

STETSON OIL & GAS LTD.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2011

STETSON OIL & GAS LTD.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim consolidated financial statements of the Corporation have been prepared by and are the responsibility of the Corporation's management.

The Corporation's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim consolidated financial statements by an entity's auditor.

Date: Aug 26, 2011

"Darren Moulds" (signed)

Darren Moulds
Chief Financial Officer

STETSON OIL & GAS LTD.

INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS *(unaudited)*

<i>(\$ Canadian)</i>	June 30, 2011	December 31, 2010
ASSETS		
Current		
Cash and cash equivalents	\$ 3,720,663	\$ 466,733
Accounts receivable	384,539	525,634
Prepaid expenses and deposits	10,596	55,702
Discontinued operations (Note 5)	-	6,667,823
	4,115,798	7,715,892
Long-term		
Restricted cash (Note 16)	3,607,239	74,595
Reclamation deposits (Note 9)	360,469	359,238
Property and equipment (Note 7)	-	-
Exploration and evaluation (Note 6)	8,036,817	8,287,177
	\$ 16,120,323	\$ 16,436,902
LIABILITIES		
Current		
Accounts payable and accrued liabilities	\$ 480,264	\$ 1,208,350
Discontinued operations (Note 5)	-	2,271,876
	480,264	3,480,226
Payable to joint venture partner (Note 16)	3,423,975	-
Decommissioning obligations (Note 9)	184,669	179,362
	4,088,908	3,659,588
SHAREHOLDERS' EQUITY		
Common shares (Note 10)	32,414,157	32,414,157
Warrants (Note 10)	-	-
Preferred shares (Note 10)	8,570	8,570
Contributed surplus (Note 10)	10,182,963	10,167,003
Accumulated other comprehensive loss	(723,511)	(467,361)
Deficit	(29,850,764)	(29,345,055)
	12,031,415	12,777,314
Basis of Presentation (Note 2)		
Contingencies and Commitments (Note 16)		
	\$ 16,120,323	\$ 16,436,902

Approved on behalf of the board of directors

"Ahmed Said"

Ahmed Said

"Fari Goodarzi"

Fari Goodarzi

See accompanying selected notes to the consolidated financial statements

STETSON OIL & GAS LTD.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS *(unaudited)*

<i>(\$ Canadian)</i>	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Revenue				
Petroleum and natural gas sales	\$ -	\$ 1,237	\$ -	\$ 39,739
Royalties	-	(402)	-	(12,921)
	-	835	-	26,818
Other income	4,919	404	6,394	492
Gain on farm-out (Note 16)	48,864	-	48,864	-
Gain on disposition of assets (Note 5)	11,123	-	11,123	-
	64,906	1,239	66,381	27,310
Expenses				
Operating	94	29,132	94	55,947
General and administrative (Note 12)	434,206	476,091	800,735	870,209
Bad debt expense	3,329	-	3,329	-
Stock-based compensation (Note 10)	-	900	15,960	1,800
Finance costs	5,776	9,075	10,894	27,674
Foreign exchange loss / (gain)	52,671	(352)	65,808	(17)
Depreciation (Note 7)	-	-	-	2,543
	496,076	514,846	896,820	958,156
Loss before discontinued operations	(431,170)	(513,607)	(830,439)	(930,846)
Discontinued operations (Note 5)	(33,740)	343,560	324,730	836,927
Net loss	(464,910)	(170,047)	(505,709)	(93,919)
Other comprehensive loss				
Foreign currency translation	(43,491)	345,902	(256,150)	60,538
Total comprehensive loss	(508,401)	175,855	(761,859)	(33,381)
Basic and diluted loss per share				
- continuing operations	\$ (0.00)	\$ (0.00)	\$ (0.01)	\$ (0.01)
Basic and diluted (loss)/income per share				
- discontinued operations	\$ (0.00)	\$ 0.00	\$ 0.00	\$ 0.01
Weighted average number of common shares outstanding - basic and diluted (Note 13)	108,902,260	108,902,260	108,902,260	108,902,260

See accompanying selected notes to the consolidated financial statements

STETSON OIL & GAS LTD.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY *(unaudited)*

<i>(\$ Canadian)</i>	Six months ended June 30, 2011	Six months ended June 30, 2010
Share Capital		
Balance, beginning of period	\$ 32,414,157	\$ 32,414,157
Balance, end of period	\$ 32,414,157	\$ 32,414,157
Warrants		
Balance, beginning of period	\$ -	\$ 4,771,000
Balance, end of period	\$ -	\$ 4,771,000
Preferred shares		
Balance, beginning of period	\$ 8,570	\$ 8,570
Balance, end of period	\$ 8,570	\$ 8,570
Contributed Surplus		
Balance, beginning of period	\$ 10,167,003	\$ 5,392,303
Stock-based compensation (Note 10)	15,960	1,800
Balance, end of period	\$ 10,182,963	\$ 5,394,103
Accumulated other comprehensive loss		
Balance, beginning of period	\$ (467,361)	\$ -
Foreign currency translation adjustments	(256,150)	60,538
Balance, end of period	\$ (723,511)	\$ 60,538
Deficit		
Balance, beginning of period	\$ (29,345,055)	\$ (27,858,559)
Net loss	(505,709)	(93,919)
Balance, end of period	\$ (29,850,764)	\$ (27,952,478)

See accompanying selected notes to the consolidated financial statements

STETSON OIL & GAS LTD.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS *(unaudited)*

<i>(\$ Canadian)</i>	Six months ended June 30, 2011	Six months ended June 30, 2010
Cash (used in) / provided by:		
Operating activities:		
Net loss	\$ (505,709)	\$ (93,919)
Income from discontinued operations	(324,730)	(836,927)
Items not involving cash:		
Depreciation (Note 7)	-	2,543
Finance costs (Note 9)	2,185	2,207
Stock-based compensation (Note 10)	15,960	1,800
Bad debt expense	3,329	-
Unrealized foreign exchange loss/(gain)	82,907	(20,711)
Settlement of decommissioning obligations and change in estimates (Note 9)	3,096	-
	(722,962)	(945,007)
Net change in non-cash working capital (Note 15)	(595,017)	(107,013)
	(1,317,979)	(1,052,020)
Funds from discontinued operations (Note 5)	324,730	836,927
	(993,249)	(215,093)
Financing activities:		
Increase in bank indebtedness (Note 8)	-	257,957
	-	257,957
Investing activities:		
Reclamation deposits (Note 9)	(1,231)	(1,025)
Restricted cash (Note 16)	(3,532,644)	(4,608)
Advances from joint venture partner (Note 16)	3,447,760	-
Acquisition of oil and gas properties (Note 6)	(435)	(40,444)
Disposition of oil and gas properties (Note 5)	4,395,947	-
Net change in non-cash working capital (Note 15)	-	(20,923)
Discontinued operations (Note 5)	-	(67,169)
	4,309,397	(134,169)
Increase / (decrease) in cash	3,316,148	(91,305)
Net effect of foreign exchange on cash held in foreign	(62,218)	(5,119)
Cash, beginning of period	466,733	415,679
Cash, end of period	\$ 3,720,663	\$ 319,255

Supplemental cash flow information:

Interest paid	-	25,467
Income taxes paid	-	-

See accompanying selected notes to the consolidated financial statements

STETSON OIL & GAS LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

1. REPORTING ENTITY

Stetson Oil & Gas Ltd. (the "Company" or "Stetson") is a publicly traded company incorporated and domiciled in Alberta, Canada with the registered office located at Suite 1100, 505 – 3rd Street SW, Calgary, Alberta, T2P 3E6.

The Company is in the business of exploring, developing and producing conventional oil and gas reserves. These consolidated financial statements include Stetson Oil & Gas Ltd. and its wholly-owned subsidiaries Stetson Oil and Gas Corporation Ltd., Stetson Oil and Gas Holdings (Barbados) Ltd., and Llanos 11 Holdings (Colombia) Ltd. Stetson is a public company and trades on the TSX Venture Exchange under the symbol "SSN".

2. BASIS OF PRESENTATION

These interim consolidated financial statements represent Stetson's financial results of operations and financial position under initial adoption of International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). As a result of initial adoption in this period IFRS 1 (First-time adoption of International Financial Reporting Standards) has been applied. As such these interim consolidated financial statements do not include all necessary disclosures that are required for annual statements in accordance with IFRS. These statements should be read in conjunction with the December 31, 2010 year ended consolidated financial statements as well as comparative reconciliations of Canadian GAAP to IFRS which are included in Note 17. Quarterly financial information may change depending on subsequent changes to IFRS.

a) Statement of compliance

The interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards under IAS 34, Interim Financial Reporting, and comply with NI 52-107. The consolidated financial statements were authorized for issue by the Board of Directors on August 26, 2011.

b) Basis of measurement

The interim condensed consolidated financial statements have been prepared on the historical cost basis except for the following:

- i. derivative financial instruments are measured at fair value; and
- ii. held for trading financial assets are measured at fair value with changes in fair value recorded in earnings.

The methods used to measure fair values are discussed in Note 4.

c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

d) Use of estimates and judgments

The preparation of the interim condensed consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies regarding certain types of assets, liabilities, revenues and expenses in the preparation of the consolidated financial statements. Actual results could differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following notes:

- Note 4 – determination of fair values
- Note 6 – exploration and evaluation assets
- Note 9 – decommissioning obligations
- Note 10 – measurement of stock-based compensation

Reserve estimates impact a number of the areas referred to above; in particular, the valuation of property and equipment and the calculation of depletion and depreciation.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

e) **Going concern**

These interim condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Accordingly, the financial statements do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and meet its liabilities and commitments in other than the normal course of business and at amounts different from those in the accompanying consolidated financial statements.

3. SUMMARY OF ACCOUNTING POLICIES

The accompanying interim condensed consolidated financial statements should be read in conjunction with Note 3 of Stetson's March 31, 2011 interim condensed consolidated financial statements as the accounting policies applied by the Company are disclosed therein.

4. DETERMINATION OF FAIR VALUES

A number of Stetson'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 based on the following methods:

Property and equipment

Fair value of property and equipment ("P&E") is based on market values which are the estimated amount that the property could be disposed of to an arm's length buyer after proper marketing. Market value of any oil and natural gas interests included in property and equipment is estimated based on discounted future cash flows that are anticipated to be derived from production based on externally prepared reserve reports.

Exploration and evaluation

Fair value of exploration and evaluation ("E&E") assets is determined based on market value to an arm's length buyer as described in property and equipment above. As E&E assets are not proven assets, they have uncertainties that make it difficult to assess future cash flows; as such market conditions and assessment by management are used to determine fair value.

Cash, cash equivalents, accounts receivable and accounts payable

Due to the short term maturity of these items, the balances approximate their carrying value.

Restricted cash, reclamation deposits, payable to joint venture partner

The fair value of restricted cash, reclamation deposits, and payable to joint venture partner is determined based on carrying value as their long-term nature does not significantly impact the fair value.

Stock-based compensation

The fair value of each option granted is determined using the Black-Scholes option pricing model. Inputs included in the model include expected dividend yield, expected volatility, risk-free interest rate, forfeiture rate, and an expected life. The forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest.

5. DISCONTINUED OPERATIONS

In February 2010, the board of directors determined that, in order to fund potential activities on its North Dakota property and to begin pursuit of other international activities, Stetson would consider selling all of its Canadian assets and hired Sayer Energy Advisors to assist in the process. In January 2011, the Company entered into a definitive agreement to sell all of its active Canadian oil and gas properties, including oil and gas assets in Alberta and Saskatchewan, along with resource tax pools related thereto, to an arms-length party.

The purchase and sale agreement was based on an effective date of December 1, 2010 and included consideration payable by the Purchaser of \$5,000,000, subject to closing adjustments. The sale was closed on March 9, 2011, with net proceeds of \$4,395,947. The final statement of adjustments was completed on June 7, 2011 with an additional \$58,718 payable to Stetson.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

Operating results related to the disposed assets and liabilities have been included in Discontinued Operations on the Consolidated Balance Sheets, the Consolidated Statements of Comprehensive Loss and the Consolidated Statements of Cash Flows.

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Revenue				
Petroleum and natural gas sales	\$ 337	\$ 716,579	\$ 774,102	\$ 1,630,248
Royalties	(2,791)	(141,794)	(118,044)	(303,439)
	(2,454)	574,785	656,058	1,326,809
Expenses				
Operating	31,003	225,209	323,018	480,692
Transportation	283	6,016	8,310	9,190
	31,286	231,225	331,328	489,882
(Loss)/income from discontinued operations	\$ (33,740)	\$ 343,560	\$ 324,730	\$ 836,927

Sale price	\$ 5,000,000
Interim statement of adjustments	(457,588)
Final statement of adjustments	58,718
	4,601,130
Estimated disposition costs	146,465
Net proceeds	\$ 4,454,665
Assets disposed	6,715,418
Liabilities disposed	(2,271,876)
Gain on disposition	\$ 11,123

6. EXPLORATION AND EVALUATION ASSETS

	E&E Assets
Balance at January 1, 2010	\$ 8,676,850
Additions	43,320
Foreign currency translation	(432,993)
Balance at December 31, 2010	\$ 8,287,177
Additions	435
Foreign currency translation	(250,795)
Balance at June 30, 2011	\$ 8,036,817

Costs included as intangible exploration and evaluation assets at June 30, 2011 total \$8,036,817 (December 31, 2010 - \$8,287,177) representing all of Stetson's North Dakota assets. The North Dakota asset has not yet proved commercial viability or technical feasibility therefore remains included as part of E&E.

There were no indications, events or changes in circumstances which would cause the Company to question whether the carrying amount may not be recoverable; as such no provision for impairment has been recorded.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

7. PROPERTY AND EQUIPMENT

Property and equipment consists of furniture and fixtures, computer hardware, computer software, and vehicles less accumulated depreciation. As at June 30, 2011 and December 31, 2010 all property and equipment was fully depreciated.

8. LOAN FACILITY

On December 31, 2010, the Company had a \$1,500,000 revolving demand loan facility available with a Canadian chartered bank. The interest rate on outstanding debt was set at the bank's prime lending rate plus 2.25%. The facility was secured by a floating charge over all of Stetson's assets. There was no outstanding balance under the revolving facility at December 31, 2010. As a result of the disposition of Stetson's active Canadian properties (Note 5), the facility was cancelled in March 2011.

9. DECOMMISSIONING OBLIGATIONS

The following table presents a reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of oil and gas properties:

	June 30, 2011	December 31, 2010
Balance, beginning of period	\$ 179,362	\$ 226,083
Liabilities incurred and acquired	7,228	-
Settlement of liabilities	(3,196)	(51,157)
Disposition of liabilities	-	-
Accretion expense	2,185	4,413
Change in estimates	(910)	23
Balance, end of period	\$ 184,669	\$ 179,362

The total future decommissioning obligations are estimated based on the Company's net ownership interest in all wells and facilities relating to continuing operations, the estimated costs to abandon and reclaim these wells and facilities, and the estimated timing of the costs to be incurred in future periods. The key assumptions, upon which the carrying amount of the decommissioning obligation is based, include a risk free rate ranging between 1.53% and 3.73% and an inflation factor of 2.0%. The total undiscounted amount of the estimated cash flows required to settle the asset retirement obligations is approximately \$177,945 (December 31, 2010 - \$175,430) which will be incurred over the next one to ten years.

At June 30, 2011, the Company had reclamation deposits of \$360,469 (December 31, 2010 - \$359,238) held by the Energy Resources Conservation Board ("ERCB"). As a result of the sale of active Canadian properties, the Company expects to be refunded a portion of these deposits upon completion of the ERCB's reassessment of Stetson's remaining license liability rating.

10. CAPITAL STOCK

(a) Authorized

Unlimited common shares without par value
Unlimited preferred shares without par value

b) Common shares

	Number of shares	Amount
Balance December 31, 2010 and June 30, 2011	108,902,260	\$ 32,414,157

There was no change in common shares outstanding between the year ended December 31, 2010 and the six months ended June 30, 2011.

STETSON OIL & GAS LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

(c) Preferred shares

	Number of shares	Amount
Balance December 31, 2010 and June 30, 2011	85,696,408	\$ 8,570

There was no change in preferred shares outstanding between the year ended December 31, 2010 and the six months ended June 30, 2011.

(d) Stock-based compensation

The Company has granted options for the purchase of common shares to its directors and officers. The aggregate number of shares that may be issuable pursuant to options granted under the Plan will not exceed 10% of the issued common shares of the Company at the date of grant. No more than 5% of the issued shares of the Company may be granted to any one optionee. The options are non-transferable and non-assignable and may be granted for a term not exceeding five years. The exercise price of the options may not be less than the greater of \$0.10 and the market price, subject to all applicable regulatory requirements.

The following table depicts the stock options transactions during the period:

	Number of stock options	Weighted average exercise price (\$)
Balance December 31, 2010	10,140,000	\$ 0.23
Granted	200,000	0.10
Cancelled/forfeited	(4,295,000)	0.25
Expired	(100,000)	1.00
Balance June 30, 2011	5,945,000	\$ 0.20

As at June 30, 2011, the following stock options are outstanding:

Exercise Price	Options Outstanding	Remaining Life (Years)	Options Exercisable
\$0.10	200,000	2.81	200,000
\$0.10	1,100,000	0.42	1,100,000
\$0.10	200,000	4.70	200,000
\$0.20	3,380,000	2.35	3,380,000
\$0.30	945,000	1.53	945,000
\$0.36	100,000	0.78	100,000
\$1.00	20,000	0.03	20,000
\$0.20	5,945,000	1.92	5,945,000

The fair value of options granted during the six months ended June 30, 2011 was determined using the Black-Scholes option pricing model used the following weighted average assumptions: expected dividend yield of 0%, expected volatility of 168%, a risk-free interest rate of 2.63%, expected forfeiture rate of 1.72% and an expected life of 5 years. Terms for vesting rules are approved by the Board of Directors on each grant and in the period ended June 30, 2011, all options granted vested immediately. During the six months ended June 30, 2011, the Company recorded \$15,960 (June 30, 2010 - \$1,800) of stock-based compensation expense related to stock options. No options were issued in 2010.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

(e) Contributed Surplus

	Amount
Balance December 31, 2010	\$ 10,167,003
Stock-based compensation	15,960
Balance June 30, 2011	\$ 10,182,963

11. RELATED PARTY TRANSACTIONS

The Company paid \$48,000 to directors or companies controlled by directors, for professional and consulting fees during the period ended June 30, 2011 (2010 - \$61,702).

Stetson shares its office premises with other companies that have common directors and/or officers. The Company reimburses the related companies for its proportional share of the expenses and charges the related companies for expenses incurred on their behalf. During the period ended June 30, 2011, the Company incurred \$109,657 (2010 - \$92,512) of expenses on behalf of those companies while they incurred \$211,618 (2010 - \$184,247) on Stetson's behalf. As at June 30, 2011, net accounts payable to these companies was \$84,566 (2010 - \$347,189).

All of the above transactions are in the normal course of operations and are measured at the exchange amount equaling the consideration established and agreed to by the related parties.

Also refer to Note 16 for discussion of related party transactions between the Company and Sagres.

12. GENERAL AND ADMINISTRATIVE EXPENSES

The breakdown of significant cost categories included in general and administrative expense is as follows:

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Salaries, wages, benefits and employee expenses	\$ 69,189	\$ 35,206	\$ 106,974	\$ 49,146
Office rent and supplies	80,182	117,264	120,538	240,162
Outside services / consulting	265,070	303,643	526,001	563,816
Website, advertising, investor relations	2,261	3,541	2,926	4,364
Other	17,504	16,437	44,296	12,721
Total	\$ 434,206	\$ 476,091	\$ 800,735	\$ 870,209

13. NET LOSS PER SHARE

The number of shares used to calculate the diluted net loss per share for the three and six months ended June 30, 2011 included the weighted average number of Stetson common shares outstanding of 108,902,260 and 108,902,260, respectively, plus nil shares related to the dilutive effect of the conversion of stock options and warrants as the stock options and warrants would be anti-dilutive (June 30, 2010 three and six months ended – 108,902,260).

14. CAPITAL MANAGEMENT

Stetson considers its capital structure to include shareholders' equity and working capital. The policy of the Company is to maintain a capital base to ensure it is able to sustain the future development of the Company's business objectives. The Company manages its capital through the issuance of shares as well as prudently managing expenditures relating to acquisition, exploration and development of resource properties. The Company is evaluating and pursuing international activities and as determined by future plans may need to access additional capital. The ability of the Company to access the equity market will dictate whether the capital necessary to meet the Company's business objectives is attainable.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

The Company's overall capital risk management strategy remains unchanged as at June 30, 2011.

In 2009, the Company obtained a \$1,500,000 demand loan facility with a Canadian chartered bank. At December 31, 2010 no funds had been drawn on the facility and the Company was fully compliant with its debt covenants. In March 2011, the loan facility was terminated.

15. SUPPLEMENTAL CASH FLOW INFORMATION

	Six months ended June 30, 2011	Six months ended June 30, 2010
Changes in non-cash working capital:		
Accounts receivable, net of bad debt expense	\$ 137,766	\$ 393,557
Prepaid expenses and deposits	45,106	23,199
Accounts payable and accrued liabilities	(728,086)	(554,095)
Net effect of foreign exchange on non-cash working capital	(49,803)	9,403
	\$ (595,017)	\$ (127,936)
Operating activities	\$ (595,017)	\$ (107,013)
Investing activities	-	(20,923)
	\$ (595,017)	\$ (127,936)

16. CONTINGENCIES AND COMMITMENTS

Colombia

In May 2011, the Company signed a Hydrocarbon Exploration and Production Contract (E&P Contract) with the Agencia Nacional de Hidrocarburos of Colombia (ANH) for LLA-11 (Llanos Block). The Llanos Block in the Llanos Basin was successfully won by the Company during a bid round held on June 22, 2010, in Cartagena, Colombia (the "Bid"). The Company has granted a 90% private interest in the Block to a wholly-owned subsidiary of Sagres Energy Inc. ("Sagres") in consideration for the Company retaining a 10% carried interest during the first exploration phase (the "Carried Interest"), which consists of a minimum expenditure of USD\$9,500,000 over a 36 month period.

The Llanos Block carries an additional royalty of 1% payable to the Government of Colombia in addition to the basic royalty scheme established under Colombia Law, being 8% for up to 5,000 bopd of production and increasing to 25% for a 600,000 bopd field. All other terms of the contract are standard to the model E&P Contract. Sagres will have an option to acquire the Company's Carried Interest in the Block over the next twelve months at a mutually agreed price.

Stetson entered into a Letter of Intent ("LOI") with a private Ontario company ("Ontario Co.") for Ontario Co. to acquire a 90% private interest in the Block in consideration for paying to Stetson a fee of USD\$50,000, agreeing to reimburse Stetson for all expenses of the Bid and to allow Stetson to retain the Carried Interest. Subsequent to the Bid, Ontario Co. was acquired by Sagres. The transaction closed in May 2011.

The transaction may be considered a Non-Arm's Length Transaction for the purposes of the TSX Venture Exchange as Stetson and Ontario Co. had a common officer at the time the terms of the LOI were negotiated.

As at June 30, 2011, Stetson has outstanding Standby Letters of Credit totaling USD\$3,660,000 relating to the Llanos Block, with maturities up to 36 months. The Letters of Credit were secured by cash which has been classified as Restricted Cash on the Interim Condensed Consolidated Balance Sheet. Funds were advanced to the Company by Sagres to secure these Letters of Credit and are reported on the Interim Condensed Consolidated Balance Sheet at June 30, 2011 as payable to joint venture partner.

North Dakota

Pursuant to an agreement entered into with the Tribal Council of the Three Affiliated Tribes of the Fort Berthold Reservation in North Dakota to lease certain oil and gas mineral rights, the Company and its joint venture partner completed the initial commitment well and an additional two wells are to be drilled prior to August 28, 2012. Pursuant to the terms of the agreement, Stetson is carried on all costs through the re-completion of the existing well and abandonment thereof if required. Stetson has approximately a 40% working interest on

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For the period ended June 30, 2011

the tribal acreage and a 50% working interest on the allottee acreage.

The Company also has an Irrevocable Letter of Credit in the amount of USD \$75,000 relating to its oil and gas mining leases on tribally or individual-owned Indian land including the Fort Berthold Reservation in the State of North Dakota, as required by the Bureau of Indian Affairs. As at June 30, 2011, the Letter of Credit was secured by cash holdings, which have been classified as restricted cash on the Consolidated Balance Sheet.

Statement of Claim

On October 29, 2008, the Company filed a statement of claim against Thomas Weisel Partners Canada Inc. seeking to recover damages incurred by the Company as a result of the incomplete bought deal financing of July 2008. The Company has filed a copy of the Statement of Claim under its profile on SEDAR.

Other Contingencies and Commitments

The Company has guarantees and other commitments in the normal course of business that would not have a material adverse effect on the Company's liquidity, financial condition or results of operations.

17. TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

As disclosed in Note 2, the interim consolidated financial statements represent Stetson's initial presentation of the financial information and comparatives under IFRS. The change in accounting policy bears a significant impact on presentation, classification and value of the information stated.

IFRS 1- First Time Adoption of IFRS

IFRS 1 allows first time adopters to elect certain exemptions from applying application of certain IFRS standards retrospectively from the date of transition of January 1, 2010. The exemptions elected and applied by the Company are to have opening Accumulated Other Comprehensive Loss to be nil as at the date of transition, as well as to elect full cost book value as deemed cost which will allow the Company to measure oil and gas assets at the date of transition to IFRS. Due to this election all foreign currency translation differences, prior to the date of transition, have been included in the Company's deficit and oil and gas assets are deemed as cost at the date of transition. Adjustments subsequent to the transition date for translation of foreign subsidiaries have been included in Other Comprehensive Loss. See reconciliation discussions in Note 19 of the March 31, 2011 financial statements for a more detailed impact of this change.

COMPARATIVE RECONCILIATIONS

The accounting policies referenced in Note 3 have been applied in preparing the both the interim condensed consolidated financial statements for the period ended June 30, 2011 and the comparative information throughout the statements and the notes. Reconciliations of the adjustments required to report previously reported financial information under Canadian GAAP to IFRS for comparative purposes of these interim consolidated financial statements are presented on the following pages and in the financial statements of the period ended March 31, 2011.

STETSON OIL & GAS LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

INTERIM CONDENSED CONSOLIDATED BALANCE SHEET (unaudited)

June 30, 2010 (\$ Canadian)	Canadian GAAP	IFRS Adjustments			IFRS
		Exploration & Evaluation Note 19 A	Decommissioning obligations Note 19 D	Foreign Currency Translation Note 19 C	
ASSETS					
Current					
Cash	\$ 319,255	-	-	-	\$ 319,255
Accounts receivable	1,318,060	-	-	-	1,318,060
Prepaid expenses and deposits	13,208	-	-	-	13,208
Discontinued operations	8,217,386	-	-	-	8,217,386
	9,867,909	-	-	-	9,867,909
Long-term					
Restricted cash	83,103	-	-	-	83,103
Reclamation deposits	358,590	-	-	-	358,590
Property and equipment	9,426,305	(9,426,035)	-	-	270
Exploration and evaluation	-	9,426,035	-	(632,362)	8,793,673
	\$ 19,735,907	-	-	(632,362)	\$ 19,103,545
LIABILITIES					
Current					
Accounts payable and accrued liabilities	\$ 1,650,117	-	-	-	\$ 1,650,117
Bank loan	257,957	-	-	-	257,957
Discontinued operations	2,271,251	-	-	-	2,271,251
	4,179,325	-	-	-	4,179,325
Decommissioning obligations	183,204	-	45,126	-	228,330
	4,362,529	-	45,126	-	4,407,655
SHAREHOLDERS' EQUITY					
Common shares	32,414,157	-	-	-	32,414,157
Warrants	4,771,000	-	-	-	4,771,000
Preferred shares	8,570	-	-	-	8,570
Contributed surplus	5,394,103	-	-	-	5,394,103
Accumulated other comprehensive loss	-	-	(40)	60,578	60,538
Deficit	(27,214,452)	-	(45,086)	(692,940)	(27,952,478)
	15,373,378	-	(45,126)	(632,362)	14,695,890
	\$ 19,735,907	-	-	(632,362)	\$ 19,103,545

STETSON OIL & GAS LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

INTERIM CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS *(unaudited)*

Three months ended June 30, 2010	Canadian GAAP	IFRS Adjustments		IFRS
		Decommissioning obligations Note 19 D	Foreign Currency Translation Note 19 C	
<i>(\$ Canadian)</i>				
Revenue				
Petroleum and natural gas sales	\$ 1,237	-	-	\$ 1,237
Royalties	(402)	-	-	(402)
	835	-	-	835
Other income	404	-	-	404
	1,239	-	-	1,239
Expenses				
Operating	29,132	-	-	29,132
General and administrative	476,091	-	-	476,091
Stock-based compensation	900	-	-	900
Finance costs	7,954	1,121	-	9,075
Foreign exchange loss/(gain)	(15,154)	-	14,802	(352)
Depreciation	386	(386)	-	-
	499,309	735	14,802	514,846
Loss before discontinued operations	(498,070)	(735)	(14,802)	(513,607)
Discontinued operations	343,560	-	-	343,560
Net loss	(154,510)	(735)	(14,802)	(170,047)
Other comprehensive loss				
Foreign currency translation	-	(34)	345,936	345,902
	-	(34)	345,936	345,902
Total comprehensive income/(loss)	\$ (154,510)	(769)	331,134	\$ 175,855

STETSON OIL & GAS LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

INTERIM CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS *(unaudited)*

Six months ended June 30, 2010	Canadian GAAP	IFRS Adjustments		IFRS
		Decommissioning obligations Note 19 D	Foreign Currency Translation Note 19 C	
<i>(\$ Canadian)</i>				
Revenue				
Petroleum and natural gas sales	\$ 39,739	-	-	\$ 39,739
Royalties	(12,921)	-	-	(12,921)
	26,818	-	-	26,818
Other income	492	-	-	492
	27,310	-	-	27,310
Expenses				
Operating	55,947	-	-	55,947
General and administrative	870,209	-	-	870,209
Stock-based compensation	1,800	-	-	1,800
Finance costs	25,467	2,207	-	27,674
Foreign exchange loss/(gain)	13,511	-	(13,528)	(17)
Depreciation	3,323	(780)	-	2,543
	970,257	1,427	(13,528)	958,156
Loss before discontinued operations	(942,947)	(1,427)	13,528	(930,846)
Discontinued operations	836,927	-	-	836,927
Net income/(loss)	(106,020)	(1,427)	13,528	(93,919)
Other comprehensive loss				
Foreign currency translation	-	(40)	60,578	60,538
	-	(40)	60,578	60,538
Total comprehensive income/(loss)	\$ (106,020)	(1,467)	74,106	\$ (33,381)

STETSON OIL & GAS LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

SIGNIFICANT ACCOUNTING POLICY CHANGES

The below discussion explains the significant differences between Stetson's accounting policies applied by the Company under Canadian GAAP compared to the new accounting policies under IFRS.

A. Exploration and Evaluation – IFRS 6

Under Canadian GAAP Stetson used the full cost method of oil and gas accounting whereby all costs relating to the exploration for and development of petroleum and natural gas reserves were capitalized and included with property and equipment. Such costs include land acquisition, drilling of productive and non-productive wells, geological and geophysical, production facilities, carrying costs directly related to unproved properties and corporate expenses directly related to acquisition, exploration and development activities.

IFRS 6 mandates that E&E costs must be separated from P&E into tangible or intangible pools according to the nature of the assets acquired. These costs include acquisition of rights to explore, exploration drilling, carrying costs of unproved properties, and any other activities relating to evaluation of technical feasibility and commercial viability of extracting an oil and gas resource.

For the six months ended June 30, 2010, \$9,426,035 was reclassified from P&E to E&E as defined by IFRS 6. This adjustment had no impact on net loss.

B. Property and equipment – IAS 16

The most significant accounting impact to property and equipment is the removal of E&E assets as described above. Although IAS 16 requires P&E components to be broken out based on their cash generating units and the review of the useful life of each major asset that has been recorded, there is minimal impact due to the small number of tangible assets that the Company currently holds.

All property and equipment that is held in the US subsidiaries under Canadian GAAP were held at historical cost using the exchange rate at the date of purchase. Under IFRS these assets must be revalued at the period end exchange rate due to the change in classification of the foreign subsidiaries under IFRS. All translation differences arising from these adjustments are recognized as a part of Other Comprehensive Income/Loss.

C. Effects of Foreign Currency translation – IAS 21

Translation of foreign subsidiaries for consolidation

Under Canadian GAAP all foreign subsidiaries were assessed as integrated and were translated for consolidation using the temporal method. Under this method monetary assets and liabilities were translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities were translated at rates in effect on the dates the assets were acquired or liabilities were incurred. Revenue and expense were translated at the rates of exchange prevailing at the date of the transaction. Foreign exchange gains and losses were recorded in the consolidated statement of earnings as they arose.

Under IFRS the assessment of functional currency is different than that of Canadian GAAP in that the focus is mainly on the primary economic environment in which it operates rather than financing received and dependency on the reporting entity with which it is consolidated. As such the functional currency assessed using IFRS criteria for the subsidiaries is USD (CAD under previous GAAP). Any exchange gains and losses due to translation to the reporting entities functional currency for consolidation are recorded as a part of Other Comprehensive Income/Loss rather than included in Net Income/Loss.

The adjustments required are twofold:

- The first is to revalue the assets in E&E and property and equipment using the period end rates and record this difference to Other Comprehensive Income/Loss. This adjustment is required as under Canadian GAAP these assets would have been carried at the historical rate and therefore no translation differences would have been included in the Canadian GAAP foreign exchange gains/losses;
- Secondly, the exchange gain/loss included on the income statement is analyzed for amounts relating to the translation of foreign subsidiaries with these amounts being reclassified as Other Comprehensive Income/Loss.

STETSON OIL & GAS LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the period ended June 30, 2011

The Company has chosen to make the election for the optional IFRS 1 exemption to deem the cumulative translation differences to be nil at the date of transition, and reclassify any such amounts determined in accordance with previous GAAP at that date to retained earnings. Below is a discussion of the impact of this change on comparative balances as shown in the reconciliations above.

June 30, 2010 Balance Sheet adjustment for foreign held assets

As at June 30, 2010, a total of \$632,362 was recorded as foreign exchange loss adjusted against exploration and evaluation assets and included as other comprehensive income/loss.

Three months ended June 30, 2010

For the three months ended June 30, 2010, an adjustment of \$14,802 was made in order to remove foreign exchange differences on translation of subsidiaries that were previously included on the income statement under Canadian GAAP to other comprehensive income/loss. The adjustment attributed to the increase in net loss of \$154,510 under Canadian GAAP to \$170,047 under IFRS.

Six months ended June 30, 2010

For the six months ended June 30, 2010, an adjustment of \$13,528 was made in order to remove foreign exchange differences on translation of subsidiaries that were previously included on the income statement under Canadian GAAP to other comprehensive income/loss. The adjustment attributed to the decrease in net loss of \$106,020 under Canadian GAAP to \$93,919 under IFRS.

D. Decommissioning obligations

Under Canadian GAAP, asset retirement obligations were measured as the estimated fair value of the reclamation and abandonment expenditures expected to be incurred. Liabilities were not re-measured to reflect period end discount rates.

Under IFRS, decommissioning obligations are measured as the best estimate of the expenditure to be incurred. IFRS requires that the decommissioning obligation be re-measured using the period end discount rate which is the risk free rate.

Upon transition to IFRS, Stetson elected to re-measure its decommissioning obligations upon transition to IFRS and recognize the difference in deficit. The application of this election resulted in a \$43,659 increase to the decommission obligations on the Company's Consolidated Balance Sheet as at January 1, 2010. Adjustments to accretion expense of \$769 and \$1,467, respectively, are reflected in the Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2010.

E. Cash Flow Statement adjustments

The transition to IFRS from Canadian GAAP had no significant impact on cash used/generated by the Company. Presentation adjustments were made to conform with the IFRS adjustments as shown in the above reconciliations, with no impact on the bottom line change in cash.

F. Summary of effect on current and deferred taxes

The above adjustments had no bottom line impact on income taxes. A valuation allowance is taken on all existing deferred tax balances due to the uncertainty of their utilization. There is no impact on the consolidated financial statements as a result of the conversion to IFRS.