

Caspian Energy Inc.

Consolidated Financial Statements

December 31, 2013 and 2012

Management's Responsibility

To the Shareholders of Caspian Energy Inc.:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that the transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the consolidated financial statements.

The Board of Directors, through its Audit Committee is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Audit Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

MNP LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, the Audit Committee and management to discuss their audit findings.

May 27, 2014

(signed) "*Brian Korney*"

Brian Korney, Chief Financial Officer

Independent Auditors' Report

To the Shareholders of Caspian Energy Inc.:

We have audited the accompanying consolidated financial statements of Caspian Energy Inc., and its subsidiary, which comprise the consolidated statements of financial position as at December 31, 2013, December 31, 2012 and January 1, 2012, and the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years ended December 31, 2013 and December 31, 2012, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Caspian Energy Inc. and its subsidiary as at December 31, 2013, December 31, 2012 and January 1, 2012, and their financial performance and their cash flows for the years ended December 31, 2013 and December 31, 2012, in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt on Caspian Energy Inc.'s ability to continue as a going concern.

May 27, 2014
Calgary, Alberta

MNP LLP
Chartered Accountants

Caspian Energy Inc.

Consolidated Statements of Financial Position

As at

(in thousands of Canadian dollars)

	December 31 2013 \$	December 31 2012 \$ (Note 5)	January 1 2012 \$ (Note 5)
Assets			
Current assets			
Cash and cash equivalents (Note 8)	17	19	2,199
Trade and other receivables	4	2	1
	21	21	2,200
Non-current assets			
Property, plant and equipment	–	4	9
Investment in Aral (Note 21)	–	–	–
Total assets	21	25	2,209
Liabilities			
Current liabilities			
Trade and other payables	1,950	848	2,007
Promissory note (Note 9)	47	–	–
Convertible debentures (Note 10)	15,949	11,011	–
Derivative liability (Note 10)	–	208	–
	17,946	12,067	2,007
Non-current liabilities			
Loan payable (Note 11)	5,656	4,034	2,041
Convertible debentures (Note 10)	–	–	6,287
Derivative liability (Note 10)	–	–	2,363
Total liabilities	23,602	16,101	12,698
Equity			
Share capital (Note 13)	143,559	143,358	143,092
Warrants (Note 14)	247	313	272
Contributed surplus	18,260	17,660	16,055
Deficit	(185,647)	(177,407)	(169,908)
Total equity	(23,581)	(16,076)	(10,489)
Total liabilities and equity	21	25	2,209

Reporting entity and going concern (Note 1)

Subsequent events (Note 24)

Approved by the Board of Directors

(signed) “*Gordon Harris*” Director

(signed) “*Michael Nobbs*” Director

Caspian Energy Inc.

Consolidated Statements of Loss and Comprehensive Loss For the years ended December 31

(in thousands of Canadian dollars)

	2013	2012
	\$	\$
		(Note 5)
Revenue		
Oil and natural gas revenue, net	14	11
Expenses		
General and administrative	2,056	2,004
Operating expenses	9	8
Share-based compensation (Note 15)	370	1,519
Depreciation	4	5
	2,439	3,536
Operating loss before other items	(2,425)	(3,525)
Derivative fair value adjustment (Note 10)	208	2,111
Finance expense (Note 17)	(6,023)	(6,085)
Loss and comprehensive loss	(8,240)	(7,499)
Loss per share (Note 16)	(0.36)	(0.33)

Caspian Energy Inc.

Consolidated Statements of Changes in Equity For the years ended December 31

(in thousands of Canadian dollars)

	2013	2012
	\$	\$
		(Note 5)
Share capital		
Balance, January 1	143,358	143,092
Issuance of shares (Note 13)	201	163
Exercise of warrants	–	103
Balance, December 31	143,559	143,358
Warrants		
Balance, January 1	313	272
Issuance of warrants (Note 14)	64	183
Exercise of warrants	–	(56)
Expiry of warrants	(130)	(86)
Balance, December 31	247	313
Contributed surplus		
Balance, January 1	17,660	16,055
Share-based compensation (Note 15)	370	1,519
Equity contribution (Note 15)	100	–
Expiry of warrants	130	86
Balance, December 31	18,260	17,660
Deficit		
Balance, January 1	(177,407)	(169,908)
Loss and comprehensive loss	(8,240)	(7,499)
Balance, December 31	(185,647)	(177,407)
Total Equity	(23,581)	(16,076)

Caspian Energy Inc.
Consolidated Statements of Cash Flows
For the years ended December 31

(in thousands of Canadian dollars)

	2013	2012
	\$	\$
Cash flow provided by (used in)		(Note 5)
Operating activities		
Loss and comprehensive loss	(8,240)	(7,499)
Adjustments for:		
Share-based compensation	370	1,519
Depreciation	4	5
Finance expense	4,247	5,186
Derivative fair value adjustment	(208)	(2,111)
Foreign exchange	1,714	(160)
Changes non-cash working capital		
Trade and other receivables	(2)	(1)
Trade and other payables	1,102	(1,159)
Net cash used in operating activities	(1,013)	(4,220)
Financing activities		
Proceeds from issuance of common shares	–	47
Proceeds from promissory note	41	–
Proceeds from loan payable, net	870	1,993
Equity contribution	100	–
Net cash provided by financing activities	1,011	2,040
Change in cash and cash equivalents	(2)	(2,180)
Cash and cash equivalents – January 1	19	2,199
Cash and cash equivalents – December 31	17	19

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

All tabular amounts are in thousands of Canadian dollars except as otherwise indicated.

1. Reporting entity and going concern

Caspian Energy Inc. (“Caspian” or the “Company”) is a publicly traded company on the NEX, a separate board of TSX Venture Exchange under the stock symbol CEK. Caspian is engaged in the exploration for and development and production of oil and gas in the Republic of Kazakhstan (“ROK”). Its primary operating activities are carried out through its wholly-owned subsidiary, Caspian Energy Ltd. (“CEL”). Caspian’s registered office is located at 396 11th Avenue S.W., Calgary, Alberta, Canada.

The Company’s principal assets are a 40% interest in Aral Petroleum Capital LLP (“Aral”), held by CEL. The remaining 60% of Aral is held by Asia Sixth Energy Resources Limited (“ASER”) and its subsidiary Groenzee BV (collectively “Asia Sixth”).

Through its interest in Aral, the Company has the right to explore and develop certain oil and gas properties in Kazakhstan, known as the North Block, a 2,200 square kilometre area located in the vicinity of the Kazakh pre-Caspian basin. The Company also has minor resource interests in Canada.

Going concern

These consolidated financial statements have been presented on a going concern basis. For the year ended December 31, 2013, the Company reported a loss of \$8.2 million (2012 – \$7.5 million) and used funds for operating activities of \$1.0 million (2012 – \$4.2 million). As at December 31, 2013, the Company had a net working capital deficiency of \$17.9 million (2012 – \$12.0 million) and a cumulative deficit equal to \$185.6 million (2012 – \$177.4 million).

On September 24, 2013, the Company’s common shares were delisted from the Toronto Stock Exchange (“TSX”) due to the Company’s failure to meet the continued listing requirements of the TSX. On November 28, 2013, the Company commenced trading on NEX, which provides a trading forum for listed companies that have fallen below the TSX’s continued listing requirements. The Company will remain listed on NEX until it is able to meet the requirements of the TSX or the TSX Venture Exchange.

As at December 31, 2013, Caspian management performed an assessment of the value of the Company’s 40% interest in certain assets of Aral and recognized an impairment of \$21,012 (Note 21(b)).

The Company’s ability to continue as a going concern is in significant doubt and is dependent upon obtaining financing to fund exploration and development activities and general and administrative expenses and on Aral achieving profitable operating results from its Kazakhstan operations. There are no assurances that these initiatives will be successful.

On June 3, 2013, the Company signed a number of agreements (the “Transaction Agreements”) which:

- Provide for the availability of a USD 20 million “New Loan” from Asia Sixth to Aral under the “Aral Loan Agreement” for the purpose of funding operations, including the work prescribed in the work program agreed with the Ministry of Oil and Gas in Kazakhstan;
- Amend the USD 6 million loan agreement (Note 11) between the Company and Asia Sixth to allow the Company to draw USD 100,000 each month for nine months from June 2013 to November 2013 and to draw an additional USD 1.4 million as early as December 28, 2013. These funds will enable the Company to bring current all of its existing trade and other payables and to cover its budgeted operating expenses over the next 18 months;
- Provide for the sale and transfer of part of its ownership interest (the “Interest”) in Aral to Asia Sixth resulting in the Company’s interest in Aral to reduce from 40% to 33.5% for consideration of USD 1. The sale and transfer of the Interest will be completed upon satisfaction or waiver of the following conditions:
 - Conditions in favour of Asia Sixth include: (i) consent from the Ministry of Oil and Gas of Kazakhstan which may take 6-18 months but will not prevent other conditions to proceed before this consent is

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

received, (ii) a waiver from the Government of Kazakhstan relating to its priority right to purchase the Interest, and (iii) approval of the Company's debenture holders (Note 10).

- Conditions in favour of CEL include: (i) receipt of a letter from Asia Sixth's investors confirming the availability of loans of not less than USD 20 million; (ii) receipt by Aral of an initial USD 2 million of advances from Asia Sixth required to complete certain specified testing of oil wells (received in July 2013); and (iii) Asia Sixth having failed in its obligation to make advances under the loan agreements.
- Provides a guarantee by the Company of the "Relevant Percentage" of the obligations owed by Aral to Asia Sixth under the Aral Loan Agreement (Note 20). The "Relevant Percentage" is defined as 40%, provided that upon completion of the transfer of the 6.5% interest to Asia Sixth, the Relevant Percentage will mean 33.5%.
- Provide for a pledge by the Company of all of its interest in Aral in favour of Asia Sixth as security for: (i) the Company's obligations under the USD 6 million loan facility (Note 11), and (ii) the Relevant Percentage of Aral's obligations under the Aral Loan Agreement.
- Provides for the complete and deep subordination of all obligations currently owing by Aral to the Company, in favour of obligations owing by Aral to Asia Sixth under the Aral Loan Agreement.
- Prohibits the Company from taking any action to enforce its rights in respect of the subordinated obligations so long as any amounts remain owing by Aral to Asia Sixth.

As at December 31, 2013, the Company had USD 1.3 million of available funds remaining under the USD 6 million facility agreement with Asia Sixth (Note 11).

On February 19, 2014, the Company's shareholders approved:

- The one-for-ten consolidation of the Company's common shares.
- The January 15, 2014 agreement to amend the Company's convertible debentures (Note 10) that amends the conversion price such that an aggregate of 108,319,091 (post-consolidated) common shares would be issued to the debenture holders on conversion.

The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and classification of liabilities that might be necessary should the Company be unable to continue its operations. Such adjustments could be material.

All common share, warrant, stock option and performance share figures presented herein are on a post-consolidated basis.

2. Basis of presentation

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee in effect for the fiscal year beginning January 1, 2013. The consolidated financial statements were authorized for issue by the Board of Directors on May 27, 2014.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for held-for-trading financial assets which are measured at fair value with changes in fair value recorded in profit or loss. The methods used to measure fair values are discussed in Note 7.

(c) Functional and presentation currency

Functional currency is the currency of the primary economic environment in which a company operates.

These consolidated financial statements are presented in Canadian dollars ("CAD"), which is the Company's

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

functional currency. Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of such transactions or from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in finance expense within the consolidated statements of loss and comprehensive loss.

3. Significant accounting policies

(a) Basis of consolidation

(i) Subsidiaries:

The Company's primary operating activities are carried out through its wholly-owned subsidiary, CEL. Subsidiaries are entities controlled by the Company. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

Transactions eliminated on consolidation:

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(ii) Joint arrangements:

The Company's joint arrangement with respect to its interest in Aral is classified as a joint venture and is accounted for using the equity method whereby the Company's share of individual assets and liabilities are replaced with a net investment in joint ventures amount in the consolidated statements of financial position and individual revenues and expenses are replaced with earnings/losses from investment in joint ventures amount in the consolidated statements of loss.

(b) Financial instruments

All financial instruments are initially recognized at fair value on the consolidated statements of financial position. The Company has classified each financial instrument into one of the following categories: fair value through profit or loss (assets and liabilities), loans and receivables, financial assets available-for-sale, financial assets held-to-maturity, and other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

(i) Non-derivative financial instruments:

Non-derivative financial instruments comprise cash and cash equivalents, trade and other receivables, trade and other payables, promissory note, loan payable and convertible debentures. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below:

Financial assets at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such instruments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in the consolidated statements of loss and comprehensive loss. The Company has designated cash and cash equivalents at fair value through profit or loss.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

Other

Other non-derivative financial instruments, such as trade and other receivables, trade and other payables, promissory note, loan payable and the liability component of convertible debentures are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Derivative financial instruments:

The Company evaluates all financial instruments for freestanding and embedded derivatives. The conversion feature of convertible debentures is an embedded derivative as the USD principal amount is convertible into common shares at a CAD conversion price. As a result, the Company recognizes the fair values of the derivative components at the date of issuance, with the remainder of the proceeds attributed to the liability component of the convertible debentures. The derivative component is marked-to-market at each reporting date using the Black-Scholes pricing model to estimate the fair value. The liability component accretes up to the principal balance at maturity.

(iii) Share capital:

Common shares and warrants are classified as equity. Incremental costs directly attributable to the issue of common shares, warrants and share options are recognized as a deduction from equity, net of any tax effects.

The Company uses the Black-Scholes pricing model to estimate the fair value of warrants on the date of issuance. Inputs into the Black-Scholes pricing model require estimates, including such items as estimated volatility of the Company's stock and the estimated life of the financial instruments being fair valued.

(c) **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, cash in bank accounts and highly liquid bank deposits with original maturities of less than three months.

(d) **Trade and other receivables**

Trade and other receivables are initially recognized at fair value and subsequently accounted at amortized cost using the effective interest method less provision for impairment of such receivables. A provision for impairment of trade and other receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognised in the consolidated statements of loss and comprehensive loss. The primary factor that the Company considers whether a receivable is impaired is its overdue status.

(e) **Property and equipment**

Property and equipment is comprised of office and computer equipment carried at cost. Depreciation methods, useful lives and residual values of tangible assets are reviewed at each reporting date. Depreciation is calculated on a straight-line basis over three to ten years. Property and equipment was fully depreciated as at December 31, 2013.

(f) **Impairment**

(i) 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.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

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 the consolidated statements of loss and comprehensive 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.

(ii) Non-financial assets:

The carrying amounts of the Company's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its 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. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the consolidated statements of comprehensive loss. 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.

(g) Provisions

Provisions are recognized when the Company has a present or constructive obligation as a result of a past event that can be estimated with reasonable certainty and are measured at the amount that the Company would rationally pay to be relieved of the present obligation. To the extent that provisions are estimated using a present value technique, such amounts are determined by discounting the expected future cash flows at a risk-free pre-tax rate and adjusting the liability for the risks specific to the liability.

(h) Trade and other payables

Trade and other payables are accrued when the counterparty has performed its obligations under the contract. Trade and other payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

(i) Promissory note and loan payable

Promissory note and loan payable are initially recorded at fair value including transaction costs and subsequently measured at amortized cost using the effective interest method. The Company capitalizes borrowing costs to finance construction of qualifying assets during the period of the time that is required to complete the asset for its intended

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

use. All other borrowings costs are expensed. Interest costs on borrowings are recognized in the period in which they are incurred regardless of how the borrowings are applied. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

(j) Revenue recognition

Oil and natural gas revenues are recognized when title and risks pass to the purchaser and payment is reasonably assured.

(k) Finance income and expenses

Finance income and expenses comprise interest income, interest expense on borrowings and convertible debentures, accretion on convertible debentures, the unwinding of discount on other financial assets and liabilities and foreign exchange gains and losses. Interest income and interest expense are recognized as amounts accrue in the consolidated statements of loss and comprehensive loss using the effective interest rate method.

(l) Operating leases

Where the Company is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor, the total lease payments are charged to profit or loss on a straight-line basis over the term of the lease.

(m) Tax expense

Tax expense is comprised of current and deferred tax. Tax expense 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 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 asset and liability 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. 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 statement of financial position 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.

(n) Share-based compensation

The Company grants options to purchase common shares to employees and directors under its stock option plan. Share-based compensation to these individuals is measured at the fair value of the options issued and recognized as expense over the vesting periods with a corresponding increase to contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Proceeds received on exercise of

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

stock options, along with amounts previously included in contributed surplus, are credited to share capital.

The Company enters into consulting services agreements whereby remuneration for services is based on the achievement of certain performance criteria and compensated with common shares of the Company. Share-based compensation for the related consulting services is measured at the fair value of the number of shares expected to be issued under the agreement and recognized as expense with a corresponding increase to contributed surplus. The fair value is estimated at the commencement of consulting services and at each reporting date thereafter until the earlier of the expiry of the agreement or the achievement of the performance criteria. At each fair value measurement date, the Company estimates the expected length time to meet the performance criteria and the likelihood that the performance criteria will be met. The initial fair value and subsequent changes in the fair value of consulting services is included in the consolidated statements of loss and comprehensive loss with a corresponding increase or decrease to contributed surplus.

(o) Per share amounts

Basic earnings (loss) per share is calculated by dividing the income (loss) attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees and directors, performance shares, warrants and convertible debentures. The calculation assumes the proceeds on exercise of options are used to repurchase shares at the current market price. The effects of in-the-money warrants and options granted to employees and non-employees are anti-dilutive in loss periods.

4. New and revised standards

(a) Standards and amendments effective in the current year

On January 1, 2013, the Company adopted new standards for IFRS 10, “Consolidated Financial Statements”, IFRS 11 “Joint Arrangements”, IFRS 12 “Disclosure of Interests in Other Entities”, IFRS 13 “Fair Value Measurement” as well as consequential amendments to IAS 28 “Investments in Associates and Joint Ventures”.

IFRS 10 replaces the previous guidance on control and consolidation. IFRS 10 requires consolidation of an investee only if the investor possesses power over the investee, has exposure or rights to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. As a result of the adoption of IFRS 10 effective January 1, 2013, and in accordance with the transitional provisions of IFRS 10, the Company re-assessed its control conclusions and determined that there were no changes in the consolidation status of its wholly-owned subsidiary.

The impact of the adoption of IFRS 11 is disclosed in Note 5.

IFRS 12 sets out the annual disclosure requirements for the Company’s interests in subsidiaries, joint arrangements and associates. The adoption of IFRS 12 resulted in additional disclosures in the Company’s consolidated financial statements for the year ended December 31, 2013.

IFRS 13 improves consistency and reduces complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRS. Adoption of this standard had no significant impact on the Company’s financial statements other than the inclusion of fair value information disclosures for financial instruments in its consolidated financial statements as disclosed in Note 7.

The adoption of consequential amendments to IAS 28 had no impact on the Company’s consolidated financial statements.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

(b) New and amended standards not yet adopted

The Company has reviewed amendments to accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Company:

IFRS 2 Share-based Payment

Amendments to IFRS 2 Share-based Payment revised the definitions of 'vesting conditions' and 'market condition' and add definitions for 'performance condition' and 'service condition'. Amendments apply to share-based payment transactions for which the grant date is on or after July 1, 2014.

IAS 24 Related Party Disclosures

Amendments to IAS 24 Related Party Disclosures clarify that an entity providing key management services to the reporting entity is a related party of the reporting entity.

IAS 32 Financial Instruments: Presentation

Amendments to IAS 32 Financial Instruments: Presentation clarify that an entity has a legally enforceable right to set-off if that right is (a) not contingent on a future event; and (b) enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties. The amendments also clarify that when a settlement mechanism provides for either net settlement or gross settlement, it is equivalent to net settlement.

IAS 36 Impairment of Assets

In May 2013, the International Accounting Standards Board issued an amendment to IAS 36 Impairment of Assets. These narrow-scope amendments address the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal.

IAS 39 Financial Instruments: Recognition and Measurement

In November 2013, the IASB published amendments to IAS 39 Financial Instruments: Recognition and Measurement through a document entitled "Novation of Derivatives and Continuation of Hedge Accounting". The amendments provide some relief from the discontinuation of hedge accounting when a novation is made as a consequence of laws or regulations or the introduction of laws or regulations, subject to certain criteria.

The above amendments are effective for annual periods beginning on or after January 1, 2014. The Company is currently assessing the impact of these amendments on its consolidated financial statements.

5. Adoption of IFRS 11

The adoption of IFRS 11 resulted in the deconsolidation of the Company's 40% proportionate share of Aral and the application of the equity method of accounting for the investment in Aral. Changes have been applied retrospectively in accordance with IAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors", resulting in the restatement of prior period financial information.

Under IFRS 11, interests in joint arrangements are classified as either joint operations or joint ventures depending on the Company's rights to the assets and obligations for the liabilities of the arrangements. When making this assessment, the Company's considers the structure of the arrangements, the legal form of any separate vehicles, the contractual terms of the arrangements and other facts and circumstances.

Joint operations continue to be proportionately consolidated whereas joint ventures, such as the Company's interest in Aral, now require the application of the equity method of accounting. Under the equity method, the Company's share of individual assets and liabilities are replaced with a net investment in joint ventures amount in the consolidated statements of financial position and individual revenues and expenses are replaced with earnings/losses from investment in joint ventures amount in the consolidated statements of loss and comprehensive loss.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

The Company recognized the deemed cost of its investment in Aral at January 1, 2012, as the net of the carrying amounts of the assets and liabilities previously proportionately consolidated by the Company, which were negative net assets. As a result, the Company assessed whether it has legal or constructive obligations in relation to the Aral's negative net assets and concluded that it does not have any such obligations. The Company did not recognise the corresponding liability for its share of Aral's negative net assets, rather it adjusted deficit as at January 1, 2012 and December 31, 2012 for its cumulative unrecognised share of losses of Aral of \$8.5 and \$22.5 million, respectively.

The effects of the change on the Company's consolidated statements of financial position as at January 1, 2012, and December 31, 2012, and on the Company's consolidated statements of loss and comprehensive loss and consolidated statements of cash flows for the year ended December 31, 2012 are summarized below:

Consolidated Statement of Financial Position	December 31, 2012		
	Previously Reported	Deconsolidation of Aral	Restated
Assets			
Current assets			
Cash and cash equivalents	55	(36)	19
Trade and other receivables	1,427	(1,425)	2
Inventory	540	(540)	–
	2,022	(2,001)	21
Non-current assets			
Restricted cash	8	(8)	–
VAT receivable	2,541	(2,541)	–
Exploration and evaluation assets	21,238	(21,238)	–
Property, plant and equipment	15,104	(15,100)	4
Total assets	40,913	(40,888)	25
Liabilities			
Current liabilities			
Trade and other payables	20,366	(19,518)	848
Loans payable	37,350	(37,350)	–
Convertible debentures	11,011	–	11,011
Derivative liability	208	–	208
	68,935	(56,868)	12,067
Non-current liabilities			
Taxes payable	45	(45)	–
Decommissioning liabilities	238	(238)	–
Loans payable	8,484	(4,450)	4,034
Total liabilities	77,702	(61,601)	16,101
Equity			
Share capital	143,358	–	143,358
Warrants	313	–	313
Contributed surplus	17,660	–	17,660
Accumulated other comprehensive income	1,821	(1,821)	–
Deficit	(199,941)	22,534	(177,407)
Total equity	(36,789)	20,713	(16,076)
Total liabilities and equity	40,913	(40,888)	25

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

Consolidated Statement of Financial Position

January 1, 2012

	Previously Reported	Deconsolidation of Aral	Restated
Assets			
Current assets			
Cash and cash equivalents	2,296	(97)	2,199
Trade and other receivables	732	(731)	1
Inventory	987	(987)	–
	4,015	(1,815)	2,200
Non-current assets			
Restricted cash	290	(290)	–
VAT receivable	1,305	(1,305)	–
Exploration and evaluation assets	29,107	(29,107)	–
Property, plant and equipment	7,406	(7,397)	9
Total assets	42,123	(39,914)	2,209
Liabilities			
Current liabilities			
Trade and other payables	15,116	(13,109)	2,007
Loans payable	34,538	(34,538)	–
	49,654	(47,647)	2,007
Non-current liabilities			
Decommissioning liabilities	249	(249)	–
Loans payable	2,100	(59)	2,041
Convertible debentures	6,287	–	6,287
Derivative liability	2,363	–	2,363
Total liabilities	60,653	(47,955)	12,698
Equity			
Share capital	143,092	–	143,092
Warrants	272	–	272
Contributed surplus	16,055	–	16,055
Accumulated other comprehensive income	484	(484)	–
Deficit	(178,433)	8,525	(169,908)
Total equity	(18,530)	8,041	(10,489)
Total liabilities and equity	42,123	(39,914)	2,209

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

Consolidated Statement of Loss and Comprehensive Loss

For the year ended December 31, 2012

	Previously Reported	Deconsolidation of Aral	Restated
Revenue			
Oil and natural gas revenue, net	3,683	(3,672)	11
Expenses			
General and administrative	3,045	(1,041)	2,004
Operating expenses	2,476	(2,468)	8
Transportation	1,321	(1,321)	–
Share-based compensation	1,519	–	1,519
Depletion and depreciation	751	(746)	5
Impairment of exploration and evaluation assets	9,796	(9,796)	–
	18,908	(15,372)	3,536
Operating loss before other items	(15,225)	11,700	(3,525)
Derivative fair value adjustment	2,111	–	2,111
Finance expense	(7,761)	1,676	(6,085)
Other expense	(633)	633	–
Loss	(21,508)	14,009	(7,499)
Foreign exchange translation	1,337	(1,337)	–
Comprehensive loss	(20,171)	12,672	(7,499)
Loss per share	(0.95)	0.62	(0.33)

Consolidated Statement of Cash Flows

For the year ended December 31, 2012

	Previously Reported	Deconsolidation of Aral	Restated
Cash flow provided by (used in)			
Net cash used in operating activities	(11,698)	7,478	(4,220)
Net cash provided by financing activities	11,598	(9,558)	2,040
Net cash used in investing activities	(2,141)	2,141	–
Change in cash and cash equivalents	(2,241)	61	(2,180)
Cash and cash equivalents – beginning of year	2,296	(97)	2,199
Cash and cash equivalents – end of year	55	(36)	19

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

6. Critical accounting judgments and estimates in applying accounting policies

(a) Judgments

Judgment is used in situations when there is a choice and/or assessment requirement by management. The following are critical judgments apart from those involving estimations (disclosed below), that management has made in the process of applying the Company's accounting policies and that have a significant effect on the amounts recognized in the consolidated financial statements.

(i) Going concern

As discussed in Note 1, these consolidated financial statements have been prepared in accordance with IFRS on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business within the foreseeable future. Management uses judgment to assess the Company's ability to continue as a going concern and the existence of conditions that cast doubt upon the going concern assumption.

It is management's assessment that the going concern assumption is appropriate based on the following events:

- On November 28, 2013, the Company obtained a listing on the NEX.
- As at December 31, 2013, the Company had USD 1.3 million of available funds remaining under a credit facility with Asia Sixth.
- Subsequent to December 31, 2013, the Company executed an agreement for conversion of Debentures for which shareholder approval was received and pursuant to which the Debentures were converted to common shares of the Company, thereby reducing its debt burden and interest expense.

(ii) Equity method of accounting for the investment in Aral

Management applied judgment in its assessment of whether the Company's joint arrangement, structured through a Limited Liability Partnership (the "Partnership"), constitutes a joint operation requiring proportionate consolidation or a joint venture requiring the equity method of accounting.

Based on management's judgment, the joint arrangement is a joint venture based on the following:

- Aral's Charter represents a contractual arrangement between the participants of the Partnership and establishes joint control over the operations of Aral.
- Aral's Charter specifies that the assets and liabilities held by the Partnership are the assets and liabilities of the Partnership, not assets and liabilities of the participants of the Partnership.

(iii) Investment in Aral

Management uses judgment to assess the existence of impairment indicators such as events or changes in circumstances that may indicate the disclosed amount of certain of Aral's assets, such as exploration and evaluation assets and property, plant and equipment, may not be recoverable.

(iv) Loan impairment

Management applied judgment in its assessment that the carrying amount of the loan receivable due from Aral is impaired as collectability of principal and interest are uncertain until such time as Aral achieves profitable operating results from its Kazakhstan operations. As at December 31, 2013, the loan from Aral in the amount of \$65.0 million was 100% provided for (2012 – \$55.1 million and 100% provided for) and the amount of impairment offsetting interest income and the effects of foreign exchange translation recorded in the 2013 consolidated statement of loss and comprehensive loss was \$9.9 million (2012 – \$9.1 million).

(v) Deferred taxes

Judgments are made by management to determine the likelihood of whether deferred tax assets at the end of the

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

reporting period will be realized from future taxable earnings.

(vi) Performance criteria of share-based payments

Management applied judgment in its assessment of the likelihood of performance criteria in the consulting agreement disclosed in Note 15 being met. Based on management's judgment, the likelihood of the performance criteria being met is negligible as the direct consequences of the consulting services performed to date have yielded no significant improvements to the flow of petroleum for the wells specified in the consulting agreement.

(vii) Contingencies

Management uses judgment to assess the existence of contingencies. By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. Management also uses judgment to assess the likelihood of the occurrence of one or more future events.

(b) Estimates

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected. The significant areas of estimation uncertainty are as follows:

(i) Stock options, performance shares, warrants and derivative financial instruments

The estimated fair value of derivative financial instruments resulting in financial assets and liabilities, by their very nature, are subject to measurement uncertainty. The Company uses the Black-Scholes pricing model to estimate the fair value of stock options, performance shares, warrants and derivative financial instruments, which is based on significant assumptions such as volatility, forfeiture rate, interest rate, dividend yield, expected term and, with respect to performance shares, the likelihood of performance criteria being met.

(ii) Deferred taxes

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such income taxes are subject to measurement uncertainty.

(iii) Contingencies

When contingencies exist, management estimates the related financial impact to the Company of the possible outcomes of one or more future events.

7. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements.

The fair value hierarchy is as follows:

- Level 1 – quoted prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 – inputs for the asset or liability that are not based on observable market data.

Cash and cash equivalents have been measured using level 1 inputs. The derivative liability (Note 10) has been measured

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

using level 2 inputs.

(a) Cash and cash equivalents, trade and other receivables, trade and other payables and promissory note

The fair value of cash and cash equivalents, trade and other receivables, trade and other payables and promissory note is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2013, the fair value of these balances approximated their carrying value due to their short term to maturity.

(b) Convertible debentures

The carrying value of convertible debentures includes the liability component and the embedded derivative related to the conversion feature of the debentures. The embedded derivative is recognized at its fair value on the date of issuance, with the remainder of the proceeds attributed to the liability component of the convertible debentures. The derivative component is marked-to-market at each reporting date using the Black-Scholes pricing model to estimate the fair value. Subsequent to issuance, the liability component is accreted up to face value using the effective interest method.

As at December 31, 2013, the fair value of the liability and embedded derivative components of convertible debentures approximated their carrying value due to their short term to maturity as disclosed in Note 10.

(c) Loan payable

The fair value of the loan payable is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2013, the fair value of the loan payable was estimated at \$8.5 million using a discounted cash flow analysis based on the Company's expected borrowing rate for similar borrowing arrangements.

(d) Stock options, performance shares, warrants and derivative financial instruments

The fair values of stock options, performance shares and warrants are measured using a Black-Scholes pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected forfeiture rate (based on historic forfeitures), expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

Measurement inputs for performance shares include the likelihood of the performance criteria being met and the expected length of time until the performance criteria are met. As management's assessment that the likelihood of the performance criteria will be met is negligible, no further calculations were considered necessary.

The Black-Scholes pricing model calculations for 2013 and 2012 were based on the following significant assumptions:

	Warrants Note 14		Stock Options Note 15	
	2013	2012	2013	2012
Risk-free interest rate	1.05%	1.45%	1.44%	1.47%
Expected volatility range	140 – 141 %	133 – 199%	177 – 178%	178 – 182 %
Expected life	2 years	2 years	5 years	5 years
Forfeiture rate	0%	0%	0%	0%
Dividends	0%	0%	0%	0%

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

8. Cash and cash equivalents

	2013	2012
Cash in CAD	13	16
Cash in USD	3	3
Cash in Pounds Sterling	1	–
	<u>17</u>	<u>19</u>

9. Promissory note

On April 1, 2013, the Company entered into a promissory note agreement with an officer of the Company in the principal amount of \$41,127. The promissory note is unsecured, matures on December 31, 2013 and bears interest at 20% per annum. As at December 31, 2013, the \$47,296 balance is comprised of \$41,127 of principal plus \$6,169 of accrued interest. The balance of principal plus accrued interest was repaid in full in January 2014.

10. Convertible debentures

As at December 31, 2013 and 2012, the Company had USD 12.5 million principal amount of 10% per annum convertible debentures (the “Debentures”) with a maturity date of June 2, 2013 and secured with Caspian shares issued and outstanding.

The Company was not able to repay the Debentures on the maturity date. The terms of the Debentures provide that a default occurs if there is a failure to pay principal on maturity and such failure to pay is not remedied within 30 days after receipt of written notice from the debenture holders (the “Holders”). In late June of 2013, the Company received notices from each of the Holders providing the Company with written notice of payment defaults.

The Company and the Holders entered into a remedial period extension agreement dated July 26, 2013 (the “Extension Agreement”) pursuant to which, among other things, the Holders agreed to extend the remedial period to August 26, 2013 during which time the Company could remedy the payment defaults before such payment defaults would constitute defaults under the Debenture agreements. Such remedial period was further extended pursuant to amendments to the Extension Agreement dated August 26, 2013, September 26, 2013, October 26, 2013, November 26, 2013 and December 17, 2013.

The December 17, 2013 amendment extended the remedial period to February 20, 2014. On January 15, 2014, the Company entered into a further extension agreement (the “Amended Extension Agreement”) with the Holders, pursuant to which the Company and Holders executed the Debenture Amendment which provides for the conversion (the “Conversion”) of the outstanding Debentures, and the obligations owing thereunder, into an aggregate of 108,319,092 post-consolidation shares (Note 1), based on a consolidation ratio and representing approximately 82.5% of the Company’s outstanding common shares on the business day following the receipt of shareholder approval for, among other things, the one-for-ten share consolidation (Note 1) and the Conversion.

The Company received shareholder approval on February 19, 2014 and on February 20, 2014, following approval by the NEX board of the TSX Venture Exchange, the Debentures were converted to 108,319,091 common shares.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

A continuity of the Debentures as at December 31, 2013 is as follows:

	Total	Liability component	Derivative liability of conversion feature
Balance, December 31, 2011	8,650	6,287	2,363
Interest and accretion	5,245	5,245	–
Fair value adjustment	(2,111)	–	(2,111)
Settlement of accrued interest	(405)	(405)	–
Foreign exchange	(160)	(116)	(44)
Balance, December 31, 2012	11,219	11,011	208
Interest and accretion	4,165	4,165	–
Fair value adjustment	(208)	–	(208)
Settlement of accrued interest	(163)	(163)	–
Foreign exchange	936	936	–
Balance, December 31, 2013	15,949	15,949	–

Interest continued to accrue on the debenture principal amount at 10% per annum during the remedial period and extensions. The fair value of the conversion is \$nil at December 31, 2013 as it expired on the maturity date, June 2, 2013.

11. Loan payable

In connection with the Company's sale of a 10% interest in Aral to Asia Sixth in 2011, the Company entered into a facility agreement with Asia Sixth pursuant to which Asia Sixth will advance up to USD 6 million in loans to Caspian, of which USD 2 million remained available as at June 3, 2013.

On June 3, 2013, the terms of the facility agreement were amended to the following terms, which represent a refinement of the original terms:

- Amounts advanced under the facility will bear interest at a rate of 10% per annum until December 28, 2016 and 18% per annum, compounded annually, thereafter until November 1, 2020.
- The Company is permitted to draw up to USD 100,000 during each calendar month until November 2013 at which time, until expiry, the Company may draw the undrawn balance of the remaining USD 2,000,000.
- The ability to draw under the facility expires after 12 months from the amendment date.
- The loan is to be repaid with all proceeds received by the Company by way of dividends from Aral or from the sale of any asset by the Company.
- The balance of all principal and interest still owing on November 1, 2020 must be repaid on such date.
- The Company provided a pledge of all of its interest in Aral in favour of Asia Sixth as security for the Company's obligations under the facility.

As at December 31, 2013, the Company had received total draws under the facility of USD 4.7 million (December 31, 2012 – USD 3.85).

As at December 31, 2013, the \$5,656,041 balance owing Asia Sixth is comprised of \$5,026,321 of principal plus \$629,720 of accrued interest (December 31, 2012 – \$4,033,855 balance comprised of \$3,863,987 of principal plus \$196,868 of accrued interest).

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

12. Taxes

The following is a reconciliation of income taxes calculated at the combined Federal and Provincial rates with the income tax expense in the consolidated statement of loss and deficit:

	2013	2012
Loss before income taxes	(8,240)	(7,499)
Expected recovery at statutory tax rate of 25%	(2,060)	(1,875)
Change in deferred tax asset not recognized	(71)	1,749
Non-deductible share-based compensation	93	380
Change in tax pool estimates and other non-deductible (non-taxable) items	2,038	(254)
	—	—

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

	2013	2012
Deferred tax assets (liabilities)		
Tax losses available for carry forward	19,947	19,347
Tax reserves	(7,838)	(6,583)
Derivative liability	—	(583)
Property and equipment	52	51
	12,161	12,232
Deferred tax asset not recognized	(12,161)	(12,232)
	—	—

As at December 31, 2013, the Company had estimated Canadian tax pools of \$48.5 million (2012 – \$46.1 million) available for deduction against future Canadian taxable income which expire between 2015 and 2033.

13. Share capital

(a) Authorized

Unlimited number of voting common shares, without stated par value

(b) Issued

	Number of shares	Amount
Balance, December 31, 2011	22,329,308	143,092
Exercise of share purchase warrants (i)	56,800	103
Convertible debenture interest obligation (ii)	309,559	163
Balance, December 31, 2012	22,695,667	143,358
Convertible debenture interest obligation (iii)	326,110	201
Balance, December 31, 2013	23,021,777	143,559

- (i) On January 5, 2012, the Company issued 56,800 common shares on the exercise of 56,800 share purchase warrants at a weighted average exercise price of \$0.80 for gross proceeds of \$46,684 and a pro-rata share of warrant fair value in the amount of \$56,345.
- (ii) During 2012, the Company issued 309,559 common shares at a weighted average price of \$0.53 per share plus 83,601 share purchase warrants with an exercise price of \$1.91, 31,818 share purchase warrants with an exercise price of \$1.84 and 39,361 share purchase warrants with an exercise price of \$1.41 as settlement of Debenture interest. See Note 10. The common shares were valued at the trading price at the time of issue.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

(iii) During 2013, the Company issued 326,110 common shares at a weighted average price of \$0.62 per share, 64,334 share purchase warrants with an exercise price of \$0.87 and 98,721 share purchase warrants with an exercise price of \$0.57 as settlement of Debenture interest. See Note 10. The common shares were valued at the trading price at the time of issue.

14. Warrants

A continuity of warrants outstanding as at December 31 is summarized as follows:

	Number of warrants	Weighted average exercise price	Amount
Balance, December 31, 2011	333,832	\$ 1.74	272
Exercised (Note 13(b)(i))	(56,800)	0.82	(56)
Issued (Note 13(b)(ii))	154,780	1.77	183
Expired	(53,404)	1.94	(86)
Balance, December 31, 2012	378,408	1.86	313
Issued (Note 13(b)(iii))	163,055	0.60	64
Expired	(223,628)	1.92	(130)
Balance, December 31, 2013	317,835	\$ 1.17	247

The fair value of warrants issued in 2013 and 2012 was determined using the Black-Scholes pricing model as disclosed in Note 7(d).

Information about warrants as at December 31, 2013 is summarized in the following table:

Exercise price	Number of warrants outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)
\$ 0.57	98,721	\$ 0.57	1.28
\$ 0.64	64,334	0.64	1.02
\$ 1.41	39,361	1.41	0.75
\$ 1.84	31,818	1.84	0.52
\$ 1.91	83,601	1.91	0.29
	317,835	\$ 1.17	0.83

15. Share-based compensation

(a) Stock options

The Company has a stock option plan (“the Plan”) for which up to 15% of the issued and outstanding common shares can be reserved for issuance to directors, officers and employees. Options are granted at the discretion of the Board of Directors. The exercise price, vesting period and expiration period are fixed at the time of grant at the discretion of the Board of Directors in accordance with terms of the Plan.

On April 9, 2012, the Company granted 600,000 options exercisable at \$1.90 per share to directors, officers and consultants of the Company. The options vested immediately, and expire on April 9, 2017.

On November 8, 2012, the Company granted 500,000 options exercisable at \$0.95 per share to directors, officers and consultants of the Company. The options vested immediately, and expire on November 8, 2017.

On January 25, 2013, the Company granted 500,000 options exercisable at \$0.70 per share to directors, officers and consultants of the Company. The options vest immediately and expire on January 25, 2018.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

On April 1, 2013, the Company granted 75,000 options exercisable at \$0.50 per share to a consultant of the Company. The options vest immediately and expire on April 1, 2018.

The fair value of the options granted in 2013 was estimated to be \$369,606 (2012 – \$1,519,000) and recognized as share-based compensation in the consolidated statements of loss and comprehensive loss. The fair value of options was estimated using the Black-Scholes pricing model as disclosed in Note 7(d).

A continuity of options outstanding as at December 31 is summarized as follows:

	2013		2012	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Opening	2,179,162	\$ 1.75	1,711,058	\$ 3.03
Granted	575,000	0.61	1,100,000	1.47
Expired	(120,000)	(3.60)	(150,000)	(8.80)
Cancelled	–	–	(481,896)	(3.44)
Closing	2,634,162	\$ 1.43	2,179,162	\$ 1.75
Exercisable	2,634,162	\$ 1.43	2,179,162	\$ 1.75

Information about options outstanding and exercisable as at December 31, 2013 is summarized in the following table:

Exercise price	Number of options outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)	Number of options exercisable
\$ 0.05	75,000	\$ 0.50	4.25	75,000
\$ 0.07	500,000	0.70	4.07	500,000
\$ 0.095	500,000	0.95	3.49	500,000
\$ 0.18	744,162	1.80	2.37	744,162
\$ 0.19	600,000	1.90	3.02	600,000
\$ 0.20	215,000	2.00	1.31	215,000
	2,634,162	\$ 1.43	2.90	2,634,162

(b) Performance shares

The Company entered into an agreement on August 18, 2012 and amended in January 2013, (“the Amended Consulting Agreement”) with a petrophysicist (the “Consultant”) for the provision of consulting services in connection with the exploitation, development and completion of eight Aral wells in the Republic of Kazakhstan. Pursuant to the amended Consulting Agreement, remuneration for consulting services is performance based and the Consultant will be compensated with common shares of the Company according to certain performance criteria.

In consideration for the provision of services pursuant to the amended Consulting Agreement, the Company has agreed to issue the following Consideration Shares and Bonus Shares (collectively, the performance shares) to the Consultant:

- In respect of each well where, as a direct consequence of the services provided by the Consultant, the flow of petroleum in relation to such well when measured in accordance with the Amended Consulting Agreement has a barrels of oil per day rate (“Bopd Rate”) in excess of 2,000, the Company will issue 250,000 common shares in respect of such well (the “Consideration Shares”). The maximum number of Consideration Shares issuable pursuant to the Amended Consulting Agreement is 2 million.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

- Provided always that as a direct consequence of the services provided by the Consultant, the flow of petroleum in relation to any well when measured in accordance with the Amended Consulting Agreement is in excess of a Bopd Rate of 2,000, the Company will issue the following additional common shares (the “Bonus Shares”):
 - (a) if at any time during the period of four years commencing on the date of the Amended Consulting Agreement, the volume weighted average trading price of the Company’s common shares (as quoted on the Toronto Stock Exchange (the “TSX”) or such other exchange on which the Company’s common shares are listed) exceeds \$25.00 for a period of not less than 20 trading days, 50,000 common shares;
 - (b) if at any time during the period of four years commencing on the date of the Amended Consulting Agreement, the volume weighted average trading price of the Company’s common shares (as quoted on the TSX or such other exchange on which the Company’s common shares are listed) exceeds \$50.00 for a period of not less than 20 trading days, 150,000 common shares; and
 - (c) if at any time during the period of four years commencing on the date of the Amended Consulting Agreement, the volume weighted average trading price of the Company’s common shares (as quoted on the TSX or such other exchange on which the Company’s common shares are listed) exceeds \$100.00 for a period of not less than 20 trading days, 400,000 common shares.

The maximum number of Bonus Shares issuable pursuant to the Amended Consulting Agreement is 600,000.

If all performance criteria are met, the Consultant would be entitled to a maximum of 2.6 million common shares of the Company (the “Maximum Consideration”). At the Company’s option, the Company can elect to satisfy all or a portion of consideration payable in cash. Any amounts elected to be paid in cash would be determined by the number of Consideration Shares or Bonus Shares payable multiplied by the market price of the Company’s common shares at the close of trading on the date the particular Consideration Shares or Bonus Shares became payable.

The fair value of performance shares at inception of the agreement and at subsequent reporting dates, including the modification related to the January 2013 amendments, was estimated to be a negligible amount and therefore no amount has been recognized in the consolidated financial statements in respect of the consulting services performed as of December 31, 2013.

In April 2013, the Company received \$100,000 as consideration for the amendments made in January 2013 which has been recognized as an equity contribution in contributed surplus.

16. Per share amounts

	<u>2013</u>	<u>2012</u>
Net loss for the year	(8,240)	(7,499)
Weighted average number of shares (in thousands) – basic:		
Issued common shares at January 1	22,696	22,329
Effect of shares issued during the year	268	224
	<u>22,964</u>	<u>22,553</u>
Net loss per share – basic and diluted	<u>(0.36)</u>	<u>(0.33)</u>

The effect of stock options, performance shares, Debentures and warrants is anti-dilutive in loss periods.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

17. Finance expense

	2013	2012
Interest on promissory note	6	–
Interest on convertible debentures	1,486	936
Loss on settlement of convertible debenture interest	102	346
Accretion of convertible debentures	2,679	3,963
Interest expense on loan payable	405	270
Net foreign exchange loss	1,345	570
Net finance expense	6,023	6,085

18. Directors and key management remuneration

The Company considers its directors and executives to be key management personnel. Compensation attributed to key management personnel comprises the following:

	2013	2012
Salaries	799	672
Director fees	210	174
Share-based compensation	370	1,519
	1,379	2,365

19. Supplemental cash flow disclosure

During 2013, the Company paid \$nil (2012 – \$nil) of interest in cash and settled \$163,000 (2012 – \$405,000) of interest through the issuance of common shares and warrants.

The Company did not pay any income taxes in 2013 or 2012.

20. Guarantee in favour of Asia Sixth

In connection with the Transaction Agreements signed on June 3, 2013 (Note 1), the Company agreed to provide a guarantee of its 40% share of the obligations owed by Aral to Asia Sixth under the Aral Loan Agreement.

As at December 31, 2013, obligations owed by Aral to Asia Sixth under the Aral Loan Agreement totalled USD 28.6 million comprised of USD 21.1 million of existing loans (as defined by the Aral Loan Agreement) and USD 7.5 million of amounts advanced under the USD 20 million of “New Loan” portion of the Aral Loan Agreement.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

21. Selected financial information for Aral Petroleum Capital LLP

As at December 31, 2013 and 2012, the Company held a 40% interest in Aral, recognized in these consolidated financial statements using the equity method of accounting. As the investment is in a negative net asset position, there is no representation of the investment in the Company's consolidated financial statements. To date, the Company has not received any dividends from Aral.

(a) Aral's results of operations, assets and liabilities

A summary of Aral's results of operations, assets and liabilities as at and for the years ended December 31, 2013 and 2012 is presented below:

	2013	2012
Oil and natural gas revenue, net	2,186	9,180
General and administrative expenses	(2,313)	(2,603)
Operating and transportation expenses	(3,749)	(9,473)
Depletion and depreciation expense	(616)	(1,865)
Impairment of exploration and evaluation assets	–	(24,490)
Interest expense	(6,707)	(4,330)
Other expense	(3,388)	(3,823)
Loss and comprehensive loss	(14,587)	(37,404)
	2013	2012
Cash and cash equivalents	161	90
Other current assets	5,626	4,913
Total current assets	5,787	5,003
Exploration and evaluation assets	83,259	61,974
Property, plant and equipment (Note 21(b)(i))	52,529	39,220
Other non-current assets	9,943	6,373
Total non-current assets	145,731	107,567
Total assets	151,518	112,570
Trade and other payables	65,821	48,795
Current loans payable	164,047	148,826
Total current liabilities	229,868	197,621
Long-term loans payable	37,226	11,125
Other non-current liabilities	1,237	708
Total non-current liabilities	38,463	11,833
Total liabilities	268,331	209,454

The Company engaged McDaniel & Associates Consultants Ltd. for the preparation of an evaluation of crude oil reserves in the East Zhagabulak Field, Kazakhstan based on forecast prices and costs as of December 31, 2013 (the "2013 McDaniel's Report").

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

The estimated recoverable amounts at various discount rates expected to be derived from the East Zhagabulak Field's proved plus probable reserves based on the 2013 McDaniel's Report are as follows:

	10%	15%	20%
Proved Reserves	–	–	–
Probable Reserves	2,805	(834)	(3,212)
Total Proved Plus Probable Reserves	2,805	(834)	(3,212)

(b) Caspian's 40% interest in Aral's results of operations, assets and liabilities

A summary of the Company's 40% interest in Aral's results of operations, assets and liabilities as at and for the years ended December 31, 2013 and 2012 is presented below:

	2013	2012
Oil and natural gas revenue, net	874	3,672
General and administrative expenses	(924)	(1,041)
Operating and transportation expenses	(1,500)	(3,789)
Depletion and depreciation expense	(246)	(746)
Impairment of exploration and evaluation assets	–	(9,796)
Impairment of property, plant and equipment (i)	(21,012)	–
Interest expense	(2,683)	(2,610)
Other finance expense	(1,355)	(651)
Loss and comprehensive loss	(26,846)	(14,961)

	2013	2012
Current assets	2,314	2,001
Exploration and evaluation assets	33,304	24,790
Property, plant and equipment (i)	–	15,688
Total assets (i)	39,595	45,028
Current liabilities	91,947	79,048
Total liabilities	107,332	83,782

- (i) Based on the uncertainty surrounding the economic recoverability of Aral's proved and probable reserves given the current market and cost structure, Caspian management have recorded an impairment charge of \$21,012 on its share of Aral's property, plant and equipment. This impairment charge has no impact on Caspian's consolidated financial position as at December 31, 2013 and consolidated financial performance for the year then ended as the carrying amount of the Company's investment in Aral has already been reduced to zero.
- (ii) As at December 31, 2013, the Company's unrecognized 40% interest of Aral's cumulative losses recognized by Aral was \$46,328 (2012 – \$40,494). The Company's unrecognized 40% interest of Aral's cumulative losses as at December 31, 2013, including the impairments recognized by the Company as noted above, increased to \$67,340.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

22. Financial risk management

The Company's activities expose it to a variety of financial risks that arise as a result of its operating and financing activities such as credit risk, liquidity risk and market risk. This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors oversees management's establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyse the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(a) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company's trade and other receivables are with customers in the petroleum and natural gas business and are subject to normal credit risks. The Company's cash and cash equivalents consist of cash in bank accounts and highly liquid bank deposits with original maturities of less than three months. Accordingly, the Company views credit risk as minimal.

The maximum exposure to credit risk is as follows:

	2013	2012
Cash and cash equivalents	17	19
Trade and other receivables	4	2
	21	21

As at December 31, 2013, the average aging of trade and other receivables is 60 days.

(b) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. There is presently significant liquidity risk in that the Company will not be able to meet its financial obligations as they come due (Note 1). The Company aims to maintain 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 or investments.

The following are contractual maturities of financial liabilities, including estimated interest payments as at December 31, 2013:

	Carrying amount	Total contractual cash flows	2014	2015	2016 and beyond
Trade and other payables	1,950	1,950	1,950	–	–
Promissory note	47	47	47	–	–
Loan payable	5,656	11,689	503	503	10,683
Convertible debentures and derivative liability	15,949	16,123	16,123	–	–

(c) Market risk:

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates, will affect the Company's net earnings or the value of the financial instruments. The objective of market risk

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

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, 2013 or 2012.

(i) Currency risk:

Currency risk is the risk that a variation in exchange rates between the Canadian dollar and foreign currencies will affect the Company's operating and financial results. The Company is exposed to currency risk arising from the translation of USD denominated monetary assets and liabilities into Canadian dollars.

At December 31, 2013, the Company had cash and cash equivalents denominated in United States dollars of \$2,659 (2012 – \$3,227) and trade and other payables denominated in United States dollars of \$54,905 (2012 – \$42,798). At December 31, 2013, with other variables unchanged, a 1% movement in the Canadian dollar against the United States dollar would have a nominal effect on the Company's consolidated net loss in 2013 and 2012.

At December 31, 2013, the Company had cash and cash equivalents denominated in Great Britain pound ("GBP") of £560 (2012 – £170) and trade and other payables denominated in GBP of £461,918 (2012 – £205,669). At December 31, 2013, with other variables unchanged, a 1% movement in the Canadian dollar against the GBP would have less than a \$8,135 (2012 – \$3,270) effect on the Company's consolidated net loss.

(ii) Interest rate risk:

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Interest earned on cash and short-term investments is at nominal rates and therefore, the Company does not consider interest rate risk to be significant. The Company has no variable interest-bearing financial liabilities. The Company had no interest rate swaps or financial contracts in place at December 31, 2013 or 2012.

(iii) Commodity price risk:

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. The Company had no commodity price risk derivative contracts at December 31, 2013 or 2012. At December 31, 2013, with other variables unchanged, a 1% movement in commodity prices would have a nominal effect on the Company's consolidated net loss in 2013 and 2012.

23. 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 resources to provide an appropriate investment return to its shareholders. The Company monitors its capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may:

- Issue new shares through a public offering or private placement;
- Utilize its working capital; or
- Access other forms of debt.

The Company considers its capital structure to include shareholders' equity, working capital and loan payable:

	2013	2012
Total shareholders' equity (deficit)	(23,581)	(16,076)
Working capital (deficiency)	(17,925)	(12,046)
Loan payable	5,656	4,034

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

Working capital deficiency includes \$15,949 (2012 – \$11,011) of Debentures which were converted to common shares of the Company on February 20, 2014.

24. Subsequent events

- (a) On February 19, 2014, the Company's shareholders approved the one-for-ten consolidation of the Company's common shares.
- (b) On February 19, 2014, the Company's shareholders approved the conversion of Debentures (Note 10) pursuant to which the Company issued 108,319,091 common shares on February 20, 2014.