



DIAZ RESOURCES LTD.

*Table Of Contents*

Corporate Profile ..... 2

Corporate Summary ..... 2

Message to Shareholders ..... 3

Management’s Discussion and Analysis (“MD&A”) ..... 7

Condensed Consolidated Financial Statements ..... 24

Notes to the Condensed Consolidated Financial Statements ..... 28

CORPORATE INFORMATION ..... 54

## Corporate Profile

Diaz Resources Ltd. is an oil and gas exploration, development and production company with reserves, land holdings and production in Canada and the United States. The Company's principal focus is the exploitation of oil resources in Alberta and Saskatchewan through horizontal drilling. The majority of the Company's revenue is being generated from oil production in Alberta. The Company also has natural gas revenues generated in Alberta and Texas.

## Corporate Summary

<i>(Thousands, except shares and per share amounts)</i>	Nine Months Ended Sept 30	
	2011	2010
<b>Financial</b>		
Revenue (net of royalty expense)	\$ 3,747	\$ 4,932
Cash flow from operations**	116	1,123
per share, diluted	0.00	0.01
Loss for the period	(2,764)	(3,249)
per share, diluted	(0.03)	(0.04)
Capital additions	3,641	3,600
Dispositions	1,777	396
Net capital additions	1,864	3,204
Working capital (Net current debt)	(243)	(6,714)
Convertible debentures*	(12,188)	(6,604)
Total assets	34,764	34,722
Total shares outstanding at period end	90,878,252	85,903,000
<b>Operations</b>		
Production		
Gas (MMcfd)	1.7	2.4
Oil (Bopd)	113	122
BOEd (6 Mcf = 1 Bbl)	400	519
Product Prices		
Gas (\$/Mcf)	\$4.25	\$4.79
Heavy oil (\$/bbl)	\$65.72	\$60.70
Other oil and liquids (\$/Bbl)	\$79.12	\$66.19

\* Convertible debentures have a face value of \$7.1 million with maturity on March 27, 2014, and a face value of \$8.0 million with a maturity of March 31, 2016. See Note 8, "Convertible Debentures", in the notes to the financial statements for the nine months ended September 30, 2011.

\*\* Non GAAP Measurement

## Message to Shareholders

### Highlights

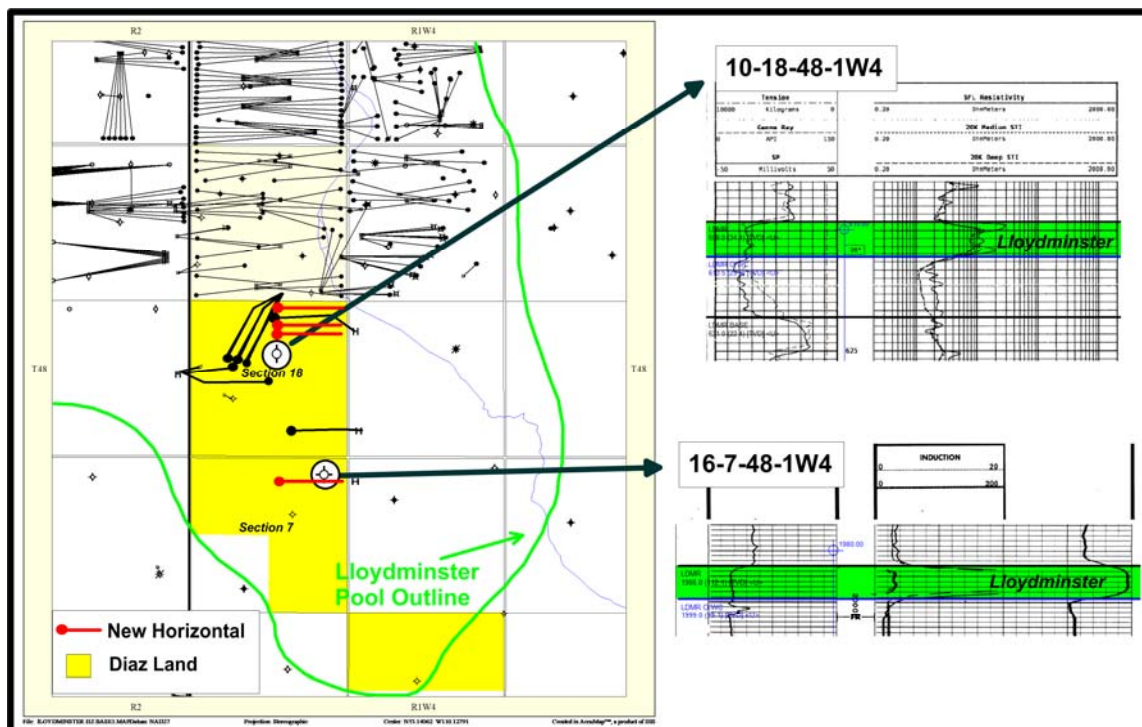
The Company made significant progress towards increasing oil production rates during Q3 2011 as it drilled four new wells during the quarter in its ongoing development program with funds sourced from property sales. Diaz sold four non-core properties which generated approximately \$1.6 million. Diaz did not need to draw on its bank line during the third quarter, which leaves the Company positioned to proceed with additional planned drilling in the fourth quarter.

Diaz drilled three wells in its ongoing Lloydminster development program – all of which were successful.

Of note, and more significant, was the Company's participation in the drilling of a horizontal well at Macklin, Saskatchewan, which was placed on production September 18, 2011, and has steadily produced in excess of 100 barrels of oil per day (45 bopd net), to date. Diaz plans to drill two offset wells to this well in November and anticipates a continuous development program if results warrant.

### Lloydminster Drilling Program

#### Lloydminster, Alberta



Section 18-48-1 W4 in the Lloydminster area, Diaz 50% working interest, is currently the primary development focus of the Company.

Production rates from the three newest wells on section 18 commenced at an average of 75 Bopd and are expected to gradually decline to approximately 30 Bopd after twelve months. Diaz will monitor the production characteristics of these wells and plans additional drilling following this review.

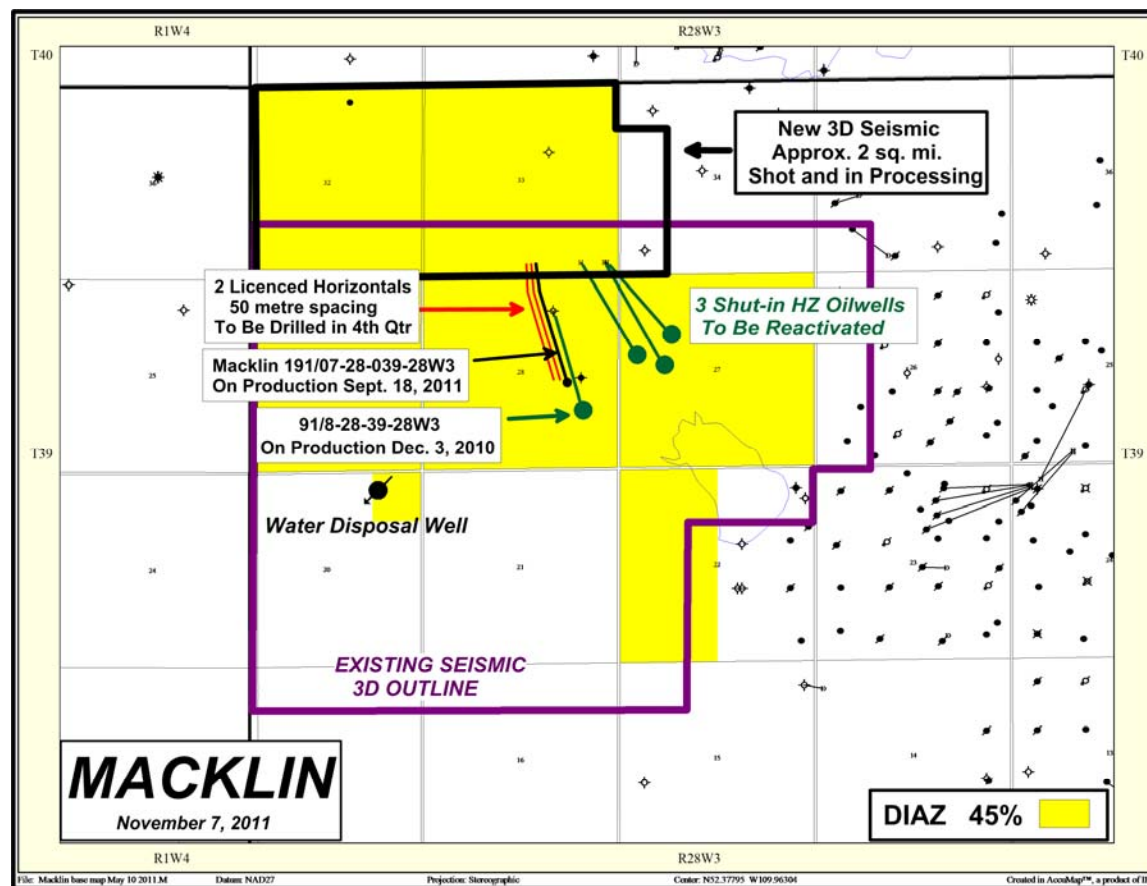
Diaz also participated in a horizontal well in section 7-48-1 W4. The well, in which Diaz has a 15% working interest, has been producing at approximately 25 Bopd, with no water, to date. This well is situated just south of a well located at 2-18-48-1 W4 which is still producing with cumulative production of 22,000 barrels. The Company anticipates further drilling adjacent to these wells in 2012.

## Macklin, Saskatchewan

At Macklin, Saskatchewan, Diaz participated for a 45% interest in a Dina horizontal heavy oil well. The well has exhibited excellent production characteristics, having produced at over 100 Bopd, for the past 50 days.

Following the completion of the well Diaz acquired a 45% interest in section 33-39-28 W3 immediately to the north of the current pool, and has shot a two section 3D seismic program to delineate further locations.

Based on the success of the recent well, Diaz plans to drill two, 50 meter offset, horizontal wells during November of this year.



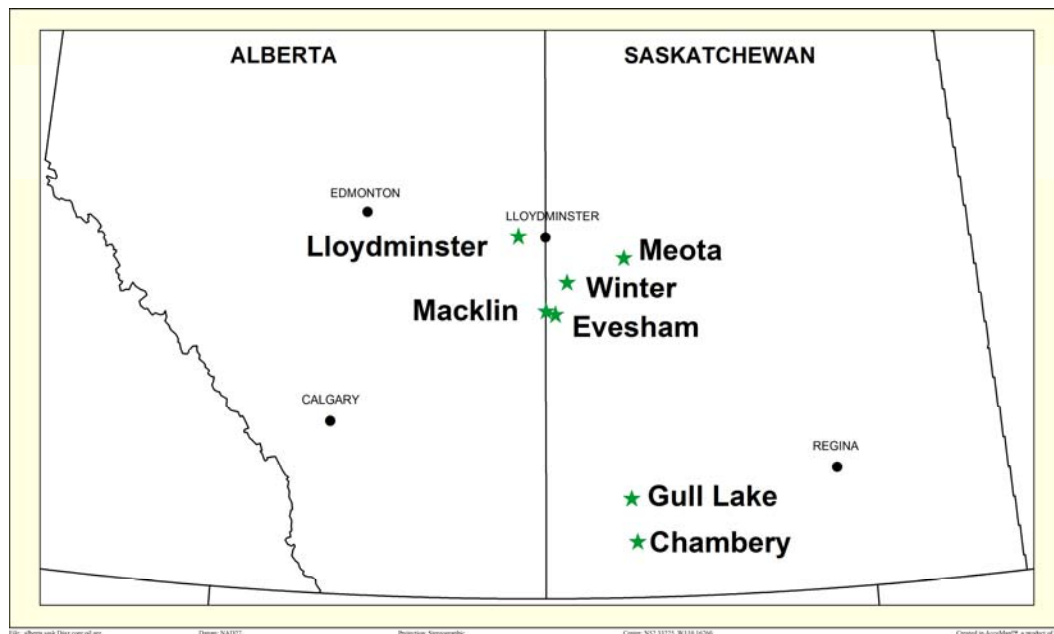
## Ongoing Exploration Program – Alberta and Saskatchewan

To date, Diaz has acquired oil and gas leases on five prospects in Alberta (5,258 gross acres, 2,850 net acres) and eight prospects in Saskatchewan (19,758 gross acres, 11,371 net acres) for a total inventory of eleven heavy oil projects and two medium/light oil projects. The primary pay zones are Lloydminster in Alberta and the Dina, Shaunavon and Birdbear zones in Saskatchewan.

Of significance, Diaz holds two prospective leases on the active Birdbear oil development play in Saskatchewan, which are currently being closely offset by NuVista and Talisman drilling locations.

In addition, Diaz holds two leases on the developing Shaunavon oil play, at Gull Lake, immediately offsetting lands that were purchased for over \$1 million per section and are currently being drilled by Arc Resources.

Below is a map of the current active exploration and development areas for the Company:



## Financial

For the nine months ended September 30, 2011, revenue decreased to \$3.7 million compared with \$4.9 million for the prior year period. Cash flow from operations for the period decreased to \$116,000 or nil per share compared with cashflow of \$1.1 million or \$0.01 per share for the prior year period. Diaz reported a loss for the nine month period of \$2.8 million or (\$0.03) per share versus a loss of \$3.2 million or (\$0.04) per share in the prior year period.

Capital expenditures for the first nine months of 2011 totalled \$3.6 million compared with \$3.6 million in the prior year period. Capital expenditures for Q3 2011 and the nine month period were financed primarily from working capital, disposition of non-core properties and the proceeds from an \$8.0 million private placement financing.

Diaz exited the quarter with net current debt of \$243,000 compared with \$6.4 million at the beginning of the year. The Company's bank line was reviewed subsequent to the quarter and was confirmed to be \$3.1 million. The line is currently undrawn.

## Production

The Company's total production for Q3 2011 decreased 23% to average 390 BOEd compared with the prior year period average of 507 BOEd.

Of significance however, in September, the last month of the quarter, the impact of Diaz's new oil production increased, with oil sales representing 68% of the company's revenue compared with an average of 51% for the nine month period.

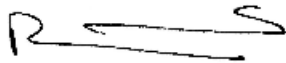
## *Business Outlook*

Diaz expects oil prices to hold above \$90 per barrel (WTI) for the remainder of 2011 as industrial activity in North America slowly recovers and demand for oil in developing countries continues to increase.

Due to the high level of activity on North American shale gas projects and increasing natural gas storage levels, it seems unlikely that natural gas prices will improve in the medium term. Consequently, Diaz is keeping its investments in natural gas to an absolute minimum.

The Company will continue to focus on its heavy oil development programs in the Lloydminster and Macklin areas and if successful, Diaz should exit 2011 with a significant increase in its oil production from current levels.

On behalf of the Board,



R.W. Lamond, Chairman



D.K. Clark, Chief Operating Officer

**November 10, 2011**

## Management's Discussion and Analysis ("MD&A")

November 10, 2011

This Management's Discussion and Analysis ("MD&A") for Diaz Resources Ltd. ("Diaz" or the "Company") should be read with the unaudited interim condensed consolidated financial statements for the period ended September 30, 2011, as well as the audited Consolidated Financial Statements and MD&A for the year ended December 31, 2010.

### *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 condensed consolidated financial statements of Diaz have been prepared by and are the responsibility of the Company's management. The Company'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 financial statements by an entity's auditor.

### *IFRS*

The interim condensed consolidated financial statements for the nine months ended September 30, 2011, including required comparative information, have been prepared in accordance with International Financial Reporting Standards 1, First-time Adoption of International Financial Reporting Standards, and with International Accounting Standard ("IAS") 34, Interim Financial Reporting, as issued by the International Accounting Standards Board ("IASB"). Prior to 2011, the Company prepared its Interim and Annual Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles ("previous GAAP"). Unless otherwise noted, 2010 comparative information has been prepared in accordance with IFRS.

The adoption of IFRS on January 2011 has not had an impact on the Company's operations, strategic decisions or cash flow from operations. The most significant area of impact was the adoption of the IFRS upstream accounting principles. Further information on the IFRS impacts is provided in the Accounting Policy Changes Section of this MD&A. Reconciliations between previous GAAP and IFRS Balance Sheets, Net Earnings, Operating Earnings and other financial metrics are included in Note 17 in the unaudited condensed consolidated financial statements of the Company for the nine months ended September 30, 2011.

The following discussion and analysis is management's assessment of Diaz's historical, financial and operating results. All dollar amounts are in Canadian dollars unless otherwise indicated.

The reader should be aware that historical results are not necessarily indicative of future performance.

### *Corporate Summary*

The Corporate Summary included on page two of this report is included in the MD&A by reference.

### *Non-GAAP Measures*

Certain measures in this document do not have any standardized meaning as prescribed by IFRS and previous GAAP and, therefore, are considered non-GAAP measures. Non-GAAP measures are commonly used in the oil and gas industry and by Diaz to provide shareholders and potential investors with additional information regarding the Company's liquidity and its ability to generate funds to finance its operations.

Non-GAAP measures include the term "cash flow from operations", which should not be considered an alternative to, or more meaningful as an indicator of the Company's performance than, "cash flow provided by operating activities", as determined in accordance with accounting principles generally accepted in Canada. Diaz's determination of "cash flow from operations" may not be particularly comparable to that reported by other companies especially those in other industries. Management uses "cash flow from operations" as a measure of operating performance as the measure is not exposed to

non-cash working capital movements, which for a small company, could be material and misleading. The reconciliation of “cash flow from operating activities” and “cash flow from operations” is as follows:

(\$ Thousands, unaudited)	Three Months Ended		Nine Months Ended	
	Sept 30		Sept 30	
	2011	2010	2011	2010
Cash provided by (used for) Operating Activities:	\$ 1,575	\$ 794	\$ 1,243	\$ 527
Adjusted for:				
Change in non-cash working capital	(1,610)	(582)	(1,127)	596
Cash flow from operations	\$ (35)	\$ 212	\$ 116	\$ 1,123

The Company also presents “annualized cash flow from operations” which equals four times quarterly “cash flow from operations”. “Cash flow” per share is calculated using the weighted average shares outstanding consistent with the calculation of earnings per share. In addition, the Company presents “Net current debt”, which is calculated as the aggregate of current assets and current liabilities.

**BOE Presentation** – The term barrels of oil equivalent (BOE) may be misleading, particularly if used in isolation. A BOE conversion ratio of 6 Mcf: 1 Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All BOE conversions in this report are derived by converting gas to oil in the ratio of six Mcf of gas to one Bbl of oil.

**Forward-looking Statements** – Certain of the statements contained herein including, without limitation, financial and business prospects and financial outlook, reserve and production estimates, drilling and re-completion plans, timing of drilling, completion and tie-in of wells and capital expenditures and the timing thereof may be forward-looking statements. Words such as “may”, “will”, “should”, “could”, “anticipate”, “believe”, “expect”, “intend”, “plan”, “potential”, “continue” and similar expressions may be used to identify these forward-looking statements. These statements reflect management’s beliefs at the date of the report and are based on information available to management at that time. Forward-looking statements involve significant risk and uncertainties.

A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources and the risk factors outlined under “Risk Factors” in the Company’s Annual Information Form and elsewhere herein. The recovery and reserve estimates of Diaz’s reserves provided herein are estimates only and there is no guarantee that the estimated reserves will be recovered. As a consequence, actual results may differ materially from those anticipated in the forward-looking statements. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could affect Diaz’s operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website ([www.sedar.com](http://www.sedar.com)) or at Diaz’s website ([www.diazresources.com](http://www.diazresources.com)). Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, including but not limited to assumptions as to the price of oil and natural gas, interest rates, exchange rates and the regulatory and legal environment in which Diaz operates, the producibility of Diaz’s reserves, the capital expenditures program and future operations and other matters, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and the Company assumes no obligation to update or review them to reflect new events or circumstances except as required by applicable securities laws.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Company’s general expectations concerning this industry is based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market

research and industry analysis and on assumptions based on data and knowledge of this industry which the Company believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While the Company is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

## Operations

In Q3, 2011, 68% of Diaz' 390 BOEd consisted of Natural Gas which is unchanged compared with the same period in the prior year. Diaz owns interests in producing properties in Alberta and Saskatchewan in Canada, and in Texas in the United States. Where meaningful, the following production information has been segmented for each of the Company's geographic areas of operations.

Oil & Gas Production	Three Months Ended		Nine Months Ended	
	2011	Sept 30 2010	2011	Sept 30 2010
<b>Gas - Canada</b>				
Retlaw	416	484	426	520
Enchant	278	373	279	372
Therien	173	143	157	149
Carmangay	65	78	66	82
Other	233	467	368	757
<b>Gas - Canada (Mcf)</b>	<b>1,165</b>	<b>1,545</b>	<b>1,296</b>	<b>1,880</b>
<b>Oil &amp; Liquids - Canada</b>				
<b>Heavy Oil</b>				
Lloydminster & Macklin	107	130	90	89
<b>Other Oil &amp; NGLs</b>				
Other	18	28	21	30
<b>Oil &amp; Liquids - Canada (Bopd)</b>	<b>125</b>	<b>158</b>	<b>111</b>	<b>119</b>
<b>BOEd - Canada (6 Mcf = 1 Bbl)</b>	<b>319</b>	<b>416</b>	<b>327</b>	<b>432</b>
<b>Gas - U.S.</b>				
Provident City	220	290	250	279
Other	196	236	173	248
<b>Gas - U.S. (Mcf)</b>	<b>416</b>	<b>526</b>	<b>423</b>	<b>527</b>
<b>Oil &amp; Liquids - U.S.</b>				
Provident City	1	3	1	2
Other	1	-	1	1
<b>Oil &amp; Liquids - U.S. (Bopd)</b>	<b>2</b>	<b>3</b>	<b>2</b>	<b>3</b>
<b>BOEd - U.S. (6 Mcf = 1 Bbl)</b>	<b>71</b>	<b>91</b>	<b>73</b>	<b>91</b>
<b>Gas - Company (Mcf)</b>	<b>1,581</b>	<b>2,071</b>	<b>1,719</b>	<b>2,407</b>
<b>Oil and Liquids - Company (Bopd)</b>	<b>127</b>	<b>161</b>	<b>113</b>	<b>122</b>
<b>BOEd - Company</b>	<b>390</b>	<b>507</b>	<b>400</b>	<b>523</b>

Canadian oil production has decreased 21% to 125 Bopd for Q3 2011 compared with 158 Bopd for the prior year period. For the nine month period, oil production decreased 7% to 111 Bopd compared with 119 Bopd for the prior year period. Both period decreases resulted from the timing of the Company's heavy oil development program at Lloydminster. The 2010 drilling program added production from new wells during the third quarter while the 2011 drilling program added production from new wells during the fourth quarter.

The Company's total production for the nine month period decreased 24% to 400 BOEd compared with the prior year period average of 523 BOEd. In Canada, the production rate decreased 24% as a result of a general decline in production from mature wells and natural gas wells at Leahurst and Big Bend that are shut-in. Declines were partially offset by Lloydminster heavy oil production which maintained approximately 90 Bopd for the current and prior year nine month periods. In the U.S., production rates for the nine month period fell by 20% compared with average rates in the prior year period as the Company ceased development work in the U.S. and well production declines have continued.

Product Prices	Three Months Ended		Nine Months Ended	
	2011	Sept 30 2010	2011	Sept 30 2010
<b>Canada</b>				
Natural Gas (\$/Mcf)	\$ 3.72	\$ 4.66	\$ 4.36	\$ 4.92
Heavy Oil (\$/Bbl)	\$ 62.10	\$ 56.40	\$ 65.72	\$ 60.70
Other Oil & Liquids (\$/Bbl)	\$ 74.75	\$ 59.71	\$ 77.69	\$ 65.40
<b>\$/BOE</b>	<b>\$ 38.53</b>	<b>\$ 39.05</b>	<b>\$ 40.29</b>	<b>\$ 38.51</b>
<b>U.S.</b>				
Natural Gas (\$/Mcf)	\$ 3.98	\$ 4.07	\$ 3.93	\$ 4.32
Oil & Liquids (\$/Bbl)	\$ 83.99	\$ 75.14	\$ 90.12	\$ 77.37
<b>\$/BOE</b>	<b>\$ 25.60</b>	<b>\$ 26.13</b>	<b>\$ 26.00</b>	<b>\$ 27.57</b>
<b>\$/BOE - Company</b>	<b>\$ 36.17</b>	<b>\$ 36.74</b>	<b>\$ 37.68</b>	<b>\$ 36.60</b>

In Canada, average prices per BOE for the nine month period were 4.6% higher than prices in the prior year period. During the quarter, natural gas prices were lower by 20% and heavy oil prices were higher by 10.1% when compared with Q3 2010. Natural gas revenue was increased by the Company's fixed price contract, outlined in more detail below. In the U.S., natural gas prices were lower and oil prices were higher during the quarter compared with Q3 2010.

Overall, average BOE prices for Q3 2011 were 1.6% lower than in the prior year period.

Canada Natural Gas Prices Adjusted For Fixed Gas Contracts	Three Months Ended		Nine Months Ended	
	2011	Sept 30 2010	2011	Sept 30 2010
<b>Canada</b>				
Gas price without contracts \$/Mcf	\$ 3.57	\$ 3.32	\$ 3.60	\$ 3.99
Fixed gas contract benefit (cost) \$/Mcf	\$ 0.15	\$ 1.34	\$ 0.76	\$ 0.93
<b>Gas price with contracts \$/Mcf</b>	<b>\$ 3.72</b>	<b>\$ 4.66</b>	<b>\$ 4.36</b>	<b>\$ 4.92</b>
<b>Fixed gas contract benefit (cost) \$ '000</b>	<b>\$ 16</b>	<b>\$ 189</b>	<b>\$ 268</b>	<b>\$ 472</b>

The Canadian natural gas price includes the effect of fixed gas contracts in the current and prior periods.

As detailed above, Diaz added \$268,000 to its revenue for the first nine months of 2011 but only \$16,000 in Q3 2011 as a result of fixed gas contracts. Diaz has put in place fixed gas price contracts for approximately half of the Company's anticipated 2011 gas production, at prices between \$4.00 per Mcf and \$4.46 per Mcf.

Revenue from Oil and Gas Production, before royalties (\$ Thousands)	Three Months Ended		Nine Months Ended	
	2011	Sept 30 2010	2011	Sept 30 2010
<b>Canada</b>				
Natural Gas	\$ 398	\$ 656	\$ 1,542	\$ 2,490
Heavy Oil	609	667	1,614	1,478
Other Oil and Liquids	122	157	436	537
<b>Total - Canada</b>	<b>1,129</b>	<b>1,480</b>	<b>3,592</b>	<b>4,505</b>
<b>U.S.</b>				
Natural Gas	152	195	453	622
Oil and natural gas liquids	16	21	66	61
<b>Total - U.S.</b>	<b>168</b>	<b>216</b>	<b>519</b>	<b>683</b>
<b>Total Production Revenue - Company</b>	<b>\$ 1,297</b>	<b>\$ 1,696</b>	<b>\$ 4,111</b>	<b>\$ 5,188</b>

In Canada, for the third quarter of 2011, declines in average natural gas production and lower average prices resulted in natural gas revenue before royalty of \$398,000, a 39% decline from natural gas revenues before royalty reported in Q3 2010. Heavy oil revenue and other oil and liquids revenue also declined by 9% and 22% respectively to \$609,000 and \$122,000 in Q3 2010. The decrease in heavy oil revenue resulted from the timing of new wells added late in Q3 2011 versus new wells that were on

production for the all of Q3 2010. Production declines were offset by slightly higher oil prices. Natural gas production declines of 21% in the U.S. during the quarter combined with lower gas prices to reduce natural gas revenues by 22%.

For the nine month period, declining Canadian and US average gas production and lower prices resulted in a 36% drop in revenues to \$2.0 million from a combined \$3.1 million in the prior year period. This was partially offset by heavy oil revenues. Overall production revenues for the period were down 21% to \$4.1 million compared with the prior year period.

<b>Royalties</b> (\$ Thousands, except per BOE and percentage amounts)	<b>Three Months Ended</b> <b>Sept 30</b>		<b>Nine Months Ended</b> <b>Sept 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Canada</b>				
Crown	\$ 39	\$ 11	\$ 247	\$ 115
Freehold	17	19	52	24
<b>Royalties</b>	<b>56</b>	<b>30</b>	<b>299</b>	<b>139</b>
per BOE	\$ 1.86	\$ 0.75	\$ 3.35	\$ 1.18
Royalties as a percentage of revenue	4.7%	1.9%	8.2%	3.0%
<b>U.S.</b>				
Royalties	49	66	156	194
per BOE	\$ 7.46	\$ 7.45	\$ 7.81	\$ 7.85
Royalties as a percentage of revenue	26.0%	27.7%	28.9%	28.0%
<b>Total Royalties - Company</b>	<b>\$ 105</b>	<b>\$ 96</b>	<b>\$ 455</b>	<b>\$ 333</b>
<b>per BOE</b>	<b>\$ 2.89</b>	<b>\$ 2.06</b>	<b>\$ 4.17</b>	<b>\$ 2.35</b>

In Canada, total royalty expense in Q3 2011 increased when compared with Q3 2010 as Lloydminster wells that have produced for more than one year no longer receive the Alberta 5% fixed royalty. Diaz anticipates royalty rates should average approximately 10% - 15% of Canadian revenue for 2011.

In the United States, royalties as a percentage of revenue have continued to be in the normal range for the properties. Royalties are generally fixed rates in the U.S. and Diaz expects royalty rates to average 28% to 31% of U.S. revenue during 2011.

<b>Operating and Transportation Expense</b> (\$ Thousands, except per BOE amount)	<b>Three Months Ended</b> <b>Sept 30</b>		<b>Nine Months Ended</b> <b>Sept 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Canada</b>				
per BOE	517	640	1,588	2,087
	17.63	16.89	17.80	17.85
<b>U.S.</b>				
per BOE	32	44	98	171
	4.95	5.31	4.93	6.90
<b>Total Expense - Company</b>	<b>549</b>	<b>684</b>	<b>1,686</b>	<b>2,258</b>
<b>per BOE</b>	<b>15.31</b>	<b>14.82</b>	<b>15.44</b>	<b>15.93</b>

In Canada, third quarter operating costs per BOE were 4% higher than the prior year period while total operating costs for Q3 2011 decreased 19% to \$517,000 compared with \$640,000 in Q3 2010. The Company drilled a water disposal well for heavy oil production in the Lloydminster area and commenced water injection in Q1 2011. The water injection well has reduced the overall water disposal costs at the Lloydminster field which is reflected in the year to date reduced operating costs per BOE.

In the U.S., operating costs on a BOE basis for the three and nine month periods decreased compared with the prior year periods as one time costs related to repairs and maintenance in the prior year have not recurred in the current year.

<b>Summary of Operating Netback</b> (\$ Thousands, except per BOE amounts)	<b>Three Months Ended</b> <b>Sept 30</b>		<b>Nine Months Ended</b> <b>Sept 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Natural Gas	\$ 550	\$ 851	\$ 1,995	\$ 3,112
Heavy Oil	609	667	1,614	1,478
Other Oil & Liquids	138	178	502	598
<b>Total Gas, Oil &amp; Liquids</b>	<b>1,297</b>	<b>\$ 1,696</b>	<b>\$ 4,111</b>	<b>\$ 5,188</b>
Royalties	(105)	(96)	(455)	(333)
Operating expenses	(549)	(684)	(1,686)	(2,258)
<b>Operating netback</b>	<b>\$ 643</b>	<b>\$ 916</b>	<b>\$ 1,970</b>	<b>\$ 2,597</b>
<b>\$/BOE</b>				
Total Gas, Oil & Liquids	\$ 36.17	\$ 36.74	\$ 37.68	\$ 36.60
Royalties	(2.89)	(2.06)	(4.17)	(2.35)
Operating expenses	(15.31)	(14.82)	(15.44)	(15.93)
<b>Operating netback</b>	<b>\$ 17.97</b>	<b>\$ 19.86</b>	<b>\$ 18.07</b>	<b>\$ 18.32</b>

Operating netbacks for the quarter were down \$1.89 per BOE to \$17.97 per BOE, a 10% reduction when compared with Q3 2010. This resulted from decreased revenues per BOE plus increased operating costs and royalties per BOE.

Netbacks for the nine month period were down \$0.25 per BOE to \$18.07 per BOE, a minor decrease when compared with the prior year period. Increased revenues per BOE and reduced operating costs were offset by increased royalties per BOE.

<b>Overhead</b> (\$ Thousands, except per BOE amounts)	<b>Three Months Ended</b> <b>Sept 30</b>		<b>Nine Months Ended</b> <b>Sept 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Gross expenses	\$ 843	\$ 884	\$ 2,628	\$ 2,579
Recovered from exploration joint venture *	(514)	(449)	(1,227)	(973)
Recovered from third parties	(98)	(36)	(181)	(100)
Capitalized	107	(105)	(269)	(653)
<b>Net overhead</b>	<b>\$ 338</b>	<b>\$ 294</b>	<b>\$ 951</b>	<b>\$ 853</b>
<b>Per BOE</b>	<b>\$ 9.42</b>	<b>\$ 6.41</b>	<b>\$ 8.72</b>	<b>\$ 6.02</b>

\* The Company has a joint venture with Tuscany Energy Ltd. whereby it participates in new oil and natural gas projects for a 45% working interest – Tuscany 55%. Diaz provides administrative, operating and exploration services for Tuscany in exchange for payment of a portion of the related costs of Diaz.

Gross overhead costs for Q3 2011 decreased 5% to \$843,000 compared with the prior year quarter. Net overhead costs increased 15% as a year-to-date reduction in capitalized overhead during the quarter was partially offset by increased recoveries from joint venture and third parties.

Gross overhead costs for the nine month period increased 2% to just over \$2.6 million compared with the prior year period of just under \$2.6 million. Cost increases for the nine month period are primarily attributable to the second quarter when additional legal and listing fees related to the listing of Diaz on the TSX Venture exchange and additional audit review costs relating to the transition of Diaz to IFRS reporting were incurred. Net overhead costs increased 12% as a reduction in capitalized overhead was partially offset by increased recoveries from joint venture and third parties.

<b>Interest Expense</b> (\$ Thousands, except per BOE and percentage amounts)	<b>Three Months Ended</b> <b>Sept 30</b>		<b>Nine Months Ended</b> <b>Sept 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Interest expense	\$ 406	\$ 233	\$ 990	\$ 677
Debenture accretion and issue costs	174	17	397	312
Interest expense	\$ 580	\$ 250	\$ 1,387	\$ 989
per BOE	\$ 16.16	\$ 5.42	\$ 12.72	\$ 6.98
Average interest rate on bank debt	0.0%	5.4%	6.1%	4.8%
Average bank debt	\$ -	\$ 5,629	\$ 3,519	\$ 5,253
Interest rate on convertible debentures	10.50%	8.75%	10.50%	8.75%
Convertible debentures - face value	\$ 15,085	\$ 7,085	\$ 15,085	\$ 7,085

Interest expense for Q3 2011 was significantly higher than the prior year period as overall debt and interest rates were higher. For the nine month period, higher interest rates, and overall debt resulted in a 40% increase in interest expense. The increase in debenture value from \$7 million to \$15 million occurred late in Q2 2011.

<b>Depletion, Depreciation &amp; Amortization</b> (\$ Thousands, except per BOE Amounts)	<b>Three Months Ended</b> <b>Sept 30</b>		<b>Nine Months Ended</b> <b>Sept 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Canada</b>				
Depletion and depreciation	\$ 846	\$ 1,012	\$ 2,423	\$ 2,750
Total - Canada	\$ 846	\$ 1,012	\$ 2,423	\$ 2,750
per BOE	\$ 28.87	\$ 22.60	\$ 27.18	\$ 23.50
<b>U.S.</b>				
Depletion and depreciation	\$ 266	\$ 462	\$ 804	\$ 1,365
Total - U.S.	\$ 266	\$ 462	\$ 804	\$ 1,365
per BOE	\$ 40.55	\$ 54.53	\$ 40.29	\$ 55.13
<b>Total - Company</b>	\$ 1,112	\$ 1,474	\$ 3,227	\$ 4,115
per BOE	\$ 31.01	\$ 28.13	\$ 29.58	\$ 29.03

For 2011, the Company's depletion, depreciation and amortization costs increased slightly to \$29.58 per BOE compared with \$29.03 per BOE for the prior year. Increased charges per BOE in Canada were partially offset by reduced per BOE charges in the US. In Canada, the depletion charge for the three and nine month periods has increased resulting from increased production year-over-year from the Lloydminster field which carries a depletion charge of approximately \$46 per barrel. Diaz expects the depletion charge per barrel at Lloydminster will go down as reserves are added from continued development drilling. Depletion expense is calculated based on the Company's proved reserves.

<b>Capital Expenditures</b> (\$ Thousands)	<b>Three Months Ended</b> <b>Sept 30</b>		<b>Nine Months Ended</b> <b>Sept 30</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Land	\$ 143	\$ 335	\$ 462	\$ 683
Geological and geophysical	14	24	257	294
Drilling and completions	1,570	513	2,074	2,073
Equipment, facilities and pipelines	443	28	848	550
Total	\$ 2,170	\$ 900	\$ 3,641	\$ 3,600

For Q3 2011, the Company drilled three new horizontal wells at Lloydminster and one new horizontal well at Macklin along with completions and equipment for the wells. In the prior year period, Diaz drilled just one vertical oil well.

## Quarterly Financial Information

(\$ Thousands, except production, price and per share amounts)	Three months ended							
	2011			2010				2009 (Previous GAAP)
	Sept 30	June 30	Mar 31	Dec 31	Sep 30	June 30	Mar 31	Dec 31
Production (BOEd)	390	399	411	465	507	525	532	532
Price (\$/BOE)	36.17	36.44	37.17	39.05	36.74	35.05	37.98	34.87
Total revenue	1,249	1,077	1,421	1,796	1,630	1,542	1,761	1,568
Cash flow from operations ** per share (basic and diluted)	(35) (0.00)	(169) (0.00)	320 0.00	557 0.01	409 0.00	335 0.00	383 0.00	359 0.00
Loss per share (basic and diluted)	(1,552) (0.02)	(1,159) (0.01)	(53) 0.00	(4,038) (0.01)	2,511 (0.01)	(928) (0.02)	(1,198) (0.02)	(2,912) (0.04)
Overhead	338	320	293	307	296	190	367	313
Net capital additions (dispositions)	483	603	778	749	776	771	1,692	(187)
Total assets	34,764	33,236	34,161	34,029	34,722	37,004	36,876	36,657
Convertible debentures*	12,188	12,042	6,026	6,682	6,604	6,527	6,451	6,377
Working capital (net current debt)	(243)	317	(6,864)	(6,402)	(6,714)	(6,357)	(5,908)	(5,844)

\* Convertible debentures have a face value of \$7.1 million with maturity on March 27, 2014, and a face value of \$8.0 million with a maturity of March 31, 2016. See Note 8, "Convertible Debentures", in the notes to the interim condensed financial statements for the nine months ended September 30, 2011.

\*\* Non GAAP Measurement

Diaz's production rate peaked at 532 BOEd in Q1 2010 and has declined during the past five quarters. However, average commodity prices have both increased and decreased over the same period resulting in uneven fluctuations in revenue and cash flow from operations.

## Liquidity and Capital Resources

Diaz completed the nine months ended September 30, 2011, with net current debt of \$243,000 compared with \$6.4 million of current net debt at the beginning of the year.

On September 30, 2011, the Company had a \$3.3 million secured loan with a Canadian financial institution which was fully available at period end (Q3 2010 - \$6.1 million used). The loan facility was reduced to \$3.1 million subsequent to period end after the completion of a review of the Company's properties by the bank.

As of November 10, 2011, Diaz had 90,760,352 common shares issued and outstanding.

## Normal Course Issuer Bid ("NCIB")

Diaz is authorized to repurchase up to 4,500,000 Common Shares through the facilities of the TSX Venture Exchange pursuant to a normal course issuer bid, which expires on July 17, 2012. Shares repurchased pursuant to the bid are cancelled. To date, 80,000 shares have been repurchased pursuant to the current NCIB at an average price of \$0.06 per share.

## Business Risk

The Company is engaged in the exploration, development, production and acquisition of crude oil and natural gas. Diaz's business is inherently risky and there is no assurance that hydrocarbon reserves will be discovered and economically produced.

Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates and currency exchange rates. Operational risks include competition, environmental factors, reservoir performance uncertainties, a complex regulatory environment and safety concerns.

The Company minimizes its business risks by focusing on a select group of properties. This enables Diaz to have more control over the timing, direction and costs related to exploration and development opportunities. The geological focus is on areas in which the prospects are well understood by management. Technological tools are regularly used to reduce risk and increase the probability of success. The Company closely follows all government regulations and has an up-to-date emergency response plan that has been communicated to all field operations by management. Diaz also carries insurance coverage to protect itself against potential losses.

Employing a highly motivated and experienced staff of petroleum and natural gas professionals further minimizes the business risk.

The Company is exposed to commodity price and market risk for its principal products of petroleum and natural gas. Commodity prices are influenced by a wide variety of factors of which most are beyond the control of Diaz. To manage this risk, the Company has entered into a number of fixed price sales contracts in relation to natural gas prices in Canada.

### *Contractual Obligations and Commitment*

In the normal course of business, Diaz is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancelable. Diaz has an obligation with respect to an office lease for a minimum payment of \$38,000 in 2011, \$152,000 in 2012, and \$114,000 in 2013.

The Company also has asset retirement obligations with respect to the abandonment and reclamation of wells and facilities owned by the Company. Diaz includes the present value of the estimated liabilities for such costs on its balance sheet. The total estimated undiscounted cost of these liabilities at September 30, 2011, was \$5.2 million (2010 – \$4.8 million).

The Company issued \$650,000 of flow-through shares in December 2010 and has approximately \$529,000 remaining to spend on exploration costs prior to December 31, 2011. The Company is undergoing two seismic programs in Q4 2011 which should satisfy the spending requirement.

### *Off Balance Sheet Arrangements*

Diaz does not currently utilize any off balance sheet arrangements with unconsolidated entities to enhance liquidity and capital resource positions or for any other purpose.

### *Related Party Transactions*

Humboldt Capital Corporation (“Humboldt”) and certain of its officers and directors owned 36% of the outstanding shares of Diaz at November 4, 2011. Humboldt’s business includes the ownership, acquisition and sale of securities in other companies and Humboldt owns significant interests in companies in the oil and gas sector, which compete with Diaz and operate jointly with Diaz, from time to time, in certain areas. These include Tuscany Energy Ltd. (“Tuscany”), and Paris Energy Inc. (“Paris”) which also have certain common officers and directors. The following table sets forth the respective ownership of Humboldt and its officers and directors in Diaz, Paris and Tuscany as at November 4, 2011:

- 36% of Diaz common shares,
- 70% of Paris common shares, and
- 36% of Tuscany common shares.

The Company has a joint venture with Tuscany Energy Ltd. whereby it participates in new oil and natural gas projects for a 45% working interest – Tuscany 55%. Diaz provides administrative, operating and

exploration services for Tuscany in exchange for payment of a portion of the related costs of Diaz. Charges for these services to Tuscany and its wholly owned subsidiary are shown below.

At September 30, 2011, Tuscany owed Diaz \$403,000 (2010 – \$298,000) through the normal course of business.

For the nine months ended September 30, 2011 and 2010, Diaz recovered the following amounts related to certain overhead services from:

	Nine Months Ended Sept. 30, 2011	Nine Months Ended Sept. 30, 2010
Humboldt	\$246,000	\$249,000
Paris	\$18,000	\$19,000
Sharon*	\$285,000	\$250,000
Tuscany	\$509,000	\$388,000

\* Sharon became a wholly owned subsidiary of Tuscany on June 2, 2011.

These transactions were conducted in the normal course of operations and measured at the amount of consideration established and agreed to by the related parties.

### *Application of Critical Accounting Estimates*

Diaz's financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies used by Diaz are disclosed in Note 2 to the condensed consolidated financial statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discusses such accounting policies and is included in Management's Discussion and Analysis to aid the reader in assessing the critical accounting policies and practices of the Company and the likelihood of materially different results being reported.

Diaz's management reviews its estimates regularly. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates.

### *Accounting Policy Changes*

The following discussion explains the significant differences between Diaz's previous GAAP accounting policies and those applied by the Company under IFRS. IFRS policies have been retrospectively and consistently applied except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS for first-time adopters.

The most significant changes to the Company's accounting policies relate to the accounting for upstream costs. Under previous GAAP, Diaz followed the Canadian Institute of Chartered Accountants ("CICA") guideline on full cost accounting in which all costs directly associated with the acquisition of, the exploration for, and the development of natural gas and liquids reserves were capitalized on a country-by-country cost centre basis. Costs accumulated within each country cost centre were depleted using the unit-of-production method based on proved reserves determined using estimated future prices and costs. Upon transition to IFRS, the Company was required to adopt new accounting policies for upstream activities, including exploration and evaluation costs and development costs.

Under IFRS, exploration and evaluation costs are those expenditures for an area where technical feasibility and commercial viability has not yet been determined. Development costs include those expenditures for areas where technical feasibility and commercial viability has been determined. Diaz adopted the IFRS 1 exemption whereby the Company deemed its January 1, 2010 IFRS upstream asset costs to be equal to its previous GAAP historical upstream property, plant and equipment net book value. Accordingly, exploration and evaluation costs were deemed equal to the unproved properties balance and the development costs were deemed equal to the upstream full cost pool balance. Under IFRS,

exploration and evaluation costs are presented as exploration and evaluation assets and development costs are presented within property, plant and equipment on the condensed consolidated balance sheet.

The following provides summary reconciliations of Diaz's 2010 previous GAAP and IFRS results, along with a discussion of the significant IFRS accounting policy changes.

## Summary Earnings (Loss) Reconciliation

(\$ Thousands, unaudited)	2010				
	Annual	Q4	Q3	Q2	Q1
<b>Net income (loss) - Previous GAAP</b>	\$ (4,228)	\$ (526)	\$ (1,104)	\$ (1,112)	\$ (1,486)
<b>Addition / (deduction)</b>					
Exploration and evaluation	221	(1)	-	(50)	50
Depletion, depreciation and accretion	476	(24)	(475)	143	247
Impairments	(317)	87	389	-	-
Asset retirement obligation	195	304	146	(138)	(8)
	575	366	60	(45)	289
<b>Net earnings (loss) - IFRS</b>	(3,653)	(160)	(1,044)	(1,157)	(1,197)

## Summary Cash Flow From Operations Reconciliation

(\$ Thousands, unaudited)	2010				
	Annual	Q4	Q3	Q2	Q1
<b>Cash flow from operations - Previous GAAP <sup>(1)</sup></b>	\$ 1,684	\$ 557	\$ 409	\$ 335	\$ 383
<b>Addition / (deduction)</b>					
Exploration and evaluation	-	-	-	-	-
Depletion, depreciation and accretion	-	-	-	-	-
Impairments	-	-	-	-	-
Gain on restatement of ARO	-	-	-	-	-
	-	-	-	-	-
<b>Cash flow from operations - IFRS <sup>(1)</sup></b>	1,684	557	409	335	383

(1) A Non-GAAP measure, which is defined under the Non-GAAP Measures section of this MD&A.

## Exploration and Evaluation

Exploration and evaluation assets at January 1, 2010 were deemed to be \$771,000, representing the unproved properties balance under previous GAAP. This resulted in a reclassification of \$771,000 from property, plant and equipment to exploration and evaluation assets on Diaz's condensed consolidated balance sheet as at January 1, 2010. The Company took an impairment of the exploration and evaluation assets at January 1, 2010, of \$68,000. As at December 31, 2010, the Company's exploration and evaluation assets were approximately \$1.5 million.

Under previous GAAP, exploration and evaluation costs were capitalized as property, plant and equipment in accordance with the CICA's full cost accounting guidelines. Under IFRS, Diaz capitalizes these costs initially as exploration and evaluation assets. Once technical feasibility and commercial viability of the area has been determined, the capitalized costs are transferred from exploration and evaluation assets to property, plant and equipment. Under IFRS, unrecoverable exploration and

evaluation costs associated with an area and costs incurred prior to obtaining the legal rights to explore are expensed.

During the twelve months ended December 31, 2010, Diaz transferred \$338,000 capitalized exploration and evaluation costs to property, plant and equipment and did not expense any exploration and evaluation assets. The application of IFRS for exploration and evaluation costs did not result in any change to Diaz's previous GAAP Net Earnings for the twelve months ended December 31, 2010.

### **Depreciation, Depletion and Amortization**

Development costs at January 1, 2010 were deemed to be \$32.9 million, representing the upstream full cost pool balance under previous GAAP. Consistent with previous GAAP, these costs are capitalized as property, plant and equipment under IFRS. Under previous GAAP, development costs were depleted using the unit-of-production method calculated for each country cost centre. Under IFRS, development costs are depleted using the unit-of-production method calculated at the Cash Generating Unit (CGU) level. The IFRS 1 exemption permitted the Company to allocate development costs to the CGU level using proved and probable reserve values for each CGU as at January 1, 2010.

Depleting at a CGU level under IFRS resulted in an \$476,000 decrease to Diaz's DD&A expense for the twelve months ended December 31, 2010. Diaz's net loss decreased \$476,000 after tax, compared to previous GAAP for the twelve months ended December 31, 2010 as a result of depleting at a CGU level under IFRS.

### **Impairments**

Under previous GAAP, an upstream impairment was recognized if the carrying amount exceeded the undiscounted cash flows from proved reserves for a country cost centre. An impairment was measured as the amount by which the carrying value exceeded the sum of the fair value of the proved and probable reserves and the costs of unproved properties. Impairments recognized under previous GAAP were not reversed.

Under IFRS, an upstream impairment is recognized if the carrying value exceeds the recoverable amount for a CGU. Upstream areas are aggregated into CGUs based on their ability to generate largely independent cash flows. If the carrying value of the CGU exceeds the recoverable amount, the CGU is written down with an impairment recognized in net earnings. Impairments recognized under IFRS are reversed when there has been a subsequent increase in the recoverable amount. Impairment reversals are recognized in net earnings and the carrying amount of the CGU is increased to its revised recoverable amount as if no impairment had been recognized for the prior periods.

For the twelve months ended December 31, 2010, Diaz recognized an after-tax impairment of \$317,000 relating to the Company's natural gas assets in Alberta. The impairment recognized was based on the difference between the December 31, 2010 net book value of the assets and the recoverable amount. The recoverable amount was determined using the greater of fair value less costs to sell or value in use, based on discounted future cash flows of proved and probable reserves using forecast prices and costs. Under previous GAAP, these assets were included in the Canadian cost centre ceiling test, which were not impaired at December 31, 2010.

### **Dispositions**

Under previous GAAP, proceeds from dispositions of upstream assets were deducted from the full cost pool without recognition of a gain or loss unless the deduction resulted in a change to the country cost centre depletion rate of 20 percent or greater, in which case a gain or loss was recorded.

Under IFRS, gains or losses are recorded on dispositions and are calculated as the difference between the proceeds and the net book value of the asset disposed.

### **Asset Retirement Obligation**

Under previous GAAP, the asset retirement obligation was measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. Liabilities were not re-measured to reflect period end discount rates.

Under IFRS, the asset retirement obligation is measured as the best estimate of the expenditure to be incurred and requires that the asset retirement obligation be re-measured using period end discount rates.

In conjunction with the IFRS 1 exemption regarding upstream assets discussed above, Diaz was required to re-measure its asset retirement obligation upon transition to IFRS and recognize the difference in retained earnings. The application of this exemption resulted in a \$488,000 increase to the asset retirement obligation on Diaz's condensed consolidated balance sheet as at January 1, 2010 and a corresponding charge to retained earnings of \$488,000. Subsequent IFRS re-measurements of the obligation are recorded through property, plant and equipment with an offsetting adjustment to the asset retirement obligation. As at December 31, 2010, excluding the January 1, 2010 adjustment, Diaz's asset retirement obligation increased by \$432,000 which primarily reflects the re-measurement of the obligation using risk free discount rates for obligations within 5 years, 10 years or longer of 2.45%, 3.16% and 3.54% respectively as at December 31, 2010.

### Share-based payments

Under previous GAAP, the Company adopted the fair value method for accounting for stock based compensation whereby the fair value of each tranche of the option granted is estimated on the date of the grant using the Black-Scholes option pricing model. Using the fair value method, compensation costs of stock based compensation are estimated and charged to earnings over the vesting period of the options. IFRS requires the same method so no changes were required in transition.

### Foreign Currency

As permitted by IFRS 1, the Company elected to apply the exemption to set the cumulative foreign currency translation adjustment to zero upon transition to IFRS. Accordingly, \$307,000 was recognized as an adjustment to retained earnings on January 1, 2010. The reclassification had no impact on total shareholders' equity as at January 1, 2010. As a result of the election, the accounts of the Company have not been retrospectively restated using IFRS foreign currency principles.

Future foreign currency translation gains and losses that are recognized from the cumulative foreign currency translation adjustment will differ under IFRS compared to previous GAAP due to the exemption taken above. The IFRS adjustments discussed above are recorded in the Company's functional currency and are subject to translation for presentation purposes. The associated foreign currency impacts are reported in accumulated other comprehensive income.

### Income Tax

Deferred income taxes have been adjusted to reflect the tax effect arising from the differences between IFRS and previous GAAP. However, the Company has a future tax asset that exceeds the tax impacts of those differences. As the Company has determined that the future tax asset will not be recoverable, Diaz has taken a valuation allowance which removes the future tax asset from the balance sheet. This results in no deferred income tax change between IFRS and previous GAAP.

### Other Exemptions

Other significant IFRS 1 exemptions taken by Diaz at January 1, 2010 include the following:

- Business combinations and jointly controlled operations entered into prior to January 1, 2010 were not retrospectively restated under IFRS.
- Leases were not reassessed to determine whether an arrangement contained a lease under International Financial Reporting Interpretations Committee 4, Determining whether an arrangement contains a Lease, for contracts that were already assessed under previous GAAP.

The remaining IFRS 1 exemptions were not applicable or material to the preparation of Diaz's condensed consolidated balance sheet at the date of transition to IFRS on January 1, 2010.

### Upstream Assets And Reserves

Reserves estimates can have a significant impact on earnings, as they are a key input to the Company's DD&A calculations and impairment tests. Costs accumulated within each area are depleted using the unit-of-production method based on proved reserves using estimated future prices and costs. Costs subject to depletion include estimated future costs to be incurred in developing proved reserves. A downward revision in reserves estimates or an increase in estimated future development costs could result in the recognition of a higher DD&A charge to net earnings.

Upstream assets, including exploration and evaluation costs and development costs, are aggregated into cash generating units based on their ability to generate largely independent cash flows. If the carrying value of the cash-generating unit exceeds the recoverable amount, the cash-generating unit is written down with an impairment recognized in net earnings. The recoverable amount of an asset or cash-generating unit is the greater of its fair value less costs to sell and its value in use. Fair value less costs to sell may be determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs. A downward revision in reserves estimates could result in the recognition of impairments charged to net earnings.

Reversals of impairments are recognized when there has been a subsequent increase in the recoverable amount. In this event, the carrying amount of the asset or cash-generating unit is increased to its revised recoverable amount with an impairment reversal recognized in net earnings.

All of Diaz's oil and gas reserves and resources are evaluated and reported on by independent qualified reserves evaluators. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to numerous uncertainties and various interpretations. Reserves estimates can be revised upward or downward based on the results of future drilling, testing, production levels and economics of recovery based on cash flow forecasts. Contingent resources are not classified as reserves due to the absence of a commercial development plan that includes a firm intent to develop within a reasonable time frame.

### **Asset Retirement Obligations**

Asset retirement obligations include present obligations where the Company will be required to retire tangible long-lived assets such as producing well sites and natural gas processing plants. The asset retirement obligation is measured at the present value of the expenditure expected to be incurred. The associated asset retirement cost is capitalized as part of the cost of the related long-lived asset. Changes in the estimated obligation resulting from revisions to estimated timing, amount of cash flows or changes in discount rate are recognized as a change in the asset retirement obligation and the related asset retirement cost.

Increases in the estimated asset retirement obligation and costs increase the corresponding charges of accretion and DD&A to net earnings. A decrease in discount rates decreases the asset retirement obligation, which decreases the accretion charged to net earnings. Actual expenditures incurred are charged against the accumulated asset retirement obligation.

### **Income Tax Accounting**

Diaz follows the liability method of accounting for income taxes. Under this method, deferred income taxes are recorded for the effect of any temporary difference between the accounting and income tax basis of an asset or liability, using the enacted or substantively enacted income tax rates. Current income taxes for the current and prior periods are measured at the amount expected to be recoverable from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period. The deferred income tax assets and liabilities are adjusted to reflect changes in enacted or substantively enacted income tax rates that are expected to apply, with the corresponding adjustment recognized in net earnings or in shareholders' equity depending on the item to which the adjustment relates.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

## Financial Instruments

All financial instruments are required to be measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as “held-for-trading,” “available-for-sale,” “held-to-maturity,” “loans and receivables” or “other financial liabilities” as defined by the standard.

Cash and cash equivalents are measured at fair value, which approximates carrying value due to the short-term nature of these instruments. Accounts receivable are designated as “loans and receivables” and are carried at amortized cost. Accounts payable are designated as “other financial liabilities” and are carried at cost. Long-term debt, which includes convertible debentures, is designated as “other financial liabilities” and carried at amortized cost using the effective interest method. The financing costs associated with the Company’s \$7.085 million private placement of unsecured convertible debentures on March 26, 2007, and the Company’s \$8.0 million private placement of secured convertible debentures on June 14, 2011, are included in the amortized cost of the debt. However, on January 17, 2011, the terms of the 2007 convertible debentures changed significantly resulting in the Company fully expensing \$152,000 of unamortized financing costs and recalculating the debt versus equity components of the convertible debenture.

The Company’s financial instruments that are included in the balance sheet are comprised of cash, accounts receivable, accounts payable, bank debt and the convertible debentures.

### Fair values of financial assets and liabilities

The fair values of financial instruments that are included in the balance sheet approximate their carrying amount due to the short-term maturity of those instruments except for the convertible debentures which are carried at amortized costs using the interest rate method.

### Credit risk

Credit risk is the risk that the counterparty to a financial asset will default, resulting in the Company incurring a financial loss. The Company is exposed to credit risk on its accounts receivable to a maximum of the carrying value of the aforementioned items at the end of the period. A substantial portion of the Company’s accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. The exposure to credit risk is approximately \$528,000 which represents accounts receivable balances in excess of 90 days. Management has reviewed the items comprising the accounts receivable balance and determined that all accounts are collectible; accordingly there has been no allowance for doubtful accounts recorded.

### Interest rate risk

The Company is exposed to risks from interest rate fluctuation on its bank loan which is based on Prime rates. Interest rate risk is specific to the interest expense charged to income on the Company’s bank debt. The Company believes a 25% volatility is a reasonable measure when assessing the potential impact of a change in interest rate. Variations in interest rates on the Company’s bank debt could have resulted in gains (losses) impacting net earnings as at September 30, 2011, as follows:

(\$ Thousands)	Favourable 25% Change	Unfavourable 25% Change
Interest expense	\$ (40)	\$ 40

### Liquidity risk

The Company is exposed to liquidity risk from the possibility that it will encounter difficulty meeting its financial obligations. The Company manages this risk by forecasting cash flows in an effort to match operating cash flow to future expenditures and to arrange financing, if necessary. It may take many years and substantial cash expenditures to pursue exploration and development activities on all of the Company’s existing undeveloped properties. Accordingly, the Company may need to raise additional funds from outside sources in order to explore and develop its properties. There is no assurance that adequate funds from debt and equity markets will be available to the Company in a timely manner. The timing of cash outflows relating to financial liabilities are outlined in the table below:

(\$ Thousands)	< 1 year	years 2 & 3	> 3 years
Accounts payable and accrued liabilities	4,174	-	-
Bank loan	-	-	-
Convertible debentures plus interest	1,584	9,881	9,260

At September 30, 2011 the Company has met all the obligations associated with its financial liabilities. The majority of the Company's accounts payable are current. The bank loan is a demand loan and is classified as a current liability of less than one year. Convertible debentures are payable on March 27, 2014 and March 31, 2016.

### Foreign currency exchange risk

The Company is exposed to fluctuations in foreign currency exchange rates as the Company has a U.S. subsidiary with a functional currency of United States dollars while the functional currency of the Company is Canadian dollars. As a result, fluctuations in the United States dollar against the Canadian dollar could result in unanticipated fluctuations in the Company's financial results which are denominated in Canadian dollars.

The Company's exposure to foreign currency exchange risk at September 30, 2011, can be summarized as follows:

(\$ Thousands)	Balance Sheet	Canada	USA
	Total	Cdn \$ Equivalent	
Cash and cash equivalents	1,618	1,521	97
Accounts receivable	1,981	1,826	155
Accounts payable	(4,174)	(4,004)	(170)
<b>Total</b>	<b>(575)</b>	<b>(657)</b>	<b>82</b>

### Commodity price risk

Inherent to the Company's business of producing petroleum and natural gas is the commodity price risk where fluctuations in the market price of petroleum and natural gas could significantly impact the Company's ability to generate cash flow from operating activities. The Company believes a 10% volatility is a reasonable measure when assessing the potential impact of commodity price changes on natural gas and oil prices. Variations in commodity prices could have resulted in gains (losses) impacting net earnings as at September 30, 2011, as follows:

(\$ Thousands)	Favourable 10% Change	Unfavourable 10% Change
Natural gas price	\$ 200	\$ (200)
Crude oil price	\$ 212	\$ (212)

### Internal Controls over Financial Reporting (ICFR)

The Chief Executive Officer and Chief Financial Officer of Diaz (the "Certifying Officers") have designed internal controls over financial reporting or caused them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The Certifying Officers have assessed the design and effectiveness of the Company's ICFR at September 30, 2011.

As at September 30, 2011, there were no changes to the controls over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

The Certifying Officers have evaluated the internal controls over financial reporting and have determined that the ICFR is effective.

### *Disclosure Controls and Procedures (DC&P)*

The Chief Executive Officer and Chief Financial Officer of Diaz (the “Certifying Officers”) have designed disclosure controls and procedures or caused them to be designed under our supervision, to provide reasonable assurance that:

- (i) material information relating to the issuer is made known to the Certifying Officers by others, particularly during the period in which the annual filings are being prepared; and
- (ii) information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation.

The Certifying Officers have evaluated the disclosure controls and procedures and have determined that the DC&P are effective as at September 30, 2011.

### *Outlook*

Diaz expects oil prices to hold above \$90 per barrel (WTI) for the remainder of 2011 as industrial activity in North America slowly recovers and demand for oil in developing countries continues to increase.

Due to the high level of activity on North American shale gas projects and increasing natural gas storage levels, it seems unlikely that natural gas prices will improve in the medium term. Consequently, Diaz is keeping its investments in natural gas to an absolute minimum.

The Company will continue to focus on its heavy oil development programs in the Lloydminster and Macklin areas and if successful, Diaz should exit 2011 with a significant increase in its oil production relative to current levels.

## Condensed Consolidated Financial Statements

### Condensed Consolidated Balance Sheets

As at (\$ Thousands, unaudited)	Note	Sept 30 2011	December 31 2010
<b>ASSETS</b>			
Cash		\$ 1,618	\$ 89
Accounts receivable		1,981	1,955
Income tax receivable		25	24
Prepaid expense		307	120
<b>Total current assets</b>		<b>3,931</b>	<b>2,188</b>
Property, plant and equipment (net)	5	28,842	30,502
Exploration and evaluation assets		1,991	1,469
<b>Total non-current assets</b>		<b>30,833</b>	<b>31,971</b>
<b>Total assets</b>		<b>\$ 34,764</b>	<b>\$ 34,159</b>
<b>LIABILITIES</b>			
Accounts payable and accrued liabilities		\$ 4,174	\$ 2,834
Bank debt	4	-	5,755
<b>Total current liabilities</b>		<b>4,174</b>	<b>8,589</b>
Convertible debentures	8	12,188	6,682
Deferred tax liability		1,266	1,377
Asset retirement obligation	9	4,569	4,237
<b>Total non-current liabilities</b>		<b>18,023</b>	<b>12,296</b>
<b>Total liabilities</b>		<b>22,197</b>	<b>20,885</b>
<b>EQUITY</b>			
Share capital	6	22,082	22,141
Warrants	6	252	252
Other equity	8	3,162	847
Contributed surplus	6	1,624	1,996
Accumulated other comprehensive loss		217	44
Deficit		(14,770)	(12,006)
<b>Total equity</b>		<b>12,567</b>	<b>13,274</b>
<b>Total liabilities and equity</b>		<b>\$ 34,764</b>	<b>\$ 34,159</b>

See Note 10, Commitments

Approved by the Board:

(Signed) "R.W. Lamond" Director

(Signed) "C.A. Teare" Director

See accompanying Notes to condensed consolidated financial statements.

## Condensed Consolidated Statement of Operations

(\$ Thousands, except per share amounts, unaudited)	Note	Three Months Ended Sept 30		Nine Months Ended Sept 30	
		2011	2010	2011	2010
<b>Revenue</b>					
Oil and natural gas revenue	2	\$ 1,192	\$ 1,600	\$ 3,656	\$ 4,855
Other income		57	(166)	91	77
		<b>1,249</b>	<b>1,434</b>	<b>3,747</b>	<b>4,932</b>
<b>Expenses</b>					
Operating and transportation		549	684	1,686	2,258
Overhead		338	294	951	853
Stock based compensation		16	37	46	481
Interest expense		580	250	1,387	989
Foreign exchange loss (gain)		-	1	-	3
Depletion and depreciation	2	1,112	1,474	3,227	4,115
		<b>2,595</b>	<b>2,740</b>	<b>7,297</b>	<b>8,699</b>
Gain (loss) on property dispositions		(90)	-	(90)	308
Gain (loss) due to revaluation		(164)	(157)	705	(157)
Loss before income tax		<b>(1,600)</b>	<b>(1,463)</b>	<b>(2,935)</b>	<b>(3,616)</b>
Income tax					
Current tax expense (recovery)		(9)	9	4	18
Deferred tax expense (recovery)		(39)	(76)	(175)	(385)
Total income tax (recovery)		<b>(48)</b>	<b>(67)</b>	<b>(171)</b>	<b>(367)</b>
Net loss for the period		<b>(1,552)</b>	<b>(1,396)</b>	<b>(2,764)</b>	<b>(3,249)</b>

## Condensed Consolidated Statement of Comprehensive Loss

(\$ Thousands, except per share amounts, unaudited)	Note	Three Months Ended Sept 30		Nine Months Ended Sept 30	
		2011	2010	2011	2010
<b>Net loss for the period</b>		<b>\$ (1,552)</b>	<b>\$ (1,396)</b>	<b>\$ (2,764)</b>	<b>\$ (3,249)</b>
Other comprehensive loss					
Unrealized loss on translation of subsidiary financial statements into reporting currency		294	(55)	172	(112)
Comprehensive loss		<b>\$ (1,258)</b>	<b>\$ (1,451)</b>	<b>\$ (2,592)</b>	<b>\$ (3,361)</b>

See accompanying Notes to condensed consolidated financial statements.

## Condensed Consolidated Statement of Changes in Shareholders' Equity

(\$ Thousands)	2011		2010	
<b>Share Capital</b>				
Balance at January 1,	\$	22,141	\$	20,614
Common Shares Issued (net of tax and issue costs)		(52)		1,226
Repurchased for Cancellation		(7)		(11)
Balance at Sept 30,	\$	22,082	\$	21,829
<b>Warrants</b>				
Balance at January 1,	\$	252	\$	-
Warrants Issued				331
Balance at sept 30,	\$	252	\$	331
<b>Other Equity</b>				
Balance at January 1,	\$	847	\$	847
Revaluation of Equity component of original Debenture		439		
New debenture issued June, 2011		1,876		
Balance at sept 30,	\$	3,162	\$	847
<b>Contributed Surplus</b>				
Balance at January 1,	\$	1,996	\$	1,759
Revaluation of Equity component of Debenture		(439)		
Option Compensation		67		191
Balance at Sept 30,	\$	1,624	\$	1,950
<b>Deficit</b>				
Balance at January 1,	\$	(12,006)	\$	(7,724)
Net Earnings / (Loss)		(2,764)		(3,249)
Gain on Revaluation of Asset Retirement Obligation				
Balance at Sept 30,	\$	(14,770)	\$	(10,973)
<b>Accumulated Other Comprehensive Loss</b>				
Balance at January 1,	\$	44	\$	-
Unrealized Loss on Translation of subsidiary financial statements into reporting currency		173		(111)
Balance at Sept 30,	\$	217	\$	(111)

See accompanying Notes to condensed consolidated financial statements.

## Condensed Consolidated Statement of Cash Flows

(\$ Thousands, unaudited)	Note	Three Months Ended		Nine Months Ended	
		2011	2010	2011	2010
<b>Cash provided by (used for):</b>					
<b>Cash flows from operating activities</b>					
Loss for the period		\$ (1,552)	\$ (1,088)	\$ (2,764)	\$ (3,249)
Non-cash items:					
Interest - amortization of debenture issue costs		338	103	576	312
Depreciation, depletion and accretion		1,112	1,474	3,227	4,115
Fair value revaluation of convertible debenture		-	70	(884)	157
Loss (gain) on property dispositions		90	(308)	90	(308)
Stock based compensation		16	37	46	481
Deferred tax expense (recovery)		(39)	(76)	(175)	(385)
Cash flow from operations		(35)	212	116	1,123
Change in non-cash working capital	14	1,610	582	1,127	(596)
		1,575	794	1,243	527
<b>Cash flows from investing activities</b>					
Property, plant & equipment - additions		(2,170)	(900)	(3,641)	(3,600)
Property, plant & equipment - disposition proceeds		1,687	350	1,777	396
		(483)	(550)	(1,864)	(3,204)
<b>Cash flows from financing activities</b>					
Convertible debenture (net of expenses)		-	-	7,948	-
Increase (decrease) in bank debt		-	87	(5,755)	1,714
Common Shares					
Issued for cash		-	-	-	1,416
Share issue costs		(52)	-	(52)	(187)
Repurchased for cancellation		(6)	(10)	(7)	(14)
		(58)	77	2,134	2,929
<b>Increase (decrease) in cash</b>		<b>1,034</b>	<b>321</b>	<b>1,513</b>	<b>252</b>
Net effect of foreign exchange translations on cash flows		15	(13)	16	(9)
Cash, beginning of period		569	39	89	104
Cash, end of period		\$ 1,618	\$ 347	\$ 1,618	\$ 347

See accompanying Notes to condensed consolidated financial statements.

## Notes to the Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2011 (unaudited)

### *Preface*

Diaz Resources Limited and its subsidiaries ("Diaz" or "the Company") are in the business of the exploration for, the development of, and the production of natural gas, crude oil and natural gas liquids.

Diaz Resources Limited is a publicly traded company, incorporated and headquartered in Canada. The address of its office is 1800, 633 – 6<sup>th</sup> Avenue, S.W. Calgary, Alberta T2P 2Y5.

These interim condensed consolidated financial statements were approved and authorized for issuance by the Board of Directors ("the Board") on November 10, 2011.

### *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 unaudited interim condensed consolidated financial statements of Diaz for the three and nine months ended September 30, 2011, have been prepared by and are the responsibility of the Company's management. The Company'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 financial statements by an entity's auditor.

### *1. Basis of Presentation*

In conjunction with the Company's annual audited Consolidated Financial Statements to be issued under International Financial Reporting Standards ("IFRS") for the year ended December 31, 2011, these interim condensed consolidated financial statements present Diaz's financial results of operations and financial position under IFRS for the nine months ended September 30, 2011, including 2010 comparative periods. As a result, they have been prepared in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards" and with International Accounting Standard ("IAS") 34, "Interim Financial Reporting", as issued by the International Accounting Standards Board ("IASB"). These interim condensed consolidated financial statements do not include all the necessary annual disclosures in accordance with IFRS. Previously, the Company prepared its interim and annual Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles ("previous GAAP").

The preparation of these interim condensed consolidated financial statements resulted in selected changes to Diaz's accounting policies as compared to those disclosed in the Company's annual audited consolidated financial statements for the period ended December 31, 2010 issued under previous GAAP. A summary of the significant changes to Diaz's accounting policies is disclosed in Note 17 along with reconciliations presenting the impact of the transition to IFRS for the comparative periods as at January 1, 2010, as at and for the nine months ended September 30, 2010, and as at and for the twelve months ended December 31, 2010.

A summary of Diaz's significant accounting policies under IFRS is presented in Note 2. These policies have been retrospectively and consistently applied except where specific exemptions permitted an alternative treatment upon transition to IFRS in accordance with IFRS 1 as disclosed in Note 17.

The policies applied in these interim condensed consolidated financial statements are based on IFRS issued and outstanding as of August 22, 2011, the date that the board of directors approved the statements. Any subsequent changes to IFRS that are given effect in the company's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim condensed consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

These interim condensed consolidated financial statements have been prepared on a historical cost basis.

## 2. Accounting Policies

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Diaz Resources Inc. and Orbit Oil & Gas Inc.

The Corporation's principal business activity is the exploration, development and operation of oil and natural gas properties in Canada and in the United States. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business.

Management has made the necessary estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses in the preparation of the financial statements. Accordingly, actual results may differ from estimated amounts but management does not believe such differences will materially affect Diaz's financial position or results of operations.

### Exploration and Evaluation Assets

All costs directly associated with the exploration and evaluation of oil, natural gas and liquids reserves are initially capitalized. Exploration and evaluation costs are those expenditures for an area where technical feasibility and commercial viability has not yet been determined. These costs include unproved property acquisition costs, geological and geophysical costs, asset retirement costs, exploration and evaluation drilling, sampling and appraisals. Costs incurred prior to acquiring the legal rights to explore an area are charged directly to net earnings as exploration and evaluation expense.

When an area is determined to be technically feasible and commercially viable, the accumulated costs are transferred to property, plant and equipment. When an area is determined not to be technically feasible and commercially viable or the Company decides not to continue with its activity, the unrecoverable costs are charged to net earnings as exploration and evaluation expense.

### Development and Production Assets

Items of property, plant and equipment, which include crude oil and natural gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. The development and production assets are grouped into cash generating units (CGU) for the purpose of impairment testing. The cost of property, plant and equipment as at January 1, 2010, the date of transition, was allocated to the CGU's based on geographical location and the related field processing and transportation infrastructure. Within a CGU, when significant parts of property, plant and equipment have different useful lives, the parts are accounted for as separate items (major components) of property, plant and equipment. All costs directly associated with the development of natural gas and liquids reserves are capitalized on an area-by-area basis. Development costs include expenditures for areas where technical feasibility and commercial viability has been determined. These costs include proved property acquisitions, development drilling, completion, gathering and infrastructure, asset retirement costs and transfers of exploration and evaluation assets.

Costs accumulated within each Cash Generating Unit are depleted using the unit-of-production method based on proved and probable reserves using estimated future prices and costs. Costs subject to depletion include estimated future costs to be incurred in developing proved and probable reserves. Costs of major development projects are excluded from the costs subject to depletion until they are available for use.

For disposals of properties, a gain or loss is recognized in net earnings.

### Impairment of Long-Term Assets

The carrying value of long-term assets is reviewed quarterly for indicators that the carrying value of an asset or cash-generating unit may not be recoverable. If indicators of impairment exist, the recoverable amount of the asset or cash-generating unit is estimated. If the carrying value of the asset or cash-generating unit exceeds the recoverable amount, the asset or cash-generating unit is written down with an impairment recognized in net earnings.

Exploration and Evaluation assets are grouped and examined for indicators of impairment on a quarterly basis. Development & Production assets are aggregated into “cash generating units” (CGU’s) based on a number of factors including geography, existence of shared infrastructure, and the ability to generate largely independent cash inflows.

The recoverable amount of an asset or cash-generating unit is the greater of its fair value less costs to sell and its value in use. Fair value is determined to be the amount for which the asset could be sold in an arm's length transaction.

For upstream assets, fair value less costs to sell may be determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or cash-generating unit.

Reversals of impairments are recognized when there has been a subsequent increase in the recoverable amount. In this event, the carrying amount of the asset or cash-generating unit is increased to its revised recoverable amount with an impairment reversal recognized in net earnings. The recoverable amount is limited to the original carrying amount less depreciation, depletion and amortization as if no impairment had been recognized for the asset or cash-generating unit for prior periods.

### **Corporate Asset Depreciation**

Costs associated with office furniture, fixtures, leasehold investments, and information technology are depreciated at an annual rate of 20%, on a declining balance basis.

### **Capitalization of Costs**

Expenditures related to renewals or betterments that improve the productive capacity or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred. General and administrative costs that are directly related to productive oil and gas assets are capitalized to the related CGU.

### **Business Combinations**

Business combinations are accounted for using the acquisition method. The acquired identifiable net assets are measured at their fair value at the date of acquisition. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Associated transaction costs are expensed when incurred.

### **Asset Retirement Obligation**

Asset retirement obligations include present obligations, legal or constructive, where the Company will be required to retire tangible long-lived assets such as producing well sites and natural gas processing plants. The asset retirement obligation is measured at the present value of the expenditure expected to be incurred. The associated asset retirement cost is capitalized as part of the cost of the related long-lived asset. Changes in the estimated obligation resulting from revisions to estimated timing, amount of cash flows or changes in discount rate are recognized as a change in the asset retirement obligation and the related asset retirement cost.

Amortization of asset retirement costs are included in depreciation, depletion and amortization in the condensed consolidated statement of operations. Increases in asset retirement obligations resulting from the passage of time are recorded as interest expense in the condensed consolidated statement of operations.

Actual expenditures incurred are charged against the accumulated asset retirement obligation. Any difference between actual expenditures and the carrying value of the obligation is recognized as a gain or loss in the period.

## **Income Tax Accounting**

Diaz follows the liability method of accounting for income taxes. Under this method, deferred income taxes are recorded for the effect of any temporary difference between the accounting and income tax basis of an asset or liability, using the enacted or substantively enacted income tax rates. Current income taxes for the current and prior periods are measured at the amount expected to be recoverable from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period. The deferred income tax assets and liabilities are adjusted to reflect changes in enacted or substantively enacted income tax rates that are expected to apply, with the corresponding adjustment recognized in net earnings or in shareholders' equity depending on the item to which the adjustment relates.

## **Cash and Cash Equivalents**

Cash includes cash and cash-like short-term investments that can be liquidated into cash on less than 90-days notice. The Company did not have cash equivalents at the balance sheet dates.

## **Jointly Controlled Operations**

Certain of the Company's crude oil and natural gas activities involve jointly controlled operations. The condensed consolidated financial statements reflect the Company's proportionate share of the jointly controlled assets and liabilities and proportionate share of related revenues and costs.

## **Share Based Compensation Plan**

The Company has an equity-settled share-based compensation plan, which is described in Note 7. The Company has adopted the fair value method for accounting for stock based compensation whereby the fair value of the option granted is estimated on the date of the grant using the Black-Scholes option pricing model. Using the fair value method, compensation costs of stock based compensation are estimated and charged to earnings over the vesting period of the options.

## **Foreign Currency Translation**

Foreign currency balances of foreign subsidiaries are expressed in Canadian dollars on the following basis:

- Monetary assets and liabilities – at the period end rate of exchange;
- Other assets and liabilities – at the period end rate of exchange; and
- Revenues and expenses – at average rates of exchange for the period.

## **Flow-Through Shares**

Share capital is reduced by the future tax effect of renouncing income tax cost to the purchaser of flow-through shares when the tax pools are renounced and the share capital has been spent on qualifying assets. The tax effect is calculated using the expected rate of tax.

## **Revenue Recognition**

Revenue associated with the sale of crude oil, natural gas and natural gas liquids owned by the Company is recognized when title passes from the Company to its customers and collectability is reasonably assured. Revenue is presented net of royalties under IFRS.

## **Significant Accounting Judgements and Estimation Uncertainties**

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for asset retirement obligation are based on estimates. The impairment test of CGU's is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. The Black-Scholes option pricing model is used to estimate stock option values based on estimates of the current risk free interest rate, expected life of the options, and expected volatility of the underlying common share price. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

The discount rates used to determine the net present value of Asset Retirement Obligations are pre-tax risk-free rates relevant to the expected time remaining until abandonment on a property by property basis.

## **Financial Instruments**

All financial instruments are required to be measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as "Fair Value through Profit or Loss", "Loans and Receivables", "available-for-sale, and "Financial Liabilities at amortized cost".

## **Financial Instrument Disclosures**

Fair values are now required to be determined following a three level hierarchy:

Level 1: quoted prices in active markets for identical assets or liabilities;

Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and

Level 3: inputs for the asset or liability that are not based on observable market data.

The Company has cash, which is considered to be level 2.

## **Earnings per share**

Basic earnings (loss) per share are calculated by dividing the weighted average number of the aggregate outstanding shares during the period into net earnings (loss) attributable to the shareholders.

Diluted earnings per share are calculated by dividing the diluted weighted average number of aggregate outstanding shares during the period in the net earnings for the period. Diluted loss per share is calculated by dividing the basic weighted average aggregate outstanding shares into the loss for the period as using the diluted weighted average shares would be anti-dilutive.

## **3. *Recent IFRS Pronouncements***

### **Adopted**

March 31, 2011 was Diaz's first reporting period under IFRS. Accounting standards effective for periods beginning on or after January 1, 2011 have been adopted as part of the transition to IFRS.

## **Issued but not in effect**

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, *Consolidated Financial Statements* (IFRS 10), IFRS 11, *Joint Arrangements* (IFRS 11), IFRS 12, *Disclosure of Interests in Other Entities* (IFRS 12), IAS 27, *Separate Financial Statements* (IAS 27), IFRS 13, *Fair Value Measurement* (IFRS 13) and amended IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

## **IFRS 9 - Financial Instruments**

IFRS 9 replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The adoption of this standard should not have a material impact on Diaz's condensed consolidated financial statements.

## **IFRS 10 – Consolidation**

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation—Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

## **IFRS 11 - Joint Arrangements**

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

## **IFRS 12 – Disclosure of Interests in Other Entities**

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

## **IFRS 13 - Fair Value Measurement**

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

## Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, *Separate Financial Statements* (IAS 27), and IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

### 4. Bank Debt

All credit facilities that are revolving in nature must be disclosed as liabilities. Diaz utilizes a secured revolving production loan that is payable on demand and is subject to an annual review and, therefore, is considered “current” for disclosure purposes and has been disclosed under current liabilities as bank debt.

On September 30, 2011, the Company had a \$3.3 million secured loan with a Canadian financial institution which was fully available (Q3 2010 - \$6.1 million used). The loan facility was reduced to \$3.1 million subsequent to the period after the completion of a review of the Company’s properties by the bank. The loan is a revolving facility that is charged interest at prime plus 2.0% per annum.

### 5. Property, Plant and Equipment

Property, Plant and Equipment

(\$ Thousands)	Property, Plant and Equipment, Net	Exploration and Evaluation
As at January 1, 2010	\$ 103,136	\$ 703
Capital expenditures	2,423	1,448
Transfers from (to) property, plant and equipment	338	(338)
Dispositions	-	(346)
Foreign currency translation and other	(11)	2
As at December 31, 2010	\$ 105,886	\$ 1,469
Capital expenditures	2,922	719
Transfers from (to) property, plant and equipment	167	(167)
Dispositions	(2,286)	(36)
Foreign currency translation and other	1,069	6
As at Sept 30, 2011	\$ 107,758	\$ 1,991

Accumulated Depletion, Depreciation and Amortization

(\$ Thousands)	Property, Plant and Equipment, Net
As at January 1, 2010	\$ (70,312)
Depreciation, Depletion and amortization	(4,762)
Impairments	(317)
Foreign currency translation and other	7
As at December 31, 2010	\$ (75,384)
Depreciation, Depletion and amortization	(3,227)
Dispositions	456
Foreign currency translation and other	(761)
As at Sept 30, 2011	\$ (78,916)

## Net Book Value (Property, Plant and Equipment)

(\$ Thousands)	
As at January 1, 2010	\$ 32,824
As at December 31, 2010	\$ 30,502
As at Sept 30, 2011	\$ 28,842

For the nine months ended September 30, 2011, administrative expenses and stock based compensation of \$289,000 related to exploration and development activities were capitalized as part of property, plant and equipment (2010 - \$694,000).

For the calculation of depletion expense, estimated future costs to develop the proved reserves were added to property, plant and equipment. At September 30, 2011, future costs were \$4,536,000 (2010 - \$6,629,000).

The Company based its estimates on U.S. gas at Nymex, adjusted for heat content and basis differential and for Canadian gas at the AECO price to the end of 2015 and then inflated by 2% each subsequent year. Oil prices used were WTI for U.S. properties and Edmonton Light for Canadian properties, both adjusted for quality differentials.

	Price Estimates Used for Ceiling Test			
	Nymex (\$U.S./Mcf)	AECO (\$Cdn/Mcf)	Edmonton Light (\$Cdn/Bbl)	Heavy Oil Hardisty (\$Cdn/Bbl)
2011	4.30	3.85	88.00	68.00
2012	4.60	4.20	99.95	77.00
2013	5.20	4.70	101.95	76.75
2014	5.85	5.30	104.00	76.00
2015	6.20	5.65	106.10	78.10

Prices inflate at 2% per year after 2015.

The carrying value of long-term assets is reviewed quarterly for indicators that the carrying value of an asset or cash-generating unit may not be recoverable. If indicators of impairment exist, the recoverable amount of the asset or cash-generating unit is estimated. If the carrying value of the asset or cash-generating unit exceeds the recoverable amount, the asset or cash-generating unit is written down with an impairment recognized in net earnings.

No impairment was required for the nine month period ended September 30, 2011 (2010 - nil).

## 6. Share Capital

### Authorized

Unlimited number of Common Shares, no stated par value.

### Voting rights

Common shares carry voting rights of one vote per share.

## Issued

	Number of Shares	Amount (thousands)
<b>Common Shares</b>		
Balance, December 31, 2010	90,878,252	\$ 22,141
Share issue costs		(52)
Issued for cash	-	-
Allocated to agent's options and warrants	-	-
Repurchased for cancellation	(102,900)	(7)
Balance, Sept 30, 2011	90,775,352	\$ 22,082

	Amount (thousands)
<b>Contributed Surplus</b>	
Balance, December 31, 2010	\$ 1,996
Option compensation for the period	67
Adjustment to the equity component of debenture	(439)
Balance, Sept 30, 2011	\$ 1,624

## Normal Course Issuer Bid ("NCIB")

Diaz is authorized to repurchase up to 4,500,000 Common Shares through the facilities of the TSX Venture Exchange pursuant to a normal course issuer bid, which expires on July 17, 2012. Shares repurchased pursuant to the bid are cancelled. To date, 80,000 shares have been repurchased pursuant to the current NCIB at an average price of \$0.06 per share for the nine months ended September 31, 2011. 102,900 shares have been repurchased and cancelled under two separate NCIB's.

## Earnings per share

The treasury stock method is used to determine the dilutive effect of stock options, warrants and other dilutive instruments. Under the treasury stock method, only "in the money" dilutive instruments impact the dilution calculations. The diluted weighted average shares outstanding for September 30, 2011, does not include the conversion of the Convertible Debentures into 127,921,667 common shares as the conversion would be anti-dilutive. The anti-dilutive effect is caused because the increase in after tax earnings from the reduced interest payments on the Debentures is higher on a per share basis than the basic earnings (loss) per share.

Basic earnings (loss) per share are calculated by dividing the weighted average number of the aggregate outstanding shares during the period into net earnings (loss) attributable to the shareholders.

Diluted earnings per share are calculated by dividing the diluted weighted average number of aggregate outstanding shares during the period into the net earnings for the period. Diluted loss per share is calculated by dividing the basic weighted average aggregate outstanding shares into the loss for the period as using the diluted weighted average shares would be anti-dilutive. Stock options are not shown to be dilutive in the periods shown below as they were all out-of-the-money compared with the average stock prices during those periods.

Shares Outstanding (Three months, unaudited)	Three Months Ended		Nine Months Ended	
	2011	Sept 30 2010	2011	Sept 30 2010
Weighted average shares outstanding	90,829,700	85,936,882	90,861,395	83,425,945
Dilutive effect of stock options	-	-	-	-
Diluted weighted average shares outstanding	90,829,700	85,936,882	90,861,395	83,425,945

## Stock Option Plan

The Corporation's stock option plan permits the granting of options to purchase common shares to officers, directors, employees and other persons who provide ongoing management or consulting services to the Corporation and its subsidiaries. The stock option plan currently limits the number of common shares that may be issued on exercise of options to 10% of the number of outstanding common

shares from time to time. Any increase in the issued and outstanding common shares will result in an increase in the available number of common shares issuable under the stock option plan. Additionally, any exercise of options will make new grants available under the stock option plan.

Options granted pursuant to the stock option plan have a term not to exceed five years and vest as follows:

- 1/3 on grant date
- 1/3 on first anniversary of grant date
- 1/3 on second anniversary of grant date

As at September 30, 2011, there are a total of 4,960,000 options granted and outstanding under the stock option plan with a weighted average exercise price of \$0.2000 per share. A total of 3,872,483 options with a weighted average exercise price of \$0.2100 are exercisable at September 30, 2011.

Fixed Options	Sept 30, 2011		December 31, 2010	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	6,320,000	\$ 0.3260	7,635,000	\$ 0.4146
Granted	-	\$ -	560,000	\$ 0.1900
Exercised	-	\$ -	-	\$ -
Expired	(1,360,000)	\$ 0.2787	(1,875,000)	\$ -
Cancelled	-	\$ -	-	\$ 0.3650
Outstanding, end of period	4,960,000	\$ 0.2000	6,320,000	\$ 0.3260
Options exercisable, end of period	3,872,483	\$ 0.2100	4,945,814	\$ 0.3958

Exercise Price	Outstanding September 30, 2011	Weighted Average Remaining Life (years)	Exercisable September 30, 2011
\$0.00 - \$0.24	3,262,500	3.3295	2,174,983
\$0.25 - \$0.49	1,697,500	1.7832	1,697,500
	4,960,000	2.6542	3,872,483

## Warrants

Warrants issued during the prior year relate to the equity financing concluded on March 31, 2010. Each warrant entitles the holder to purchase one common share of the Corporation for \$0.20 until the warrant expires on March 12, 2012. Also issued during the financing were 655,160 agent's options. Each agent option entitles the holder to purchase one unit for \$0.156 until March 12, 2012 or March 30, 2012 depending on the tranche of the financing. Each unit contains one common share and one half of a purchase warrant on the same terms as the other warrants issued in the financing.

Warrants	Sept 30, 2011		December 31, 2010	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	5,374,910	\$ 0.1946	-	\$ -
Granted	-	\$ -	5,374,910	\$ 0.1946
Exercised	-	\$ -	-	\$ -
Expired	-	\$ -	-	\$ -
Cancelled	-	\$ -	-	\$ -
Outstanding, end of period	5,374,910	\$ 0.1946	5,374,910	\$ 0.1946
Options exercisable, end of period	5,374,910	\$ 0.1946	5,374,910	\$ 0.1946

The Company accounts for its issued options using the fair value method whereby costs have been recognized in the financial statements for share options granted to employees, directors and consultants. The impact on these costs of using the fair value method increased option expenses for the nine months ended September 30, 2011 by \$46,000 (2010 - \$481,000). Agent's options were valued using the same method; however, the resulting calculation increased share issue expense.

The fair value of each option or warrant granted is estimated on the date of grant using the Black-Scholes option-pricing model with assumptions as follows:

	Risk Free Interest Rate (%)	Expected Life (Years)	Expected Volatility	Weighted Average Future Value Per Option
2010	2.29	4.5	0.77	0.0728

## 7. Capital Disclosures

Diaz manages shareholder equity and debt as capital. Diaz uses the terms cash flow from operations, annualized cash flow and net debt in its analysis below which are non-GAAP measures. Cash flow from operations should not be considered an alternative to, or more meaningful as an indicator of the Company's performance than cash flow from operating activities, as determined in accordance with accounting principles generally accepted in Canada. Diaz's determination of cash flow from operations may not be particularly comparable to that reported by other companies, especially those in other industries. Management uses cash flow from operations as a measure of operating performance as the measure is not exposed to non-cash working capital movements, which for a small company, could be material and misleading. The reconciliation of cash flow from operating activities and cash flow from operations is as follows:

(\$ Thousands, unaudited)	Three Months Ended Sept 30		Nine Months Ended Sept 30	
	2011	2010	2011	2010
Cash provided by (used for) Operating Activities:	\$ 1,575	\$ 794	\$ 1,243	\$ 527
Adjusted for:				
Change in non-cash working capital	(1,610)	(582)	(1,127)	596
Cash flow from operations	\$ (35)	\$ 212	\$ 116	\$ 1,123

The Company also uses annualized cash flow from operations which equals four times the quarterly cash flow from operations. In addition, the Company presents "Net current debt", which is calculated as the aggregate of current assets and current liabilities.

Diaz's objectives when managing capital are:

- To safeguard the Company's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and
- To provide an adequate return to shareholders by investing in oil and gas activities commensurate with the level of risk management deems acceptable.

Diaz sets the level of capital in proportion to its risk of achieving sufficient annualized operating cashflows with the goal of maintaining its net current debt repayability ratio to less than twenty-four months. The Company makes adjustments to capital in light of changes in economic conditions and risk characteristics of the underlying assets. In order to maintain or adjust the capital structure Diaz may issue new shares, sell assets or increase its short-term or long-term debt.

The ratio of net debt to annualized cashflow from operations is the primary ratio of capital that Diaz uses. In the long term, the ratio of net debt to annualized cash flow from operations is an important target. Net debt repayability is a calculation to determine the number of months required to repay net debt from current cashflow from operations. The ratio is calculated as follows:

<b>Net Current Debt Repayability</b> <i>(Thousands, except for months)</i>	<b>Nine Months Ended</b>	
	<b>2011</b>	<b>Sept 30 2010</b>
Current liabilities	4,174	\$ 8,907
Less Current assets	3,931	\$ 2,193
(Working capital) Net current debt	243	6,714
Convertible Debentures	12,188	6,604
Net debt	\$ 12,431	\$ 13,318
Annualized Cashflow from Operations	\$ (140)	\$ 1,636
Months estimated to repay net current debt	NA	49.25
Months estimated to repay net debt	NA	97.69

These ratios are unacceptably high and the Company has not achieved its goal in the last two years. Management believes that the issue of convertible debentures late in Q2 2011 will provide the Company with sufficient resources to drill its heavy oil development projects which should increase its production and cashflow. This should reduce the ratio to acceptable levels in the future.

## 8. Convertible Debentures

In March 2007, the Company issued unsecured subordinated convertible debentures for gross proceeds of \$7,085,000. The debentures are compound financial instruments and as such have been recorded as a liability and as equity. The residual valuation method was used to determine the equity portion of the debentures. Under this approach, the liability component was valued first, and the difference between the proceeds of the debentures and the fair value of the liability was assigned to the equity component. The present value of the liability was calculated using a discount rate of 12% which approximated the interest rate that would have been applicable to non-convertible debt of the Company at the time the debentures were issued. During 2007, debenture issue costs of \$590,000 were charged against the liability component of the debenture. These costs were to be charged to interest expense over the initial five year life of the debenture using the effective interest rate method.

With the change in debenture terms effective January 17, 2011 all issue costs have been expensed. Also, the present value of the liability component was re-calculated using a discount rate of 18% which approximated the interest rate that would have been applicable to non-convertible debt of the Company at the time the debentures terms were changed. While this did not extinguish the existing obligation from a legal perspective, under IFRS the company is required to assess both the legal form and substance of the agreement. Management determined that the renegotiation of terms is an extinguishment in substance, and as a result was required to write off the original costs of issue, which were being amortized over the life of the debenture.

<b>Debenture issued March, 2007</b> <b>(\$ Thousands)</b>	<b>Nine Months Ended</b>	
	<b>2011</b>	<b>Sept 30 2010</b>
Liability component of debenture before adjustments	\$ 6,682	\$ 6,377
Adjustment for the revaluation of the debenture	\$ (884)	
Adjustments - expensed to interest		
Accretion of liability	235	90
Issue costs	(43)	60
Liability component of debenture	\$ 5,990	\$ 6,527

The initial terms were:

- Maturity on March 27, 2012, unless earlier redeemed or converted.
- Interest at 8.75% per year, paid semi-annually.
- The principal amount of each debenture is convertible into common shares of Diaz at the option of the holder at any time prior to maturity at a conversion price of \$0.90 per share.

- The Corporation may, at its option, elect to satisfy its obligation to pay all or any portion of the principal amount by issuing and delivering to holders on the maturity date that number of Common Shares obtained by dividing the \$0.90 per share redemption price by 95% of the current trading price of a Common Share.

On January 17, 2011, more than two thirds of the debenture holders signed a resolution authorizing the change of the terms of the debenture as follows:

- Maturity on March 26, 2014, unless earlier redeemed or converted.
- From January 17, 2011, interest at 10.5% per year, paid semi-annually.
- Diaz can not redeem the debentures prior to December 3, 2012.
- The principal amount of each debenture is convertible into common shares of Diaz at the option of the holder at any time prior to maturity at a conversion price of \$0.333 per share.
- The Corporation may, at its option, elect to satisfy its obligation to pay all or any portion of the principal amount by issuing and delivering to holders on the maturity date that number of Common Shares obtained by dividing the \$0.333 per share redemption price by 95% of the current trading price of a Common Share.

Debt issued June, 2010	Nine Months Ended	
(\$ Thousands)	2011	Sept 30 2010
Liability component of debenture before adjustments	\$ 6,124	\$ -
Adjustments - expensed to interest		
Accretion of liability	74	-
Liability component of debenture	\$ 6,198	\$ -

In June 2011, the Company issued secured subordinated convertible debentures for gross proceeds of \$8,000,000. The debentures are compound financial instruments and as such have been recorded as a liability and as equity. The residual valuation method was used to determine the equity portion of the debentures. Under this approach, the liability component was valued first, and the difference between the proceeds of the debentures and the fair value of the liability was assigned to the equity component. The present value of the liability was calculated using a discount rate of 18% which approximated the interest rate that would have been applicable to non-convertible debt of the Company at the time the debentures were issued. Debenture issue costs of \$44,000 were charged against the liability component of the debenture. These costs were to be charged to interest expense over the initial five year life of the debenture using the effective interest rate method.

## 9. Asset Retirement Obligation

The Company recognizes the fair value of an asset retirement obligation ("ARO") as a liability in the period in which it is incurred if a reasonable estimate of fair value can be made. The present value of the estimated ARO is capitalized as part of the net capitalized asset base and the depletion of the capitalized asset retirement cost is determined on a basis consistent with depletion of the Company's other assets. With time, accretion will increase the carrying amount of the obligation. Accretion is expensed.

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

(\$ Thousands)	Nine Months Ended	
	2011	Sept 30 2010
Asset Retirement Obligation, beginning of year	\$ 4,237	\$ 3,381
Liabilities incurred	60	215
Liabilities settled	-	-
Increase (decrease) for change in estimates	132	112
ARO reduction for property sales	-	-
Accretion expense	87	160
Foreign exchange difference	53	7
Asset Retirement Obligation, end of period	\$ 4,569	\$ 3,875

The total undiscounted amount of estimated cash flows required to settle the obligation is \$5,151,000 which has been discounted using average risk free rates of 1.44 to 2.83 percent. Most of these obligations are expected to be paid between 2012 and 2017.

## 10. Commitments

The Company has committed to future minimum payments under an operating base lease covering office facilities as follows:

(\$ Thousands)	Amount (Thousands)
Six Months Ended June 30,	
2011	38
2012	152
2013	114
2014	-
2015	-

The Company has the following gas price contracts in place for future periods:

Fixed Price Volume	Fixed Price (\$/Mcf)	Time Period for Contract
475 Mcfd	4.00	Oct 1, 2011 - Oct 31, 2011
475 Mcfd	4.46	Nov 1, 2011 - Mar 31, 2012

The Company issued \$650,000 of flow-through shares in December 2010 and has \$650,000 remaining to spend on exploration costs prior to December 31, 2011.

## 11. Financial Instruments

All financial instruments are required to be measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading," "available-for-sale," "held-to-maturity," "loans and receivables" or "other financial liabilities" as defined by the standard.

Cash and cash equivalents are measured at fair value, which approximates carrying value due to the short-term nature of these instruments. Accounts receivable are designated as "loans and receivables" and are carried at amortized cost. Accounts payable are designated as "other financial liabilities" and are carried at cost. Long-term debt, which includes the convertible debenture, is designated as "other financial liabilities" and carried at amortized cost using the effective interest method. The financing costs associated with the Company's \$7.085 million private placement of unsecured convertible debentures on March 26, 2007, and the Company's \$8.0 million private placement of secured convertible debentures on June 14, 2011, are included in the amortized cost of the debt. However, on January 17, 2011, the terms of the 2007 convertible debentures changed significantly resulting in the Company fully expensing \$152,000 of unamortized financing costs and recalculating the debt versus equity components of the convertible debenture.

The Company's financial instruments that are included in the balance sheet are comprised of cash, accounts receivable, accounts payable, bank debt and the convertible debentures.

### Fair values of financial assets and liabilities

The fair values of financial instruments that are included in the balance sheet approximate their carrying amount due to the short-term maturity of those instruments except for the convertible debentures which are carried at amortized costs using the interest rate method.

### Credit risk

Credit risk is the risk that the counterparty to a financial asset will default, resulting in the Company incurring a financial loss. The Company is exposed to credit risk on its accounts receivable to a maximum of the carrying value of the aforementioned items at the end of the period. A substantial portion of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. The exposure to credit risk is approximately \$528,000 which represents accounts receivable balances in excess of 90 days. Management has reviewed the items comprising the accounts receivable balance and determined that all accounts are collectible; accordingly there has been no allowance for doubtful accounts recorded.

### Interest rate risk

The Company is exposed to risks from interest rate fluctuation on its bank loan which is based on Prime rates. Interest rate risk is specific to the interest expense charged to income on the Company's bank debt. The Company believes a 25% volatility is a reasonable measure when assessing the potential impact of a change in interest rate. Variations in interest rates on the Company's bank debt could have resulted in gains (losses) impacting net earnings as at September 30, 2011, as follows:

(\$ Thousands)	Favourable 25% Change	Unfavourable 25% Change
Interest expense	\$ (40)	\$ 40

### Liquidity risk

The Company is exposed to liquidity risk from the possibility that it will encounter difficulty meeting its financial obligations. The Company manages this risk by forecasting cash flows in an effort to match operating cash flow to future expenditures and to arrange financing, if necessary. It may take many years and substantial cash expenditures to pursue exploration and development activities on all of the Company's existing undeveloped properties. Accordingly, the Company may need to raise additional funds from outside sources in order to explore and develop its properties. There is no assurance that adequate funds from debt and equity markets will be available to the Company in a timely manner. The timing of cash outflows relating to financial liabilities are outlined in the table below:

(\$ Thousands)	< 1 year	years 2 & 3	> 3 years
Accounts payable and accrued liabilities	4,174	-	-
Bank loan	-	-	-
Convertible debentures plus interest	1,584	9,881	9,260

At September 30, 2011 the Company has met all the obligations associated with its financial liabilities. The majority of the Company's accounts payable are current. The bank loan is a demand loan and is classified as a current liability of less than one year. Convertible debentures are payable on March 27, 2014 and March 31, 2016.

### Foreign currency exchange risk

The Company is exposed to fluctuations in foreign currency exchange rates as the Company has a U.S. subsidiary with a functional currency of United States dollars while the functional currency of the Company is Canadian dollars. As a result, fluctuations in the United States dollar against the Canadian dollar could result in unanticipated fluctuations in the Company's financial results which are denominated in Canadian dollars.

The Company's exposure to foreign currency exchange risk at September 30, 2011, can be summarized as follows:

(\$ Thousands)	Balance Sheet	Canada	USA
	Total	Cdn \$ Equivalent	
Cash and cash equivalents	1,618	1,521	97
Accounts receivable	1,981	1,826	155
Accounts payable	(4,174)	(4,004)	(170)
<b>Total</b>	<b>(575)</b>	<b>(657)</b>	<b>82</b>

### Commodity price risk

Inherent to the Company's business of producing petroleum and natural gas is the commodity price risk where fluctuations in the market price of petroleum and natural gas could significantly impact the Company's ability to generate cash flow from operating activities. The Company believes a 10% volatility is a reasonable measure when assessing the potential impact of commodity price changes on natural gas and oil prices. Variations in commodity prices could have resulted in gains (losses) impacting net earnings as at September 30, 2011, as follows:

(\$ Thousands)	Favourable 10% Change	Unfavourable 10% Change
Natural gas price	\$ 200	\$ (200)
Crude oil price	\$ 212	\$ (212)

## 12. Related Party Transactions

Humboldt Capital Corporation ("Humboldt") and certain of its officers and directors owned 36% of the outstanding shares of Diaz at November 4, 2011. Humboldt's business includes the ownership, acquisition and sale of securities in other companies and Humboldt owns significant interests in companies in the oil and gas sector, which compete with Diaz and operate jointly with Diaz, from time to time, in certain areas. These include Tuscany Energy Ltd. ("Tuscany"), and Paris Energy Inc. ("Paris") which also have certain common officers and directors. The following table sets forth the respective ownership of Humboldt and its officers and directors in Diaz, Paris and Tuscany as at November 4, 2011:

- 36% of Diaz common shares,
- 70% of Paris common shares, and
- 36% of Tuscany common shares.

The Company has a joint venture with Tuscany Energy Ltd. whereby it participates in new oil and natural gas projects for a 45% working interest – Tuscany 55%. Diaz provides administrative, operating and exploration services for Tuscany in exchange for payment of a portion of the related costs of Diaz. Charges for these services to Tuscany and its wholly owned subsidiary are shown below.

At September 30, 2011, Tuscany owed Diaz \$403,000 (2010 – \$298,000) through the normal course of business.

For the nine months ended September 30, 2011 and 2010, Diaz recovered the following amounts related to certain overhead services from:

	Nine Months Ended Sept. 30, 2011	Nine Months Ended Sept. 30, 2010
Humboldt	\$246,000	\$249,000
Paris	\$18,000	\$19,000
Sharon*	\$285,000	\$250,000
Tuscany	\$509,000	\$388,000

\* Sharon became a wholly owned subsidiary of Tuscany on June 2, 2011.

These transactions were conducted in the normal course of operations and measured at the amount of consideration established and agreed to by the related parties.

### 13. Segmented Information

The following table sets forth the operating segments of the company:

(\$ Thousands, unaudited)	Three Months Ended		Nine Months Ended	
	2011	Sept 30 2010	2011	Sept 30 2010
<b>Revenue (net)</b>				
Canada	\$ 1,110	\$ 1,235	3,364	\$ 4,394
United States	139	199	383	538
	\$ 1,249	\$ 1,434	\$ 3,747	\$ 4,932
<b>Overhead (net)</b>				
Canada	\$ 335	\$ 225	\$ 894	\$ 676
United States	3	69	57	177
	\$ 338	\$ 294	\$ 951	\$ 853
<b>Interest Expense</b>				
Canada	\$ 580	\$ 254	\$ 1,387	\$ 989
United States	-	(4)	-	-
	\$ 580	\$ 250	\$ 1,387	\$ 989
<b>Current Taxes</b>				
Canada	\$ -	\$ (9)	\$ -	\$ (9)
United States	(9)	18	4	27
	\$ (9)	\$ 9	\$ 4	\$ 18
<b>Cash Flow from Operations</b>				
Canada	\$ (147)	\$ 148	\$ (108)	\$ 963
United States	112	64	224	160
	\$ (35)	\$ 212	\$ 116	\$ 1,123
<b>Depletion, Depreciation &amp; Accretion</b>				
Canada	\$ 846	\$ 1,011	\$ 2,423	\$ 2,750
United States	266	463	804	1,365
	\$ 1,112	\$ 1,474	\$ 3,227	\$ 4,115
<b>Net Loss</b>				
Canada	\$ (1,429)	\$ (1,071)	\$ (2,390)	\$ (2,421)
United States	(123)	(325)	(374)	(828)
	\$ (1,552)	\$ (1,396)	\$ (2,764)	\$ (3,249)
<b>Additions to Property, Plant &amp; Equipment</b>				
Canada	\$ 2,170	\$ 860	\$ 3,557	\$ 3,528
United States	-	40	84	72
	\$ 2,170	\$ 900	\$ 3,641	\$ 3,600
<b>Identifiable Assets, Net</b>				
Canada	\$ 29,676	\$ 28,749	\$ 29,676	\$ 28,749
United States	5,088	6,479	5,088	6,479
	\$ 34,764	\$ 35,228	\$ 34,764	\$ 35,228

## 14. Supplemental Cash Flow Information

(\$ Thousands, unaudited)	Three Months Ended		Nine Months Ended	
	Sept 30		Sept 30	
	2011	2010	2011	2010
Interest paid during the period	\$ -	\$ -	\$ 637	\$ 207
Taxes paid during the period	\$ -	\$ -	\$ 4	\$ -
Changes in non-cash working capital balances				
Accounts receivable	\$ (671)	\$ 1,726	\$ (27)	\$ 1,021
Prepaid expenses	\$ (67)	\$ 6	\$ (187)	\$ 87
Accounts payable and accrued liabilities	\$ 2,348	\$ (1,150)	\$ 1,341	\$ (1,704)
	\$ 1,610	\$ 582	\$ 1,127	\$ (596)

## 15. Subsequent Events

The Company's production loan was reviewed in October 2011 by the Company's financial institution and as a result, the loan was reduced to \$3.1 million from \$3.3 million.

## 16. Reclassification

Certain information provided for prior periods has been reclassified to conform to the presentation adopted in 2011.

## 17. Transition to IFRS

IFRS 1 requires the presentation of comparative information as at the January 1, 2010 transition date and subsequent comparative periods as well as the consistent and retrospective application of IFRS accounting policies. To assist with the transition, the provisions of IFRS 1 allow for certain mandatory and optional exemptions for first-time adopters to alleviate the retrospective application of all IFRSs.

The following reconciliations present the adjustments made to the Company's previous GAAP financial results of operations and financial position to comply with IFRS 1. A summary of the significant accounting policy changes and applicable exemptions are discussed following the reconciliations. Reconciliations include the Company's condensed consolidated balance sheets as at January 1, 2010, September 30, 2010 and December 31, 2010, and condensed consolidated statement of operations and condensed consolidated statements of comprehensive loss for the nine months ended September 30, 2010 and for the twelve months ended December 31, 2010.

# IFRS Opening Consolidated Balance Sheet

As at January 1, 2010

(\$ Thousands, unaudited)	Previous GAAP	IFRS Adjustments				IFRS
		E&E (Note 17a)	Foreign Exchange (Note 17g)	Impairments (Note 17c)	ARO (Note 17e)	
<b>ASSETS</b>						
Cash	\$ 104	\$ -	\$ -	\$ -	\$ -	\$ 104
Accounts receivable	2,400					2,400
Income tax receivable	329					329
Prepaid expense	229					229
<b>Total current assets</b>	<b>3,062</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,062</b>
Property, plant and equipment	103,907	(771)				103,136
Accumulated depletion and depreciation	(70,312)					(70,312)
Exploration and evaluation assets	-	771		(68)		703
<b>Total non-current assets</b>	<b>33,595</b>	<b>-</b>	<b>-</b>	<b>(68)</b>	<b>-</b>	<b>33,527</b>
<b>Total assets</b>	<b>\$ 36,657</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (68)</b>	<b>\$ -</b>	<b>\$ 36,589</b>
<b>LIABILITIES</b>						
Accounts payable and accrued liabilities	\$ 4,508	\$ -	\$ -	\$ -	\$ -	\$ 4,508
Bank debt	4,398					4,398
<b>Total current liabilities</b>	<b>8,906</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>8,906</b>
Convertible debentures	6,377					6,377
Future income tax liability	1,942					1,942
Asset retirement obligation	3,381				488	3,869
<b>Total non-current liabilities</b>	<b>11,700</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>488</b>	<b>12,188</b>
<b>Total liabilities</b>	<b>20,606</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>488</b>	<b>21,094</b>
<b>EQUITY</b>						
Share capital	20,614	-	-	-	-	20,614
Warrants	-					-
Other equity	847					847
Contributed surplus	1,759					1,759
Accumulated other comprehensive loss	(307)		307			-
Deficit	(6,862)		(307)	(68)	(488)	(7,725)
<b>Total equity</b>	<b>16,051</b>	<b>-</b>	<b>-</b>	<b>(68)</b>	<b>(488)</b>	<b>15,495</b>
<b>Total liabilities and equity</b>	<b>\$ 36,657</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (68)</b>	<b>\$ -</b>	<b>\$ 36,589</b>

## Consolidated Balance Sheet

As at September 30, 2010

(\$ Thousands, unaudited)	Previous GAAP	IFRS Adjustments				IFRS
		E&E (Note 17a)	DD&A (Note 17b)	Foreign Exchange (Note 17g)	ARO (Note 17e)	
<b>ASSETS</b>						
Cash	\$ 347	\$ -	\$ -	\$ -	\$ -	\$ 347
Accounts receivable	1,707					1,707
Income tax receivable	(3)					(3)
Prepaid expense	142					142
<b>Total current assets</b>	<b>2,193</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,193</b>
Property, plant and equipment	106,818	(922)				105,896
Accumulated depletion and depreciation	(74,289)		124			(74,165)
Exploration and evaluation assets	-	1,305				1,305
<b>Total non-current assets</b>	<b>32,529</b>	<b>383</b>	<b>124</b>	<b>-</b>	<b>-</b>	<b>33,036</b>
<b>Total assets</b>	<b>\$ 34,722</b>	<b>\$ 383</b>	<b>\$ 124</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 35,229</b>
<b>LIABILITIES</b>						
Accounts payable and accrued liabilities	\$ 2,795	\$ -	\$ -	\$ -	\$ -	\$ 2,795
Bank debt	6,112					6,112
<b>Total current liabilities</b>	<b>8,907</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>8,907</b>
Convertible debentures	6,604					6,604
Future income tax liability	1,519					1,519
Asset retirement obligation	3,717				609	4,326
<b>Total non-current liabilities</b>	<b>11,840</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>609</b>	<b>12,449</b>
<b>Total liabilities</b>	<b>20,747</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>609</b>	<b>21,356</b>
<b>EQUITY</b>						
Share capital	21,829	-	-	-	-	21,829
Warrants	331					331
Other equity	847					847
Contributed surplus	1,950					1,950
Accumulated other comprehensive loss	(418)			307		(111)
Deficit	(10,564)	383	124	(307)	(609)	(10,973)
<b>Total equity</b>	<b>13,975</b>	<b>383</b>	<b>124</b>	<b>-</b>	<b>(609)</b>	<b>13,873</b>
<b>Total liabilities and equity</b>	<b>\$ 34,722</b>	<b>\$ 383</b>	<b>\$ 124</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 35,229</b>

## Consolidated Balance Sheet

As at December 31, 2010

(\$ Thousands, unaudited)	Previous GAAP	IFRS Adjustments					IFRS
		E&E (Note 17a)	DD&A (Note 17b)	Impairments (Note 17c)	ARO (Note 17e)	Foreign Exchange (Note 17g)	
<b>ASSETS</b>							
Cash	\$ 89	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 89
Accounts receivable	1,955						\$ 1,955
Income tax receivable	24						\$ 24
Prepaid expense	120						\$ 120
<b>Total current assets</b>	<b>2,188</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,188</b>
Property, plant and equipment	107,082	(1,250)			54	-	105,886
Accumulated depletion and depreciation	(75,241)		174	(317)			(75,384)
Exploration and evaluation assets	-	1,469					1,469
<b>Total non-current assets</b>	<b>31,841</b>	<b>219</b>	<b>174</b>	<b>(317)</b>	<b>54</b>	<b>-</b>	<b>31,971</b>
<b>Total assets</b>	<b>\$ 34,029</b>	<b>\$ 219</b>	<b>\$ 174</b>	<b>\$ (317)</b>	<b>\$ 54</b>	<b>\$ -</b>	<b>\$ 34,157</b>
<b>LIABILITIES</b>							
Accounts payable and accrued liabilities	\$ 2,835	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,835
Bank debt	5,755						\$ 5,755
<b>Total current liabilities</b>	<b>8,590</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>8,588</b>
Convertible debentures	6,682						6,682
Future income tax liability	1,377						1,377
Asset retirement obligation	3,805				432	-	4,237
<b>Total non-current liabilities</b>	<b>11,864</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>432</b>	<b>-</b>	<b>12,296</b>
<b>Total liabilities</b>	<b>20,454</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>432</b>	<b>-</b>	<b>20,884</b>
<b>EQUITY</b>							
Share capital	22,141	-	-	-	-	-	22,141
Warrants	252						252
Other equity	847						847
Contributed surplus	1,996						1,996
Accumulated other comprehensive loss	(571)					307	(264)
Deficit	(11,090)	219	174	(317)	(378)	(307)	(11,699)
<b>Total equity</b>	<b>13,575</b>	<b>219</b>	<b>174</b>	<b>(317)</b>	<b>(378)</b>	<b>-</b>	<b>13,273</b>
<b>Total liabilities and equity</b>	<b>\$ 34,029</b>	<b>\$ 219</b>	<b>\$ 174</b>	<b>\$ (317)</b>	<b>\$ 54</b>	<b>\$ -</b>	<b>\$ 34,157</b>

## Consolidated Statement of Operations

### Nine Months Ended September 30, 2010

(\$ Thousands, except per share amounts, unaudited)	Previous GAAP	IFRS Adjustments			IFRS
		E&E (Note 17a)	DD&A (Note 17b)	ARO (Note 17e)	
<b>Revenue, Net of Royalties</b>	\$ 4,933	\$ -	\$ -	\$ -	\$ 4,933
<b>Expenses</b>					
Operating and transportation	2,261				2,261
Overhead	853				853
Stock based compensation	481				481
Interest expense	901			88	989
Foreign exchange loss (gain)	-				-
Site restoration loss (gain)	-			157	157
Property disposition loss (gain)	-			(308)	(308)
Depletion and Depreciation	4,504		(389)		4,115
Property, plant & equipment impairment	-				-
	9,000	-	(389)	(63)	8,548
Loss before income tax	(4,067)	-	389	63	(3,615)
Income tax					
Current tax expense (recovery)	18				18
Deferred tax expense (recovery)	(383)				(383)
Total income tax (recovery)	(365)	-	-	-	(365)
Net income (loss)	(3,702)	-	389	63	(3,250)

## Consolidated Statement of Comprehensive Loss

### Nine Months Ended September 30, 2010

(\$ Thousands, except per share amounts)	Previous GAAP	IFRS Adjustments			IFRS
		E&E (Note 17a)	DD&A (Note 17b)	ARO (Note 17e)	
<b>Net income (loss)</b>	\$ (3,702)	\$ -	\$ 389	\$ 63	\$ (3,250)
Other comprehensive loss					
Unrealized loss on translation of subsidiary financial statements into reporting currency	(111)	-	-	-	(111)
	(111)	-	-	-	(111)
Comprehensive loss	\$ (3,813)	\$ -	\$ 389	\$ 63	\$ (3,361)

## Consolidated Statement of Operations

### Twelve Months Ended December 31, 2010

(\$ Thousands, except per share amounts, unaudited)	Previous GAAP	IFRS Adjustments				IFRS
		E&E	DD&A	Impairments	ARO	
		(Note 17a)	(Note 17b)	(Note 17c)	(Note 17e)	
<b>Revenue, Net of Royalties</b>	\$ 6,508	\$ 221	\$ -	\$ -	\$ -	\$ 6,729
<b>Expenses</b>						
Operating and transportation	2,803					2,803
Overhead	1,160					1,160
Stock based compensation	142					142
Interest expense	1,222				(195)	1,027
Depletion and Depreciation	5,940		(476)			5,464
Property, plant & equipment impairment	-			317		317
	11,267	-	(476)	317	(195)	10,913
Loss before income tax	(4,759)	221	476	(317)	195	(4,184)
Income tax						
Current tax expense (recovery)	(55)					(55)
Deferred tax expense (recovery)	(476)					(476)
Total income tax (recovery)	(531)	-	-	-	-	(531)
Net income (loss)	(4,228)	221	476	(317)	195	(3,653)

## Consolidated Statement of Comprehensive Loss

### Twelve Months Ended December 31, 2010

(\$ Thousands, except per share amounts)	Previous GAAP	IFRS Adjustments				IFRS
		E&E	DD&A	Impairments	ARO	
		(Note 17a)	(Note 17b)	(Note 17c)	(Note 17e)	
<b>Net income (loss)</b>	\$ (4,228)	\$ 221	\$ 476	\$ (317)	\$ 195	\$ (3,653)
Other comprehensive loss						
Unrealized loss on translation of subsidiary financial statements into reporting currency	(264)	-	-	-	-	(264)
Unrealized gain on revaluation of ARO						
	(264)	-	-	-	-	(264)
Comprehensive loss	\$ (4,492)	\$ 221	\$ 476	\$ (317)	\$ 195	\$ (3,917)

The most significant changes to the Company's accounting policies relate to the accounting for upstream costs. Under previous GAAP, Diaz followed the Canadian Institute of Chartered Accountants ("CICA") guideline on full cost accounting in which all costs directly associated with the acquisition of, the exploration for, and the development of natural gas and liquids reserves were capitalized on a country-by-country cost centre basis. Costs accumulated within each country cost centre were depleted using the unit-of-production method based on proved reserves determined using estimated future prices and costs. Upon transition to IFRS, the Company was required to adopt new accounting policies for upstream activities, including exploration and evaluation costs and development costs.

Under IFRS, exploration and evaluation costs are those expenditures for an area where technical feasibility and commercial viability has not yet been determined. Development costs include those expenditures for areas where technical feasibility and commercial viability has been determined. Diaz adopted the IFRS 1 "full cost" exemption whereby the Company deemed its January 1, 2010 IFRS upstream asset costs to be equal to its previous GAAP historical upstream property, plant and equipment net book value. Accordingly, exploration and evaluation costs were deemed equal to the unproved

properties balance and the development costs were deemed equal to the upstream full cost pool balance. Under IFRS, exploration and evaluation costs are presented as exploration and evaluation assets and development costs are presented within property, plant and equipment on the condensed consolidated balance sheet.

The following provides summary reconciliations of Diaz's 2010 previous GAAP and IFRS results, along with a discussion of the significant IFRS accounting policy changes.

**(a) Exploration and Evaluation**

Exploration and evaluation assets at January 1, 2010 were deemed to be \$694,000, representing the unproved properties balance under previous GAAP. This resulted in a reclassification of \$694,000 from property, plant and equipment to exploration and evaluation assets on Diaz's condensed consolidated balance sheet as at January 1, 2010. The Company took an impairment of the exploration and evaluation assets at January 1, 2010, of \$68,000. As at June 30, 2011, the Company's exploration and evaluation assets were approximately \$1.5 million.

Under previous GAAP, exploration and evaluation costs were capitalized as property, plant and equipment in accordance with the CICA's full cost accounting guidelines. Under IFRS, Diaz capitalizes these costs initially as exploration and evaluation assets. Once technical feasibility and commercial viability of the area has been determined, the capitalized costs are transferred from exploration and evaluation assets to property, plant and equipment. Under IFRS, unrecoverable exploration and evaluation costs associated with an area and costs incurred prior to obtaining the legal rights to explore are expensed.

During the twelve month period ended December 31, 2010, Diaz transferred \$338,000 from exploration and evaluation costs to property, plant and equipment and did not expense any exploration and evaluation assets. The application of IFRS for exploration and evaluation costs did not result in any change to Diaz's previous GAAP Net Earnings for the twelve months ended December 31, 2010.

**(b) Depreciation, Depletion and Amortization**

Development costs at January 1, 2010 were deemed to be \$32.9 million, representing the upstream full cost pool balance under previous GAAP. Consistent with previous GAAP, these costs are capitalized as property, plant and equipment under IFRS. Under previous GAAP, development costs were depleted using the unit-of-production method calculated for each country cost centre. Under IFRS, development costs are depleted using the unit-of-production method calculated at the Cash Generating Unit (CGU) level. The IFRS 1 exemption permitted the Company to allocate development costs to the CGU level using proved and probable reserve values for each CGU as at January 1, 2010.

Depleting at a CGU level under IFRS resulted in an \$476,000 decrease to Diaz's DD&A expense for the twelve months ended December 31, 2010. Diaz's net loss decreased \$476,000 after tax, compared to previous GAAP for the twelve months ended December 31, 2010 as a result of depleting at a CGU level under IFRS.

### **(c) Impairments**

Under previous GAAP, an upstream impairment was recognized if the carrying amount exceeded the undiscounted cash flows from proved reserves for a country cost centre. An impairment was measured as the amount by which the carrying value exceeded the sum of the fair value of the proved and probable reserves and the costs of unproved properties. Impairments recognized under previous GAAP were not reversed.

Under IFRS, an upstream impairment is recognized if the carrying value exceeds the recoverable amount for a CGU. Upstream areas are aggregated into CGUs based on their ability to generate largely independent cash flows. If the carrying value of the CGU exceeds the recoverable amount, the CGU is written down with an impairment recognized in net earnings. Impairments recognized under IFRS are reversed when there has been a subsequent increase in the recoverable amount. Impairment reversals are recognized in net earnings and the carrying amount of the CGU is increased to its revised recoverable amount as if no impairment had been recognized for the prior periods.

For the twelve months ended December 31, 2010, Diaz recognized an after-tax impairment of \$317,000 relating to the Company's natural gas assets in Alberta. The impairment recognized was based on the difference between the December 31, 2010 net book value of the assets and the recoverable amount. The recoverable amount was determined using the greater of fair value less costs to sell or value in use, based on discounted future cash flows of proved and probable reserves using forecast prices and costs. Under previous GAAP, these assets were included in the Canadian cost centre ceiling test, which were not impaired at December 31, 2010.

### **(d) Dispositions**

Under previous GAAP, proceeds from dispositions of upstream assets were deducted from the full cost pool without recognition of a gain or loss unless the deduction resulted in a change to the country cost centre depletion rate of 20 percent or greater, in which case a gain or loss was recorded.

Under IFRS, gains or losses are recorded on dispositions and are calculated as the difference between the proceeds and the net book value of the asset disposed. Diaz did not have any dispositions for the twelve months ended December 31, 2010, so there was no difference in recorded values under IFRS compared to previous GAAP results.

### **(e) Asset Retirement Obligation**

Under previous GAAP, the asset retirement obligation was measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. Liabilities were not re-measured to reflect period end discount rates.

Under IFRS, the asset retirement obligation is measured as the best estimate of the expenditure to be incurred and requires that the asset retirement obligation be re-measured using period end discount rates.

In conjunction with the IFRS 1 exemption regarding upstream assets discussed above, Diaz was required to re-measure its asset retirement obligation upon transition to IFRS and recognize the difference in retained earnings. The application of this exemption resulted in a \$488,000 increase to the asset retirement obligation on Diaz's condensed consolidated balance sheet as at January 1, 2010 and a corresponding charge to retained earnings of \$488,000. Subsequent IFRS re-measurements of the obligation are recorded through property, plant and equipment with an offsetting adjustment to the asset retirement obligation. As at December 31, 2010, excluding the January 1, 2010 adjustment, Diaz's asset retirement obligation increased by \$432,000 which primarily reflects the re-measurement of the obligation using risk free discount rates for obligations within 5 years, 10 years or longer of 2.45%, 3.16% and 3.54% respectively as at December 31, 2010.

### **(f) Share-based payments**

Under previous GAAP, the Company adopted the fair value method for accounting for stock based compensation whereby the fair value of the option granted is estimated on the date of the grant using the Black-Scholes option pricing model. Using the fair value method, compensation costs of stock based

compensation are estimated and charged to earnings over the vesting period of the options. IFRS requires the same method so no changes were required in transition.

**(g) Foreign Currency**

As permitted by IFRS 1, the Company elected to apply the exemption to set the cumulative foreign currency translation adjustment to zero upon transition to IFRS. Accordingly, \$307,000 was recognized as an adjustment to retained earnings on January 1, 2010. The reclassification had no impact on total shareholders' equity as at January 1, 2010. As a result of the election, the accounts of the Company have not been retrospectively restated using IFRS foreign currency principles.

Future foreign currency translation gains and losses that are recognized from the cumulative foreign currency translation adjustment will differ under IFRS compared to previous GAAP due to the exemption taken above. The IFRS adjustments discussed above are recorded in the Company's functional currency and are subject to translation for presentation purposes. The associated foreign currency impacts are reported in accumulated other comprehensive income.

**(h) Income Tax**

Deferred income taxes have been adjusted to reflect the tax effect arising from the differences between IFRS and previous GAAP. However, the Company has a future tax asset that exceeds the tax impacts of those differences. As the Company has determined that it is not probable that the future tax asset will be recoverable, Diaz has removed this item from its balance sheet. This results in no deferred income tax change between IFRS and previous GAAP.

**(i) Other Exemptions**

Other significant IFRS 1 exemptions taken by Diaz at January 1, 2010 include the following:

- Business combinations and jointly controlled operations entered into prior to January 1, 2010 were not retrospectively restated under IFRS.
- Leases were not reassessed to determine whether an arrangement contained a lease under International Financial Reporting Interpretations Committee 4, Determining whether an Arrangement contains a Lease, for contracts that were already assessed under previous GAAP.

The remaining IFRS 1 exemptions were not applicable or material to the preparation of Diaz's condensed consolidated balance sheet at the date of transition to IFRS on January 1, 2010.

## CORPORATE INFORMATION

### *Directors*

Robert W. Lamond  
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Calgary, Alberta

Donald K. Clark  
Calgary, Alberta

John G.F. McLeod <sup>(2)</sup>  
Okotoks, Alberta

Robert L. McPherson <sup>(1) (3)</sup>  
Calgary, Alberta

Roger Hume <sup>(1)</sup>  
Kelowna, British Columbia

- <sup>(1)</sup> Member of the Audit Committee  
<sup>(2)</sup> Member of the Compensation Committee  
<sup>(3)</sup> Member of the Corporate Governance Committee

### *Legal Counsel*

Burnet, Duckworth & Palmer LLP  
Calgary, Alberta

### *Registrar and Transfer Agent*

Computershare Trust Company of Canada  
Calgary, Alberta  
Toronto, Ontario

### *Officers*

R.W. Lamond  
President, Chairman of the Board & CEO

D.K. Clark  
Vice President, Operations & COO

B.R. Perry  
Chief Financial Officer

C.S. Cohen  
Corporate Secretary

R.D. Arsenault  
Controller

### *Subsidiaries*

Diaz Resources, Inc.  
Orbit Oil & Gas Inc.

### *Auditors*

PricewaterhouseCoopers LLP  
Calgary, Alberta

### *Stock Exchange Listing*

Toronto Stock Exchange  
Trading Symbol: DZR

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