Caspian Energy Inc.

Consolidated Financial Statements
December 31, 2008 and 2007

PRICEWATERHOUSECOOPERS

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Auditors' Report

To the Shareholders of
Caspian Energy Inc.

We have audited the consolidated balance sheets of **Caspian Energy Inc.** (the "Company") as at December 31, 2008 and 2007 and the consolidated statements of income (loss), comprehensive income (loss) and deficit and cash flows for the each of the years in the two year period ended December 31, 2008. These consolidated 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 present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2008 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Caspian Energy Inc.

Consolidated Balance Sheets

As at December 31, 2008 and 2007

	2008 $	2007 $
Assets		
Current assets		
Cash and cash equivalents	6,423,922	4,373,919
Accounts receivable	11,142	935,773
Prepaids and other deposits	266,419	2,310,302
Inventory (note 3)	605,863	454,302
	7,307,346	8,074,296
VAT receivable (note 2)	406,519	-
Restricted cash (note 5)	404,681	253,132
Property, plant and equipment (note 4)	119,757,178	124,795,793
	127,875,724	133,123,221
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	7,120,361	3,458,427
Asset retirement obligation (note 5)	291,545	252,279
Loan payable (note 6)	4,339,485	6,947,055
Future income taxes (note 8)	-	967,400
Convertible debentures (note 7)	23,531,717	17,669,238
	35,283,108	29,294,399
Shareholders' Equity		
Share capital (note 9)	126,338,341	121,470,892
Warrants to purchase common shares (note 9)	-	946,508
Contributed surplus (note 11)	15,311,590	14,467,311
Deficit	(49,057,315)	(33,055,889)
	92,592,616	103,828,822
	127,875,724	133,123,221

Going concern (note 1)

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors

(signed) "Gord Harris" Director (signed) "William Ramsay" Director

Caspian Energy Inc.

Consolidated Statements of Income (Loss), Comprehensive Income (Loss) and Deficit

For the years ended December 31, 2008 and 2007

	2008 $	2007 $
Revenue		
Oil and gas revenue, net	9,183,212	6,269,118
Interest	95,067	282,139
Other	62,280	15,614
	9,340,559	6,566,871
Expenses		
General and administrative	6,256,580	3,584,285
Accretion of convertible debentures (note 7)	363,044	393,312
Interest (note 7)	2,123,331	1,777,641
Operating	3,197,008	2,163,997
Transportation	1,944,230	487,257
Stock-based compensation (notes 10 and 11)	844,279	2,437,039
Foreign exchange loss	4,426,520	5,780,432
Depletion, depreciation and accretion	7,002,673	2,411,418
	26,157,665	19,035,381
Income (Loss) before income taxes	(16,817,106)	(12,468,510)
Future income taxes (recovery) expense	(815,680)	740,178
Net income (loss) and comprehensive income (loss) for the year	(16,001,426)	(13,208,688)
Deficit – Beginning of year	(33,055,889)	(19,847,201)
Deficit – End of year	(49,057,315)	(33,055,889)
Basic and diluted income (loss) per share (note 9)	(0.14)	(0.13)

Going concern (note 1)

See accompanying notes to consolidated financial statements.

Caspian Energy Inc.

Consolidated Statements of Cash Flows

For the years ended December 31, 2008 and 2007

	2008 $	2007 $
Cash provided by (used in)		
Operating activities		
Net income (loss) and comprehensive income (loss) for the year	(16,001,426)	(13,208,688)
Items not affecting cash		
Stock-based compensation	844,279	2,437,039
Unrealized foreign exchange loss (gain)	4,223,892	(3,113,236)
Depletion, depreciation and accretion	7,002,673	2,411,418
Interest on convertible debentures	1,202,244	1,777,641
Accretion of convertible debentures	363,044	393,312
Future income taxes (recovery) expense	(815,680)	740,178
	(3,180,974)	(8,562,336)
Changes in non-cash working capital balances	3,207,417	(262,893)
	26,443	(8,825,229)
Financing activities		
Loan payable	(2,607,570)	6,947,055
Issuance of common shares and warrants	4,347,635	-
Share issue expenses	(426,694)	-
	1,313,371	13,835,390
Investing activities		
Acquisition of property, plant and equipment	(2,003,324)	(8,991,257)
Increase in VAT receivable	(406,519)	-
Increase in restricted cash	(151,549)	-
Changes in non-cash working capital balances	3,271,581	(1,720,215)
	710,189	(1,720,215)
Increase (decrease) in cash and cash equivalents	2,050,003	(10,545,444)
Cash and cash equivalents – Beginning of year*	4,373,919	17,022,285
Cash and cash equivalents – End of year*	6,423,922	6,476,841
Interest received	95,067	385,076

*Cash and cash equivalents consist of cash and short term investments with a maturity date of less than three months.

See accompanying notes to consolidated financial statements.

1 Nature of operations and going concern

Caspian Energy Inc. ("Caspian" or the "Company") is engaged in the exploration for and development and production of oil and gas in the Republic of Kazakhstan. Its primary operating activities are carried out through its wholly-owned subsidiary, Caspian Energy Ltd. ("Caspian Ltd.").

Caspian's principal assets are a 50% interest in Aral Petroleum Capital LLP ("Aral"), held by Caspian Ltd. Through its interest in Aral, Caspian has the right to explore and develop certain oil and gas properties in Kazakhstan, known as the North Block, a 3,458 square kilometre area located in the vicinity of the Kazakh pre-Caspian basin. The Company also has minor resource interests in Canada.

Aral's exploration and development rights to the North Block were granted pursuant to the terms of an exploration contract between the government of Kazakhstan and Aral (the "Exploration Contract"). The initial three-year term of the Exploration Contract was extended for a two-year period (expiring in December 2007) and a further extension of two years to December 31, 2009 with a minimum work commitment of US $19.1 million has now been placed into effect.

Under the terms of the Exploration Contract, Aral was obligated to spend at least US $20.8 million under a minimum work program in respect of the North Block during the initial three-year term of the contract. The expenditures include processing and reinterpretation of geological and geophysical data of prior years, two dimensional and three dimensional seismic shoots and surveys, drilling exploration wells, well reactivations and well surveys and testing. The minimum work program matured at the end of calendar 2005. As of December 31, 2005, Aral's financial obligation under the minimum work program had been discharged. The work program extension to December 2008 included drilling three wells to a combined total of 8,500 metres with a monetary obligation of US $20.15 million. At December 31, 2007, Aral had contract shortfalls aggregating US $7.1 million. Management of Aral believes the Company is in compliance with its commitments under the Minimum Working Program and received authorization from the Ministry of Energy and Natural Resources and other competent bodies to carry over fulfillment of the above shortfalls to the year ending December 31, 2008. At December 31, 2008, Aral had discharged these obligations.

Under terms of a shareholders' agreement dated June 25, 2004, among Caspian Ltd., Azden Management Limited ("Azden") and Aral, Caspian was committed to fund Aral's US $20.8 million obligation under the initial work program. This financial commitment was satisfied, in full, by the Company. In addition, Caspian Ltd. has undertaken, on a best efforts basis, to raise financing of US $84.0 million to fund Aral's operations pursuant to the Exploration Contract. At March 31, 2007, Caspian Ltd. had discharged this undertaking.

Going concern

These financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles applicable to a going concern. The Company reported a net loss of $16,001,426 and funds generated from operating activities of ($3,180,974) for the year ended December 31, 2008. The Company had net working capital of $186,985 and a cumulative deficit equal to $49,057,315 at year end.

Note 1 – Nature of operations and going concern (continued)

On March 1, 2006, the Company received US $16 million and issued 10% per annum, convertible debentures in that amount secured with Caspian Ltd. Shares. The debentures mature on March 2, 2011 and are convertible into common shares of the Company at a conversion price of $2.45 per share. The Company is required to pay interest on the principal plus any accrued, but unpaid, interest amount outstanding on a quarterly basis. Each debentures holder is entitled to receive current interest in cash, if the Company is formally notified of this circumstance within ten business days of the quarter end and the Company is obligated to pay the applicable interest within five days from quarter end. During this fiscal year, certain debentures holders requested and were paid two cash interest payments of US $357,260 pertaining to each of the first and second quarters and US $129,661 pertaining to the fourth quarter. Certain debentures holders have requested that interest totalling US $129,661 be paid in cash pertaining to the first calendar quarter of 2009. To date, this payment has not been made. Due to the Company's limited financial resources, management has undertaken to meet with each of the debentures holders to negotiate settlement of the interest obligation through avenues other than cash payment. If management does not reach an agreeable alternative to the cash payment and fails to make that payment within the stipulated time frame, an event of default occurs pursuant to the debentures contract. If the delinquency is not remedied within 30 days of the default, the debentures holders then may formally notify the Company of such circumstance and demand payment of the delinquent interest to be made within ten business days. Failing payment by the Company, the debentures holders may demand that their principal and accrued interest be immediately paid and appoint a private Receiver to accomplish such objective. If the private receiver wishes to dispose of the property in the Republic of Kazakhstan, ministerial assent is required.

If all debentures holders demand that cash interest payments be made beginning with the second quarter of 2009 and assuming the first quarter cash request was discharged, and Caspian complies, the Company would have a cash deficit of approximately US $90,000 occurring in October 2009.

In accordance with the shareholders' agreement in respect of Aral, Caspian is obligated to jointly fund the minimum work program of Aral pursuant to the Exploration Contract.

During the third quarter of 2008, the minimum work program was extended to December 2009 and contains a 2009 exploration commitment which aggregates US $10.5 million. Currently, Caspian does not have the cash resources to discharge its 50% share of this commitment, but is pursuing a farmout of the North Block, which may result in an up-front cash payment plus an undertaking of the exploration and development obligations of the Company by the farmor to earn a portion of Caspian's interest in the Block.

The Company's ability to continue as a going concern is in significant doubt and is dependent upon a successful outcome to the negotiations taking place with the debentures holders and a positive conclusion to its farmout activities and to achieving profitable operating results from its Kazakhstan operations..

The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence. Such adjustments could be material.

2 Significant accounting policies

The consolidated financial statements of Caspian are stated in Canadian dollars and have been prepared in accordance with Canadian GAAP.

Note 2 - Significant accounting policies (continued)

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash and short-term investments with an initial maturity date of three months or less.

Inventory

Inventory is recorded at the lower of cost calculated using the weighted average method, and net realizable value. Cost comprises direct materials and where applicable direct labour costs and those overheads which have been incurred in bringing the inventories to their present location and condition. Net realizable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Joint ventures

The Company's oil and gas exploration and development activities are conducted mainly in Kazakhstan through its 50% interest in Aral and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

VAT receivable

As of December 31, 2008, Aral did not currently expect to claim VAT and thus classified it as falling due after more than one year. As of December 31, 2007, the Company had assessed it could have claimed VAT recoverable during the ensuing twelve months, since test oil production was expected to increase in 2008; accordingly VAT reclaimable was classified as current and included in prepaid and other assets.

Property, plant and equipment

a) Capitalized costs

The Company follows the full cost method of accounting for oil and natural gas operations, whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are

Note 2 - Significant accounting policies (continued)

capitalized. Such costs include lease acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, the cost of petroleum and natural gas production equipment and overhead charges directly related to exploration and development activities. Proceeds from the sale of oil and gas properties are applied against capital costs, with no gain or loss recognized, unless such a sale would change the rate of depletion and depreciation by 20% or more, in which case, a gain or loss would be recorded.

b) Depletion, depreciation and amortization

The capitalized costs are depleted and depreciated using the unit-of-production method based on proven petroleum and natural gas reserves, as determined by independent consulting engineers. Oil and natural gas liquids reserves and production are converted into equivalent units of natural gas based on relative energy content on a ratio of six thousand cubic feet of gas to one barrel of oil. Significant development projects and expenditures on exploration properties are excluded from calculation of depletion prior to assessment of the existence of proved reserves.

Other property, machinery and equipment are recorded at historical cost. Depreciation is calculated on a straight-line basis at the following annual rates:

Buildings	8%
Machinery and equipment	8%
Vehicles	7%
Other fixed assets	10%

c) Ceiling test

The Company follows the Canadian accounting guideline on full cost accounting. In applying the full cost guideline, Caspian calculates its ceiling test for each cost centre by comparing the carrying value of oil and natural gas properties and production equipment to the sum of undiscounted cash flows expected to result from Caspian's proved reserves. If the carrying value is not fully recoverable, the amount of impairment is measured by comparing the carrying value of oil and gas properties and production and equipment to the estimated net present value of future cash flows from proved plus probable reserves using a risk-free interest rate and expected future prices. Any excess carrying value above the net present value of the future cash flows is recorded as a permanent impairment.

d) Unproved property

Costs of acquiring and evaluating unproven properties are initially excluded from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are determined or the property is considered to be impaired, the

Note 2 - Significant accounting policies (continued)

cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost centre.

e) Asset retirement obligation

Caspian records the fair value of asset retirement obligations ("ARO") as a liability in the period in which it incurs a legal obligation to restore an oil and gas property, typically when a well is drilled or other equipment is put in place. The associated asset retirement costs are capitalized as part of the carrying amount of the related asset and depleted using a unit-of-production method over the life of the proved reserves. Subsequent to initial measurement of the obligations, the obligations are adjusted at the end of each reporting period to reflect the passage of time and changes in estimated future cash flows underlying the obligation. Actual costs incurred on settlement of the ARO are charged against the ARO.

Income taxes

Income taxes are calculated using the liability method of tax accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying value amount on the balance sheet are used to calculate future income tax assets and liabilities. Future income tax assets and liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

Stock-based compensation

The Company grants options to purchase common shares to employees and directors under its stock option plan. Under this standard, future awards are accounted for using the fair value of accounting for stock-based compensation. Under the fair value method, an estimate of the value of the option is determined at the time of grant using a Black-Scholes option-pricing model. The fair value of the option is recognized as an expense and contributed surplus over the vesting period of the option. Proceeds received on exercise of stock options, along with amounts previously included in contributed surplus, are credited to share capital.

Revenue recognition

Revenue from the sale of oil and natural gas is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation, and production-based royalty expenses will be recognized in the same period in which the related revenue is earned and recorded.

Measurement uncertainty

The amounts recorded for depletion and depreciation of property, plant and equipment, the provision for asset retirement obligations and the amounts used for ceiling test calculations are based on estimates of reserves and future costs. The Company's reserve estimates are reviewed annually by an independent engineering firm. The amounts disclosed relating to fair values of stock options issued are based on estimates of future volatility of

Note 2 - Significant accounting policies (continued)

the Company's share price, expected lives of options, and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty.

Loss per share

Basic per share amounts are calculated using the weighted average number of shares outstanding during the period. Diluted per share amounts are calculated based on the treasury stock method whereby the weighted average number of shares is adjusted for the dilutive effect of options. The Company applies the treasury stock method for the calculation of diluted net loss per share whereby the effect of the "in the money" instruments such as stock options and warrants affect the calculation. The treasury stock method assumes that the proceeds from the exercise are used to repurchase common shares of the Company at the weighted average market price during the year.

Financial instruments

Fair values

The fair values of cash and cash equivalents, restricted cash, deposits, accounts receivable, accounts payable and accrued liabilities, convertible debentures, loan payable and stock based compensation approximate their carrying values due to their short-term maturity.

Credit risk

Substantially all of the Company's accounts receivable are due from companies in the oil and gas industry and are subject to the normal industry credit risks. The carrying value of accounts receivable reflects management's assessment of the associated credit risks.

Foreign currency

All operations are considered financially and operationally integrated. Results of operations are translated to Canadian dollars, using average rates for revenues and expenses, except depreciation which is translated at the rate of exchange applicable to the related assets. Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Foreign exchange gains and losses are recorded in the statement of loss.

Adoption of new accounting policies

The CICA issued three new accounting standards: Section 1535, Capital Disclosures, Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation. These new standards are effective for fiscal years beginning on or after October 1, 2007 and the Company adopted them on January 1, 2008.

Note 2 – Significant accounting policies (continued)

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose is to enable the users of the financial statements to evaluate the entity's objectives, policies and processes for management capital. The only effects of adopting this standard are discloses of the Company's capital and how it is managed as included in note 14.

Sections 3862 and 3863 replaces Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The additional disclosures required under these standards are included in note 13.

Section 1400 – General Standards of Financial Statement Presentation, which is effective for interim periods beginning on or after January 1, 2008 has been amended to include requirements to assess and disclose the Company's ability to continue as a going concern. The adoption of this new section is reflected in note 1 to the financial statements.

Future accounting changes

The CICA, in February 2008, issued CICA Handbook Section 3064 – Goodwill and Intangible Assets which will be adopted on January 1, 2009 and replaces Section 3062 – Goodwill and Other Intangible Assets and Section 3450 – Research and Development Costs. This section clarifies the criteria for recognition of assets, intangible assets and internally developed intangible assets. Items that no longer meet the definition of an asset are no longer recognized with assets. 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 financial statements but does not expect that the adoption of this new Section will have a material impact on its financial statements.

The Accounting Standards Board has confirmed the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS"). Caspian will be required to adopt IFRS for the year beginning January 1, 2011. The application of IFRS in Canada and particularly to the oil and gas industry requires further clarification and as a result the effect of the IFRS adoption on the Company's accounting policies and reporting standards and practices has not yet been determined.

3 Inventory

	2008 $	2007 $
Oil inventory	497,967	187,300
Fuel	7,607	25,748
Construction materials	3,145	2,742
Spare parts	5,688	5,004
Other materials	91,456	233,508
	605,863	454,302

4 Property, plant and equipment

	2008 $	2007 $
Petroleum and natural gas assets	128,586,585	126,806,121
Other assets	3,306,522	3,122,928
	131,893,107	129,929,049
Accumulated depletion and depreciation	(12,135,929)	(5,133,256)
	119,757,178	124,795,793

Excluded from the depletable base of oil and gas assets at December 31, 2008 are unproved properties of $78,061,478 (2007 – $72,049,847).

The Company applied the ceiling test to its capitalized assets at December 31, 2008 and 2007 and determined that there was no impairment of such carrying costs.

	WTI Crude oil price $US/bbl
2009	60.00
2010	71.40
2011	83.20
2012	90.20
2013	97.40

The prices increase by 2% for years thereafter.

During the year ended December 31, 2008, the Company capitalized $307,823 (2007 – $269,548) of general and administrative expenses related directly to exploration and development activities.

5 Asset retirement obligation

The Company records the fair value of asset retirement obligations as a liability in the period in which it incurs the legal obligation.

The asset retirement obligation results from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at December 31, 2008 is $314,297, which will be incurred between 2014 and 2019. A credit-adjusted risk-free rate of 16.5% was used to calculate the fair value of the asset retirement obligations, and an inflation factor of 19.0%.

Note 5 – Asset retirement obligation (continued)

A reconciliation of the asset retirement obligation is provided below:

	2008 $	2007 $
Opening balance	252,279	156,255
Liabilities incurred	-	94,490
Accretion	39,266	19,574
Change in estimate	-	(18,040)
Closing balance	291,545	252,279

Under the terms of the Exploration Contract (note 1), the Company is required to create a fund to finance actual future restoration costs, equal to 1% of the capital costs of exploration. At December 31, 2008 and 2007, $404,681 and $253,132, respectively have been placed in a restricted bank account related to the funding requirement.

6 Loan payable

Pursuant to the Participants Agreement By and Among Azden Management Limited and Caspian Energy Ltd. and Aral Petroleum Capital Limited Liability Partnership, subsequent to reaching the US $84 million threshold on advances by Caspian to Aral, Caspian and Azden shall jointly finance, in equal proportions, the next stages of exploration by Aral. As at December 31, 2008, $8,678,972 had been advanced by Azden to Aral and is recorded as a loan payable in Aral's accounts. Caspian's proportionate share of this liability is $4,339,485.

7 Convertible debentures

On March 1, 2006, the Company received US $16 million and issued 10% per annum, convertible debentures in a like amount secured with Caspian Ltd. shares. The debentures mature on March 2, 2011 and are convertible at any time and from time to time into common shares of the Company at a conversion price of $2.45 per share. The Company may repay the principal amount of the debentures, in whole or in part, or require conversion into common shares of the Company if the volume-weighted average trading price of the common shares, for 40 consecutive trading days, is at least $4.08.

	Face amount $	Fair value of conversion option $	Accretion $	Interest $	Carrying value $
Debentures issued, opening balance	15,712,000	(1,483,805)	674,480	2,766,563	17,669,238
Accretion of discount	-	-	363,044	-	363,044
Translation adjustment	4,887,272	-	-	(590,081)	4,297,191
Interest accrual	-	-	-	1,202,244	1,202,244
Balance – December 31, 2008	20,599,272	(1,483,805)	1,037,524	3,378,726	23,531,717

8 Future income taxes

Future income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The Company has provided for certain taxes based upon statutory regulations of Kazakhstan. The Company is subject to permanent tax differences due to the fact that certain expenses are not deductible for income tax purposes under Kazakh laws.

The provision for taxes differs from that computed using the combined Canadian federal and provincial statutory rate as follows:

	2008 **$**	**2007** **$**
Loss before income taxes	(16,817,106)	(12,468,510)
Expected recovery at statutory tax rate of 30% (2007 – 32.10%)	(5,045,132)	(4,002,392)
Losses for which no benefit is being recognized	3,172,879	3,929,165
Non-deductible stock-based compensation	253,284	782,290
Non-deductible expenses	(277,321)	(230,724)
Change in corporate tax rate	1,080,610	261,839
Future income taxes	(815,680)	740,178

The tax effects on major temporary differences that give rise to the future tax liability are as follows:

	2008 **$**	**2007** **$**
Future tax asset (liability)		
Tax losses available for carry forward	356,191	307,790
Other	94,271	47,244
Difference in the tax bases and carrying values of property, plant and equipment	674,222	(1,322,434)
	1,124,684	(967,400)
Valuation allowance due to uncertainty of future profits	(1,124,684)	-
Net future tax asset (liability)	-	(967,400)

9 Share capital

Authorized

Unlimited number of voting common shares, without stated par value

Issued

	Number of shares	Amount $
Issued and outstanding as at December 31, 2007 and 2006	104,343,263	121,470,892
Warrants expired (i)	-	946,508
Rights offering (ii)	17,390,543	4,347,636
Share issue costs (iii)	-	(426,695)
Issued and outstanding as at December 31, 2008	121,733,806	126,338,341

i) On April 5, 2008, 588, 270 broker warrants, with fair value of $945,508, which entitled the holder to purchase one common share at a price of $2.77 expired unexercised.

ii) A Rights Offering, which closed May 28, 2008, placed 17,390,543 units at a price of $0.25 per unit. Each unit comprised one common share in the Company and one-half of on share purchase warrant.

iii) Share issue costs have not been tax-effected as there is no guarantee of the Company's future profitability.

Stock options

The Company has a stock option plan (the "Plan") under which it may grant options to directors, officers and employees for the purchase of up to 15% of the number of common shares from time to time. Options are granted at the discretion of the board of directors. The exercise price, vesting period and expiration period are also fixed at the time of grant at the discretion of the Board of Directors in accordance with terms of the Plan.

Changes to the Company's stock options are summarized as follows:

	Number of options	Weighted average option price $
Balance – December 31, 2006	11,059,932	1.64
Granted	2,668,845	0.88
Expired	(400,000)	2.15
Balance – December 31, 2007	13,328,777	1.47
Granted	2,322,082	0.36
Balance – December 31, 2008	15,650,859	1.31
Exercisable – December 31, 2008	15,584,192	1.31

Note 9 – Share capital (continued)

The following is a summary of stock options outstanding and exercisable as at December 31, 2008:

	Options outstanding		Options exercisable	
Range of exercise price $	**Options outstanding**	**Weighted average remaining contractual life in years**	**Weighted average exercise price $**	**Options exercisable**
0.36	2,322,082	4.5	0.36	2,322,082
0.75	2,079,090	0.7	0.75	2,079,090
0.86	800,000	3.1	0.86	733,333
0.89	1,868,845	3.3	0.89	1,868,845
1.25	1,043,433	2.7	1.25	1,043,433
1.34	900,000	3.0	1.34	900,000
1.61	843,271	1.5	1.61	843,271
1.75	1,100,000	1.5	1.75	1,100,000
2.00	1,050,000	1.0	2.00	1,050,000
2.15	3,644,138	0.7	2.15	3,644,138
	15,650,859		1.31	15,584,192

Per share amounts

The weighted average number of common shares outstanding during the period ended December 31, 2008 of 114,729,943 (2007 – 104,343,263 shares) was used to calculate loss per share amounts.

In computing diluted loss per share, no shares were added to the weighted average number of common shares outstanding during the year ended December 31, 2008 (2007 – nil) as they are anti-dilutive.

Warrants

8,695,262 share purchase warrants are outstanding at December 31, 2008. Each warrant is exercisable at an exercise price of $0.45 until the earlier of May 28, 2011 or 30 days following the receipt of a notice from the Company that the closing price of the shares for any 20 consecutive trading days exceeded $0.75.

On April 5, 2008, 588,270 broker warrants, with a fair value of $945,508, which entitled the holder to purchase one common share at a price of $2.77, expired unexercised.

10 Stock-based compensation

Options granted to both employees and non-employees are accounted for using the fair value method. The fair value of common share options granted in the year ended December 31, 2008 was estimated to be $844,279 as at the grant date using a Black-Scholes option-pricing model and the following assumptions:

Note 10 – Stock based compensation (continued)

Risk free interest rate	4.11 – 4.27%
Expected life	5 year average
Expected volatility	84 – 122%
Expected dividend yield	0%

The estimated fair value of the options is amortized to expense and credited to contributed surplus over the option vesting period on a straight-line basis.

11 Contributed surplus

	2008 $	2007 $
Balance – Beginning of year	14,467,311	12,030,272
Stock options issued to employees, officers and directors	844,279	2,437,039
Balance – End of year	15,311,590	28,934,622

The term and vesting conditions of each option may be fixed by the board when the option is granted, but the term cannot exceed 5 years from the date upon which the option is granted.

The options granted to directors, officers and employees may be exercised over five years from the date of granting and expire from time to time to June 2013.

The debentures are convertible into common shares of the Company at a price of $2.45 per share and mature on March 31, 2011.

12 Commitments and contingencies

In accordance with the shareholders' agreement in respect of Aral, Caspian was obligated to fund the initial work program of Aral pursuant to the Exploration Contract. The minimum work program was US $20.8 million and matured at the end of calendar 2005. As at December 31, 2005, this obligation was fully discharged. The work program extension to December 2007 included drilling three wells to a combined total of 8,500 metres with a monetary obligation of US $20.15 million. No additional seismic was required. The work program extension to December 2009 includes drilling seven wells to a combined total of 8,500 metres with a monetary obligation of US $19.085 million. The Company's calendar 2006 minimum work program with the Republic of Kazakhstan was approved for US $12.2 million and was discharged during 2006. The Company's calendar 2007 work program was approved for US $8.4 million with amendment for another US $23.7 million). At December 31, 2007, Aral had contract shortfalls aggregating US $7.1 million. Management of Aral believed the Company was in compliance with its commitments under the Minimum Working Program and received authorization from the Ministry of Energy and Natural Resources and other competent bodies to carry over fulfillment of the above shortfalls to the year ending December 31, 2008. At December 31, 2008, Aral had discharged these obligations

Note 12 – Commitments and contingencies (continued)

During the third quarter of 2008, the minimum work program was extended to December 2009 and contains a 2009 exploration commitment which aggregates US $10.5 million. Currently, Caspian does not have the cash resources to discharge its 50% share of this commitment, but is pursuing a farmout of the North Block, which will result in an up-front cash payment plus an undertaking of the exploration and development obligations of the Company by the farmor to earn a portion of Caspian's interest in the Block. A request for an extension of three years (through year 2012) of the exploration period for the North Block contract has been submitted to applicable government regulatory bodies.

The Company's principal business activities through Aral are within the Republic of Kazakhstan. Laws and regulations affecting businesses operating in the Republic of Kazakhstan are subject to rapid changes and the Company's assets and operations could be at risk in the event of negative changes in the political and business environment.

Under the Exploration Contract, Aral is required to pay royalties at a rate of 3% of the volume of hydrocarbons produced and sold based upon the average selling price (less transportation expenses) of the production. Aral is also obligated to allocate 10% of produced hydrocarbons to the ROK. Aral believes that in accordance with the Exploration Contract, the test production phase is excluded from the burden of royalties and that royalties are payable only at the experimental-industrial phase or when a Production Contract is concluded. If Aral's perspective is incorrect and rejected by Kazakh tax authorities, additional taxes and fines approximating $1.74 million may be levied.

Kazakh tax legislation and practice is in a state of continuous development and therefore is subject to varying interpretations and frequent changes which may be retroactive. Further the interpretation of tax and transfer pricing legislation by tax authorities as applied to the transactions and activities of the Company may not coincide with that of management. Non-compliance with Kazakhstan tax laws and regulations can lead to the imposition of substantial additional taxes, penalties and interests. Tax period remain open to review by the Kazakh tax authorities for five years. Whilst there is a risk that the Kazakh tax authorities may challenge the policies applied, including those relating to transfer pricing, management believes that they would be successful in defending any such challenge. Accordingly, at December 31, 2008, no provision for potential tax liabilities had been recorded (2007 – no provision).

Under the terms of the Exploration Contract, the historical costs amount to USD $15,787 thousand out of which the Company has paid USD $101 thousand in accordance with the terms of the Exploration Contract. The unpaid amount relates to the historical costs for the North block. The management believes that the Company will enter into a Production Contract only in relation to the areas of the North block that will have commercial reserves. Management believes therefore that it is unlikely that the Company will be required to pay the full amount of remaining historical costs but may be required to pay a portion thereof related to the Production Contract area as agreed upon in any such Production Contract. The Exploration Contract specifies that the terms of payment for such costs will be agreed upon in a Production Contract.

13 Financial instruments

Caspian's financial instruments included in the consolidated balance sheet are comprised of cash and cash equivalents, restricted cash, accounts receivable, prepaid and other deposits and, accounts payable. The fair values of these financial instruments approximate their carrying amounts due to the short-term nature of the instruments. A substantial portion of Caspian's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

A substantial portion of Caspian's activities are settled in foreign currencies and consequently, the Company is subject to fluctuations in currency translation rates.

The liability and equity components of the convertible debentures are presented separately in accordance with their substance. The liability component is accreted to the amount payable at maturity by way of a charge to earnings using the effective interest method.

There is presently significant liquidity risk in that the Company will not be able to meet its financial obligations as they come due (refer to Note 1). The Company ensures that there is sufficient capital in order to meet short term business requirements, after taking into account cash flows from operations and the Company's holdings of cash and cash equivalents. The Company's cash and cash equivalents are invested in business accounts, which are available upon demand for the Company's requirements. Cash and cash equivalents are not invested in any asset backed deposits/investments.

The Company operates in Kazakhstan through its joint venture investment in Aral Petroleum Capital LLP (Aral). Like other foreign entities operating there, the Company is subject to currency exchange controls administered by the Republic of Kazakhstan (ROK). A significant portion of the Company's funding structure for its Kazakh operations consists of advancing loans to its Kazakh incorporated joint venture and it is possible the Company may not be able to acceptably repatriate such funds once the joint venture is able to repay the loans or repatriate other funds such as operating profits should any develop.

The following are the contractual maturities of financial liabilities:

	Carrying Amount ($)	**Contractual Cashflow ($)**	**2009**	**2010**	**2011**
Accounts payable and accrued liabilities	7,120,361	7,120,361	7,120,361	-	-
Loan payable	4,339,485	4,339,485	-	-	-
Convertible debentures	23,531,717	23,531,717	-	-	23,531,717

At December 31, 2008 the Company had working capital of $186,985.

The Company's existing sources of financing and expected cash flow from operating activities are not sufficient to meet: (i) the repayment of the Loan payable of $4,339,485, which has no specified repayment terms; and (ii) the Convertible Debentures plus accrued interest, totalling $23,531,717 on December 31, 2008, which mature on March 2, 2011.

Note 13 – Financial instruments (continued)

Caspian, through Aral, has a contractual commitment to expend USD 10.5 million during calendar 2009 to discharge its exploration obligations pursuant to its exploration license with the ROK. To fund this circumstance, the Company is pursuing a farmout of the North Block, which will result in an up-front cash payment plus an undertaking of the exploration and development obligations to earn a portion of the Company's interest.

Caspian prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Petroleum and natural gas production and prices are monitored regularly to provide current cash flow estimates.

Market risk is the risk that changes in market prices, such as commodity prices and interest rates, will affect the Company's net earnings or the value of the financial instruments. The objective of market risks management is to manage and control exposures within acceptable limits, while maximizing returns. Caspian may utilize derivative instruments to manage market risk. The Company had no financial derivative contracts at December 31, 2008.

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Lower commodity prices reduce the Company's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. From time to time the Company may attempt to mitigate commodity price risk through the use of financial derivatives. The Company had no financial derivative contracts at December 31, 2008.

14 Capital Management

The Company's general policy is to maintain a sufficient capital base in order to manage its business effectively with the goal of increasing the value of its assets and thus its underlying share value. The Company's objectives when managing capital are to maintain financial flexibility to meet financial obligations; to facilitate growth; and to optimize the use of capital sources to provide an appropriate investment return to its shareholders.

Caspian strives to properly exploit its current asset base and to acquire top quality assets. To that end, the Company is not averse to maintaining a high ratio of debt to total capital if management determines the assets it is acquiring or the projects it is drilling are of high quality.

The capital structure of the Company is as follows:

	2008	**2007**
Total shareholders' equity	$92,592,616	$103,828,822
Total shareholders' equity as a % of total capital	77%	83%
Working capital	$186,985	$4,615,869
Total indebtedness	$27,871,202	$25,583,693
Total debt as a % of total capital	23%	21%
Total Capital	$119,757,178	$124,795,793

15 Segmented information

The Company's activities are conducted in two geographic segments: Canada and Kazakhstan. All activities relate to exploration for and development of petroleum and natural gas.

	Canada $	Kazakhstan $	December 31, 2008 Total $
Revenue			
Oil and gas revenue, net	21,258	9,161,954	9,183,212
Interest	95,067	-	95,067
Other	10,000	52,280	62,280
	126,325	9,214,234	9,340,559
Expenses			
General and administrative	2,957,890	3,298,690	6,256,580
Accretion of convertible debentures	363,044	-	363,044
Interest	2,123,331	-	2,123,331
Operating	8,260	3,188,748	3,197,008
Transportation	247	1,943,983	1,944,230
Stock-based compensation	844,279	-	844,279
Foreign exchange (gain) loss	(20,000,694)	24,427,214	4,426,520
Depletion, depreciation and accretion	5,000	6,997,673	7,002,673
	(13,698,643)	39,856,308	26,157,665
Income (loss) before income taxes	13,824,968	(30,642,074)	(16,817,106)
Future income tax recovery	-	815,680	815,680
Net income (loss) for the year	13,824,968	(29,826,394)	(16,001,426)
Assets			
Current assets	4,419,090	2,888,256	7,307,346
Restricted cash	-	404,681	404,681
VAT receivable	-	406,519	406,519
Property, plant and equipment, net	24,173	119,733,005	119,757,178
	4,443,263	123,432,461	127,875,724
Liabilities	24,818,327	10,464,781	35,283,108

Note 15 – Segmented information (continued)

	Canada $	Kazakhstan $	December 31, 2007 Total $
Revenue			
Oil and gas revenue, net	40,249	6,228,869	6,269,118
Interest	282,139	-	282,139
Other	-	15,614	15,614
	322,388	6,244,483	6,566,871
Expenses			
General and administrative	2,910,834	673,451	3,584,285
Accretion of convertible debentures	393,312	-	393,312
Interest	1,777,641	-	1,777,641
Operating	12,075	2,151,922	2,163,997
Transportation	342	486,915	487,257
Stock-based compensation	2,437,039	-	2,437,039
Foreign exchange loss (gain)	14,763,369	(8,982,937)	5,780,432
Depletion, depreciation and accretion	5,000	2,406,418	2,411,418
Future income taxes	-	740,178	740,178
	22,299,612	(2,524,053)	19,775,559
Net (loss) income for the year	(21,977,224)	8,768,536	(13,208,688)
Assets			
Current assets	3,557,712	4,516,584	8,074,296
Restricted cash	-	253,132	253,132
Property, plant and equipment, net	29,173	124,766,620	124,795,793
	3,586,885	129,536,336	133,123,221
Liabilities	18,573,413	10,720,986	29,294,399