# AFRICA OIL CORP.

## Year End Report to Shareholders

## December 31, 2011

**AFRICA OIL CORP.**
**MANAGEMENT'S DISCUSSION AND ANALYSIS**
**(Amounts expressed in United States dollars unless otherwise indicated)**
**For the years ended December 31, 2011 and 2010**

Management's discussion and analysis ("MD&A") focuses on significant factors that have affected Africa Oil Corp. and its subsidiaries (the "Company" or "AOC") and such factors that may affect its future performance. In order to better understand the MD&A, it should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2011 and 2010 and related notes thereto.

The financial information in this MD&A is derived from the Company's audited consolidated financial statements which have been prepared in United States ("U.S.") dollars, in accordance with International Financial Reporting Standard as issued by the International Accounting Standards Board. Previously, the Company prepared its Interim and Annual Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles.

The effective date of this MD&A is March 23, 2012.

Additional information about the Company and its business activities is available on SEDAR at www.sedar.com.

## PROFILE AND STRATEGY

AOC is a Canadian-based company whose common shares are traded on the TSX Venture Exchange and the First North list of the NASDAQ OMX Stock Exchange in Sweden under the symbol "AOI". The Company is an international oil and gas exploration and development company, based in Canada, with oil and gas interests in Kenya, Ethiopia, Puntland (Somalia), and Mali.

AOC's long range plan is to increase shareholder value through the acquisition and exploration of oil and gas assets, located in under-explored geographic areas, in the early phase of the upstream oil and gas life-cycle and maturing them into marketable opportunities for larger oil and gas industry players. The Company is focused on high-impact exploration opportunities and has secured a portfolio of primarily East African oil and gas assets which provide the shareholders exposure to multiple identified prospects and leads, geographically and geologically diversified across multiple countries and four under-explored petroleum systems. AOC's mission is to de-risk this portfolio of oil and gas prospects and leads, while generating additional prospects and leads, through continuous oil and gas exploration activities. The Company is pursuing a farmout strategy aiming to leverage the current working interest holdings in each of its operated blocks. AOC aims to continue to identify additional highly prospective exploration targets in geologically favorable settings. The Company will continue to consider acquisition and merger opportunities with a focus on North Africa and the Middle East. In general, AOC will continue its portfolio approach to exploring a large number of oil and gas opportunities with the goal of increasing shareholder value.

The Company has acquired and commenced exploration activities on multiple exploration Blocks in East Africa (refer to table below). The East African Rift Basin system is one of the last great rift basins to be explored. New discoveries have been announced on all sides of the Company's virtually unexplored land position including the major Tullow Oil plc Albert Graben oil discovery in neighboring Uganda. Similar to the Albert Graben play model, the Company's concessions have older wells, a legacy database, and host numerous oil seeps indicating a proven petroleum system. Good quality existing seismic show robust leads and prospects throughout AOC's project areas. The Company now holds exploration acreage of over 300,000 $km^2$ (gross) in this exciting new world-class exploration play fairway. The Company aims to have completed significant seismic and drilling programs on the majority of the Company's blocks over the next two years. East Africa is a vastly under-explored region where renewed interest is being shown by a growing number of mid to large sized oil companies wishing to add to their exploration portfolios.

## WORKING INTERESTS

The following table summarizes the Company's net working interests in the various production sharing contracts/agreements, based on working interest ownership:

| **Country** | **Block/Area** | **December 31, 2010 Net Working Interest % (1)** | **December 31, 2011 Net Working Interest % (1)** |
|---|---|---|---|
| Kenya | Block 10A | 55% | 30% |
| Kenya | Block 9 | 20.0% | 100.0% |
| Kenya | Block 10BB | 80% | 50% |
| Kenya | Block 12A | 100% | 50% |
| Kenya | Block 13T | 100% | 50% |
| Kenya | Block 10BA | 0% | 50% |
| Ethiopia | Blocks 2/6 (4) | 55% | 0% |
| Ethiopia | Blocks 7/8 | 55% | 55% |
| Ethiopia | Adigala | 50% | 50% |
| Ethiopia | South Omo | 30% | 30% |
| Mali | Block 7 | 0% | 25% |
| Mali | Block 11 | 0% | 25% |
| Puntland, Somalia | Dharoor Valley | 65% | 31% (3) |
| Puntland, Somalia | Nugaal Valley (2) | 65% | 31% (3) |

Footnotes:
[1] Net Working Interests are subject to back-in rights or carried working interests, if any, of the respective governments or national oil companies of the host governments.
[2] Nugaal Valley net working interest is subject to AOC fulfilling its sole funding obligation during the exploration period (see Commitments and Contingencies section below).
[3] Represents AOC's Net Working Interest subsequent to the formation of a new Puntland focused exploration company (see "New Puntland (Somalia) Focused Exploration Company"). AOC owns approximately 51.4% of the new company. This figure represents the Company's Net Working Interest in the production sharing agreements, net of the 48.6% minority interest in the new company.
[4] The Company has relinquished Blocks 2/6. Ministerial approval to waive remaining commitments has been provided.

## RECENT DEVELOPMENTS

### New Puntland (Somalia) Focused Exploration Company

During September 2011, the Company closed its previously announced transaction (the "Horn Transaction") with Denovo Capital Corp. ("Denovo") pursuant to which Denovo acquired all of the issued and outstanding shares of Canmex Holdings (Bermuda) I Ltd. ("Canmex"), a wholly owned subsidiary of the Company. Canmex holds a 60% interest in the production sharing agreements ("PSAs") for the Dharoor Valley Exploration Area and the Nugaal Valley Exploration Area in Puntland, Somalia.

Prior to closing, Denovo effected a consolidation of its share capital on the basis of 0.65 new shares for each old share, and changed its name to Horn Petroleum Corporation ("Horn"). Horn also completed a non-brokered private placement of an aggregate of 45,535,195 subscription receipts at a price of

CAD$0.90 per subscription receipt for gross proceeds of $41.3 million. The subscription receipts were converted into common shares and warrants of Horn on September 20, 2011. AOC acquired 11,111,111 post-consolidation shares and 11,111,111 post-consolidation share purchase warrants in the Horn private placement. In connection with the private placement, Horn paid a finder's fee, consisting of the issuance of an aggregate of 812,417 common shares and the payment of $0.9 million in cash. All securities issued pursuant to the Offering were subject to a statutory hold period which expired December 3, 2011.

Subsequent to the Horn Transaction, AOC holds 51.4% of the outstanding shares of Horn, as well, a management services arrangement has been completed between Horn and AOC in which the management of AOC are responsible for the operating decisions of Horn. As such, the former shareholder of Canmex, AOC, is deemed to control Horn. As a result of the Horn Transaction and the $41.3 million private placement, the Company has successfully raised the anticipated funds required for its planned two well exploratory drilling program in Puntland (Somalia). Spudding of the first well occurred on January 16, 2012. Horn's common shares and warrants trade on the TSX Venture Exchange under the symbols "HRN" and "HRN.WT", respectively.

**Ethiopia Production Sharing Agreements**

During the third quarter of 2011, the Company relinquished Blocks 2/6 and the Ministry of Mines in Ethiopia agreed to waive remaining commitments. The Company paid $1.2 million to the Ministry of Mines in Ethiopia, in lieu of unfulfilled commitments with respect to Blocks 2/6 PSA.

In the fourth quarter of 2011, the Ministry of Mines in Ethiopia approved the Company and its partners' entry into the next exploration period on the Adigala Block with amended minimum work commitments. Under the PSA which expires in July 2013, AOC and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 7,500 kilometers of full tensor gravity) with a minimum gross expenditure of $1.75 million.

**Tullow Farmout and Lion Farmout Amendment**

During the first quarter of 2011, the Company completed a farmout transaction with Tullow Oil plc ("Tullow") on Blocks 10BB, 10A, 12A and 13T in Kenya. The farmout on the South Omo Block in Ethiopia was completed on December 9, 2010. Tullow has acquired a 50% interest in, and operatorship of five of AOC's east African exploration blocks.

Under the terms of the Tullow farmout agreement, Tullow acquired a 50% interest in, and operatorship of, Blocks 10BB and 10A in Kenya and of the South Omo Block in Ethiopia. In consideration for the assignment of these interests, Tullow has paid to AOC $9.5 million, representing 50% of AOC's audited past costs in the blocks. Tullow continues to fund its 50% working interest and AOC's working interest share of future joint venture expenditures in these blocks from July 1, 2010, the effective date, until the cap of $23.75 million (based on AOC's carried interest) is reached. Once the expenditure cap has been met, AOC will be responsible for its working interest share of future costs.

Additionally, Tullow exercised an option to acquire 50% of AOC's interest in, and operatorship of, two additional exploration blocks in Kenya, 12A and 13T. Tullow has paid to AOC $1.7 million as compensation for past costs. Tullow and AOC are responsible for their working interest share of joint venture expenditures in these blocks going forward.

The Company also amended their farmout agreement with Lion Energy Corp. ("Lion"). The amendment reduced Lion's interest in Block 10BB to 10% (originally 20%) and eliminated its interest in Block 10A (originally 25%). As consideration, the Company paid Lion $2.5 million in cash and issued to Lion 2.5 million common shares of AOC. The Company also agreed to the elimination of future expenditure promotes in Block 10BB and on the Company's projects in Puntland (Somalia).

**Acquisition of Lion Energy Corp.**

Effective June 20, 2011, the Company completed the acquisition of all of the issued and outstanding common shares of Lion Energy Corp. ("Lion"), a publicly traded oil and gas company listed on the TSX Venture Exchange. Pursuant to the agreement with Lion, AOC acquired, by way of a plan of arrangement, all of the issued and outstanding shares of Lion in consideration for 14,962,447 AOC shares, net of 2,500,000 AOC shares Lion owned at the date of acquisition. The Company also issued 287,250 stock options which expired between 30 and 90 days from the effective date of the transaction and 2,289,000 share purchase warrants that expired unexercised on June 29, 2011. The value of consideration issued, net of AOC shares acquired was $21.7 million.

Lion was a joint venture partner of AOC in Kenya and Puntland (Somalia), and held the following working interests; 33.3% in Block 9 (Kenya), 10% in Block 10BB (Kenya), and 15% in each of Dharoor Valley and Nugaal Valley (Puntland). The Company's subsidiary that held the exploration licenses in Puntland (Somalia) has been sold to Horn in return for shares in Horn (see above, "New Puntland (Somalia) Focused Exploration Company"). In addition to the above properties, Lion had net working capital of $20.1 million at close, excluding the value of the AOC shares held by Lion.

**Kenya Block 9 – AOC Enters the First Additional Exploration Period**

The Company, together with its joint venture partner Lion, entered into the First Additional Exploration Phase under the Block 9 production sharing contract ("PSC") in Kenya. As a result of the withdrawal of its two other joint venture partners, AOC held a 66.7% working interest in the PSC and was approved by the government as Operator of Block 9. Lion held the remaining 33.3%. The First Additional Exploration Phase commenced on December 31, 2010 and will expire on December 31, 2013 with a one well work commitment (minimum depth 1,500 meters). Effective June 20, 2011, the close of the Lion acquisition, AOC holds 100% working interest in the Block 9 PSC.

In addition to the gas prospectivity on the block (see discussion below in Operations Update section), the northwestern portion of the Block contains the Kaisut Basin which is an extension of the Anza Basin oil play currently being pursued by AOC and its joint venture partners in Block 10A. Several leads have been identified in this area on legacy 2D seismic data and the 750 kilometer 2D seismic survey which was completed in the third quarter of 2011 aimed at upgrading these leads into drillable prospects.

**Acquisition of Centric Energy**

Effective February 23, 2011, the Company completed the acquisition of all of the issued and outstanding common shares of Centric Energy Corp. ("Centric"), a publicly traded oil and gas company listed on the TSX Venture Exchange. Pursuant to the acquisition agreement, AOC acquired, by way of a plan of arrangement, all of the issued and outstanding shares of Centric in consideration for 30,155,524 AOC shares and $9,917. The consideration issued was valued at $60.2 million.

The primary asset acquired was Block 10BA in Kenya which is strategically located within the highly prospective East African Tertiary Rift System between AOC's Block 10BB and its South Omo Block. This trend hosts the recent discoveries in the Albert Graben in Uganda where up to 2.5 billion barrels of oil have been discovered by Tullow. In addition, Centric also had a carried 25% interest in Block 7 and Block 11, both located in the Republic of Mali and operated by Heritage Oil Corporation.

Block 10BA is highly under-explored, with only sparse seismic data acquired in 1991. It covers 16,205 square kilometers (gross) and is directly north of the Loperot oil discovery drilled by Shell Exploration (Kenya) in 1992, within AOC's Block 10BB. The planned acquisition of new seismic data onshore and offshore is expected to considerably improve the understanding of the hydrocarbon potential of this Block.

Prior to the acquisition, Centric farmed out 50% working interest in Block 10BA to Tullow. In consideration for the assignment of these interests, Tullow paid Centric $1.0 million for past costs in the block. Tullow will earn a 50% participating interest and operatorship in Block 10BA by funding 80% of the first $30 million of gross joint venture expenditures under the Block 10BA PSC. Once the expenditure cap has been met, each joint venture partner will be responsible for its working interest share of future costs.

An independent assessment of the prospective resources of Block 10BA has been prepared in accordance with National Instrument 51-101 – Standards for Disclosure for Oil and Gas Activities. This report calculates gross prospective resources for 25 Centric leads and prospects in the Block. The total of the prospective resources ranges from a low case (P90) of 955 million barrels of oil up to a high case (P10) of 4,379 million barrels of oil, with a best estimate (P50) of 2,188 million barrels of oil.

The Company holds a 25% interest in two exploration licenses in Mali where its costs are carried by Heritage Oil Corporation under the terms of a farmout agreement through the primary seismic program and the first exploration well. The area of the licenses totals approximately 64,000 square kilometers and is part of the Cretaceous-age Central Africa Rift Trend which contains significant oil accumulations in Chad, Sudan and Niger. The basin has been sparsely explored with only 600 kilometers of older vintage seismic data, the most recent shot in 1974, and one exploration well, drilled in 1976. A nearby water well had significant shows of oil and gas demonstrating an active petroleum system. The Company and its partner have completed the acquisition of 848 km of 2D seismic in Block 11 and 243 km in Block 7.

**Extensions in Puntland (Somalia) and Red Emperor Farmout**

In January 2011, amending agreements were entered into with the Government of Puntland, represented by the Puntland Petroleum and Mineral Agency, in respect of the PSAs for the Dharoor Valley Exploration Area and the Nugaal Valley Exploration Area. Under the PSAs, as amended, the First Exploration Agreement had been extended for a further 12 months, from January 17, 2011 to January 17, 2012.

Under the amended PSAs, the Company was obligated to spud a minimum of one exploratory well in the Dharoor Valley Exploration Area by July 27, 2011. A second exploratory well was required to be spudded in the Nugaal Valley Exploration Area or, at the option of AOC, in the Dharoor Valley Exploration Area, by September 27, 2011.

In conjunction with this amendment, the Company completed its farmout agreement with Red Emperor Resources NL ("Red Emperor"). Under the terms of the farmout agreement and an election made by Red Emperor to increase their interests, Red Emperor will earn a 20% interest in both the Dharoor Valley and Nugaal Valley Blocks and is committed to paying a disproportionate share of costs related to the one well drilling commitment included in the first exploration period of both the Dharoor Valley and Nugaal Valley PSAs.

During July 2011, the existing PSAs in respect of the Dharoor Valley and Nugaal Valley Exploration areas were further amended requiring execution of a drilling contract by July 31, 2011, drilling operations to commence on the first well by November 15, 2011, and drilling operations to commence on a second well by January 17, 2012. The Company agreed to relinquish 15,627 km2 (gross) of the Nugaal Valley Exploration area, perform a surface geochemistry survey in the Nugaal Valley Exploration area, and pay the Puntland State of Somalia $1,000,000 in infrastructure and development support fees of which $500,000 was paid during 2011, $250,000 was paid subsequent to year end on spud of the first well and the remaining $250,000 is due on completion of the first exploration well.

In February 2012, the Puntland Government granted the Company an extension of the first exploration period expiry date for the Dharoor Valley and Nugaal Valley Exploration areas to October 17, 2012 in order to provide for sufficient time to evaluate drilling results of both wells required under the PSAs.

The Company's subsidiary that holds the exploration licenses in Puntland (Somalia) has been sold to Horn Petroleum Corporation in return for shares in Horn (see above, "New Puntland (Somalia) Focused Exploration Company").

**Convertible Debenture**

As part of the Company's acquisition in April of 2009 of Lundin Petroleum AB's ("LPAB") oil and gas operations in Kenya and Ethiopia, a subsidiary of LPAB provided the Company with a $23.8 million US dollar denominated convertible debenture to finance the acquisition. The convertible loan from LPAB carries an interest rate of USD six-month LIBOR plus 3%. The loan, including any accrued and unpaid interest, is convertible, at the option of either AOC or LPAB, into shares of the Company on the basis of CAD$0.90 per common share. The convertible debenture was to mature December 31, 2011.

In March 2011, the Company and LPAB amended the terms of the loan agreement to allow for full or partial conversion of the loan prior to the maturity date if agreed to, in writing, by both parties. On March 3, 2011, AOC and LPAB agreed to convert $13.0 million of the convertible loan into 14 million shares of the Company. In April 2011, AOC and LPAB agreed to convert the remaining $10.8 million of the convertible loan plus $0.2 million of accrued interest into 11,850,100 shares of the Company.

**Exercise of Warrants**

In accordance with agreements entered into with warrant holders, the Company elected to exercise its rights to accelerate the expiry date of certain of its outstanding warrants to purchase common shares of AOC.

On November 22, 2010, the Company gave notice to the holders of the remaining warrants granted in April 2009 accelerating the expiry date of those warrants to December 23, 2010. Of the 37,421,018 warrants granted in April 2009, 37,220,365 were exercised in 2010 and 161,653 expired unexercised in 2010. On the exercise of warrants in 2010, the Company issued 37,220,365 common shares, realizing net proceeds of $55.2 million. The Company extended the expiry 39,500 warrants to March 23, 2011 as it had difficulty notifying these warrant holders. In the first quarter of 2011, 30,000 of the remaining warrants were exercised prior to March 23, 2011 and the remaining 9,500 warrants expired unexercised. On the exercise of warrants in 2011, the Company issued 30,000 common shares, realizing net proceeds of $46,242.

The Company also had 1,500,000 common share purchase warrants outstanding that were issued on September 9, 2010 (the "Additional Warrants"). On November 22, 2010, the Company gave notice to the holder of the Additional Warrants accelerating the expiry date of those warrants to May 22, 2011. In April 2011, all 1,500,000 warrants were exercised. On the exercise of warrants in 2011, the Company issued 1,500,000 common shares, realizing net proceeds of $2,362,500.

Subsequent to December 31, 2011, the remaining 6,521,601 common share purchase warrants outstanding were converted into common shares of AOC for gross proceeds of CAD $9.8 million.

**Study Block Definitive Agreement**

In December 2010, AOC signed a definitive agreement with the Government of Ethiopia to jointly study the Rift Valley Block. The Block is located north of the Company's South Omo Block and encompasses the remainder of the Tertiary age East Africa Rift Trend in Ethiopia. The Company has committed to carry out an airborne geophysical survey over the Block, which spans 42,519 square kilometers (gross). The Joint Study Agreement has an 18 month term, following which AOC will have the exclusive right to enter into negotiations for a PSC for all or part of the Rift Valley Block.

**Court Proceedings – Interstate Petroleum Ltd. ("IPL")**

On December 27, 2010, IPL, a Kenyan entity, filed a Notice of Appeal in respect of a ruling by the High Court in Kitale, Kenya dismissing certain court proceedings initiated by IPL. The court proceedings had been initiated by IPL to dispute the administrative process that lead to the issuance of exploration permits in respect of, amongst others, Blocks 10BB, 10BA, 12A and 13T (the "Blocks"), and the Company was named as a party to the proceedings.

An application to strike IPL's Notice of Appeal had initially been scheduled for September 23, 2011 but was adjourned to January 31, 2012. The matter did not proceed on that date, however, in response to allegations, made by IPL, of a conflict on the part of one of the judges. The hearing for the Company's striking out application has now been set for May 3, 2012.

Concurrently, a winding-up petition in respect of IPL, which had been filed by the Company in the High Court Registry at Kitale, Kenya had been scheduled to be heard on February 1, 2012. At that hearing, IPL raised a number of objections concerning the petition. On February 16, 2012, the Court ruled in favor of IPL in respect of the objections. A new petition, which addresses the objections raised by IPL, is being prepared for filing in March 2012.

On January 30, 2012, a Judicial Petition was brought before the High Court of Kenya at Kitale by IPL and certain third parties associated with IPL. Following the hearing, which was held ex parte, those parties were granted leave to apply for orders compelling the Company to vacate certain disputed acreage comprising the Blocks and to refrain from carrying on with exploration for crude oil and gas within that acreage. The Company will be notified of, and will attend at, any subsequent hearings in respect of this matter and will request that the proceedings be dismissed as frivolous.

## OPERATIONS UPDATE

The Company continues its aggressive exploration efforts. Two high impact oil exploration wells are currently being drilled. The Shabeel-1 well, located on the Dharoor Block in Puntland (Somalia), is currently drilling at a depth of approximately 2,400 meters while the Ngamia-1 well, located on Block 10BB in Kenya, is currently drilling at a depth of over 1,000 meters (additional details on both wells below). It is anticipated that two drilling rigs will operate on the Company's blocks throughout 2012. It is anticipated that the results of these two wells will be available during the second quarter of 2012.

AOC, with partner Tullow, have completed the acquisition and processing of approximately 60,000 line kilometers of Full Tensor Gravity ("FTG") in Blocks 10BB, 10BA, 13T, 12A, 10A, and South Omo of Kenya and Ethiopia. The use of this new technology, developed by the US military, provides much greater resolution than traditional gravity and magnetic reconnaissance methods. This enhanced resolution allows operators to more precisely define prospective areas prior to acquiring seismic data. FTG seismic surveys are being acquired in a timeframe of months, at 5- 10% of the cost of a loose grid of 2D seismic data. This is allowing operators to focus their seismic programs towards prospect-delineation sooner, and get to drillable prospects faster and more cost-effectively. Tullow has successfully used FTG to provide a structural model of fault blocks in the Albert Graben.

During 2012, the Company's planned exploration activities include the drilling of five exploration wells and the acquisition of over 2,100 kilometers of 2D seismic. In addition to the Shabeel-1 and Ngamia-1 wells, which are currently being drilled, it is anticipated that the Shabeel North well will be drilled in Puntland (Somalia), the Paipai well will be drilled on Block 10A in Kenya and an exploration well will be drilled on the South Omo Block in Ethiopia. It is anticipated that 2D seismic will be acquired on Blocks 10BA, 10BB, 12A, 13T and South Omo.

**KENYA**

The Company and Tullow, its operating partner in each of the Kenyan Blocks other than Block 9, are actively exploring for oil as described below.

<u>Block 10BB</u>

The Company and its operating partner on the Block, Tullow, spudded the partnership's first well, Ngamia-1, on January 24, 2012. The Ngamia prospect will test the oil potential of Miocene age sandstones within a three way dip closure against the West Lokichar rift fault. Ngamia is directly analogous to successful oil accumulations drilled by Tullow and partners early in the exploration efforts in the Lake Albert graben of Uganda. The Company is currently drilling the 12 ¼" section of the well at a depth of 1040m with the Weatherford 804 rig. The well is planned to reach total depth of approximately 2700m. In addition to drilling operations, the Company and its partner are currently acquiring new 2D seismic in adjacent Block 13T and will be extending two lines (approximately 150km) into Block 10BB over the Kamba prospect. The drilling of the Ngamia-1 well satisfies the last remaining work obligation (first period) under the Block 10BB PSC.

<u>Block 13T</u>

The Company and its operating partner on the Block, Tullow, expect to complete acquiring new 2D seismic over the eastern portion of the block by the end of the first quarter of 2012. Approximately 500 km of seismic data will be acquired by the seismic subcontractor Bureau of Geophysical Prospecting ("BGP"). The seismic program has been focused on areas of interest based on the final-processed FTG. Interpretation of reprocessed vintage seismic data, in addition to new preliminary seismic data, has revealed a string of interesting structures on trend with the Ngamia feature of Block 10BB. The current seismic program is focused on further delineation of these leads to mature them to drillable prospects. The acquisition of the 500 km of 2D seismic fully satisfies the work obligations (first period) under the Block 13T PSC.

<u>Block 10A</u>

The Company and its operating partner on the Block, Tullow, have agreed on the location of the first exploratory well in Block 10A. The prospect to be drilled is the Paipai prospect with a proposed total depth of 4150m. Paipai is a large four-way closed structure with Cretaceous-age sandstone targets at multiple depths. The Weatherford 804 rig, currently at the Ngamia-1 location, will mobilize to Paipai directly after completion of Ngamia operations. The Paipai civil works associated with the location have been completed and sufficient materials have been purchased and mobilized to the location. The Paipai well will complete the required work obligations under the Block 10A PSC.

<u>Block 10BA</u>

The Company and its operating partner on the Block, Tullow, have completed an FTG survey over most of Block 10BA, covering all of Lake Turkana and most of the adjacent onshore areas. The seismic contractor, BGP has been contracted to acquire approximately 1350 km of mixed offshore, transition zone, and onshore 2D seismic data focused on structural leads identified from both vintage seismic data and the FTG results. Current seismic operations include establishment of the base camp, testing the recording equipment, and working with local stakeholders to ensure the acquisition program avoids any environmentally sensitive areas. The 2D seismic program will fulfill the work obligations (first period) under the Block 10BA PSC.

Block 12A
The Company and its operating partner on the Block, Tullow, have completed a FTG survey over the entire Block 12A. Based upon the FTG results, an area of interest, the Kerio Valley, has been identified in the southwestern portion of the block where future 2D seismic acquisition will be focused. The BGP seismic crew in Block 13T is expected mobilize to Block 12A at the beginning of the second quarter of 2012 upon completion of seismic in Block 13T. Additionally, geologic fieldwork in Block 12A has identified excellent quality reservoir and oil-prone source rocks exposed in outcrop. The 2D seismic program will satisfy the work obligations (first period) under the Block 12A PSC.

Block 9
The Company holds 100% interest in Block 9 where a major new seismic acquisition program of 750 km was completed in 2011. The new data was acquired over the Kaisut sub-basin in northwestern Block 9. Based upon the new data set, several large prospects have been identified. The Company will consider farmout opportunities on this block. One exploration well is expected to be drilled during 2013, which will satisfy the remaining work obligations (second period) under the Block 9 PSC.

**Ethiopia**

South Omo Block
The Company and its operating partner on the Block, Tullow, have completed approximately 65% of a 1000 km 2D seismic program in the western portion of the South Omo Block. Seismic acquisition is being undertaken by a third BGP crew. The recently acquired FTG data over the South Omo Block has been used extensively to lay out the new seismic program. A number of very interesting leads have thus far been identified and an infill seismic program will be acquired in the current campaign to mature these leads to drillable prospects. One exploratory well is programmed in the block before the end of 2012, which will then satisfy the remaining work obligations (first period) under the South Omo PSA.

Ogaden Blocks 7/8
The Company and its partners continue their focus on the El Kuran oil and gas accumulation in Block 8, discovered in the early 1970's. The Company has completed a second phase reservoir characterization study over the El Kuran structure and an economic evaluation is underway. The Company is currently analyzing the economic feasibility of re-drilling and testing the El Kuran structure in hopes of proving up movable, commercial quantities of oil and gas. Additionally, the Company is seeking tenders for the drilling and third party services for one well on El Kuran.

Adigala Block
The Company and its partner have entered the second exploration period for the Adigala Block following successful negotiations with the Ethiopian Ministry of Mines to alter the PSA work obligations. During the first quarter of 2012, the Company completed an airborne FTG survey, the key work obligation in the amended PSA. Geologic fieldwork commenced in February of this year with a focus on critical outcrops along the periphery of the sedimentary basin. 2D seismic data acquired in 2009 will undergo special reprocessing in hopes of improving the data quality.

Rift Valley Joint Study Block
The Company completed the acquisition of high resolution gravity and magnetic data over the Rift Valley Block. The block is on trend with highly prospective blocks in the Tertiary rift valley such as Ethiopian South Omo block, and Kenyan blocks 10BA, 10BB, 13T, and 12A.

## PUNTLAND (SOMALIA)

Dharoor and Nugaal Valley Blocks

Horn Petroleum is currently drilling its first well in the Dharoor Valley Block. The Shabeel-1 exploration well spudded in January of 2012 and is currently at a depth of approximately 2400 meters. The upper 1600 meters of section drilled to date includes a thick section of Tertiary limestones and shales that appear to be a regional seal as no oil or gas shows were encountered above this depth. The Company then completed drilling a 400 meter section composed of interbedded sandstones and shales believed to be Upper Cretaceous in age. Most of the sandstone intervals in this section have exhibited oil and gas shows confirming the existence of a working petroleum system. Determination of the quality of the reservoir and prospectivity of any potential oil bearing intervals cannot be determined until downhole electric logs and formation tests are concluded. The last 400 meters drilled was primarily through Cretaceous limestone.

The well has a planned total depth of 3800 meters and has yet to penetrate the main reservoir targets in the Lower Cretaceous and Jurassic. It is expected that the next electrical logging run will be coincident with the running of the 9 5/8" casing at approximately 2400 to 2700 meters. Operations continue to run smoothly with no material security or operational incidents. Drilling of the Shabeel-1 well is expected to be complete during April of 2012 and testing equipment is currently being mobilized to the site. Assuming successful drilling results, it is anticipated that testing results will be available in the second quarter of 2012. Upon completion of drilling the Shabeel-1 well, the rig will move to the Shabeel North-1 well, where 30 inch conductor pipe is in place and a 50 meter pilot hole has already been drilled.

The Puntland Government and Dharoor Valley communities are fully supportive of the drilling project and have ensured they will do all necessary to allow the project to move forward safely and expeditiously.

## MALI

Blocks 7 and 11

The Company and its partner, Heritage Oil and Gas Ltd. ("Heritage") in 2011 completed the acquisition of 848 km of 2D seismic in Block 11 and 243 km in Block 7. The new seismic data has been interpreted and technical meetings are scheduled with the Operator to agree on a forward exploration strategy. The Company's share of costs for initial seismic and the drilling of the first exploratory well are fully carried by its single partner and Operator, Heritage.

## SELECTED QUARTERLY INFORMATION

| **Three months ended** (thousands, except per share amounts) | **31-Dec 2011** | **30-Sep 2011** | **30-Jun 2011** | **31-Mar 2011** | **31-Dec 2010** | **30-Sep 2010** | **30-Jun 2010** | **31-Mar 2010** |
|---|---|---|---|---|---|---|---|---|
| Operating expenses ($) | 3,777 | 2,857 | 1,530 | 2,989 | 2,415 | 1,388 | 1,329 | 1,072 |
| Interest income ($) | 226 | 276 | 220 | 244 | 54 | 24 | 4 | 5 |
| Foreign exchange gain (loss) ($) | 2,067 | (6,792) | 670 | 1,582 | 1,590 | 440 | (106) | 64 |
| Fair market value gain (loss) - warrants ($) | 4,010 | 2,292 | 1,764 | 779 | 3,755 | (8,469) | (4,276) | 6,882 |
| Fair market value gain (loss) - convertible debenture ($) | - | - | 309 | 1,722 | (6,687) | (9,469) | (1,743) | 4,642 |
| Fair market gain (loss) on marketable securities ($) | 776 | (396) | (145) | - | - | - | - | - |
| Gain on acquisition of Lion Energy | - | - | 4,143 | - | - | - | - | - |
| Writedown of oil and gas properties | - | - | 6,969 | - | - | - | - | - |
| Dilution loss on sale of subsidiary | - | 4,579 | - | - | - | - | - | - |
| Net income (loss) ($) attributable to common shareholders | 696 | (11,140) | (1,538) | 1,338 | (3,703) | (18,862) | (7,450) | 10,521 |
| Net income (loss) ($) attributable to non-controlling interest | 2,606 | (915) | - | - | - | - | - | - |
| Weighted average shares - Basic | 211,413 | 211,320 | 195,974 | 154,451 | 108,243 | 91,366 | 70,520 | 70,205 |
| Weighted average shares - Diluted | 212,656 | 212,019 | 198,859 | 162,549 | 119,960 | 91,366 | 70,520 | 74,275 |
| Basic earnings (loss) per share ($) | - | (0.05) | (0.01) | 0.01 | (0.03) | (0.21) | (0.11) | 0.15 |
| Diluted earnings (loss) per share ($) | - | (0.05) | (0.02) | (0.01) | (0.03) | (0.21) | (0.11) | 0.08 |
| Oil and gas expenditures ($) | 20,883 | 9,392 | 6,037 | 4,974 | 2,553 | 8,538 | 1,431 | 2,902 |

During 2011, Horn was formed as a new Puntland focused exploration company. The Horn Transaction has been accounted for as an acquisition of Horn's net assets by Canmex (reverse acquisition) as AOC, the sole owner of Canmex prior to the Horn Transaction, controls Horn subsequent to the Horn Transaction. Effectively as a result of the Horn Transaction and Horn private placement, AOC through its wholly owned subsidiary acquired 51.4% of the newly formed entity. While the results of Canmex have historically been consolidated in the Company's financial statements, effective September 20, 2011, the 48.6% non-controlling interest in Horn will be accounted for in the consolidated results of the Company.

As the Company is in the exploration stage, no oil and gas revenue has been generated to date.

The Company's results were affected by four items occurring during the second and third quarters of 2011 for the first time:

1. The gains and losses on revaluation of marketable securities are the result of changes in the value of 10 million shares held in Encanto Potash Corp which were acquired on the acquisition of Lion;
2. The gain relating to the acquisition of Lion in the second quarter of 2011 was a result of the Company acquiring net working capital and intangible exploration assets in excess of the consideration issued. The consideration paid was valued at $21.7 million, net of AOC shares acquired, versus working capital acquired of $20.1 million, excluding the value of AOC shares held by Lion, and the fair market value of intangible assets acquired estimated at $5.7 million;
3. Expenditures relating to Blocks 2/6 were written off to due to impairment in the second quarter of 2011. AOC relinquished Blocks 2/6 and Ministerial approval to waive remaining commitments was obtained. The Company paid $1.2 million with respect to its share of the settlement with the Government of Ethiopia, in lieu of unfulfilled commitments with respect to the Blocks 2/6 PSA; and
4. A dilution loss was recorded on the sale of a subsidiary as a result of the Horn Transaction. In accordance with IFRS, when a reverse acquisition occurs, any excess of the fair value of the consideration paid over the value of the net assets acquired is recognized in the consolidated

statement of net loss and comprehensive loss as an expense. The Company has recorded a loss on reverse acquisition of $4.6 million as a result of the Horn Transaction.

*Operating expenses*

Operating expenses were relatively consistent on a quarterly basis until the fourth quarter of 2010 when they increased $1.0 million to $2.4 million. The increase in the fourth quarter of 2010 was due to increased compensation costs, increased listing fees associated with our listing on the NASDAQ OMX Stock Exchange in Sweden, and increased professional fees associated with farmout activity and the Centric acquisition. Operating expenses increased a further $0.6 million in the first quarter of 2011. This increase was due to a $1.3 million increase in stock-based compensation costs associated with stock options granted in the first quarter of 2011, partially offset by a reduction in professional fees and listing fees from elevated levels experienced in the fourth quarter of 2010. The $1.5 million reduction in operating expenses from the first quarter of 2011 to the second quarter of 2011 is due mainly to a reduction in stock-based compensation costs. The $1.3 million increase from the second quarter to the third quarter of 2011 can be attributed to increased stock-based compensation costs associated with stock option grants in Horn, as well as professional fees and listing fees associated with the Horn Transaction. The $0.9 million increase from the third quarter to the fourth quarter of 2011 can be attributed to increased stock-based compensation costs associated with AOC stock option grants in the quarter and a $0.4 million donation made by Horn to the Lundin Foundation, a registered Canadian non-profit organization that provides grants and risk capital to organizations dedicated to alleviating poverty in developing countries.

*Interest income*

Interest income increased in the first quarter of 2011 due to a significant increase in cash late in the fourth quarter of 2010 as a result of cash received on the exercise of warrants.

*Foreign exchange gains and losses*

The foreign exchange gains and losses are the direct result of changes in the value of the Canadian dollar in comparison to the US dollar. The Company has been holding large Canadian dollar cash balances as the result of Horn's private placement (CAD $41 million net proceeds), cash acquired on the Lion acquisition and warrant exercises at the end of 2010. The Company has recorded foreign exchange gains when the Canadian dollar has strengthened versus the US dollar, and has recorded losses when the Canadian dollar has weakened versus the US dollar.

*Fair market value adjustments – warrants and convertible debenture*

The fair market value adjustments to warrants and convertible debt are performed on a quarterly basis. The warrants entitle the holder to acquire a fixed number of common shares for a fixed Canadian dollar price per share. The convertible debenture entitled the holder to convert the US dollar denominated loan into common shares for a fixed Canadian dollar price per share. In accordance with IFRS, an obligation to issue shares for a price that is not fixed in the company's functional currency (US dollar for AOC), and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of operations as they arise.

During the second quarter of 2011, the convertible debenture was fully repaid. Accordingly, fair market value gains or losses relating to the convertible debenture have not been incurred since the second quarter of 2011.

At December 31, 2011, 6.5 million warrants were outstanding in AOC and 45.6 million warrants were outstanding in Horn. AOC holds 11.1 million of the warrants outstanding in Horn. Subsequent to year end, the remaining 6.5 million common share purchase warrants outstanding in AOC were converted into common shares. The Company will not incur fair market value adjustments on the AOC warrants subsequent to the first quarter of 2012. The Company will incur fair market value adjustments on the Horn warrants until they are exercised or they expire (65,000 expire October 12, 2012, 45,535,195 expire September 20, 2013).

## RESULTS OF OPERATIONS

| For the years ended | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Salaries and benefits | $ 1,695,987 | $ 1,369,025 |
| Stock-based compensation | 4,348,440 | 933,144 |
| Bank charges | 153,548 | 122,697 |
| Travel | 1,132,282 | 714,179 |
| Management fees | 245,258 | 228,542 |
| Office and general | 1,508,359 | 1,078,274 |
| Depreciation | 48,495 | 76,813 |
| Professional fees | 1,475,929 | 1,252,225 |
| Stock exchange and filing fees | 546,137 | 428,476 |
| Operating expenses | $ 11,154,435 | $ 6,203,375 |

Operating expenses increased $5.0 million for year ended December 31, 2011 compared to the previous year primarily due to a $3.4 million increase in stock-based compensation costs associated with stock option grants in AOC and Horn during the year, a $0.4 million donation to the Lundin Foundation which is included in office and general, and increased salary costs and travel costs associated with increased operational activity. Of the $4.3 million stock-based compensation expense in the year, $0.6 million relates to stock-based compensation expense of Horn.

## SELECTED ANNUAL INFORMATION

| Years ended December 31, | 2011 | 2010 | 2009 | |
|---|---|---|---|---|
| Statement of Operations Data | | | | |
| Interest income | $ 966,284 | $ 86,538 | $ 39,518 | * |
| Net income and comprehensive income attributable to non-controlling interest | (1,691,149) | - | - | * |
| Net loss and comprehensive loss attributable to common shareholders | 10,643,684 | 19,494,333 | 1,358,400 | |
| Data per Common Share | | | | |
| Basic loss per share ($/share) | 0.06 | 0.23 | 0.03 | * |
| Diluted loss per share ($/share) | 0.08 | 0.23 | 0.03 | * |
| Balance Sheet Data | | | | |
| Net working capital | 90,199,585 | 70,636,595 | 13,397,262 | |
| Total assets | 304,111,298 | 178,734,708 | 95,096,572 | |
| Long term liabilities | $ 2,882,441 | $ 59,273,866 | $ 62,493,256 | |

*Note: The Statement of Operations Data and Data per Common Share for the 2009 selected annual information is based on Canadian GAAP and has not been restated to conform with IFRS.

As the Company is in the exploration stage, no oil and gas revenue has been generated to date.

The increase in interest income from 2010 to 2011 is the result an increase in cash raised through Horn's non-brokered private placement, the warrant exercises in the fourth quarter of 2010, and cash and marketable securities acquired on the Lion acquisition.

The net income attributable to non-controlling interest represents the Company's non-ownership percentage of Horn's net income from Horn Transaction date (September 20, 2011) to December 31, 2011. The increase in the net loss attributable to common shareholders from 2009 to 2010 can be mainly attributed to losses on the fair market value of convertible debt and warrants as well as increased costs associated with the Company's operational expansion. The reduction of the net loss from 2010 to 2011 can be mainly attributed to gains on the fair market value of convertible debt and warrants, a gain on the acquisition of Lion, and increased interest income which were partially offset by a dilution loss on the Horn Transaction, an assets impairment on Blocks 2/6 in Ethiopia, increased stock-based compensation costs, a donation to the Lundin Foundation, and increased salary and travel costs associated with increased operational activity.

Net working capital from 2009 to 2010 was dramatically enhanced by CAD$25 million (gross) proceeds from the non-brokered private placement in July 2010 and CAD$55.8 million (gross) proceeds from warrants exercised in the fourth quarter of 2010. The improvement in working capital from 2010 to 2011 is due to the acquisition of Lion, the Horn Transaction and proceeds received from farmouts, offset partially by intangible explorations expenditures.

The increase in total assets from 2009 to 2010 is attributable to the equity financings, expansion of acreage in East Africa (Blocks 12A and 13T (Kenya) and South Omo (Ethiopia)), drilling of Bogal-1 in Block 9, and the seismic acquisition programs on Block 10BB in Kenya and the Ogaden blocks in Ethiopia. The increase in total assets from 2010 to 2011 is due to the improved working capital position, the acquisition of Centric, the acquisition of Lion, and significant intangible asset expenditures in Kenya, Ethiopia and Puntland (Somalia).

The significant decrease in long-term liabilities from 2010 to 2011 is the result of convertible debt being converted into shares of AOC during the year.

## INTANGIBLE EXPLORATION ASSETS

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Intangible exploration assets | $185,671,962 | $96,468,816 |

During the year ended December 31, 2011, AOC increased its investment in intangible exploration assets by $89.2 million. The acquisition of Centric accounted for an increase of $58.8 million. The acquisition of Lion accounted for an increase of $5.7 million. The Tullow farmout with respect to Blocks 10A, 10BB, 12A and 13T closed in the first quarter, reducing AOC's intangible exploration assets by $21.1 million, which included payments for past costs and interim payments from July 1, 2010, the effective date of the farmout, to January 26, 2011, the date the farmout closed. During the year, the Company also amended its farmout agreement with Lion resulting in AOC acquiring an additional 10% interest in Block 10BB and 25% in Block 10A, in Kenya. As consideration for this interest, AOC paid Lion $2.5 million in cash and issued 2.5 million common shares valued at $5.3 million. A further increase of $3.7 million related to payments made by Lion for their divested interest from the effective date of the amended farmout agreement, July 1, 2010, to the date the farmout closed. The impairment of Blocks 2/6 resulted in a reduction of $7.0 million.

AOC incurred $20.2 million of intangible exploration expenditures in Kenya on the Company's portion of Full Tensor Gravity ("FTG") on all Tullow-operated blocks, seismic acquisition programs in Blocks 9, 10A and 13T, and drilling costs on Blocks 10BB and 10A. Of the $20.2 million expenditures in Kenya, $0.1 million related to PSA costs and $1.2 million related to general and administrative costs. AOC incurred $14.3 million of intangible exploration expenditures in Puntland on the Company's portion of drilling costs related to an exploratory well at the Shabeel-1 location and acquisition of long-lead time materials required for drilling a second location, Shabeel North, as well as preparation and construction of the drilling site. Of the $14.3 million expenditures in Puntland, $1.0 million related to PSA costs and $1.6 million related to general and administrative costs. AOC incurred $6.8 million of intangible exploration expenditures in Ethiopia, of which $1.2 million related the Company's portion of a settlement with the Ministry of Mines in Ethiopia, in lieu of unfulfilled commitments with respect to the Blocks 2/6 PSA. The Company also incurred expenditures related to its portion of a seismic acquisition program in South Omo and a FTG program on the Adigala block. Of the $6.8 million expenditures in Ethiopia, $0.8 million related to PSA costs and $0.3 million related to general and administrative costs. Intangible exploration assets will not be subject to depletion until such time that proved oil and gas reserves are identified.

## LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2011, the Company had cash of $109.6 million and working capital of $90.2 million as compared to cash of $76.1 million and working capital of $70.6 million at December 31, 2010. Of the $109.6 million in cash at December 31, 2011, $27.6 million is cash held by Horn. The Company's liquidity and capital resource position has remained strong throughout the year. Working capital increased compared to year end due mainly to the acquisition of Lion, the Horn Transaction and proceeds received from farmouts, offset partially by intangible explorations expenditures.

The Company currently has more than sufficient funds to meet its portion of expenditure obligations as per the approved 2012 work programs. The Company's current working capital position may not provide it with sufficient capital resources to meet its minimum work obligations for all exploration periods under the various PSAs and PSCs and for general corporate purposes. To finance its future acquisition, exploration, development and operating costs, AOC may require financing from external sources, including issuance of new shares, issuance of debt or executing working interest farmout or disposition arrangements. The Company is actively marketing the opportunity for interested parties to farm in to its operated oil and gas concessions in East Africa. There can be no assurance that such financing will be available to the Company or, if available, that it will be offered on terms acceptable to AOC.

## STOCK-BASED COMPENSATION

The Company uses the fair value method of accounting for stock options granted to directors, officers and employees whereby the fair value of all stock options granted is recorded as a charge to operations. Stock-based compensation for the year ended December 31, 2011 was $4.3 million as compared to $0.9 million in 2010. The increase can be attributed to options granted by AOC in the first and fourth quarter of 2011 and options granted by Horn in the third quarter of 2011, each with 1/3 vesting immediately. Of the $4.3 million stock-based compensation expense in the year, $0.6 million relates to stock-based compensation expense of Horn. The Company continues to utilize its stock option plan as a method of recruiting, retaining and motivating personnel.

## RELATED PARTY TRANSACTIONS

*Transactions with Lorito Holdings (Guernsey) Limited ("Lorito")*

During May 2009, the Company's loans payable due to Lorito in the amount of CAD$6,000,000 plus interest of $195,521 was converted to 6,521,601 Units of the Company on the basis of CAD$0.95 per Unit. Each Unit is comprised of one common share and one share purchase warrant. Each warrant is exercisable into one common share of AOC at a price of CAD$1.50 per share over a period of three years. In the event that AOC closes at or above CAD$2.00 for a period of 20 consecutive trading days, the Company may elect to accelerate the expiry date to 30 days from the date of written notice to the warrant holder. Lorito is beneficially owned by Ellegrove Capital Ltd., a private trust the settler of which is the late Adolf H. Lundin. Subsequent to year end, Lorito exercised each of its 6,521,601 warrants into a common share of the Company.

*Transactions with Namdo Management Services Ltd ("Namdo")*

During the year ended December 31, 2011, the Company incurred management fees of $245,258 (2010 - $228,542) for administrative support services fees to Namdo. Namdo is a private corporation owned by Lukas H. Lundin. At December 31, 2011, the Company had no outstanding amounts due to Namdo in respect of management fees (2010 – Nil).

*Transactions with Horn Petroleum Corp. ("Horn")*

On September 20, 2011, a Share Purchase Agreement was executed between the Company and Horn which resulted in AOC owning 51.4% of the outstanding shares of Horn. The following transactions and resulting intercompany balances outstanding between the Company and Horn have been eliminated as the Company fully consolidates the financial statements of Horn.

The Company advanced Horn and its subsidiaries $8.6 million to fund exploration activities during 2011 (2010 – $1.7 million). On September 20, 2011, in accordance with the conditions precedent in the Share Purchase Agreement, AOC converted advances to Horn of $41.2 million into share capital. During the fourth quarter of 2011, Horn repaid the Company the remaining $7.5 million of advances made to Horn. At December 31, 2011, the Company had no outstanding balances receivable from Horn related to advances to fund exploration activities (2010 – $40.1 million).

Under the terms of a General Management and Service Agreement between Horn and the Company for the provision of management and administrative services, the Company invoiced Horn $258,116 during 2011 (2010 – Nil). At December 31, 2011, the outstanding balance receivable from Horn, recorded as a due from related party, was $258,116 (2010 – Nil). The management fee charged to Horn by the Company is expected to cover the cost of administrative expense and salary costs paid by the Company in respect services provided to Horn.

Under the terms of a Services Agreement between the Company and Horn, AOC invoiced Horn $188,620 during 2011 (2010 - $110,558) for services provided by geologists and geophysicists employed by AOC. As at December 31, 2011, $11,650 was outstanding and recorded in due from related party (2010 – Nil).

During 2011, AOC invoiced Horn $508,877 for reimbursable expenses paid by AOC on behalf of Horn. As at December 31, 2011, $109,269 was outstanding and recorded in due from related party (2010 – Nil).

During December 2011, Horn's subsidiary Canmex Holdings (Bermuda) II Ltd. commenced the transfer of $1.5 million to Horn, via AOC. At December 31, 2011, the funds were on deposit with AOC. Accordingly, the balance has been recorded as Due to related party. AOC transferred the funds to Horn subsequent to year end.

*Remuneration of Directors and Senior Management*

Remuneration of Directors and Senior Management includes all amounts earned and awarded to the Company's Board of Directors and Senior Management. Senior Management includes the Company's President and Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Vice President of Exploration, as well as the President and Chief Financial Officer of Horn. Directors include both the Company's and Horn's Directors.

Directors' fees include Board and Committee Chair retainers and meeting fees. Managements' short-term wages and benefits include salary, benefits, bonuses and any other compensation earned or awarded during the year. Share-based compensation includes expenses related to the Company's stock option plan.

| For the years ended December 31, | | 2011 | | 2010 |
|---|---|---|---|---|
| Directors' fees | $ | 112,227 | $ | 155,106 |
| Directors' share-based compensation | | 736,011 | | 163,560 |
| Managements' short-term w ages and benefits | | 2,330,184 | | 1,401,343 |
| Managements' Share-based compensation | | 2,670,595 | | 472,813 |
| | $ | 5,849,017 | $ | 2,192,822 |

For the year ended December 31, 2011, $1.1 million of management remuneration was capitalized to intangible exploration assets (2010 - $0.5 million).

## COMMITMENTS AND CONTINGENCIES

Please note that the following commitments and contingencies are representative of AOC's net obligations at the effective date of the MD&A.

**Ethiopia:**

Under the terms of the Blocks 7/8 PSA, during the initial exploration period which expires in July 2012, the Company and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 1,250 kilometers of 2D seismic) with a minimum gross expenditure of $11.0 million. In addition, the Company and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million. The Company's current working interest in Blocks 7/8 is 55%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of farmout agreements which require AOC's joint venture partners to pay a disproportionate share of joint venture costs.

In accordance with the PSA for Blocks 2/6, the initial exploration period expired in November 2011. The Company has relinquished Blocks 2/6, and the Ministry of Mines in Ethiopia has agreed to waive remaining commitments. The Company has paid $1.2 million with respect to its working interest share of the expected settlement with the Ministry of Mines in Ethiopia, in lieu of unfulfilled commitments with respect to Blocks 2/6 PSA. AOC and its partners were obligated to complete certain G&G operations (including acquisition of 1,250 kilometers of 2D seismic) with a minimum gross expenditure of $10.8 million. The Company's working interest in Block 2/6 was 55%.

Under the terms of the Adigala Block PSA, AOC and its partners have fulfilled the minimum work and financial obligations of the initial four year exploration period which expired in July 2011. The Ministry of Mines in Ethiopia approved the Company and its partners' entry into the next exploration period with amended minimum work commitments. Under the PSA which expires in July 2013, AOC and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 7,500 kilometers of full tensor gravity) with a minimum gross expenditure of $1.75 million.

Under the terms of the South Omo PSA, during the initial exploration period which was extended by the Ministry of Mines in Ethiopia and expires in January 2013, AOC and its partners are obligated to complete certain G&G operations (including acquisition of 400 kilometers of 2D seismic) with a minimum gross expenditure of $6.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $8.0 million. The Company's current working interest in the South Omo Block is 30%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of farmout agreements which require AOC's joint venture partners to pay a disproportionate share of joint venture costs. This commitment is supported by an outstanding letter of credit of $294,000 in favor of Tullow Oil plc ("Tullow") which is collateralized by a bank deposit of $294,000.

**Kenya:**

Under the terms of the Block 10A PSC, during the initial exploration period which was extended by the Ministry of Energy for the Republic of Kenya and expires in October 2012, AOC and its partners are obligated to complete G&G operations (including acquisition of 750 kilometers of 2D seismic) with a minimum gross expenditure of $7.8 million. Additionally, AOC and its partners are obligated to drill one exploration well with a minimum expenditure of $8.5 million. The Company's current working interest in Block 10A is 30%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of farmout agreements which require AOC's joint venture partners to pay a disproportionate share of joint venture costs. This commitment is supported by an outstanding bank guarantee of $0.7 million in favor of Tullow Oil plc and $2.4 million in favor of the Kenyan Government. The bank guarantee in favour of Tullow Oil plc has been collateralized by a bank deposit (see note 5). The bank has been provided with a parent company guarantee from Africa Oil Corp on the bank guarantee in favor of the Kenyan Government.

Under the terms of the Block 10BB PSC, during the initial exploration period which was extended by the Ministry of Energy for the Republic of Kenya and expires in July 2012, the Company and its partners are obligated to complete G&G operations (including acquisition of 600 kilometers of 2D seismic) with a minimum gross expenditure of $6.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million. The Company's current working interest in Block 10BB is 50%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of the farmout agreement with Tullow which require AOC's joint venture partners to pay a disproportionate share of joint venture costs. This commitment is supported by an outstanding bank guarantee of $0.9 million in favor of Tullow which is collateralized by a bank deposit of $0.9 million.

Under the terms of the Block 9 PSC, with the drilling of the Bogal-1-1 well, AOC and its partners have fulfilled and exceeded the minimum work and financial obligations of the initial exploration period. Effective December 31, 2010, the Company entered into the First Additional Exploration Phase under the Block 9 PSC in Kenya which will expire on December 31, 2013. Under the terms of the PSC, AOC and its partners are required to drill one additional exploratory well to a minimum depth of 1,500 meters per well with a minimum gross expenditure of $2.5 million. The Company's current working interest in Block 9 is 100%.

Under the terms of the Blocks 12A and 13T PSCs, during the initial exploration periods which were extended by the Ministry of Energy for the Republic of Kenya and expire in September 2012, the initial minimum gross exploration expenditures are $3.6 million (Block 12A) and $3.65 million (Block 13T). The Company and its partner are obligated to complete G&G operations including the acquisition of 500km of 2D seismic or 100 km2 of 3D seismic (or a combination thereof) on each block. The Company's current working interest in Blocks 12A and 13T is 50%. The commitments on Block 12A and 13T have been supported by outstanding bank guarantees of $270,000 and $273,750, respectively, in favour of Tullow Oil plc which have been collateralized by bank deposits (see note 5).

Under the terms of the Block 10BA PSC, during the initial exploration period which expires in April 2013, the Company and its partners are obligated to complete G&G operations (including acquisition of 200 kilometers of 2D seismic) with a minimum expenditure of $3.0 million. The Company's current working interest in Block 10BA is 50%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of the farmout agreement with Tullow which require AOC's joint venture partner to pay a disproportionate share of joint venture costs. The commitments on Block 10BA are supported by an outstanding letter of credit of $450,000 in favor of the Kenyan Government which is collateralized by bank deposit of $450,000.

**Mali:**

Under the terms of the Block 7 and 11 PSCs, the current exploration periods expire in July 2012 and June 2014, respectively. In accordance with the terms of the PSCs, the minimum gross exploration expenditures in the current exploration periods are $11.6 million (Block 7) and $8.0 million (Block 11). In exchange for 75% working interest, our partner has committed to funding all currently planned seismic, G&G, and drilling costs associated with both blocks.

**Puntland (Somalia):**

In December 2009, the Company announced amendments to its existing PSAs made in respect of the Dharoor Valley and Nugaal Valley Exploration areas. The amendments reflected the extension of initial exploration periods from 36 to 48 months, with a revised expiry period of January 17, 2011. In addition, the terms of the exploration programs were amended such that the Company, at its option, could drill one exploratory well in each of the Dharoor Valley and Nugaal Valley Exploration Areas, or two exploratory wells in the Dharoor Valley. In consideration of the extension of the exploration period, the Company agreed to voluntarily relinquish twenty-five percent of the original agreement area on or before January 17, 2010 and agreed to pay a US$1 million bonus within 30 days of a commercial discovery in each of the production blocks. Further, the Company agreed to certain enhanced abandonment and environmental safety measures and to make a one-time US$1.05 million payment to the Puntland government for development of infrastructure.

In January 2011, the Company announced further amendments to its existing PSAs made in respect of the Dharoor Valley and Nugaal Valley Exploration areas. The amendments reflected the extension of initial exploration a further 12 months, with a revised expiry period of January 17, 2012. Under the amended PSAs, the Company is obligated to spud a minimum of one exploratory well in the Dharoor Valley Exploration Area by July 27, 2011. A second exploratory well is required to be spudded in the Nugaal Valley Exploration Area or, at the option of the Company, in the Dharoor Valley Exploration Area, by September 27, 2011.

In July 2011, the existing PSAs in respect of the Dharoor Valley and Nugaal Valley Exploration areas were further amended requiring execution of a drilling contract by July 31, 2011, drilling operations to commence on the first well by November 15, 2011, and drilling operations commence on a second well by January 17, 2012. The Company agreed to relinquish 15,627 km2 (gross) of the Nugaal Valley Exploration area, perform a surface geochemistry survey in the Nugaal Valley Exploration area, and pay the Puntland State of Somalia $1,000,000 in infrastructure and development support fees of which $500,000 was paid at December 31, 2011, $250,000 was paid subsequent to year end on spud of the first well and the remaining $250,000 is due on completion of the first exploration well.

In February 2012, the Puntland Government granted the Company an extension of the first exploration period expiry date for the Dharoor Valley and Nugaal Valley Exploration areas to October 17, 2012 in order to provide for sufficient time to evaluate drilling results of both wells required under the PSAs.

Under the Joint Venture Agreement with Range Resources Ltd. ("Range"), relating to the Dharoor Valley and Nugaal Valley Exploration Blocks, the Company is obligated to solely fund $22.8 million of joint venture costs on each of the blocks ($45.5 million in total for both blocks) during the exploration period, in exchange for a 80% working interest in each block. In the event that a commercial discovery is declared on either of the Dharoor Valley and Nugaal Valley Blocks prior to the Company spending $22.8 million on that block, the Company shall be deemed to have earned its interest in that block and the Company and Range will be responsible for future expenditures on the block in proportion to their respective working interests. In the event that the Company does not fund the required $22.8 million during the initial exploration period, the Company's interest in the block would be forfeited. An additional $3.5 million will be payable to Range upon commencement of commercial production.

During the fourth quarter of 2008, the Company fulfilled its sole funding obligation related to the Dharoor Valley Block. As a result, Range is paying its 20% participating interest share of ongoing exploration costs related to this Block. In the Nugaal Valley Block, the Company has spent approximately $8.7 million towards its sole funding obligation to Range as of December 31, 2011.

## OUTSTANDING SHARE DATA

The following table outlines the maximum potential impact of share dilution upon full execution of outstanding convertible instruments as at the effective date of the MD&A:

| | |
|---|---|
| Common shares outstanding | 218,664,492 |
| Outstanding share purchase options | 10,103,503 |
| Full dilution impact on common share outstanding | 228,767,995 |

Subsequent to December 31, 2011, the remaining 6,521,601 common share purchase warrants outstanding were converted into common shares of AOC for gross proceeds of CAD $9.8 million. Further, the Company issued an additional 729,832 common shares upon exercise of stock options, granted 35,000 stock options and cancelled 32,333 subsequent to year end.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

## CRITICAL ACCOUNTING ESTIMATES

The Company's critical accounting estimates are defined as those estimates that have a significant impact on the portrayal of its financial position and operations and that require management to make judgments, assumptions and estimates in the application of IFRS. Judgments, assumptions and estimates are based on historical experience and other factors that management believes to be reasonable under current conditions. As events occur and additional information is obtained, these judgments, assumptions and estimates may be subject to change. The Company believes the following are the critical accounting estimates used in the preparation of its consolidated financial statements. The Company' significant accounting policies can be found in note 3 of the Company's Financial Statements.

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Such estimates related to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from these estimated amounts as future confirming events occur. Significant estimates used in the preparation of the consolidated financial statements include, but are not limited to, recovery of exploration costs capitalized in accordance with IFRS, stock-based compensation, income taxes and fair market value of warrants and convertible debentures.

**Intangible Explorations Assets**

The Company capitalizes costs related to the acquisition of a license interest, directly attributable general and administrative costs, expenditures incurred in the process of determining oil and gas exploration targets, and exploration drilling costs. All exploration expenditures are capitalized on a license-by-license basis within intangible exploration assets. Costs are held un-depleted until such time as the exploration phases on the license area are complete or commercially viable reserves have been discovered and extraction of those reserves is determined to be technically feasible. The determination that a discovery is commercially viable and extraction is technically feasible requires judgment.

Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are recognized in the statement of operations. If commercial reserves are established and technical feasibility for extraction demonstrated, then the related capitalized intangible exploration costs are transferred into a single field cost center within "oil and gas interests" subsequent to determining that the assets are not impaired.

Intangible exploration assets are assessed for impairment when they are reclassified to property and equipment, as oil and gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The allocation of the company's assets into CGUs requires judgment.

The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves. In determining fair value less costs to sell, recent market transactions are taken into account, if available. In the absence of such transactions, an appropriate valuation model is used.

The key assumptions the company uses for estimating future cash flows are reserves, future commodity prices, expected production volumes, future operating and development costs, among others. The estimated useful life of the CGU, the timing of future cash flows and discount rates are also important assumptions made by management.

**Stock Based Compensation**

The Company uses the fair value method, utilizing the Black-Scholes option pricing model, for valuing stock options granted to directors, officers, consultants and employees. The estimated fair value is recognized over the applicable vesting period as stock-based compensation expense. The recognized costs are subject to the estimation of what the ultimate payout will be using pricing models such as the Black-Scholes model which is based on significant assumptions such as volatility, dividend yield and expected term.

**Warrants and Convertible Debentures**

An obligation to issue shares for a price that is not fixed in the company's functional currency, and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of operations as they arise. The warrants entitle the holder to acquire a fixed number of common shares for a fixed Canadian dollar price per share. The convertible debenture entitled the holder to convert the US dollar denominated loan into common shares for a fixed Canadian dollar price per share. The estimated fair value is adjusted on a quarterly basis with gains or losses recognized in the statement of operations. The Company uses the fair value method, utilizing the Black-Scholes option pricing model, for valuing the warrants and convertible debentures. The Black-Scholes model is based on significant assumptions such as volatility, dividend yield and expected term.

**Income Tax**
The Company follows the balance sheet method of accounting for income taxes whereby future income taxes are recognized based on the differences between the carrying values of assets and liabilities reported in the Annual Financial Statements and their respective tax basis. Future income tax assets and liabilities are recognized at the tax rates at which Management expects the temporary differences to reverse. Management bases this expectation on future earnings, which require estimates for reserves, timing of production, crude oil price, operating cost estimates and foreign exchange rates. Management assesses, based on all available evidence, the likelihood that the future income tax assets will be recovered from future taxable income and a valuation allowance is provided to the extent that it is more than likely that future income tax assets will not be realized. As a result, future earnings are subject to significant Management judgment.

## NEW ACCOUNTING PRONOUNCEMENTS AND CHANGES IN ACCOUNTING POLICIES

**International Financial Reporting Standards**

On January 1, 2011, the Company adopted International Financial Reporting Standards ("IFRS") for financial reporting purposes, using a transition date of January 1, 2010. The financial statements for the year ended December 31, 2011, including required comparative information, have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB"). Previously, the Company prepared its Interim and Annual Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles ("previous GAAP"). Unless otherwise noted, 2010 comparative information has been prepared in accordance with IFRS.

The adoption of IFRS has not had an impact on the Company's operations, strategic decisions and Cash Flow.

**Future Accounting Pronouncements**

As of January 1, 2013, the following standards and amendments issued by the IASB become effective:

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity.
- IFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "Interests in Joint Ventures". The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately consolidated.
- IFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements.
- IFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.
- IAS 19, "Employee Benefits", which amends the recognition and measurement of defined benefit pension expense and expands disclosures for all employee benefit plans.

- IFRS 7, "Financial Instruments: Disclosures", which requires disclosure of both gross and net information about financial instruments eligible for offset in the balance sheet and financial instruments subject to master netting arrangements. Concurrent with the amendments to IFRS 7, the IASB also amended IAS 32, "Financial Instruments: Presentation" to clarify the existing requirements for offsetting financial instruments in the balance sheet. The amendments to IAS 32 are effective as of January 1, 2014.

As of January 1, 2015, IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's 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. The impairment and hedge accounting principles to be included in IFRS 9 have not yet been issued by the IASB.

## RISK FACTORS

The Company is subject to various risks and uncertainties, including, but not limited to, those listed below. Refer to the Company's Annual Information Form for further risk factor disclosures.

***International Operations***

AOC participates in oil and gas projects located in emerging markets, including Puntland (Somalia), Ethiopia and Kenya ("East Africa"). Oil and gas exploration, development and production activities in these emerging markets, including East Africa, are subject to significant political and economic uncertainties which may adversely affect the Company's operations. Uncertainties include, but are not limited to, the risk of war, terrorism, expropriation, nationalization, renegotiation or nullification of existing or future concessions and contracts, the imposition of international sanctions, a change in crude oil or natural gas pricing policies, a change in taxation policies, and the imposition of currency controls. These uncertainties, all of which are beyond the Company's control, could have a material adverse effect on AOC's business, prospects and results of operations. In addition, if legal disputes arise related to oil and gas concessions acquired by the Company, AOC could be subject to the jurisdiction of courts other than those of Canada. The Company's recourse may be very limited in the event of a breach by a government or government authority of an agreement governing a concession in which AOC acquires an interest. The Company may require licenses or permits from various governmental authorities to carry out future exploration, development and production activities. There can be no assurance that AOC will be able to obtain all necessary licenses and permits when required.

***International Boundary Disputes***

As a result of ongoing political disputes, the legal international boundaries between Somalia (which includes Puntland, a semi-autonomous region within Somalia) and its neighbouring countries are in dispute. For instance, in September 2007, AOC was advised that the Ministry of Water and Mineral Resources of the Republic of Somaliland was claiming ownership of the Nugaal and AhlMedo Valley basins, including some or all of the areas that comprise the Puntland PSA, granted by the Government of Puntland. That claim was repeated in correspondence received by the Company in February 2012. The Republic of Somaliland and Somalia have disputed their respective borders since May 1991 when the Republic of Somaliland was established. As recently as August 2011, there have been armed confrontations at the Somalia / Somaliland border. AOC disputes the claims of the Republic of Somaliland, however, the outcome of this dispute cannot be predicted with any certainty.

***Political Instability***

Through Horn, the Company is highly exposed to significant political risk in Puntland (Somalia). The political climate in Puntland (Somalia) is characterized by strong internal political tension, turmoil and factional fighting. The political tensions sometimes escalate into violence or the threat of violence.

On January 31, 2009, Somalia elected a new President, President Sharif Sheikh Ahmed, who vowed to unify all factions of Somalia and bring peace to neighbouring countries. President Ahmed's mandate was scheduled to expire in mid-2011, however, the Kampala Accord, which extended the mandate for an additional 12 months, was ultimately approved by the Transitional Federal Government (the "TFG") in July 2011. Regardless, Puntland's President Farole, who opened the 26th session of the Puntland Parliament in June 2011, has repudiated the Kampala Accord and has threatened to break from the TFG, claiming it did not represent Puntland in international forums.

Through Horn, the Company continues to work and cooperate with government leaders in Somalia, however, there can be no certainty as to if, or when, the current political instability will be resolved.

***Different Legal System and Litigation***

AOC's oil production and exploration activities are located in countries with legal systems that in various degrees differ from that of Canada. Rules, regulations and legal principles may differ both relating to matters of substantive law and in respect of such matters as court procedure and enforcement. Almost all material production and exploration rights and related contracts of AOC are subject to the national or local laws and jurisdiction of the respective countries in which the operations are carried out. This means that AOC's ability to exercise or enforce its rights and obligations may differ between different countries and also from what would have been the case if such rights and obligations were subject to Canadian law and jurisdiction.

AOC's operations are, to a large extent, subject to various complex laws and regulations as well as detailed provisions in concessions, licenses and agreements that often involve several parties. If AOC were to become involved in legal disputes in order to defend or enforce any of its rights or obligations under such concessions, licenses, agreements or otherwise, such disputes or related litigation may be costly, time consuming and the outcome may be highly uncertain. Even if AOC would ultimately prevail, such disputes and litigation may still have a substantially negative effect on AOC and its operations.

***Financial Statements Prepared on a Going Concern Basis***

AOC's financial statements have been prepared on a going concern basis under which an entity is considered to be able to realize its assets and satisfy its liabilities in the ordinary course of business. AOC's operations to date have been primarily financed by equity financing. AOC's future operations are dependent upon the identification and successful completion of additional equity or debt financing or the achievement of profitable operations. There can be no assurances that AOC will be successful in completing additional financing or achieving profitability. The consolidated financial statements do not give effect to any adjustments relating to the carrying values and classification of assets and liabilities that would be necessary should AOC be unable to continue as a going concern.

***Uncertainty of Title***

Although the Company conducts title reviews prior to acquiring an interest in a concession, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise that may call into question AOC's interest in the concession. Any uncertainty with respect to one or more of AOC's concession interests could have a material adverse effect on the Company's business, prospects and results of operations.

The Company has been made aware that previous operators in Somalia have made claims concerning areas covered by the Company's concessions. The Company believes that there is no merit to any of these claims. Accordingly, the Company proposes to proceed with its exploration and development program as previously disclosed.

***Competition***
The petroleum industry is intensely competitive in all aspects including the acquisition of oil and gas interests, the marketing of oil and natural gas, and acquiring or gaining access to necessary drilling and other equipment and supplies. AOC competes with numerous other companies in the search for and acquisition of prospects.

***Risks Inherent in Oil and Gas Exploration and Development***
AOC's business is subject to all of the risks and hazards inherent in businesses involved in the exploration for, and the acquisition, development, production and marketing of, oil and natural gas, many of which cannot be overcome even with a combination of experience and knowledge and careful evaluation. The risks and hazards typically associated with oil and gas operations include fire, explosion, blowouts, sour gas releases, pipeline ruptures and oil spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property, the environment or personal injury.

***Capital Requirements***
To finance its future acquisition, exploration, development and operating costs, AOC may require financing from external sources, including from the issuance of new shares, issuance of debt or execution of working interest farm-out agreements. There can be no assurance that such financing will be available to the Company or, if available, that it will be offered on terms acceptable to AOC. If additional financing is raised through the issuance of equity or convertible debt securities, control of the Company may change and the interests of shareholders in the net assets of AOC may be diluted. If unable to secure financing on acceptable terms, AOC may have to cancel or postpone certain of its planned exploration and development activities which may ultimately lead to the Company's inability to fulfill the minimum work obligations under the terms of its various PSAs and PSCs. Availability of capital will also directly impact the Company's ability to take advantage of acquisition opportunities.

***Foreign currency exchange rate risk***
The Company is exposed to changes in foreign exchange rates as expenses in international subsidiaries, oil and gas expenditures, or financial instruments may fluctuate due to changes in rates. The Company's exposure is partially offset by sourcing capital projects and expenditures in US dollars. AOC had no forward exchange contracts in place as at or during the year ended December 31, 2011.

For the year ended December 31, 2011, a 5% increase or decrease in the value of the Canadian dollar in relation to the US dollar, which is the Company's functional currency, would have resulted in an approximately $3.9 million (2010 - $0.8 million) increase or decrease in foreign exchange gains, respectively.

At December 31, 2011, the Company had $79.8 million Canadian dollars (2010 - $70.4 million Canadian dollars) in cash and cash equivalents. Subsequent to December 31, 2011, the Company acquired US dollars reducing its Canadian dollars held by CAD $45.2 million.

***Interest rate risk***
The Company's outstanding convertible debenture was fully repaid in April 2011. The Company does not have any current exposure to fluctuations in interest rates.

***Liquidity risk***
Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Liquidity describes a company's ability to access cash. Companies operating in the upstream oil and gas industry, during the exploration phase, require sufficient cash in order to fulfill their work commitments in accordance with contractual obligations and to be able to potentially acquire strategic oil and gas assets.

The Company will potentially issue debt or equity and enter into farmout agreements with joint venture partners to ensure the Company has sufficient available funds to meet current and foreseeable financial requirements. The Company actively monitors its liquidity to ensure that its cash flows and working capital are adequate to support these financial obligations and the Company's capital programs. The Company will also adjust the pace of its exploration activities to manage its liquidity position.

***Credit risk***
Credit risk is the risk of loss if counterparties do not fulfill their contractual obligations. The majority of our credit exposure relates to amounts due from our joint venture partners. The risk of our joint venture partners defaulting on their obligations per their respective joint operating and farmout agreements is mitigated as there are contractual provisions allowing the Company to default joint venture partners who are non-performing and reacquire any previous farmed out working interests.

***OUTLOOK***

The Company enters 2012 in a very strong financial position with cash of $109.6 million and working capital of $90.2 million. The 2012 year will be a pivotal year for the AOC, as the Company expects to drill five exploration wells in the year. The exploration wells anticipated for 2012 include Ngamia (Block 10BB - Kenya) and Shabeel-1 (Dharoor Valley – Puntland) which are currently in progress as well as an additional well in each of Block 10A (Kenya), South Omo (Ethiopia), and Dharoor (Puntland, Somalia). The Company also expects to complete its initial seismic programs covering all existing blocks under PSA with the completion of an additional 2,100 kilometers of 2D seismic covering the remainder of the South Omo Block, as well as Blocks 10BA and 12A. The Company believes that it has sufficient working capital available to fund the entire 2012 work program.

***Forward Looking Statements***
Certain statements in this document are "forward-looking statements". Forward-looking statements are statements that are not historical fact and are generally identified by words such as "believes", "anticipates", "expects", "estimates", "pending", "intends", "plans" or similar words suggesting future outcomes. By their nature, forward-looking statements and information involve assumptions, inherent risks and uncertainties, many of which are difficult to predict, and are usually beyond the control of management, that could cause actual results to be materially different from those expressed by these forward-looking statements and information. Risks and uncertainties include, but are not limited to, risk with respect to general economic conditions, regulations and taxes, civil unrest, corporate restructuring and related costs, capital and operating expenses, pricing and availability of financing and currency exchange rate fluctuations. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements.

The Company does not undertake to update or re-issue the forward-looking statements and information that may be contained herein, whether as a result of new information, future events or otherwise.

Any statements regarding the following are forward-looking statements:

- expected closing dates for the completion of proposed transactions;
- planned exploration activity including both expected drilling and geological and geophysical related activities;
- anticipated future financing requirements
- future crude oil, natural gas or chemical prices;
- future sources of funding for our capital program;
- availability of potential farmout partners;

- government or other regulatory consent for exploration, development, farmout or acquisition activities;
- future production levels;
- future capital expenditures and their allocation to exploration and development activities;
- future earnings;
- future asset acquisitions or dispositions;
- future debt levels;
- availability of committed credit facilities;
- possible commerciality;
- development plans or capacity expansions;
- future ability to execute dispositions of assets or businesses;
- future sources of liquidity, cash flows and their uses;
- future drilling of new wells;
- ultimate recoverability of current and long-term assets;
- ultimate recoverability of reserves or resources;
- expected finding and development costs;
- expected operating costs;
- estimates on a per share basis;
- future foreign currency exchange rates;
- future market interest rates;
- future expenditures and future allowances relating to environmental matters;
- dates by which certain areas will be developed or will come on stream or reach expected operating capacity; and
- changes in any of the foregoing.

Statements relating to "reserves" or "resources" are forward-looking statements, as they involve the implied assessment, based on estimates and assumptions that the reserves and resources described exist in the quantities predicted or estimated, and can be profitably produced in the future.

The forward-looking statements are subject to known and unknown risks and uncertainties and other factors which may cause actual results, levels of activity and achievements to differ materially from those expressed or implied by such statements. Such factors include, among others:

- market prices for oil and gas and chemical products;
- our ability to explore, develop, produce and transport crude oil and natural gas to markets;
- ultimate effectiveness of design or design modification to facilities;
- the results of exploration and development drilling and related activities;
- volatility in energy trading markets;
- foreign-currency exchange rates;
- economic conditions in the countries and regions in which we carry on business;
- governmental actions including changes to taxes or royalties, changes in environmental and other laws and regulations;
- renegotiations of contracts;
- results of litigation, arbitration or regulatory proceedings; and
- political uncertainty, including actions by terrorists, insurgent or other groups, or other armed conflict,
- conflict between states.

The impact of any one risk, uncertainty or factor on a particular forward-looking statement is not determinable with certainty as these factors are interdependent, and management's future course of action would depend on our assessment of all information at that time. Although we believe that the expectations conveyed by the forward-looking statements are reasonable based on information available to us on the date such forward-looking statements were made, no assurances can be given as to future results, levels of activity and achievements.

Undue reliance should not be placed on the statements contained herein, which are made as of the date hereof and, except as required by law, we undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained herein are expressly qualified by this cautionary statement.

## Independent Auditor's Report

**To the Shareholders of**
**Africa Oil Corp.**

We have audited the accompanying consolidated financial statements of Africa Oil Corp. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010 and the consolidated statements of net loss and comprehensive loss, equity and cash flows for the years ended December 31, 2011 and 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

### 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 audits 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.

*PricewaterhouseCoopers LLP, Chartered Accountants*
*111 5th Avenue SW, Suite 3100, Calgary, Alberta, Canada T2P 5L3*
*T: +1 403 509 7500, F: +1 403 781 1825, www.pwc.com/ca*

**Opinion**

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

PricewaterhouseCoopers LLP

**Chartered Accountants**
Calgary, Alberta, Canada
March 23, 2012

# AFRICA OIL CORP.

Consolidated Balance Sheets
(Expressed in United States dollars)

| | Note | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | | $ 109,558,445 | $ 76,125,834 | $ 11,145,486 |
| Marketable securities | 6(b) | 2,605,745 | - | - |
| Accounts receivable | | 2,717,024 | 2,323,208 | 5,396,253 |
| Prepaid expenses | | 599,727 | 595,729 | 508,344 |
| | | 115,480,941 | 79,044,771 | 17,050,083 |
| Long-term assets | | | | |
| Restricted cash | 5 | 2,919,000 | 3,181,500 | 1,800,000 |
| Property and equipment | 7 | 39,395 | 39,621 | 107,549 |
| Intangible exploration assets | 8 | 185,671,962 | 96,468,816 | 76,138,940 |
| | | 188,630,357 | 99,689,937 | 78,046,489 |
| Total assets | | $ 304,111,298 | $ 178,734,708 | $ 95,096,572 |
| **LIABILITIES AND EQUITY** | | | | |
| Current liabilities | | | | |
| Accounts payable and accrued liabilities | | $ 23,768,545 | $ 7,122,007 | $ 3,244,871 |
| Current portion of w arrants | 11 | 1,512,811 | 874,949 | - |
| Current portion of convertible debenture | 9 | - | 411,220 | 407,950 |
| | | 25,281,356 | 8,408,176 | 3,652,821 |
| Long-term liabilities | | | | |
| Warrants | 11 | 2,882,441 | 5,195,914 | 21,673,039 |
| Convertible debenture | 9 | - | 54,077,952 | 40,820,217 |
| | | 2,882,441 | 59,273,866 | 62,493,256 |
| Total liabilities | | 28,163,797 | 67,682,042 | 66,146,077 |
| Equity attributable to common shareholders | | | | |
| Share capital | 10(b) | 306,509,909 | 163,231,076 | 62,712,759 |
| Contributed surplus | | 8,425,304 | 4,391,940 | 3,313,753 |
| Deficit | | (75,283,481) | (56,570,350) | (37,076,017) |
| | | 239,651,732 | 111,052,666 | 28,950,495 |
| Non-controlling interest | | 36,295,769 | - | - |
| Total equity | | 275,947,501 | 111,052,666 | 28,950,495 |
| Total liabilities and equity | | $ 304,111,298 | $ 178,734,708 | $ 95,096,572 |

| | |
|---|---|
| Commitments and contingencies | 16 |
| Subsequent events | 22 |
| Reconciliation of Canadian GAAP to IFRS | 24 |

The notes are an integral part of the consolidated financial statements.

Approved on behalf of the Board:

*"CAMERON BAILEY"* ______________________________
**CAMERON BAILEY, DIRECTOR**

*"KEITH HILL"* ______________________________
**KEITH HILL, DIRECTOR**

# AFRICA OIL CORP.

Consolidated Statements of Net Loss and Comprehensive Loss
(Expressed in United States dollars)

| For the years ended | Note | December 31, 2011 | December 31, 2010 |
|---|---|---|---|
| Operating expenses | | | |
| Salaries and benefits | | $ 1,695,987 | $ 1,369,025 |
| Stock-based compensation | 12 | 4,348,440 | 933,144 |
| Bank charges | | 153,548 | 122,697 |
| Travel | | 1,132,282 | 714,179 |
| Management fees | 19 | 245,258 | 228,542 |
| Office and general | | 1,508,359 | 1,078,274 |
| Depreciation | 7 | 48,495 | 76,813 |
| Professional fees | | 1,475,929 | 1,252,225 |
| Stock exchange and filing fees | | 546,137 | 428,476 |
| | | 11,154,435 | 6,203,375 |
| Impairment of intangible exploration assets | 8 | 6,969,413 | - |
| Gain on acquisition of Lion Energy | 6(b) | (4,143,051) | - |
| Dilution loss on sale of subsidiary | 6(c) | 4,578,634 | - |
| Finance income | 18 | (12,079,274) | (2,075,089) |
| Finance expense | 18 | 2,472,378 | 15,366,047 |
| Net loss and comprehensive loss | | 8,952,535 | 19,494,333 |
| Net income and comprehensive income attributable to non-controlling interest | 6(c) | (1,691,149) | - |
| Net loss and comprehensive loss attributable to common shareholders | | 10,643,684 | 19,494,333 |
| Net loss per share | 21 | | |
| Basic | | $ 0.06 | $ 0.23 |
| Diluted | | $ 0.08 | $ 0.23 |
| Weighted average number of shares outstanding | 21 | | |
| Basic | | 193,417,492 | 85,164,170 |
| Diluted | | 194,030,846 | 85,164,170 |

The notes are an integral part of the consolidated financial statements.

# AFRICA OIL CORP.

Consolidated Statement of Equity
(Expressed in United States dollars)

| | Note | | December 31, 2011 | December 31, 2010 |
|---|---|---|---|---|
| **Share capital:** | **10(b)** | | | |
| Balance, beginning of year | | $ | 163,231,076 | $ 62,712,759 |
| Acquisition of Centric Energy | | | 60,165,193 | - |
| Acquisition of Lion Energy, net of AOC shares aquired | | | 21,561,185 | - |
| Issued on conversion of convertible debenture | | | 52,214,817 | - |
| Amended farmout agreement with Lion Energy | | | 5,274,675 | - |
| Private placement, net | | | - | 23,176,474 |
| Exercise of warrants | | | 3,023,756 | 73,582,210 |
| Assignment of Blocks 12A and 13T in Kenya | | | - | 3,243,470 |
| Farmout ageement finder's fees | | | 166,858 | 422,588 |
| Exercise of options | | | 872,349 | 93,575 |
| Balance, end of year | | | 306,509,909 | 163,231,076 |
| **Contributed surplus:** | | | | |
| Balance, beginning of year | | $ | 4,391,940 | $ 3,313,753 |
| Expiration of warrants | 11 | | 3,676 | 79,818 |
| Acquisition of Lion Energy | 6(b) | | 110,606 | - |
| Stock based compensation | 12 | | 4,348,440 | 933,144 |
| Issuance of shares in lieu of finder's fee | 10(b) | | (166,858) | 94,960 |
| Exercise of options | 12 | | (262,500) | (29,735) |
| Balance, end of year | | | 8,425,304 | 4,391,940 |
| **Deficit:** | | | | |
| Balance, beginning of year | | $ | (56,570,350) | $ (37,076,017) |
| Dilution loss through equity | 6(c) | $ | (8,069,447) | |
| Net loss and comprehensive loss attributable to common shareholders | | $ | (10,643,684) | (19,494,333) |
| Balance, end of year | | $ | (75,283,481) | (56,570,350) |
| Total equity attributable to common shareholders | | $ | 239,651,732 | 111,052,666 |
| **Non-controlling interest:** | | | | |
| Balance, beginning of year | | $ | - | $ - |
| Non-controlling interest on disposal of Canmex | 6(c) | $ | 34,604,620 | - |
| Net income and comprehensive income attributable to non-controlling interest | 6(c) | $ | 1,691,149 | - |
| Balance, end of year | | $ | 36,295,769 | - |
| Total equity | | $ | 275,947,501 | $ 111,052,666 |

The notes are an integral part of the consolidated financial statements.

# AFRICA OIL CORP.

Consolidated Statements of Cash Flows
(Expressed in United States dollars)

| For the years ended | | December 31, 2011 | December 31, 2010 |
|---|---|---|---|
| Cash flow s provided by (used in): | Note | | |
| Operations: | | | |
| Net loss and comprehensive loss for the year | | $ (8,952,535) | $ (19,494,333) |
| Item not affecting cash: | | | |
| Stock-based compensation | 12 | 4,348,440 | 933,144 |
| Share-based accrual for finder's fee | | - | 94,960 |
| Depreciation | 7 | 48,495 | 76,813 |
| Gain on marketable securities | 18 | (235,830) | - |
| Gain on acquisition of Lion Energy | 6(b) | (4,143,051) | - |
| Impairment of intangible exploration assets | 8 | 6,969,413 | - |
| Dilution loss on sale of subsidiary | 6(c) | 4,578,634 | - |
| Fair value adjustment - w arrants | 18 | (8,845,456) | 2,108,312 |
| Fair value adjustment - convertible debt | 18 | (2,031,704) | 13,257,735 |
| Unrealized foreign exchange (gain)/loss | | 1,901,474 | (1,968,176) |
| Changes in non-cash operating w orking capital | | (621,614) | 459,425 |
| | | (6,983,734) | (4,532,120) |
| Investing: | | | |
| Property and equipment expenditures | 7 | (39,446) | (8,885) |
| Intangible exploration expenditures | 8 | (41,285,520) | (15,424,461) |
| Farmout proceeds, net | 8,17 | 14,900,160 | - |
| Cash received on business acquisitions, net of cash issued | 6 | 18,636,869 | - |
| Proceeds on disposal of Canmex, net of investment in Horn | 6(c) | 29,923,128 | - |
| Changes in non-cash investing w orking capital | | 16,612,868 | 7,558,958 |
| | | 38,748,059 | (7,874,388) |
| Financing: | | | |
| Common shares issued, net of issuance costs | 10(b) | 3,019,716 | 78,387,475 |
| Repayment of liability portion of convertible debt | 9 | (411,220) | (854,296) |
| Deposit of cash for bank guarantee | 5 | (2,175,000) | (1,381,500) |
| Release of bank guarantee | 5 | 2,887,500 | - |
| Changes in non-cash financing w orking capital | | 168,569 | (704,599) |
| | | 3,489,565 | 75,447,080 |
| Effect of exchange rate changes on cash and cash equivalents denominated in foreign currency | | (1,821,279) | 1,939,776 |
| Increase in cash and cash equivalents | | 33,432,611 | 64,980,348 |
| Cash and cash equivalents, beginning of year | | 76,125,834 | $ 11,145,486 |
| Cash and cash equivalents, end of year | | 109,558,445 | $ 76,125,834 |
| Supplementary information: | | | |
| Interest paid | | 411,220 | 854,296 |
| Taxes paid | | Nil | Nil |

The notes are an integral part of the consolidated financial statements.

**1) Incorporation and nature of business:**

Africa Oil Corp. (collectively with its subsidiaries, "AOC" or the "Company") was incorporated on March 29, 1993 under the laws of British Columbia and is an international oil and gas exploration company based in Canada with oil and gas interests in Kenya, Ethiopia, Puntland (Somalia) and Mali. The Company's registered address is Suite 2610, 1066 West Hastings Street Vancouver, BC, V6E 3X1.

AOC is an exploration stage enterprise that participates in oil and gas projects located in emerging markets, in sub-Saharan Africa. To date, AOC has not found proved reserves and is considered to be in the exploration stage. Oil and gas exploration, development and production activities in these emerging markets, are subject to significant uncertainties which may adversely affect the Company's operations. Uncertainties include, but are not limited to, the risk of war, terrorism, expropriation, nationalization or other title disputes, renegotiation or nullification of existing or future concessions and contracts, the imposition of international sanctions, a change in crude oil or natural gas pricing policies, a change in taxation policies, and the imposition of currency controls, in addition to the risks associated with exploration activities. These uncertainties, all of which are beyond the Company's control, could have a material adverse effect on AOC's business, prospects and results of operations. In addition, if legal disputes arise related to oil and gas concessions acquired by the Company, AOC could be subject to the jurisdiction of courts other than those of Canada. The Company's recourse may be very limited in the event of a breach by a government or government authority of an agreement governing a concession in which AOC has or may acquire an interest. The Company may require licenses or permits from various governmental authorities to carry out future exploration, development and production activities. There can be no assurance that AOC will be able to obtain all necessary licenses and permits when required.

**2) Basis of preparation:**

a) Statement of compliance:

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), and to require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these consolidated financial statements. In the financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

Subject to certain transition elections disclosed in note 24, the Company has consistently applied the same accounting policies in its opening IFRS balance sheet at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 24 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of March 23, 2012 the date the Board of Directors approved the statements.

b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis. Where there are assets and liabilities calculated on a different basis, this fact is disclosed in the relevant accounting policy.

c) Functional and presentation currency:

These consolidated financial statements are presented in United States (US) dollars. The functional currencies of all the Company's individual entities are US dollars which represents the currency of the primary economic environment in which the entities operate.

d) Use of estimates and judgments:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are noted below with further details of the assumptions contained in the relevant note.

*i) Exploration and evaluation costs:*

Exploration and evaluation costs are initially capitalized as intangible exploration assets with the intent to establish commercially viable reserves. The Company is required to make estimates and judgments about the future events and circumstances regarding whether the carrying amount of intangible exploration assets exceeds its recoverable amount (see note 8).

*ii) Share-based payments:*

Charges for share-based payments are based on the fair value at the date of the award. The shares are valued using Black-Scholes, and inputs to the model include assumptions on share price volatility, discount rates and expected life outstanding (see note 12).

*iii) Derivative financial instruments:*

The Company's warrants and convertible debenture are treated as derivative financial liabilities. The estimated fair value, based on the Black-Scholes model, of each is adjusted on a quarterly basis with gains or losses recognized in the statement of net loss and comprehensive loss. The Black-Scholes model is based on significant assumptions such as volatility, dividend yield and expected term (see note 11).

## 3) Significant accounting policies:

Subject to certain IFRS 1 transition elections, the accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements, and have been applied consistently by the Company and its subsidiaries.

a) Basis of consolidation:

i) Subsidiaries:

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The acquisition method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The fair value of property, plant and equipment and intangible exploration assets recognized in a business combination, is based on market values. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of net loss and comprehensive loss.

ii) Jointly controlled operations and jointly controlled assets:

Many of the Company's oil and natural gas activities involve jointly controlled assets. The consolidated financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

iii) Transactions eliminated on consolidation:

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

b) Foreign currency:

Monetary assets and liabilities denominated in foreign currencies are translated into US dollars at exchange rates prevailing at the balance sheet date and non-monetary assets and liabilities are translated at rates in effect on the date of the transaction. Revenues and expenses are translated at exchange rates at the date of transaction. Exchange gains or losses arising from translation are included in the statement of net loss and comprehensive loss.

c) Property and equipment and Intangible exploration assets:

*i) Pre-exploration expenditures:*

Costs incurred prior to obtaining the legal rights to explore an area are recognized in the statement of net loss and comprehensive loss as incurred.

*ii) Exploration expenditures:*

Exploration expenditures include costs associated with the acquisition of a license interest, directly attributable general and administrative costs, expenditures incurred in the process of determining oil and gas exploration targets, and exploration drilling costs. All exploration expenditures are capitalized on a license-by-license basis within intangible exploration assets. Costs are held un-depleted until such time as the exploration phases on the license area are complete, the license area is relinquished, or commercially viable reserves have been discovered and extraction of those reserves is determined to be technically feasible.

If commercial reserves are established and technical feasibility for extraction demonstrated, then the related capitalized intangible exploration costs are transferred into a single field cost center within "oil and gas interests" subsequent to determining that the assets are not impaired (see "Impairment" below). Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are recognized in the statement of net loss and comprehensive loss.

Net proceeds from any disposal of an intangible exploration asset are recorded as a reduction in intangible explorations assets.

iii) *Development and production costs:*

All costs incurred after the technical feasibility and commercial viability of producing hydrocarbons has been demonstrated are capitalized within "oil and gas interests" on a field-by-field basis. Subsequent expenditures are capitalized only where it either enhances the economic benefits of the development/producing asset or replaces part of the existing development/producing asset. Any remaining costs associated with the part replaced are expensed in the statement of net loss and comprehensive loss.

Net proceeds from any disposal of "oil and gas interests" are recorded as a gain or loss on disposal recognized in the statement of net loss and comprehensive loss to the extent that the net proceeds exceed or are less than the appropriate portion of the net capitalized costs of the asset.

d) Depletion and depreciation:

The net carrying value of "oil and gas interests" are depleted on a field-by-field basis using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production.

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible.

Such reserves are considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

For property and equipment, depreciation is recognized in the statement of net loss and comprehensive loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Land is not depreciated. The estimated useful lives for other property and equipment, consisting of primarily office and computer equipment, for the current and comparative years are from one to three years.

e) Impairment:

i) Financial assets carried at amortized cost:

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in the statement of net loss and comprehensive loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the statement of net loss and comprehensive loss.

ii) Non-financial assets:

The carrying amounts of the Company's non-financial assets, other than intangible exploration assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and other intangible assets that have indefinite lives or that are not yet available for use, an impairment test is completed each year. Intangible exploration assets are assessed for impairment when they are reclassified to property and equipment, as oil and gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves. In determining fair value less costs to sell, recent market transactions are taken into account, if available. In the absence of such transactions, an appropriate valuation model is used.

The goodwill, if any, acquired in a business combination, for the purpose of impairment testing, is allocated to the CGU's that are expected to benefit from the synergies of the combination. Intangible exploration assets are allocated to related CGU's when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (oil and gas interests in property and equipment).

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of net loss and comprehensive loss. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

f) Stock-based compensation:

The Company has a stock option plan as described in note 12. The Company uses the fair value method, utilizing the Black-Scholes option pricing model, for valuing stock options granted to directors, officers, consultants and employees. The estimated fair value is recognized over the applicable vesting period as stock-based compensation expense and an increase to contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. When the stock options are exercised, the proceeds received and the applicable amounts recorded in contributed surplus are credited to share capital.

g) Finance income and expenses:

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in the statement of net loss and comprehensive loss using the effective interest method. The capitalization rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Company's outstanding borrowings during the period.

Interest income is recognized as it accrues in the statement of net loss and comprehensive loss, using the effective interest method.

Gains and losses related to revaluation of marketable securities, warrants and convertible debentures and related to foreign currency are reported under each of finance income and finance expenses on a net basis.

h) Income tax:

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the statement of net loss and comprehensive loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

i) Earnings per share:

Basic earnings per share is calculated by dividing the statement of net loss and comprehensive loss by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the statement of net loss and comprehensive loss and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees, warrants outstanding and convertible debentures. The weighted average number of diluted shares is calculated in accordance with the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase common shares at the average market price.

j) Financial instruments:

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

*i) Financial assets and liabilities at fair value through profit or loss:*

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. The Company has acquired marketable securities in the Lion Energy Corp. acquisition that management intends to sell in the short term. Derivatives are also included in this category unless they are designated as hedges.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of net loss and comprehensive loss. Gains and losses arising from changes in fair value are presented in the statement of net loss and comprehensive loss within financing income or expense in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which is classified as non-current. The Company does not have any financial instruments in this category.

ii) *Available-for-sale investments:*

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company does not have any financial instruments in this category.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive loss. Available-for-sale investments are classified as non-current, unless the investment matures within twelve months, or management expects to dispose of them within twelve months.

Interest on available-for-sale investments, calculated using the effective interest method, is recognized in the statement of net loss and comprehensive loss as part of interest income. Dividends on available-for-sale equity instruments are recognized in the statement of net loss and comprehensive loss when the Company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive loss to the statement of net loss and comprehensive loss.

iii) *Loans and receivables:*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise cash and cash equivalents, restricted cash and accounts receivable. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

iv) *Financial liabilities at amortized cost:*

Financial liabilities at amortized cost include accounts payables and are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, accounts payables are measured at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

v) *Derivative financial instruments:*

The Company has issued warrants and a convertible debenture that are treated as derivative liabilities. All derivatives have been classified as held-for-trading, are included on the balance sheet within warrants and convertible debenture liabilities, and are classified as current or non-current based on the contractual terms specific to the instrument.

(1) Warrants

The warrants entitle the holder to acquire a fixed number of common shares for a fixed Canadian dollar price per share. An obligation to issue shares for a price that is not fixed in the Company's functional currency, and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of net loss and comprehensive loss as they arise. The Company has recorded these changes as financing income and expenses (see note 11).

(2) Convertible debenture

The convertible debenture entitles the holder to convert the US dollar denominated loan into common shares for a fixed Canadian dollar price per share. In accordance with IFRS, an obligation to issue shares for a price that is not fixed in the Company's functional currency, and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of net loss and comprehensive loss as they arise. The Company has recorded these changes as financing income and expenses (see note 9).

k) Provisions:

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

Decommissioning obligations:

The Company's activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the asset retirement obligations are charged against the provision to the extent the provision was established.

**4) Future accounting changes:**

As of January 1, 2013, the following standards and amendments issued by the IASB become effective:

- IFRS 10, "Consolidated Financial Statements", which is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity.
- IFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "Interests in Joint Ventures". The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately consolidated.

(Expressed in United States dollars unless otherwise indicated)

- IFRS 12, "Disclosure of Interests in Other Entities", which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements.
- IFRS 13, "Fair Value Measurement", which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.
- IAS 19, "Employee Benefits", which amends the recognition and measurement of defined benefit pension expense and expands disclosures for all employee benefit plans.
- IFRS 7, "Financial Instruments: Disclosures", which requires disclosure of both gross and net information about financial instruments eligible for offset in the balance sheet and financial instruments subject to master netting arrangements. Concurrent with the amendments to IFRS 7, the IASB also amended IAS 32, "Financial Instruments: Presentation" to clarify the existing requirements for offsetting financial instruments in the balance sheet. The amendments to IAS 32 are effective as of January 1, 2014.

As of January 1, 2015, IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's 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. The impairment and hedge accounting principles to be included in IFRS 9 have not yet been issued by the IASB.

**5) Restricted cash:**

At December 31, 2011, the Company has a restricted cash balance of $2,919,000 (December 31, 2010 - $3,181,500) which represents the following bank deposits securing outstanding letters of credit:

| Block | In favor of | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|---|
| 10A | Tullow Oil plc | $ 731,250 | $ - | $ - |
| 10BB | Republic of Kenyan | - | 1,800,000 | 1,800,000 |
| 10BB | Tullow Oil plc | 900,000 | - | - |
| 12A | Republic of Kenyan | - | 540,000 | - |
| 12A | Tullow Oil plc | 270,000 | - | - |
| 13T | Republic of Kenyan | - | 547,500 | - |
| 13T | Tullow Oil plc | 273,750 | - | - |
| South Omo | Tullow Oil plc | 294,000 | 294,000 | - |
| 10BA | Republic of Kenyan | 450,000 | - | - |
| | | $ 2,919,000 | $ 3,181,500 | $ 1,800,000 |

**6) Acquisitions and divestitures:**

a) Centric Energy Corp.

On February 23, 2011, the Company acquired all of the issued and outstanding commons shares of Centric Energy Corp. ("Centric") for total consideration of $60.2 million. Centric was an oil and gas exploration company with operations in Kenya and the Republic of Mali. The consideration consisted of $9,917 of cash and 30,155,524 common shares of the Company valued at CAD$1.98 per share, being the trading price of the shares on the date the acquisition closed. The financial results of Centric's operations have been included in the Company's consolidated financial statements since the effective date.

(Expressed in United States dollars unless otherwise indicated)

The preliminary purchase price was allocated based on fair values as follows:

| **Net Assets acquired** | | |
|---|---|---|
| Cash and cash equivalents | $ | 748,877 |
| Accounts receivable | | 135,886 |
| Restricted cash | | 450,000 |
| Property and equipment | | 8,823 |
| Intangible exploration assets | | 58,831,524 |
| Total net assets acquired | $ | 60,175,110 |

| **Consideration** | | |
|---|---|---|
| Shares issued | $ | 60,165,193 |
| Cash issued | | 9,917 |
| Total purchase price | $ | 60,175,110 |

Had Centric been consolidated from January 1, 2011, net loss of AOC per the consolidated statement of net loss and comprehensive loss would have been $1,236,122 higher.

b) Lion Energy Corp.

On June 20, 2011, the Company acquired all the issued and outstanding common shares of Lion Energy Corp. ("Lion") for total consideration of $21.7 million. Lion was an oil and gas exploration company with operations in Kenya and Puntland (Somalia). The consideration consisted of 17,462,447 common shares of the Company. At the date of the acquisition Lion owned 2,500,000 shares of the Company, resulting in 14,962,447 net shares of the Company being issued valued at CAD$1.41 per share, being the trading price of the shares on the date the acquisition closed. The Company also issued 287,250 stock options of the Company fair valued at CAD$0.38 based on the Black Scholes option pricing model and assumed 2,289,000 outstanding Lion warrants. The warrants were amended to acquire AOC shares at CAD$2.50. No value was attributed to the amended Lion warrants which all expired out of the money shortly after the acquisition.

(Expressed in United States dollars unless otherwise indicated)

The preliminary purchase price was allocated based on fair values as follows:

| **Net Assets Acquired** | |
|---|---|
| Cash | $ 17,897,909 |
| Accounts receivable | 3,426,216 |
| Marketable securities | 2,453,250 |
| Intangible exploration assets | 5,681,000 |
| Accounts payable and accrued liabilities | (3,643,533) |
| Total net assets acquired | $ 25,814,842 |
| **Consideration** | |
| Shares issued, net of AOC shares acquired | 21,561,185 |
| Share options issued | 110,606 |
| Total consideration | $ 21,671,791 |
| Gain on acquisition | $ 4,143,051 |

The marketable securities acquired were 10 million shares in Encanto Potash Corp. ("Encanto") which trades the TSX Venture Exchange. These securities are stated at fair value with gains or losses on revaluation recorded on the statement of net loss and comprehensive loss. All of the Encanto shares acquired were sold subsequent to December 31, 2011.

Had Lion been consolidated from January 1, 2011, net loss per the consolidated statement of net loss and comprehensive loss would have been $1,199,245 higher.

c) Horn Petroleum Corporation ("Horn")

On September 20 2011, the Company transferred ownership of its wholly owned subsidiary, Canmex Holdings (Bermuda) I Ltd. ("Canmex"), the entity which indirectly owns a 60% interest in Production Sharing Agreements with the Puntland State of Somalia, in return for 27,777,778 shares in Horn (formerly Denovo Capital Corp.) (the "Transaction").

Prior to close of the Transaction, Horn completed a consolidation of its issued and outstanding common shares on the basis of 0.65 new common shares for each existing common share. Horn also completed a non-brokered private placement of an aggregate of 45,535,195 subscription receipts at a price of CAD$0.90 per subscription receipt for gross proceeds of $41.3 million. AOC acquired 11,111,111 of the subscription receipts. The subscription receipts were converted into common shares and warrants of Horn on September 20, 2011. In connection with the private placement, Horn paid a finder's fee, consisting of the issuance of an aggregate of 812,417 common shares and the payment of $0.9 million in cash. All securities issued pursuant to the offering were subject to a statutory hold period which expired December 3, 2011.

Subsequent to the Transaction, AOC held 51.4% of the outstanding shares of Horn, as well, a management services arrangement has been agreed between Horn and AOC in which the management of AOC are responsible for the operating decisions of Horn. As such, the former shareholder of Canmex, AOC, is deemed to control Horn.

(Expressed in United States dollars unless otherwise indicated)

In accordance with IFRS, changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances, the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received shall be recognized directly in equity and attributed to the owners of the parent. The following table outlines the consideration received versus the non-controlling interest adjustment:

| **Net consideration received** | | |
|---|---|---|
| Cash, net of cash issued | $ | 29,923,128 |
| Accounts payable and accrued liabilities | | (179,179) |
| Warrant liability | | (7,787,410) |
| | $ | 21,956,539 |
| | | |
| **Non-controlling interest adjusted** | | 34,604,620 |
| | $ | (12,648,081) |

The total difference by which the non-controlling interests are adjusted and the fair value of the consideration received was $12.6 million of which $4.6 million is recognized as a dilution loss in the statement of net loss and comprehensive loss on the consolidation of Horn and $8.1 million is recognized as a dilution loss through equity.

## 7) Property and equipment:

| | | **December 31, 2011** | | **December 31, 2010** |
|---|---|---|---|---|
| Cost, beginning of year | $ | 166,599 | $ | 157,714 |
| Additions | | 39,446 | | 8,885 |
| Business acquisitions (note 6(a)) | | 8,823 | | - |
| Cost, end of year | | 214,868 | | 166,599 |
| | | | | |
| Accumulated depreciation, beginning of year | | (126,978) | | (50,165) |
| Depreciation | | (48,495) | | (76,813) |
| Accumulated depreciation, end of year | | (175,473) | | (126,978) |
| | | | | |
| Net carrying amount, beginning of year | $ | 39,621 | $ | 107,549 |
| Net carrying amount, end of year | $ | 39,395 | $ | 39,621 |

As at December 31, 2011, the Company has recorded $39,395 of property and equipment (December 31, 2010 - $39,621) consisting primarily of office and computer equipment. The Company depreciates its property and equipment on a straight line basis over the useful life of the assets (one to three years). During the year ended December 31, 2011, AOC recorded depreciation expense of $48,495 (2010 - $76,813). The Company has reviewed property and equipment and determined that there is no indication of impairment.

(Expressed in United States dollars unless otherwise indicated)

**8) Intangible exploration assets:**

| | | December 31, 2011 | | December 31, 2010 |
|---|---|---|---|---|
| Net carrying amount, beginning of year | $ | 96,468,816 | $ | 76,138,940 |
| Additions, net | | 41,285,520 | | 20,329,876 |
| Impairment of Intangible exploration assets | | (6,969,413) | | |
| Farmout proceeds, net | | (9,625,485) | | - |
| Business acquisitions (note 6) | | 64,512,524 | | - |
| Net carrying amount, end of year | $ | 185,671,962 | $ | 96,468,816 |

As at December 31, 2011, $185.7 million of exploration expenditures have been capitalized as intangible exploration assets (December 31, 2010 - $96.5 million). These expenditures relate to the Company's share of exploration projects which are pending the determination of proven and probable petroleum reserves, and include geological and geophysical expenditures, exploratory drilling expenditures, costs required under the Company's Productions Sharing Agreements with the respective governments, and general and administrative costs related to exploration activities. At December 31, 2011, no intangible exploration assets have been transferred to oil and gas interests as commercial reserves have not been established and technical feasibility for extraction has not been demonstrated.

During the year ended December 31, 2011, the Company capitalized $3.1 million of general and administrative expenses related to intangible exploration assets (December 31, 2010 – $1.6 million). During the year ended December 31, 2011, the Company capitalized $0.2 million of interest expense in relation to its convertible debt to intangible exploration assets (December 31, 2010 – $0.9 million).

During 2011, management relinquished Blocks 2/6 in Ethiopia. Accordingly, the Company has written-off $7.0 million of capitalized intangible exploration assets of which $1.2 million represents the Company's portion of settlement costs with the Government of Ethiopia related to unfulfilled work obligations on the block.

Although the Company believes that it has title to its oil and natural gas properties, it cannot control or completely protect itself against the risk of title disputes or challenges.

**9) Convertible debenture:**

As part of the Company's acquisition in April of 2009 of Lundin Petroleum AB's ("LPAB") oil and gas operations in Kenya and Ethiopia, a subsidiary of LPAB provided the Company with a $23.8 million US dollar denominated convertible debenture to finance the acquisition. The convertible loan from LPAB carried an interest rate of USD six-month LIBOR plus 3%. The loan, including any accrued and unpaid interest, was convertible, at the option of either AOC or LPAB, into shares of the Company on the basis of CAD$0.90 per common share. The convertible debenture was to mature December 31, 2011.

In March 2011, the Company and LPAB amended the terms of the loan agreement to allow for full or partial conversion of the loan prior to the maturity date if agreed to, in writing, by both parties. On March 3, 2011, AOC and LPAB agreed to convert $13.0 million of the convertible loan into 14 million shares of the Company.

In April 2011, AOC and LPAB agreed to convert the remaining $10.8 million of the convertible loan plus $0.2 million of accrued interest into 11,850,100 shares of the Company.

(Expressed in United States dollars unless otherwise indicated)

The Company accounted for the convertible debenture as a liability as the instrument entitled the holder to convert the US dollar denominated loan into common shares for a fixed Canadian dollar price per share. In accordance with IFRS, an obligation to issue shares for a price that is not fixed in the Company's functional currency, and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of net loss and comprehensive loss as they arise. The Company has recorded these changes in financing income and expenses.

The following table outlines the change in the convertible debt for the years ended December 31, 2011 and December 31, 2010:

| | | December 31, 2011 | | December 31, 2010 |
|---|---|---|---|---|
| Balance, beginning of the year | $ | 54,489,172 | $ | 41,228,167 |
| Fair market value adjustment | | (2,031,704) | | 13,257,735 |
| Converted portion of convertible debenture | | (52,214,817) | | - |
| Accrued interest | | 168,569 | | 857,567 |
| Repayment of interest | | (411,220) | | (854,297) |
| Balance, end of the year | $ | - | $ | 54,489,172 |
| Less, current portion of convertible debenture | $ | - | | (411,220) |
| Long-term portion of convertible debt, end of the year | $ | - | $ | 54,077,952 |

## 10) Share capital:

a) The Company is authorized to issue an unlimited number of common shares with no par value.

b) Issued:

| | | December 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|---|
| | Note | Shares | Amount | Shares | Amount |
| Balance, beginning of year | | 135,806,100 | $ 163,231,076 | 70,205,496 | $ 62,712,759 |
| Acquisition of Centric Energy | 6(a) | 30,155,524 | 60,165,193 | - | - |
| Acquisition of Lion, net of AOC shares aquired | 6(b) | 14,962,447 | 21,561,185 | | |
| Issued on conversion of convertible debenture | 9 | 25,850,100 | 52,214,817 | - | - |
| Amended Farmout Agreement with Lion Energy | 17(ii) | 2,500,000 | 5,274,675 | - | - |
| Private placements, net of issue costs | (i) | - | - | 25,416,666 | 23,176,474 |
| Exercise of warrants, net of issue costs | 11 | 1,530,000 | 3,023,756 | 37,220,365 | 73,582,210 |
| Assignment of Blocks 12A and 13T in Kenya | (ii) | - | - | 2,500,000 | 3,243,470 |
| Farmout ageement finder's fees | 17 | 103,306 | 166,858 | 405,240 | 422,588 |
| Exercise of options | 12 | 505,582 | 872,349 | 58,333 | 93,575 |
| Balance, end of year | | 211,413,059 | $ 306,509,909 | 135,806,100 | $ 163,231,076 |

i) In July 2010, the Company closed a non-brokered private placement, issuing an aggregate of 25 million common shares of AOC at a price of CAD$1.00 per share for gross proceeds of CAD$25,000,000. Shares issued pursuant to the private placement were subject to a four month hold period. The Company incurred finder's fees and share issue costs of $1,072,385, including 416,666 shares issued in lieu of finder's fees, realizing net proceeds of $23,176,474.

ii) In September of 2010, the Company completed the assignment of a 100% interest in Blocks 12A and 13T in Kenya. The Blocks were assigned to the Company by Platform Resources Inc. ("Platform"), a wholly owned subsidiary of Alberta Oilsands Inc. In consideration for Platform's interest in Blocks 12A and 13T, AOC issued to Platform 2.5 million AOC common shares, valued at $3.2 million, and 1.5 million AOC share purchase warrants, valued at $0.8 million, exercisable into one common share at a price of CAD$1.50 per share for a period of two years. The terms of the warrants included an accelerated expiry provision which was exercised by the Company in November 2010. The warrants were exercised in April 2011, and the Company realized net proceeds of $2,362,500.

(Expressed in United States dollars unless otherwise indicated)

**c)** In June of 2011, the Company acquired 2.5 million of its own shares through the purchase of Lion Energy (see note 6(b)). The total amount paid to acquire the shares was deducted from share capital. The shares were held as treasury shares until they were surrendered for cancellation, and returned to treasury on December 15, 2011. No consideration was paid to AOC in connection with the cancellation and return to treasury. No gain or loss is recognized in the consolidated statement of net loss and comprehensive loss on the purchase, sale, issue or cancellation of the Company's own equity shares.

## 11) Warrants:

| | Note | Number of AOC Warrants | | Amount ($) |
|---|---|---|---|---|
| **Balance, January 1, 2010:** | | **43,952,013** | **$** | **21,673,039** |
| Expiration of warrants | (a),(b) | (170,547) | | (79,818) |
| Exercise of warrants | (b) | (37,220,365) | | (18,435,049) |
| Issuance of warrants | 10(b)(ii),(c) | 1,500,000 | | 804,379 |
| Fair market value adjustment | | - | | 2,108,312 |
| **Balance, December 31, 2010:** | | **8,061,101** | **$** | **6,070,863** |
| Current portion of warrants | | 1,500,000 | | 874,949 |
| Long-term portion of warrants | | 6,561,101 | $ | 5,195,914 |
| Expiration of warrants | (b),6(b) | (2,298,500) | | (3,676) |
| Exercise of warrants | (b),(c) | (1,530,000) | | (613,889) |
| Issuance of warrants | 6(b),6(c) | 2,289,000 | | - |
| Fair market value adjustment | | - | | (3,940,487) |
| **Balance, December 31, 2011:** | | **6,521,601** | **$** | **1,512,811** |

At December 31, 2011, the Company also recorded $2.9 million in long-term warrant liability on consolidation of its 51.4% ownership in Horn.

a) On July 7, 2010, whole share purchase warrants issued on July 21, 2009 as part of a business acquisition expired unexercised.

b) On November 22, 2010, the Company elected to accelerate the expiry date for all outstanding warrants issued as part of the April 28, 2009 private placement. The expiry date with respect to these warrants was amended to December 23, 2010. Of the 37,421,018 warrants granted in April 2009, all of which were outstanding at the beginning of 2010, 37,220,365 were exercised and 161,153 expired unexercised. The expiry for the remaining 39,500 warrants was extended to March 23, 2011. As a result of warrants exercised in 2010, the Company issued 37,220,365 common shares, realizing net proceeds of $55.2 million. The fair value of warrants transferred to share capital was $18.4 million. In the first quarter of 2011, 30,000 of the remaining warrants were exercised and 9,500 expired unexercised. As a result of warrants exercised in the first quarter of 2011, the Company issued 30,000 common shares, realizing net proceeds of $46,242. The fair value of warrants transferred to share capital was $15,389.

(Expressed in United States dollars unless otherwise indicated)

On November 22, 2010, the Company elected to accelerate the expiry date for 1,500,000 warrants issued to Platform as consideration for the assignment of blocks 12A and 13T (note 10(b)(ii)). The expiry date with respect to these warrants was amended to May 22, 2011. On April 20, 2011 all outstanding warrants held by Platform were exercised. As a result of the warrants being exercised the Company issued 1,500,000 common shares, realizing net proceeds of $2,362,500. The fair value of warrants transferred to share capital was $598,500.

The following table outlines the exercise price and expiration dates of outstanding common share purchase warrants at December 31, 2011:

| Issue Date | Number of Warrants | Exercise Price (CAD$) | Expiration Date |
|---|---|---|---|
| May 8, 2009 | 6,521,601 | $ 1.50 | May 8, 2012 |

Subsequent December 31, 2011, the remaining 6,521,601 warrants were exercised. Upon exercise of the remaining warrants, the Company received CAD$9.8 million gross proceeds and issued 6,521,601 common shares.

Each warrant is measured at fair valued quarterly using the Black-Scholes options pricing model. The fair value of warrants outstanding for the years December 31, 2011 and December 31, 2010 were estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

| | December 31, 2011 | December 31, 2010 | January 1, 2010 2010 |
|---|---|---|---|
| Number of outstanding at the end of the year | 6,521,601 | 8,061,101 | 43,952,013 |
| Fair value of w arrants outstanding ($ per w arrant) | 0.23 | 0.75 | 0.49 |
| Risk-free interest rate (%) | 0.80 | 1.25 | 1.69 |
| Expected life (years) | 0.35 | 1.17 | 2.33 |
| Expected volatility (%) | 53 | 60 | 84 |

**12) Share purchase options:**

At the 2010 Annual General Meeting, held on May 27, 2010, the Company approved the stock option plan (“the Plan”) which was last amended at the 2008 Annual General Meeting. The Plan provides that an aggregate number of common shares which may be reserved for issuance as incentive stock options shall not exceed 10% of the common shares outstanding, and option exercise prices will reflect current trading values of the Company’s shares. The term of any option granted under the Plan will be fixed by the Board of Directors and may not exceed five years from the date of grant. Vesting periods are determined by the Board of Directors and no optionee shall be entitled to a grant of more than 5% of the Company’s outstanding issued shares.

(Expressed in United States dollars unless otherwise indicated)

The Company's share purchase options outstanding are as follows:

| | December 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| | Number of shares | Weighted average exercise price (CAD$) | Number of shares | Weighted average exercise price (CAD$) |
| Outstanding, beginning of year | 3,946,667 | 1.67 | 2,527,500 | 1.99 |
| Granted | 8,112,250 | 1.70 | 1,617,500 | 1.13 |
| Expired or cancelled | (722,667) | 4.30 | (140,000) | 1.24 |
| Exercised | (505,582) | 1.16 | (58,333) | 1.12 |
| Balance, end of year | 10,830,668 | 1.54 | 3,946,667 | 1.67 |

The fair value of each option granted is estimated on the date of grant using the Black-Scholes options pricing model. The fair value of each option granted by the Company during the years ended December 31, 2011 and December 31, 2010 was estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

| | 2011 | 2010 |
|---|---|---|
| Number of options granted during the year | 8,112,250 | 1,617,500 |
| Fair value of options granted ($ per option) | 0.66 | 0.52 |
| Risk-free interest rate (%) | 1.33 | 1.63 |
| Expected life (years) | 2.17 | 2.25 |
| Expected volatility (%) | 68 | 80 |
| Expected dividend yield | - | - |

The following table summarizes information regarding the Company's stock options outstanding at December 31, 2011:

| Weighted Average Exercise price (CAD$/share) | Number outstanding | Weighted average remaining contractual life in years |
|---|---|---|
| 2.10 | 2,243,666 | 2.04 |
| 1.94 | 300,000 | 2.21 |
| 1.88 | 100,000 | 2.27 |
| 1.85 | 400,000 | 2.17 |
| 1.70 | 50,000 | 2.47 |
| 1.69 | 65,000 | 2.38 |
| 1.62 | 91,668 | 0.31 |
| 1.56 | 50,000 | 2.90 |
| 1.49 | 4,408,667 | 2.87 |
| 1.27 | 50,000 | 2.63 |
| 1.18 | 1,045,000 | 0.21 |
| 1.13 | 1,384,167 | 1.21 |
| 1.05 | 140,000 | 0.60 |
| 1.00 | 100,000 | 0.72 |
| 0.89 | 402,500 | 0.67 |
| 1.54 | 10,830,668 | 2.02 |

During the year ended December 31, 2011, the Company recognized $3.7 million and $0.6 million in stock-based compensation expense related to stock options of AOC and Horn, respectively (2010 - $0.9 million and nil, respectively). The Company recognizes Horn's stock-based compensation expense on the consolidation of Horn's financial results.

**13) Financial risk management:**

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration and financing activities such as:

- credit risk;
- liquidity risk; and
- market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

a) Credit risk:

Credit risk is the risk of loss if counterparties do not fulfill their contractual obligations. The majority of our credit exposure relates to amounts due from our joint venture partners. The risk of our joint venture partners defaulting on their obligations per their respective joint operating and farmout agreements is mitigated as there are contractual provisions allowing the Company to default joint venture partners who are non-performing and reacquire any previous farmed out working interests. The maximum exposure for the Company is equal to the sum of its cash, restricted cash, and accounts receivable. None of the Company's accounts receivable at December 31, 2011 was past due.

b) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Liquidity describes a company's ability to access cash. Companies operating in the upstream oil and gas industry, during the exploration phase, require sufficient cash in order to fulfill their work commitments in accordance with contractual obligations and to be able to potentially acquire strategic oil and gas assets.
The Company will potentially issue equity and enter into farmout agreements with joint venture partners to ensure the Company has sufficient available funds to meet current and foreseeable financial requirements. The Company actively monitors its liquidity to ensure that its cash flows and working capital are adequate to support these financial obligations and the Company's capital programs. The Company will also adjust the pace of its exploration activities to manage its liquidity position.

c) Market risk:

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments.

i) Foreign currency exchange rate risk:

The Company is exposed to changes in foreign exchange rates as expenses in international subsidiaries, oil and gas expenditures, or financial instruments may fluctuate due to changes in rates.

The Company's exposure to foreign currency exchange risk is mitigated by the fact that the Company sources the majority of its capital projects and expenditures in US dollars. The Company has not entered into any derivative instruments in an effort to mitigate exposure to fluctuations in foreign exchange rates.

For the year ended December 31, 2011, a 5% increase or decrease on an annualized basis in the value of the Canadian dollar in relation to the US dollar, which is the Company's functional currency, would have resulted in an approximately $3.9 million (2010 - $0.8 million) increase or decrease in foreign exchange gains, respectively.

At December 31, 2011, the Company had $79.8 million Canadian dollars (2010 - $70.4 million Canadian dollars) in cash and cash equivalents. Subsequent to December 31, 2011, the Company acquired US dollars reducing its Canadian dollars held by CAD $45.2 million.

ii) Interest rate risk:

As at December 31, 2011, the Company's has no outstanding convertible debenture. The convertible debenture was repaid in full during the year. The Company further has not entered into any derivative instruments or borrowing arrangements in which exposure to fluctuations in interest rates exists.

iii) Commodity price risk:

The Company is not currently directly exposed to fluctuations in commodity prices as AOC is currently in the exploration phase and has no production.

**14) Capital management:**

The Company's objective when managing capital structure is to maintain balance sheet strength in order to ensure the Company's strategic exploration and business development objectives are met while providing an appropriate return to shareholders relative to the risk of the Company's underlying assets.

The Company manages its capital structure and makes adjustments to it based on changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure which currently consists exclusively of equity instruments, the Company may issue additional shares, issue debt, execute working interest farm-out arrangements and revise its capital expenditures program. In addition, the Company manages its cash and cash equivalents balances based on forecasted capital outlays and foreign exchange risks in order to ensure that the risk of negative foreign exchange effects are minimized while ensuring that interest yields on account balances are appropriate. The Company does not have externally imposed capital requirements.

**15) Segment information:**

The Company determines and presents operating segments based on the information that internally is provided to the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), who are the Company's chief operating decision makers. An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses. An operating segment's operating results, for which discrete financial information is available, are reviewed regularly by the CEO and CFO to make decisions about resources to be allocated to the segment and assess its performance. The Company has a single class of business which is international oil and gas exploration. The geographical areas are defined by the Company as operating segments in accordance with IFRS. The Company currently operates in a number of geographical areas based on location of operations, being Puntland (Somalia), Ethiopia, Kenya and Mali.

| **At December 31, 2011** (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | **Total** |
|---|---|---|---|---|---|---|
| Total assets | $ 54,452 | $ 18,794 | $ 117,065 | $ 3,132 | $ 110,668 | **$ 304,111** |
| Intangible exploration assets | 53,041 | 17,491 | 112,022 | 3,118 | - | **185,672** |
| Property and equipment | - | - | - | 9 | 30 | **39** |

| **At December 31, 2010** (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | **Total** |
|---|---|---|---|---|---|---|
| Total assets | $ 39,763 | $ 25,889 | $ 43,838 | $ - | $ 69,245 | **$ 178,735** |
| Intangible exploration assets | 38,759 | 17,619 | 40,091 | - | - | **96,469** |
| Property and equipment | - | - | - | - | 40 | **40** |

| **Year ended December 31, 2011** (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | **Total** |
|---|---|---|---|---|---|---|
| **Capital expenditures** | | | | | | |
| Intangible exploration assets, net | $ 14,282 | $ 6,841 | $ 20,163 | $ - | $ - | **$ 41,286** |
| Property and equipment | - | - | - | - | 39 | **39** |
| | $ 14,282 | $ 6,841 | $ 20,163 | $ - | $ 39 | **$ 41,325** |
| **Statement of operations** | | | | | | |
| Expenses | $ 44 | $ 2 | $ 272 | $ 45 | $ 10,791 | **$ 11,154** |
| Writedown of oil and gas properties | - | 6,969 | - | - | - | **6,969** |
| Gain on Aquisition of Lion Energy | - | - | - | - | (4,143) | **(4,143)** |
| Dilution loss on sale of subsidiary | - | - | - | - | 4,579 | **4,579** |
| Finance income | - | - | - | - | (12,079) | **(12,079)** |
| Finance expense | - | - | - | - | 2,472 | **2,472** |
| Segmented loss/(gain) | $ 44 | $ 6,971 | $ 272 | $ 45 | $1,620 | **$ 8,952** |

| **Year ended December 31, 2010** (thousands) | Puntland | Ethiopia | Kenya | Mali | Corporate | **Total** |
|---|---|---|---|---|---|---|
| **Capital expenditures** | | | | | | |
| Intangible exploration assets, net | $ 756 | $ 5,199 | $ 9,469 | $ - | $ - | **$ 15,424** |
| Property and equipment | - | - | - | - | 9 | **9** |
| | $ 756 | $ 5,199 | $ 9,469 | $ - | $ 9 | **$ 15,433** |
| **Statement of operations** | | | | | | |
| Expenses | $ 67 | $ 61 | $ 189 | $ - | $ 5,886 | **$ 6,203** |
| Financial Expense | - | - | - | - | 15,366 | **15,366** |
| Finance Income | - | - | - | - | (2,075) | **(2,075)** |
| | $ 67 | $ 61 | $ 189 | $ - | $ 19,177 | **$ 19,494** |

**16) Commitments and contingencies:**

a) Contractual obligations

i) Puntland (Somalia):

In December 2009, the Company announced amendments to its existing Production Sharing Agreements (PSAs) made in respect of the Dharoor Valley and Nugaal Valley Exploration areas. The amendments reflected the extension of initial exploration periods from 36 to 48 months, with a revised expiry period of January 17, 2011. In addition, the terms of the exploration programs were amended such that the Company, at its option, could drill one exploratory well in each of the Dharoor Valley and Nugaal Valley Exploration Areas, or two exploratory wells in the Dharoor Valley. In consideration of the extension of the exploration period, the Company agreed to voluntarily relinquish twenty-five percent of the original agreement area on or before January 17, 2010 and agreed to pay a US$1 million bonus within 30 days of a commercial discovery in each of the production blocks. Further, the Company agreed to certain enhanced abandonment and environmental safety measures and to make a one-time US$1.05 million payment to the Puntland government for development of infrastructure.

In January 2011, the Company announced further amendments to its existing PSAs made in respect of the Dharoor Valley and Nugaal Valley Exploration areas. The amendments reflected the extension of initial exploration a further 12 months, with a revised expiry period of January 17, 2012. Under the amended PSAs, the Company was obligated to spud a minimum of one exploratory well in the Dharoor Valley Exploration Area by July 27, 2011. A second exploratory well was required to be spudded in the Nugaal Valley Exploration Area or, at the option of the Company, in the Dharoor Valley Exploration Area, by September 27, 2011.

In July 2011, the existing PSAs with Canmex made in respect of the Dharoor Valley and Nugaal Valley Exploration areas were further amended requiring execution of a drilling contract by July 31, 2011, drilling operations to commence on the first well by November 15, 2011, and drilling operations commenced on a second well by January 17, 2012. Canmex agreed to relinquish 15,627 km2 (gross) of the Nugaal Valley Exploration area, perform a surface geochemistry survey in the Nugaal Valley Exploration area, and pay the Puntland State of Somalia $1,000,000 in infrastructure and development support fees of which $500,000 was paid at December 31, 2011, $250,000 was paid subsequent to year end upon spud of the first well and the remaining $250,000 is due on completion of the first exploration well.

In February 2012, the Puntland Government granted the Company an extension of the first exploration period expiry date for the Dharoor Valley and Nugaal Valley areas to October 17, 2012 in order to provide for sufficient time to evaluate drilling results of both wells required under the PSAs.

Under the Joint Venture Agreement with Range Resources Ltd. (“Range”), relating to the Dharoor Valley and Nugaal Valley Exploration Blocks, the Company is obligated to solely fund $22.8 million of joint venture costs on each of the blocks ($45.5 million in total for both blocks) during the exploration period, in exchange for a 80% working interest in each block. In the event that a commercial discovery is declared on either of the Dharoor Valley and Nugaal Valley Blocks prior to the Company spending $22.8 million on that block, the Company shall be deemed to have earned its interest in that block and the Company and Range will be responsible for future expenditures on the block in proportion to their respective working interests. In the event that the Company does not fund the required $22.8 million during the initial exploration period, the Company's interest in the block would be forfeited. An additional $3.5 million will be payable to Range upon commencement of commercial production.

During the fourth quarter of 2008, the Company fulfilled its sole funding obligation related to the Dharoor Valley Block. As a result, Range is paying its 20% participating interest share of ongoing exploration costs related to this Block. In the Nugaal Valley Block, the Company has spent approximately $8.7 million towards its sole funding obligation to Range as of December 31, 2011.

ii) Ethiopia:

Under the terms of the Blocks 7/8 PSA, during the initial exploration period which expires in July 2012, the Company and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 1,250 kilometers of 2D seismic) with a minimum gross expenditure of $11.0 million. In addition, the Company and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million. The Company's current working interest in Blocks 7/8 is 55%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of farmout agreements which require AOC's joint venture partners to pay a disproportionate share of joint venture costs.

In accordance with the PSA for Blocks 2/6, the initial exploration period expired in November 2011. The Company has relinquished Blocks 2/6, and the Ministry of Mines in Ethiopia agreed to waive remaining commitments. The Company has paid $1.2 million with respect to its working interest share of the expected settlement with the Ministry of Mines in Ethiopia, in lieu of unfulfilled commitments with respect to Blocks 2/6 PSA. The Company's working interest in Block 2/6 was 55%.

Under the terms of the Adigala Block PSA, AOC and its partners have fulfilled the minimum work and financial obligations of the initial four year exploration period which expired in July 2011. The Ministry of Mines in Ethiopia approved the Company and its partners' entry into the next exploration period with amended minimum work commitments. Under the PSA which expires in July 2013, AOC and its partners are obligated to complete certain geological and geophysical ("G&G") operations (including acquisition of 7,500 kilometers of full tensor gravity) with a minimum gross expenditure of $1.75 million.

Under the terms of the South Omo PSA, during the initial exploration period which was extended by the Ministry of Mines in Ethiopia and expires in January 2013, AOC and its partners are obligated to complete certain G&G operations (including acquisition of 400 kilometers of 2D seismic) with a minimum gross expenditure of $6.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $8.0 million. The Company's current working interest in the South Omo Block is 30%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of farmout agreements which require AOC's joint venture partners to pay a disproportionate share of joint venture costs. This commitment is supported by an outstanding letter of credit of $294,000 in favor of Tullow Oil plc ("Tullow") which is collateralized by a bank deposit of $294,000 (see note 5).

iii) Kenya:

Under the terms of the Block 10A Production Sharing Contract ("PSC"), during the initial exploration period which was extended by the Ministry of Energy for the Republic of Kenya and expires in October 2012, AOC and its partners are obligated to complete G&G operations (including acquisition of 750 kilometers of 2D seismic) with a minimum gross expenditure of $7.8 million. Additionally, AOC and its partners are obligated to drill one exploration well with a minimum expenditure of $8.5 million. The Company's current working interest in Block 10A is 30%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of farmout agreements which require AOC's joint venture partners to pay a disproportionate share of joint venture costs. This commitment is supported by an outstanding bank guarantee of $0.7 million in favour of Tullow Oil plc and $2.4 million in favor of the Kenyan Government. The bank guarantee in favour of Tullow Oil plc has been collateralized by a bank deposit (see note 5). The bank has been provided with a parent company guarantee from Africa Oil Corp on the bank guarantee in favor of the Kenyan Government.

Under the terms of the Block 10BB PSC, during the initial exploration period which was extended by the Ministry of Energy for the Republic of Kenya and expires in July 2012, the Company and its partners are obligated to complete G&G operations (including acquisition of 600 kilometers of 2D seismic) with a minimum gross expenditure of $6.0 million. Additionally, AOC and its partners are required to drill one exploration well with a minimum gross expenditure of $6.0 million. The Company's current working interest in Block 10BB is 50%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of the farmout agreement with Tullow which require AOC's joint venture partners to pay a disproportionate share of joint venture costs. This commitment is supported by an outstanding bank guarantee of $0.9 million in favour of Tullow which has been collateralized by a bank deposit (see note 5).

Under the terms of the Block 9 PSC, with the drilling of the Bogal-1-1 well, AOC and its partners had fulfilled and exceeded the minimum work and financial obligations of the initial exploration period. Effective December 31, 2010, the Company entered into the First Additional Exploration Phase under the Block 9 PSC in Kenya which will expire on December 31, 2013. Under the terms of the PSC, AOC is required to drill one additional exploratory well to a minimum depth of 1,500 meters with a minimum gross expenditure of $2.5 million. The Company's current working interest in Block 9 is 100%.

Under the terms of the Blocks 12A and 13T PSCs, during the initial exploration periods which were extended by the Ministry of Energy for the Republic of Kenya and expire in September 2012, the initial minimum gross exploration expenditures are $3.6 million (Block 12A) and $3.65 million (Block 13T). The Company and its partner are obligated to complete G&G operations including the acquisition of 500km of 2D seismic or 100 km2 of 3D seismic (or a combination thereof) on each block. The Company's current working interest in Blocks 12A and 13T is 50%. The commitments on Block 12A and 13T have been supported by outstanding bank guarantees of $270,000 and $273,750, respectively, in favour of Tullow Oil plc which have been collateralized by bank deposits (see note 5).

Under the terms of the Block 10BA PSC, during the initial exploration period which expires in April 2013, the Company and its partners are obligated to complete G&G operations (including acquisition of 200 kilometres of 2D seismic) with a minimum expenditure of $3.0 million. The Company's current working interest in Block 10BA is 50%; however, the Company's portion of minimum expenditures is expected to be less than its working interest due to the terms of the farmout agreement with Tullow which require AOC's joint venture partner to pay a disproportionate share of joint venture costs. The commitments on Block 10BA are supported by an outstanding letter of credit of $450,000 in favor of the Kenyan Government which is collateralized by bank deposit of $450,000 (see note 5).

(Expressed in United States dollars unless otherwise indicated)

iv) Mali:
Under the terms of the Block 7 and 11 PSCs, the current exploration periods expire in July 2012 and June 2014, respectively. In accordance with the terms of the PSCs, the minimum gross exploration expenditures in the currently exploration periods are $11.6 million (Block 7) and $8 million (Block 11). In exchange for 75% working interest, our partner has committed to funding all currently planned seismic, G&G, and drilling costs associated with both blocks.

v) Office Lease Costs:
The Company has committed to future minimum payments at December 31, 2011 under a Canadian operating lease that includes the rental of office space and proportionate share of operating costs and office equipment as follows:

| | |
|---|---|
| 2012 | 212,808 |
| 2013 | 127,643 |
| 2014 | - |
| 2015 | - |
| 2016 | - |
| Total minimum payments | 340,451 |

vi) Title disputes:
In many of the countries in which the Company operates, land title systems are not developed to the extent found in many industrial countries and there may be no concept of registered title. Although the Company believes that it has title to its oil and gas properties, it cannot control or completely protect itself against the risk of title disputes or challenges. There can be no assurance that claims or challenges by third parties against the Company's properties will not be asserted at a future date.

**17) Farmout agreements:**

The Company has entered into the following farmout agreements reducing the Company's working interest and net commitments under the respective PSCs.

i) Tullow Oil plc:
During September 2010, the Company signed a definitive farmout agreement with Tullow Oil plc ("Tullow") allowing Tullow to acquire a 50% interest in, and operatorship of, Blocks 10BB and 10A in Kenya and of the South Omo Block in Ethiopia. In consideration for the assignment of these interests, Tullow has paid to AOC $9.5 million, representing 50% of AOC's audited past costs in the blocks. Tullow will fund its 50% working interest and AOC's working interest share of future joint venture expenditures in these blocks from July 1, 2010, the effective date, until the cap of $23.75 million

(based on AOC's carried interest) is reached. Once the expenditure cap has been met, AOC will be responsible for its working interest share of future costs.

Additionally, Tullow has also exercised an option to acquire 50% of AOC's interest in, and operatorship of, two additional exploration blocks in Kenya, 12A and 13T, recently acquired by AOC. Tullow has paid to AOC $1.7 million as compensation for past costs. Tullow and AOC will be responsible for their working interest share of future joint venture expenditures in these blocks going forward. The effective date of this agreement is July 1, 2010.

The South Omo portion of this farmout agreement closed during December 2010 while the farmouts relating to Blocks 10A, 10BB, 12A and 13T closed during January 2011.

ii) Lion Energy Corp.:
The following farmout agreements were entered into with Lion Energy Corp. ("Lion") prior to the Company acquiring Lion; (see note 6(b)):

During August 2009, the Corporation completed a definitive farmout agreement with Lion (formerly Raytec Metals Corp.) in respect of production sharing contracts relating to the corporation's Somalia Interests and Kenyan Interests. Under the terms of the farmout agreement with Lion, AOC agreed to the following:

- transfer of a 15 percent license interest in the Nugaal and Dharoor Valley Production Sharing Agreements;
- transfer of a 10 percent license interest in the Block 9 Production Sharing Agreement;
- transfer of a 25 percent license interest in the Block 10A Production Sharing Agreement; and,
- transfer of a 20 percent license interest in the Block 10BB Production Sharing Agreement.

Under the terms of the farmout agreement, Lion was obligated to pay a disproportionate share of costs associated with the planned work programs to be carried out in the subject areas throughout 2009 and 2010. The effective date of the farmout is August 19, 2009. AOC agreed to issue 810,480 common shares of the Company as a finder's fee in consideration for services provided in the negotiation and completion of the Lion farmout agreement. Half of the share consideration was issued during the three months ended June 30, 2010. The remaining common shares to be issued under the agreement will be issued from time to time as Lion fulfills their funding obligations under the Lion farmout agreement, subject to TSX Venture Exchange approval.

During September 2010, the Company amended their farmout agreement with Lion. The amendment resulted in Lion reducing its interest in Block 10BB to 10% (originally 20%) and eliminating its interest in Block 10A (originally 25%). As consideration, AOC paid Lion US$2.5 million in cash and issued to Lion 2.5 million common shares of AOC. The Company also agreed to the elimination expenditure promotes in Block 10BB and on the Company's projects in Puntland (Somalia) from effective date forward. The effective date of this agreement is July 1, 2010. The amended farmout agreement with Lion closed on January 26, 2011.

(Expressed in United States dollars unless otherwise indicated)

iii) Red Emperor Resources NL:

During August 2010, AOC executed a definitive farmout agreement with Red Emperor Resources NL ("Red Emperor") pursuant to which Red Emperor acquired a participating interest in the Dharoor Valley and Nugaal Valley Blocks located in Puntland (Somalia). Under the terms of the farmout agreement and an election made by Red Emperor to increase their interests, Red Emperor will earn a 20% interest in both the Dharoor Valley and Nugaal Valley Blocks and is committed to paying a disproportionate share of costs related to the one well drilling commitment included in the first exploration period of both the Dharoor Valley and Nugaal Valley Production Sharing Agreements. The farmout agreement was completed during the first quarter of 2011. The effective date of this agreement is June 15, 2010.

iv) East Africa Exploration Limited:

During May, 2009 the Company executed a farmout agreement with Black Marlin Energy Limited's East Africa Exploration Limited ("EAX") for their entry into the production sharing contracts in both the Federal Democratic Republic of Ethiopia (Ethiopia) and Kenya. Under the terms of the farmout agreement with EAX, AOC agreed to the following:

- transfer a 30 percent license interest in the Block 2/6 and 7/8 Production Sharing Agreements located in the Ogaden Basin of Southern Ethiopia;
- transfer a 20 percent license interest to EAX in the Block 10A Production Sharing Contract (PSC) located in the Anza Basin of northern Kenya.

Under the terms of the farmout agreement, EAX is obligated to pay a disproportionate share of costs associated with the planned work programs to be carried out in the subject areas. As consideration for past costs incurred by the Company, EAX has paid the Company $1,700,000. The effective date of the EAX farmout agreement is December 9, 2009.

**18) Finance income and expense:**

Finance income and expense for the years ended December 31, 2011 and 2010 is comprised of the following:

| **For the years ended** | **December 31, 2011** | **December 31, 2010** |
|---|---|---|
| Gain on marketable securities | 235,830 | - |
| Fair value adjustment - w arrants | 8,845,456 | (2,108,312) |
| Fair value adjustment - convertible debt | 2,031,704 | (13,257,735) |
| Interest and other income | 966,284 | 86,538 |
| Foreign exchange gain/(loss) | (2,472,378) | 1,988,551 |
| Financial Income | 12,079,274 | 2,075,089 |
| Financial expense | (2,472,378) | (15,366,047) |

**19) Related party transactions:**

a) Transactions with Lorito Holdings (Guernsey) Limited (“Lorito”)

During May 2009, the Company’s loans payable due to Lorito in the amount of CAD$6,000,000 plus interest of $195,521 was converted to 6,521,601 Units of the Company on the basis of CAD$0.95 per Unit. Each Unit was comprised of one common share and one share purchase warrant. Each warrant is exercisable into one common share of AOC at a price of CAD$1.50 per share over a period of three years. In the event that AOC closes at or above CAD$2.00 for a period of 20 consecutive trading days, the Company may elect to accelerate the expiry date to 30 days from the date of written notice to the warrant holder. Lorito is beneficially owned by Ellegrove Capital Ltd., a private trust the settler of which is the late Adolf H. Lundin. Subsequent to year end, Lorito exercised each of its 6,521,601 warrants into a common share of the Company.

b) Transactions with Namdo Management Services Ltd (“Namdo”)

During the year ended December 31, 2011, the Company incurred management fees of $245,258 (2010 - $228,542) for administrative support services fees to Namdo. Namdo is a private corporation owned by Lukas H. Lundin. At December 31, 2011, the Company had no outstanding amounts due to Namdo in respect of management fees (2010 – Nil).

c) Transactions with Horn Petroleum Corp. (“Horn”)

On September 20, 2011, a Share Purchase Agreement was executed between the Company and Horn which resulted in AOC owning 51.4% of the outstanding shares of Horn. The following transactions and resulting intercompany balances outstanding between the Company and Horn have been eliminated as the Company fully consolidates the financial statements of Horn.

The Company advanced Horn and its subsidiaries $8.6 million to fund exploration activities during 2011 (2010 – $1.7 million). On September 20, 2011, in accordance with the conditions precedent in the Share Purchase Agreement, AOC converted advances to Horn of $41.2 million into share capital. During the fourth quarter of 2011, Horn repaid the Company the remaining $7.5 million of advances made to Horn. At December 31, 2011, the Company had no outstanding balances receivable from Horn related to advances to fund exploration activities (2010 – $40.1 million).

Under the terms of a General Management and Service Agreement between Horn and the Company for the provision of management and administrative services, the Company invoiced Horn $258,116 during 2011 (2010 – Nil). At December 31, 2011, the outstanding balance receivable from Horn, recorded as a due from related party, was $258,116 (2010 – Nil). The management fee charged to Horn by the Company is expected to cover the cost of administrative expense and salary costs paid by the Company in respect services provided to Horn.

Under the terms of a Services Agreement between the Company and Horn, AOC invoiced Horn $188,620 during 2011 (2010 - $110,558) for services provided by geologists and geophysicists employed by AOC. As at December 31, 2011, $11,650 was outstanding and recorded in due from related party (2010 – Nil).

(Expressed in United States dollars unless otherwise indicated)

During 2011, AOC invoiced Horn $508,877 for reimbursable expenses paid by AOC on behalf of Horn. As at December 31, 2011, $109,269 was outstanding and recorded in due from related party (2010 – Nil).

During December 2011, Horn's subsidiary Canmex Holdings (Bermuda) II Ltd. commenced the transfer of $1.5 million to Horn, via AOC. At December 31, 2011, the funds were on deposit with AOC. Accordingly, the balance has been recorded as due to related party. AOC transferred the funds to Horn subsequent to year end.

d) Remuneration of Directors and Senior Management

Remuneration of Directors and Senior Management includes all amounts earned and awarded to the Company's Board of Directors and Senior Management. Senior Management includes the Company's President and Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Vice President of Exploration, as well as the President and Chief Financial Officer of Horn. Directors include both the Company's and Horn's Directors.

Directors' fees include Board and Committee Chair retainers and meeting fees. Managements' short-term wages and benefits include salary, benefits, bonuses and any other compensation earned or awarded during the year. Share-based compensation includes expenses related to the Company's stock option plan.

| **For the years ended December 31,** | **2011** | **2010** |
|---|---|---|
| Directors' fees | 112,227 | 155,106 |
| Directors' share-based compensation | 736,011 | 163,560 |
| Managements' short-term wages and benefits | 2,330,184 | 1,401,343 |
| Managements' share-based compensation | 2,670,595 | 472,813 |
| | 5,849,017 | 2,192,822 |

For the year ended December 31, 2011, $1.1 million of management remuneration was capitalized to intangible exploration assets (2010 - $0.5 million).

**20) Subsidiaries:**

The Company has the following wholly owned subsidiaries; 0845379 B.C. Ltd. (British Columbia), Africa Oil Holdings Cooperatief U.A. (Netherlands), Africa Oil Turkana B.V. (Netherlands), Africa Oil Kenya B.V. (Netherlands), Africa Oil Ethiopia B.V (Netherlands), Africa Oil Turkana Ltd. (Kenya), 0903658 B.C. Ltd. (British Columbia), Centric Energy Holdings (Barbados) Inc. (Barbados), Centric Energy Kenya (Barbados) Inc. (Barbados), Centric Energy (Kenya) Ltd. (Kenya), Mali Oil Development SARL (Mali, West Africa), Lion Energy Corp. (Canada), Lion Energy Antilles N.V. (Curacao), Lion Energy Kenya (9) N.V. (Curacao), Lion Energy (10A) N.V. (Curacao), Lion Energy (10BB) N.V. (Curacao), Lion Energy Puntland (Dharoor) N.V. (Curacao), and Lion Energy Puntland (Nogal) N.V. (Curacao). The Company owns 51.4% of the issued and outstanding shares of Horn Petroleum Corporation (Canada), which wholly owns the following subsidiaries: Canmex Holdings (Bermuda) I Ltd. (Bermuda), Canmex Holdings (Bermuda) II Ltd. (Bermuda), and Africa Oil Holdings (Bermuda) I Ltd. (Bermuda).

(Expressed in United States dollars unless otherwise indicated)

**21) Earnings per share:**

| For the years ended December 31, | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | | Weighted Average | | | Weighted Average | |
| | Earnings | Number of shares | Per share amounts | Earnings | Number of shares | Per share amounts |
| Basic loss per share | | | | | | |
| Net loss attributable to common shareholders | $ 10,643,684 | 193,417,492 | $ 0.06 | $ 19,494,333 | 85,164,170 | $ 0.23 |
| Effect of dilutive securities | | | | | | |
| Warrants | 3,940,487 | 613,355 | | - | - | |
| Dilutive loss per share | $ 14,584,171 | 194,030,846 | $ 0.08 | $ 19,494,333 | 85,164,170 | $ 0.23 |

**22) Subsequent event:**

**i)** Entry in to next exploration period in Adigala – see note 16(a)(i).

**ii)** Sale of marketable securities – see note 6(b).

**iii)** Exercise of warrants – see note 11 and 19.

**23) Income Taxes:**

Substantially all of the differences between actual income tax expense (recovery) of nil and the expected federal, AB and BC statutory corporate income tax recovery related to losses not recognized and share issue costs. The Company has estimated non-capital losses carry forward of $19.9 million which expire from 2012 through 2031.

The following table reconciles the expected tax recovery calculated at the Canadian statutory rate with the actual tax recovery:

| For the years ended December 31, | 2011 | 2010 |
|---|---|---|
| Net loss and comprehensive loss | 8,952,535 | 19,494,333 |
| Combined federal and provincial statutory income tax rate | 26.5% | 28.0% |
| Expected tax recovery | 2,372,422 | 5,458,413 |
| Stock-based compensation | (1,152,337) | (261,280) |
| Non-taxable portion of gains on marketable securities | 31,247 | - |
| Non-taxable income (expense) items | 768,914 | (3,830,971) |
| Unrecognized tax losses | (2,020,247) | (1,366,162) |
| Tax recovery | - | - |

(Expressed in United States dollars unless otherwise indicated)

The Company has the following un-booked deductible temporary differences at December 31, 2011 and 2010:

| For the years ended December 31, | 2011 | 2010 |
|---|---|---|
| Unbooked deductible temporary differences | | |
| Capital assets | $ 122,108 | $ - |
| Share issuance costs | 5,655,567 | 2,101,868 |
| Capital losses carried forward | 5,029,250 | 2,261,560 |
| Non-capital losses carried forward | 30,375,442 | 9,092,900 |
| | 41,182,366 | 13,456,329 |

**24) Reconciliation of Canadian GAAP to IFRS:**

As disclosed in Note 2, these consolidated financial statements represent the Company's first annual presentation of the financial results of operations and financial position under IFRS as at and for the year ended December 31, 2011, including 2010 comparative periods. As a result, the Company followed IFRS 1, "First-time Adoption of International Financial Reporting Standards" in preparing its consolidated financial statements. Prior to 2011, the Company prepared its consolidated financial statements in accordance with previous GAAP.

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

The following reconciliations present the adjustments made to the Company's previous GAAP financial results of operations and financial position to comply with IFRS 1.

(Expressed in United States dollars unless otherwise indicated)

## Consolidated Balance Sheets
As at January 1, 2010

| | Note | Canadian GAAP | Effect of transition to IFRS | IFRS |
|---|---|---|---|---|
| | 23(a) | | | |
| **ASSETS** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | | $ 11,145,486 | $ - | $ 11,145,486 |
| Accounts receivable | | 5,396,253 | - | 5,396,253 |
| Prepaid expenses | | 508,344 | - | 508,344 |
| | | 17,050,083 | - | 17,050,083 |
| Long-term assets | | | | |
| Restricted cash | | 1,800,000 | - | 1,800,000 |
| Property and equipment | | 107,549 | - | 107,549 |
| Oil and gas interest | (i) | 75,750,771 | (75,750,771) | - |
| Intangible exploration assets | (i)(iv) | - | 76,138,940 | 76,138,940 |
| | | 77,658,320 | 388,169 | 78,046,489 |
| Total assets | | $ 94,708,403 | $ 388,169 | $ 95,096,572 |
| **LIABILITIES AND EQUITY ATTRIBUTABLE TO COMMON SHAREHOLDERS** | | | | |
| Current liabilities | | | | |
| Accounts payable and accrued liabilities | | $ 3,244,871 | $ - | $ 3,244,871 |
| Current portion of convertible debenture | (iv) | 903,416 | (495,466) | 407,950 |
| | | 4,148,287 | (495,466) | 3,652,821 |
| Long-term liabilities | | | | |
| Warrants | (iii) | - | 21,673,039 | 21,673,039 |
| Convertible debenture | (iv) | 1,326,630 | 39,493,587 | 40,820,217 |
| | | 1,326,630 | 61,166,626 | 62,493,256 |
| Total liabilities | | 5,474,917 | 60,671,160 | 66,146,077 |
| Equity attributable to common shareholders | | | | |
| Share capital | | 62,712,759 | - | 62,712,759 |
| Warrants | (iii) | 11,862,296 | (11,862,296) | - |
| Equity portion of convertible debenture | (iv) | 21,578,986 | (21,578,986) | - |
| Contributed surplus | | 3,313,753 | - | 3,313,753 |
| Deficit | (vi) | (10,051,042) | (27,024,975) | (37,076,017) |
| Accumulated comprehensive income | (ii) | (183,266) | 183,266 | - |
| Total equity attributable to common shareholders | | 89,233,486 | (60,282,991) | 28,950,495 |
| Total liabilities and equity attributable to common shareholders | | $ 94,708,403 | $ 388,169 | $ 95,096,572 |

(Expressed in United States dollars unless otherwise indicated)

**Consolidated Balance Sheets**
As at December 31, 2010

| | Note | | Canadian GAAP | | Effect of transition to IFRS | IFRS |
|---|---|---|---|---|---|---|
| | 23(a) | | | | | |
| **ASSETS** | | | | | | |
| Current assets | | | | | | |
| Cash and cash equivalents | | $ | 76,125,834 | $ | - | $ 76,125,834 |
| Accounts receivable | | | 2,323,208 | | - | 2,323,208 |
| Prepaid expenses | | | 595,729 | | - | 595,729 |
| | | | 79,044,771 | | - | 79,044,771 |
| Long-term assets | | | | | | |
| Restricted cash | | | 3,181,500 | | - | 3,181,500 |
| Property and equipment | | | 39,621 | | - | 39,621 |
| Oil and gas interest | (i) | | 95,372,778 | | (95,372,778) | - |
| Intangible exploration assets | (i)(iv) | | | | 96,468,816 | 96,468,816 |
| | | | 98,593,899 | | 1,096,038 | 99,689,937 |
| Total assets | | $ | 177,638,670 | $ | 1,096,038 | $ 178,734,708 |
| **LIABILITIES AND EQUITY ATTRIBUTABLE TO COMMON SHAREHOLDERS** | | | | | | |
| Current liabilities | | | | | | |
| Accounts payable and accrued liabilities | (v) | $ | 7,059,507 | $ | 62,500 | $ 7,122,007 |
| Current portion of w arrants | (iii) | | - | | 874,949 | 874,949 |
| Current portion of convertible debenture | (iv) | | 1,525,447 | | (1,114,227) | 411,220 |
| | | | 8,584,954 | | (176,778) | 8,408,176 |
| Long-term liabilities | | | | | | |
| Warrants | (iii) | | | | 5,195,914 | 5,195,914 |
| Convertible debenture | (iv) | | - | | 54,077,952 | 54,077,952 |
| | | | - | | 59,273,866 | 59,273,866 |
| Total liabilities | | | 8,584,954 | | 59,097,088 | 67,682,042 |
| Equity attributable to common shareholders | | | | | | |
| Share capital | (iii) | | 154,820,376 | | 8,410,700 | 163,231,076 |
| Warrants | (iii) | | 2,598,531 | | (2,598,531) | - |
| Equity portion of convertible debenture | (iv) | | 21,578,986 | | (21,578,986) | - |
| Contributed surplus | (iii)(v) | | 4,260,957 | | 130,983 | 4,391,940 |
| Deficit | (vi) | | (14,021,868) | | (42,548,482) | (56,570,350) |
| Accumulated comprehensive income | (ii) | | (183,266) | | 183,266 | - |
| Total equity attributable to common shareholders | | | 169,053,716 | | (58,001,050) | 111,052,666 |
| Total liabilities and equity attributable to common shareholders | | $ | 177,638,670 | $ | 1,096,038 | $ 178,734,708 |

# AFRICA OIL CORP.

Notes to Consolidated Financial Statements
For the years ended December 31, 2011 and 2010
(Expressed in United States dollars unless otherwise indicated)

**Consolidated Statement of Loss and Comprehensive Loss**
Year ended December 31, 2010

| | Note | Canadian GAAP | Effect of transition to IFRS | IFRS |
|---|---|---|---|---|
| | 23(a) | | | |
| Expenses | | | | |
| Salaries and benefits | | $ 1,369,025 | $ - | $ 1,369,025 |
| Stock-based compensation | | 933,144 | - | 933,144 |
| Bank charges | | 122,697 | - | 122,697 |
| Travel | | 714,179 | - | 714,179 |
| Management fees | | 228,542 | - | 228,542 |
| Office and general | | 1,078,274 | - | 1,078,274 |
| Depreciation | | 76,813 | - | 76,813 |
| Professional fees | (v) | 1,094,765 | 157,460 | 1,252,225 |
| Stock exchange and filing fees | | 428,476 | - | 428,476 |
| | | 6,045,915 | 157,460 | 6,203,375 |
| Finance income | | (2,075,089) | - | (2,075,089) |
| Finance expense | (iii)(iv) | - | 15,366,047 | 15,366,047 |
| Loss and comprehensive loss for the year attributable to common shareholders | | 3,970,826 | 15,523,507 | 19,494,333 |
| Loss per share | | | | |
| Basic and diluted | | $ 0.05 | | $ 0.23 |
| Weighted average number of shares outstanding | | | | |
| Basic and diluted | | 85,164,170 | | 85,164,170 |

(Expressed in United States dollars unless otherwise indicated)

a) Notes to reconciliations

i) IFRS 1 election for full cost oil and gas entities

The Company elected an IFRS 1 exemption whereby exploration and evaluation assets were reclassified from the full cost pool to intangible exploration assets at the amount that was recorded under Canadian GAAP. This resulted in the following increase in intangible exploration assets with a corresponding decrease in oil and gas interests:

| | January 1, 2010 | December 31, 2010 |
|---|---|---|
| Oil and gas interest | (75,750,771) | (95,372,778) |
| Intangible exploration assets | 75,750,771 | 95,372,778 |

ii) IFRS 1 election for cumulative translation differences

The Company elected an IFRS 1 exemption whereby cumulative translation differences for all foreign subsidiaries and foreign equity method investments to be deemed zero at transition with offsetting entry recorded directly to deficit.

iii) Warrants

The warrants entitle the holder to acquire a fixed number of common shares for a fixed Canadian dollar price per share. In accordance with IFRS, an obligation to issue shares for a price that is not fixed in the Company's functional currency, and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of net loss and comprehensive loss as they arise. The Company has recorded these changes in financing income and expenses. Under Canadian GAAP, the warrants were classified as equity and changes in fair value were not recognized. This change in accounting resulted in the following adjustments:

| | January 1, 2010 | December 31, 2010 |
|---|---|---|
| Warrants (Current Portion - Liabilities) | - | 874,949 |
| Warrants (Liabilities) | 21,673,039 | 5,195,914 |
| Warrants (Shareholders' Equity) | (11,862,296) | (2,598,531) |
| Share capital | - | 8,410,700 |
| Contributed surplus | - | 36,023 |
| Deficit | (9,810,743) | (11,919,055) |
| Financing income | - | - |
| Financing expense | - | 2,108,312 |

iv) Convertible debenture

The convertible debenture entitled the holder to convert the US dollar denominated loan into common shares for a fixed Canadian dollar price per share. In accordance with IFRS, an obligation to issue shares for a price that is not fixed in the Company's functional currency, and that does not qualify as a rights offering, must be classified as a derivative liability and measured at fair value with changes recognized in the statement of net loss and comprehensive loss as they arise. The Company has recorded these changes in financing income and expenses. Under Canadian GAAP, the majority of the convertible debenture was classified as equity and changes in fair value were not recognized.

(Expressed in United States dollars unless otherwise indicated)

This change in accounting resulted in the following adjustments:

| | January 1, 2010 | December 31, 2010 |
|---|---|---|
| Intangible exploration assets | 388,169 | 1,096,038 |
| Current portion of convertible debenture (Liabilities) | (495,466) | (1,114,227) |
| Convertible debenture (Liabilities) | 39,493,587 | 54,077,952 |
| Equity portion of convertible debenture | (21,578,986) | (21,578,986) |
| Deficit | (17,030,966) | (30,288,701) |
| Financing income | - | - |
| Financing expense | - | 13,257,735 |

v) Finder's fees

The Company was obligated to pay a finder's fee with respect to the Red Emperor farmout when a drilling contract was in place with respect to the first well in the Dharoor block of Puntland (Somalia). Under IFRS, this obligation is recognized when it is more likely than not that a drilling contract will be obtained. Under Canadian GAAP, the obligation would not be realized until the contract was signed. The obligation was payable in shares and cash.

vi) Deficit

The reconciliation in deficit from Canadian GAAP to IFRS is the result of the accumulated adjustments in Note 24(a)(i) through (v).

vii) Consolidated statement of cash flows

There has been no significant change to the consolidated statements of cash flows.