Canadian Overseas Petroleum Limited

Consolidated Financial Statements

As at and for the years ended December 31, 2011 and 2010

Management's Responsibility for Consolidated Financial Statements

The information provided in these consolidated financial statements, is the responsibility of management. In the preparation of the statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying consolidated financial statements.

Management maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to facilitate the preparation of relevant and timely information.

Deloitte & Touche LLP was appointed by the shareholders to serve as the Company's external auditors. They have examined the consolidated financial statements and provided their independent auditor's report. The audit committee has reviewed the consolidated financial statements with management and the auditors, and has reported to the Board of Directors. The Board of Directors has approved the consolidated financial statements as presented.

Signed "Arthur S. Millholland"
Arthur S. Millholland
President and Chief Executive Officer
March 28, 2012

Signed "Aleksandra Owad"
Aleksandra Owad
Chief Financial Officer
March 28, 2012

Independent Auditor's Report

To the Shareholders of Canadian Overseas Petroleum Limited

We have audited the accompanying consolidated financial statements of Canadian Overseas Petroleum Limited, which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of comprehensive loss, consolidated statements of changes in equity, and consolidated statements of cash flows for the years ended December 31, 2011 and December 31, 2010, and the notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Canadian Overseas Petroleum Limited as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2 to the consolidated financial statements which indicates that Canadian Overseas Petroleum Limited is pursuing exploration projects and contracts that, if successful, will require substantial additional financing. Canadian Overseas Petroleum Limited incurred a loss of $53.4 million during the year ended December 31, 2011 (2010: $9.3 million) and had negative cash flows from operating activities of $16.8 million (2010: $6.2 million). These conditions, along with other matters as set forth in Note 2, indicate the existence of a material uncertainty that casts significant doubt about Canadian Overseas Petroleum Limited's ability to continue as a going concern.

Signed "Deloitte & Touche LLP"

Chartered Accountants

March 28, 2012
Calgary, Alberta

Canadian Overseas Petroleum Limited
Consolidated Statements of Financial Position
(in thousands of Canadian dollars)

	December 31, 2011	December 31, 2010	January 1, 2010
Assets			
Current			
Cash and cash equivalents *(note 4)*	**$ 71,924**	$ 37,403	$ 1,439
Accounts receivable	**446**	83	75
Prepaid expenses	**163**	22	277
	72,533	37,508	1,791
Deposit for seismic data *(note 5)*	**15,255**	-	-
Deposits and prepayments	**43**	43	70
Exploration and evaluation assets *(note 6)*	**20,594**	-	-
Office equipment	**227**	59	70
	$ 108,652	$ 37,610	$ 1,931
Liabilities			
Current			
Accounts payable and accrued liabilities	**$ 2,407**	$ 989	$ 1,901
Provision for loss on UK contracts *(note 7)*	**32,641**	-	-
Loan	**-**	-	1,802
	35,048	989	3,703
Shareholders' Equity			
Share capital *(note 8)*	**100,768**	41,833	8,063
Warrants *(note 9)*	**37,359**	11,007	306
Contributed capital reserve *(note 9)*	**9,113**	4,317	1,074
Deficit	**(73,964)**	(20,536)	(11,215)
Accumulated other comprehensive income	**328**	-	-
	73,604	36,621	(1,772)
	$ 108,652	$ 37,610	$ 1,931

Nature of operations (note 1)
Commitments and contractual obligations (note 11)
Subsequent events (note 7 and note 11)

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board:

Signed "Arthur S. Millholland"
Director

Signed "J. Christopher McLean"
Director

Canadian Overseas Petroleum Limited
Consolidated Statements of Comprehensive Loss
(in thousands of Canadian dollars, except per share amounts)

	2011	2010
Operations		
Services to third parties	**$ 189**	$ 6
Loss on UK contracts *(note 7)*	**(37,926)**	-
Exploration	**(1,657)**	-
Pre-license costs *(note 5)*	**(1,694)**	-
Administrative	**(8,413)**	(5,590)
Depreciation	**(30)**	(11)
Stock-based compensation *(note 8)*	**(4,796)**	(3,243)
	(54,327)	(8,838)
Finance income and costs		
Interest income	**593**	17
Interest and financing charges	**(40)**	(461)
Foreign exchange gain (loss)	**346**	(39)
	899	(483)
Loss	**(53,428)**	(9,321)
Gain on translation of foreign subsidiaries	**328**	-
Comprehensive loss	**$ (53,100)**	$ (9,321)
Loss per share (basic and diluted)	**$(0.21)**	$(0.32)
Weighted average number of shares outstanding	**257,332,284**	29,290,398

See accompanying notes to the consolidated financial statements.

Canadian Overseas Petroleum Limited

Consolidated Statements of Changes in Equity

(in thousands of Canadian dollars)

	Share Capital	Warrants	Contributed Capital Reserve	Deficit	Accumulated Other Comprehensive Income	Total Equity
Balance at January 1, 2010	**$ 8,063**	**$ 306**	**$ 1,074**	**$ (11,215)**	**$ -**	**$ (1,772)**
Comprehensive loss for the year				(9,321)		**(9,321)**
Transactions with owners, recorded directly to equity						
Issue of common shares – net of issue costs	33,770					**33,770**
Issue of share purchase warrants		10,701				**10,701**
Stock options granted			3,243			**3,243**
Balance at December 31, 2010	**$ 41,833**	**$ 11,007**	**$ 4,317**	**$ (20,536)**	**$ -**	**$ 36,621**
Comprehensive loss for the year				(53,428)	328	**(53,100)**
Transactions with owners, recorded directly to equity						
Issue of common shares – net of issue costs	58,890					**58,890**
Issue of share purchase warrants		26,364				**26,364**
Exercise of warrants	45	(12)				**33**
Stock options granted			4,796			**4,796**
Balance at December 31, 2011	**$ 100,768**	**$ 37,359**	**$ 9,113**	**$ (73,964)**	**$ 328**	**$ 73,604**

See accompanying notes to the consolidated financial statements.

Canadian Overseas Petroleum Limited
Consolidated Statements of Cash Flows
(in thousands of Canadian dollars)

	2011	2010
Cash Used In Operating Activities		
Loss	**$ (53,428)**	$ (9,321)
Add (subtract) non-cash items:		
Stock-based compensation	**4,796**	3,243
Net finance (income) / expense	**(593)**	444
Depreciation	**30**	11
Loss on UK contracts *(note 7)*	**32,641**	-
Unrealized foreign exchange loss	**-**	40
Funds used in operations	**(16,554)**	(5,583)
Change in non-cash working capital *(note 15)*	**(210)**	(638)
	(16,764)	(6,221)
Financing Activities		
Issuance of common shares and warrants, net of issue costs	**85,287**	44,304
Repayment of loan	**-**	(2,000)
Interest paid	**-**	(96)
	85,287	42,208
Investing Activities		
Additions to office equipment	**(198)**	-
Additions to oil and gas exploration assets	**(20,594)**	-
Deposit for seismic data *(note 5)*	**(14,465)**	-
Interest income	**593**	17
Net change in non-cash working capital *(note 15)*	**1,764**	-
	(32,900)	17
Increase in cash and cash equivalents during the year	**35,623**	36,004
Effect of foreign exchange on cash and cash equivalents held in foreign currencies	**(1,102)**	(40)
Cash and cash equivalents, beginning of year	**37,403**	1,439
Cash and cash equivalents, end of year	**$ 71,924**	$ 37,403

See accompanying notes to the consolidated financial statements.

1. NATURE OF OPERATIONS

Canadian Overseas Petroleum Limited ("COPL" or the "Company"), is a widely-held publicly traded company incorporated and domiciled in Canada. The Company's common shares are traded on the TSX Venture Exchange in Canada. The Company's registered office is in Calgary, Alberta at 400, 604 – 1st Street SW.

COPL and its subsidiaries are involved in the identification, acquisition, exploration and development of oil and natural gas offshore reserves. Currently the Company has the following subsidiaries, all of which are wholly-owned:

- COPL Technical Services Limited which is involved in providing technical services to the COPL group of companies;
- Canadian Overseas Petroleum (UK) Limited which conducts the Company's operations in the UK North Sea; and
- Canadian Overseas Petroleum (Bermuda Holdings) Limited and Canadian Overseas Petroleum (Bermuda) Limited ("COPL B"), which were created in May 2011 to conduct anticipated operations in offshore Liberia.

2. BASIS OF PREPARATION AND GOING CONCERN

Basis of Preparation and Compliance

The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The Company began preparing its consolidated financial statements using IFRS effective January 1, 2011 and has followed IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"). Previously, the Company prepared its interim and annual consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). The Company has prepared its IFRS opening statement of financial position as at January 1, 2010, the date of transition to IFRS. As at the date of transition, the Company did not hold material assets and did not carry on operations other than those related to management and administration. Accordingly, the implementation of IFRS did not trigger any adjustments from GAAP in the process of preparing IFRS opening balances (other than account reclassifications disclosed in respective notes), after taking into account the mandatory exemptions and optional elections available under IFRS 1:

- IFRS 3, "Business Combinations" has not been applied to acquisitions of subsidiaries that occurred before January 1, 2010, the Company's date of transition to IFRS; and
- IFRS 2, "Share-based Payment" has not been applied to equity instruments that were granted on or before November 7, 2002, nor has it been applied to equity instruments granted after November 7, 2002 that vested before January 1, 2010.

The Company's consolidated financial statements have been prepared on an historical cost basis, except for certain financial assets and liabilities that have been measured at fair value.

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. All financial information presented in tables has been rounded to the nearest thousand Canadian dollars except where otherwise indicated.

2. BASIS OF PREPARATION AND GOING CONCERN (continued)

Going Concern

These consolidated financial statements are prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business.

Currently, the Company does not have material cash inflows and/or adequate financing to develop profitable operations. The Company is pursuing exploration projects and contracts (Note 11) that, if successful, will require substantial additional financing before they are able to generate positive operating cash flows. Accordingly, the Company's continued successful operations are dependent on its ability to obtain additional financing. There is no assurance that the Company will be able to obtain adequate financing in the future or that such financing will be obtained on terms advantageous to the Company.

Consequently, the Company's ability to continue as a going concern is dependent on management's ability to complete equity or debt financings. With no assurance that such financing will be obtained in 2012, there is a significant doubt that the Company will be able to continue as a going concern. These consolidated financial statements do not give effect to adjustments that would be necessary to the carrying values and classifications of assets and liabilities should the Company be unable to continue as a going concern.

The consolidated financial statements were authorized for issue by the Company's Board of Directors on March, 28 2012.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements include the financial statements of COPL and its subsidiaries.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. All intercompany transactions and balances have been eliminated on consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include cash held at banks, short-term deposits with a maturity of three months or less, cash held in escrow and credit card deposits. Cash held in escrow is cash held at banks for which use is restricted to particular projects in accordance with escrow agreements.

Office Equipment

Office furniture and equipment are recognized at purchase price net of depreciation, which is calculated on a straight line basis over estimated useful life.

Foreign Currency Translation

The consolidated financial statements are presented in Canadian dollars, which is currently the Company's functional and reporting currency.

Transactions denominated in foreign currencies are translated at the exchange rate prevailing on the transaction date. At each period end, monetary assets and liabilities denominated in a foreign currency are translated at the exchange rate prevailing at the period end date. All differences are recognized in net earnings. Non-monetary assets, liabilities and transactions denominated in a foreign currency and measured at historical cost are translated at the exchange rate in effect at the transaction date. Non-monetary items measured at fair value are translated using the exchange rates at the date when the fair value was determined.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign Currency Translation (continued)

For the purpose of consolidation, assets and liabilities of foreign subsidiaries are translated using the exchange rate prevailing at the period end date. The statements of comprehensive loss and cash flows are translated using the average exchange rates for the period. Foreign exchange differences resulting from such transactions are recorded in Shareholders' Equity as accumulated other comprehensive income. As at December 31, 2011, accumulated other comprehensive income is composed solely of foreign currency translation adjustments.

Revenue Recognition

Third party service revenue is recognized at contractual amounts as the related services are provided. The Company recognizes interest income as it is earned.

Pre-License Costs

The Company expenses amounts incurred in the evaluation and development of potential business ventures until the related business arrangements are consummated. The costs incurred prior to the award of oil and gas licenses, concessions and other exploration rights are recognized as an expense in the period incurred.

Exploration and Evaluation ("E&E")

The cost of exploring, appraising and evaluating oil and gas properties, including costs of farming into or acquiring the rights to explore, geological and geophysical studies, seismic data and modeling, exploration and/or appraisal drilling and directly related overheads are capitalized and classified as intangible E&E assets. These costs are accumulated in cost centers by field or project in anticipation of future allocation to Cash Generating Units ("CGU").

E&E assets are not amortized prior to the conclusion of appraisal activities. Once active exploration is completed, commercial reserves are discovered and the project is approved for development, E&E assets related to particular projects will be reclassified to development and production assets and the carrying amounts will be assessed for impairment and adjusted (if appropriate) to their estimated recoverable amounts. If commercial reserves are not discovered, the E&E asset is written off to exploration expenses in the statement of comprehensive loss.

The E&E phase of a particular project is completed when either the technical feasibility and commercial viability of extracting oil or gas are demonstrable for the project or there is no prospect of a positive outcome for the project.

Jointly Controlled Assets and Operations

The Company's oil and gas activities are carried out jointly with other partners through farm-in agreements and joint operating agreements. The Company accounts for its proportionate share of the results, assets and liabilities related to these operations.

Stock-Based Compensation

The Company issues equity-settled stock options to its employees, directors and consultants and follows the fair value method of accounting. A Black-Scholes option-pricing model is used to determine the fair value of the award at the time the options are granted. The related expense is charged to the statement of comprehensive loss with a corresponding increase in equity as contributed capital reserve over the vesting term. Consideration received on the exercise of an option is credited to share capital, along with the related stock-based compensation previously recognized in contributed capital reserve.

Leases

Rent payable for assets under operating lease is charged to the statement of comprehensive loss on a straight-line basis over the lease term.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Per Share Data

Basic net income (loss) per share is calculated using the weighted average number of shares outstanding during the year. The treasury stock method is used to calculate diluted earnings per share. This method assumes that only in-the-money stock options and warrants are exercised and that any proceeds would be used to purchase common shares at the average market price during the year.

Financial Instruments

All financial instruments are initially recognized at fair value on the statement of financial position. The Company has classified each financial instrument into one of the following categories: financial assets and liabilities at Fair Value Through Profit and Loss ("FVTPL"), loans and receivables, financial assets available-for-sale, financial assets held-to-maturity and other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

Financial assets and liabilities at FVTPL are subsequently measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax.

Financial assets "held-to-maturity", "loans and receivables" and "other financial liabilities" are subsequently measured at amortized cost using the effective interest method.

The Company determines the classification of its financial instruments at initial recognition and where allowed and appropriate, re–evaluates this designation at each financial year end.

Deferred Income Tax

The Company uses the liability method of accounting for income taxes, whereby deferred income tax assets and liabilities are recognized based on temporary differences between the tax basis of assets and liabilities and their carrying amount in the consolidated financial statements, and for unused tax loss carry-forwards.

Deferred tax assets and liabilities are measured using tax rates that have been enacted or substantively enacted at the statement of financial position date.

Deferred income tax assets are recognized only to the extent it is probable that taxable profit will be available to utilize the associated tax deductions.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to offset current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same tax jurisdiction.

Significant accounting judgments and estimates

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions and to use judgment that affects the reported amounts of assets, liabilities, revenues and expenses. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accordingly, actual results may differ from those estimated amounts and differences may be material.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant accounting judgments and estimates (continued)

In particular, significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements are:

- Stock-based compensation and warrants – the amounts recorded in respect of stock options and share purchase warrants granted are based on the Company's estimation of their fair value, calculated using assumptions regarding the life of the option or warrant, interest rates and volatility. By their nature, these estimates and assumptions are subject to uncertainty, and the actual fair value of options or warrants may differ at any time;
- Deferred income tax - management assesses the likelihood that deferred income tax assets will be realized from future taxable earnings, the amount of which is subject to measurement uncertainty; and
- Provisions, commitments and contingent liabilities – amounts recorded as provisions and amounts disclosed as commitments and contingent liabilities are estimated based on provisions of the related contracts and management's best knowledge at the time of issuing the consolidated financial statements. The actual results ultimately may differ from those estimates as future confirming events occur.

Significant judgments are involved in the determination of the functional currency of the subsidiaries and the time when exploration and evaluation assets are expected to be used for commercial production.

Future Accounting Standards

As of January 1, 2015, the Company will be required to adopt IFRS 9, "Financial Instruments" which will replace IAS 39, "Financial Instruments: Recognition and Measurement" and will provide for a classification model of financial assets and liabilities with two categories: amortized costs and fair value. Currently, the Company does not expect the adoption of IFRS 9 to have a material impact on the Company's consolidated financial statements.

In May, 2011 the IASB issued the following standards: IFRS 10, "Consolidated Financial Statements", IFRS 11, "Joint Arrangements", IFRS 12, "Disclosure of Interests in Other Entities", IFRS 13, "Fair Value Measurement", and amended IAS 27, "Separate Financial Statements" and IAS 29, "Investments in Associates and Joint Ventures". These standards and amendments have not yet been adopted by the Company and are effective January 1, 2013 with early adoption permitted. The Company does not expect the adoption of these standards and amendments to have a material impact on the Company's consolidated financial statements.

4. CASH AND CASH EQUIVALENTS

	December, 31 2011	December 31, 2010	January, 1 2010
Cash	**$ 3,889**	$ 36,873	$ 309
Short-term deposits	**-**	500	1,100
Cash in escrow accounts	**67,735**	-	-
Credit card deposits	**300**	30	30
	$ 71,924	$ 37,403	$ 1,439

Cash balances earn interest, whenever possible, at floating rates based on daily bank deposit rates. Short-term deposits are made for periods varying between one day and three months, depending on immediate cash requirements and earn interest at the respective short term deposit rates.

As at December 31, 2011, $67.7 million was held in banks in escrow accounts restricted by escrow agreements signed with UK partners for use on specific exploration projects, including $32.6 million of escrow funds related to the loss on UK contracts (note 7).

Credit card deposits are bank deposits that cover the maximum credit limit available for corporate credit cards.

The fair value of cash and cash equivalents was $71.9 million as at December 31, 2011, $37.4 million as at December 31, 2010 and $1.4 million as at January 1, 2010. The Company deposits its cash with reputable Canadian and UK banks. The Company did not have any overdraft facilities in place as at December 31, 2011, December 31, 2010 and January 1, 2010.

5. DEPOSIT FOR SEISMIC DATA

In May 2011, the Company (via its Bermuda subsidiary, COPL B) signed a Sale and Purchase Agreement (“SPA”) with Peppercoast Petroleum plc (“Peppercoast”) to acquire a 100% interest in Block LB-13 offshore Liberia, for which closure is subject to several conditions, including approval from the Liberian government (discussed further in Note 11). As part of this transaction, the Company has also entered into a number of contractual arrangements in respect of a 3D seismic survey for Block LB-13. A deposit of US$15.0 million (approximately $14.5 million at the time of payment and approximately $15.3 million as at December 31, 2011) was made by the Company to settle Peppercoast’s account payable for acquisition and processing of the 3D seismic survey, thereby satisfying Peppercoast’s work obligations for the first phase of the Production Sharing Contract (“PSC”) for Block LB-13. In lieu of this, the Company received a license agreement from TGS-Nopac Geological Company for a copy of the 3D seismic survey covering the 2,023 square kilometers of Block LB-13. The US$15.0 million payment is secured by first fixed and floating charges over all existing and future assets owned by Peppercoast and has been recognized as a long-term deposit until the completion of the SPA transaction.

In addition, during the year ended December 31, 2011, the Company has incurred $1.7 million of costs related to the transaction with Peppercoast, which are recognized as pre-license costs and expensed as incurred.

6. EXPLORATION AND EVALUATION ASSETS

	UK North Sea
	$
As at January 1, 2010 and December 31, 2010	**-**
Additions at cost	**20,594**
As at December 31, 2011	**20,594**

The additions to exploration and evaluation assets of $20.6 million for the year ended December 31, 2011 are related to the Company's exploration project in the UK North Sea, carried out with UK partner on a non-operator basis.

7. LOSS ON UK CONTRACTS

The Company had in place a Sale and Purchase Agreement ("SPA") with BG International Limited ("BG") in respect of Block 23/21 Rest of Block Shallow ("RoB') (Newt, Lower Toad, West Columbus and Upper Toad prospects) and Block 22/15 (the Esperanza prospect and Banks discovery). The agreement provided for a certain amount of funds to be kept in an escrow account with BG to cover the purchase consideration, which was dependent on the cost of drilling exploration wells. From October through December 2011, the first well was drilled and tested in the Esperanza prospect in Block 22/15 and although successful, encountered significant cost overruns. As per the SPA, the Company was required to immediately deposit additional funds into the escrow account. The Company did not make the deposit but did engage in a discussion with BG on alternatives. On January 4, 2012, a Supplemental Agreement was signed with BG wherein, among other things, BG agreed not to serve a default notice but the deposit amount was increased to $50 million and was required by January 31, 2012. Considering a number of factors, including the state of the capital markets, the dilutive effect on the current and prospective assets values per share, the costs overruns on the Esperanza well, the delay in drilling of three wells in Block 23/21 RoB, the funds already in escrow (of approximately GBP 30.4 million as at December 31, 2011) being more than sufficient to cover all the BG's out-of-pocket costs, restrictions imposed by BG and other reasons, the Company was not in a position to deposit the funds requested by BG. During the period subsequent to the drilling of Esperanza well, the Company and its financial advisors continued to communicate with BG and proposed a number of alternative options to top up the escrow account with BG over a period of time rather than immediately. All these proposals were rejected by BG. The purchase consideration for the Esperanza project of approximately $33.2 million (GBP 21 million) was released from escrow to BG on January 31, 2012 and a formal SPA termination notice was provided to COPL on February 13, 2012.

In addition, the Company had an Earn-in Agreement with SSE E&P UK Limited ("SSE") pursuant to which COPL would pay 100% of SSE's 16.67% share of the total drilling costs in the Lower Toad, Newt and West Columbus exploration prospects to earn an 8.33% working interest in such prospects. Due to termination of the SPA agreement with BG, the anticipated exploration wells in Block 23/21 RoB are not going to be drilled. Accordingly, a respective termination agreement of the Earn-in Agreement (currently in preparation) will be signed by both parties.

7. LOSS ON UK CONTRACTS (continued)

As a result, while reviewing its legal alternatives, the Company has recognized a loss on UK contracts of $37.9 million (GBP 23.9 million) for the year ended December 31, 2011, which includes all the costs related to agreements with BG and SSE as follows:

		Year ended December, 31 2011
Consideration and costs settled in 2011:		
Payments to BG (site survey costs re Block 23/21 RoB and Esperanza)	$	2,738
Payments to SSE (re: Block 23/21 RoB)		492
COPL's own cost (re Block 23/21 RoB and Esperanza)		2,055
		5,285
Consideration held in escrow as at December 31, 2011:		
Payments to BG made in 2012 (well drilling and testing at Esperanza)		32,106
Payments to SSE made in 2012 (re: Block 23/21 RoB)		22
Estimated additional costs in respect of termination		513
Provision for loss on UK contracts		**32,641**
Total loss on UK contracts	$	**37,926**

As at the date of release of the consolidated financial statements, approximately GBP 10.0 million ($15.8 million) remain in the escrow account with BG. The amount is in dispute as both the Company and BG are claiming rights to this amount and as such, it will not be released by the escrow agent to either party without both parties' consent or a court order.

8. SHARE CAPITAL

a) Authorized and Issued Common Shares

Authorized

An unlimited number of common voting shares (the "Common Shares") without nominal or par value and an unlimited number of preferred shares, issuable in series.

Issued

The issued share capital is as follows:

	Pre-Consolidation Number of Common Shares	Post-Consolidation Number of Common Shares	Amount
Balance, January 1, 2010 (i)	**66,608,888**	**16,652,222**	**$ 8,063**
Issued for payment of Bridge Loan fees (ii)	721,694	180,424	167
Issued pursuant to private placement (iii)	27,490,315	6,872,582	6,955
Issued for payment of finders' fees on private placement (iv)	1,042,841	260,711	264
Issued pursuant to public offering – first release condition (v)		78,000,000	29,640
Share issue costs (iii & v)	-	-	(3,256)
Balance, December 31, 2010 (i)		**101,965,939**	**$ 41,833**
Issued pursuant to public offering – second release condition (vi)		182,000,000	69,160
Issued pursuant to exercise of warrants		51,000	33
Contributed capital reserve on warrants exercised		-	12
Share issue costs (vi)		-	(10,270)
Balance, December 31, 2011		**284,016,939**	**$ 100,768**

Further to shareholders' and Board of Directors' approvals and effective August 3, 2010, the Company's common shares were consolidated on a one for four basis, i.e. one post-consolidation common share for every four pre-consolidation common shares. Common share numbers and earnings per share amounts have been retroactively adjusted to reflect the share consolidation.

(i) As at January 1, 2010 and December 31, 2010, the number of common shares includes 250,000 common shares (1,000,000 pre-consolidation common shares) held in escrow. These shares were issued on December 7, 2009, at an issue price of $2.40 per share ($0.60 pre-consolidation) to acquire 100% of the shares of the Company's subsidiaries. The shares held in escrow were accounted for as contingently returnable shares at December 31, 2010, and were not considered outstanding and were not included in the computation of basic loss per share until they were released from escrow. The transaction was approved by the TSX-V on February 3, 2011 and the respective common shares were released to the beneficial holders.

8. SHARE CAPITAL (continued)

a) Authorized and Issued Common Shares (continued)

(ii) On May 5, 2010, the Company issued to Endeavour Financial Corporation 180,424 common shares (721,694 pre-consolidation common shares) as payment for a fee of $167,000 in respect of the Bridge Loan. Pursuant to the Bridge Loan agreement, the fee was due if the loan was not repaid in full by April 1, 2010. The number of common shares was calculated based on the 5-day volume weighted average closing price of the Company's shares immediately before April 1, 2010. The fee of $167,000 was recognized in the statement of comprehensive loss as interest and financing charges in 2010.)

(iii) On May 14, 2010 and May 21, 2010, the Company closed the private placement of 6,872,582 units at $1.20 per unit (27,490,315 pre-consolidation units at $0.30 per unit) for total gross proceeds of $8.2 million. Each unit consisted of one common share and one half of a share purchase warrant. Each whole warrant entitled the holder to acquire an additional common share at an exercise price of $2.00 (pre-consolidation exercise price of $0.50); all these warrants expired unexercised on November 14, 2011. The fair value of the share purchase warrants issued was estimated at $1.3 million using a Black-Scholes option pricing model with the following assumptions:

	2010
Risk-free interest rate	2.0%
Weighted average life (years)	1.5
Expected volatility	100%
Expected dividend yield	0%

(iv) The Company paid, whenever applicable, a finder's fee by issuing units equivalent to 5% of the units subscribed via a particular broker. As the result, there were 260,711 units (1,042,841 pre-consolidation units) issued as finder's fees, with the exercise price and expiry date of these share purchase warrants consistent with the warrants issued as part of the private placement. The value of $313,000, representing the subscription value of the units issued as finder's fees together with legal fees of $69,000, was recognized as share issue costs. The fair value of share purchase warrants issued as finder's fee was estimated at $49,000 using a Black-Scholes option pricing model with the same assumptions as noted above. These warrants expired unexercised on November 14, 2011.

(v) On November 23, 2010, the Company filed a prospectus to obtain financing for its operations in the UK North Sea. The offering provided for the sale of 260,000,000 subscription receipts ("Subscription Receipts") at a price of $0.50 per Subscription Receipt. Each Subscription Receipt entitled the holder to receive one common share of COPL ("Common Share") and one half of one (0.5) common share purchase warrant of COPL ("Warrant"), upon the satisfaction of certain Release Conditions (as defined in the prospectus). Each Warrant entitles the holder to purchase one Common Share at $0.65 within 36 months from the closing date, provided that the Warrants will expire if not exercised within 10 days of notice from COPL that the 20 day volume weighted average trading price of Common Shares is greater than $1.25.

The closing of the Offering occurred on December 1, 2010. The gross proceeds from the sale of Subscription Receipts of $130 million were held in escrow pending satisfaction of the First and Second Release Conditions (as defined in the prospectus). The agent was entitled to a cash commission equal to 6% of the gross proceeds of the Offering ("Agent's Fee"), with 30% payable on satisfaction of the First Release Condition and 70% on satisfaction of the Second Release Condition.

8. SHARE CAPITAL (continued)

a) Authorized and Issued Common Shares (continued)

On December 10, 2010, the First Release Condition was met as the Company signed farm-in agreements in respect of the Fulla and Bluebell projects (as defined in the prospectus). Accordingly 78,000,000 Subscription Receipts were converted into 78,000,000 Common Shares and 39,000,000 Warrants, and funds of approximately $36.6 million were released to the Company ($39.0 million gross proceeds, net of Agent's Fee and expenses). The fair value of the Warrants issued was estimated at $9.4 million using a Black-Scholes option pricing model with the following assumptions:

	2010
Risk-free interest rate	1.5%
Weighted average life (years)	1.5
Expected volatility	80%
Expected dividend yield	0%

(vi) On February 22, 2011, the Second Release Condition was met as the Company signed earn-in agreements in respect of North Sea prospects in Block 23/21 RoB and Block 22/15 (as defined in the prospectus). Accordingly 182,000,000 Subscription Receipts were converted into 182,000,000 Common Shares and 91,000,000 Warrants, and funds of approximately $85.5 million were released to the Company ($91.0 million gross proceeds, net of Agent's Fee and expenses). The fair value of the Warrants issued was estimated at $21.8 million using a Black-Scholes option pricing model with the assumptions as presented above in item (v).

In addition, upon satisfaction of both Release Conditions, the Company issued 15,600,000 share purchase warrants to its agent as compensation warrants in an amount equal to 6% of the aggregate number of Subscription Receipts sold pursuant to the offering. Each agent's warrant entitles the holder to purchase one Common Share of COPL for the period until December 1, 2012 at an exercise price of $0.50. The fair value of the agent's warrants issued was estimated at $4.5 million using a Black-Scholes option pricing model with the assumptions as presented above in item (v) and was recognized as share issue costs.

b) Warrants

A summary of status of the Company's warrants as at December 31, 2011 and 2010 is as follows:

	2011		**2010**	
	Number of Warrants	**Wt. Avg. Exercise Price**	**Number of Warrants**	**Wt. Avg. Exercise Price**
Balance, beginning of year	**42,566,646**	**$ 0.76**	425,000	$ 2.00
Issued	**106,600,000**	**0.63**	42,566,646	0.76
Exercised	**(51,000)**	**0.65**	-	-
Expired	**(3,566,646)**	**2.00**	(425,000)	2.00
Balance, end of year	**145,549,000**	**$ 0.63**	42,566,646	$ 0.76

8. SHARE CAPITAL (continued)

b) Warrants (continued)

The summary of the Company's share purchase warrants issued during the year ended December 31, 2011 is as follows:

	Number of Warrants issued and Outstanding	**Exercise Price**	**Expiry Date**
Public Offering – First Release (Note 8a v)	38,949,000	$0.65	December 1, 2013
Public Offering – Second Release (Note 8a v)	91,000,000	$0.65	December 1, 2013
Public Offering – Agent Warrants (Note 8a v)	15,600,000	$0.50	December 1, 2012
	145,549,000	$0.63	

c) Incentive Stock Options

The Company has a stock option plan where the number of common shares reserved under the plan shall not exceed 10% of the issued and outstanding common shares and the number reserved for any one individual may not exceed 5% of the issued and outstanding shares. Exercise prices for stock options granted are determined by the closing market price on the day before the date of grant.

During 2011, the Company granted to its directors, officers, employees and consultants the following stock options, which vest immediately and expire in five years from date of grant:

- On February 23, 2011 - 12,415,000 stock options to acquire common shares at an exercise price of $0.68. The related stock-based compensation expense of $4.7 million has been recognized in the statement of comprehensive loss.
- On July 1, 2011 - 300,000 stock options to acquire common shares at an exercise price of $0.46 per share. The related stock-based compensation expense of $0.1 million has been recognized in the statement of comprehensive loss.

The fair value of each option granted is estimated on the date of grant using a Black-Scholes option pricing model with the following assumptions:

	2011	2010
Risk-free interest rate	1.5%	1.5 – 2.0%
Weighted average life (years)	4.0	4.0
Expected volatility	75%	80 – 100%
Expected dividend yield	0%	0%

During the year ended December 31, 2011, 242,500 stock options granted to consultants expired, as they no longer provide services to the Company.

No stock options were exercised during the years ended December 31, 2011 and December 31, 2010.

8. SHARE CAPITAL (continued)

c) Incentive Stock Options (continued)

As at December 31, 2011, a total of 22,065,000 stock options to purchase common shares were outstanding, having a weighted average exercise price of $0.67 per share with a remaining weighted average contractual life of 3.99 years. Changes to the Company's stock options are summarized as follows:

	2011			**2010**		
	Number of Options		**Wt. Avg. Exercise Price**	**Number of Options**		**Wt. Avg. Exercise Price**
Balance, beginning of year	**9,592,500**	**$**	**0.66**	1,402,500	$	0.80
Granted	**12,715,000**		**0.67**	8,262,500		0.64
Expired	**(242,500)**		**0.80**	(72,500)		0.80
Balance, end of year	**22,065,000**	**$**	**0.67**	9,592,500	$	0.66
Exercisable, end of year	**22,065,000**	**$**	**0.67**	9,592,500	$	0.66

9. CONTRIBUTED CAPITAL RESERVE AND WARRANTS

		December 31, 2011		December 31, 2010
Contributed capital reserve:				
Balance, beginning of period	**$**	**4,317**	$	1,074
Stock-based compensation (Note 8c)		**4,796**		3,243
Balance, end of period	**$**	**9,113**	$	4,317
Warrants:				
Balance, beginning of period	**$**	**11,007**	$	306
Fair value of warrants issued (Note 8a iii-v)		**26,364**		10,701
Warrants exercised (Note 8a iii-v)		**(12)**		-
Balance, end of period	**$**	**37,359**	$	11,007

10. DEFERRED INCOME TAX

The tax effects of the temporary differences on deferred income tax assets (liabilities) are as follows:

	2011	2010
Non-capital income tax losses	**$ 3,182**	$ 2,552
Pre-trading expenses - UK	**25,737**	-
Capital losses	**632**	632
Share issue costs	**489**	653
E & E assets	**50**	-
Office equipment assets	**17**	3
	30,107	3,840
Unrecognized tax benefits	**(30,107)**	(3,840)
Deferred income tax assets (liabilities)	**$ -**	$ -

The Company did not recognize a deferred tax asset as at December 31, 2011 as currently, it is not expected that the assets will be recoverable in the foreseeable future.

The temporary differences associated with investment in subsidiaries, for which a deferred tax liability was not recognized amounted to $28.0 million as at December 31, 2011 (2010 - $0.2 million).

The provision for income taxes (recoveries) differing from the statutory income tax rates are as follows:

	2011	2010
Loss	**$ (53,428)**	$ (9,321)
Income tax rates	**26.5%**	28%
Provision at statutory rates	**(14,158)**	(2,610)
Tax rate differential (UK and Bermuda)	**(12,054)**	-
Non-deductible items:		
Stock-based compensation	**1,340**	908
Amortization of warrants	**-**	83
Depreciation in excess of capital allowance	**13**	3
Other	**44**	23
Share issue costs	**(173)**	(859)
Effect of tax rates changes (Canada and UK)	**(1,163)**	210
Change in previously estimated tax pools	**(230)**	(212)
Change in unrecognized tax benefits	**26,267**	2,454
Effect of foreign exchange	**114**	-
Deferred income tax provision (recovery)	**$ -**	$ -

10. DEFERRED INCOME TAX (continued)

As at December 31, 2011, the Company had approximately $12.7 million (2010 - $10.2 million) of non-capital losses, which can be applied against taxable income earned in Canada with the following expiry dates:

- $4,000 on December 31, 2014
- $238,000 on December 31, 2026
- $253,000 on December 31, 2027
- $130,000 on December 31, 2028
- $3,158,000 on December 31, 2029
- $5,710,000 on December 31, 2030
- $3,235,000 on December 31, 2031

As at December 31, 2011, the Company also had capital losses of approximately $5.1 million (2010 - $5.1 million), which will carry forward indefinitely to reduce capital gains taxed in Canada.

In addition, the Company had approximately $41.5 million (GBP 26.3 million) of pre-trading expenses in the UK as at December 31, 2011. These amounts will become non-capital losses within the next seven years if the Company obtains trading status in the UK, and these losses can be carried forward indefinitely against future income earned in the UK.

11. COMMITMENTS AND CONTRACTUAL OBLIGATIONS

As at December 31, 2011, the Company has the following commitments other than the obligations under UK contracts in dispute (as discussed in note 7):

	Total	**Less than One Year**	**One to Three Years**	**Four to Five Years**	**After Five Years**
UK drilling commitments	**7,900**	7,900	-	-	-
Office lease	**4,232**	535	1,069	1,069	1,559
	12,132	8,435	1,069	1,069	1,559

UK drilling commitments of $7.9 million as at December 31, 2011 relate to an offshore exploration well, which was drilled, plugged and abandoned in March 2012.

The Company is committed under an operating lease agreement for the rental of office space in Calgary. The approximate lease payments total $4.2 million and are payable over the next eight years.

On May 18, 2011 the Company (via its Bermuda subsidiary, COPL B) signed a Sale and Purchase Agreement ("SPA") with Peppercoast to acquire a 100% interest in Block LB-13 offshore Liberia for a total sum of US$85.0 million (approximately $86.4 million) payable in cash (to a maximum of US$50.0 million) and common shares of COPL. The transaction is expected to close in the second quarter of 2012, assuming certain conditions can be satisfied, including obtaining consents of the National Oil Company of Liberia ("NOCAL") and the Government of Liberia. Block LB-13 covers an area of approximately 2,400 square kilometres and is governed by a Production Sharing Contract ("PSC") with an eight year exploration license that commenced in May 2007 and is divided into three phases, the first phase being four years, the second phase two years and the third phase another two years. Subject to completion of the SPA with Peppercoast, the Company will be committed to drill a well within the second phase and an additional well within the third phase of the PSC.

11. COMMITMENTS AND CONTRACTUAL OBLIGATIONS (continued)

On November 16, 2011, the Company signed an Asset Acquisition Agreement with ExxonMobil Exploration and Production Liberia Limited ("ExxonMobil"), a wholly owned subsidiary of the ExxonMobil Corporation, with respect to the onward sale of certain interests in Block LB-13 offshore Liberia. Under the terms of the sale, which is subject to the approval of the NOCAL and the Government of Liberia and to the satisfaction or waiver of other closing conditions, ExxonMobil will acquire a 70% interest in the PSC governing Block LB-13 immediately following COPL B's acquisition of a 100% interest from Peppercoast. In return, ExxonMobil will pay COPL B US$55.0 million (approximately $55.9 million) and pay COPL B's portion of the first well to be drilled on Block LB-13 to a maximum of US$36.0 million. If less than US$36.0 million is spent on COPL B's proportionate cost for the first well, the balance will be applied towards COPL B's costs of a second well, if drilled. Additionally, ExxonMobil will pay COPL B's share of joint venture costs estimated at approximately US$6.0 million up to the completion of the first well. COPL B's equity interest in the PSC (Block) will be 30% upon closing and ExxonMobil will be the PSC's (Block's) designated operator.

Currently, the Company does not have material cash inflows and/or adequate financing to develop profitable operations. The Company is pursuing exploration projects and contracts that, if successful, will require substantial additional financing before they are able to generate positive cash flows. Accordingly, the Company's continued successful operations are dependent on its ability to obtain additional financing. No assurance can be provided that the Company will raise the required levels of financing.

12. RELATED PARTY TRANSACTIONS

a) Transactions with Directors and Officers

Transactions with the Company's directors and officers in the form of consulting services occurred in the normal course of business and have been recorded at exchange amounts based on commercial rates and terms agreed to in the related consulting contracts. The expense, receivables and payables related to consulting services provided by directors and officers during the year ended December 31 are as follows:

	2011	2010
Consulting fees	**$ 119**	$ 622

As at December 31, 2011, accounts due from related parties amounted to $19,000 (December 31, 2010 - $22,000, January 1, 2010 - $nil), which represented travel advances, with $nil payable to related parties (December 31, 2010 - $5,000; January 1, 2010 - $nil) for outstanding travel expenses.

12. RELATED PARTY TRANSACTIONS (continued)

b) Remuneration of Directors and Other Key Management Personnel

The key management personnel of the Company are comprised of executives of the Company and members of Canadian Overseas Petroleum Limited's Board of Directors. The remuneration of directors and key management personnel during the years ended December 31 are as follows:

	2011	2010
Short-term benefits	**$ 1,673**	$ 1,535
Post-employment benefits	**-**	-
Other long-term benefits	**-**	-
Stock-based compensation	**2,860**	2,952
Termination benefits	**-**	-
	$ 4,533	$ 4,487

Short-term benefits include annual salaries, directors' fees and health and other taxable benefits. The 2010 balance includes a portion of the consulting fees from Note 12(a).

Stock-based compensation relates to stock options granted during the year and represent the fair value of options granted using a Black-Scholes option pricing model (Note 8(c)) as at the date of grant.

13. FINANCIAL INSTRUMENTS

The Company has classified its cash and cash equivalents and other deposits as financial assets at FVTPL and has measured them at fair value. Accounts receivable are classified as loans and receivables; accounts payable, accrued liabilities and loans are classified as other liabilities; these items are measured at amortized cost.

a) Fair values

As at December 31, 2011, December 31, 2010 and January 1, 2010, the fair values of all financial instruments not carried at fair value approximated their carrying values due to their short-term maturity.

(b) Foreign exchange risk

With the Company's current exploration activities carried out in the UK, significant amounts are transacted in or referenced to currencies other than the Canadian dollar, including the British Pound and U.S. dollar. As a result, fluctuations in the exchange rates between the Canadian dollar, British Pound and U.S. dollar can have a significant effect on the Company's financial position and its reported results. To mitigate a portion of its exposure and to the extent it is feasible, the Company keeps its funds in currencies applicable to its known short-term commitments.

Cash and cash equivalents includes amounts denominated in foreign currencies:

	December 31, 2011	**December 31, 2010**	**January 1, 2010**
British Pounds	**41,698**	1,000	**-**
U.S. Dollars	**682**	-	**-**

13. FINANCIAL INSTRUMENTS (continued)

(c) Credit risk

The Company's accounts receivable are mainly due from the government (Goods and Services Tax in Canada and Value Added Tax in UK) and from its employees in respect of travel advances. The Company believes there is no unusual exposure associated with these receivables. No amounts are considered to be past due and no allowance for doubtful accounts has been recorded in the accounts. As at December 31, 2011, the Company holds $71.9 million of cash and cash equivalents with Canadian and UK chartered banks. Management has assessed the associated credit risk as relatively low.

Should the SPA transaction discussed in Note 11 fail to close, the long-term deposit for seismic data (Note 5) will become a receivable from Peppercoast and subject to credit risk at that time.

(d) Interest rate risk

The Company's policy is to keep its cash, whenever possible, in interest bearing accounts with its banking institutions. The Company periodically monitors the interest rates offered and is satisfied with the credit ratings of its banks.

14. CAPITAL MANAGEMENT

The Company's objectives when managing capital are:

- to safeguard the Company's ability to continue as a going concern;
- to maintain statement of financial position strength and optimal capital structure, while ensuring the Company's strategic objectives are met; and
- to provide an appropriate return to shareholders relative to the risk of the Company's underlying assets

In the management of capital, the Company includes shareholders' equity and interest bearing debt defined as long-term loans and current portion of long-term loans. Shareholders' equity includes share capital, warrants, contributed capital reserve and deficit.

The Company maintains and adjusts its capital structure based on changes in economic conditions and the Company's planned requirements. The Company may adjust its capital structure by issuing new equity and/or debt, selling and/or acquiring assets, and controlling the capital expenditure program.

The Company is not subject to any external capital requirements. There were no changes in the Company's capital management policies during the year ended December 31, 2011.

15. NET CHANGE IN NON-CASH WORKING CAPITAL

	Year ended December 31, 2011	Year ended December 31, 2010
Increase in accounts receivable	**$ (116)**	$ (8)
(Increase)/decrease in prepaid expenses	**(141)**	255
Decrease in long-term rent deposit	**-**	27
Increase/(decrease) in operating accounts payable and accrued liabilities	**47**	(912)
Net change in operating non-cash working capital	**$ (210)**	$ (638)
Increase in accounts receivable related to exploration assets	**$ (247)**	$ -
Increase in accounts payable related to exploration assets	**1,371**	-
Non-cash transaction:		
Net effect of foreign exchange	**640**	-
Net change in investing non-cash working capital	**1,764**	$ -