



## **FINANCIAL STATEMENTS**

**DECEMBER 31, 2010 and 2009**

**Note to Reader:**

Please be advised that Alberta Oilsands Inc. (the "Company") is re-filing its financial statements for the year ended December 31, 2010 (the "Financial Statements") because the auditors' report included in the original filing of the Financial Statements was inadvertently not signed by the Company's auditors, KPMG LLP. This re-filed version of the Financial Statements includes a signed version of the auditors' report and, except for this change, is identical to the original version of the Financial Statements.

## Management's Responsibility

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To the Shareholders of Alberta Oilsands Inc.:

Management is responsible for the preparation and presentation of the accompanying financial statements, including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting principles and ensuring that all information in the annual report is consistent with the statements. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors exercises its responsibilities for financial controls through an Audit Committee. The Audit Committee is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Committee has the responsibility of meeting with management and the external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

KPMG LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

April 18, 2011

*"signed"*  
Shabir Premji  
Executive Chairman

*"signed"*  
Michael Lee  
President



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## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Alberta Oilsands Inc.

We have audited the accompanying financial statements of Alberta Oilsands Inc., which comprise the balance sheets as at December 31, 2010 and 2009, the statements of operations, comprehensive loss, and deficit and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the 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 financial statements.

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

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Alberta Oilsands Inc. as at December 31, 2010 and 2009, and its results of operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

**KPMG LLP**

Calgary, Canada

April 18, 2011

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# Alberta Oilsands Inc.

## Balance Sheets

December 31

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| <b>Assets</b>  | <b>2010</b>          | <b>2009</b>          |
|--|----------------------|----------------------|
| Current  |                      |                      |
| Cash and cash equivalents ( <i>note 4</i> )                | \$ 4,652,658         | \$ 6,880,447         |
| Short-term investments ( <i>note 5</i> )                   | –                    | 1,051,381            |
| Investment in equity instruments ( <i>notes 6 and 17</i> ) | 5,576,060            | –                    |
| Accounts receivable  | 311,185              | 3,054,865            |
| Subscription receivable ( <i>note 9</i> )                  | –                    | 32,800               |
| Prepaid expenses   | 403,804              | 213,951              |
|  | <u>10,943,707</u>    | <u>11,233,444</u>    |
| Reclamation deposit  | 910,380              | 249,262              |
| Property and equipment ( <i>note 7</i> )                   | 53,199,726           | 47,617,698           |
|  | <u>\$ 65,053,813</u> | <u>\$ 59,100,404</u> |
| <br>   |                      |                      |
| <b>Liabilities</b>   |                      |                      |
| Current  |                      |                      |
| Accounts payable and accrued liabilities                   | \$ 2,378,379         | \$ 1,565,611         |
| Commodity contract ( <i>note 17c</i> )                     | –                    | 6,687                |
| Future income taxes ( <i>note 12</i> )                     | 200,166              | –                    |
|  | <u>2,578,545</u>     | <u>1,572,298</u>     |
| Asset retirement obligation ( <i>note 8</i> )              | 1,154,949            | 1,043,966            |
| Future income taxes ( <i>note 12</i> )                     | 4,891,442            | 4,243,195            |
|  | <u>8,624,936</u>     | <u>6,859,459</u>     |
| <br>   |                      |                      |
| <b>Shareholders' Equity</b>                                |                      |                      |
| Share capital ( <i>note 9</i> )                            | 63,668,969           | 58,756,475           |
| Warrants ( <i>note 10</i> )                                | 864,327              | 617,637              |
| Contributed surplus ( <i>note 11</i> )                     | 6,811,812            | 6,147,842            |
| Deficit  | (14,916,231)         | (13,281,009)         |
|  | <u>56,428,877</u>    | <u>52,240,945</u>    |
|  | <u>\$ 65,053,813</u> | <u>\$ 59,100,404</u> |

Basis of presentation (*note 1*), Commitments (*note 16*)  
Subsequent events (*notes 17 and 19*)

On behalf of the Board

“signed Shabir Premji”

Director

“signed Michael Lee”

Director

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See accompanying notes to the financial statements.

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**Alberta Oilsands Inc.****Statements of Operations, Comprehensive Loss, and Deficit  
For the years ended December 31**

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|   | 2010                   | 2009                   |
|---|------------------------|------------------------|
| <b>Revenue</b>  |                        |                        |
| Petroleum and natural gas sales                               | \$ 2,453,182           | \$ 2,979,929           |
| Royalties   | (443,272)              | (409,963)              |
|   | <u>2,009,910</u>       | <u>2,569,966</u>       |
| Unrealized gain (loss) on commodity contract (note 17c)       | 133,687                | (133,687)              |
| Interest income   | 10,213                 | 40,022                 |
|   | <u>2,153,810</u>       | <u>2,476,301</u>       |
| <b>Expenses</b>   |                        |                        |
| Production  | 1,004,061              | 1,395,623              |
| Transportation  | 98,291                 | 134,275                |
| General and administrative                                    | 2,964,858              | 2,252,242              |
| Business development (note 13)                                | –                      | 328,473                |
| Stock-based compensation (note 9)                             | 520,733                | 761,951                |
| Financing costs   | –                      | 160,068                |
| Unrealized gain on investment in equity instruments (note 17) | (1,429,746)            | –                      |
| Interest  | 23,516                 | 70,322                 |
| Accretion   | 87,582                 | 34,978                 |
| Depletion and depreciation (note 7)                           | 4,628,503              | 1,951,922              |
|   | <u>7,897,798</u>       | <u>7,089,854</u>       |
| <b>Loss before the undernoted</b>                             | <u>(5,743,988)</u>     | <u>(4,613,553)</u>     |
| Sale of Kenya interests (notes 6 and 17)                      | 4,146,314              | –                      |
| Associated business development costs (note 13)               | (600,533)              | –                      |
| <b>Net gain on sale</b>                                       | <u>3,545,781</u>       | <u>–</u>               |
| <b>Loss before income taxes</b>                               | <u>(2,198,207)</u>     | <u>(4,613,553)</u>     |
| Future income tax reduction (note 12)                         | 562,985                | 953,074                |
| <b>Net loss and comprehensive loss for the year</b>           | <u>(1,635,222)</u>     | <u>(3,660,479)</u>     |
| Deficit, beginning of year                                    | (13,281,009)           | (9,620,530)            |
| <b>Deficit, end of year</b>                                   | <u>\$ (14,916,231)</u> | <u>\$ (13,281,009)</u> |
| <b>Net loss per share</b>                                     |                        |                        |
| Basic and diluted (Note 9)                                    | <u>\$ (0.02)</u>       | <u>\$ (0.04)</u>       |

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See accompanying notes to the financial statements.

**Alberta Oilsands Inc.**  
**Statements of Cash Flows**  
**For the years ended December 31**

|   | <u>2010</u>         | <u>2009</u>         |
|---|---------------------|---------------------|
| <b>Operating</b>                                    |                     |                     |
| Net loss for the year                               | \$ (1,635,222)      | \$ (3,660,479)      |
| Non-cash items:                                     |                     |                     |
| Unrealized gain on investment in equity instruments | (1,429,746)         | –                   |
| Stock-based compensation                            | 520,733             | 761,951             |
| Financing costs                                     | –                   | 35,068              |
| Accretion   | 87,582              | 34,978              |
| Depletion and depreciation                          | 4,628,503           | 1,951,922           |
| Sale of Kenya interests                             | (4,146,314)         | –                   |
| Future income tax recovery                          | (562,985)           | (953,074)           |
| Unrealized (gain) loss on financial instruments     | (6,687)             | 6,687               |
|   | <u>(2,544,136)</u>  | <u>(1,822,947)</u>  |
| Change in non-cash working capital <i>(note 14)</i> | <u>(83,262)</u>     | <u>(158,191)</u>    |
|   | <u>(2,627,398)</u>  | <u>(1,981,138)</u>  |
| <b>Financing</b>                                    |                     |                     |
| Issuance of shares, net of costs                    | 6,169,655           | 9,726,705           |
| Proceeds from exercise of warrants                  | 10,000              | –                   |
| Proceeds from exercise of options                   | 124,162             | –                   |
| Change in non-cash working capital <i>(note 14)</i> | (241,520)           | 152,764             |
|   | <u>6,062,297</u>    | <u>9,879,469</u>    |
| <b>Investing</b>                                    |                     |                     |
| Short-term investments maturities                   | 8,558,994           | 2,993,685           |
| Purchase of short term investments                  | (7,507,613)         | (2,050,820)         |
| Expenditures on property and equipment              | (9,908,207)         | (12,724,649)        |
| Proceeds on disposal of property and equipment      | 163,879             | 18,995              |
| Reclamation deposit                                 | (661,118)           | (123,937)           |
| Change in non-cash working capital <i>(note 14)</i> | 3,691,377           | (6,502,974)         |
|   | <u>(5,662,688)</u>  | <u>(18,389,700)</u> |
| <b>Decrease in cash and cash equivalents</b>        | <b>(2,227,789)</b>  | <b>(10,491,369)</b> |
| Cash and cash equivalents, beginning of year        | 6,880,447           | 17,371,816          |
| <b>Cash and cash equivalents, end of year</b>       | <b>\$ 4,652,658</b> | <b>\$ 6,880,447</b> |
| <b>Supplemental cash flow information:</b>          |                     |                     |
| Interest paid                                       | \$ 73,952           | \$ 169,804          |

See accompanying notes to the financial statements.

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# **Alberta Oilsands Inc.**

## **Notes to Financial Statements**

### **For the years ended December 31, 2010 and 2009**

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#### **1. Basis of presentation**

Alberta Oilsands Inc. ("the Company") is incorporated under the Business Corporations Act (Alberta) and is listed on the TSX Venture Exchange. The Company is involved in the production, exploration and development of resource properties in Western Canada. Prior to September 2010, the financial statements consolidated the accounts of the Company, its wholly owned subsidiary, Platform Resources Inc. ("Platform"), and Platform's subsidiary Platform Resources (Kenya) Limited after the elimination of all intercompany transactions and balances. On September 9, 2010, Alberta Oilsands Inc. and Platform Resources Inc. amalgamated.

These financial statements have been prepared on a going concern basis which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. The Company has incurred operating losses over the past four years. The ability of the Company to continue as a going concern and the recoverability of amounts shown for the properties is dependent upon the existence of economically recoverable reserves and upon the Company's ability to obtain additional financing to continue the development of the Company's properties and generate funds therefrom and to meet current and future obligations. The financial statements do not reflect adjustments in the carrying values of the assets and liabilities, expenses and the balance sheet classifications that would be used if the going concern assumption were not appropriate. Such adjustments could be material.

#### **2. Significant accounting policies**

The financial statements have been prepared by management in accordance with generally accepted accounting principles in Canada. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements and accompanying notes. Actual results could differ from these estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment within the reasonable limits of materiality and the framework of the significant accounting policies summarized below:

**a) Cash and cash equivalents**

Cash and cash equivalents consist of bank balances and term deposits with maturities at the date of purchase of three months or less.

**b) Short term investments**

Short term investments consist of investments with maturities of three months or more.

**c) Prepaid expenses**

Prepaid expenses consist of deposits and prepaid annual fees which are amortized over the term of the related payment.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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## 2. Significant accounting policies (continued)

### d) Property and equipment

#### i) Capitalized costs

The Company follows the full cost method of accounting for its petroleum and natural gas operations. Under this method all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized on a country-by-country basis. Costs include lease acquisition costs, geological and geophysical expenses, cost of drilling both productive and non-productive wells, asset retirement costs and directly related overhead. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion and depreciation by more than 20%.

#### ii) Depletion and depreciation

Depletion of petroleum and natural gas properties and depreciation of production equipment, net of estimated salvage or residual value, is provided using the unit-of-production method based upon estimated gross proved petroleum and natural gas reserves as determined by independent engineers. The costs of significant unevaluated properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment occurs. For depletion and depreciation purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Office equipment is depreciated on a declining balance basis over its estimated useful life at rates varying from 20% to 45%.

#### iii) Impairment test

Under the full cost method of accounting, a "ceiling test" is performed to recognize and measure impairment, if any, of the carrying amount of petroleum and natural gas properties. Impairment is recognized if the carrying amount of the petroleum and natural gas properties, less the cost of undeveloped properties, net of impairment, exceeds the estimated undiscounted future cash flows from the Company's proved reserves. The future cash flows are based on a forecast of prices adjusted for quality and transportation differentials, and costs, as provided by an independent third party. The magnitude of the impairment, if any, is then measured by comparing the carrying amount of petroleum and natural gas properties less the cost of undeveloped properties, net of impairment, to the estimated discounted future cash flows from the Company's proved and probable reserves. The future cash flows are discounted at the Company's risk-free interest rate, using forecasted prices and costs.

Any impairment recognized is recorded as additional depletion and depreciation expense.

### e) Asset retirement obligation

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred and records a corresponding increase in the carrying amount of the related property and equipment. The fair value is determined through a review of engineering studies, industry guidelines, and management's estimate on a site-by-site basis. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the statement of operations. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. The increase in the carrying amount of the asset is amortized using the unit of production method based on estimated gross proved reserves as determined by independent engineers. Actual costs incurred upon settlement of the asset retirement obligations are charged against the asset retirement obligation to the extent of the liability recorded.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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#### 2. Significant accounting policies (continued)

##### f) Flow-through shares

A portion of the Company's exploration activities is financed through proceeds received from the issue of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to the share subscribers. To recognize the foregone tax benefits to the Company the carrying amount of the shares issued is reduced by the tax effect of the benefits renounced to subscribers. The tax effect of the renouncement is recorded when the renouncement documents are filed with the tax authorities.

##### g) Future income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method future tax assets and liabilities are determined based on differences between financial reporting and income tax basis of assets and liabilities, and are measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in the statement of operations in the period in which the change is substantively enacted. A valuation allowance is recorded against a future income tax asset if it is more likely than not that the asset will not be realized.

##### h) Joint operations

Substantially all of the exploration, development and production activities of the Company are conducted jointly with others and these financial statements reflect only the Company's proportionate interest in such activities.

##### i) Revenue recognition

Petroleum and natural gas sales are recognized as revenue when commodities are delivered and title passes to purchasers.

##### j) Per share amounts

Basic per share amounts are computed by dividing the net loss by the weighted average number of common shares outstanding during the year. The Company utilizes the treasury stock method in the determination of diluted per share amounts. Under this method, the diluted weighted average number of shares is calculated assuming that proceeds arising from the exercise of options and other dilutive instruments where the market price exceeds option price are used to purchase, for cancellation, common shares of the Company at their average market price for the period. The weighted average number of shares is then adjusted by the net change.

##### k) Stock options

Under the Company's stock option plan described in note 9, options to purchase common shares are granted to directors, employees and consultants at current market prices. Stock-based compensation is recorded over the vesting period of the options with a corresponding amount recorded as contributed surplus. Stock-based compensation for options granted to directors and employees is based on the estimated fair value at the time of the grant. Stock-based compensation for options granted to consultants is based on the estimated fair value at each balance sheet date until the related options are fully vested. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that vested options expire, previously recognized compensation expense associated with such stock options is not reversed. If unvested options are forfeited, previously recognized compensation expense associated with the options is reversed. If unvested options are cancelled, compensation expense is accelerated to be fully recognized in the period of cancellation.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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## 2. Significant accounting policies (continued)

### l) Comprehensive loss

Comprehensive loss is the change in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources and includes unrealized gains and losses on financial assets classified as available-for-sale. The Company has reported a statement of comprehensive loss combined with the statement of operations. When related amounts are recorded, a new category for accumulated other comprehensive income (loss) will be presented in the shareholders' equity section of the balance sheet.

### m) Financial instruments

All financial instruments, including all derivatives, are required to be recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities except those held-for-trading and available for sale are measured at amortized cost determined using the effective interest rate method. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to earnings when derecognized or impaired. The Company has classified its financial assets and liabilities as follows:

| <u>Held-for-trading</u>          | <u>Loans and receivables</u> | <u>Other liabilities</u>                 |
|----------------------------------|------------------------------|--|
| Cash and cash equivalents        | Accounts receivable          | Accounts payable and accrued liabilities |
| Short-term investments           | Subscription receivable      |  |
| Investment in equity instruments |                              |  |
| Commodity contract               |                              |  |

At each balance sheet date, the Company will assess financial assets for impairment with any impairment recorded in the statement of operations.

The Company may use various types of derivative financial instruments to manage risks associated with crude oil and natural gas price fluctuations. These instruments are not used for trading or speculative purposes. Proceeds and costs realized from holding the related contracts are recognized in petroleum and natural gas revenues at the time that each transaction under a contract is settled. For the unrealized portion of such contracts, the Company utilizes the fair value method of accounting. The fair value is based on an estimate of the amounts that would have been paid to or received from counterparties to settle these instruments given future market prices and other relevant factors. The method requires the fair value of the derivative financial instruments to be recorded at each balance sheet date with the unrealized gains or losses on these contracts recorded through the statement of operations.

The Company has elected to account for its physical delivery sale contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts on an accrual basis rather than as non-financial derivatives.

The Company expenses all transaction costs as incurred in relation to the acquisition of a financial asset or liability.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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## 2. Significant accounting policies (continued)

### n) Use of estimates

The amounts recorded for depletion and depreciation of property and equipment and the ceiling test are based on estimates of gross reserves, production rates, oil and gas prices, royalties, future costs and other relevant assumptions. Inherent in the provision of asset retirement obligations are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal and regulatory environments. To the extent future revisions to these assumptions impact the provision of the existing asset retirement obligation liability, a corresponding adjustment is made to the property and equipment balance. Amounts related to the fair value of stock options and warrants are based on estimates of share price volatility, risk-free interest rate and expected lives of options and warrants. Future income tax assets and liabilities are reported based on estimates of future income tax rates. Amounts reported for the fair value of commodity price risk contracts are based on the counterparties' estimates of future commodity prices and volatility of those prices. By their nature, these estimates and related future cash flows are subject to measurement uncertainty, and the impact on the financial statements of future periods could be material. These assumptions are reviewed periodically and, as adjustments become necessary, they are reported in the statement of operations in the periods in which they become known.

## 3. Changes in accounting policies

### International Financial Reporting Standards ("IFRS")

On January 1, 2011, the Company will adopt IFRS for publicly accountable enterprises as required by the Accounting Standards Board of Canada. Entities are required to adopt IFRS effective January 1, 2011 with a restatement of the comparative periods for 2010 including an opening balance sheet as at January 1, 2010. Under IFRS, the primary audience is the capital markets and as a result, there is significantly more disclosure required. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policies and increased note disclosures which must be addressed.

## 4. Cash and cash equivalents

|                             | 2010         | 2009         |
|-----------------------------|--------------|--------------|
| Cash in bank                | \$ 4,600,137 | \$ 5,377,694 |
| Cash in investment accounts | 52,521       | 1,502,753    |
|                             | \$ 4,652,658 | \$ 6,880,447 |

Cash is held in various investment accounts and earns nominal interest.

## 5. Short-term investments

As at December 31, 2010, the Company held investments of nil (December 31, 2009 – \$1,051,381).

## 6. Investment in equity instruments

On September 9, 2010, the Company completed the sale of its interests in Kenya to Africa Oil Corp. ("Africa Oil") in exchange for 2,500,000 common shares and 1,500,000 common share purchase warrants of Africa Oil with an exercise price of \$1.50 per warrant over a life of two years. See note 17 for further information.

**Alberta Oilsands Inc.**  
**Notes to Financial Statements**  
**For the years ended December 31, 2010 and 2009**

**7. Property and equipment**

|                                      | 2010                 |  |                      |
|--------------------------------------|----------------------|--|----------------------|
|                                      | Cost                 | Accumulated<br>depletion and<br>depreciation | Net                  |
| Petroleum and natural gas properties |                      |  |                      |
| Oil sands properties                 | \$ 46,358,498        | \$ –   | \$ 46,358,498        |
| Conventional properties              | 21,967,246           | 15,188,900                                   | 6,778,346            |
| Office equipment                     | 219,764              | 156,882                                      | 62,882               |
|                                      | <u>\$ 68,545,508</u> | <u>\$ 15,345,782</u>                         | <u>\$ 53,199,726</u> |
|                                      |                      |  |                      |
|                                      | 2009                 |  |                      |
|                                      | Cost                 | Accumulated<br>depletion and<br>depreciation | Net                  |
| Petroleum and natural gas properties |                      |  |                      |
| Oil sands properties                 | \$ 38,419,578        | \$ –   | \$ 38,419,578        |
| Conventional properties              | 19,723,558           | 10,585,500                                   | 9,138,058            |
| Office equipment                     | 191,841              | 131,779                                      | 60,062               |
|                                      | <u>\$ 58,334,977</u> | <u>\$ 10,717,279</u>                         | <u>\$ 47,617,698</u> |

During the year ended December 31, 2010, the Company capitalized \$412,635 (2009 - \$283,875) of general and administrative costs, \$362,942 (2009 - \$247,411 of stock-based compensation of which \$226,894 relates to options and \$20,517 relates to warrants) and \$79,860 (2009 - \$82,470) of related future incomes taxes. Of the \$362,942 in capitalized stock based compensation, \$239,580 relates to stock options and \$123,362 relate to warrants. At December 31, 2010, the Company excluded \$46,358,498 (December 31, 2009 – \$38,419,578) of costs in oil sands properties from the depletion and ceiling test calculations. In addition, \$535,000 (December 31, 2009 – \$343,750) of future development costs have been included in the depletion calculation.

The Company completed a ceiling test on its conventional property and equipment at December 31, 2010 and determined that there was an impairment in the amount of \$2,250,000 (December 31, 2009 – nil). During the year ended December 31, 2010, an impairment loss was included in depletion and depreciation for a total of \$2,450,000 of which \$200,000 was recognized in the three and nine months ended September 30, 2010 and \$2,250,000 in the three months ended December 31, 2010. For the purposes of the December 31, 2010 impairment test, the following benchmark prices were used:

|                                 | Edmonton Light<br>Cdn\$/bbl | AECO Spot<br>\$/MMbtu |
|---------------------------------|-----------------------------|-----------------------|
| 2011                            | 85.00                       | 4.25                  |
| 2012                            | 90.00                       | 4.75                  |
| 2013                            | 95.00                       | 5.25                  |
| 2014                            | 100.00                      | 6.00                  |
| 2015                            | 103.00                      | 6.50                  |
| Escalation rate thereafter - 2% |                             |                       |

# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

#### 8. Asset retirement obligation

The following table presents the reconciliation of the carrying amount of the obligation associated with the retirement of the property and equipment:

|                      | 2010                | 2009                |
|----------------------|---------------------|---------------------|
| Balance, January 1   | \$ 1,043,966        | \$ 935,700          |
| Liabilities incurred | 95,608              | 95,410              |
| Dispositions         | (71,740)            | (75,000)            |
| Revisions            | (467)               | 52,878              |
| Accretion            | 87,582              | 34,978              |
| Balance, December 31 | <u>\$ 1,154,949</u> | <u>\$ 1,043,966</u> |

The following significant assumptions were used to estimate the asset retirement obligation:

|  | 2010         | 2009         |
|--|--------------|--------------|
| Undiscounted abandonment costs                 | \$ 2,870,600 | \$ 2,938,846 |
| Credit adjusted risk-free rate                 | 8 – 10%      | 8 – 10%      |
| Inflation rate                                 | 2%           | 2%           |
| Weighted average expected timing of cash flows | 9 years      | 10 years     |

#### 9. Share capital

##### a) Common shares issued

|  | Number<br>of Shares | Amount               |
|--|---------------------|----------------------|
| Balance, December 31, 2008                             | 79,651,375          | \$ 52,237,820        |
| Issue of units (i)                                     | 12,781,250          | 4,550,448            |
| Issue of flow-through shares (ii)                      | 12,778,000          | 5,750,100            |
| Share issue costs ( <i>net of tax of \$275,773</i> )   | –                   | (827,322)            |
| Tax effect of flow-through shares issued in 2008 (iii) | –                   | (2,954,571)          |
| Balance, December 31, 2009                             | 105,210,625         | 58,756,475           |
| Exercise of stock options (iv)                         | 694,832             | 234,175              |
| Exercise of warrants (v)                               | 20,000              | 10,137               |
| Issue of flow through shares (vi)                      | 12,520,000          | 6,122,865            |
| Issue of flow through shares (vii)                     | 470,000             | 300,800              |
| Share issue costs ( <i>net of tax of \$105,987</i> )   | –                   | (317,958)            |
| Tax effect of flow-through shares issued in 2009 (ii)  | –                   | (1,437,525)          |
| Balance, December 31, 2010                             | <u>118,915,457</u>  | <u>\$ 63,668,969</u> |

- (i) Pursuant to a prospectus in November 2009, the Company issued a total of 12,781,250 units at a price of \$0.40 per unit for gross proceeds of \$5,112,500. 57,000 of these units were issued to directors and officers. Each unit consisted of one common share and one common share purchase warrant of the Company. Each warrant entitles the holder to purchase one common share at an exercise price of \$0.50 per common share up until November 17, 2011. The fair value of the warrants was estimated to be \$562,052 (note 10). The value of this unit issuance, net of the warrants, is \$4,550,448 which has been allocated to share capital. Share issue costs of \$1,103,095 were incurred for this prospectus. A subscription receivable in the amount of \$22,800 was recognized and these proceeds were received subsequent to December 31, 2009.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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#### 9. Share Capital (continued)

##### a) Common shares issued (continued)

- (ii) Pursuant to a prospectus in November 2009, the Company issued 12,778,000 flow-through common shares at a price of \$0.45 per share for total gross proceeds of \$5,750,100. 165,000 of these units were issued to directors and officers. The renunciation documents were filed with the tax authorities in February 2010 at which time the tax effect of the qualifying expenditures in the amount of \$1,437,525 was recognized. The Company incurred the required \$5,750,100 in qualifying expenditures by December 31, 2010. A subscription receivable in the amount of \$10,000 was recognized at December 31, 2009 and these proceeds were received in 2010.
- (iii) Pursuant to a non-brokered private placement in August 2008, the Company issued 12,440,300 flow-through common shares at a price of \$0.95 per share. The renunciation documents were filed with the tax authorities in February 2009 at which time the tax effect of the qualifying expenditures in the amount of \$2,954,571 was recognized.
- (iv) During the year ended December 31, 2010, the Company issued 694,832 common shares on the exercise of 694,832 stock options at exercise prices ranging from \$0.13 to \$0.40 per common share for cash proceeds of \$124,162. In addition to the cash proceeds a pro-rata allocation of the options' fair value in the amount of \$110,013 was reclassified from contributed surplus to share capital.
- (v) During the year ended December 31, 2010, the Company issued 20,000 common shares on the exercise of 20,000 warrants at an exercise price of \$0.50 per common share for cash proceeds of \$10,000. In addition to the cash proceeds a pro-rata allocation of the warrant fair value in the amount of \$137 was reclassified from warrants to share capital.
- (vi) In November 2010, the Company issued 12,520,000 units at \$0.50 per unit for cash proceeds of \$6,260,000. Each unit is comprised of one common share issued on a flow through basis and one half of a share purchase warrant. Each whole warrant entitles the holder to purchase one common share at an exercise price of \$0.70 per common share up until November 2012. The fair value of the warrants was estimated to be \$137,135 (note 10). The value of this unit issuance, net of the warrants, is \$6,122,865 which has been allocated to share capital. Share issue costs of \$405,897 were incurred for this prospectus. Directors and officers subscribed for 60,000 flow-through common shares. The Company is required to incur qualifying expenditures of \$6,260,000 by December 31, 2011.
- (vii) On December 29, 2010, the Company issued 470,000 flow-through common shares for \$0.64 per share for cash proceeds of \$300,800. Share issue costs of \$18,048 were incurred for this prospectus. The Company is required to incur qualifying expenditures of \$300,800 by December 31, 2011.

##### b) Stock options

During the year ended December 31, 2010, the Company granted a total of 3,880,000 (2009 – 316,000) stock options which vest one-third upon grant date and one-third on the first and second anniversaries of the grant date and expire five years from the grant date. The initial total fair value of the options granted was estimated to be \$1,092,838 (2009 - \$42,823).

**Alberta Oilsands Inc.**  
**Notes to Financial Statements**  
**For the years ended December 31, 2010 and 2009**

**9. Share Capital** (continued)

**b) Stock options** (continued)

The Black-Scholes pricing model was used to estimate the fair value of the options granted using a forfeiture rate of nil, a dividend yield of nil, and the following significant assumptions:

|  | 2010    | 2009    |
|--|---------|---------|
| Weighted average risk-free interest rate | 2.13%   | 2.11%   |
| Weighted average volatility              | 105%    | 103%    |
| Expected life                            | 5 years | 5 years |

The following is a continuity of stock options:

|                                     | 2010        |                                 | 2009        |                                 |
|-------------------------------------|-------------|---------------------------------|-------------|---------------------------------|
|                                     | Options     | Weighted average exercise price | Options     | Weighted average exercise price |
| Opening                             | 5,527,156   | \$ 0.47                         | 7,622,856   | \$ 0.85                         |
| Granted                             | 3,880,000   | 0.39                            | 316,000     | 0.20                            |
| Exercised                           | (694,832)   | 0.18                            | –           | –                               |
| Cancelled for directors/officers    | –           | –                               | (1,560,000) | 1.99                            |
| Cancelled for employees/consultants | –           | –                               | (204,000)   | 2.06                            |
| Expired                             | (229,000)   | 0.31                            | (360,000)   | 0.30                            |
| Forfeited                           | (1,631,001) | 0.46                            | (287,700)   | 0.97                            |
| Closing                             | 6,852,323   | \$ 0.46                         | 5,527,156   | \$ 0.47                         |

The following summarizes information about stock options outstanding as at December 31, 2010:

| Range of exercise prices | Number outstanding | Weighted average remaining contractual life (years) | Options outstanding weighted average exercise price | Number exercisable | Options exercisable weighted average exercise price |
|--------------------------|--------------------|---|---|--------------------|---|
| \$ 0.13                  | 1,329,667          | 2.95  | \$ 0.13   | 1,271,333          | \$ 0.13   |
| \$ 0.14 – \$ 0.37        | 1,631,000          | 2.71  | 0.34  | 1,088,997          | 0.35  |
| \$ 0.38 – \$ 0.61        | 3,122,000          | 3.76  | 0.43  | 1,405,324          | 0.47  |
| \$ 0.62 – \$ 1.47        | 517,656            | 1.99  | 1.04  | 517,656            | 1.04  |
| \$ 1.48 – \$ 2.21        | 252,000            | 1.50  | 2.09  | 252,000            | 2.09  |
|                          | 6,852,323          | 3.14  | \$ 0.46   | 4,535,310          | \$ 0.50   |

Of the total options outstanding, 4,885,500 are held by directors, officers and management. The Company recognized stock-based compensation as follows for the years ended December 31:

|   | 2010       | 2009       |
|---|------------|------------|
| Capitalized to property and equipment ( <i>note 7</i> ) | \$ 440,727 | \$ 226,894 |
| Expensed  | 520,733    | 761,951    |
|   | \$ 961,460 | \$ 988,845 |

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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#### 9. Share Capital (continued)

##### c) Per share amounts

Basic per share amounts are calculated using the weighted average number of shares outstanding of 106,986,858 for the year ended December 31, 2010 (2009 – 82,704,408). All of the Company's outstanding options and warrants were excluded as they were considered to be anti-dilutive.

#### 10. Warrants

The following is a continuity of warrants:

|                            | Warrants    | Value      | Weighted<br>average<br>exercise price |
|----------------------------|-------------|------------|---------------------------------------|
| Balance, December 31, 2008 | –           | \$ –       | \$ 0.00                               |
| Issued (i)                 | 4,000,000   | 20,517     | 0.75                                  |
| Issued (ii)                | 650,000     | 35,068     | 0.50                                  |
| Issued (iii)               | 12,781,250  | 562,052    | 0.50                                  |
| Balance, December 31, 2009 | 17,431,250  | 617,637    | 0.56                                  |
| Issued (iv)                | 6,260,000   | 137,135    | 0.70                                  |
| Issued (i)                 | 2,000,000   | 123,362    | 0.50                                  |
| Expired (i)                | (2,000,000) | (13,670)   | 0.50                                  |
| Exercised (note 9(a)(v))   | (20,000)    | (137)      | 0.50                                  |
| Balance, December 31, 2010 | 23,671,250  | \$ 864,327 | \$ 0.60                               |

- i) On July 8, 2009, the Company granted 4,000,000 common share purchase warrants to the Fort McMurray Airport Authority. Each whole warrant entitles the holder to acquire one common share of the Company for the following periods: 2,000,000 warrants were exercisable at a price of \$0.50 per common share until July 8, 2010 and 2,000,000 warrants are exercisable at a price of \$1.00 per common share until July 8, 2011. The fair value of the warrants was estimated at \$20,517 using the Black-Scholes pricing model based on a forfeiture rate of 0%, a dividend yield of nil, volatility of 50%, a risk-free interest rate of 1.16%, and a weighted average expected life of 1.5 years. The fair value of the warrants has been capitalized to the oil sands properties in the year ended December 31, 2009. The warrants which expired in July 2010 were reissued on November 8, 2010 with an exercise price of \$0.50 and a term of two years. The Black-Scholes pricing model was used to estimate the fair value of the warrants granted using a forfeiture rate of nil, a dividend yield of nil, interest rate of 1.52%, volatility of 50% and an expected life of 2 years resulting in a fair value of \$123,362 which was capitalized to the oil sands properties in the year ended December 31, 2010.
- ii) On October 15, 2009, the Company granted 650,000 common share purchase warrants. Each warrant entitles the holder to one common share of the Company at a price of \$0.50 per common share until April 15, 2011. The fair value of the warrants was estimated at \$35,068 using the Black-Scholes pricing model based on a forfeiture rate of 0%, a dividend yield of nil, volatility of 50%, a risk-free interest rate of 1.52%, and an expected life of 1.5 years. The fair value of the warrants was expensed and included in financing costs in the year ended December 31, 2009.

**Alberta Oilsands Inc.**  
**Notes to Financial Statements**  
**For the years ended December 31, 2010 and 2009**

**10. Warrants (continued)**

- iii) In November 2009, the Company granted 12,781,250 common share purchase warrants as part of the unit issuance (note 9(a)). Each warrant entitles the holder to one common share of the Company at a price of \$0.50 per common share up until November 17, 2011. The fair value of the warrants was estimated at \$562,052 using the Black-Scholes pricing model based on a forfeiture rate of 0%, a dividend yield of nil, volatility of 50%, a risk-free interest rate of 1.31%, and a weighted average expected life of 2 years.
- iv) On November 19 and 30, 2010, the Company issued 1,250,000 and 5,010,000 warrants respectively as part of the unit issuance (note 9(a)(vi)) with an exercise price of \$0.70 and a term of 18 months. The Black-Scholes pricing model was used to estimate the fair value of the warrants granted using a forfeiture rate of nil, a dividend yield of nil, interest rate of 1.60% and 1.61% respectively, volatility of 50% and an expected life of approximately 1.5 years resulting in a fair value of \$90,736 and \$46,399 respectively recorded in share issue costs.

The following summarizes information about the warrants outstanding as at December 31, 2010, all of which are exercisable:

| Exercise price | Number of warrants | Weighted average remaining contractual life (years) | Weighted average exercise price (\$) |
|----------------|--------------------|---|--------------------------------------|
| \$0.50         | 15,411,250         | 0.98  | \$0.50                               |
| \$0.70         | 6,260,000          | 1.39  | \$0.70                               |
| \$1.00         | 2,000,000          | 0.52  | \$1.00                               |
|                | 23,671,250         | 1.05  | \$0.60                               |

**11. Contributed surplus**

|   |              |
|---|--------------|
| Balance, December 31, 2008                                    | \$ 5,158,997 |
| Stock-based compensation expensed                             | 761,951      |
| Stock-based compensation capitalized                          | 226,894      |
| Balance, December 31, 2009                                    | 6,147,842    |
| Stock-based compensation expensed                             | 520,733      |
| Stock-based compensation capitalized                          | 239,580      |
| Reclassification of fair value for warrants expired (note 10) | 13,670       |
| Reclassification of fair value for options exercised (note 9) | (110,013)    |
| Balance, December 31, 2010                                    | \$ 6,811,812 |

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**Alberta Oilsands Inc.**  
**Notes to Financial Statements**  
**For the years ended December 31, 2010 and 2009**

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**12. Income taxes**

The Company's computation of income taxes is as follows:

|   | 2010                | 2009                |
|---|---------------------|---------------------|
| Expected income tax reduction at 28.02% (2009 – 29.02%) | \$ (615,938)        | \$ (1,338,788)      |
| Non deductible items                                    | 145,909             | 237,181             |
| Changes in enacted tax rates and other                  | (92,957)            | 148,533             |
| Future income tax                                       | <u>\$ (562,985)</u> | <u>\$ (953,074)</u> |

The components of the net future income tax asset (liability) are as follows:

|   | 2010                  | 2009                  |
|---|-----------------------|-----------------------|
| Non-capital loss carryforwards                  | \$ 1,397,291          | \$ 1,550,633          |
| Asset retirement obligation                     | 288,737               | 260,992               |
| Share issue costs                               | 472,076               | 569,500               |
| Unrealized (gain) loss on financial instruments | (200,165)             | 37,432                |
| Property and equipment                          | (7,049,546)           | (6,661,752)           |
| Future income tax liability                     | <u>\$ (5,091,607)</u> | <u>\$ (4,243,195)</u> |
| Future income tax liability - current           | (200,165)             | –                     |
| Future income tax liability – long term         | <u>\$ (4,891,442)</u> | <u>\$ (4,243,195)</u> |

As at December 31, 2010 the Company has approximately \$26.2 million (2009 - \$20.2 million) in tax pools and \$5.5 million (2009 - \$6.2 million) in non-capital losses available for deduction against future taxable income. The expiration of the losses is as follows:

|      |                     |
|------|---------------------|
| 2027 | \$ 1,200,000        |
| 2028 | 2,100,000           |
| 2029 | 2,200,000           |
|      | <u>\$ 5,500,000</u> |

**13. Business development expenses**

During the year ended December 31, 2010 the Company incurred \$600,533 of business development expenses which were netted against the gain from the sale of the Kenyan interests (note 6). For the year ended December 31, 2009, the Company incurred \$328,473 related to the pursuit of projects outside of the Canadian oil and gas exploration and development business.

**14. Change in non-cash working capital**

|  | 2010                | 2009                  |
|--|---------------------|-----------------------|
| Accounts receivable                      | \$ 2,743,680        | \$ (2,715,165)        |
| Prepaid expenses                         | (189,853)           | (88,946)              |
| Accounts payable and accrued liabilities | 812,768             | (3,704,290)           |
|  | <u>\$ 3,366,595</u> | <u>\$ (6,508,401)</u> |

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**Alberta Oilsands Inc.**  
**Notes to Financial Statements**  
**For the years ended December 31, 2010 and 2009**

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**14. Change in non-cash working capital** (continued)

The change in non-cash working capital has been allocated to the following activities:

|           | 2010         | 2009           |
|-----------|--------------|----------------|
| Operating | \$ (83,262)  | \$ (158,191)   |
| Financing | (241,520)    | 152,764        |
| Investing | 3,691,377    | (6,502,974)    |
|           | \$ 3,366,595 | \$ (6,508,401) |

**15. Related party transactions**

The Company had the following related party transactions:

- a) During the year ended December 31, 2010, the Company was charged \$321,474 (2009 - \$341,353) in legal fees by legal firms in which a former director and in which a current officer of the Company are partners. These costs are included in general and administrative expense, share issue costs and business development costs. Included in accounts payable at December 31, 2010 is \$162,368 (December 31, 2009 – \$219,839) due to the legal firms. These transactions are in the normal course of operations and were recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.
- b) As at December 31, 2009 a subscription receivable in the amount of \$32,800 was due from a former officer of the Company related to the unit and flow-through share issuance in November 2009. This amount was received during 2010.

**16. Commitments**

Except as disclosed elsewhere in the financial statements, the Company had the following commitments as at December 31, 2010:

- a) The Company has granted a three percent gross overriding royalty on all production with respect to specific properties.
- b) On July 8, 2009, the Company signed a Gross Overriding Royalty, Access and Cooperation Agreement (the "Agreement") with the Fort McMurray Airport Authority ("FMAA"). In consideration for FMAA granting access rights, the Company granted to FMAA a two percent gross overriding royalty on the petroleum substances produced from the specified lands. In addition, the Company granted FMAA an aggregate of 4,000,000 common share purchase warrants of which 2,000,000 expired in July 2010. These warrants were reissued on November 8, 2010 (note 10).
- c) Pursuant to flow-through issuances in November and December 2010, the Company is required to incur \$6,560,800 of qualifying expenditures by December 31, 2011. Approximately \$665,000 of these expenditures were incurred by December 31, 2010.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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#### 17. Financial instruments and financial risk management

The Company's financial instruments include cash and cash equivalents, short-term investments, investment in equity instruments, accounts receivable, subscription receivable, accounts payable and accrued liabilities, and commodity contract. The carrying values of these financial instruments, excluding the investment in equity instruments and commodity contracts, approximate their fair values due to their relatively short periods to maturity. The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

The fair value of cash and short term investments is considered level 1 as it is determined by cash balances and investments held at financial institutions. The fair value of the commodity contract is considered to be level 2 as it is estimated by discounting the difference in the contract price and forward prices using the remaining volumes in the contract. The fair value of the investment in equity instruments comprised of common shares is considered to be level 1 as the shares are held in a publicly traded company. The fair value of the investment in equity instruments comprised of warrants is considered to be level 2. The valuation of the investment is calculated as follows:

|                      | September 9,<br>2010 | December 31,<br>2010 | Change in<br>Fair Value |
|----------------------|----------------------|----------------------|-------------------------|
| <b>Common shares</b> | 2,500,000            | 2,500,000            |                         |
| Share price          | \$ 1.34              | \$ 1.96              |                         |
|                      | \$ 3,350,000         | \$ 4,916,060         | \$ 1,566,060            |
| <b>Warrants</b>      |                      |                      |                         |
| Fair value           | \$ 796,314           | \$ 660,000           | \$ (136,314)            |
|                      | <u>\$ 4,146,314</u>  | <u>\$ 5,576,060</u>  | <u>\$ 1,429,746</u>     |

The price of Africa Oil's common shares on September 9, 2010 was \$1.34 per share resulting in a fair value of \$3,350,000 for the common shares on the date of the transaction. Notice to accelerate the expiry of the warrants was served on November 22, 2010. As the investment in Africa Oil has been classified as a financial instrument held for trading, the increase of \$1,429,746 in fair value has been recognized as an unrealized gain on investment in equity instruments in the statement of operations.

Subsequent to December 31, 2010 all of the Africa Oil shares and warrants were sold and therefore the net cash proceeds received for the sale have been used for the fair value of the investment.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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#### 17. Financial instruments and financial risk management (continued)

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies as set out herein.

##### a) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The cash and cash equivalents is available at any time and the investments are redeemable within a short period of time. The cash is held with a Schedule I bank. Short term investments are primarily a T-Bill held by an investment firm. The Company's policy is to ensure that its investments are liquid and not invested in asset-backed commercial paper products.

A substantial portion of the Company's accounts receivable is with joint venture partners in both the oil sands area and conventional properties. Purchasers of the Company's petroleum and natural gas are subject to credit review to minimize the risk of non-payment. As at December 31, 2010, the maximum credit exposure is the carrying amount of the accounts receivable and accruals of \$311,185 (December 31, 2009 – \$3,054,865) plus cash and cash equivalents and short-term investments of \$4,652,658 (December 31, 2009 - \$7,931,828).

As at December 31, 2010, \$191,953 of the Company's receivables consisted of December revenue due from marketers, \$70,970 in GST, and the remaining \$48,262 is comprised of receivables due from joint venture partners. Receivables from petroleum and natural gas marketers are typically collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any significant collection issues with its petroleum and natural gas marketers.

Joint venture receivables are typically collected within one to two months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. As at December 31, 2010, the largest amount owing from one joint venture partner is \$10,544.

Further risk exists with joint venture partners as disagreements occasionally arise which increases the potential for non-collection. For properties that are operated by the Company, production can be withheld from joint venture partners who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to joint venture partners from which it can net receivable balances.

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**Alberta Oilsands Inc.**  
**Notes to Financial Statements**  
**For the years ended December 31, 2010 and 2009**

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**17. Financial instruments and financial risk management** (continued)

**a) Credit risk** (continued)

The Company provided an allowance for a doubtful account of \$3,219 during the year ended December 31, 2010 (2009 - \$6,732). The Company would only choose to write-off a receivable balance (as opposed to providing an allowance) after all reasonable avenues of collection had been exhausted.

The Company considers its receivables to be aged as follows:

|                               | 2010              | 2009                |
|-------------------------------|-------------------|---------------------|
| Current                       | \$ 292,330        | \$ 422,446          |
| Past due by less than 90 days | 18,455            | 10,296              |
| Past due by more than 90 days | 400               | 20,154              |
|                               | <u>311,185</u>    | <u>452,896</u>      |
| Cash call receivable          | -                 | 2,601,969           |
|                               | <u>\$ 311,185</u> | <u>\$ 3,054,865</u> |

**b) Liquidity risk**

Liquidity risk is the risk that the Company will incur difficulties meeting its current and future financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

The Company anticipates it will have adequate liquidity to fund its financial liabilities through its existing working capital and the subsequent financing (note 19). The Company's financial liabilities are comprised of accounts payable and accrued liabilities which have expected maturities of less than one year resulting in their current classification on the balance sheet.

**c) Market risk**

Market risk consists of currency risk, commodity price risk and interest rate risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks.

All such transactions are conducted in accordance with a risk management policy as set out herein.

**i) Currency risk**

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum and natural gas sales are denominated in Canadian dollars; however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at December 31, 2010 or 2009.

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# Alberta Oilsands Inc.

## Notes to Financial Statements

### For the years ended December 31, 2010 and 2009

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#### 17. Financial instruments and financial risk management (continued)

##### c) Market risk (continued)

###### ii) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above. Should the Company choose to mitigate commodity price risk through the use of financial derivatives and physical delivery fixed price sales contracts, all such contracts would require approval of the Board of Directors.

In October 2009, the Company signed a commodity "collar" price risk contract for the period November 1, 2009 to October 31, 2010. The notional quantity under this contract was for 50 barrels of oil per day at prices per barrel of \$70.00 (floor strike price) and \$79.50 (cap strike price). For the year ended December 31, 2010, the Company realized losses of \$25,961 under the contract which has been included in petroleum and natural gas sales revenue. The mark-to-market value of the contract at December 31, 2010 is nil as the contract expired on October 31, 2010 resulting in unrealized gain of \$133,687 being recognized.

###### iii) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk primarily through its variable interest rate on its cash and cash equivalents and short-term investments. For the year ended December 31, 2010, if interest rates had been 1% higher with all other variables held constant, loss for the year would have been \$18,200 (2009 - \$38,600) lower due to increased interest income. An equal and opposite impact would have occurred had interest rates been lower by the same amounts. The Company had no interest rate contracts outstanding at December 31, 2010 or 2009.

#### 18. Capital management

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute on its capital expenditure program, which includes expenditures primarily in the oil sands properties, which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

Consideration must also be given to the seasonality of the Company's operations. The majority of the capital expenditures are carried on in the oil sand properties which are dependent on weather conditions. Lease and road preparation for the delineation drilling is dependent upon the roads being dry to support the equipment being moved. The typical "spring break-up" curtails the Company's activity levels.

The Company considers its capital structure to include working capital of \$8,365,163 (December 31, 2009 – \$9,661,146), and shareholders' equity of \$56,428,877 (December 31, 2009 – \$52,240,945). The Company monitors capital based on annual funds from operations from its conventional oil and gas properties which are utilized to partially fund the general and administrative expenses. The Company prepares budgets for its capital expenditures, which are updated as necessary and are reviewed and periodically approved by the Company's Board of Directors.

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# **Alberta Oilsands Inc.**

## **Notes to Financial Statements**

### **For the years ended December 31, 2010 and 2009**

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#### **18. Capital management (continued)**

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other factors that influence commodity prices and cash flows from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

In order to maintain or adjust the capital structure, the Company will consider the potential level of credit facilities that may be attainable as a result of the potential value of the oil sands properties, availability of other sources of debt with different characteristics than conventional debt, the sale of assets, limiting the size of the capital expenditure program, joint venture and other financial partners, and issuing new equity if available on favorable terms.

There has been no change in the Company's approach to capital management during the year ended December 31, 2010. The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

#### **19. Subsequent events**

- a) On March 15, 2011, the Company issued 20 million common shares on a flow-through basis at a price of \$0.50 per common share. This financing closed on March 22, 2011 and resulted in net cash proceeds of approximately \$9.4 million. In addition, the Company issued 1.2 million warrants to the underwriter at an exercise price of \$0.50 per common share. Each warrant entitles the holder to purchase one common share of the Company until March 21, 2014.
- b) On March 25, 2011, the Company granted 3,331,000 options with an exercise price of \$0.40 per share with a five year life. Options vest one third immediately and the remaining one third vests each on March 25, 2012 and March 25, 2013.