Canadian Overseas Petroleum Limited

Consolidated Financial Statements

As at and for the years ended December 31, 2012 and 2011

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 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 22, 2013

Signed "Aleksandra Owad"
Aleksandra Owad
Chief Financial Officer
March 22, 2013

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, 2012 and 2011, and the consolidated statements of comprehensive loss, consolidated statements of changes in equity, and consolidated statements of cash flows for the years then ended, 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, 2012 and 2011, and its financial performance and its cash flows for the years then ended 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 $56.6 million during the year ended December 31, 2012 (2011: $53.4 million) and had negative cash flows from operating activities of $66.3 million (2011: $16.8 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 LLP"

March 21, 2013
Calgary, Alberta

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

As at	**December 31, 2012**	December 31, 2011
Assets		
Current		
Cash and cash equivalents *(note 4)*	**$ 4,374**	$ 71,924
Accounts receivable	**237**	446
Prepaid expenses	**212**	163
	4,823	72,533
Deposit for seismic data *(note 5)*	**14,924**	15,255
Deposits and prepayments	**49**	43
Exploration and evaluation assets *(note 6)*	**-**	20,594
Office equipment	**218**	227
	$ 20,014	$ 108,652
Liabilities		
Current		
Accounts payable and accrued liabilities *(note 7)*	**$ 3,194**	$ 2,407
Provision for loss on UK contracts *(note 8)*	**-**	32,641
	3,194	35,048
Shareholders' Equity		
Share capital *(note 9)*	**100,768**	100,768
Warrants *(note 10)*	**37,359**	37,359
Contributed capital reserve *(note 10)*	**9,113**	9,113
Deficit	**(130,602)**	(73,964)
Accumulated other comprehensive income	**182**	328
	16,820	73,604
	$ 20,014	$ 108,652

Nature of operations (note 1)
Commitments and contractual obligations (note 12)
Subsequent events (note 12)

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)

For the years ended December 31	2012	2011
Operations		
Services to third parties	**$ 129**	$ 189
Loss on UK contracts *(note 8)*	**(182)**	(37,926)
Exploration *(note 6)*	**(8,455)**	(1,657)
Exploration & Evaluation write off *(note 6)*	**(20,954)**	-
Derecognition of cash held in escrow *(note 8)*	**(16,101)**	-
Pre-license costs *(note 5)*	**(2,170)**	(1,694)
Administrative	**(8,825)**	(8,413)
Depreciation	**(54)**	(30)
Stock-based compensation *(note 9)*	**-**	(4,796)
	(56,612)	(54,327)
Finance income and costs		
Interest income	**57**	593
Interest and financing charges	**(11)**	(40)
Foreign exchange (loss) / gain	**(72)**	346
	(26)	899
Loss	**(56,638)**	(53,428)
(Loss) / gain on translation of foreign subsidiaries	**(146)**	328
Comprehensive loss	**$ (56,784)**	$ (53,100)
Loss per share (basic and diluted)	**$(0.20)**	$(0.21)
Weighted average number of shares outstanding	**284,016,939**	257,332,284

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 / (Loss)	Total Equity
Balance at January 1, 2011	**$ 41,833**	**$ 11,007**	**$ 4,317**	**$ (20,536)**	**$ -**	**$ 36,621**
Comprehensive (loss) / income 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**
Comprehensive loss for the year				**(56,638)**	**(146)**	**(56,784)**
Balance at December 31, 2012	**$ 100,768**	**$ 37,359**	**$ 9,113**	**$ (130,602)**	**$ 182**	**$ 16,820**

See accompanying notes to the consolidated financial statements.

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

For the years ended December 31	2012	2011
Cash Used In Operating Activities		
Loss	**$ (56,638)**	$ (53,428)
Add (subtract) non-cash items:		
Stock-based compensation	**-**	4,796
Interest income	**(57)**	(593)
Depreciation	**54**	30
Loss on UK contracts *(note 8)*	**-**	32,641
Exploration & Evaluation write off *(note 6)*	**20,954**	-
Unrealized foreign exchange loss	**(106)**	-
Funds used in operations	**(35,793)**	(16,554)
Change in non-cash working capital *(note 16)*	**(30,458)**	(210)
	(66,251)	(16,764)
Financing Activities		
Issuance of common shares and warrants, net of issue costs	**-**	85,287
	-	85,287
Investing Activities		
Additions to office equipment	**(45)**	(198)
Additions to Exploration & Evaluation assets	**(360)**	(20,594)
Deposit for seismic data *(note 5)*	**-**	(14,465)
Interest income	**57**	593
Net change in non-cash working capital *(note 16)*	**(1,125)**	1,764
	(1,473)	(32,900)
(Decrease) / increase in cash and cash equivalents during the year	**(67,724)**	35,623
Effect of foreign exchange on cash and cash equivalents held in foreign currencies	**174**	(1,102)
Cash and cash equivalents, beginning of year	**71,924**	37,403
Cash and cash equivalents, end of year	**$ 4,374**	$ 71,924

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 ("COPL UK"), which conducts the Company's operations in the United Kingdom ("UK") North Sea;
- 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;
- COPL New Zealand Limited, which was incorporated in New Zealand ("NZ") on November 8, 2012.

2. BASIS OF PREPARATION AND GOING CONCERN

Basis of Preparation and Compliance

The Company's consolidated financial statements for the years ended December 31, 2012 and 2011 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

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.

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 12) that will require substantial additional financing before they are able to generate positive operating cash flows. These exploration projects are dependent on the final execution of the contract and obtaining regulatory approval. 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. With no assurance such financing will be obtained in 2013, 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, 21 2013.

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, bankers' acceptances, 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.

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, 2012, 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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)
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.

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 the terms 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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Future Accounting Standards

As of January 1, 2015 , the Company will be required to adopt IFRS 9 "Financial Instruments", which is the result of the first phase of the IASB project to replace IAS 39 "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. Portions of the standard remain in development and the full impact of the standard on COPL's consolidated financial statements will not be known until the project is complete.

In May 2011, the IASB released the following new standards: IFRS 10, "Consolidated Financial Statements", IFRS 11, "Joint Arrangements", IFRS 12, "Disclosures of interests in other entities" and IFRS 13, "Fair Value Measurement". Each of these standards is to be adopted for fiscal years beginning January 1, 2013 with earlier adoption permitted. A brief description of each new standard follows below:

- IFRS 10, "Consolidated Financial Statements" supersedes IAS 27 "Consolidation and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities". This standard provides a single model to be applied in control analysis for all investees including special purpose entities. The adoption of this standard is not expected to have an impact on the Company's financial statements.
- IFRS 11, "Joint Arrangements" divides joint arrangements into two types, joint operations and joint ventures, each with their own accounting model. All joint arrangements are required to be reassessed on transition to IFRS 11 to determine their type to apply the appropriate accounting. The adoption of this standard is not expected to have an impact on the Company's financial statements.
- IFRS 12, "Disclosure of Interests in Other Entities" combines in a single standard the disclosure requirements for subsidiaries, associates and joint arrangements as well as unconsolidated structured entities. The adoption of this standard is not expected to have an impact on the Company's financial statements.
- IFRS 13, "Fair Value Measurement" defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The adoption of this standard is not expected to have an impact on the Company's financial statements.

4. CASH AND CASH EQUIVALENTS

($ 000's)	**December 31, 2012**	December 31, 2011
Cash	**$ 2,914**	$ 3,889
Bankers' Acceptance	**1,199**	-
Cash in escrow accounts	**-**	67,735
Credit card deposits	**261**	300
	$ 4,374	$ 71,924

Cash balances earn interest, whenever possible, at floating rates based on daily bank deposit rates. Bankers' Acceptances are made for periods varying between one and three months, depending on immediate cash requirements and earn interest at the respective Bankers' Acceptance 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 8).

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 $4.4 million as at December 31, 2012 ($71.9 million as at December 31, 2011). 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, 2012 and 2011.

5. DEPOSIT FOR SEISMIC DATA

In May 2011, the Company (via its Bermuda subsidiary, COPL B) signed a Sale and Purchase Agreement ("PSPA") 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. 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 $14.9 million as at December 31, 2012) 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. The Company also 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 PSPA transaction (discussed further in note 12).

In addition, during the year ended December 31, 2012, the Company incurred $2.2 million (2011 - $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	
($ 000's)	**2012**	**2011**
As at January 1	**20,594**	**-**
Additions at cost	**360**	**20,594**
Write offs at cost	**(20,954)**	**-**
As at December 31	**-**	**20,594**

In 2012, the Company wrote off exploration and evaluation assets of $21.0 million related to the Fulla exploration project of Block 206/5a in the UK North Sea. Although the Fulla exploration well drilled in late 2011 encountered an oil column, further analysis revealed that a development of the existing discoveries is not commercially viable and that there is insufficient prospectivity to conduct further exploration/appraisal work. In October 2012, the operator confirmed its intent to relinquish the license.

Costs related to the Bluebell prospect of approximately $8.5 million for the year ended December 31, 2012 (2011 - $1.7 million), were recorded as exploration expenses as the well drilled in March 2012 was not successful.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

($ 000's)	**2012**	2011
Accounts payable trade	**1,774**	861
UK joint venture payables	**944**	1,371
Accrued liabilities	**462**	167
Other	**14**	8
Total	**3,194**	2,407

8. LOSS ON UK CONTRACTS

The Company had 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 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 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, the funds already in escrow (approximately $49.0 or GBP 30.9 million as at December 31, 2011) being more than sufficient to cover all of 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 drilling the 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 of 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.

8. LOSS ON UK CONTRACTS (continued)

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 will not be drilled. Accordingly, a termination agreement of the Earn-in Agreement was signed on June 19, 2012 and $8.3 million (GBP 5.2 million) of funds held in escrow with SSE was returned to the Company.

While reviewing legal alternatives, the Company has incurred a loss on UK contracts of $0.2 million for the year ended December 31, 2012 (2011 - $37.9 million), which includes costs related to the terminated agreements with BG and SSE.

At the time of the SPA termination, there was approximately $16.1 million (GBP 10.1 million) remaining in escrow with BG which was in dispute as both the Company and BG were claiming the funds. On April 4, 2012, BG filed a claim with the High Court of Justice against COPL UK and the escrow agent seeking an order directing the escrow agent to release the escrow funds to BG. COPL UK filed a counter-claim in May 2012 for a return of these funds.

On October 12, 2012, the High Court of Justice ruled that the escrow agent should release the funds held in escrow to BG, but did not rule on the underlying dispute between the parties. The Company is pursuing steps to obtain the funds back from BG. On November 5, 2012 the escrow funds were transferred to BG. As a result the Company has derecognized the cash held in escrow as at September 30, 2012, as the recovery of this amount is uncertain and is subject to the outcome of ongoing litigation between the Company and BG on this and other matters.

The Court also ruled that the Company is liable to pay legal fees to BG in the amount of GBP 65,000 (approximately $103,000) and legal fees of the escrow agent of approximately GBP 42,000 (approximately $67,000). These legal costs are accounted for as an increase in a loss on UK contracts for the year ended December 31, 2012.

9. 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:

	Number of Common Shares	Amount
Balance, January 1, 2011	**101,965,939**	**$ 41,833**
Issued pursuant to public offering – second release condition	182,000,000	69,160
Issued pursuant to exercise of warrants	51,000	33
Contributed capital reserve on warrants exercised	-	12
Share issue costs	-	(10,270)
Balance, December 31, 2011	**284,016,939**	**$ 100,768**
Balance, December 31, 2012	**284,016,939**	**$ 100,768**

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. The First Release Condition was met on December 10, 2010.

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, the remaining 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 following assumptions:

9. SHARE CAPITAL

a) Authorized and Issued Common Shares (continued)

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

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 Warrants issued was estimated at $4.5 million using a Black-Scholes option pricing model with the assumptions as presented above and was recognized as share issue costs. These warrants expired on December 1, 2012.

b) Warrants

A summary of status of the Company's warrants as at December 31, 2012 and 2011 is as follows:

	2012		2011	
	Number of Warrants	**Wt. Avg. Exercise Price**	**Number of Warrants**	**Wt. Avg. Exercise Price**
Balance, beginning of year	**145,549,000**	**$ 0.63**	**42,566,646**	**$ 0.76**
Issued	**-**	**-**	**106,600,000**	**0.63**
Exercised	**-**	**-**	**(51,000)**	**0.65**
Expired	**(15,600,000)**	**0.50**	**(3,566,646)**	**2.00**
Balance, end of year	**129,949,000**	**$ 0.65**	**145,549,000**	**$ 0.63**

There were no warrants issued in 2012. 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 – Second Release	91,000,000	$0.65	December 1, 2013
Public Offering – Agent Warrants	15,600,000	$0.50	December 1, 2012
	106,600,000	$0.63	

The summary of the Company's share purchase warrants outstanding at December 31, 2012 is as follows:

	Number of Warrants outstanding	**Exercise Price**	**Expiry Date**
Public Offering – First Release	38,949,000	$0.65	December 1, 2013
Public Offering – Second Release	91,000,000	$0.65	December 1, 2013
	129,949,000	$0.65	

9. SHARE CAPITAL (continued)

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 was estimated on the date of grant using a Black-Scholes option pricing model with the following assumptions:

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

During the year ended December 31, 2012, 1,500,000 stock options granted to an employee expired and 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, 2012 and December 31, 2011.

As at December 31, 2012, a total of 20,565,000 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 2.98 years. Changes to the Company's stock options are summarized as follows:

	2012		**2011**	
	Number of Options	**Wt. Avg. Exercise Price**	**Number of Options**	**Wt. Avg. Exercise Price**
Balance, beginning of year	**22,065,000**	**$ 0.67**	9,592,500	$ 0.66
Granted	**-**	**-**	12,715,000	0.67
Expired	**(1,500,000)**	**0.66**	(242,500)	0.80
Balance, end of year	**20,565,000**	**$ 0.67**	22,065,000	$ 0.67
Exercisable, end of year	**20,565,000**	**$ 0.67**	22,065,000	$ 0.67

10. CONTRIBUTED CAPITAL RESERVE AND WARRANTS

($ 000's)		**December 31, 2012**		December 31, 2011
Contributed capital reserve:				
Balance, beginning of year	**$**	**9,113**	$	4,317
Stock-based compensation (note 9c)		**-**		4,796
Balance, end of year	**$**	**9,113**	$	9,113
Warrants:				
Balance, beginning of year	**$**	**37,359**	$	11,007
Fair value of warrants issued (note 9a)		**-**		26,364
Warrants exercised		**-**		(12)
Balance, end of year	**$**	**37,359**	$	37,359

11. DEFERRED INCOME TAX

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

($ 000's)		**2012**		2011
Non-capital income tax losses	**$**	**4,752**	$	3,182
Pre-trading expenses - UK		**30,874**		25,737
Capital losses		**632**		632
Share issue costs		**1,140**		489
E & E assets		**136**		50
Office equipment assets		**46**		17
		37,580		30,107
Unrecognized tax benefits		**(37,580)**		(30,107)
Deferred income tax assets (liabilities)	**$**	**-**	$	-

The Company did not recognize a deferred tax asset as at December 31, 2012 or 2011, as currently, it is not expected that the assets will be recoverable in the foreseeable future.

The temporary differences associated with investments in subsidiaries, for which a deferred tax liability was not recognized amounted to $26.3 million as at December 31, 2012 (2011 - $28.0 million).

11. DEFERRED INCOME TAX (continued)

The provision for income taxes (recoveries) differs from the expected amounts using statutory income tax rates as follows:

($ 000's)		**2012**		2011
Loss	**$**	**(56,638)**	$	(53,428)
Income tax rates		**25.0%**		26.5%
Provision at statutory rates		**(14,160)**		(14,158)
Tax rate differential (UK and Bermuda)		**(14,985)**		(12,054)
Non-deductible items:				
Stock-based compensation		**-**		1,340
Amortization of warrants		**-**		-
Depreciation in excess of capital allowance		**26**		13
Other		**210**		44
Share issue costs		**(434)**		(173)
Effect of tax rates changes (Canada and UK)		**(1,292)**		(1,163)
Change in previously estimated tax pools		**24,160**		(230)
Change in unrecognized tax benefits		**7,473**		26,267
Effect of foreign exchange		**(998)**		114
Deferred income tax provision (recovery)	**$**	**-**	$	-

As at December 31, 2012, the Company had approximately $19.0 million (2011 - $12.7 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
- $4,643,000 on December 31, 2031; and
- $4,873,000 on December 31, 2032.

As at December 31, 2012, the Company also had capital losses of approximately $5.1 million (2011 - $5.1 million), which will carry forward indefinitely to reduce capital gains taxed in Canada.

In addition, the Company had cumulative pre-trading expenses in the UK as at December 31, 2012 of approximately $49.8 million or GBP 30.8 million (2011 - $41.5 million or GBP 26.3 million). 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. If the Company does not obtain trading status the amounts will expire after seven years.

12. COMMITMENTS AND CONTRACTUAL OBLIGATIONS

As at December 31, 2012, the Company has the following commitments other than the obligations under UK contracts in dispute (as discussed in note 8):

($ 000's)	Total	Less than One Year	One to Three Years	Four to Five Years	After Five Years
NZ exploration commitments	**1,700**	200	1,500	-	-
Office lease	**3,725**	554	1,077	1,069	1,025
	5,425	754	2,577	1,069	1,025

NZ exploration commitments of $1.7 million as at December 31, 2012 relate to a minimum work programme to be carried out under a 50% exploration license in New Zealand. In addition, the Company acts as a guarantor of its partner's commitments (the remaining 50%) in this New Zealand license.

The Company is committed under an operating lease agreement for the rental of office space in Calgary, Canada and Aberdeen, UK. The approximate total lease payments are $3.7 million and are payable over the next seven years.

Liberia transactions

On May 18, 2011 the Company (via its Bermuda subsidiary, COPL B) signed a Sale and Purchase Agreement ("PSPA") with Peppercoast to acquire a 100% interest in Block LB-13 offshore Liberia

On November 16, 2011, the Company signed an Asset Purchase Agreement with ExxonMobil Exploration and Production Liberia Limited ("ExxonMobil"), a wholly owned subsidiary of the ExxonMobil Corporation, to sell a 70% interest in the Production Sharing Contract ("PSC") governing Block LB-13 immediately following COPL B's acquisition of a 100% interest from Peppercoast.

In April 2012, the National Oil Company of Liberia ("NOCAL') accepted the proposed joint venture between ExxonMobil and COPL B as satisfying in principle the technical and financial competence requirements of the transfer provisions for the PSC governing Block LB-13 subject to agreeing on proposed amendments to the PSC. The negotiations between NOCAL, Exxon, Peppercoast and the Company continued during the rest of 2012.

On March 8, 2013, a Restated and Amended PSC for Block LB-13 offshore Liberia was agreed and the President of Liberia has approved and signed the appropriate paperwork related to the PSC so that it can be sent to the Liberian Legislature for a ratification vote. The terms of the PSC will take effect once ratification has occurred and the PSC is enacted into law. Completion of the transactions contemplated is expected to occur shortly after ratification and remain subject to a number of conditions, including ratification.

12. COMMITMENTS AND CONTRACTUAL OBLIGATIONS (continued)

Liberia transactions (continued)

Certain terms of the previously signed purchase agreements between COPL, COPL B and Peppercoast, and between COPL B and ExxonMobil have been amended. COPL B and ExxonMobil have amended the Asset Purchase Agreement such that COPL B will now have a 20% working interest in Block LB-13 and ExxonMobil as operator will have an 80% working interest. ExxonMobil will continue to pay COPL B's working interest portion of drilling expenses for the first $120 million of gross drilling costs committed under the PSC, and COPL B's share of joint venture costs. In addition, the payment terms as between COPL B and Peppercoast have also changed from the initial PSPA agreement. The new arrangements call for the completion of the acquisition of the original PSC by COPL B to be funded by NOCAL such that NOCAL shall pay the obligations of COPL B to Peppercoast. Following that transfer, ExxonMobil will pay to NOCAL (1) all funds owed to COPL B under the Asset Purchase Agreement, and (2) on behalf of COPL B and ExxonMobil, all amounts owed by COPL B and ExxonMobil to the Government of Liberia on account of the issuance of the PSC. Upon that payment, the PSC shall be owned 20% by COPL B and 80% by ExxonMobil.

As a result of these changes, COPL will no longer issue any shares to Peppercoast to complete the transaction. Further, other than legal costs, usual closing costs and on-going fees under the PSC, COPL and COPL B will have no net cash outlay or cost in connection with the closings other than forgiveness of accounts receivable related to the $15 million 3D seismic license fee owing by Peppercoast to COPL, which is disclosed as a deposit on seismic on the balance sheet, and other inter-company amounts, as well as $7 million of fees payable to the Government of Liberia.

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.

13. 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:

($ 000's)	**2012**	2011
Consulting fees	**$ 119**	$ 119

As at December 31, 2012, accounts due from related parties amounted to $26,000 (December 31, 2011 - $19,000), which represented travel advances, with $nil payable to related parties (December 31, 2011 - $nil) for outstanding travel expenses.

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:

($ 000's)	**2012**	2011
Short-term benefits	**$ 1,812**	$ 1,673
Stock-based compensation	**-**	2,860
	$ 1,812	$ 4,533

Short-term benefits include annual salaries, directors' fees and health and other taxable benefits. The 2011 and 2012 balances include the consulting fees (note 13 (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 as at the date of grant.

14. 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 and accrued liabilities are classified as other liabilities; these items are measured at amortized cost.

a) Fair values

As at December 31, 2012 and 2011, 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, 2012	**December 31, 2011**
British Pounds	**587**	41,698
U.S. Dollars	**317**	682

(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, 2012, the Company holds $4.4 million of cash and cash equivalents with Canadian and UK chartered banks. Management has assessed the associated credit risk as relatively low.

Should the PSPA transaction discussed in note 12 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.

15. 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, if any. 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, 2012.

16. NET CHANGE IN NON-CASH WORKING CAPITAL

		Year ended December 31, 2012		Year ended December 31, 2011
Increase in accounts receivable	**$**	**(36)**	$	(116)
Increase in prepaid expenses		**(49)**		(141)
Increase in deposits and prepayments		**(6)**		-
Increase in operating accounts payable and accrued liabilities		**2,199**		47
Decrease in provision for loss on contract		**(32,641)**		-
Non-cash transaction:				
Net effect of foreign exchange		**75**		-
Net change in operating non-cash working capital	**$**	**(30,458)**	$	(210)
Decrease/(increase) in accounts receivable related to exploration assets	**$**	**247**	$	(247)
(Decrease)/increase in accounts payable related to exploration assets		**(1,372)**		1,371
Non-cash transaction:				
Net effect of foreign exchange		**-**		640
Net change in investing non-cash working capital	**$**	**(1,125)**	$	1,764