Falcon Oil & Gas Ltd.

Consolidated Financial Statements
Year Ended 31 December 2012

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INDEPENDENT AUDITORS REPORT

To the Shareholders of Falcon Oil & Gas Ltd.

We have audited the accompanying consolidated financial statements of Falcon Oil & Gas Ltd., which comprise the consolidated statements of financial position as at 31 December 2012 and 2011, the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the 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 our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Falcon Oil & Gas Ltd. as at 31 December 2012 and 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

Calgary, Canada
April 12, 2013

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Falcon Oil & Gas Ltd.
Consolidated Statements of Operations and Comprehensive Loss

	Notes	Year Ended 31 December 2012 $'000	Year Ended 31 December 2011 $'000
Revenue			
Oil and natural gas revenue	5	**21**	33
		21	33
Expenses			
Exploration and evaluation expenses	6	**(1,654)**	(1,629)
Production and operating expenses		**(37)**	(34)
Depletion and depreciation	14	**(342)**	(368)
Impairment of non-current assets	13	**-**	(26,035)
General and administrative expenses		**(6,206)**	(7,703)
Share based compensation	19	**(2,380)**	(2,435)
Write-down of inventories		**(552)**	(641)
Reversal of litigation expense	24	**-**	1,533
Restructuring	25	**(792)**	-
Other income		**276**	543
		(11,687)	(36,769)
Results from operating activities		**(11,666)**	(36,736)
Fair value (loss) / gain – warrants in issue	23	**(2,019)**	4,213
Finance income	7	**81**	818
Finance expense	7	**(4,111)**	(3,122)
Net finance expense		**(4,030)**	(2,304)
Net loss and comprehensive loss for the year		**(17,715)**	(34,827)
Net loss and comprehensive loss attributable to:			
Owners of the parent		**(17,441)**	(34,561)
Non-controlling interests		**(274)**	(266)
Net loss and comprehensive loss for the year		**(17,715)**	(34,827)
Net loss per share attributable to equity holders of the company			
Basic and diluted	8	**(3 cent)**	(5 cent)

The notes are an integral part of these consolidated financial statements.

On behalf of the Board:

Gregory Smith
Philip O'Quigley

Falcon Oil & Gas Ltd.
Consolidated Statements of Financial Position

	Notes	At 31 December 2012 $'000	At 31 December 2011 $'000
Assets			
Non-current assets			
Exploration and evaluation assets	13	**74,019**	70,977
Property, plant and equipment	14	**5,703**	5,224
Trade and other receivables	15	**1,265**	731
		80,987	76,932
Current assets			
Cash and cash equivalents	16	**2,884**	15,358
Restricted cash	17	**386**	51
Trade and other receivables	15	**1,756**	1,932
Inventories		**-**	628
		5,026	17,969
Total assets		**86,013**	94,901
Equity and liabilities			
Equity attributable to owners of the parent			
Share capital	18	**339,334**	339,006
Contributed surplus		**41,858**	39,654
Retained deficit		**(334,279)**	(316,838)
		46,913	61,822
Non-controlling interests		**10,882**	11,156
Total equity		**57,795**	72,978
Liabilities			
Non-current liabilities			
Convertible debentures	22	**-**	5,960
Derivative financial liabilities	23	**5,292**	3,314
Decommissioning provision	24	**10,955**	8,663
		16,247	17,937
Current liabilities			
Accounts payable and accrued expenses	25	**3,122**	3,836
Convertible debentures	22	**8,773**	-
Derivative financial liabilities	23	**26**	-
Decommissioning provision	24	**50**	150
		11,971	3,986
Total liabilities		**28,218**	21,923
Total equity and liabilities		**86,013**	94,901

The notes are an integral part of these consolidated financial statements.

Falcon Oil & Gas Ltd.
Consolidated Statements of Changes in Equity

	Notes	Share capital $'000	Contributed surplus $'000	Retained Deficit $'000	Equity interests of the parent $'000	Non-controlling interests $'000	Total equity $'000
At 1 January 2011		331,215	37,874	(282,277)	**86,812**	11,422	**98,234**
Private placement of shares		6,924	-	-	**6,924**	-	**6,924**
Issuance of shares		648	(648)	-	**-**	-	**-**
Options exercised		15	(7)	-	**8**	-	**8**
Share based compensation		-	2,435	-	**2,435**	-	**2,435**
Share bonus to employees & consultants		107	-	-	**107**	-	**107**
Private placement to officers & a director		97	-	-	**97**	-	**97**
Net loss for the year		-	-	(34,561)	**(34,561)**	(266)	**(34,827)**
At 31 December 2011		339,006	39,654	(316,838)	**61,822**	11,156	**72,978**
Issuance of shares to former officer	18	54	-	-	**54**	-	**54**
Options exercised	18	274	(122)	-	**152**	-	**152**
Share based compensation		-	2,326	-	**2,326**	-	**2,326**
Net loss for the year		-	-	(17,441)	**(17,441)**	(274)	**(17,715)**
At 31 December 2012		339,334	41,858	(334,279)	**46,913**	10,882	**57,795**

The notes are an integral part of these consolidated financial statements.

Falcon Oil & Gas Ltd.
Consolidated Statements of Cash Flows

	Notes	2012 $'000	2011 $'000
		Year Ended 31 December	
Cash flows from operating activities			
Net loss for the year		**(17,715)**	(34,827)
Adjustments for:			
Share based compensation		**2,380**	2,435
Share bonus		**-**	204
Depletion and depreciation		**342**	368
Impairment of non-current assets		**-**	26,035
Reversal of litigation expense		**-**	(1,533)
Fair value (loss) / gain – warrants in issue		**2,019**	(4,213)
Net finance expense		**4,030**	2,304
Other		**-**	20
Change in non-cash working capital	12	**668**	(1,845)
Interest paid		**(1,061)**	(1,170)
Interest received	7	**66**	83
Net cash used in operating activities		**(9,271)**	(12,139)
Cash flows from investing activities			
Increase in restricted cash		**(335)**	-
Exploration and evaluation assets		**(2,834)**	(13,397)
Proceeds from farm-out transaction, net		**-**	19,609
Property, plant and equipment		**(325)**	(157)
Net cash used in investing activities		**(3,494)**	6,055
Cash flows from financing activities			
Proceeds from private placement of units offering, net		**-**	13,480
Proceeds from private placement of warrants		**-**	945
Proceeds from exercise of share options		**152**	8
Net cash from financing activities		**152**	14,433
Change in cash and cash equivalents		**(12,613)**	8,349
Effect of exchange rates on cash & cash equivalents		**139**	(265)
Cash and cash equivalents at beginning of year		**15,358**	7,274
Cash and cash equivalents at end of year		**2,884**	15,358

The notes are an integral part of these consolidated financial statements.

1. General Information

Falcon Oil & Gas Ltd. is an oil and gas company engaged in the acquisition, exploration and development of unconventional and conventional oil and gas assets. Falcon's interests are located in Australia, Hungary, South Africa and Canada.

Falcon is incorporated in British Columbia, Canada and headquartered in Dublin, Ireland with a technical team based in Budapest, Hungary. Falcon's Common Shares are traded on the TSX Venture Exchange (symbol: FO.V); AIM, the market operated by the London Stock Exchange (symbol: FOG) and ESM, the market regulated by the Irish Stock Exchange (symbol: FAC).

2. Accounting policies

The significant accounting policies adopted by the Group are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation and going concern

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee.

The Group consolidated financial statement have been prepared on a going concern basis which assumes that the Group will be able to meet its liabilities as they fall due for the foreseeable future.

For the year ended 31 December 2012, the Company incurred a net loss of $17.7 million and operating cash outflows of $9.3 million and as at 31 December 2012, had a retained deficit of $334.3 million.

On 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange (symbol: FOG) and the ESM market of the Irish Stock Exchange (symbol: FAC) of the Company's existing share capital and the additional 120,381,973 new common shares in the capital of the Company to be issued pursuant to the concurrent conditional brokered private placement of new common shares at a price of Stg14 pence (CDN$0.215) per share to raise gross proceeds of $25 million (£16.9 million). Trading in these shares commenced on AIM and ESM on 28 March 2013.

Having given due consideration to the cash requirements of the Group and having raised capital in the gross amount of $25 million, the Board of Directors ("the Board") has a reasonable expectation that the Group will have adequate resources to continue in operational existence for the foreseeable future. For this reason, the Board continues to adopt the going concern basis in preparing this financial information.

Notwithstanding the Group's recent fundraising, the Group's ability to continue as a going concern is dependent upon either its ability to raise additional capital from the sale of additional common shares or other debt or equity instruments, asset dispositions, having producing assets and/ or entering into joint arrangement with third parties.

Historical cost convention

The consolidated financial statements have been prepared on the historical cost basis with the exception of certain derivative financial instruments which are measured at fair value.

Foreign currency translation

(i) Functional and presentation currency
The consolidated financial statements are presented in United States dollars, the functional currency of all group entities. All amounts, except as otherwise indicated, are presented in thousands of dollars.

CDN$ where referenced in the financial statements represents Canadian Dollars. £ / Stg where referenced in the financial statements represents British Pounds Sterling.

2. Accounting policies (continued)

(ii) Transactions and balances
Transactions in foreign currencies are translated to United States dollars, the functional currency of all group entities, at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to United States dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognised in the statement of operations and comprehensive loss.

Basis of consolidation

These consolidated financial statements include the accounts of the Company and the accounts of its subsidiaries. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Company's equity. Non-controlling interests consists of the non-controlling interest at the date of the change in ownership plus the non-controlling interest's share of changes in equity since that date.

All of the Company's subsidiaries are wholly owned except for Falcon Oil & Gas Australia Ltd. ("Falcon Australia") of which approximately 73% of the outstanding Common Shares are owned by Falcon. The consolidated financial statements include non-controlling interests representing the 27% portion of Falcon Australia's assets and liabilities not owned by Falcon. The reporting dates of the Company and its subsidiaries are coterminous.

Intercompany balances and transactions, and any unrealised income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements, except when losses realised on intercompany transactions are evidence of impairment.

Financial assets

The Group classifies its financial assets in the following categories: at fair value through the statement of operations and comprehensive loss, loans and receivables and available-for-sale. The classification depends on the purposes for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

***(i) Financial assets at fair value through the* statement of operations and comprehensive loss**
Financial assets at fair value through the statement of operations and comprehensive loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purposes of selling in the short term. Derivatives are also categorized as held for trading unless they are designated as hedges. Asset in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non-current.

(ii) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are initially recognised at fair value and subsequently recorded at amortised cost. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Group's loans and receivables comprise "trade and other receivables", "cash and cash equivalents" and "restricted cash" in the balance sheet.

(iii) Available-for-sale financial assets
Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They mainly include investments the Group would have in equity securities in which the Group does not have significant influence or control. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period.

2. Accounting policies (continued)

Available-for-sale financial assets are carried at fair value. Changes in the fair value are recognised in other comprehensive income/loss. When available-for-sale financial assets are sold or impaired the accumulated fair value adjustments previously recognised in equity are included in the statement of operations and comprehensive loss as gains and losses. At 31 December 2012 and 31 December 2011, the Group had no assets categorised within this category.

Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

Derivative financial instruments

Derivatives (including embedded derivatives) are initially recognised at fair value of the date a derivative contract is entered into and subsequently re-measured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group has not designated any derivatives as hedges as at 31 December 2012 or 31 December 2011.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related. Changes in the fair value of separable embedded derivatives are recognised immediately in the statement of operations and comprehensive loss.

Warrants

Warrants which do not meet the criteria to be classified as an equity instrument are classified at fair value through the statement of operations and comprehensive loss and are recorded on the statement of financial position at fair value. Transaction costs are recognised in the statement of operations and comprehensive loss as incurred.

Compound financial instruments - debentures

Compound financial instruments issued by the Group where the exercise of the conversion feature does not result in a fixed number of shares being issued for a fixed amount in the functional currency of the Company, are separated into a host contract, the note, and embedded derivatives.

The Group has an 11% convertible redeemable debenture in issue at 31 December 2012 and 31 December 2011.

The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. Subsequent to initial recognition, the liability component of the compound financial instrument is measured at amortised cost using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

Share capital

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

Property, plant and equipment and intangible exploration assets

(i) Recognition and measurement

- Exploration and evaluation ("E&E") expenditures

Pre-license costs are recognised in the statement of operations and comprehensive loss as part of exploration and evaluation expenses as incurred.

2. Accounting policies (continued)

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalised as either tangible or intangible exploration and evaluation assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability. The company does not capitalise interest in relation to exploration and evaluation assets.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proven reserves have been discovered. Upon determination of proven reserves, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within tangible assets referred to as oil and natural gas interests.

Proceeds from disposal or farm-out transactions of intangible exploration assets are used to reduce the carrying amount of the assets. When proceeds exceed the carrying amount, the difference is recognised as a gain. When the Company disposes of its' full interests, gains or losses are recognised in accordance with the policy for recognising gains or losses on sale of plant, property and equipment.

- Development and production costs

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into CGU's for impairment testing. When significant parts of an item of property, plant and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised net within "other income" or "other expenses" in the statement of operations and comprehensive loss.

- Other fixed assets
Costs incurred on office fixtures and fittings are stated at historical cost less accumulated deprecation and any recognised impairment.

(ii) Subsequent costs
Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognised as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognised in the statement of operations and comprehensive loss as incurred. Such capitalised oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in the statement of operations and comprehensive loss as incurred.

(iii) Depletion, depreciation and amortisation
The net carrying value of development or production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development and decommissioning costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

2. Accounting policies (continued)

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable and a 50 percent statistical probability that it will be less. The equivalent statistical probabilities for the proven component of proven and probable reserves are 90 percent and 10 percent, respectively.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered proven and probable if the ability to produce is supported by either actual production or a conclusive formation test. The area of reservoir considered proven includes (a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, or both, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geophysical, geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of oil and natural gas controls the lower proved limit of the reservoir.

Reserves which can be produced economically through application of improved recovery techniques (such as fluid injection) are only included in the proven and probable classification when successful testing by a pilot project, the operation of an installed program in the reservoir, or other reasonable evidence (such as, experience of the same techniques on similar reservoirs or reservoir simulation studies) provides support for the engineering analysis on which the project or program was based.

For other assets, depreciation is recognised in the statement of operations and comprehensive loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment of two to seven years. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

Leased assets

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognised on the Company's statement of financial position.

Payments made under operating leases are recognised in the statement of operations and comprehensive loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

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.

2. Accounting policies (continued)

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

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

All impairment losses are recognised in the statement of operations and comprehensive loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost the reversal is recognised in the statement of operations and comprehensive loss.

(ii) Non-financial assets
The carrying amounts of the Company's non-financial assets, other than E&E 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. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

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.

E&E assets are allocated to related CGU's when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (oil and natural gas interests in property, plant and equipment).

An impairment loss is recognised if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognised in the statement of operations and comprehensive loss. Impairment losses recognised in respect of CGU's are allocated to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

Impairment losses recognised 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 amortisation, if no impairment loss had been recognised.

Share based compensation

Share based compensation is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. The amount recognised as expense is adjusted for an estimated forfeiture rate for options that will not vest, which is adjusted as actual forfeitures occur, until the shares are fully vested. Consideration paid upon the exercise of stock options, together with corresponding amounts previously recognised in contributed surplus, is recorded as an increase to share capital.

2. Accounting policies (continued)

Provisions

A provision is recognised if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognised for future operating losses.

(i) Decommissioning provisions
The Company's activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. Provision is made for the estimated cost of site restoration and capitalised in the relevant asset category.

Decommissioning provisions are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the statement of financial position date. Subsequent to initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognised as finance costs whereas increases/decreases due to changes in the estimated future cash flows are recorded against the related asset. Actual costs incurred upon settlement of the decommissioning provisions are charged against the provision to the extent the provision was established.

(ii) Legal matters
A provision for legal matters is recognised when legal action is threatened or initiated, and management considers it probable that the legal actions will result in an obligation for the Company. The provision is determined based on the expected cash flows, including legal expenses, and considering the time value of money. When the legal matter relates to exploration and evaluation activities, the recognition of the provision and subsequent change in the expected cash flows is recorded in exploration and evaluation assets.

(iii) Restructuring provisions
Restructuring provisions comprise lease fulfillment obligations, employee termination payments and associated costs. Termination benefits are payable when employment is terminated before normal retirement date. The Group recognises these benefits when it is demonstrable committed to terminating the employment of current employees in line with a formal plan. The restructuring provision is classified within accrued expenses.

Segment reporting

The operating segment is reported in a manner consistent with the internal reporting provided to the chief operating decision-maker ("CODM"). The CODM is considered to be the Board of Directors.

Revenue

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. Revenue is measured net of discounts, customs duties and royalties. Royalty income is recognised as it accrues in accordance with the terms of the overriding royalty agreements.

Finance income and expenses

Finance expense comprises interest expense on borrowings, accretion of the discount on provisions, changes in fair value of derivatives and impairment losses recognised on financial assets.

Borrowing costs incurred for the construction of qualifying assets are capitalised during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognised in the statement of operations and comprehensive loss using the effective interest method. The capitalisation rate used to determine the amount of borrowing costs to be capitalised is the weighted average interest rate applicable to the Company's outstanding borrowings during the period.

2. Accounting policies (continued)

Interest income is recognised as it accrues in the statement of operations and comprehensive loss, using the effective interest method.

Foreign currency gains and losses, reported under finance income and expenses, are reported on a net basis.

Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the statement of operations and comprehensive loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the statement of financial position method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Inventories

Inventories are stated at the lower of costs and net realisable value. Cost comprises cost of purchase, i.e. the supplier’s invoice price (net of discounts), with the addition of charged such as freight or duty where appropriate. Net realisable value comprises the actual or estimated selling price (net of discounts) less all costs to be incurred in selling and distribution.

Earnings per share

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effect of dilutive instruments such as options granted to employees.

3. Critical accounting estimates and judgments

Preparation of financial statements pursuant to IFRS requires a significant number of judgemental assumptions and estimates to be made. This impacts the income and expenses recognised in the statement of operations and comprehensive loss together with the valuation of the assets and liabilities in the statement of financial position. Such estimates and judgements are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances and are subject to continual re-evaluation. It should be noted that the impact of valuation in some assumptions and estimates can have a material impact on the reported results.

The following are key sources of estimation uncertainty and critical accounting judgements in applying the Group’s accounting policies:

3. Critical accounting estimates and judgments (continued)

Critical judgments

(i) Exploration and evaluation assets
The carrying value of exploration and evaluation assets was $74.0 million at 31 December 2012 (2011: $71.0 million). The Company has determined that there are no indicators of impairment present in accordance with IFRS 6 “Exploration for and evaluation of mineral interests” and thus impairment evaluations were not performed on these assets.

Management’s conclusion that no facts or circumstances exist that suggested the exploration and evaluation assets may be impaired required judgment based on experience and the expected progress of current exploration and evaluation activities and the successful completion of farm-out projects.

The critical judgments are:

Beetaloo Basin, Northern Territory, Australia: Under the terms of the Hess Agreement, Hess has the option until 30 June 2013 to acquire a 62.5% working interest in the Hess Area of Interest, by committing to drill and evaluate five exploration wells at Hess’ sole cost, one of which must be a horizontal well. In the event that Hess decides not to drill and evaluate five wells, its obligations under the Hess Agreement will cease and Falcon Australia will become responsible for 100% of any exploration and development costs of the Hess Area of Interest. If Falcon Australia were unable to secure participation by a new farm-in or joint venture partner for the development of the Hess Area of Interest, its ability to develop and realise its investment in the asset could be significantly curtailed. A decision by Hess not to exercise its option would have an adverse effect on the Group’s business, prospects, financial condition and results of operations. Management have assumed that Hess will exercise its option.

Makó Trough, Hungary: Under the terms of the NIS Agreement, NIS will earn 50% of the net production revenues from the initial three wells being drilled in the Algyö Play, and will have an option to acquire a right of first negotiation for future drilling operations in the Algyö Play, sharing any potential future costs and revenue with the Group, on terms to be negotiated. In the event that NIS decide not participate in any further drilling operations in the Algyö Play, Falcon will become responsible for 100% of any exploration and development costs in the Algyö Play under the Makó Production Licence. If the Group were unable to secure participation by a new farm-in or joint venture partner for the development of the Algyö Play, its ability to develop and realise its investment in the asset could be significantly curtailed. This could have an adverse effect on the Group’s business, prospects, financial condition and results of operations. Management have assumed that the NIS agreement will yield results.

Critical estimates

(ii) Going concern
The consolidated financial statements have been prepared on the going concern basis. In considering the financial position of the Group, the Company has considered the forecasted operating and capital expenditures for the foreseeable future and cash flows relating to its financing. Forecasting those cash flows requires significant judgment when estimating expected operating expenditure, capital expenditure, proceeds from share issuances and cash outflows required to redeem the company’s convertible debt.

(iii) Decommissioning Provision
The decommissioning provision represents the Company’s best estimate of the costs involved in the various exploration and production licence areas to return them to their original condition in accordance with the licence terms. These estimates include certain management assumptions with regard to future costs, inflation rates and discount rates.

4. Management of capital

The Company's objectives when managing capital are to safeguard its ability to continue as a going concern in order to explore and develop its petroleum and natural gas properties. The Company manages the components of shareholders' equity and its cash as capital, and makes adjustments to these components in response to the Company's business objectives and the economic climate. To maintain or adjust its capital structure, the Company may issue new common shares or debt instruments, or borrow money or acquire or convey interests in other assets. The Company does not anticipate the payment of dividends in the foreseeable future.

The Company's investment policy is to hold excess cash in highly-liquid, short-term instruments, such as bankers' acceptances and guaranteed investment certificates issued by major European, Canadian or United States financial institutions, with initial maturity terms of less than three months from the original date of acquisition, selected with regard to the Company's anticipated liquidity requirements.

5. Segment information

Based on internal reporting information, it was determined that there is one reportable segment. All of the Company's operations are in the petroleum and natural gas industry with its principal business activity being in the acquisition, exploration and development of petroleum and natural gas properties. The Company has producing petroleum and natural gas properties located in Canada and considers the results from its operations to relate to the petroleum and natural gas properties. The Company has unproven petroleum and natural gas properties and interests in Australia, South Africa and Hungary.

The key performance measures reviewed for the segment which management believe is the most relevant information when evaluating the results of the Group are:

- the progress and extent to which farm out agreements have been executed over the Group's acreage; and
- cash flow, capital expenditure and operating expenses.

An analysis of the geographic areas is as follows:

	Australia $'000	**South Africa $'000**	**Hungary $'000**	**Ireland $'000**	**Canada $'000**	**United States $'000**	**Total $'000**
Year ended 31 December 2012							
Revenue	**-**	**-**	**8**	**-**	**13**	**-**	**21**
Net (loss) / income (i)	**(833)**	**668**	**(4,746)**	**-**	**(9,767)**	**(2,763)**	**(17,441)**
At 31 December 2012							
Capital assets (ii)	**49,873**	**-**	**29,665**	**184**	**-**	**-**	**79,722**

	Australia $'000	South Africa $'000	Hungary $'000	Canada $'000	United States $'000	Total $'000
Year ended 31 December 2011						
Revenue	-	-	2	31	-	33
Net loss (i)	(708)	(280)	(28,717)	(2,577)	(2,279)	(34,561)
At 31 December 2011						
Capital assets (ii)	48,221	-	27,814	-	166	76,201

(i) Net (loss) /income attributable to owners of the parent.
(ii) Capital assets consist of exploration & evaluation assets and property, plant and equipment.

6. Exploration and evaluation expenses

Exploration and evaluation expenses consist of:

		Year Ended 31 December	
		2012	2011
	Notes	**$'000**	$'000
Exploration and evaluation expenses		**(2,654)**	(1,629)
Recovery of past cost relating to South Africa	(i)	**1,000**	-
		(1,654)	(1,629)

(i) On 12 December 2012, Falcon entered into an exclusive cooperation agreement with Chevron to jointly seek exploration opportunities in the Karoo Basin. The Chevron Agreement provides for Falcon to work exclusively with Chevron for a period of five years to jointly seek to obtain exploration rights in the Karoo Basin subject to the parties mutually agreeing participation terms applicable to each right. As part of the Chevron Agreement, Chevron made a cash payment to Falcon of $1 million as a contribution to past costs. This was received in February 2013.

7. Finance income and expense

		Year Ended 31 December	
		2012	2011
	Notes	**$'000**	$'000
Finance income			
Interest income on bank deposits		**66**	84
Derivative gains – unrealised[(i)]	23	**15**	734
		81	818
Finance expense			
Effective interest on loans and borrowings		**(3,721)**	(2,429)
Accretion of decommissioning provisions	24	**(209)**	(267)
Net foreign exchange loss		**(181)**	(426)
		(4,111)	(3,122)
Net finance expense		**(4,030)**	(2,304)

(i) Derivative gains – unrealised gains arising on the convertible debt conversion feature

8. Net loss per share

Basic and diluted loss per share is calculated as follows:

	Year Ended 31 December	
	2012	2011
	$'000	$'000
Loss attributable to equity holders of the company	**(17,441)**	(34,561)
Weighted average number of common shares in issue - (thousands)	**695,819**	669,677
Loss per share	**(3 cents)**	(5 cents)

All outstanding convertible securities, options and warrants are excluded from the calculation of net loss per share as the effect of these assumed conversions and exercises is anti-dilutive.

9. Income taxes

A reconciliation of the expected tax benefit computed by applying the combined federal and provincial Canadian tax rates of 25% (2011: 26.5%) to the loss before tax to the actual tax result is as follows:

	Year Ended 31 December	
	2012	2011
	$'000	$'000
Loss before tax	(17,441)	(34,561)
Combined Federal and provincial tax rate	25%	26.5%
Computed income tax benefit	(4,360)	(9,159)
Increase (decrease) in income taxes resulting from:		
Effect of foreign income tax rates	93	4,437
Change in income tax rates in jurisdictions	(2,369)	887
Effect of change in foreign exchange rates	(234)	688
Unrecognised benefit of prior period loss carryforwards	1,781	(1,348)
Non-deductible stock based compensation	603	645
Derivatives	1,186	(937)
Other	82	(119)
Change in deferred tax benefits not recognised	3,218	4,906
Tax result	-	-

The Group's deductible differences included in the Group's unrecognised deferred tax asset are as follows:

	At 31 December	
	2012	2011
	$'000	$'000
Trading losses	**119,841**	142,458
Exploration and evaluation assets and property, plant and equipment	**212,419**	163,419
Other	**8,387**	8,387
	340,647	314,264

The Group's accumulated trading losses carryforwards as at 31 December 2012 to reduce future years' taxable income are as follows:

	2012	Expiration
Canada	28,146	2015 to 2032
United States	17,948	2027 to 2032
Hungary	51,089	No expiration
Australia	22,658	No expiration
	119,841	

The other deductible temporary differences do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of the tax losses, exploration and evaluation assets and other as it is not probable that future tax profit will be available against which the Company can utilise these benefits in the foreseeable future.

10. Directors' remuneration & transactions with key management personnel

Directors' remuneration is analysed as follows:

Executive directors[iii]

	Year	Salary $'000	Pension contribution $'000	Other $'000	Bonus $'000	Director fees $'000	[iv] Share-based payment $'000
Philip O'Quigley	**2012**	**113**	**20**	**1**	**-**	**-**	**188**
(appointed 25 September 2012)	2011	-	-	-	-	-	-
Dr. György Szabó [i]	**2012**	**180**	**-**	**-**	**-**	**-**	**112**
	2011	222	-	-	-	9	157
Robert Macaulay [ii]	**2012**	**142**	**-**	**-**	**-**	**17**	**84**
(resigned 25 September 2012)	2011	324	-	-	100	-	69

(i) Dr. György Szabó resigned as chairman of Falcon Oil and Gas Ltd with effect from 7 September 2011. He continues to serve the Company as a Director and as co-Managing Director of the Company's Hungarian subsidiary TXM Oil and Gas Exploration Kft.
(ii) Mr. Macaulay was appointed President and CEO in November 2010. He stepped down on 1 May 2012 and Mr. Philip O'Quigley was appointed on the same day. No amounts have been paid to Mr. Macaulay in connection with his termination. Mr. Macaulay remained on the Board of Directors as a Non-executive Director until his resignation on 25 September 2012. Under the terms of his employment agreement, as President and Interim CEO, Mr. Macaulay was awarded 300,000 shares in Falcon Oil and Gas Ltd, which were granted in December 2012. In addition the company paid the cost of personal taxes relating to the granting of these shares.
(iii) Directors' remuneration is fixed by the Compensation Committee of the board.
(iv) Share based payments represents the non-cash expense attributable to the relevant options held by each Director. For further details on the fair value calculation of these amounts, refer to note 19.

Non-executive

	Director fees[i]		Share-based payments[ii]	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
John Craven	**48**	27	**35**	70
Daryl H. Gilbert	**37**	23	**157**	161
JoAchim Conrad	**36**	23	**21**	42
Gregory Smith	**42**	27	**24**	49
Igor Akhmerov	**42**	23	**15**	28
David Harris (appointed 25 September 2012)	**9**	-	**-**	-
Thomas G. Harris (resigned 3 November 2011)	**-**	23	**-**	28
Andrew Morris (appointed 3 November 2011; resigned 25 September 2012)	**32**	5	**-**	-

(i) Directors' remuneration is fixed by the Compensation Committee of the board.
(ii) Share based payments represents the non-cash expense attributable to the relevant options held by each Director. For further details on the fair value calculation of these amounts, refer to note 19.

10. Directors' remuneration & transactions with key management personnel (continued)

Transactions with key management comprising Directors and other senior management

Key management personnel comprise the Board of Directors and senior management. The remuneration of key management personnel was as follows:

	For the year ended 31 December	
	2012	2011
	$'000	$'000
Directors' fees	262	158
Salaries and other emoluments	984	1,286
Share based compensation	1,823	1,222
Defined contribution pension plans	38	-
Termination benefits	236	-
	3,343	2,666

Remuneration of Directors and Senior Management includes all amounts earned and awarded to the Company's Board of Directors and Senior Management.

Senior Management includes the Group's Chief Executive Officer, Chief Financial Officer, the Managing Director of the Group's subsidiary (Falcon TXM) and the Group's head of Technical and the previous Chief Operating Officer.

Eoin Grindley (Chief Financial Officer) is, pursuant to his employment contract, entitled to 3,000,000 stock options which have not yet been granted.

Directors' fees include Board and Committee fees. Short-term wages and benefits include salary, benefits and bonuses earned or awarded during the year. Share-based compensation includes expenses related to the Company's long-term incentive compensation.

11. Compensation expense and auditors' remuneration

(i) Compensation expense

The Company's consolidated statements of operations and comprehensive loss are prepared primarily by nature of expense, with the exception of compensation costs which are included in both exploration and evaluation expenses and general and administrative expenses, share based compensation which is reflected as a separate financial statement component and termination benefits which are reflected in restructuring costs. The following is a summary of total compensation:

	For the year ended 31 December	
	2012	2011
	$'000	$'000
Exploration and evaluation expenses	**966**	620
General and administrative expenses	**2,147**	2,535
Share based compensation	**2,410**	2,435
Termination benefits	**567**	-
	6,090	5,590

11. Compensation expense and auditors' remuneration (continued)

(ii) Auditors' remuneration

Remuneration of the auditors for the audit of the Group financial statements of Falcon Oil & Gas Ltd and other services to the Group is as follows:

	For the year ended 31 December	
	2012	2011
	$'000	$'000
Audit fees	**248**	342
Tax fees	**81**	102
All other fees	**2**	-
	331	444

The above amounts exclude Canadian/ Australian GST and European VAT as appropriate. The amounts exclude the reimbursement of expenses paid to the Group's auditors. Audit fees include the amount of CDN$65,000 for the quarterly review of Falcon's financial statements (2011: CDN$79,000) and work in the amount of CDN$43,000 on the IFRS conversion project during 2011.

12. Supplemented cash flow information

Changes in non-cash working capital is comprised of:

	Year Ended 31 December	
	2012	2011
	$'000	$'000
Trade and other receivables	**176**	(566)
Write-down of inventories	**552**	641
Inventories	**-**	409
Accounts payable and accrued expenses	**(60)**	(2,329)
	668	(1,845)

13. Exploration and evaluation assets

	Australia $'000	South Africa $'000	Hungary $'000	Total $'000
At 1 January 2011	52,258	-	46,497	98,755
Additions	15,572	-	2,259	17,831
Impairment	-	-	(26,000)	(26,000)
Proceeds from farm-out transaction, net of transaction costs	(19,609)	-	-	(19,609)
At 31 December 2011	48,221	-	22,756	70,977

13. Exploration and evaluation assets (continued)

	Australia $'000	South Africa $'000	Hungary $'000	Total $'000
At 1 January 2012	48,221	-	22,756	70,977
Additions	1,652	-	-	1,652
Disposals	-	-	(140)	(140)
Decommissioning provision	-	-	1,530	1,530
At 31 December 2012	**49,873**	**-**	**24,146**	**74,019**

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proven or probable reserves. Additions represent the Company's costs incurred on E&E assets during the period.

The impairment of intangible exploration assets, and any eventual reversal thereof, is recognised as additional depletion, depreciation and amortisation expense in the statement of operations and comprehensive loss as impairment of non-current assets.

As at 31 December 2012, there were no indicators of impairment as defined by IFRS 6, and as such no impairment testing was performed.

For the year ended 31 December 2011, the Company identified indicators that there was a potential for impairment of a portion of its Hungarian assets, specifically the depths of the Makó production license below the Algyö formation. Those identified indicators include a lack of progress in exploration activities during the year in those deeper zones, limited availability of funds to perform further exploratory activities in the near future in the deeper zones and limitation of discussions about a potential farm-out for the deeper zone play. The Company determined that the carrying value of the Hungarian properties exceeded its estimated recoverable amount and recorded an impairment of $26.0 million. The estimated recoverable value was assessed by the Company utilising a valuation model based on potential joint venture partners as evidenced by discussions being held and an assessment of the valuation of the prospect based on potential farm-out arrangements.

Beetaloo Basin, Northern Territory, Australia

Falcon Australia, Falcon's 72.7% owned subsidiary, is the registered holder of four exploration permits covering approximately 7 million acres (approximately 28,000 km2) in the Beetaloo Basin, a sparsely populated area of the Northern Territory.

In April 2011, Falcon Australia entered into a joint venture with Hess Australia (Beetaloo) Pty. Ltd, whereby Hess agreed to collect seismic data over an area covering three of the four Beetaloo Exploration Permits, excluding an area covering approximately 100,000 acres (approximately 405 km2) surrounding the Shenandoah-1 well-bore (the "Area of Interest").

Under the terms of the E&P Agreement, Hess paid $20.0 million to the Company (i) as a participation fee for the exclusive right to conduct operations for the exploration, drilling, development and production of hydrocarbons from the Area of Interest and (ii) as consideration for warrants to acquire 10,000,000 common shares in the capital of Falcon exercisable from 14 November 2011 through 13 January 2015 at an exercise price of CDN$0.19 per share (the "Hess Warrants"). The $20.0 million of gross proceeds received from Hess in 2011 were reduced by closing costs of $1.3 million resulting in net proceeds of $18.7 million which were allocated $17.7 million to the farm-out transaction and $0.9 million to the warrants (see note 23).

Since the date of this agreement, Hess has spent in excess of $55 million acquiring 3,490 kilometres of 2D seismic data which is currently being interpreted. Hess has the option, exercisable until 30 June 2013, to acquire a 62.5% working interest in the Area of Interest by committing to drill and evaluate five exploration wells at Hess' sole cost, one of which must be a horizontal well. All costs to plug and abandon the five exploration wells will also be borne solely by Hess. The drilling and evaluation of the five exploration wells must meet the minimum work requirements of the work program. Costs to drill wells after the five exploration wells will be borne 62.5% by Hess and 37.5% by Falcon Australia.

13. Exploration and evaluation assets (continued)

In November 2011, Falcon Australia, in accordance with the work program for Permit EP 98, completed the testing and stimulation of the Shenandoah-1 well at its sole cost, and the well has been plugged and abandoned. Falcon Australia provided Hess with the data obtained from these activities, and in 2011 Hess paid Falcon Australia $2.0 million which was recorded against the carrying amount of the Australian exploration and evaluation asset.

Karoo Basin, South Africa

Falcon holds a Technical Cooperation Permit (“TCP”) covering an area of approximately 7.5 million acres (approximately 30,327 km2) onshore Karoo Basin, South Africa.

The TCP grants Falcon an exclusive right to apply for an exploration right over the underlying acreage. In February 2011, a moratorium on the processing of all new applications relating to the exploration and production of shale gas in the Karoo Basin was put in place, and in April 2011 the processing of all existing applications was suspended whilst the South African Department of Mineral Resources conducted an environmental study on the effects of hydraulic stimulation and developed a system to regulate onshore exploration activities. In September 2012, the South African Government announced a decision to lift the moratorium on the processing of existing shale gas exploration permit applications following the publication of legislation (expected in Q2 2013), and consequently the company is awaiting exploration rights to be awarded.

In December 2012, Falcon entered into a cooperation agreement with Chevron to jointly seek unconventional exploration opportunities in the Karoo Basin. The Chevron Agreement provides for Falcon to work exclusively with Chevron for a period of five years to jointly seek to obtain exploration rights in the Karoo Basin subject to the parties mutually agreeing participation terms applicable to each right (see note 6).

All expenditures and recoveries of costs associated with the TCP and with the application for the exploration permit are charged/ credited to operations as exploration and evaluation expenses.

Makó Trough, Hungary

Falcon began operations in Hungary in 2005 and it is the most progressed asset in its portfolio. Falcon’s subsidiary, TXM, holds the 35-year Makó Production Licence covering an area of approximately 245,775 acres (approximately 1,000 km2) located in the Makó Trough, part of the greater Pannonian Basin of central Europe. The Makó Licence is located approximately ten kilometres from the MOL Group owned and operated Algyö field. The Makó Licence area is transected by existing gas pipelines, including a 12 kilometre gas pipeline built by Falcon in 2007, which together offer potential access to local and international markets.

The Makó Trough contains two distinct plays:

- a play targeting gas prospects in the shallower Algyö Play at depths between 2,300 metres and 3,500 metres; and
- a deeper unconventional play targeting significant contingent resources in the Deep Makó Trough.

In January 2013, Falcon agreed a three-well drilling exploration programme with Naftna industrija Srbije jsc (“NIS”), owned 56% by Gazprom Group, to target the Algyö Play (“the agreement area”). NIS have made a cash payment of $1.5 million to Falcon in 2013 and agreed to drill three exploration wells by July 2014. NIS will earn 50% of net production from the first three wells, and has the option to participate in any future drilling on terms to be negotiated, after paying Falcon $2.75 million. Falcon is to be fully carried on the drilling and testing of the three exploration wells.

If NIS does not fulfill their drilling obligations under the participation agreement, TXM will retain 100% interest in the Agreement Area.

If the NIS earn-in is completed, NIS and TXM will share future exploration, appraisal and development costs and production in the Agreement Area in accordance with their participating interests held under a joint operating agreement. TXM shall be the Operator under both the participation agreement and the joint operating agreement.

14. Property, plant and equipment

	Canadian natural gas interests $'000	Pipeline and facilities $'000	Furniture and equipment $'000	Total $'000
Cost:				
At 1 January 2011	466	3,831	3,318	7,615
Additions	-	-	158	158
Disposals	-	-	(91)	(91)
At 31 December 2011	466	3,831	3,385	7,682
Depletion, depreciation and amortisation:				
At 1 January 2011	(423)	-	(1,671)	(2,094)
Depletion and depreciation	(8)	-	(360)	(368)
Impairment	(35)	-	-	(35)
Disposals	-	-	39	39
At 31 December 2011	(466)	-	(1,992)	(2,458)
Net book value:				
At 31 December 2011	-	3,831	1,393	5,224

	Canadian natural gas interests $'000	**Pipeline and facilities $'000**	**Furniture and equipment $'000**	**Total $'000**
Cost:				
At 1 January 2012	**466**	**3,831**	**3,385**	**7,682**
Additions	**-**	**-**	**375**	**375**
Decommissioning provisioning	**-**	**453**	**-**	**453**
Disposals	**-**	**-**	**(1,113)**	**(1,113)**
At 31 December 2012	**466**	**4,284**	**2,647**	**7,397**
Depletion, depreciation and amortisation:				
At 1 January 2012	**(466)**	**-**	**(1,992)**	**(2,458)**
Depletion and depreciation	**-**	**-**	**(342)**	**(342)**
Disposals	**-**	**-**	**1,106**	**1,106**
At 31 December 2012	**(466)**	**-**	**(1,228)**	**(1,694)**
Net book value:				
At 31 December 2012	**-**	**4,284**	**1,419**	**5,703**

15. Trade and other receivables

		At 31 December
	2012	2011
	$'000	$'000
Non-current		
Deposits	**558**	570
Other prepayments	**707**	161
	1,265	731

			At 31 December
		2012	2011
	Note	**$'000**	$'000
Current			
Accounts receivable		**8**	2
Chevron receivable	6	**1,000**	-
Deposits		**39**	77
Prepayments		**330**	252
GST/ VAT receivable		**339**	899
Other receivables		**40**	702
		1,756	1,932

16. Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held on call with banks, other short term highly liquid investments with initial maturities of three months or less at inception and bank overdrafts where a legal right of offset exists. Bank overdrafts where no legal right of set-off exists are shown within borrowings in current liabilities in the statement of financial position.

17. Restricted cash

Restricted cash includes cash held by financial institutions as collateral for ongoing Group operations.

18. Share capital

At 31 December 2012 and 2011, the Company was authorised to issue an unlimited number of common shares, without par value. The following are the rights, preferences and restrictions attaching to the common shares:

- The Shareholders are entitled to one vote per Common Share at a shareholder meeting;
- The Company's articles do not impose any pre-emptive rights upon the transfer of the Common Shares;
- Subject to the BCA and any regulatory or stock exchange requirements applicable to the Company, the articles of the Company do not contain any provisions relating to mandatory disclosure of an ownership interest in the Common Shares above a certain threshold;
- Shareholders are entitled to receive on a pro rata basis such dividends, if any, as and when declared by Falcon's board of directors at its discretion from funds legally available therefor, and upon the liquidation, dissolution or winding up of Falcon are entitled to receive on a pro rata basis the net assets of Falcon after payment of debts and other liabilities, in each case subject to the rights, privileges, restrictions and conditions attaching to any other series or class of shares ranking senior in priority to or on a pro rata basis with the holders of Common Shares with respect to dividends or liquidation. All rights are the same for residents or non-residents of Canada.

18. Share capital (continued)

- Annual general meetings must be held at least once in each calendar year and not more than 15 months after the last annual reference date. The directors may, whenever they see fit, call a meeting of Shareholders. The Company must send notice of the shareholder meeting at least 21 days before the meeting. A quorum for a meeting of Shareholders is two persons who are, or who represent by proxy, Shareholders who, in the aggregate, hold at least 5% of the issued shares entitled to be voted at the meeting. If there is only one Shareholder entitled to vote at a meeting of Shareholders, the quorum is one person who is, or who represents by proxy, that Shareholder, present in person or by proxy, may constitute the meeting.
- Pursuant to the Business Corporations Act (British Columbia, Canada), the Company may by special resolution of the Shareholders vary or delete any special rights or restrictions attached to the Common Shares.

The following is a reconciliation of issued and outstanding common shares:

	Number of shares	Share capital $'000
At January 1, 2011	602,216,800	331,215
Issuance of shares in a private placement, net of offering costs	87,050,000	6,924
Issuance of shares to two former officers	5,000,000	648
Options exercised	50,000	15
Shares issued to employees and consultants	676,800	107
Issuance of shares in a private placement to officers and a director	660,900	97
At December 31, 2011	**695,654,500**	**339,006**
Options exercised – Quarter 3, 2012	**600,000**	**165**
Options exercised – Quarter 4, 2012	**400,000**	**109**
Issuance of shares to a former officer	**300,000**	**54**
At 31 December 2012	**696,954,500**	**339,334**

On 11 April 2011, Falcon issued 87,050,000 units (the "Units") at $0.16 (CDN$0.15) per unit by way of a non-brokered private placement for aggregate gross proceeds of $13.7 million (CDN$13.1 million), before offering costs of $194. Each Unit consists of one common share in the capital of Falcon (each, a "Common Share") and three-quarters of one Common Share purchase warrant (each, a "Warrant"), each whole Warrant being exercisable into a Common Share for a period of 36 months from the date of its issuance at an exercise price of $0.19 (CDN$0.18) per share. As at the date of the close of the offering, the Warrants were valued at $6.5 million and included in derivative liabilities. As at 31 December 2012, the fair value of the Warrants is $4.5 million with change in fair value since 1 January 2012 of $1.9 million included in net finance expenses (see note 23).

In 2010, the Company agreed to issue five million shares of common stock to two former officers (valued at $0.6 million). As these shares had not been issued at 31 December 2010 the value of the shares was included in contributed surplus at that date. In 2011 the common shares were issued and the aggregate related value of $0.6 million was reclassified from contributed surplus to share capital.

In October 2011, the Company granted 676,800 common shares to non–executive employees and consultants as a bonus consideration for services. These shares were valued at $107 based on $0.16 (CDN$0.15) per share. In October 2011, the Company issued 660,900 common shares in a private placement to certain officers and a director for $97, at a price of $0.16 (CDN$0.15) per share.

In Quarter 3 2012, per the table above, the Company issued 600,000 Common Shares and subsequently in December 2012 issued 400,000 Common shares pursuant to exercises of stock options.

In December 2012, the Company issued 300,000 Common Shares to an ex-employee as compensation for his employment.

19. Share based compensation

The Group, in accordance with the policies of the TSX-V, may grant options to directors, officers, employees and consultants, to acquire up to 10% of the Company's issued and outstanding common stock. The exercise price of each option is based on the market price of the Company's stock at the date of grant, which may be discounted in accordance with TSX-V policies. The exercise price of all options granted has been based on the market price of the Company's stock at the date of grant, and no options have been granted at a discount to the market price. The options can be granted for a maximum term of five years. The Company records compensation expense over the vesting period based on the fair value at the grant date of the options granted. These amounts are recorded as contributed surplus. Any consideration paid on the exercise of these options together with the related contributed surplus associated with the exercised options is recorded as share capital. The Group incurred share based expense of $2.4 million during 2012 (2011: $2.4 million) which includes $54,000 relating to the issuance of shares to an ex-employee (refer to note 18).

A summary of the Group's stock option plan as of 31 December 2012 and 31 December 2011 and changes during the year then ended, is presented below:

	2012		2011	
	Number of options	**Weighted average exercise price CDN$**	Number of options	Weighted average exercise price CDN$
Outstanding as at beginning of year	**29,764,500**	**0.41**	21,764,500	1.81
Granted	**6,000,000**	**0.10**	17,810,000	0.15
Expired	**(978,333)**	**0.73**	(8,623,333)	1.28
Forfeited	**(949,167)**	**1.10**	(1,136,667)	0.46
Exercised	**(1,000,000)**	**0.15**	(50,000)	0.16
Outstanding as at end of year	**32,837,000**	**0.35**	29,764,500	0.41
Exercisable as at end of year	**21,323,667**	**0.48**	15,021,000	0.57

During the year ended 31 December 2012, the Company granted 6 million options at an exercise price of $0.10 (CDN$0.10) (2011: 17.8 million at $0.15 (CDN$0.15)) per share. Of the options granted during 2012, all vest 1/3 ratably at the anniversary date over three years, and have an expiry date of 1 May 2017. Of the options granted during the year ended 31 December 2011, all vest 1/3 at the date of grant, with the remainder vesting ratably at the anniversary date over the two years thereafter. Eoin Grindley (Chief Financial Officer) is, pursuant to his employment contract, entitled to 3,000,000 stock options which have not yet been granted.

The exercise prices of the outstanding options are as follows:

Options	**Exercise price CDN$**	**Date of grant**	**Date of Expiry**	**Weighted average exercise price CDN$**	**Weighted average contractual life (years)**
1,000,000	1.000	6 May 2008	6 May 2013	1.000	0.35
5,985,000	1.180	5 June 2008	5 June 2013	1.180	0.43
3,312,000	0.170	30 August 2010	30 August 2015	0.170	2.66
16,390,000	0.145	23 May 2011	23 May 2016	0.145	3.39
150,000	0.145	1 June 2011	1 June 2016	0.145	3.42
6,000,000	0.100	1 May 2012	1 May 2017	0.100	4.33
32,837,000				**0.350**	**2.86**

19. Share based compensation (continued)

The fair value of the granted options was estimated using a Black Scholes model with the following weighted average inputs:

	2012 CDN$	2011 CDN$
Fair value as at grant date	0.08	0.15
Share price	0.10	0.15
Exercise price	0.10	0.15
Volatility	104%	105% – 106%
Option life	5.00 years	5.00 years
Dividends	Nil	Nil
Risk-free interest rate	1.59%	2.23% – 2.44%

A forfeiture rate of 11% (2011: 16%) is used when recording share based compensation. This estimate is adjusted based on the actual forfeiture rate.

As illustrated in Note 25, of the $2.4 million charge in the current year $1.1 million was as a result of allowing existing Denver employees to retain their vested and unvested options in accordance with the terms of the original grant although they were made redundant. This was treated as accelerated vesting and modification under IFRS 2 "Share based payment". The fair value of the modification was estimated using a Black Scholes model with the following weighted average inputs:

	2012 CDN$
Fair value as at modification date	0.00 - 0.08
Share price	0.12
Exercise price	0.145 - 1.00
Volatility	91% - 106%
Option life	0.08 years - 3.92 years
Dividends	Nil
Risk-free interest rate	1.02% - 1.15%

20. 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.

(i) *Cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued expenses*
The fair value of cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued expenses is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. As at 31 December 2012 and 2011, the fair value of accounts receivable and accounts payable and accrued expenses approximated their carrying value due to their short term to maturity.

(ii) *Derivatives*
The fair value of the conversion feature embedded in the convertible note is calculated using a Black Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, 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 behavior), expected dividends, and the risk-free interest rate (based on government bonds).

20. Determination of fair values (continued)

(iii) *Convertible debentures*
The fair value of host contract of the convertible debentures is determined for disclosure purposes by calculating the present value of the expected future cash flow using the market rate of interest at the reporting date.

(iv) *Share based compensation*
The Company accounts for its share based compensation using the fair value method of accounting for stock options granted to directors and employees using the Black-Scholes option-pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, 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 behavior), expected dividends, and the risk-free interest rate (based on government bonds). A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

21. Financial Instruments and risk management

(i) Fair Value
The following tables provide fair value measurement information for financial assets and liabilities as at 31 December 2012 and 2011. The carrying value of cash and cash equivalents, restricted cash, accounts receivable, and accounts payable and accrued expenses included in the consolidated statement of financial position approximate fair value due to the short term nature of those instruments.

	31 December 2012		31 December 2011	
	Carrying value $'000	**Fair value $'000**	Carrying value $'000	Fair value $'000
Financial assets:				
Cash and cash equivalents, including restricted cash	**3,270**	**3,270**	15,409	15,409
Loans and receivables:				
Accounts receivable	**3,021**	**3,021**	2,663	2,663
Financial liabilities:				
Other financial liabilities:				
Accounts payable and accrued expenses	**3,122**	**3,122**	3,836	3,836
Convertible debentures	**8,773**	**11,014**	5,960	9,670

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1 Fair Value Measurements
- Level 1 fair value measurements are based on unadjusted quoted market prices.

Level 2 Fair Value Measurements
- Level 2 fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices.

Level 3 Fair Value Measurements
- Level 3 fair value measurements are based on unobservable information. No financial assets or liabilities have been valued using the Level 3 fair value measurements.

21. Financial Instruments and risk management (continued)

31 December 2012	Carrying amount $'000	Fair value $'000
Financial liabilities:		
Conversion feature – convertible debt	**26**	**26**
Private placement warrants	**4,505**	**4,505**
Hess warrants	**787**	**787**
31 December 2011		
Financial liabilities:		
Conversion feature – convertible debt	41	41
Private placement warrants	2,652	2,652
Hess warrants	621	621

All instruments in the table are Level 2 instruments.

(ii) Financial risk disclosures

The Company thoroughly examines the various financial instrument risks to which it is exposed and assesses the impact and likelihood of those risks. These risks may include credit risk, liquidity risk, market risk and other price risks. Where material, these risks are reviewed and monitored by the Board of Directors.

Credit Risk
The Company's credit risk is limited to cash and receivables. The Group maintains cash accounts at five financial institutions. The Group periodically evaluates the credit worthiness of financial institutions. The Group believes that credit risk associated with cash is minimal. Receivables are not significant to the Group. The Group's credit risk has not changed significantly from the prior year.

Liquidity Risk
The Group has in place a planning and budgeting process to help determine the funds required to support the Group's normal operating requirements on an ongoing basis and its planned capital expenditures. The Group's overall liquidity risk and going concern is discussed in note 2.

The following are the contractual maturities of financial liabilities, including estimated interest payments:

31 December 2012	**Carrying amount $'000**	**Contractual cash flows $'000**	**One year or less $'000**	**One to three years $'000**
Non-derivative financial liabilities:				
Accounts payable and accrued expenses	**3,122**	**3,122**	**3,122**	**-**
Convertible debentures	**8,773**	**11,898**	**11,898**	**-**
	11,895	**15,020**	**15,020**	
Derivative financial liabilities:				
Convertible debt conversion feature	**26**	**-**	**-**	**-**
Private placement warrants	**4,505**	**-**	**-**	**-**
Hess warrants	**787**	**-**	**-**	**-**
	5,318	**-**	**-**	**-**

21. Financial Instruments and risk management (continued)

31 December 2011	Carrying amount $'000	Contractual cash flows $'000	One year or less $'000	One to three years $'000
Non-derivative financial liabilities:				
Accounts payable and accrued expenses	3,836	3,836	3,836	–
Convertible debentures	5,960	12,245	1,160	11,085
	9,796	16,081	4,996	11,085
Derivative financial liabilities:				
Convertible debt conversion feature	41	–	–	–
Private placement warrants	2,652	–	–	–
Hess warrants	621	–	–	–
	3,314	–	–	–

Currency Risk
Financial instruments that impact the Company's net (income) /loss due to currency fluctuations include Canadian dollar, Hungarian forint, Euro and Australian dollar denominated cash and cash equivalents, accounts receivable, reclamation deposits, accounts payable, and capital commitments for Hungarian and Australian operations.

The Company has a convertible debenture denominated in Canadian dollar, which exposes Falcon to fluctuations in exchange rates between Canadian and U.S. dollars. Such an exposure does also arise as a result of expense items, including certain general and administrative and production costs and interest expense on the convertible debt, being incurred in Canadian dollars. A one cent strengthening/weakening of the Canadian dollar against the U.S. dollar would decrease/increase total shareholders' equity and income/loss by less than $0.1 million.

The Company's exposure to other currencies, including the Hungarian forint, Euro and Australian dollar, does not result in a significant change to total shareholders' equity and income when the respective currencies strengthen or weaken by one cent against the U.S. dollar.

Interest Rate Risk
The Company has no significant exposure to interest rate risk as its debentures have a fixed rate of interest.

22. Convertible debentures

On 30 June 2009, the Company completed an offering of 11,910 units at a price of $865 (CDN$1,000) per unit (the "Offering"). Each unit consisted of one 11% convertible unsecured debenture in the principal amount of $779 (CDN$900) (each, a "Debenture") that matures on the fourth anniversary of its issuance (30 June 2013) pursuant to the terms of a trust indenture dated 30 June 2009 (the "Trust Indenture"), and 250 common shares in the capital of Falcon (the "Unit Shares") (collectively, a "Unit"). The Debentures bear interest at an annual rate of 11% calculated and payable semi-annually in arrears on 1 January and 1 July in each year commencing 1 January 2010. The Debentures are unsecured direct obligations of the Company. In certain circumstances the Trust Indenture may restrict the Company from incurring additional indebtedness for borrowed money or from mortgaging, pledging or charging its property to secure any additional indebtedness.

Optional Conversion Privilege
Each Debenture may be converted into common shares of the Company ("Debenture Shares") at the option of the Debenture holder (the "Optional Conversion Privilege") at any time prior to the close of business on the earlier of the maturity date and the business day immediately preceding the date fixed by the Company for redemption of the Debentures (either of such dates, the "Optional Conversion Date"), at a conversion price of CDN$0.60 per common share (the "Conversion Price"), being a conversion ratio of approximately 1,667 Debenture Shares for each CDN$1,000 principal amount of Debentures. The Conversion Price is subject to adjustment upon the occurrence of certain events. Debenture holders converting their Debentures will receive accrued and unpaid interest in cash thereon up to, but not including, the Optional Conversion Date.

22. Convertible debentures (continued)

No fractional shares will be issued. Notwithstanding the foregoing, no Debentures may be converted during the 10 business days preceding and including 1 January and 1 July in each year, commencing 1 January 2010 as the registers of the Indenture Trustee (as defined in the Trust Indenture) will be closed during such periods. The optional conversion privilege is an embedded derivative for accounting purposes and recorded as a liability at fair value (see note 23).

As at 31 December 2012, the face value of the convertible debentures, due on maturity at 30 June 2013, is $10.8 million (CDN$10.7 million).

As at 31 December 2012, convertible debentures are recorded at $8.8 million (2011: $6.0 million).

23. Derivative liabilities

Derivative liabilities consist of the fair value of the convertible debt conversion feature, the fair value of the private placement warrants and the fair value of the Hess warrants. Changes in the fair value of the derivative liabilities are recorded as part of net finance expenses. The composition of the derivative liabilities as at 31 December 2012 and 2011, and the changes therein for the years then ended, are as follows:

	Convertible Debt Conversion Feature $'000	Private Placement Warrants $'000	Hess Warrants $'000	Total $'000
At 1 January 2011	775	-	-	775
Fair value of derivatives issued	-	6,541	945	7,486
Derivative gains – unrealised – warrants in issue	-	(3,889)	(324)	(4,213)
Derivative gains – unrealised – Convertible debt conversion feature	(734)	-	-	(734)
At 31 December 2011	41	2,652	621	3,314
Derivative gains – unrealised – Convertible debt conversion feature	**(15)**	**-**	**-**	**(15)**
Derivative loss – unrealised – warrants in issue	**-**	**1,853**	**166**	**2,019**
At 31 December 2012	**26**	**4,505**	**787**	**5,318**

The fair value of the derivative liabilities is analysed between current and Non-current below:

	Convertible Debt Conversion Feature $'000	Private Placement Warrants $'000	Hess Warrants $'000	Total $'000
Non-current	-	4,505	787	5,292
Current	26	-	-	26
At 31 December 2012	**26**	**4,505**	**787**	**5,318**

24. Provisions

(i) Decommissioning provision

A reconciliation of the decommissioning provision for the years ended 31 December 2012 and 2011 is provided below:

	2012 $'000	2011 $'000
Balance as at beginning of year	**8,813**	6,310
Revision to provisions	**1,983**	2,236
Accretion	**209**	267
Balance as at end of year	**11,005**	8,813
Non-current	**10,955**	8,663
Current	**50**	150
Balance as at end of year	**11,005**	8,813

The Group's decommissioning provision results from its ownership interest in oil and natural gas assets. The total decommissioning provision is estimated based on the Group's net ownership interest in the wells, estimated costs to reclaim and abandon these wells and the estimated timing of the costs to be incurred in future years. The Group's has estimated the net present value of the decommissioning provision to be $11.0 million as at 31 December 2012 (2011: $8.8 million) based on an undiscounted total future liability of $13.3 million (2011: $13.1 million). These payments are expected to be made over the next 20 years with the majority of costs to be incurred between 2027 and 2031. The discount factor, being the risk free rate related to the liability, was 1.3% as at 31 December 2012 (2011: 2.6%).

(ii) Legal

The Company may, from time to time, be involved in various claims, lawsuits, disputes with third parties, or breach of contract incidental to the operations of its business.

On 10 November 2009, as amended on 16 March 2011, the Group was served with a complaint by a former vendor of TXM arising out of a dispute related to TXM's alleged failure to pay for certain oilfield equipment. On 29 July 2011, TXM and the vendor entered into a settlement agreement resulting in a reduction of the provision of $1.5 million. All obligations due to the vendor have been paid as at 31 December 2011.

The Company is not currently involved in any claims, disputes, litigation or other actions with third parties which it believes could have an adverse effect on its financial condition or results of operations.

25. Accounts payable and accrued expenses

	Note	2012 $'000	At 31 December 2011 $'000
Current			
Accounts payable		**939**	2,940
Accrued expenses		**1,793**	877
Royalties payable		**24**	19
Restructuring provision	**(i)**	**366**	-
		3,122	3,836

(i) Restructuring provision

During the 2012 the Group relocated its corporate headquarters from Denver, Colorado to Dublin, Ireland. In connection with that decision, all individuals and consultants in Denver were terminated. At 31 December 2012, the Company has recorded management's best estimate of the remaining expenses related to this restructuring, including severance and employee related benefits, certain share-based compensation expenses, acceleration of the recognition of certain future expenses and acceleration of the depreciation of certain assets. The Denver office closed on 28 September 2012.

The following is a summary of restructuring expenses related to the relocation of the corporate headquarters including the line in the consolidated statement of operations and comprehensive loss in which the expense is recognised:

	Year Ended 31 December **2012** **$'000**
Restructuring expense:	
Severance and health benefits	567
Rent expense, net of sublease	176
Other	49
Total restructuring expense	792
Share based compensation	1,078
Depreciation	114
Total	1,984

26. Related party transactions

Key management personnel

Disclosures with regard to key management personnel are included in note 10.

27. Commitments and contingencies

(i) Lease commitments

The Group has entered into lease agreements for office space in:

- Denver, Colorado, expiring April 2015;
- Budapest, Hungary expiring 2 August 2015; and
- Dublin, Ireland, with a break clause exercisable in October 2017.

27. Commitments and contingencies (continued)

The Group is obligated to pay the following minimum future rental commitments under non-cancelable operating leases with a remaining term of at least one year:

	$'000
Year ending 31 December	
2013	**420**
2014	**427**
2015	**242**
2016	**97**
2017	**81**
Thereafter	**-**
	1,267

As part of the Group's restructuring process during the year, the Group has sub-let its Denver premises. This sub lease rental income has not been included in the table above. A total amount of $0.3 million is expected to be received under the sublease ending April 2015.

(ii) Work program commitments

Australia - Beetaloo Basin, Northern Territory, Australia

Under the terms of Falcon Australia's exploration permit EP-99, which is not covered by the Hess Agreement, Falcon Australia must spend a minimum of $1.5 million by 31 December 2013 in collecting 2D seismic data on acreage within exploration permit EP-99. Falcon Australia intends to meet this commitment either through a farm-out arrangement or through its own resources.

South Africa - Karoo Basin, South Africa

On receipt of an approved exploration right in South Africa, the Group will be required to make a payment to the South African government of approximately $0.7 million as part of the process to obtain an exploration permit.

Hungary - Makó Trough, Hungary

The Group is not committed to any independent technical operations in Hungary other than joint operations with NIS, and as such no material capital expenditures are expected.

(iii) Contractual commitments

Under existing agreements with two advisors, the Group is obligated to pay a success fee for services provided in relation to certain of the Group's assets. The success fees are based on the cash or cash equivalent value of the net amount received directly or indirectly by the Group. The agreements have been terminated during 2011 and 2012 respectively but payments will continue after termination until all relevant cash or cash equivalents amounts are finalised.

28. Comparatives

Comparative figures have been adjusted where necessary, to conform with changes in presentation or where additional analysis has been provided in the current period.

The impact of the fair value movements associated with the issue of warrants included in "Net finance expense" during the year ended 31 December 2011 of €4.2 million, previously shown within, has been reclassified to the face of the statement of operations and comprehensive loss as "Fair value (loss) / gain – warrants in issue".

29. Standards, Interpretations and Amendments to Published Standard that are not yet effective

Several new standards and amendments to existing standards and interpretations, which have been issued by the IASB, and which are expected to apply to the Group are not yet effective and have not been applied in preparing these financial statements. The Group does not expect adoption of these new standards and interpretations, to have a material impact on the financial statements. The Group's initial view of the impact of these accounting changes is outlined below:

Pronouncement	Nature of change	Impact
Amendments to IAS 1, 'Presentation of financial statements' *Effective date:- Financial periods beginning on or after 1 July 2012*	The amendments to IAS 1, 'Presentation of Financial Statements' require companies to group together items within other comprehensive income (OCI) that may be reclassified to the Statement of operations. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two separate statements.	Not significant.
Amendments to IAS 19, 'Employee benefits' *Effective date:- Financial periods beginning on or after 1 January 2013*	The amended standard eliminates the option for deferred recognition of all changes in the present value of the defined benefit obligation and in the fair value of plan assets (including the corridor approach). In addition, the amended standard requires a net interest approach, which will replace the expected return on plan assets, and will enhance the disclosure requirements for defined benefit plans.	Not significant.
Amendments to IAS 32 and IFRS 7 'Financial Instruments' on Asset and Liability Offsetting *Effective date:- IFRS 7 : Financial periods beginning on or after 1 January 2013* *Effective date:- IAS 32: Financial periods beginning on or after 1 January 2014.*	These amendments are to the application guidance in IAS 32, 'Financial Instruments: Presentation' that clarify some of the requirement for offsetting financial assets and financial liabilities on the balance sheet. The IASB has also published an amendment to IFRS 7, 'Financial Instruments: Disclosures'. These new disclosures are intended to facilitate comparison between those entities that prepare IFRS financial statements to those that prepare financial statements in accordance with US GAAP.	Not significant.
IFRS 10,'Consolidated Financial Statements' *Effective date:- Financial periods beginning on or after 1 January 2013*	This standard replaces IAS 27, 'Consolidated and Separate Financial Statements' and SIC-12, 'Consolidation – Special Purpose Entities'. It establishes a single control model that applies to all entities, including those that were previously considered special purpose entities under SIC-12. An investor controls an investee when it is exposed, or has rights to variable returns from the investee, and has the ability to affect those returns through its power over the investee. The assessment of control is based on all facts and circumstances and the conclusion is reassessed if there is an indication that there are changes in facts and circumstances.	Not significant.
IFRS 11,'Joint arrangements' *Effective date:- Financial periods beginning on or after 1 January 2013*	IFRS 11 supersedes IAS 31, 'Interests in Joint Ventures' and SIC-13, 'Jointly-controlled Entities – Nonmonetary Contributions by Venturers'. IFRS 11 classifies joint arrangements as either joint operations or joint ventures and focuses on the nature of the rights and obligations of the arrangement. IFRS 11 requires the use of the equity method of accounting for joint arrangements by eliminating the option to use the proportionate consolidation method.	The Group is currently assessing the impact of IFRS 11, given its post balance sheet announcement with NIS.
IFRS 12, ' Disclosure of Interest in Other Entities' *Effective date:- Financial periods beginning on or after 1 January 2013.*	IFRS 12 establishes the provision of information on the nature, associated risks, and financial effects of interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities, as disclosure objectives. IFRS 12 requires more comprehensive disclosure, and specifies minimum disclosures that an entity must provide to meet the disclosure objectives. While the standard is effective for annual periods beginning on or after 1 January 2013, entities are permitted to include any of the disclosure	The Group is assessing the impact of adopting IFRS 12.

Pronouncement	Nature of change	Impact
	requirements in IFRS 12 into their consolidated financial statements without early adopting IFRS 12.	
IFRS 13, ' Fair Value Measurement' *Effective date:- Financial periods beginning on or after 1 January 2013*	In May 2011, the IASB issued IFRS 13, 'Fair Value Measurement' which establishes a single source of guidance for fair value measurement under IFRS. IFRS 13 provides a revised definition of fair value and guidance on how it should be applied where its use is already required or permitted by other standards within IFRS and introduces more comprehensive disclosure requirements on fair value measurement.	Not significant.
IAS 27 (revised), ' Separate Financial Statements' *Effective date:- Financial periods beginning on or after 1 January 2013*	IAS 27 (revised) includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10.	Not significant.
IAS 28 (revised),'Investments in Associates and Joint Ventures' *Effective date:- Financial periods beginning on or after 1 January 2013*	IAS 28 (revised) includes the requirements for joint ventures, as well as associates to be equity accounted following the issue of IFRS 11.	Not significant.
Improvements to IFRSs (2009-2011) *Effective date:- Financial periods beginning on or after 1 January 2013*	The annual improvements process provides a vehicle for making non-urgent but necessary amendments to IFRSs.	Not significant
IFRS 9,'Financial instruments' *Effective date:- Financial periods beginning on or after 1 January 2015*	IFRS 9 is the first step in the process to replace IAS 39, 'Financial instruments: recognition and measurement'. The first stage of IFRS 9 dealt with the classification and measurement of financial assets and was issued in November 2009. An addition to IFRS 9 dealing with financial liabilities was issued in October 2010. The main changes from IAS 39 are summarised as follows: • the multiple classification model in IAS 39 is replaced with a single model that has only two classification categories: amortised cost and fair value; • classification under IFRS 9 is driven by the entity's business model for managing financial assets and the contractual characteristics of the financial assets; • the requirement to separate embedded derivatives from financial asset hosts is removed; • the cost exemption for unquoted equities is removed; • most of IAS 39's requirements for financial liabilities are retained, including amortised cost accounting for most financial liabilities; • guidance on separation of embedded derivatives will continue to apply to host contracts that are financial liabilities; and • fair value changes attributable to changes in own credit risk for financial liabilities designated under the fair value option other than loan commitments and financial guarantee contracts are required to be presented in the statement of comprehensive income unless the treatment would create or enlarge an accounting mismatch in profit or loss. These amounts are not subsequently reclassified to the Statement of operations but may be transferred within equity.	The Group is assessing the impact of adopting IFRS 9. The impact is not expected to be significant. The impact of IFRS 9 may change as a consequence of further developments resulting from the IASB's financial instruments project.

30. Subsequent events

On 21 January 2013, the Group announced the completion of the acquisition of 2D seismic data by Hess over the Hess Area of Interest in the Beetaloo Basin, Northern Territory, Australia. During 2011 and 2012, Hess acquired 3,490 km of 2D seismic data at an estimated cost in excess of $55 million, which is currently being interpreted.

On 22 January 2013, Falcon agreed a three-well drilling exploration programme with NIS to target the Algyö Play. NIS has made a cash payment of $1.5 million to Falcon and agreed to drill three exploration wells by July 2014. NIS will earn 50 % of net production from the first three wells, and has the option to participate in any future drilling on terms to be negotiated, after paying Falcon $2.75 million. Falcon is to be fully carried on the drilling and testing of the three exploration wells.

On 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange (symbol: FOG) and the ESM market of the Irish Stock Exchange (symbol: FAC) of the Company's existing share capital and the additional 120,381,973 new common shares in the capital of the Company to be issued pursuant to the concurrent conditional brokered private placement of new common shares at a price of Stg14 pence (CDN$0.215) per share to raise gross proceeds of $25 million (£16.9 million). Trading in these shares commenced on AIM and ESM on 28 March 2013.

31. Approval of financial statements

These Consolidated Financial Statements were approved by the Board of Directors and authorised for issue on 12 April 2013.

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