Tethys Petroleum Limited

(formerly known as Tethys Petroleum Investments Limited)

Consolidated Financial Statements

December 31, 2008

PRICEWATERHOUSECOOPERS

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March 31, 2009

Auditors' Report

To the Shareholders of
Tethys Petroleum Limited

We have audited the consolidated balance sheets of Tethys Petroleum Limited as at December 31, 2008 and 2007 and the consolidated statements of operations and comprehensive loss, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

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TETHYS PETROLEUM LIMITED
(formerly known as Tethys Petroleum Investments Limited)

Consolidated Balance Sheet

	Note	As at December 31, 2008	December 31, 2007
		(Expressed in 000's United States dollars)	
ASSETS			
Current Assets			
Cash and cash equivalents		22,200	26,692
Prepayments	**3**	900	351
Accounts Receivable		1,124	219
Inventory		213	-
Other current assets		640	790
Total current assets		25,077	28,052
Non Current Assets			
Prepayments	**3**	1,514	3,062
Restricted Cash	**5**	587	318
Value added tax recoverable	**6**	4,843	2,752
Capital assets	**7**	73,793	37,472
Total non-current assets		80,737	43,604
Total Assets		105,814	71,656
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities			
Accounts payable		1,219	1,388
Current portion of long term debt	**8**	853	-
Accrued & other liabilities		1,516	891
Total current liabilities		3,588	2,279
Non Current Liabilities			
Long term debt	**8**	5,096	-
Other non-current liabilities	**9**	523	776
Asset retirement obligation	**10**	433	661
Total non current liabilities		6,052	1,437
Total Liabilities		9,640	3,716
Stockholders' equity	**13**		
Share capital		145,237	99,483
Contributed Surplus	**14**	7,472	3,527
Warrants	**15**	17,717	16,555
Accumulated deficit		(74,252)	(51,625)
Total stockholders' equity		96,174	67,940
Total Liabilities and Stockholders' Equity		105,814	71,656
Commitments and contingencies	**11**		

See accompanying notes to these financial statements

Approved by the board of directorson March 31, 2008

"D Robson" Director *"B Murphy"* Director

TETHYS PETROLEUM LIMITED
(formerly known as Tethys Petroleum Investments Limited)

Consolidated Statement of Operations and Comprehensive Loss

	Note	Year ended December 31, 2008	2007
		(Expressed in 000's United States dollars except share data)	
Revenues Net of Royalties			
Oil and gas sales		5,360	194
		5,360	194
Expenses			
Operating		1,334	19
Selling, general and administrative		13,421	9,461
Stock based compensation	**14**	3,945	17,624
Depreciation, depletion and amortization (2007 includes ceiling test write down of $12.8 million)	**7**	6,449	13,057
		25,149	40,161
Operating Loss		(19,789)	(39,967)
Other Income/(Expense):			
Interest, net		754	(1,437)
Foreign exchange (losses)		(3,060)	(96)
Finance charges		(373)	(238)
Other		(159)	(41)
Total Other (Expense)		(2,838)	(1,812)
Loss Before Income Taxes		(22,627)	(41,779)
Income taxes		-	-
Net Loss and Comprehensive Loss for the year		(22,627)	(41,779)
Weighted average number of common shares outstanding	**14**	55,987,525	33,274,413
Basic and diluted loss per share		(0.40)	(1.26)

See accompanying notes to these financial statements

TETHYS PETROLEUM LIMITED
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Consolidated Statement of Cash Flows

	Note	Year ended December 31	
		2008	**2007**
		(Expressed in 000's United States dollars)	
Operating activities:			
Net loss for the year		(22,627)	(41,779)
Items not affecting cash			
Stock based compensation		3,945	17,624
Accretion		56	-
Finance costs		-	238
Non-cash interest expense		-	1,916
Depreciation, depletion and amortization		6,449	13,057
Unrealised foreign exchange loss		1,363	-
Net change in non-cash working capital items	4	(844)	(305)
Net cash used in operating activities		(11,658)	(9,249)
Investing activities:			
Capital expenditures		(42,343)	(23,001)
Restricted cash		(269)	(113)
Value added tax recoverable		(2,091)	(1,666)
Change in oil & gas suppliers prepayments		1,548	820
Net change in non-cash working capital items		(217)	226
Net cash used in investing activities		(43,372)	(23,734)
Financing activities:			
Proceeds from sale of common stock		50,000	67,337
Share issue costs		(4,246)	(5,169)
Proceeds (Repayment) from long term debt		7,430	(5,000)
Amortisation of debt discount		(1,030)	-
Other non-current liabilities		(253)	744
Net cash provided by financing activities		51,901	57,912
Foreign exchange loss on cash held in foreign currency		(1,363)	-
Net increase/(decrease) in cash and cash equivalents		(4,492)	24,929
Cash and cash equivalents, beginning of year		26,692	1,763
Cash and cash equivalents, end of year		22,200	26,692
Supplemental disclosure of cash and non-cash transactions			
Interest paid		454	375

See accompanying notes to these financial statements

TETHYS PETROLEUM LIMITED
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Consolidated Statements of Changes in Stockholders' Equity

	Common Stock					
	No of Shares Issued	Share Capital	Contributed Surplus	Warrants Reserve	Accumulated Deficit	Total Stockholders' Equity
			(Expressed in 000's United States dollars except share data)			
Total December 31, 2006	70,000,000	22,315	-	2,220	(9,846)	14,689
Shares Issued pursuant to Private Placement	34,674,390	17,337	-	-	-	17,337
	104,674,390	39,652	-	2,220	(9,846)	32,026
Share restructure 1:5	20,934,878	39,652	-	2,220	(9,846)	32,026
Issue of shares to acquire 30% of BN Munai	6,000,000	15,000	-	-	-	15,000
Initial Public Offering (IPO)	18,181,818	50,000	-	-	-	50,000
Share Warrants and Options	-	-	3,527	14,335	-	17,862
Finance Costs	-	(5,169)	-	-	-	(5,169)
Net loss in 2007	-	-	-	-	(41,779)	(41,779)
Total December 31, 2007	45,116,696	99,483	3,527	16,555	(51,625)	67,940
Share Warrants and Options	-	-	3,945	1,162	-	5,107
Public offering	21,276,596	50,000	-	-	-	50,000
Share issue costs	-	(4,246)	-	-	-	(4,246)
Net loss in 2008	-	-	-	-	(22,627)	(22,627)
Total December 31, 2008	66,393,292	145,237	7,472	17,717	(74,252)	96,174

See accompanying notes to these financial statements

TETHYS PETROLEUM LIMITED
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2008

NOTE 1 - NATURE OF OPERATIONS AND GOING CONCERN

Tethys Petroleum Limited (formerly known as Tethys Petroleum Investments Limited) was headquartered in Guernsey, British Isles and incorporated in the Cayman Islands. The Company's domicile was moved from Guernsey, British Isles to the Cayman Islands on July 17, 2008. Tethys Petroleum Limited and its consolidated subsidiaries (collectively "Tethys" or "the Company"), is an oil and gas company operating within the Republic of Kazakhstan and the Republic of Tajikistan. Tethys' principal activity is the acquisition of and development of crude oil and natural gas fields.

Significant Business Risks and Basis of Presentation

Since inception, the Company has incurred significant losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2008. Also as described in note 11, the Company has significant short-term and longer term contractual commitments that will necessitate cash outflows. The ability of the Company to successfully carry out its business plan is primarily dependent upon its ability not only to maintain the current level of gas production but also to achieve further production of commercial oil and gas and to control the costs of operating and capital expenditures. While these factors create doubt about the Company's ability to continue as a going concern, management is confident of achieving the Company's short term plans.

The Company completed an Initial Public Offering (IPO) of equity securities on the Toronto Stock Exchange (TSX) on June 27, 2007. The Company subsequently issued additional capital for gross proceeds of US$50,000,000 on June 27, 2008 that generated sufficient funds to secure its future at least in the short term. In the event the Company is unable to generate significant revenues and cash flows from operations it may need to seek further funding from its shareholders or alternative sources. There can be no assurances that management will be successful with these initiatives.

The financial statements have been prepared on the basis that the Company will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. These financial statements do not reflect adjustments in the carrying values of assets and liabilities reported, revenue or expenses and the balance sheet classification used, that would be necessary if the going concern assumption was not appropriate. Such adjustments could be material.

Foreign Operations

Tethys' future operations and earnings will depend upon the results of Tethys' operations in the Republics of Kazakhstan and Tajikistan. There can be no assurance that Tethys will be able to successfully conduct such operations, and a failure to do so would have a material adverse effect on Tethys' financial position, results of operations and cash flows. Also, the success of Tethys' operations will be subject to numerous contingencies, some of which are beyond management control. These contingencies include general and regional economic conditions, prices for crude oil and natural gas, competition and changes in regulation. Since Tethys is dependent on international operations, specifically those in Kazakhstan and Tajikistan, Tethys will be subject to various additional political, economic and other uncertainties. Among other risks, Tethys' operations may be subject to the risks and restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

Concentration of Credit Risk

Although Tethys' cash and cash equivalents and accounts receivable are exposed to potential credit loss, Tethys does not believe such risk to be significant.

In order to reduce concentration of credit risk associated with cash and cash equivalent balances, the Company has spread its cash investments over three recognized financial institutions with appropriate credit ratings. Although a

significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss.

Concentration of credit risk associated with accounts receivable balances is as a result of contracted gas sales to only one customer during the year. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. The Company's sales commenced in December 2007 and the Company has not experienced any credit loss to date. Although a portion of the Accounts receivable balance has been outstanding more than 60 days as at December 31, 2008, the Company has not recorded a provision against the amount as it does not consider the balance to be impaired.

Market Risks

As an independent oil and gas producer, Tethys' revenue, profitability and future rate of growth are substantially dependent upon prevailing prices for oil and gas, which are dependent upon numerous factors beyond Tethys' control, such as economic, political and regulatory developments and competition from other sources of energy. The energy markets have historically been very volatile, and there can be no assurance that oil and gas prices will not be subject to wide fluctuations in the future. A substantial or extended decline in oil and gas prices could have a material adverse effect on Tethys' financial position, results of operations, cash flows and Tethys' access to capital and on the quantities of oil and gas reserves that may be economically produced.

Gas Pipeline

The Company is economically dependent on Bukhara-Urals trunk line. The trunk line carries gas from Central Asia through Kazakhstan and into the Russian export system. If anything adverse should occur to restrict the operation of the trunk line then the sales revenue would cease. The Bukhara-Urals trunk line is owned by Intergas Central Asia which is currently a Kazakh State company and no problems are currently envisaged with respect to exporting the Company's gas through the system. However, there is no guarantee that the trunk line owners will continue to accept the Company's gas, that excessively high transportation charges won't be imposed, or that the trunk line capacity will be available to the Company. Although the Company does not regard this as a significant risk at present, there is a possibility that the Company may encounter these situations in the future. The Uzbekistan economy, and to a lesser extent the Russian economy, are also dependent upon the Bukhara-Urals pipeline and consequently, Management expects that there would be significant efforts to minimize any break in supply.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Consolidated Financial Statements and notes thereto are prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). All dollar amounts are expressed in United States (U.S.) dollars. Tethys has adopted U.S. dollars as the reporting and functional currency since its revenue and expenses are closely tied to the U.S. dollar and in order to facilitate a more direct comparison to other international crude oil and natural gas exploration and development companies. All references to US$ and $ are to the Unites States dollar. All tabular amounts are in thousands of United States dollars.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of Tethys and its wholly owned subsidiaries and are presented in accordance with generally accepted accounting principles of the United States of America (US GAAP). All significant intercompany transactions and accounts have been eliminated.

In most respects, the accounting policies applied conform to accounting principles generally accepted in Canada (Canadian GAAP). The differences between US GAAP and Canadian GAAP that apply to the Company are explained in Note 19)

Measurement Uncertainty

The preparation of financial statements in conformity with US GAAP requires Management to make estimates and assumptions, and use judgments regarding the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Such estimates primarily relate to unsettled transactions and events as of the date of the Consolidated Financial Statements. Accordingly, actual results may differ from those estimates amounts as future confirming events occur.

Amounts recorded for depreciation, depletion and amortisation, asset retirement costs and obligations and amounts used for ceiling test and impairment calculations are based on estimates of natural gas reserves and the costs to be incurred for developing those reserves. By their nature, these estimates of reserves, including estimates of prices, costs and related future cash flows are subject to measurement uncertainty. Refer to note 7 for additional disclosure relating to the measurement uncertainty specific to the Company's full cost ceiling test.

The amount of valuation allowance against deferred taxes is subject to measurement uncertainty. The estimates, assumption and judgments made in relation to the fair value of stock based compensation and warrants and the associated expense recognition is subject to measurement uncertainty. The estimated fair value of financial assets and liabilities, by their very nature, are subject to measurement uncertainty.

Accordingly, the impact of these estimates, assumptions and judgments on the Consolidated Financial Statements in future periods could be material.

Cash and Cash Equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

Inventory

Inventory is valued at the lower of cost or net realisable value and on a first in, first out basis.

Fair Value of Financial Instruments

The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their carrying amount due to the short term maturity of the instruments. Long term debt and other non-current liabilities have been recorded at amortized cost using the effective interest rate method.

Property, plant and equipment

Oil and Gas Properties

Tethys accounts for oil and gas properties and interests in accordance with the full cost accounting method. Under the full cost method, all directly attributable acquisition, exploration and development costs associated with oil and gas properties are capitalized on a country by country cost centre basis.

Capitalized costs include the cost of drilling and equipping productive wells, including the estimated costs of dismantling and abandoning these assets, dry hole costs, lease acquisition costs, seismic and other geological and geophysical costs, delay rentals and costs related to such activities. General and administrative costs directly attributable to the exploration and development of oil and gas properties are also capitalised.

Proved oil and gas properties

Costs accumulated within each cost centre are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Capitalized costs subject to depletion include estimated future costs to be incurred in developing proved reserves. Proceeds from the divestiture of properties are normally deducted from the full cost pool

without recognition of gain or loss unless that deduction would result in a change to the rate of depreciation, depletion and amortization of 20 percent or greater, in which case a gain or loss is recorded. Costs of major development projects and costs of acquiring and evaluating significant unproved properties are excluded, on a cost centre basis, from the costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties, or impairment has occurred. Costs that have been impaired are included in the costs subject to depreciation, depletion and amortization.

An impairment loss is recognized in net earnings when the carrying amount of a cost centre is not recoverable and the carrying amount of the cost centre exceeds the sum of the discounted cash flows from proved reserves. The discounted cash flow calculation assumes constant pricing, discounts the cash-flows at 10% and takes into account the expected future costs to develop proved reserves, estimated operating expenses and income taxes (the "ceiling amount"). If the ceiling amount is less than the carrying amount, an impairment loss is recognized in the amount of such deficiency.

Unproved oil and gas properties

The costs of investments in unproved properties and portions of costs associated with major development projects are excluded from the calculation of depreciation, depletion and amortization until it is determined whether or not proved reserves are attributable to the properties exist, or impairment has occurred.

In cost centres where proved reserves have been established, significant unproved properties are evaluated periodically, but not less than annually, for impairment. If a reduction in value has occurred, these property costs are considered impaired and are transferred to the related full cost pool. Unproved properties whose acquisition costs are not individually significant are aggregated and the portion of such costs estimated to be ultimately non-productive, based on experience is amortized to the full cost pool over an average holding period.

In cost centres where the existence of proved reserves has not yet been determined, leasehold costs, seismic costs and other costs incurred during the exploration phase remain capitalized in unproved property cost centres until proved reserves have been established or until exploration activities cease or impairment occurs. If exploration activities result in the establishment of a proved reserve base, amounts in the unproved property cost centre are reclassified as proved properties and become subject to depreciation, depletion and amortization and the application of the ceiling test. If exploration efforts are unsuccessful in establishing proved reserves, it may be determined that the value of exploratory costs incurred there have been permanently diminished in part or in whole. Therefore, based on the impairment evaluation and future exploration plans, the unproved property cost centres related to the area of interest could be impaired, and accumulated costs charged against earnings.

Oil and gas equipment

Drilling rigs are carried at cost less accumulated depreciation using the unit of production method based on the number of operating days. Management estimates the useful life of the drilling rigs to be 3,650 operating days. Related drilling rig equipment is depreciated on a straight line basis over the estimated useful life of each asset which ranges from 3 to 15 years.

Corporate assets

Office furniture and fixtures, leasehold improvements and information technology are carried at cost less accumulated depreciation, which is calculated on a straight line basis over the estimated useful life of the asset, which ranges from 3 to 5 years.

Expenditures for major renewals and betterments, which extend the original estimated economic useful lives of applicable assets, are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts and any gain or loss thereon is reflected in operations.

If the carrying amount of the asset is not viewed as recoverable, the asset is considered impaired and the carrying value of the asset is reduced to the estimated recoverable amount. See "Impairment of Long-Lived Assets" below.

Revenue Recognition

Tethys recognizes revenues when hydrocarbons have been produced and delivered and payment is reasonably assured.

Foreign Currency Translation

The US dollar is the functional currency for Tethys and its subsidiaries' operations. All monetary assets and liabilities denominated in foreign currency are translated into US dollars at the rate of exchange in effect at the balance sheet date and the resulting unrealized translation gains or losses are reflected in operations. Non-monetary assets are translated at historical exchange rates. For the Kazakhstan and Tajikistan entities, revenue and expense items (excluding depreciation and amortization which are translated at the same rates as the related assets) are translated at the average rate of exchange. In all other entities, foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of transaction.

Income Taxes

The Company accounts for income taxes under the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The principal temporary differences arise from depreciation on property, plant and equipment, and tax losses carried forward and, in relation to acquisitions, on the differences between the fair values of the net assets acquired and their tax base. Tax rates enacted by the balance sheet date are used to determine the deferred income tax. Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. A valuation allowance is provided for deferred tax assets if management consider it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain.

Impairment of Long Lived Assets

The Company evaluates its long lived assets, other than its oil and gas properties, for impairment using the guidance of Statement of Financial Accounting Standard ("SFAS") 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*. An impairment loss shall be recognized only if the carrying amount of a long-lived asset or asset group is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset or asset group is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset or asset group exceeds its fair value.

Asset retirement obligations

The fair value of estimated asset retirement obligations is recognised in the Consolidated Balance Sheet when incurred and a reasonable estimate of fair value can be made.

Asset retirement obligations include those legal obligations where the Company will be required to retire tangible long lived assets such as producing and exploratory well sites. The asset retirement cost, equal to the initially estimated fair value of the asset retirement obligation, is capitalised as part of the cost of the related long lived asset. Changes in the estimated obligation resulting from revisions to the estimated timing or amount of undiscounted cash flows are recognised as a change in the asset retirement obligation and the related asset retirement cost.

Amortisation of asset retirement costs are included in depreciation, depletion and amortisation expense in the Consolidated Statement of Operations and Comprehensive Loss. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion of asset retirement obligation in the Consolidated Statement of Operations and Comprehensive Loss

Actual expenditures incurred are charged against the accumulated obligation.

Recently Adopted Pronouncements

Fair Value Measurements

As of January 1, 2008 Tethys adopted SFAS 157 *Fair Value Measurements.* This statement replaces multiple existing definitions of fair value with a single definition, establishes a consistent framework for measuring fair value and expands financial statement disclosures regarding fair value measurements. This standard applies where other accounting pronouncements require fair value measurements and does not require new fair value measurements. The adoption of this standard did not have a material impact on the Consolidated Financial Statements.

The Fair Value Option for Financial Assets and Financial Liabilities

As of January 1, 2008 Tethys adopted SFAS 159 *The Fair Value Option for Financial Assets and Financial Liabilities*. This statement permits entities to choose to measure financial assets and liabilities, except those that are specifically scoped out of the Statement, at fair value. The election to measure a financial asset or liability at fair value can be made on an instrument-by-instrument basis and is irrevocable. The Company elected not to adopt the fair value option provisions of SFAS 159 for its financial assets and liabilities. Adoption of this standard did not have a material impact on the Company's Consolidated Financial Statements.

Recently Issued Accounting Pronouncements

In December 2007, the FASB issued SFAS 141 (revised 2007) *Business Combinations* (SFAS 141R), which replaces FASB Statement 141. SFAS 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS 141R requires the acquiring Company to measure almost all assets acquired and liabilities assumed in the acquisition at fair value as of the acquisition date. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 and should be applied prospectively with the exception of income taxes which should be applied retrospectively for all business combinations. Early adoption is prohibited. As the Company is adopting IFRS as of January 1, 2009, the adoption of SFAS 141 will not be applicable.

In March 2008, the FASB issued SFAS 161 *Disclosures about Derivative Instruments and Hedging Activities*, (SFAS 161), an amendment to SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*. SFAS 161 requires enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement would be effective for the Company's interim and annual consolidated financial statements beginning January 1, 2010. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. As the Company is adopting IFRS as of January 1, 2009, the adoption of SFAS 161 will not be applicable.

FUTURE CHANGES IN ACCOUNTING POLICY

The Accounting Standards Board (AsSB) confirmed in February 2008 that Canadian publicly accountable enterprises will be required to report in accordance with International Financial Reporting Standards (IFRS) for financial reporting periods beginning on and after January 1, 2011. As a foreign issuer, Tethys has elected to early adopt IFRS and will report in accordance with IFRS from January 1, 2009. Tethys will prepare its first financial statements under IFRS for the interim period ended March 31, 2009.

NOTE 3 – PREPAYMENTS

Prepayments consisted of the following:

	As at December 31,	
	2008	**2007**
Contractors	1,514	3,062
Other prepayments	900	351
Balance	2,414	3,413

Prepaid contractor amounts relate to suppliers who were paid in advance for materials and services relating to both the Akkulka and the Kul-Bas contracts. For the Akkulka contract, the prepayments relate to the drilling of a new well and payments on compressors, pipes and associated construction work that will constitute phase two of the Company's gas production plan. For Kul-Bas the prepayment related primarily to the drilling of a new well. Refer to note 11 for additional information relating to the above contracts and associated commitments.

Other prepayments primarily relate to prepaid insurance and other corporate operating expense items.

NOTE 4 – NET CHANGES IN NON-CASH WORKING CAPITAL

	Year ended December 31,	
	2008	**2007**
Accounts receivable	(905)	(219)
Inventory	(213)	-
Other current assets	150	(788)
Prepayments	(549)	(20)
Accounts payable	(169)	510
Accruals and other liabilities	625	438
Balance	(1,061)	(79)

Changes in non-cash working capital are categorised below:

	Year ended December 31,	
	2008	**2007**
Operating activities	(844)	(305)
Investing activities	(217)	226
Balance	(1,061)	(79)

NOTE 5 – RESTRICTED CASH

Restricted cash at December 31, 2008 consisted of bank deposits that have been placed to satisfy local Kazakhstan requirements in respect of asset retirement obligations.

NOTE 6 – VALUE ADDED TAX RECOVERABLE

Non-current VAT recoverable represents VAT on capital expenditures in Kazakhstan that is allowed as an offset against VAT on revenues.

NOTE 7 - CAPITAL ASSETS

Capital assets, net of accumulated depletion, depreciation and amortization ("DD&A") and impairment, include the following at December 31, 2008:

	Cost	Accumulated DD&A & Impairment	Net Capital Assets
Oil and gas properties			
Proved properties	56,939	(19,060)	37,879
Unproved properties	13,934	-	13,934
	70,873	(19,060)	51,813
Plant and equipment			
Oil & gas equipment	16,830	(72)	16,758
Oil and gas equipment under construction	3,210	-	3,210
Vehicles	1,388	(187)	1,201
Office equipment, furniture, fixtures and other	967	(156)	811
	22,395	(415)	21,980
Balance	93,268	(19,475)	73,793

Capital assets, net of accumulated of accumulated depletion, depreciation and amortization ("DD&A") and impairment, include the following at December 31, 2007:

	Cost	Accumulated DD&A & Impairment	Net Capital Assets
Oil and gas properties			
Proved properties	39,727	(12,975)	26,752
Unproved properties	7,749	-	7,749
	47,476	(12,975)	34,501
Plant and equipment			
Oil and gas equipment	178	-	178
Oil and gas equipment under construction	1,879	-	1,879
Vehicles	579	(19)	560
Office equipment, furniture, fixtures and other	386	(32)	354
	3,022	(51)	2,971
Balance	50,498	(13,026)	37,472

Proved properties consist of both the Kyzyloi and Akkulka contracts contained within the Kazakhstan cost centre. Following the establishment of commercially viable reserves, the proved properties have been subject to depreciation, depletion and amortisation on a unit of production basis.

Unproved property assets relate to activities being carried out in relation to properties where there are no proved reserves as at December 31, 2008. Unproved property costs split by country cost centres are as follows: Kazakhstan US$11,322,000, Tajikistan US$2,484,000 and other Central Asian countries US$128,000.

In the year ended December 31, 2008, US$414,600 of directly attributable general and administrative expense was capitalised to capital assets (2007 – US$316,200). Capitalised borrowing costs for the year ended December 31, 2008 was US$712,000 (2007 - US$312,000).

Oil & gas equipment includes the deep drilling rig, Telesto, plus ancillary equipment that was purchased during the year ended December 31, 2008. The Company purchased an additional drilling rig, 'Tykhe', during 2008 and this asset was under construction as at December 31, 2008. Consequently, no depreciation expense was recorded in relation to this asset. Refer to Note 11 for information regarding the associated purchase commitments.

In accordance with US GAAP a ceiling test was performed as at December 31, 2008. Calculation of the full-cost ceiling was based on constant prices and proved reserves discounted at 10%. The proved reserves balance is supported by the third party reserves report prepared by the Company's independent petroleum engineers. The ceiling test assumes natural gas sales prices in US$/Mcf as follows:

	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Kyzyloi	0.90	0.90	0.90	0.90	3.80	3.80	-	-	-
Akkulka	3.80	3.80	3.80	3.80	3.80	3.80	3.80	3.80	3.80

The assumed price of US$3.80 per Mcf for future gas sales is supported by the third party reserves report prepared by the Company's independent petroleum engineers, and represents their best estimate of the future price at which such gas will be sold.

As of the date of finalisation of these Consolidated Financial Statements, this price remains the subject of negotiations which have not been finalised. This is a source of measurement uncertainty in the Company's full cost ceiling test calculations since there can be no assurance that this price will be achieved. Using this assumed price of US$3.80 per Mcf, the Company has a ceiling test cushion (i.e. an excess of discounted future cash flows relating to proved reserves over costs subject to depletion) for the Kazakhstan cost centre balance of US$14.6 million. If the actual realised price is lower than US$3.80 per Mcf, then the amount of this ceiling test cushion would be reduced, or potentially eliminated, in which case a ceiling test impairment would be recognised. The ceiling test cushion would be reduced by approximately US$1.8 million for each US$0.10 diminution of the actual realised price below the assumed price of US$3.80 per Mcf.

NOTE 8 – LONG TERM DEBT

	As at December 31,	
	2008	**2007**
Balance, beginning of year	-	3,084
Proceeds from long term debt issued	7,430	-
Current portion of long term debt	(853)	-
Debt discount	(1,163)	-
Amortisation of debt discount	258	1,916
Principal loan repayments	(576)	(5,000)
Balance, end of year	5,096	-

Drilling rig Telesto

On March 19, 2008 the Company completed a financing arrangement for funds of US$5,300,000 to assist with the purchase of a deep drilling rig (Telesto) by means of a 3-year loan with monthly payments of interest and capital and a final balloon payment. The interest payable on the borrowed funds was 12% per annum. In addition, 795,000 warrants to purchase Tethys shares were also issued to the lenders with a term of 3 years and an exercise price of CAD$3.25. The fair value of the warrants issued was calculated using the Black-Scholes option pricing model. For warrants granted in connection with the loan financing agreement, the fair value on grant date was US$1.23 per warrant, using the following assumptions: dividend yield of 0%; expected term of 3.0 years; a risk free interest rate of 1.64%; and an expected volatility of 69%. Fair value of the warrants issued is US$980,394.

The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt. The effective interest rate method has been applied and results in the amortisation of the debt discount over the life of the loan. For the year ended December 31, 2008, US$257,935 was amortised (2007 - $Nil).

Lenders have security over the shares of Tethys Petroleum Inc. which has no other assets except the drilling rig. No corporate guarantees or security are being provided by Tethys. Borrowing costs of US$712,000 were capitalised to the asset (2007 - $Nil).

Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities, the fair value of long term debt relating to the Telesto drilling rig is US$3,632,968 (2007 - US$Nil).

Principal repayments on the loan amount are required to be made as follows:

		US$'000
To December 31,	2009	853
	2010	962
	2011	2,909
Balance		4,724

Drilling rig 'Tykhe'

At December 31, 2008 the Company received funds of US$2,130,000 relating to a financing arrangement to assist with the purchase of a second drilling rig (Tykhe). The term of the loan is 3-years. In the first year, quarterly payments of interest only are required. In years two and three, monthly payments of interest and capital are payable. A balloon payment is due at the end of year three. The interest payable on the borrowed funds is 15% per annum. In addition, 638,298 warrants to purchase Tethys shares were issued to the lenders with a term of 3 years and an exercise price of CAD$1.25. The fair value of the loan was calculated using the Black-Scholes option pricing model. For warrants granted in connection with the loan financing agreement, the fair value on the date of grant was US$0.29 per warrant, using the following assumptions: dividend yield of 0%; expected term of 3.0 years; a risk free interest rate of 1.15%; and an expected volatility of 85%. Fair value of the warrants issued is US$182,234.

The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt. The effective interest rate method has been applied and results in the amortisation of the debt discount over the life of the loan. For the year ended December 31, 2008, no amortisation was incurred as the funds were received on December 31, 2008 (2007 - $Nil).

Investors have been granted security over the shares of AOE Tykhe BV which has no other assets except the drilling rig. A corporate guarantee is being provided by Tethys.

As loan financing terms for the Tykhe drilling rig were concluded in December 2008, the carrying value of the loan approximates its fair value at December 31, 2008.

Principal repayments on the loan amount are required to be made as follows:

		US$'000
To December 31,	2009	-
	2010	493
	2011	1,637
Balance		2,130

NOTE 9 – NON CURRENT LIABILITIES

Other non-current liabilities relates to the accrual of Historic Costs due to the Government of Kazakhstan on the Kyzyloi contract in Kazakhstan. The principal amount outstanding at December 31, 2008 was US$908,098 and this is to be paid in quarterly instalments between January 2009 and March 2014.

The liability is non-interest bearing. The liability is measured at amortised cost using the effective interest rate method. The net present value of liability using an assumed rate of interest of 10% is US$680,000 of which US$157,000 is current, leaving a non-current balance of US$523,000.

Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities, the fair value of non current liability relating to historic costs is US$508,441 (2007 - US$Nil).

NOTE 10 – ASSET RETIREMENT OBLIGATION

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 assets:

	As at December 31,	
	2008	**2007**
Asset retirement obligation , Beginning of year	661	451
Liabilities incurred	274	175
Change in estimated future cash flow	(558)	-
Accretion expense	56	35
Asset retirement obligation, End of year	433	661

The total undiscounted amount of estimated cash flows required to settle the obligation is US$645,000 (2007 – US$1,600,000) which has been discounted using a weighted average credit adjusted risk free rate of 10% (2007 – 10%), Most of these obligations are not expected to be settled for several years in the future.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Kyzyloi Field Licence and Gas Production Contract

The Kyzyloi Field License and Gas Production Contract initially agreed on June 12, 2007. An amendment was granted on November 8, 2007 which extended the terms of the contract to June 13, 2014 with a commitment to spend an additional US$2,687,000 on a minimum work program focused on the development of the contractual territory. At December 31, 2008 the above commitment had been satisfied. The Company has committed to an additional minimum work program for 2009 which requires US$100,000 to be spent in completing work-overs in the contractual territory.

Akkulka Field Exploration Licence and Contract

Tethys Aral Gas ("TAG") a wholly owned subsidiary of the Company is the sole party to the Akkulka Field Exploration License and Contract #265 dated November 17, 1998. The contract initially granted TAG the exploration rights for a period of 5 years, however, the terms of the contracts have been extended to September 17, 2009 through subsequent amendments to the original contract. The latest amendment signed on November 8, 2007 committed the Company to spend an additional US$1,850,000 on a minimum work program focused on the exploration of the contractual territory. The Company is required to meet this commitment by September 17, 2009. The Company has agreed the 2009 minimum work programme with the Government and is committed to spending US$1,170,500 on exploration and development activities in 2009 which will satisfy the remaining commitments.

Furthermore, contingent upon commencement of commercial production on the Akkulka contractual territory, an additional payment in the amount of US$3,500,000 will be due to the Kazakhstan Government as a reimbursement of historical costs previously incurred by the Government in relation to the contractual territory. The amount and procedure of reimbursement will be subject to the terms and conditions to be set out in the production contract, which is yet to be agreed.

Kul-Bas Exploration and Production Contract

Kul-Bas LLP, a wholly owned subsidiary of the Company, owns a 100% interest in "Kul-Bas Exploration and Production Contract" #1897 dated November 11, 2005 (also known as "Greater Akkulka Exploration and Production Contract"), which was concluded for 25 years (first 6 years of exploration and 19 years of production). Under the contract 100% of crude oil produced in the exploration phase is required to be sent to Kazakh refineries. On commencement of commercial production, at least 20% of produced crude oil should be sent to Kazakh refineries. Any associated gas is required to be utilized in accordance with the applicable environmental legislation.The initial minimum work program for the contractual territory resulted in commitment of US$7,700,000. The minimum work program agreed for 2009 is US$706,000 for the acquisition and processing of new seismic. The remaining commitment of US$2,894,000 is required to be satisfied by November 11, 2011.

In addition to the minimum work program commitments, the Kazakhstan Government is to be compensated for the historical costs related to the contractual territory in the amount of US$3,275,780. The Company has previously paid an amount of US$49,137 in relation to this balance. No further payments on this balance are required until commencement of commercial production within the contractual territory. If and when commercial production commences, US$88,666 is due in quarterly installments until the remaining historical costs of US$3,226,643 has been paid in full.

Sales Contract

On January 5, 2006 Tethys' Kazakh subsidiary, TAG, executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from TAG's Kyzyloi field in Kazakhstan. In December 2007 this contract was assigned to Kazakhstani Petrochemical Company Kemikal LLP ("KNK").

The contracted price is US$0.90 per thousand cubic feet (Mcf) (US$32 per thousand cubic metres (Mcm)) plus VAT which was 13% in 2008 moving to 12% in 2009. The VAT receipts can be offset against VAT costs incurred on the Kyzyloi project. The Gas Supply Contract has a term until the earlier of December 1, 2012, the contract termination date, or until such time as a cumulative quantity of 850 thousand cubic metres (Mcm) of natural gas is delivered. The contract is based on a take–or–pay principle and covers all gas produced from the Kyzyloi Field Licence and Production Contract area up to termination. As at December 31, 2008, 17.55% of the contract volume had been delivered.

Tajikistan

On June 13, 2008, the Company's wholly owned subsidiary, Kulob Petroleum Limited ("KPL"), signed a Production Sharing Contract ("PSC") with the Government of the Republic of Tajikistan. Under the PSC, KPL will recover 100% of its costs from up to 70% of total production (the maximum allowed under the newly approved production sharing legislation of Tajikistan) and the remaining production (termed "Profit Oil and Gas") will be shared 70% to KPL and 30% to the Government whose share includes all taxes, levies and duties. The terms are fixed over the life of the PSC which is a minimum of 25 years.

Pursuant to the PSC, Tethys has committed to funding a work program designed to provide data for a focused exploration of the Contract Area and which will be carried out in two stages (the "Work Program"). The first phase of the Work Program will include geological studies, reprocessing of existing seismic and other geophysical data, acquisition of seismic and other geophysical data and the commencement of initial rehabilitation activities on the Beshtentyak and Khoja Sartez fields. The minimum spend commitment under Phase 1 of the contract is US$3,000,000. This expenditure must be met within 18 months on the effective date of the contract, which is December 13, 2009. This commitment will be satisfied through a contract agreed on November 14, 2008 relating to a seismic survey work program which commits the company to expenditure of US$4,925,300.

Drilling Rig Telesto

On October 16, 2007, Tethys placed an order for a new 2,000 horsepower (1,470 kN) ZJ70/4500L drilling rig (Telesto) from a Chinese supplier. The rig has a nominal drilling depth of 23,000 feet (7,000 metres). The rig was transported from China to Kazakhstan arriving in September 2008 for use on the Akkulka deep exploration program, and though drilling commenced on December 9, 2008 it stopped soon after because of technical problems. The cost of the rig is US$6,263,000 and at December 31, 2008 the final payment of US$313,150 (5%) remained outstanding but will be made after resolution of the technical problem and completion of a successful operating period.

Drilling Rig Tykhe

On July 25, 2008 Tethys placed an order for a new ZJ30 truck mounted rig (Tykhe) at a cost of US$5,350,000. The Company paid the rig deposit of US$1,605,000 in July 2008 and a stage payment of the same amount in September 2008. The third installment of US$1,872,500 will be due upon delivery in early 2009 and the final payment of US$267,500 will be made after assembly and a successful operating period.

Coiled Tubing Unit

In September 2008, Tethys placed an order for a new Coil Tubing Unit at a cost of US$1,110,000. The Company paid a deposit of US$80,000 in October 2008 with the balance of US$1,030,000 due upon delivery in early 2009.

Operating leases

Operating leases consist primarily of leases for offices. Lease commitments are as follows:

	Total	**Less than 1 year**	**1 – 3 years**	**4-5 years**
Operating leases	847,956	645,852	202,104	-

NOTE 12 – INCOME TAXES

Tethys is domiciled in the Cayman Islands which has no company income tax.

At December 31, 2008 the Company's Kazakhstan based subsidiary Tethys Aral Gas LLP had net operating loss carry forwards ("NOLs") for income tax purposes of approximately US$4,393,500. If the NOLs are not utilized to reduce taxable income in future periods, they will expire in various amounts from 2012 through 2015. The Company has established a valuation allowance for deferred taxes equal to its entire net deferred assets as management currently believes that it is more likely than not that these losses will not be utilized.

Under the Bokhtar PSC in Tajikistan, the State's production share includes all Tajik taxes, levies and duties however no revenue was generated from the Company's Tajikistan operations in 2008.

NOTE 13 –STOCKHOLDERS' EQUITY

The Company is authorised to issue 700,000,000 common shares (2007 - 500,000,000) and 50,000,000 (2007 – nil) preference shares.

On June 27, 2008 Tethys successfully completed a public offering, having placed 21,276,596 shares at a price of US$2.35 (CAD$2.39), raising US$50,000,000 (gross). The ordinary shares are listed on the Toronto Stock Exchange.

At the Annual General Meeting on April 24, 2008 the authorized share capital of the Company was increased by an additional 200,000,000 ordinary shares and 50,000,000 preference shares. The preference shares have the rights as set out in the Memorandum and Articles of Association approved at the AGM on April 24, 2008. Significant terms related to preference shares are summarized below:
may be issued in one or more series;
are entitled to any dividends in priority to the ordinary shares;
confer upon the holders thereof rights in a winding-up in priority to the ordinary shares;
may have such other rights, privileges and conditions (including voting rights) as the Board may determine prior to the first allotment of any series of preference shares, provided that if a series of preference shares has no or limited voting rights it shall be designated as such by the Board.

There are currently no preference shares outstanding.

NOTE 14 - STOCK BASED COMPENSATION

The Company has adopted a stock incentive plan referred to as the "2007 Long Term Stock Incentive Plan" pursuant to which the Company may grant stock options to any director, employee or consultant of the Company, or any subsidiary or Vazon Energy Limited (collectively, "Service Providers"). The purpose of the plan is to secure for the Company and its shareholders the benefits of incentives inherent in share ownership by employees and service providers who, in the judgment of the Board of Directors, will be largely responsible for its future growth and success.

The maximum number of Ordinary Shares reserved for issuance subsequent to the initial Purchase Offer on the Toronto Stock Exchange under the plan equals 10% of the outstanding Ordinary Shares after giving effect to the Treasury Offering. The plan is administered by the Compensation and Nomination Committee of the Board of Directors. Options may be granted pursuant to recommendations of the Compensation and Nomination Committee. The Compensation and Nomination Committee may determine the vesting schedule and term, provided that options may not have a term exceeding ten years. Subject to any resolution passed by the Compensation and Nomination Committee, options will terminate three months after an optionee ceases to be a Service Provider.

The exercise price of options granted under the plan may not be less than the closing price of Ordinary Shares on the principal stock exchange where the Ordinary Shares are listed as of the date of the option grant. The plan contains amendment provisions which allow amendments to the plan by the Board of Directors, without shareholder approval, for amendments of a "housekeeping" nature, changes to vesting or termination provisions, and discontinuance of the plan. The plan also provides that outstanding options will vest immediately on the occurrence of a "change of control" (as defined in the plan). Options granted under the plan are only assignable to certain related entities of an optionee or otherwise with the consent of the Company.

The following table summarizes the stock option activity under the 2007 Long Term Stock Incentive Plan:

	2008			**2007**		
	Number of options	Weighted average exercise price	Weighted average remaining term	Number of Options	Weighted average exercise price	Weighted average remaining term
Outstanding at December 31, 2007	4,497,000	2.76		-	-	-
Granted	2,274,000	2.51		4,497,000	2.76	-
Forfeited	(96,000)	2.75		-	-	-
Exercised	-	N/A		-		-
Expired	-	N/A		-		-
Outstanding at December 31, 2008	6,675,000	2.67	5.84	4,497,000	2.76	6.57
Exercisable at December 31, 2008	3,692,000	2.71	5.71	1,499,000	2.76	6.57

For options granted during the fiscal year ended December 31, 2008, the weighted average fair value on the date of grant, estimated using the Black-Scholes option pricing model, was $1.5493 per option, using the following weighted average assumptions: dividend yield of 0%; expected term of 4.0 years; a risk free interest rate of 3.32%; and an expected volatility of 73.5%. The options will vest over a period of two years.

For the fiscal year ended December 31, 2008, there was $3.9 million of pre-tax compensation expense for options granted under the 2007 Long Term Stock Incentive Plan. As of December 31, 2008, there was $2.8 million of total unrecognized compensation expense related to unvested stock options granted under the plan. The Company expects to recognize the expense over a weighted-average period of 1.09 years.

NOTE 15 - WARRANTS

2017 warrants

On February 14, 2007, the Company agreed to issue, and on June 8, 2007 the Company issued certain warrants (the "2017 Warrants") to purchase an aggregate of 2,090,000 Ordinary Shares. The 2017 Warrants relate to the January 24, 2007 private placement of Ordinary Shares and the recipients included, among others, a number of members of management of Tethys. The 2017 Warrants are exercisable at US$2.50 through the period ending June 2017.

Performance warrants

The Company has approved the grant to its executive officers of warrants (the "Performance Warrants") to acquire 6,767,504 Ordinary Shares as follows:

Exercise period ending	Exercise price (US$)	Number of ordinary shares
December 25, 2009	4.125	1,353,501
June 25, 2011	5.500	2,255,835
December 25, 2012	6.875	3,158,168

Warrants issued in connection with loan financing

During the fiscal year ended December 31, 2008, there were 1,433,298 warrants issued in connection with loan financing and a total cost of US$1,162,628. Refer to note 8 for further information.

The following table summarizes the warrant activity, including Performance Warrants, for the fiscal year ended December 31, 2008.

	2008			2007		
	Number of Warrants	Weighted Average Exercise Price	Weighted average remainin g term	Number of Warrants	Weighted average exercise price	Weighted average remaining term
Outstanding at December 31, 2007	10,203,658	4.04	-	1,346,154	2.50	-
Granted	1,433,298	2.33	-	8,857,504	5.07	
Forfeited	-	-	-	-		-
Exercised	-	-	-	-		
Expired	-	-	-	-		
Outstanding at December 31, 2008	11,636,956	3.82	3.89	10,203,658	4.04	4.88
Exercisable at December 31, 2008	11,636,956	3.82	3.89	10,203,658	4.04	4.88

As at December 31, 2008 all options and warrants were out of the money.

NOTE 16 - NET LOSS PER COMMON SHARE

Basic net loss per common share is computed by dividing the net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the applicable period. Diluted per share information is calculated, including the dilutive effect of stock options which are determined using the treasury stock method. The treasury stock method assumes that the proceeds that would be obtained upon exercise of “in the money” options would be used to purchase common shares at the average market price during the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

NOTE 17 - RELATED PARTY TRANSACTIONS

Vazon Energy Limited (“Vazon”) is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services from Vazon in the fiscal year ended December 31, 2008 was US$1,070,156 (2007 - US$522,237).

Kraken Financial Group (KFG) has a common director with the Company. In 2008, KFG was engaged by the Company to assist in obtaining loan financing in relation to the purchase of both Telesto and Tykhe drilling rigs. As a result of the services provided in connection with the Telesto transaction, KFG received 6% commission of the funds it was responsible for introducing to the Company. This commission is to be taken in the form 81,447 shares, which were yet to be issued at year end. As a result the Company has recognized a liability for US$234,000 (2007 - US$Nil). In relation to similar services provided in connection with the loan financing of the Tykhe drilling rig, KFG received commission of US$21,000 (2007 - US$Nil).

KFG also acted as broker for Tethys in the placement of various insurance policies, including Directors & Officers, for which the combined annual premiums were US$112,615 (2007 - US$112,000).

Oilfield Production Consultants (OPC) Ltd and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to the optimization of the existing compressors and those to be installed as part of Phase 2 gas production from Akkulka, and has consulted on certain reservoir modelling work on projects in Tajikistan. Total fees in the fiscal year ended December 31, 2008 were US$395,531 (2007- US$Nil).

Transactions with affiliates or other related parties including management of affiliates are to be undertaken on the same basis as third party arms-length transactions and have been recorded at their exchange amounts.

NOTE 18 – SUBSEQUENT EVENTS

On January 13, 2009 1,400,000 Tethys ordinary shares were issued in part settlement of the purchase of a Coil Tubing Unit the Company subsidiary Asia Oilfield Equipment BV.

On January 16, 2009 the Company announced that it had signed a 1-year gas sales contract with OJSC Kulyabgaz to supply gas to the town of Kulob in Southern Tajikistan. The price under the contract is fixed for the period of the contract at 300 Somoni (approximately USD86 per thousand cubic metres ("Mcm") (USD2.44 per thousand cubic feet ("Mcf")) and the initial contract is to supply up to 65,000 cubic metres (2.3 million cubic feet) of gas per day.

On February 27, 2009 the Company announced that its 100% subsidiary, Tethyda Limited, had signed an agreement, under which subject to certain regulatory requirements, corporate approvals and additional conditions, it is to acquire from the British company, Rosehill Energy plc ("Rosehill"), its wholly-owned subsidiary ("the Contractor") which holds Rosehill's entire interest in the Production Enhancement Contract ("PEC") for the North Urtabulak Oil Field in Uzbekistan. The consideration for the purchase of this project is 15,000,000 (fifteen million) ordinary shares of Tethys.

These shares will be restricted for resale for a period of up to one (1) year. The value of the transaction (based on a Tethys share price of US$0.42 calculated as the 5 day volume weighted average ending on February 25, 2009) is approximately US$6.5 million.

NOTE 19 – CANADIAN ACCOUNTING PRINCIPLES AND REPORTING

The Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) which in most respects conform to Canadian generally accepted accounting principles (Canadian GAAP). The differences between US GAAP and Canadian GAAP that apply to the Company are explained in this note.

RECONCILIATION OF NET EARNINGS BETWEEN US GAAP AND CANADIAN GAAP

	Year ended December 31,	
	2008	**2007**
Net loss and comprehensive loss after tax for the year under US GAAP	(22,627)	(41,779)
Impairment charge on proved properties	-	12,800
Additional DD&A on proved properties	(1,928)	-
Net loss and comprehensive loss after tax for the year under Canadian GAAP	(24,555)	(28,979)
Basic and diluted loss per share under Canadian GAAP	(0.44)	(0.87)

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT – CANADIAN GAAP

	Year ended December 31,	
	2008	**2007**
Operating Revenue	5,360	194
Expenses		
Operating expenses	1,334	19
Selling, general & administrative expense	13,421	9,461
Stock based compensation	3,945	17,624
Depreciation, depletion & amortization	8,377	257
Other (net)	2,837	1,812
Loss before income tax for the year under Canadian GAAP	(24,555)	(28,979)
Income Tax	-	-
Net Loss and Comprehensive Loss after tax for the year under Canadian GAAP	(24,555)	(28,979)
Deficit – Beginning of the year	(38,825)	(9,846)
Deficit – End of year	(63,380)	(38,825)

CONDENSED CONSOLIDATED BALANCE SHEET

	As at December 31,	
	2008	**2007**
Assets		
Current assets	25,077	28,052
Non current assets	6,944	6,132
Capital assets	84,665	50,272
Total assets	116,686	84,456
Liabilities and stockholders' equity		
Current liabilities	3,588	2,279
Non current liabilities	6,052	1,437
Total stockholders' equity	107,046	80,740
Total liabilities and stockholders' equity	116,686	84,456

Impairment of oil and gas properties under Canadian GAAP

Under Canadian GAAP, an impairment loss is recognised in net earnings when the carrying amount of a cost centre is not recoverable and the carrying amount of the cost centre exceeds its fair value. The carrying amount of the cost centre is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited to the amount by whichthe carrying amount exceeds the sum of:

(i) the fair value of proved and probable reserves
(ii) the costs of unproved properties that have been subject to a separate impairment test

Due to differences between the accounting treatment permitted under Canadian GAAP and the Company's accounting policy under US GAAP, the Company recorded an impairment charge of US$12,800,000 in the 2007 US GAAP financial statements as US GAAP permits the use of only proved reserves in the calculation of the full cost ceiling. However, as Canadian GAAP permits the use of proved and probable reserves and forecast pricing in calculating the full cost ceiling, no impairment charge was required for either 2008 or 23007. Under the Canadian GAAP ceiling test the forecast prices would have been as follows:

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Natural gas US$/Mcf									
Kyzyloi	0.90	0.90	0.90	0.90	5.43	5.65	-	-	-
Akkulka	3.80	4.16	4.47	4.68	5.43	5.65	5.86	6.07	6.25

19 (A) - RECENTLY ADOPTED STANDARDS – CANADIAN GAAP

On January 1, 2008, the Company adopted the following CICA Handbook Sections

"Inventories", Section 3031. This new standard replaces the previous standard in Section 3030 and requires inventory to be valued on a first in, first out basis or weighted average cost basis, which is consistent with Tethys former accounting policy. The new standard allows the reversal of previous write downs to net realizable value when there is a subsequent increase in value. The adoption of this standard has had no material effect on the Consolidated Financial Statements.

"Capital Disclosures", Section 1535. This new standard requires the Company to disclose its objectives, policies and processes for managing capital. For related disclosure, refer to note 19 (C).

"Financial Instruments – Presentation", Section 3863 and "Financial Instruments – Disclosures", Section 3862. The new disclosure standard increases Tethys' disclosures regarding the nature and extent of the risk associated with financial instruments and how those risks are managed. For the related disclosure, refer to note 19 (D). The new presentation standard carries forward the former presentation requirements.

19 (B) - RECENT ACCOUNTING PRONOUNCEMENTS – CANADIAN GAAP

The Accounting Standards Board (AsSB) confirmed in February 2008 that Canadian publicly accountable enterprises will be required to report in accordance with International Financial Reporting Standards (IFRS) for financial reporting periods beginning on and after January 1, 2011. Tethys has elected to early adopt IFRS and will report in accordance with IFRS from January 1, 2009. Tethys will prepare its first financial statements under IFRS for the interim period ending March 31, 2009.

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets" which will replace Section 3062 and be effective January 1, 2009. This new standard revises the criteria for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company currently has no Goodwill or Intangible Assets. As the Company is adopting IFRS on January 1, 2009, the adoption of CICA 3064 will not be applicable.

19 (C) - CAPITAL DISCLOSURES

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its expenditures on commitments from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity. During the year, the Company also entered into long term debt agreements to finance the purchase of two drilling rigs. These loans are not subject to any externally imposed capital requirements.

As the Company is engaged in acquiring properties and exploring for crude oil and natural gas, it does not currently have sufficient revenue generating activities to fund all of the company's commitments. The Company is therefore required to fund a significant portion of its commitments from existing cash and cash equivalent balances or seek additional financing through debt issuances or equity markets (refer note 1).

Financing decisions are made by Management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plan. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which the financing is available and in consideration of the balance between shareholder value creation and prudent financial risk management.

Debt levels are monitored by using the non-GAAP financial metric of Net Debt to Capitalization. Net Debt is calculated as the sum of long term debt balances (including the current portion) less the balance of cash and cash equivalents. There was no Net Debt at December 31, 2008 as the cash and cash equivalents significantly exceeded the total of long term loans. The Company had no outstanding loans at December 31, 2007.

19 (D) - FINANCIAL INSTRUMENTS AND RISK DISCLOSURES

Financial Instruments

Financial instruments of the Company consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and long term debt. The Company's cash and cash equivalents are designated as held-for-trading and 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 recorded at amortized cost, which approximates fair value due to the short term nature of the instrument.

Accounts payable and accrued liabilities are designated as other liabilities and are recorded at amortised cost. The fair value of accounts payable and accrued liabilities approximate their carrying values due to the short term nature of these instruments.

Long term debt is designated as other liabilities and held at amortised cost using the effective interest method of amortisation. The estimated carrying values of long term borrowings have been determined based on market information where available, or by discounting future payments of interest and principle at estimated interest rates expected to be available to the Company at year end. Fair value of long term debt has been disclosed at note 8. Fair value of non-current liabilities has been disclosed in note 9.

Financial risks

The Company is exposed to credit risk, liquidity risk and funding risk. The following is a description of those risks and how the Company manages exposure to them:

Credit Risk
Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations. Credit risk arises from the Company's cash and cash equivalents and accounts receivable balances.

Although Tethys' cash and cash equivalents and accounts receivable are exposed to potential credit loss, Tethys does not believe such risk to be significant.

In order to reduce concentration of credit risk associated with cash and cash equivalent balances, the Company has spread its cash investments over three recognised financial institutions with appropriate credit ratings. The Board of Director's are required to approve financial institutions prior to any significant investments being made. Although a significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss.

Concentration of credit risk associated with accounts receivable balances is as a result of contracted gas sales to only one customer during the period. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. Although a portion of the Accounts receivable balance has been outstanding more than 60 days as at December 31, 2008, the Company has not recorded a provision against the amount as it does not consider the balance to be impaired.

Liquidity Risk
Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. This risk relates to the Company's ability to generate or obtain sufficient cash or cash equivalents to satisfy these financial obligations as they become due. The Company's processes for managing liquidity risk includes preparing and monitoring capital and operating budgets, coordinating and authorizing project expenditures, and ensuring appropriate authorization of contractual agreements. The budget and expenditure levels are reviewed on a regular basis and updated when circumstances indicate change is appropriate. The Company seeks additional financing based on the results of these processes.

The timing of cash outflows relating to financial liabilities and commitments are summarized below:

	Less than 1 year	1 – 3 years	4 – 5 years	Thereafter	Total
Accounts payable and accrued liabilities	2,735	-	-	-	2,735
Long term debt[1]	1,676	6,850	-	-	8,526
Non current liabilities	173	519	216	-	908
Purchase commitments	10,385	-	-	-	10,385
Operating lease commitments	646	201	-	-	847
Total expected cash outflow	15,615	7,570	216	-	23,401

[1]Principal and interest, including current portion

Recent market turbulence has increased liquidity risk faced by the Company. In particular, significant declines in energy prices, decline in the market price for the Company's shares and a potential decline in the ability of the Company to access the capital markets. This increased risk has the potential to impact on the Company's planned exploration and development projects. The Company does not currently have plans to curtail planned projects that commenced in 2008 or that are included in the contractual commitments discussed at note 11. Management and the Board of Directors reviews the Company's cash and cash equivalent balances against the Company's commitments and assesses the timing and need for additional equity or debt financing on a regular basis. As a result, some of the Company's growth plans have been suspended until such time as the position of the markets becomes clearer, particularly in respect to future gas pricing, production revenues and fund raising opportunities that may be available to the Company. The overall focus of the short-term work programs are aimed primarily at development and production enhancement projects which will enhance short to medium term cash flow rather than pure exploration projects.

In Kazakhstan, the Company's current plans are limited to satisfying the 2009 minimum work program for each of the three contracts. In Tajikistan, the Company intends to initiate its exploration work with an extensive seismic survey while carrying out rehabilitation and work-over activities on existing deposits, to construct field reservoir models and consider horizontal and inclined drilling, field pressure support and similar techniques to increase production of oil and gas, and to look at cost effective approaches to deepening existing wells to test exploration targets. For details of the Company's contractual commitments at December 31, 2008 refer to note 11. For additional details in relation to long-term debt liabilities, refer to note 8.

There can be no assurance that debt or equity financing will be available or sufficient to meet the Company's requirements or if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial condition, results of operations and prospects.

Market Risks
Market risk is the risk of loss that may arise from changes in market factors such as commodity prices, interest rate and foreign exchange rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact any interest earned on the Company's cash and cash equivalent. The Company is also exposed to foreign exchange risk as it operates in Kazakhstan, Tajikistan and the British Isles.

Commodity Price Risk
Commodity price risk arises from the effect that fluctuations of future commodity process may have on the price received for sales of gas products. The marketability and price of natural gas that is produced and may be discovered by the Company will be affected by numerous factors that are beyond the control of the Company.

Natural gas prices are subject to wide fluctuations, The Company has entered into a fixed price contract for sales of gas from the Kyzyloi field. However, any material decline in natural gas prices could result in a reduction of Tethys' future net production revenues and impact on the commercial viability of the Company's existing and future oil and gas discoveries. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in the volumes and the value of Tethys' gas reserves. Tethys might also elect not to produce from certain wells at lower prices.

Interest Rate
Interest rate risk is the risk that the value of a financial instrument will be affected by changes in market interest rates. Existing long term debt is agreed at fixed interest rates and consequently has limited exposure to changes in market interest rates.

The Company is exposed to interest rate risk to the extent that significant reductions in market interest rates will result in a decline in the amount of interest earned on the Company's cash and cash equivalent balances. Assuming that the Company maintains the level cash and cash equivalents held at December 31, 2008 for a whole year then a change in interest rates of 1% would increase/decrease the interest earned by an amount of $200,000.

Foreign exchange risk
The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates. A material change in the value of any such foreign currency could result in a material adverse effect on the Company's cash flow and future profits. To the extent revenues and expenditures denominated in or strongly linked to the U.S. dollar are not equivalent; the Company is exposed to exchange rate risk. In addition, a significant portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. These currencies are difficult to hedge. Due to the small amount of Tenge and Somoni held at December 31, 2008 had the US dollar changed by one percent against the Kazakhstan Tenge or Somoni, with all other variables held constant, the Company's foreign exchange gain or loss would have been negligible.

The Company is not currently using exchange rate derivatives to manage exchange rate risks but is attempting to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan.

The Company holds the majority of its cash and cash equivalents in US dollars. However, the Company maintains deposits in other currencies, mainly British Pounds Sterling ("GBP") and Canadian dollars ("CDN") in order to fund ongoing general and administrative activity and other expenditure incurred in these currencies. In addition, a significant portion of the funds received in the June 2008 equity financing transaction were received in Canadian dollars. In 2008, the Company had a policy of holding Euros to meet anticipated costs of purchasing oil & gas drilling equipment, casing, drill pipe and similar (as these items were priced at that time in Euros) but this practice ceased prior to December 31, 2008.

With regard to the GBP had the US dollar changed by one percent at December 31, 2008, with all other variables held constant, the Company's foreign exchange gain or loss would have been affected by US$23,000. In relation to the Canadian dollar, had the US dollar changed by one percent, the foreign exchange gain or loss would have been affected by US$35,000.

For additional information on Risk Factors please refer to the Company's AIF.

Fair Value of Financial Assets and Liabilities

Financial instruments are 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 accounting standard.

The Company's cash and cash equivalents are designated as held-for-trading and are measured at fair value. Accounts receivable are designated as loans and receivables and measured at amortized cost using the effective interest rate method.

Accounts payable, accrued liabilities and long term debt are designated as other liabilities and are recorded at amortized cost using the effective interest rate method.. Tethys capitalizes long term debt transaction costs, premiums and discounts. These costs are capitalized within long term debt and amortized using the effective interest rate method. The fair value of obligations under the loans approximate their carrying values as the interest rates applicable to these instruments reflect current market rates.

NOTE 20 – COMPARATIVES

Certain prior periods' amounts have been reclassified to conform to the current period's presentation.