalties			**(521,037)**		(42,873)
			2,077,466		201,362
Expenses					
Operating			**1,337,223**		94,117
General and administrative	14		**3,479,141**		2,746,120
Share-based payments	9		**2,832,288**		1,628,441
Depletion and depreciation	6		**453,231**		65,843
Impairment of exploration and evaluation assets	7		**11,006,637**		-
Gain on farm-out arrangement	6		**(1,040,664)**		-
			18,067,856		4,534,521
Operating loss			**(15,990,390)**		(4,333,159)
Other income (expenses)					
Interest and other income	15		**290,928**		108,378
Foreign exchange loss			**(82,622)**		(15,132)
Finance cost	16		**(56,534)**		(27,373)
			151,772		65,873
Loss from continuing operations before tax			**(15,838,618)**		(4,267,286)
Current income tax expense	10		**(297,925)**		(30,777)
Loss from continuing operations			**(16,136,543)**		(4,298,063)
Income from discontinued operations	11		**-**		411,998
Net loss for the year			**(16,136,543)**		(3,886,065)
Exchange differences on translation of foreign operations			**(3,500,095)**		(1,662,102)
Total comprehensive loss for the year		**$**	**(19,636,638)**	$	(5,548,167)
Weighted average number of shares:					
Basic and diluted	9		**259,703,673**		190,421,925
Loss from continuing operations per share:					
Basic and diluted		**$**	**(0.06)**	$	(0.02)
Loss from discontinued operations per share:					
Basic and diluted		**$**	**-**		-
Net loss per share:					
Basic and diluted		**$**	**(0.06)**	$	(0.02)

See accompanying notes to the consolidated financial statements

MADALENA VENTURES INC.

Consolidated Statements of Cash Flows

For the years ended December 31	Note	2011	2010
			(note 20)
Cash provided by (used in):			
Operating activities			
Loss from continuing operations		**$ (16,136,543)**	$ (4,298,063)
Items not involving cash:			
Share-based payments		**2,832,288**	1,628,441
Depletion and depreciation		**453,231**	65,843
Impairment of exploration and evaluation assets	7	**11,006,637**	-
Gain on farm-out arrangement	6	**(1,040,664)**	-
Accretion on provisions		**56,534**	27,373
Abandonment expenditures	8	**(78,472)**	-
Change in other non-current assets		**(1,429)**	-
Change in non-cash working capital items	13	**415,212**	(368,156)
		(2,493,206)	(2,944,562)
Discontinued operations	11		
Income from discontinued operations		**-**	411,998
Items not involving cash:			
Gain on sale of exploration and evaluation assets		**-**	(372,371)
Additions to discontinued exploration and evaluation assets		**-**	286,345
Proceeds on sale of exploration and evaluation assets		**-**	4,084,400
Change in non-cash working capital	13	**-**	(707,272)
		-	3,703,100
Financing activities			
Issue of common shares		**1,669,511**	35,594,128
Share issue costs		**-**	(1,695,277)
Change in non-cash working capital items	13	**(3,880)**	(120,134)
		1,665,631	33,778,717
Investing activities			
Additions to exploration and evaluation assets		**(17,439,235)**	(7,815,137)
Additions to property and equipment		**(2,594,858)**	283,457
Change in non-cash working capital items	13	**(2,111,723)**	3,814,105
		(22,145,816)	(3,717,575)
Change in cash and cash equivalents		**(22,973,391)**	30,819,680
Cash and cash equivalents, beginning of the year		**40,719,947**	10,131,040
Impact of foreign exchange on cash balances		**(1,307,479)**	(230,773)
Cash and cash equivalents, end of the year		**$ 16,439,077**	$ 40,719,947

See accompanying notes to the consolidated financial statements

MADALENA VENTURES INC.
Consolidated Statements of Changes in Equity

	Note	Share Capital Number	Share Capital Amount	Warrants	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total Equity
Balance at January 1, 2010	20	**178,410,702**	**$ 38,345,561**	**$ 2,380,678**	**$ 7,092,401**	**$ -**	**$ (23,949,501)**	**$ 23,869,139**
Loss for the year		-	-	-	-	-	(3,886,065)	(3,886,065)
Public offering	9a	40,775,000	26,503,750	-	-	-	-	26,503,750
Exercise of stock options	9c	1,433,333	1,035,033	-	(778,033)	-	-	257,000
Exercise of warrants	9b	33,333,500	10,443,385	(2,110,010)	-	-	-	8,333,375
Exercise of agents' warrants	9b	3,333,350	770,671	(270,668)	-	-	-	500,003
Share issue costs	9a	-	(1,695,277)	-	-	-	-	(1,695,277)
Share-based payments	9c	-	-	-	1,618,237	-	-	1,618,237
Comprehensive loss for the year		-	-	-	-	(1,662,102)	-	(1,662,102)
Balance at December 31, 2010		**257,285,885**	**$ 75,403,123**	**$ -**	**$ 7,932,605**	**$ (1,662,102)**	**$ (27,835,566)**	**$ 53,838,060**
Loss for the year		-	-	-	-	-	(16,136,543)	(16,136,543)
Exercise of stock options	9c	2,734,632	2,459,624	-	(790,113)	-	-	1,669,511
Share-based payments	9c	-	-	-	2,931,180	-	-	2,931,180
Comprehensive loss for the year		-	-	-	-	(3,500,095)	-	(3,500,095)
Balance at December 31, 2011		**260,020,517**	**$ 77,862,747**	**$ -**	**$ 10,073,672**	**$ (5,162,197)**	**$ (43,972,109)**	**$ 38,802,113**

See accompanying notes to the consolidated financial statements

1. Corporate Information

Madalena Ventures Inc. ("Madalena" or the "Company") is incorporated pursuant to the laws of the Province of Alberta. Madalena is based in Calgary, Alberta and is involved in the exploration, development and production of petroleum and natural gas in Argentina.

2. Basis of Preparation

a) Future operations

These consolidated financial statements have been prepared on the basis that the Company is a going concern and will realize assets and discharge liabilities in the normal course of operations for the foreseeable future. Presently, Madalena has minimal production and limited cash flow from operating activities. The Company currently relies on equity financing to pay for exploration activities and overhead expenses. Therefore, the Company's ability to continue operations is dependent on identifying commercial oil and gas reserves, generating profitable operations and raising sufficient capital to complete planned exploration and development activities. The outcome of these matters cannot be predicted at this time.

b) Statement of compliance

The Company prepares its financial statements in accordance with International Financial Reporting Standards ("IFRS"). These are the Company's first annual consolidated financial statements prepared in accordance with IFRS. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These consolidated financial statements have been prepared in accordance with IFRS. Note 20 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP and as at January 1, 2011, the Company's date of transition.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as at April 20, 2012, the date the Board of Directors approved the consolidated financial statements.

c) Basis of measurement

These consolidated financial statements have been prepared on a historical cost basis. The Company's presentation currency is Canadian dollars ($).

d) Use of estimates, judgments and estimation uncertainty

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Following are the accounting policies subject to such judgments and the key sources of estimation uncertainty that the Company believes could have the most significant impact on the reported results and financial position:

Reserves

The estimate of petroleum and natural gas reserves is integral to the calculation of the amount of depletion charged to net income (loss) and is also a key determinant in assessing whether the carrying value of any of the Company's development and production assets has been impaired. Changes in reported reserves can impact asset carrying values and the decommissioning provision due to changes in expected future cash flows.

The Company's reserves are evaluated and reported on by independent reserve engineers at least annually in accordance with Canadian Securities Administrators' National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities. Reserve estimation is based on a variety of factors including engineering data, geological and geophysical data, projected future rates of production, commodity pricing and timing of future expenditures, all of which are subject to significant judgment and interpretation. Changes in market and regulatory conditions and assumptions can materially impact the estimation of net reserves.

Carrying value of development and production and exploration and evaluation assets

The Company assesses at each reporting date whether there is an indication that an asset or cash generating unit ("CGU") may be impaired. A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of cash inflows of other assets or groups of assets. The allocation of assets into CGU's requires significant judgment and interpretations with respect to the way in which management monitors operations.

If any indication exists that an asset or CGU may be impaired, the Company estimates the recoverable amount. The recoverable amounts of individual assets and CGU's have been determined based on the higher of value-in-use calculations and fair value less costs to sell. These calculations require the use of estimates and assumptions, such as estimates of proved plus probable reserves, future production rates, oil and natural gas prices, future costs and other relevant assumptions, all of which are subject to change. A material adjustment to the carrying value of the Company's development and production and exploration and evaluation assets may be required as a result of changes to these estimates and assumptions.

Decommissioning obligations

Amounts recorded for decommissioning obligations require the use of management's best estimates of future decommissioning expenditures, expected timing of expenditures and future inflation rates. The estimates are based on internal and third party information and calculations and are subject to change over time and may have a material impact on profit and loss or financial position. For more information on the Company's decommissioning provisions, see note 8.

Share-based payments

The Company measures the cost of its share-based payments to directors, officers and employees by reference to the fair value of the equity instruments at the date at which they are granted. The assumptions used in determining fair value include: expected lives of options, risk-free rates of return and stock price volatility. Changes to assumptions may have a material impact on the amounts presented. For more information on the Company's share-based payments, see note 9.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements.

a) Basis of consolidation

i. Subsidiaries

These consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its 'subsidiaries'). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Inter-company balances and transactions, including unrealized income and expenses arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

ii. Jointly controlled operations and jointly controlled assets

Substantially all of the Company's operations are conducted jointly with others and involve jointly controlled assets. Accordingly, the financial statements reflect only the Company's interest in such activities and assets.

b) Foreign currency

Items included in the financial statements of each of the Company's consolidated subsidiaries are measured using the currency of the primary economic environment in which the subsidiary operates ("the functional currency"). The consolidated financial statements are presented in Canadian dollars, which is Madalena's functional currency. The Argentine peso is the functional currency of Madalena Austral S.A. and the United States dollar is the functional currency of both Madalena Ventures International Holding Company Inc. and Madalena Ventures International Inc.

Foreign currency transactions are translated into the respective functional currencies of Madalena and its subsidiaries using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit and loss.

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

i. assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that balance sheet;
ii. income and expenses for each year are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
iii. all resulting exchange differences are recognized in a separate component of equity called 'accumulated other comprehensive income'.

When a foreign operation is disposed of, a proportionate share of the cumulative exchange differences previously recognized in equity is recognized in the statement of loss, as part of the gain or loss on sale where applicable.

c) Financial instruments

i. Financial assets

Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Company determines the classification of its financial assets at initial recognition.

Fair value through profit or loss

A financial asset or liability is classified in this category if it is held for trading. Financial assets at fair value through profit or loss are initially recognized at fair value with changes in fair value recorded through profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement at fair value, such financial assets are subsequently measured at amortized cost less impairment. Loans and receivables are comprised of cash and cash equivalents and trade and other receivables.

Held-to-maturity investments

These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in profit or loss.

Available-for-sale financial assets

Non-derivative financial assets not included in the above categories are classified as available-for- sale. They are carried at fair value with changes in fair value recognized as other comprehensive income and classified as a component of equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in the income statement. When financial assets classified as available for sale are sold, the accumulated fair value adjustments recognized in other comprehensive income are included in profit or loss.

ii. Financial liabilities

Financial liabilities are classified as financial liabilities at fair value through profit or loss and other financial liabilities, as appropriate. The Company determines the classification of its financial liabilities at initial recognition.

Fair value through profit or loss

This category comprises derivatives or liabilities acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in profit or loss.

Other financial liabilities

This category includes amounts due to related parties and trade and other payables and accrued liabilities, all of which are recognized at amortized cost.

d) Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at banks and short-term deposits with an original maturity of three months or less. For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

e) Inventories

Inventory of crude oil is valued at the lower of cost and net realizable value. Cost is determined on a first in - first out basis and relates to the cost of production.

f) Property, plant and equipment and intangible exploration and evaluation assets

i. Recognition and Measurement:

Exploration and evaluation ('E&E') expenditures

Costs incurred before acquiring the legal right to explore are recognized in net income (loss) as incurred.

E&E expenditures, including costs of licence acquisition, technical services and studies, exploratory drilling and testing and directly attributable overhead are capitalized as E&E assets according to the nature of the assets acquired. Interest and borrowing costs incurred on E&E assets are not capitalized.

E&E costs are not depleted and are accumulated in cost centres by well, field or exploration area pending determination of technical feasibility and commercial viability, which is assessed at least annually. Technical feasibility and commercial viability is considered to be demonstrable when proved or probable reserves have been assigned and there is a reasonable assessment of the economics associated with the future production of those reserves, required government and regulatory approvals have been obtained or are likely to be obtained, and management has made the decision to proceed with development and production of those reserves by incurring the future capital costs attributed to them. When the technical feasibility and commercial viability of extracting a mineral resource are demonstrable, E&E assets will be tested for impairment and reclassified from exploration assets to development and production assets, a separate category within property and equipment.

Development and production ('D&P') expenditures

D&P assets include costs incurred in developing commercial reserves and bringing them into production, together with the E&E expenditures incurred in finding the commercial reserves that have been reclassified from E&E assets as outlined above, the projected cost of retiring the assets and any directly attributable general and administrative expenses. Items of property and equipment, including D&P assets, are carried at cost less accumulated depletion and depreciation and accumulated impairment losses.

When significant parts of an item of property and equipment, including D&P assets, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property and equipment, including D&P assets, are determined by comparing the proceeds of disposal with the carrying amount of the item and are recognized in profit or loss.

ii. Subsequent costs:

Costs incurred subsequent to the determination of technical feasibility and commercial viability, costs of replacing parts of property and equipment and workovers of property and equipment are recognized only if they increase the economic benefits of the assets to which they relate. All other expenditures are recognized in profit or loss when incurred. The carrying amounts of previous inspections or any replaced or sold components are derecognized. The costs of day-to-day servicing of an item of property and equipment are recognized in profit or loss as incurred.

iii. Depletion and depreciation:

The net book values of producing assets are depleted on a field-by-field basis using the unit of production method with reference to the ratio of production in the year to the related proved and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production.

Office furniture and equipment are recorded at cost and are depreciated over the estimated useful lives of the assets using a 20% declining balance basis for Canadian office furniture and equipment, a straight line basis over 3 -10 years for Argentine office furniture and equipment and a straight line basis over the term of the lease for all leasehold improvements. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

g) Impairment

i. Non-financial assets

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment, except for D&P assets, E&E assets, inventories and deferred tax assets, which are reviewed when circumstances indicate impairment may exist and at least annually, as discussed in more detail below.

E&E assets are assessed for impairment when facts and circumstances suggest that the carrying amount exceeds the recoverable amount and when they are reclassified to D&P assets. For the purpose of impairment testing, E&E assets are grouped by concession or field with other E&E and D&P assets belonging to the same concession or field. The impairment loss will be calculated as the excess of the carrying value over recoverable amount of the E&E impairment grouping and any resulting impairment loss is recognized in profit or loss. Recoverable amount is generally determined by reference to the value in use or fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

D&P assets will be tested for impairment whenever events and circumstances arising during the development and production phase indicate that the carrying amount of a D&P asset may exceed its recoverable amount. For the purpose of impairment testing, D&P assets will be grouped into the smallest group of assets that generates cash inflows that are largely independent of cash inflows from other assets or groups of assets (the "cash generating unit" or "CGU"). The aggregate carrying value will be compared against the expected recoverable amount of the CGU, generally by reference to the present value of the future net cash flows expected to be derived from the production of proved and probable reserves. CGU's are generally defined by field except where a number of field interests can be grouped because the cash flows generated by the fields are interdependent. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro-rata basis.

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized. An impairment loss in respect of goodwill is not reversed.

ii. Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

h) Share-based payments

The Company's stock option plan allows directors, officers and employees to receive remuneration in the form of share-based payment transactions, whereby they render services as consideration for equity instruments of the Company ('equity-settled transactions'). The fair value of options granted is measured at the date of grant using the Black-Scholes option pricing model. Each tranche's fair value is recognized as a share-based payment expense on a graded-vesting basis over the period during which the options vest, with a corresponding increase in contributed surplus within equity. No expense is recognized for awards that ultimately do not vest. The number of stock options expected to vest is reviewed at least annually, with any impact being recognized immediately. Upon exercise of the stock options, the consideration received plus the amount previously recorded in contributed surplus is recorded as an increase in share capital.

i) Provisions

i. General

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost. Provisions are not recognized for future operating losses.

ii. Decommissioning obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. Decommissioning obligation costs are capitalized in the relevant asset category to which they relate.

Decommissioning obligations are measured at the present value of management's best estimate of expenditures required to settle the present obligation at the statement of financial position date. Subsequent to the initial measurement of the decommissioning obligation, the obligation is adjusted at the end of each reporting period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas changes in the estimated future cash flows are added to or deducted from the related asset in the current period. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

j) Revenue recognition

i. Petroleum and natural gas revenues

Petroleum and natural gas revenues are recognized when the significant risks and rewards of ownership have been transferred, which is when title passes to the purchaser, and payment is reasonably assured.

ii. Interest income

Interest income is recognized in profit or loss, using the effective interest rate method, as it accrues.

k) Income taxes

Income tax on the profit or loss for the periods presented comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax is recorded, using the balance sheet method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. However, deferred tax is not recorded on taxable temporary differences arising on the initial recognition of goodwill or on the initial recognition of assets and liabilities in a transaction other than a business combination that affect neither accounting nor taxable profit or loss. Deferred tax is also not recorded on differences relating to investments in subsidiaries and jointly controlled entities to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient future taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

l) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity.

m) Per share amounts

The Company presents basic and diluted earnings per share (EPS) data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential common shares.

n) Accounting standards issued but not yet applied

Unless otherwise noted, the following pronouncements and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company is in the process of evaluating the impact of adopting these standards.

i) IFRS 9 Financial Instruments applies to the classification and measurement of financial assets and liabilities as defined in IAS 39. It is effective for annual periods beginning on or after January 1, 2015.

ii) IFRS 10 Consolidated Financial Statements was issued in May 2011 and establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 replaces SIC-12 *Consolidation—Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statement.*

iii) IFRS 11 Joint Arrangements focuses on the rights and obligations of a joint arrangement, rather than its legal form (as is currently the case). To address reporting inconsistencies, the standard requires a single method to account for interests in jointly controlled entities. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers.*

iv) IFRS 12 Disclosure of Interests in Other Entities applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity.

v) IFRS 13 Fair Value Measurements defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value measurements.

vi) IAS 27 Separate Financial Statements addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements.

vii) IAS 28 Investments in Associates and Joint Ventures has been amended to included joint ventures in its scope and to address the changes in IFRS 10 -13.

viii) IAS 1 Presentation of Financial Statements has been amended to require components of other comprehensive income to be separately presented between those that may be reclassified to income and those that will not. The amendments are effective for annual periods beginning on or after July 1, 2012.

ix) IAS 32 Financial Instruments has been amended to provide clarification on the application of offsetting rules. The amendments are effective for annual periods beginning on or after July 1, 2012.

4. Cash

	December 31, 2011	December 31, 2010	January 1, 2010
Bank balances	$ 16,439,077	$ 40,719,947	$ 10,131,040

5. Inventory

Inventory at December 31, 2011 of $42,876 (December 31, 2010 - $231,751, January 1, 2010 - $nil) consists of crude oil that has been produced but not yet sold.

6. Property and equipment

	Development and Production Assets $	Furniture and Fixtures $	Total $
Cost			
At January 1, 2010	-	217,336	217,336
Additions	-	5,963	5,963
Assets transferred from exploration and evaluation	4,755,524	-	4,755,524
Effect of movement in exchange rates	(156,432)	(23)	(156,455)
At December 31, 2010	4,599,092	223,276	4,822,368
Additions	3,542,118	10,080	3,552,198
Effect of movement in exchange rates	(651,404)	(6,049)	(657,453)
At December 31, 2011	7,489,806	227,307	7,717,113
Depletion and depreciation			
At January 1, 2010	-	104,359	104,359
Depletion and depreciation charge in period	91,684	27,516	119,200
Effect of movement in exchange rates	(3,002)	(3,646)	(6,648)
At December 31, 2010	88,682	128,229	216,911
Depletion and depreciation charge in period	396,383	20,077	416,460
Effect of movement in exchange rates	(32,698)	(3,964)	(36,662)
At December 31, 2011	452,367	144,342	596,709
Net book value			
At January 1, 2010	-	112,977	112,977
At December 31, 2010	4,510,410	95,047	4,605,457
At December 31, 2011	7,037,439	82,965	7,120,404

Development and production assets consist of costs less depletion and depreciation with respect to the Company's Coiron Amargo Block. In July 2011, completion of a farm-out reduced the Company's interest in the block from 52.5% to 35% resulting in a gain of $1,040,664.

The amounts capitalized as development and production ("D&P") assets in Argentina at December 31, 2011 includes $822,157 of Value Added Tax ("VAT") (2010 - $538,829). VAT is payable on goods and services supplied to the Company and is not recoverable from the Government of Argentina, however the Company is allowed to retain VAT on any sales that it collects to the extent of the VAT recorded and paid on previous expenditures.

The depletion expense calculation for the three months ended December 31, 2011 included $12.2 million (2010 – $11.6 million) for estimated future development costs associated with proved and probable reserves in Argentina.

The benchmark prices used in the ceiling test evaluation of the Company's crude oil and natural gas reserves at December 31, 2011 were:

Year	WTI Crude Oil (US$/Barrel)	Corporate Crude Oil (US$/Barrel)	Corporate Natural Gas (US$/Mcf)
2012	100.00	75.40	2.75
2013	101.00	76.91	2.81
2014	102.00	78.45	2.86
2015	103.00	80.02	2.92
2016	104.00	81.62	2.98
2017	106.00	83.25	3.04

7. Exploration and evaluation assets

	$
Cost	
At January 1, 2010	$ 15,140,809
Additions	7,688,748
Disposals	(3,886,800)
Assets transferred to property and equipment	(4,755,524)
Effect of movement in exchange rates	(1,357,786)
At December 31, 2010	12,829,447
Additions	17,431,140
Effect of movement in exchange rates	(2,511,468)
At December 31, 2011	27,749,119
Depletion, depreciation and impairment losses	
At January 1, 2010 and December 31, 2010	-
Impairment losses	11,006,637
Effect of movement in exchange rates	(596,132)
At December 31, 2011	10,410,505
Net book value	
At January 1, 2010	15,140,809
At December 31, 2010	12,829,447
At December 31, 2011	17,338,614

E&E assets consist of the Company's intangible exploration projects in Argentina which are pending the determination of proven or probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the period. E&E assets are not depreciated or depleted. In the second quarter of 2011, the Company completed drilling and subsequently abandoned the Curamhuele X-1001 exploration well and recorded an impairment loss of $11,006,637 equal to the excess of the carrying value over the recoverable amount of the E&E impairment grouping.

The amounts capitalized as Argentina E&E assets at December 31, 2011 before impairment losses include $4,506,863 of VAT (2010 - $1,523,166). Included in impairment losses is $1,891,738 of VAT incurred during drilling of the Curamhuele X-1001 exploration well. During the year ended December 31, 2011, share-based payments directly related to exploration and evaluation activities totaling $98,892 (2010 – decrease $15,672) were capitalized.

In the fourth quarter of 2010, the Coiron Amargo block in Argentina was deemed by management to be technically feasible and commercially viable and costs attributed to the block were transferred from E&E assets to D&P assets, a separate category within property and equipment.

8. Decommissioning provisions

The Company's decommissioning obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. At December 31, 2011, the Company estimates the total undiscounted inflation-adjusted amount of cash flows required to settle its decommissioning obligations to be approximately $1.7 million (2010 - $2.1 million). The costs are expected to be incurred in the period between 2023 and 2025. The decommissioning obligations have been estimated using existing technology at current prices and discounted using discount rates that reflect current market assessments of the time value of money and the risks specific to each liability. A non-credit risk adjusted rate for Argentina of 15.49% (2010 – 10.40%) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	December 31, 2011	December 31, 2010
Balance, beginning of year	$ 602,366	$ 256,640
Additions	232,145	274,230
Revisions in interest rates	(308,189)	80,099
Revisions in estimates	-	100,916
Accretion	56,534	27,373
Costs incurred	(78,472)	-
Disposition	(122,967)	(96,146)
Effect of movement in exchange rates	(50,436)	(40,746)
Balance, end of year	$ 330,981	$ 602,366

9. Share capital

a) Common shares

Authorized

The authorized share capital of the Company consists of an unlimited number of common shares without nominal or par value.

Issued and outstanding common share activity

In November 2010, the Company issued 40,775,000 common shares at a price of $0.65 per common share for gross proceeds of $26,503,750.

b) Warrants

In December 2009, the Company completed a public offering of 66,667,000 units at an issue price of $0.15 per unit for gross proceeds to Madalena of $10,000,050. Each unit consisted of one common share and one-half (1/2) common share purchase warrant. Each whole warrant issued entitled the holder thereof to purchase one common share at a price of $0.25 per share until December 30, 2010. The Company also issued 3,333,350 agents' warrants. Each agent warrant entitled the holder thereof to purchase one common share at a price of $0.15 per share until December 30, 2010. In 2010, all of the warrants and agents' warrants were exercised.

c) Share-based payments

Employee stock option plan

Under the Company's stock option plan, directors, officers, employees and certain consultants are eligible to receive options to acquire common stock of the Company. The exercise price of the granted options is no less than the closing trading price per share on the last day preceding the date of the grant. Total options granted cannot exceed 10% of the issued and outstanding common shares of the Company. Options granted to directors, officers, employees and consultants may vest immediately or over three years on each anniversary of the grant date. Options expire three to five years from the grant date. There are no cash settlement alternatives for employees under the Company's stock option plan. Movements in the number of stock options outstanding and their related weighted average exercise prices are summarized as follows:

For the years ended	December 31, 2011		December 31, 2010	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding - beginning of year	16,565,000	$ 0.57	10,405,000	$ 0.55
Granted	2,480,000	0.76	11,160,000	0.54
Exercised	(2,734,632)	0.61	(1,433,333)	0.18
Forfeited	(333,334)	0.73	(1,133,333)	0.23
Expired	(2,000,000)	0.66	(2,433,334)	0.76
Outstanding - end of year	13,977,034	$ 0.57	16,565,000	$ 0.57
Exercisable - end of year	7,570,372	$ 0.61	7,731,667	$ 0.65

The weighted average share price on the exercise date for options exercised in 2011 was $0.96 (2010 - $0.51)

The following table summarizes the options outstanding and exercisable as at December 31, 2011:

	Outstanding		Exercisable
Exercise Price ($)	Number of options	Weighted average remaining life (years)	Number of options
0.105	432,034	1.91	432,034
0.125	200,000	2.41	100,000
0.210	3,833,334	3.08	1,266,669
0.320	300,000	3.56	100,000
0.405	30,000	1.08	30,000
0.570	50,000	2.75	-
0.600	800,000	0.47	800,000
0.690	1,330,000	4.93	443,331
0.730	166,666	4.34	166,666
0.790	5,860,000	3.98	3,906,670
0.800	375,000	3.90	125,002
0.960	600,000	4.13	200,000
	13,977,034	3.52	7,570,372

The fair value of options is measured at the date of grant using the Black-Scholes option pricing model, taking into account the terms and conditions upon which the options were granted. The fair value of the options is expensed over the period during which the options vest, with a corresponding increase in contributed surplus. The fair value of options granted during the year ended December 31, 2011 and 2010 and the assumptions used in their determination, are as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Weighted average fair value	$ 0.60	$ 0.43
Weighted average share price	$ 0.76	$ 0.54
Weighted average exercise price	$ 0.76	$ 0.54
Weighted average risk-free interest rate	1.77%	2.22%
Weighted average expected volatility	123%	123%
Expected life of option (years)	3.96	4.50
Dividend yield (%)	nil	nil

Expected volatility is estimated by considering historic daily share price volatility. The Company recognized share-based payment expense related to stock options of $2,832,288 for the year ended December 31, 2011 (2010 – $1,628,441).

d) Per share information

The diluted weighted average number of shares outstanding for the year ended December 31, 2011 was 259,703,673 (2010 – 190,421,925). For the years ended December 31, 2011 and 2010, all share options were excluded from the calculation of diluted weighted average shares outstanding as they were anti-dilutive.

10. Income taxes

The amount of income taxes computed by applying the combined Canadian federal and provincial income tax rates to income before taxes differs from the amount recorded in the financial statements. The differences are summarized as follows:

For the year ended December 31,	2011	2010
Loss from continuing operations before tax	$ (15,838,618)	$ (4,267,286)
Statutory income tax rate	26.5%	28.0%
Computed "expected" income tax recovery	(4,197,234)	(1,194,840)
Increase (decrease) in taxes resulting from:		
Effect of foreign tax rates	(930,471)	(26,367)
Share-based compensation	750,556	455,963
Unrecognized deferred tax benefit and other	4,280,134	674,168
Canadian tax rate adjustments	26,593	53,425
Non-taxable differences on foreign operations	62,219	51,116
Current equity tax expense	297,925	30,777
Other	8,203	(13,465)
Total income tax recovery	$ 297,925	30,777

The statutory rate was 26.5% in 2011 (2010- 28%). The decrease from 2010 to 2011 was due to a reduction in the 2011 Canadian corporate tax rate as part of a series of corporate rate reductions by the federal government in 2007. Current income tax expense relates to minimum taxes based on the book value of assets in Argentina.

The total temporary differences associated with the unrecognized deferred tax asset are as follows:

As at December 31,	2011	2010
Canada:		
Share issue costs	$ 1,323,399	$ 1,815,570
Non-capital losses (Expires 2026 to 2031)	13,819,549	11,672,631
Total temporary differences	$ 15,142,948	$ 13,488,201
Argentina:		
Non-capital losses (Expires 2012 to 2016)	$ 2,525,093	$ 1,915,785
Total temporary differences	$ 2,525,093	$ 1,915,785
Barbados;		
Non-capital losses (Expires 2017 to 2020)	$ 378,012	$ 2,502,760
Total temporary differences	$ 378,012	$ 2,502,760

The components of the recognized deferred income tax asset (liability) are as follows:

As at December 31,	2011	2010
Foreign exchange	$ (350,807)	$ (349,737)
Properties and equipment	250,931	272,814
Non-capital losses	99,876	76,923
Deferred income tax (liability) asset	$ -	$ -

The Company has temporary differences associated with its investment in its foreign subsidiaries and branches. As at December 31, 2011, the Company has no deferred tax liabilities in respect of these temporary differences.

11. Discontinued operations

In March 2010, the Company sold its interest in the Remada Sud Permit in Tunisia for cash consideration of US$4 million. Prior to the sale, in the first quarter of 2010 net operating revenue of $18,660 was credited to Tunisia exploration and evaluation costs. The following table provides a summary of the income from discontinued operations for the years ended December 31, 2011 and 2010:

	Year ended December 31	
	2011	2010
Canada:		
Oil and gas revenues	$ -	$ -
Royalties	-	42,330
Operating costs	-	(2,703)
Income from discontinued operations	-	39,627
Gain on sale of Tunisia property and equipment	-	372,371
Income from discontinued operations	$ -	$ 411,998

The following table summarizes the gain on sale of exploration and evaluation assets used in discontinued operations.

	Year ended December 31 2011	2010
Cash proceeds	$ -	$ 4,084,400
Decomissioning provisions	-	98,447
Working capital adjustments	-	308,768
Net book value of exploration and evaluation assets	-	(4,119,244)
Gain on sale of exploration and evaluation assets	$ -	$ 372,371

12. Segmented information

The Company's segmented information is reported by geographical area. Following the sale of its Tunisian assets in March 2010, the Company has two remaining segments, Canada (representing corporate functions) and Argentina. The segments are based on the information that is internally provided to the Chief Executive Officer, who is the Company's chief operating decision maker. No operating segments have been aggregated to form the reportable segments.

Financial information pertaining to continuing and discontinued reportable segments as at and for the years ended December 31, 2011 and 2010 is presented in the following tables:

Year ended December 31, 2011	Canada	Tunisia (discontinued)	Argentina	Total
Total assets	$ 15,628,299	$ -	$ 26,469,488	$ 42,097,787
Total liabilities	(219,280)	-	(3,076,394)	(3,295,674)
Revenue	-	-	2,598,503	2,598,503
Loss	(4,674,541)	-	(11,462,002)	(16,136,543)
Depletion and depreciation	9,956	-	443,275	453,231
Other income (expenses)	290,604	-	(138,832)	151,772
Capital expenditures	6,437	-	20,027,656	20,034,093

Year ended December 31, 2010	Canada	Tunisia (discontinued)	Argentina	Total
Total assets	$ 39,861,474	$ -	$ 19,892,754	$ 59,754,228
Total liabilities	(427,305)	-	(5,488,863)	(5,916,168)
Revenue	-	-	244,235	244,235
Income (loss)	(3,395,272)	296,677	(787,470)	(3,886,065)
Depletion and depreciation	12,500	-	53,343	65,843
Other income (expenses)	81,318	26,402	(41,847)	65,873
Capital expenditures	5,962	(286,345)	7,525,718	7,245,335

13. Supplemental cash flow information

Year ended December 31,	2011	2010
Trade and other receivables	$ 184,765	$ (904,425)
Prepaid expenses	(95,970)	(202,624)
Inventory	126,824	(186,238)
Trade and other payables	(1,916,010)	3,911,830
Change in non-cash working capital	$ (1,700,391)	$ 2,618,543
Attributable to:		
Operating activities	$ 415,212	$ (368,156)
Discontinued operations	-	(707,272)
Financing activities	(3,880)	(120,134)
Investing activities	(2,111,723)	3,814,105
	$ (1,700,391)	$ 2,618,543

14. General and administrative expenses

Year ended December 31,	2011	2010
Compensation	$ 1,244,576	$ 942,663
Office and administration	1,131,528	622,413
Professional fees	897,773	986,866
Travel	205,264	194,178
	$ 3,479,141	$ 2,746,120

Total employee benefits expenses, including share-based payments for the year ended December 31, 2011 were $4,076,684 (2010 - $2,571,104).

15. Finance income

Year ended December 31,	2011	2010
Interest income	$ 290,928	$ 108,378

16. Finance cost

Year ended December 31,	2011	2010
Accretion of asset retirement obligations	$ 56,534	$ 27,373

17. Commitments

The Company's commitment for office space and rental accommodation is as follows:

Year	Amount
2012	$ 145,000
2013	104,000
2014	46,000
2015	-

Subsequent to year end the northern 108 km^2 of the 404 km^2 Coiron Amargo Block was converted to a 25 year exploitation concession by the Province of Neuquén. In addition, the exploration period for the remainder of the Coiron Amargo Block and the Curamhuele Block was extended to November 8, 2013. The extension of the Coiron Amargo and Curamhuele blocks will require additional work commitments of US$ 51.1 million (Madalena share – US$ 29.3 million). Both exploration blocks qualify for an additional one year extension period at the end of their exploration periods in the fourth quarter of 2013.

The initial exploration period on the Cortadera Block in the Province of Neuquén expired on October 26, 2011. The joint venture has agreed a work plan with provincial authorities which will require additional work commitments and is currently working with provincial authorities to formalize the extension of the initial exploration period.

18. Financial risk and capital management

The Company is exposed to various risks that arise from its business environment and the financial instruments it holds. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework, policies and procedures. The following outlines the Company's risk exposures and explains how these risks and its capital structure are managed.

Capital management

The Company's objective is to maintain a strong capital position in order to execute on its exploration and development plans and maximize shareholder value.

The Company currently defines its capital as shareholders' equity. Changes to the relative weighting of the capital structure is driven by our business plans, changes in economic conditions and risks inherent in the oil and gas industry. In order to maintain or adjust the capital structure, the Company may consider any or all of the following activities, depending on existing economic conditions and access to external capital sources:

- Issue new shares through a public offering or private placement;
- Raise fixed or floating interest rate debt;
- Consolidate outstanding common shares; or
- Farm-out existing exploration opportunities.

The Company is not subject to any external restrictions on its capital structure and has no debt facilities.

The Company periodically reviews its capital structure in relation to its expected exploration and development budgets. As the Company is primarily in the exploration phase, certain quantitative measures used by industry peers, such as return on equity, return on capital employed and debt to equity ratios, are not relevant measures for the Company.

The Company's capital management is currently focused on completion of existing exploration commitments and providing for the Company's share of any development programs.

Credit risk

The Company is exposed to credit risk in relation to its cash and cash equivalents and trade and other receivables.

Cash and cash equivalents are held with highly rated Canadian and international banks, and therefore the Company does not believe these financial instruments are subject to material credit risk.

The Company's trade and other receivables are exposed to the risk of financial loss if the counterparty fails to meet its contractual obligations. The Company's trade and other receivables include amounts due from the sale of crude oil and from its Argentina operators which are subject to normal industry credit risk. The majority of the Company's oil production is sold to the Argentina subsidiaries of major international oil and gas companies. The carrying amounts of cash and cash equivalents and trade and other receivables represent the Company's maximum credit exposure. The Company has not recorded an allowance for doubtful accounts and has not written off any trade and other receivables in the years ended December 31, 2011 and 2010.

Liquidity risk

Liquidity risk is the risk that the Company will not meet its financial obligations as they fall due. The Company manages its liquidity risk through management of its capital structure and annual budgeting of its revenues, expenditures and cash flow. As at December 31, 2011, the Company has a working capital surplus of $14,442,910 (December 31, 2010 - $37,005,522) which together with an equity financing subsequent to year end (see note 21) and planned capital expenditures, administrative overhead requirements and commitments, is sufficient to meet all financial obligations throughout the upcoming 12 months.

Market risk

Changes in commodity prices, interest rates and foreign currency exchange rates can expose the Company to fluctuations in its net earnings and in the fair value of its financial assets and liabilities.

Commodity price risk

Price fluctuations for both crude oil and natural gas are determined by world supply and demand factors. The Company has no influence over the pricing of oil and natural gas and has not attempted to mitigate commodity price risk through the use of financial derivatives. Currently all of the Company's oil and gas revenue is from an oil property in Argentina. Oil prices in Argentina are subject to domestic market discounts which result in prices significantly below benchmark prices.

Interest rate risk

The Company is exposed to interest rate fluctuations on its investments of excess cash in short-term money market investments held with international banks.

Foreign currency exchange rate risk

Substantially all of the Company's exploration and development activities are conducted in foreign jurisdictions and a portion of the Company's cash and cash equivalents are denominated in US dollars (USD) and Argentina Pesos (ARS). Consequently, the Company is exposed to foreign currency exchange risk on a substantial portion of its financial assets. The Company has not entered into derivative exchange rate contracts to mitigate this risk.

The following table provides information on the foreign currency denominated working capital balances of the Company at December 31, 2011:

	Balance denominated in USD	ARS	Total CAD equivalent
Cash and cash equivalents	30,546	4,376,035	$ 971,037
Trade and other receivables	198,107	2,143,338	661,864
Prepaid expenses	-	832,361	178,791
Inventory	-	199,611	42,876
Trade and other payables	2,065,601	3,323,125	$ 2,814,523

Fair value of financial instruments

The Company's financial instruments include cash and cash equivalents, trade and other receivables and trade and other payables, the carrying values of which approximate their fair values due to their short-term nature. The Company has no bank indebtedness.

19. Related party transactions

These consolidated financial statements incorporate the financial statements of the Company and the subsidiaries listed in the following table:

	% of Ownership	Jurisdiction
Madalena Austral S.A.	100%	Argentina
Madalena Ventures International Holding Company Inc.	100%	Barbados
Madalena Ventures International Inc.	100%	Barbados

Transactions between the Company's subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. During the year ended December 31, 2011, the Company incurred fees of $20,304 (2010 - $132,161) payable to a law firm in which a director of the Company is a partner.

The personnel expenses of key management personnel, including directors, were as follows:

	Year ended December 31, 2011	2010
Salaries and other short-term benefits	$ 846,533	$ 785,493
Share-based payments	2,496,228	1,560,867
Total remuneration	$ 3,342,761	$ 2,346,360

20. Transition to IFRS

As stated in Note 2, these are the Company's first annual consolidated financial statements prepared in accordance with IFRS. The impact that the transition from Previous GAAP to IFRS has had on the Company's financial position, financial performance and cash flows is set out in this note.

The significant accounting policies described in Note 3 have been applied in the preparation of these financial statements for the years ended December 31, 2011 and 2010 and as at January 1, 2010, except where certain IFRS 1 exemptions have been applied as described below.

IFRS 1 *First-Time Adoption of International Financial Reporting Standards* ("IFRS 1")

IFRS 1 contains specific transitional guidance for first-time adopters of IFRS and is applied when an entity prepares its first financial statements under IFRS. In general, IFRS 1 requires a first-time adopter to apply all IFRSs retrospectively; however under IFRS 1 there are optional exemptions from some requirements of other IFRSs.

The IFRS 1 exemptions that Madalena applied to its opening IFRS balance sheet as at January 1, 2010 were as follows:

Optional Exemption	**Result of application**
Business combinations	The Company did not retrospectively apply IFRS 3 *Business Combinations* to its accounting for business combinations prior to the transition date.
Share-based payments	The Company did not apply IFRS 2 *Share-Based Payments* to its fully vested stock options outstanding as at the transition date.
Deemed cost – Full cost book value as deemed cost for oil and gas properties	The Company measured exploration and evaluation assets on transition date at the amount determined under Canadian GAAP.
Decommissioning provision included in the cost of property, plant and equipment	Madalena measured asset retirement obligations ("ARO") in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and recognized directly into retained earnings the difference between that amount and the carrying amount of ARO under Canadian GAAP.
Cumulative translation differences	The Company set cumulative translation differences for its foreign operations to zero at transition.

IFRS 1 also requires that an entity's estimates under IFRS at the date of transition be consistent with estimates made under Canadian GAAP for the same date, unless there is objective evidence that those estimates were made in error. The Company's IFRS estimates at January 1, 2010 were consistent with the estimates made under Canadian GAAP for that same date.

Reconciliations from Canadian GAAP to IFRS

An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's consolidated balance sheet, statements of loss and comprehensive loss as at and for the comparative periods is set out in the following reconciliations and in the notes that accompany the reconciliations. Certain amounts on the balance sheet and statements of loss and comprehensive loss have been reclassified to conform to the presentation adopted under IFRS.

Reconciliation of Assets, Liabilities and Equity		As at January 1, 2010			As at December 31, 2010		
	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS	Canadian GAAP	Effect of Transition to IFRS	IFRS
Assets							
Current assets							
Cash and cash equivalents		$ 10,131,040	$ -	$ 10,131,040	$ 40,719,947	$ -	$ 40,719,947
Trade and other receivables		187,193	-	187,193	1,033,938	-	1,033,938
Prepaid expenses		154,972	-	154,972	333,688	-	333,688
Inventory		-	-	-	259,970	(28,219)	231,751
		10,473,205	-	10,473,205	42,347,543	(28,219)	42,319,324
Non-current assets							
Property and equipment	a	17,224,696	(17,111,719)	112,977	20,756,519	(16,151,062)	4,605,457
Exploration and evaluation assets	a	-	15,140,809	15,140,809	-	12,829,447	12,829,447
		17,224,696	(1,970,910)	15,253,786	20,756,519	(3,321,615)	17,434,904
		$ 27,697,901	$ (1,970,910)	$ 25,726,991	$ 63,104,062	$ (3,349,834)	$ 59,754,228
Liabilities							
Current liabilities							
Trade and other payables		$ 1,601,212	$ -	$ 1,601,212	$ 5,313,802	$ -	$ 5,313,802
Decommissioning provisions	b	355,338	(98,698)	256,640	582,429	19,937	602,366
		1,956,550	(98,698)	1,857,852	5,896,231	19,937	5,916,168
Shareholders' equity							
Share capital		38,345,561	-	38,345,561	75,400,705	2,418	75,403,123
Warrants		2,380,678	-	2,380,678	-	-	-
Contributed surplus	c	7,005,506	86,895	7,092,401	7,836,272	96,333	7,932,605
Accumulated other comprehensive loss	d	-	-	-	-	(1,662,102)	(1,662,102)
Deficit		(21,990,394)	(1,959,107)	(23,949,501)	(26,029,146)	(1,806,420)	(27,835,566)
		25,741,351	(1,872,212)	23,869,139	57,207,831	(3,369,771)	53,838,060
		$ 27,697,901	$ (1,970,910)	$ 25,726,991	$ 63,104,062	$ (3,349,834)	$ 59,754,228

Reconciliation of Loss and Comprehensive Loss		Year Ended December 31, 2010		
	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
Revenue				
Oil and gas		$ 241,381	$ 2,854	$ 244,235
Royalties		(42,686)	(187)	(42,873)
		198,695	2,667	201,362
Expenses				
Operating		93,887	230	94,117
General and administrative		2,761,870	(15,750)	2,746,120
Share-based payments	c	1,533,515	94,926	1,628,441
Depletion and depreciation	e	83,091	(17,248)	65,843
		4,472,363	62,158	4,534,521
Operating loss		(4,273,668)	(59,491)	(4,333,159)
Other income (expenses)				
Interest and other income		108,378	-	108,378
Foreign exchange gain (loss)	d	(181,065)	165,933	(15,132)
Finance cost	b	(43,140)	15,767	(27,373)
		(115,827)	181,700	65,873
Loss from continuing operations before tax		(4,389,495)	122,209	(4,267,286)
Current income tax expense		(30,777)	-	(30,777)
Loss from continuing operations		(4,420,272)	122,209	(4,298,063)
Income from discontinued operations		381,520	30,478	411,998
Net loss for the year		(4,038,752)	152,687	(3,886,065)
Exchange differences on translation of foreign operations	d	-	(1,662,102)	(1,662,102)
Total comprehensive loss for the year		$ (4,038,752)	$ (1,509,415)	$ (5,548,167)

Notes to the Reconciliations:

a) Oil and gas assets

Under Canadian GAAP, the Company followed the full cost method of accounting for oil and gas properties whereby all costs associated with the exploration for and the development of oil and gas reserves were capitalized in country-based cost centers. Under IFRS, pre-exploration costs are recognized in net income (loss) as incurred. Costs incurred after the legal right to explore has been obtained and before technical feasibility and commercial viability have been determined are capitalized as E&E assets. Once an exploration area has been deemed to be technically feasible and commercially viable, E&E costs are reclassified to development and production (“D&P”) assets, a separate category of property and equipment.

At transition to IFRS, in accordance with IFRS 1 full cost exemption, Madalena measured its E&E assets at the amount determined under Canadian GAAP. As Madalena had no oil and gas assets in the D&P phase at January 1, 2010, the full Canadian GAAP PP&E balance related to oil and gas properties was allocated to E&E. As a result of the change in functional currency of its foreign operations (see note d below), Madalena recorded a decrease in the net book value of its E&E assets.

As at	January 1, 2010
E&E assets, amount determined under Canadian GAAP	$17,111,719
Impact of change in functional currency	(1,970,910)
E&E assets, net book value	$15,140,809

b) Decommissioning provisions

Under Canadian GAAP, decommissioning obligations were discounted using a Canadian dollar credit-adjusted risk-free rate. IFRS does not specify what type of rate to employ, but it does require that an entity risk-adjust either its rate or its estimated cash flows, but not both. The Company risk-adjusts its cash flows and uses a risk-free rate to discount its decommissioning obligations under IFRS.

Under Canadian GAAP, upward revisions in the amount of undiscounted estimated cash flows were discounted using the current discount rate. Downward revisions in the amount of undiscounted estimated cash flows were discounted using the discount rate that existed when the original liability was recognized. Under IFRS, current discount rates are always used and must be reviewed each reporting period and changes reflected in the liabilities. This has resulted in increased volatility in Madalena's decommissioning provision and related accretion in 2010.

From a financial statement presentation perspective, under IFRS the unwinding of discounted decommissioning liabilities is recognized in profit or loss as finance cost, as opposed to accretion expense as it was under Canadian GAAP.

On transition to IFRS, Madalena elected to utilize the IFRS 1 exemption related to decommissioning provisions and measured the obligation as at January 1, 2010 in accordance with IAS 37. The Company recognized directly into retained earnings the difference between that amount and the carrying amount of ARO under Canadian GAAP. As a result of the change in discount rates and change in functional currency of its foreign operations (see note d below), Madalena recorded a decrease in the decommissioning provision liability of $98,698 at transition to IFRS.

As at December 31, 2010, IFRS transition differences resulted in an increase in decommissioning liabilities of $19,937.

A reconciliation of the Company's decommissioning obligation as at December 31, 2010 from Canadian GAAP to IFRS is as follows:

	Canadian GAAP	Effect of Transition to IFRS	IFRS
Balance, January 1, 2010	$ 355,338	$ (98,698)	$ 256,640
Additions	193,000	81,230	274,230
Revisions in interest rates	-	80,099	80,099
Revisions in estimates	41,918	58,998	100,916
Accretion	43,141	(15,768)	27,373
Reversed on disposition	(50,968)	(45,178)	(96,146)
Effect of movement in foreign exchange rates	-	(40,746)	(40,746)
Balance, December 31, 2010	$ 582,429	$ 19,937	$ 602,366

c) Share-based payments

Under Canadian GAAP, the Company's equity-settled share-based payments ("SBP") were measured at fair value at grant date, with the fair value being charged to income on a straight-line basis over the vesting period and a corresponding increase recorded in contributed surplus. Forfeitures were accounted for as they occurred. Under IFRS, the Company is required to utilize the concept of graded vesting in its expense recognition, which results in the majority of the SBP expense being recognized up-front. IFRS also requires that the Company estimate its forfeitures up front and revise the estimate as new information becomes available.

Under Canadian GAAP, the fair value of stock options issued to non-employees was re-measured at each reporting date and changes to the fair value were amortized over the remaining vesting period of the options. Under IFRS, the Company treats options issued to its consultants in the same manner as options issued to its employees.

Upon transition to IFRS, Madalena elected to utilize the IFRS 1 Share-based payment transactions exemption. As a result, the Company only applied IFRS 2 to its stock options that were not fully vested at January 1, 2010. The impact at the transition date of the changes in expense recognition method, forfeiture estimates and treatment of options issued to non-employees was an increase in SBP expense (deficit) of $86,895.

For the year ended December 31, 2010, IFRS transition differences resulted in an increase in SBP expense of $94,926.

d) Functional currency and foreign currency translation

Under Canadian GAAP, the basis of measurement for foreign operations is dependent upon whether an operation is classified as integrated or self-sustaining. The measurement currency of integrated subsidiaries is the same currency as the parent and the measurement currency of a self-sustaining subsidiary is the foreign currency. Under IFRS, the concepts of integrated and self-sustaining subsidiaries are not included. Instead, the functional currency of each individual entity must be determined.

IAS 21 requires management to give priority to certain primary factors in determining functional currency before considering secondary factors; whereas under Canadian GAAP the factors for determining whether an operation is integrated or self-sustaining are not weighted. The weighting under IFRS often results in an entity reaching a different conclusion on functional currency for its foreign operations even though the IFRS factors are similar to those under Canadian GAAP.

Under Canadian GAAP, Madalena concluded that the functional currency of its foreign operations was the Canadian dollar. As a result of differences in the guidance for functional currency determination, the Company concluded that under IFRS the functional currency of its foreign subsidiaries is their respective local currencies:

Entity	Functional Currency under IFRS
Madalena Ventures Inc.	Canadian dollars (CAD)
Madalena Ventures International Holding Company Inc.	United States dollars (USD)
Madalena Ventures International Inc.	United States dollars (USD)
Madalena Austral SA	Argentine pesos (ARS)

In accordance with IFRS, foreign currency transactions are translated into the respective functional currencies of Madalena and its subsidiaries using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit and loss.

Under IFRS Madalena continues to present its consolidated financial statements in CAD. The Company translates the results and financial position of each of its subsidiaries from their functional currencies into CAD as follows:

i assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

ii. income and expenses for each year are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
iii. all resulting exchange differences are recognized in a separate component of equity called 'accumulated other comprehensive income'.

The resulting translation gains and losses are recognized in other comprehensive income ("OCI") and shown as accumulated other comprehensive income ("AOCI") on the balance sheet. As a consequence of this change, gains and losses related to the translation of the financial statements of these subsidiaries are recorded through other comprehensive income and do not impact net income until a disposal or partial disposal of a foreign operation occurs. Madalena did not recognize such gains and losses under Canadian GAAP because the measurement and presentation currencies of Madalena's entities were all CAD.

On transition to IFRS, Madalena elected to utilize the IFRS 1 cumulative translation differences exemption, which allowed Madalena's cumulative translation differences of $1,964,125 arising from the retrospective application of the change in the functional currencies of Madalena's foreign operations at January 1, 2010 to be reclassified to deficit.

For the year ended December 31, 2010, IFRS transition differences resulted in an exchange loss on translation of foreign operations of $1,662,102.

e) Depletion

Upon transition to IFRS, the Company adopted a policy of depleting the componentized net book values of producing assets using the unit of production method with reference to the ratio of production in the year to the related proved and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Depletion under Canadian GAAP was calculated with reference to proved reserves whereby costs accumulated in each country cost center together with an estimate of future costs to develop proved reserves were depleted using the unit of production method.

There was no impact of this difference on adoption of IFRS at January 1, 2010 as the Company had no producing assets. In the fourth quarter of 2010, the Coiron Amargo block in Argentina was deemed by management to be technically feasible and commercially viable and costs attributed to the block were transferred from E&E assets to D&P assets, a separate category within property, plant and equipment. Depletion was calculated on the Coiron Amargo asset beginning in the fourth quarter of 2010.

For the year ended December 31, 2010, IFRS transition differences resulted in a decrease in depletion expense of $17,248.

<u>Adjustments to the Statements of Cash Flow</u>

The effect of the transition to IFRS on the Company's cash flows primarily relates to the change in functional currency of the Company's foreign operations. The effect of the transition on the Company's cash flows is summarized as follows:

Year ended December 31,	2010
Operating activities:	
Funds used in operations	164,295
Change in non-cash working capital	(68,510)
Cash flow provided by operations	95,785
Cash flow provided by discontinued operations	9,720
Cash flow provided by (used in) investing activities	41,763
Impact of foreign exchange on cash balances	(147,268)
Net effect on cash flow	-

The transition to IFRS had no effect on cash flows from financing activities.

21. Subsequent Event

In March 2012, the Company completed a public offering of 54,000,000 common shares at an issue price of $1.25 per share for gross proceeds to Madalena of $67,500,000.