MANAGEMENT'S REPORT

Management is responsible for the integrity and objectivity of the information contained in this report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in this report. The accompanying consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards using estimates and careful judgment, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Company's financial position, financial performance and cash flows, in accordance with International Financial Reporting Standards. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The Company's external auditors, Deloitte LLP, have audited the consolidated financial statements. Their audit provides an independent view as to the fairness of reported financial results and the financial performance of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.

Corey C. Ruttan
President & Chief Executive Officer & Director

Alison Howard
Chief Financial Officer

Calgary, Canada
April 6, 2016

Deloitte.

Deloitte LLP
Suite 700
850 – 2nd Street SW
Calgary AB T2P 0R8

Tel: (403) 267-1700
Fax: (587) 774-5379
www.deloitte.ca

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Alvopetro Energy Ltd.

We have audited the accompanying consolidated financial statements of Alvopetro Energy Ltd. which comprise the consolidated statements of financial position as at December 31, 2015 and December 31, 2014 and the consolidated statements of operations and comprehensive loss, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Alvopetro Energy Ltd. as at December 31, 2015 and December 31, 2014 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Deloitte LLP

Chartered Professional Accountants, Chartered Accountants
April 6, 2016
Calgary, Alberta

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Thousands of United States dollars)

	Note	December 31, 2015	December 31, 2014
ASSETS			
Current			
Cash and cash equivalents		**28,733**	40,920
Restricted cash	5	**2,288**	3,373
Trade and other receivables		**247**	154
Prepaid expenditures		**280**	428
Total current assets		**31,548**	44,875
Restricted cash	5	**-**	9,749
Other assets	6	**34**	240
Exploration and evaluation assets	7	**48,409**	62,204
Property, plant and equipment	8	**4,293**	7,489
Non-current assets		**52,736**	79,682
Total assets		**84,284**	124,557
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		**2,143**	9,031
Current portion of decommissioning liabilities	10	**13**	-
		2,156	9,031
Deferred tax liability	12	**330**	4,247
Decommissioning liabilities	10	**1,066**	3,454
		3,552	16,732
Shareholders' equity			
Share capital	11	**151,937**	151,937
Contributed surplus		**1,444**	975
Deficit		**(47,812)**	(35,388)
Accumulated other comprehensive loss		**(24,837)**	(9,699)
Total shareholders' equity		**80,732**	107,825
Total liabilities and shareholders' equity		**84,284**	124,557

Subsequent events (Note 9)

Commitments and contingencies (Note 18)

The accompanying notes are an integral part of these consolidated financial statements.

Approved by:

John D. Wright
Chairman of the Board of Directors

Firoz Talakshi
Chairman of the Audit Committee

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Thousands of United States dollars, except per share amounts)

	Note	Year ended December 31, 2015	2014
Revenue			
Oil sales		**535**	1,106
Royalties and production taxes		**(38)**	(107)
Oil revenue		**497**	999
Other income		**92**	382
Total revenue and other income		**589**	1,381
Expenses			
Production	16	**872**	1,433
Transportation		**37**	44
General and administrative	16	**4,561**	5,313
Depletion and depreciation	8	**429**	441
Impairment	9	**13,038**	22,591
Accretion of decommissioning liabilities	10	**72**	94
Exploration and evaluation expense		**8**	-
Share-based compensation	11	**367**	637
Foreign exchange		**124**	2,605
Gain on property disposition	8	**(360)**	-
Total expenses		**19,148**	33,158
Loss before taxes		**(18,559)**	(31,777)
Income tax recovery	12	**(6,135)**	(68)
Net loss		**(12,424)**	(31,709)
Exchange loss on translation of foreign operations		**(15,138)**	(7,949)
Comprehensive loss		**(27,562)**	(39,658)
Net loss per share	11		
Basic		**(0.15)**	(0.37)
Diluted		**(0.15)**	(0.37)

The accompanying notes are an integral part of these consolidated financial statements.

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Thousands of United States dollars)

		Year Ended December 31,	
	Note	**2015**	2014
Common shares			
Balance, beginning of year		**151,937**	151,937
Net change		**-**	-
Balance, end of year	11	**151,937**	151,937
Contributed surplus			
Balance, beginning of year		**975**	74
Share-based compensation expense	11	**367**	637
Share-based compensation capitalized	11	**102**	264
Balance, end of year		**1,444**	975
Deficit			
Balance, beginning of year		**(35,388)**	(3,679)
Net loss		**(12,424)**	(31,709)
Balance, end of year		**(47,812)**	(35,388)
Accumulated other comprehensive loss			
Balance, beginning of year		**(9,699)**	(1,750)
Other comprehensive loss		**(15,138)**	(7,949)
Balance, end of year		**(24,837)**	(9,699)

The accompanying notes are an integral part of these consolidated financial statements.

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Thousands of United States dollars)

	Note	Year ended December 31, 2015	2014
Operating Activities			
Net loss		**(12,424)**	(31,709)
Adjustments for non-cash items:			
Depletion and depreciation	8	**429**	441
Impairment	9	**13,038**	22,591
Accretion of decommissioning liability	10	**72**	94
Share-based compensation	11	**367**	637
Gain on property disposition	8	**(360)**	-
Deferred tax recovery	12	**(6,135)**	(112)
Unrealized foreign exchange loss		**47**	336
		(4,966)	(7,722)
Changes in non-cash working capital	15	**(1,267)**	854
		(6,233)	(6,868)
Investing Activities			
Expenditures on exploration and evaluation assets	7	**(11,221)**	(42,160)
Expenditures on property, plant and equipment	8	**(886)**	(777)
Expenditures on other assets	6	**(95)**	(1,429)
Change in restricted cash	5	**10,814**	(13,122)
Changes in non-cash working capital	15	**(3,657)**	5,930
		(5,045)	(51,558)
Change in cash and cash equivalents		**(11,278)**	(58,426)
Effect of foreign exchange on cash balances		**(909)**	(922)
Cash and cash equivalents, beginning of year		**40,920**	100,268
Cash and cash equivalents, end of year		**28,733**	40,920
Cash and cash equivalents consist of:			
Cash		**8,722**	24,370
Cash equivalents		**20,011**	16,550
Supplemental information:			
Cash income taxes paid		**16**	19
Cash interest income received		**68**	349

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1 – REPORTING ENTITY

Alvopetro Energy Ltd. ("Alvopetro" or "the Company") is engaged in the exploration for, and the acquisition, development and production of, hydrocarbons in the Recôncavo, Tucano, Camamu-Almada and Sergipe-Alagoas basins onshore Brazil. Alvopetro is a publicly traded company listed on the TSX Venture Exchange (TSX: ALV.V), was incorporated under the Business Corporations Act (Alberta) on September 25, 2013 as 1774501 Alberta Ltd., and subsequently changed its name to Alvopetro Energy Ltd. on November 19, 2013.

The Company's head office and records are located at 1175, 332 6th Ave. S.W., Calgary, Alberta, Canada, T2P 0B2.

NOTE 2 – BASIS OF PRESENTATION

Basis of Measurement and Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and were authorized for issuance by the Company's Board of Directors on April 6, 2016.

The consolidated financial statements are presented in U.S dollars ("USD") which is the parent Company's functional currency.

Use of Judgments, Estimates and Assumptions

The preparation of financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that impact the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the consolidated statements of financial position as well as the reported amounts of revenue, expenses and cash flows during the periods presented. Such estimates relate primarily to unsettled transactions and events as of the date of the consolidated financial statements and actual results could differ materially from estimated amounts.

Amounts recorded for depletion and depreciation and amounts recognized for property, plant and equipment, exploration and evaluation, and impairment calculations are based on a number of factors including estimates of oil and natural gas reserves, commodity prices, future costs required to develop those reserves and anticipated future development activities as well as the expected timing of activities. To test impairment, costs are allocated into cash generating units ("CGU's") based on their ability to generate largely independent cash flows. The determination of CGU's is subject to judgment. The transfer of exploration and evaluation assets to property, plant and equipment is based on management's judgment of technical feasibility and commercial viability.

In estimating future decommissioning liabilities various assumptions are required with respect to the amount and timing of abandonment costs, inflation factors, interest rates and potential changes in the legal, regulatory, environmental and political environments. To the extent future revisions to these estimates and assumptions impact the amount of decommissioning liabilities, a corresponding adjustment is made to the property, plant and equipment and/or exploration and evaluation asset balances.

The designation of the Company's functional currencies is a judgment made by management based on the currency of the primary economic environment in which the Company operates. The functional currency of the Brazilian subsidiaries is the Brazilian Real ("BRL"). Despite the fact that the benchmark price for oil is set in USD, due to the business environment, policies and regulations in Brazil, management is of the opinion that the primary economic environment that mainly influences the Company's labour, material and other costs as well as actual cash receipts on oil sales is Brazil.

The fair value of share-based compensation is estimated using the Black-Scholes pricing model. These estimates depend on significant assumptions including expected share price volatility, risk-free interest rate, annual dividend yield and expected term of the awards.

The measurement of income tax expense, related provisions and deferred tax liabilities and assets is based on judgments in applying income tax law and estimates on the applicable tax rates, timing, likelihood and reversal of temporary differences between the accounting and tax bases of assets and liabilities. These estimates are subject to measurement uncertainty and changes in these estimates could materially impact the consolidated financial statements of future periods.

Contingent liabilities are possible obligations whose existence will only be confirmed by future events not wholly within the control of the Company. Contingent liabilities are disclosed in the consolidated financial statements unless the possibility of an outflow of economic resources is considered remote. The evaluation of the likelihood of the contingent events requires management judgment as to the probability of exposure to potential loss.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

Consolidation

These consolidated financial statements include the accounts of Alvopetro and its controlled subsidiaries. An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Intercompany transactions and balances are eliminated on consolidation. As at December 31, 2015 and 2014, the Company controls 100 percent of its subsidiaries.

Joint Operations

Oil and gas exploration and production activities may be conducted jointly with others. These consolidated financial statements reflect the Company's proportionate interests in such activities.

Cash and Cash Equivalents

Cash and cash equivalents consists of cash and hand and investments and deposits with an initial maturity of three months or less. Cash and cash equivalents are stated at cost, which approximates fair value.

Restricted Cash

Restricted cash consists of cash, cash equivalents, and short-term cash deposits (deposits with an initial maturity of one year or less) held as collateral to ensure the Company's fulfillment of work commitments and other obligations pursuant to concession contracts and credit agreements. Restricted cash is stated at cost, which approximates fair value. Restricted cash held as collateral for letters of credit expiring in less than one year is classified as current, with the remainder classified as non-current.

Exploration and Evaluation ("E&E") Assets

Pre-exploration and pre-licensing costs associated with the investigating, bidding and acquisition of petroleum properties are expensed as exploration and evaluation expense when the targeted petroleum lease or concession is not obtained. Additionally, any costs incurred in advance of obtaining the lease or concession are also expensed.

Costs incurred prior to establishing commercial viability and technical feasibility, such as land and license acquisition, technical services and studies, decommissioning liabilities, exploration drilling and testing, and directly attributable employee compensation are initially classified as E&E assets. E&E assets are not depleted and are carried forward until they are considered technically feasible and commercially viable.

E&E assets are considered technically feasible and commercially viable when proved and/or probable reserves have been assigned. Upon determination of reserves, the E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to property, plant and equipment. When E&E assets are determined not to be technically feasible and/or commercially viable or where the Company decides not to continue with the particular activity, the unrecoverable costs are charged to the consolidated statements of operations and comprehensive loss as impairment expense.

Property, Plant and Equipment ("PP&E")

PP&E costs are classified as crude oil assets and corporate assets.

Crude oil assets include all costs directly associated with the development of crude oil and gas reserves. These expenditures include proved property acquisitions, geological and geophysical costs, development drilling and completions on productive and non-productive wells, infrastructure, decommissioning liabilities and transfers from exploration and evaluation assets where technical feasibility and commercial viability has been determined.

Crude oil assets are accumulated on an area-by-area (component) basis, which, for Alvopetro, is currently by geological field. Costs accumulated within each component are depleted using the unit-of-production method based on proved plus probable reserves before royalties using estimated future prices and costs. Included in the depletion base are estimated future costs to be incurred in developing proved and probable reserves and excluded from the depletion base are estimated salvage values.

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are capitalized only when they increase the future economic benefits to be derived from the specific asset to which they relate. All other expenditures are recognized as an expense in the consolidated statements of operations and comprehensive loss as incurred. Capitalized costs generally represent amounts incurred in developing proved and/or probable reserves and enhancing production from those reserves including directly attributable employee compensation. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized as an expense in profit and loss as incurred.

Corporate assets included within PP&E consist primarily of computer equipment, leasehold improvements, office furniture and equipment, and operational equipment for use on future exploration and development projects. Depreciation of corporate assets is calculated on a straight-line basis over the useful life of the related assets.

Impairment

Individual assets are grouped for impairment purposes by CGU. An impairment test is performed whenever events or changes in circumstances indicate that the carrying value of the asset or CGU may not be recoverable. The recoverable amount is the higher of the fair value less costs of disposal and the value in use. If any such indication of impairment exists, an estimate of the CGU's recoverable amount is made. These assessments require the use of estimates and assumptions including, but not limited to, production volumes, discount rates, future commodity prices and future capital and operating costs.

E&E costs are accumulated by block according to the geographical area specified by the concession contract. When an E&E area is determined to be technically feasible and commercially viable, the accumulated costs are transferred to PP&E. E&E costs are tested for impairment at the time of transfer and when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount with the unrecoverable costs being charged to the consolidated statements of operations and comprehensive loss.

Crude oil assets are accumulated on an area-by-area (component) basis. Costs accumulated within each component are depleted using the unit-of-production method based on proved plus probable reserves before royalties using estimated future prices and costs. For impairment testing purposes, corporate assets are allocated to each of the CGU's on the basis of proportionate future net revenue consistent with the recoverable amount.

For impairment losses identified based on a CGU, the loss is allocated to the assets within the CGU or group of CGU's by reducing the carrying amount of the assets on a pro rata basis. The impairment loss is recognized as an expense in the consolidated statements of operations and comprehensive loss.

Impairment losses are assessed at each reporting date for indications that the impairment loss no longer exists or has decreased. Impairment losses can be reversed if there is a change in the estimates used to determine the recoverable amount. Reversal of impairment losses cannot exceed the carrying value of the asset prior to impairment less any depreciation and depletion that would have been taken if no impairment had been recognized.

Decommissioning Liabilities

The Company recognizes the estimated fair value of future decommissioning liabilities related to statutory, contractual or other legal obligations associated with the retirement of assets, when a reasonable estimate of the provision can be determined and it is probable that an outflow of resources will be required to settle the obligation. A corresponding increase to the carrying amount of the related asset is recorded.

Decommissioning liabilities are based on the estimated costs to abandon and reclaim all wells and facilities that are required to be abandoned under the terms of oil and gas contracts and laws and regulations within Brazil. The estimate is evaluated on a quarterly basis and any adjustment to the estimate is applied prospectively. The liability is estimated by discounting expected future cash outflows required to settle the liability using a risk-free rate. The change in net present value of the future decommissioning liabilities due to the passage of time is expensed as accretion expense on the consolidated statements of operations and comprehensive loss. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying assets. Revisions to the estimated timing of cash flows, inflation rates, discount rates or to the original estimated undiscounted costs also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligations are charged against the obligation to the extent of the liability recorded.

Revenue Recognition

Revenue is recognized when the significant risks and rewards of ownership have transferred to the buyer, when the amounts of revenue and the costs incurred or to be incurred can be measured reliably, and when collection is reasonably assured.

Share-based Compensation

The Company accounts for share-based compensation using the Black-Scholes option-pricing model to determine the fair value of stock options on grant date using various estimates including expected share price volatility, risk-free interest rate and expected term of the options.

Share-based compensation is measured at fair value on the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Forfeitures are estimated at the grant date and adjusted as actual forfeitures occur, until the options are fully vested. Consideration paid upon the exercise of stock options, together with corresponding amounts previously recognized in contributed surplus, is recorded as an increase to share capital. The Company capitalizes the portion of share-based compensation directly attributable to its exploration and development activities, with a corresponding decrease to share-based compensation expense.

Income Taxes

Income tax expense is comprised of current and deferred income taxes. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity.

The Company’s subsidiaries in Brazil have the option to compute current income taxes under either the presumed profit regime or the actual profit regime. The presumed profit regime may be selected provided revenues are below specified thresholds. Under the presumed profit regime, income is computed monthly based on a specific proportion of the Company’s gross revenues depending on the nature of the activities giving rise to those revenues. The actual profit regime is based on estimated taxable income and tax rates which are determined pursuant to tax laws enacted or substantively enacted at the reporting date. Alvopetro elected to compute Brazil corporate income tax under the presumed profit regime for the 2014 and prior taxation years, shifting to the actual profit regime for 2015.

The Company follows the liability method of accounting for deferred taxes. Under this method, deferred income tax assets or liabilities are recorded to reflect the difference between the accounting and tax base of assets and liabilities and unused tax losses. Deferred income taxes are measured using tax rates that are expected to apply to the period when the deferred tax asset is realized or the deferred tax liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax assets are recognized for deductible temporary differences to the extent it is probable that future taxable profit will be available. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent it is no longer probable that sufficient taxable profits will be available to allow the assets to be recovered. Deferred income tax assets and liabilities are offset only 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 to the extent they could be realized simultaneously.

Per Share Amounts

The Company computes basic earnings or loss per share using net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share information is calculated using the treasury stock method which assumes that any proceeds received by the Company upon the exercise of in-the-money stock options, plus unamortized stock compensation costs, would be used to buy back common shares at the average market price for the period.

Foreign and Reporting Currency

The Company's functional currencies are the BRL for all Brazil entities and the USD for all Canadian entities. Given that the Company conducts the majority of its business in international markets and its revenues are largely dependent on international commodity prices, Alvopetro has chosen to present its consolidated financial statements in USD.

Transactions in currencies other than the entity's functional currencies are recognized at the rates of exchange prevailing at the date of the transactions. At the end of each reporting period, monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the reporting period date. Non-monetary assets, liabilities, revenues and expenses are translated at transaction date exchange rates. Exchange gains or losses are included in the determination of net income as foreign exchange gains or losses.

The assets and liabilities of all Brazil entities are translated to USD at exchange rates at the reporting date. The income and expenses of foreign operations are translated to USD at exchange rates at the date of the transactions. Resultant foreign currency differences are recognized in other comprehensive income.

Financial Instruments

All financial assets and liabilities are initially recognized at fair value on the consolidated statements of financial position. Subsequent measurement of the financial instruments is based on their classification. Each financial instrument is classified into one of the following categories: financial assets at fair value through profit and loss; held-to-maturity investments, loans and receivables; available for sale financial assets; financial liabilities at fair value through profit or loss; and, financial liabilities measured at amortized cost. The classification depends on the characteristic and the purpose for which the financial instruments were acquired. Except in very limited circumstances, the classification of financial instruments is not subsequently changed.

Financial instruments carried at fair value through profit and loss on the consolidated statements of financial position include cash and cash equivalents and restricted cash. Realized and unrealized gains and losses on financial assets and liabilities carried at fair value through profit and loss are recognized in the consolidated statements of operations and comprehensive loss in the periods such gains and losses arise. Transaction costs related to these financial assets and liabilities are included in the consolidated statements of operations and comprehensive loss when incurred.

Financial instruments carried at amortized cost include trade and other receivables and accounts payable and accrued liabilities. Transaction costs incurred for these types of financial instruments are included with the initial fair value and the instrument is carried at amortized cost. These costs are amortized into net income/loss over the life of the asset or liability using the effective interest method and are included in finance and other expenses in the consolidated statements of operations and comprehensive loss. Gains and losses on financial assets and liabilities carried at amortized cost are recognized in the consolidated statements of operations and comprehensive loss when these assets or liabilities settle.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

Segmented Operations

All oil sales revenue is derived from Brazilian operations. All exploration and evaluation assets and all material property, plant and equipment are located in Brazil. The majority of the Company's cash as well as all current and non-current restricted cash are located in Canada. The Company does not have any significant revenue in Canada other than interest earned on cash and restricted cash balances.

NOTE 4 – CHANGES IN ACCOUNTING STANDARDS

New and Revised Accounting Standards

There were no new or revised accounting pronouncements that were adopted by the Company for the year ended December 31, 2015.

Standards issued but not yet effective

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Company.

Standard and Description	Date of Adoption	Expected Adoption Impact on Consolidated Financial Statements
IFRS 11 *Joint Arrangements* – was amended regarding the accounting for the acquisition of an interest in a joint operation that constitutes a business.	January 1, 2016	The Company does not expect a material impact as a result of adopting this standard in 2016.
IFRS 15 *Revenue from Contracts with Customers* – The new standard will replace IAS 18 *Revenue*, IAS 11 *Construction Contracts* and other revenue related interpretations. The new standard clarifies the principles for recognizing revenue from contracts with customers and provides a model for the recognition and measurement of sales of certain non-financial assets.	January 1, 2017	The Company is assessing the effect of this future pronouncement on its financial statements.
IFRS 9 *Financial Instruments* – As of July 2014, the IASB completed the final elements of IFRS 9 which supersedes IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 introduces new models for classification and measurement of financial instruments, hedge accounting and impairment of financial assets.	January 1, 2018	The Company is assessing the effect of this future pronouncement on its financial statements.
IFRS 16 *Leases* - IFRS 16 was issued January 2016 and replaces IAS 17 *Leases.* The standard introduces a single lessee accounting model for leases with required recognition of assets and liabilities for most leases.	January 1, 2019	The Company is assessing the effect of this future pronouncement on its financial statements.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

NOTE 5 – RESTRICTED CASH AND CREDIT FACILITY

	As at	
	December 31, 2015	December 31, 2014
Restricted cash – current	**2,288**	3,373
Restricted cash – non-current	**-**	9,749
Restricted cash - total	**2,288**	13,122

The Company has a credit support facility (the "Facility") with a Canadian bank for up to $45.0 million Canadian dollars ("CAD"). This Facility allows for the issuance of letters of credit ("LC's") and letters of guarantee in support of the financial guarantees required by the National Agency of Petroleum, Natural Gas and Biofuels (the "ANP") for Alvopetro's work commitments under the terms of its concession contracts as discussed further in Note 18. Letters of credit and letters of guarantee issued under the Facility are supported by either cash collateral posted by Alvopetro or through an Account Performance Security Guarantee from Export Development Canada ("EDC"). EDC supports up to $15.5 million of Alvopetro's LC's issued under the Facility.

As at December 31, 2015, the total amount of LC's issued under the Facility was $17.6 million (December 31, 2014 - $27.9 million), with $15.3 million (December 31, 2014 - $15.1 million) satisfied through EDC and $2.3 million (December 31, 2014 - $12.8 million) satisfied through restricted cash deposits of Alvopetro. LC's supported by EDC include $1.2 million with respect to Block 170. This work commitment was satisfied, subject to ANP approval, with the 170(B1) well in early 2016.

The entire restricted cash balance of $2.3 million at December 31, 2015 (December 31, 2014 - $3.1 million) was classified as current as it relates to LC's expiring within one year. The reduction in the overall restricted cash balance from December 31, 2014 was as a result of a $3.0 million reduction in the LC collateral requirements due to the declining BRL relative to the USD, a transition of $6.3 million of LC's to EDC coverage throughout 2015, a release of $1.2 million of LC's for completed work commitments and a release of $0.3 million in cash collateral previously posted with respected to corporate credit cards.

During the years ended December 31, 2015 and 2014, the Company earned floating-rate interest income on the restricted cash deposits under the Facility.

LC's supported by the $2.3 million of restricted cash at December 31, 2015 were released on March 31, 2016.

NOTE 6 – OTHER ASSETS

	Year ended December 31,	
	2015	2014
Balance, beginning of year	**240**	-
Deposits with suppliers for long lead items	**95**	1,429
Transfer to E&E and PP&E assets (Notes 7 & 8)	**(278)**	(1,090)
Foreign currency translation	**(23)**	(99)
Balance, end of year	**34**	240

Other assets relates to deposits with suppliers for long-lead items required for the Company's future exploration and development activities.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

NOTE 7 – EXPLORATION AND EVALUATION ASSETS

	Year ended December 31,	
	2015	2014
Balance, beginning of year	**62,204**	45,002
Capital expenditures	**11,221**	42,160
Capitalized share-based compensation	**95**	215
Transfer from other assets (Note 6)	**272**	1,090
Change in decommissioning liabilities	**104**	491
Transfer to PP&E (Note 8)	**-**	(13)
Impairment (Note 9)	**(11,514)**	(20,330)
Foreign currency translation	**(13,973)**	(6,411)
Balance, end of year	**48,409**	62,204

Capital expenditures include $0.4 million (2014- $5.6 million) of inventory purchased for use on exploration wells. General and administrative costs totaling $1.0 million (2014 - $1.8 million) that were directly related to exploration and evaluation activities have been capitalized as exploration and evaluation assets.

For the year ended December 31, 2015, the Company was assigned probable reserves on its 182(B1) well on Block 182. In accordance with the Company's accounting policy with respect to E&E as discussed in Note 3, this asset was tested for impairment at the time of reclassification and costs incurred to date were written off, resulting in a net balance transferred to PP&E of $nil. Refer to Note 9 for further details on the impairment charge.

NOTE 8 – PROPERTY, PLANT AND EQUIPMENT

	Year ended December 31,	
	2015	2014
Cost, beginning of year	**10,717**	10,529
Capital expenditures	**886**	777
Transferred from E&E (Note 7)	**-**	13
Transferred from other assets (Note 6)	**6**	-
Capitalized share-based compensation	**7**	49
Change in decommissioning liabilities	**(1,043)**	459
Foreign currency translation	**(1,877)**	(1,110)
Cost, end of year	**8,696**	10,717
Accumulated depletion, depreciation and impairment, beginning of year	**(3,228)**	(832)
Depletion and depreciation for the year	**(429)**	(441)
Impairment (Note 9)	**(1,524)**	(2,261)
Foreign currency translation	**778**	306
Accumulated depletion, depreciation and impairment, end of year	**(4,403)**	(3,228)
Net book value, end of year	**4,293**	7,489

On October 1, 2015 the Company agreed to sell 100% of its Aracaju mature field for gross proceeds of $1 and a release of all future liabilities associated with the field, including the future abandonment and reclamation obligations. The property had a net book value of $nil and associated decommissioning obligations of $0.4 million. A gain on disposition of $0.4 million was recognized in the three months ended December 31, 2015.

General and administrative costs totaling $0.1 million (2014 - $0.2 million) that were directly related to property, plant and equipment activities have been capitalized.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

NOTE 9 – IMPAIRMENT

For the year-end December 31, 2015, the Company recognized an overall impairment of $13.0 million (2014 - $22.6 million) as follows:

	Year ended December 31,	
	2015	2014
Impairment losses – PP&E		
Bom Lugar	**1,524**	2,261
Total PP&E impairment loss	**1,524**	2,261
Impairment losses – E&E		
Block 182	**7,167**	-
Block 170	**4,096**	-
Block 131	**-**	4,938
Block 132	**-**	1,387
Block 144	**-**	5,789
Block 157	**-**	4,912
Block 196	**-**	3,304
Other	**251**	-
Total E&E impairment loss	**11,514**	20,330
Total Impairment	**13,038**	22,591

PP&E Impairments

At the end of each reporting period the Company assesses impairment or impairment reversal indicators related to all of its CGU's. As a result of the continued decline in current and forecasted commodity prices, an indication of impairment existed as at December 31, 2014, September 30, 2015 and December 31, 2015 and impairment tests were performed at each of these dates. It was determined that the carrying amount of the Bom Lugar CGU exceeded its recoverable amount at December 31, 2014, September 30, 2015 and at December 31, 2015. An impairment loss of $1.5 million (2014 - $2.3 million) was recorded on the Bom Lugar field for the year ended December 31, 2015 ($1.0 million for the three months ended September 30, 2015 and $0.5 million for the three months ended December 31, 2015).

An estimated recoverable amount of $4.6 million was determined for the Bom Lugar field at December 31, 2015, based on fair value less costs of disposal calculations, which are classified as Level 3 fair value measurements as certain key assumptions are not based on observable market data but rather management's best estimates. Refer to Note 14 for information on fair value hierarchy classifications. In determining the estimated recoverable amount, the Company incorporated the net present value of the future cash flows from proved plus probable oil reserves estimated by the Company's external reserve evaluator as at December 31, 2015, discounted at a rate of 15%. The key assumptions used in determining the recoverable amounts for purposes of the impairment tests were commodity prices, discount rate, reserve volumes, future capital cost estimates, future well locations, timing of future capital investment, and anticipated foreign exchange rates for any costs denominated in BRL. The Company utilized forecasted oil prices from its external reserve evaluator as follows:

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

	Brent ($/bbl)[1] As at December 31,	
Year	**2015**	2014
2015	**actuals**	68.00
2016	**45.00**	83.00
2017	**60.00**	93.00
2018	**70.00**	94.40
2019	**80.00**	95.81
2020	**81.20**	97.25
Thereafter – escalated at	**1.5%**	1.5%

(1) Actual prices used in the computation of discounted future cash flows were adjusted for quality differentials and negotiated discounts under the Bom Lugar oil sales contract.

The impairment at Bom Lugar was primarily attributable to the decline in forecasted commodity prices. Future changes to forecasted commodity prices for crude oil could result in additional impairment charges or impairment reversals. The Company determined its estimated recoverable amount using a discount rate of 15%. Increases or decreases to the assumed discount rate could result in additional impairment charges or impairment reversals. The majority of the Company's production expenses and, to a lesser extent, a portion of the Company's future development costs, are denominated in BRL. For purposes of estimating these future costs, any costs denominated in BRL were translated to USD assuming the December 31, 2015 exchange rate. Fluctuations in the BRL relative to the USD may result in additional impairment charges or impairment reversals. The following table depicts the effects of changes in forecasted commodity prices, discount rates, and foreign exchange rates on the Bom Lugar impairment amount as at December 31, 2015.

	Increase in commodity prices of 5%	**Decrease in commodity prices of 5%**	**Increase in discount rate of 2%**	**Decrease in discount rate of 2%**	**Increase in BRL relative to USD of 5%**	**Decrease in BRL relative to USD of 5%**
Increase (decrease) in Bom Lugar impairment	**(815)**	**799**	**679**	**(829)**	**228**	**(232)**

As the estimated recoverable amount of the Jiribatuba CGU was in excess of the carrying amount, no impairment was recorded on the Jiribatuba field in any of these periods. The above fluctuations in discount rates, forecasted commodity prices and foreign exchange rates would not have not have resulted in an impairment on this property as at December 31, 2015.

E&E Impairments

During the year ended December 31 2015, the Company recorded E&E impairments of $11.5 million primarily relating to Block 182 and Block 170.

Impairment charges totaling $7.2 million were recognized in 2015 on Block 182. Of this amount, $6.8 million relates to the 182(B1) well which was reclassified to PP&E in 2015 upon the establishment of probable reserves volumes. The impairment of $6.8 million reduces the carrying amount to $nil. An estimated recoverable amount of $0.2 million was initially determined for the 182(B1) well at December 31, 2015, based on fair value less costs of disposal. In determining the estimated recoverable amount, the Company incorporated the net present value of the future cash flows from probable oil reserves estimated by the Company's external reserve evaluator as at December 31, 2015, discounted at a rate of 15%. This estimated recoverable amount was adjusted to include costs associated with equipment items held by the Company but not yet included in the carrying value of the 182(B1) well. As the value of this equipment exceeds the estimated recoverable amount, a net value of $nil was determined for the 182(B1) well. The key assumptions used in determining the recoverable amounts for purposes of the impairment tests were commodity prices, discount rate, reserve volumes, future capital cost estimates, future well locations, timing of future capital investment, and anticipated foreign exchange rates for any costs denominated in BRL. The Company utilized forecasted oil prices as disclosed above. Future changes to forecasted commodity prices, discount rates, and foreign exchange fluctuations are not expected to result in a material reversal of the impairment charge recognized in the year ended December 31, 2015 on the 182(B1) well.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

There was an additional impairment of $0.4 million booked on Block 182 relating to costs attributable to a well drilled by a predecessor company in 2012. As at December 31, 2015, the remaining book value of Block 182 of $0.9 million is attributable to future prospects on this block.

In 2015, the Company also recorded an impairment on Block 170. Subsequent to December 31, 2015, the Company drilled its first well on this block and was unsuccessful in finding any commercial quantities of oil or gas. As the Company plans to relinquish this block following the completion of the required abandonment and reclamation of the 170(B1) well, the estimated recoverable amount of this block is $nil as at December 31, 2015. The impairment expense of $4.1 million reduces the book value of this block to $nil as at December 31, 2015.

Other impairment charges in 2015 relate primarily to inventory write-offs for obsolete and/or damaged materials.

E&E impairment charges in 2014 relate to five blocks that were fully impaired as at December 31, 2014 due to limited prospectivity identified on these blocks. Four of these blocks (Blocks 131, 132, 144 and 157) were relinquished to the ANP in April 2015 and one block (Block 196) was relinquished in January 2016.

NOTE 10 – DECOMMISSIONING LIABILITIES

The decommissioning liabilities were estimated based on the net ownership interest of wells and facilities and management's estimates of costs to abandon and reclaim those wells and facilities, and the potential future timing of the costs to be incurred.

	Year ended December 31,	
	2015	2014
Balance, beginning of year	**3,454**	2,833
Liabilities incurred	**113**	450
Revisions to obligations	**(1,052)**	500
Disposition (Note 8)	**(363)**	-
Accretion	**72**	94
Foreign currency translation	**(1,145)**	(423)
Balance, end of year	**1,079**	3,454

Total undiscounted cash flows, escalated at 6.5% (2014- 6.5%) for inflation, required to settle the Company's decommissioning provision are estimated to be $1.9 million (2014 - $5.3 million) and have been discounted using an average risk free rate of 2.5% (2014 – 3.0%), which represents an estimated U.S. Treasury bill rate for a period of 20 years (2014 – 20 years), the approximate weighted-average remaining years to abandonment.

The Company recorded a revision to the decommissioning liability during the year ended December 31, 2015 as a result of a reduction in the future estimated costs associated with abandonment and reclamation of the Company's existing wells and facilities.

Of the total $1.1 million in decommissioning liabilities as at December 31, 2015, $0.01 million relates to costs expected to be incurred within one year and accordingly, is classified as current at December 31, 2015.

NOTE 11 – SHARE CAPITAL

a) Authorized

Alvopetro has an unlimited number of common shares authorized for issuance. The Company is also authorized to issue preferred shares in one or more series.

b) Issued and Outstanding Common Shares

	Number of Shares	Amount ($000s)
Balance as at December 31, 2015 and 2014	**85,166,871**	**$ 151,937**

c) Options to Purchase Common Shares

Alvopetro has a stock option plan whereby the Company may grant stock options to its directors, officers, employees and consultants. The plan allows for the issuance of up to ten percent of the outstanding common shares of the Company. The exercise price of each option is not less than the five-day volume weighted average price of the Company's common shares on the TSX Venture Exchange prior to the date of grant. Stock option terms are determined by the Company's Board of Directors but typically, options granted vest over a period of three years from the date of grant and expire five years from the date of grant. The options outstanding at December 31, 2015 are as follows:

	Number of Options	Weighted Average Exercise Price (CAD$)
Balance as at December 31, 2013	2,995,436	1.02
Granted	1,572,000	0.45
Balance as at December 31, 2014	4,567,436	0.82
Granted	2,303,500	0.34
Expired	(10,000)	1.02
Forfeited	(17,500)	0.75
Balance as at December 31, 2015	**6,843,436**	**0.66**

	Options Outstanding at December 31, 2015			Options Exercisable at December 31, 2015		
Exercise Price	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (years)	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (years)
CAD$0.28 - $0.50	3,726,000	0.37	4.4	474,161	0.40	4.0
CAD$0.51 - $1.00	40,000	0.57	3.8	20,000	0.57	3.8
CAD$1.01 - $1.24	3,077,436	1.02	3.0	2,530,531	1.02	3.0
CAD$0.28 - $1.24	**6,843,436**	**0.66**	**3.8**	**3,024,692**	**0.92**	**3.1**

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

d) Share-Based Compensation

The fair value of the stock options granted under the Alvopetro stock option plan for the year-ended December 31, 2015 has been estimated on the grant date using the Black-Scholes option pricing model. Weighted average assumptions and resultant fair values for stock options granted are as follows:

	Year ended December 31,	
	2015	2014
Risk free interest rate (%)	**0.68**	1.32
Expected term (years)	**3.35**	4.00
Expected volatility (%)	**50.00**	50.00
Dividend per share (%)	**-**	-
Forfeiture rate (%)	**5.00**	5.00
Weighted average fair value (CAD)	**0.10**	0.16

Total share-based compensation of $0.5 million was computed for the year ended December 31, 2015 (2014- $0.9 million) related to the Alvopetro stock option plan. Of this amount, approximately $0.1 million (2014- $0.3 million) was capitalized to exploration and evaluation assets and property, plant and equipment, with the remainder recognized as share-based compensation expense on the consolidated statements of operations and comprehensive loss.

e) Net Loss Per Share

Net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the applicable period. The following table provides the number of shares used in the basic and diluted per share computations:

	Year ended December 31,	
	2015	2014
Weighted average common shares outstanding, basic and diluted	**85,166,871**	85,166,871

In determination of the weighted average number of diluted common shares outstanding for the years ended December 31, 2015 and 2014, all stock options were excluded because the effect would be anti-dilutive.

NOTE 12 – TAXES

Income tax expense is comprised of the following amounts relating to current tax expense and deferred tax recovery:

	Year ended December 31,	
	2015	2014
Current income tax expense	**-**	44
Deferred income tax recovery:		
Origination of temporary differences in the current year	**(1,825)**	(112)
Change in estimated tax pools	**(4,310)**	-
Deferred income tax recovery	**(6,135)**	(112)
Income tax recovery	**(6,135)**	(68)

Alvopetro elected to compute Brazil corporate income tax under the presumed profit regime for the 2014 taxation year, shifting to the actual profit regime for 2015. The current income tax expense reflected above is the estimated current income tax according to the respective rules applicable in each year. Under the presumed profit system, profit is computed by applying certain predetermined percentages to gross revenues, resulting in an inherent tax rate of approximately three percent on Brazilian gross revenues. The election to compute taxes under the presumed profit regime is made annually and is available where total revenues from the immediately preceding year were less than BRL 72.0 million. Losses realized for tax purposes within Brazil while under the presumed profit regime do not carry-forward. Under the actual profit system, corporate tax on taxable income is 34% and tax losses may be carried forward indefinitely; however, any utilization of losses in a subsequent taxation year is limited to 30% of the taxable income in that period.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

Income tax expense differs from the amount that would have been expected by applying the statutory income tax rate to loss before taxes. The principal reasons for this difference are as follows:

	Year ended December 31,	
	2015	2014
Loss before taxes	**(18,559)**	(31,777)
Statutory income tax rate	**34%**	34%
Expected income tax recovery	**(6,310)**	(10,804)
Increase (decrease) resulting from:		
Change in unrecognized deferred tax asset	**3,674**	1,138
Change in estimated tax pools	**(4,310)**	-
Permanent difference on impairment expense	**-**	7,681
Share-based compensation	**160**	306
Permanent difference on gain on asset disposition	**31**	-
Presumed profit income tax	**-**	44
Tax losses in Brazil not available for carry-forward under the presumed profit regime	**-**	932
Impact of foreign exchange gains and losses	**1,254**	263
Other	**(634)**	372
Income tax recovery	**(6,135)**	(68)

The components of the Company's deferred tax assets and liabilities arising from temporary differences and loss carry-forwards as well as the associated amount of deferred tax recovery or expense recognized in the Company's consolidated statements of operations and comprehensive loss are outlined below. Under the presumed profit regime in Brazil, as income tax is computed based on gross revenues, there is no benefit to tax pool deductions during the period in which the Company has elected to compute tax under the presumed profit regime. However, these amounts are accumulated for Brazil tax purposes in the same manner they would be under the actual profit regime (including theoretical depletion, depreciation, and other such claims) and when a company later transitions to the actual profit regime, these tax pools may be utilized on a go-forward basis (other than any losses realized during the period in which the entity was under the presumed profit regime which will not be deductible in the future). For the 2015 taxation year, the Company elected to transition to the actual profit regime. The components of the Company’s net deferred tax liabilities arising from temporary differences and loss carry-forwards are as follows:

	PP&E and E&E assets	Decommissioning liabilities	Tax loss carryforwards	Other Brazil tax pools	Unrealized taxable foreign exchange gains	Unrecognized deferred tax asset	Total
At December 31, 2013	8,787	(963)	(786)	(3,916)	-	669	3,791
Deferred tax expense (recovery)	1,299	(367)	(2,182)	-	-	1,138	(112)
Foreign currency translation	(49)	155	-	462	-	-	568
As at December 31, 2014	10,037	(1,175)	(2,968)	(3,454)	-	1,807	4,247
Deferred tax (recovery) expense	(7,938)	515	(3,330)	-	944	3,674	(6,135)
Foreign currency translation	798	290	1,215	1,104	-	(1,189)	2,218
As at December 31, 2015	**2,897**	**(370)**	**(5,083)**	**(2,350)**	**944**	**4,292**	**330**

As at December 31, 2015 the full balance of the Company’s net deferred tax asset of $4.3 million was not recognized. The net deferred tax asset was attributable to Brazil operations. The deferred tax liability of $0.3 million at December 31, 2015 relates to Canadian operations, largely due to unrealized foreign exchange gains net of tax loss carryforwards. Total tax loss carryforwards include $12.8 million attributable to Brazil which carryforward indefinitely and $2.6 million attributable to Canada which expire between 2032 and 2035.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

NOTE 13 – CAPITAL MANAGEMENT

The Company's capital consists of the following:

	As at December 31,	
	2015	**2014**
Working capital, including current restricted cash	29,405	35,844
Non-current restricted cash	-	9,749
Shareholders' equity	80,732	107,825

Alvopetro manages its capital to support the Company's strategic growth objectives and maintain financial capacity and flexibility for the purpose of funding the Company's exploration and development activities.

The Company considers its capital structure to include working capital (including current restricted cash), non-current restricted cash, and shareholders' equity. At December 31, 2015, the Company's net working capital surplus was $29.4 million (December 31, 2014 - $35.8 million), which includes $28.7 million (December 31, 2014 - $40.9 million) of cash and $2.3 million (December 31, 2014 - $3.4 million) of current restricted cash, but excludes non-current restricted cash of $9.7 million at December 31, 2014.

The Company's current portion of restricted cash at December 31, 2015 relates to cash collateral pledged for letters of credit for Block 182 and Block 196 in the amount of $2.3 million. These letters of credit were released on March 31, 2016. At December 31, 2014, $3.1 million of the Company's current portion of restricted cash related to letters of credit expiring within the following twelve months. Additional current restricted cash at December 31, 2014 related to cash pledged for corporate credit cards.

At December 31, 2015, the Company held no non-current restricted cash (December 31, 2014 - $9.7 million). The balance at December 31, 2014 related to collateral posted for work commitments in Brazil for letters of credit with expiry dates subsequent to December 31, 2015.

The Company has performance security guarantees with EDC which support up to $15.5 million of LC's provided in respect of work commitments in Brazil. As at December 31, 2015, a total of $15.3 million of LC's were satisfied by EDC (December 31, 2014 - $15.1 million) and the Company had $0.2 million in available capacity for new LC's (December 31, 2014 - $0.4 million). Additional capacity may become available as work commitments are met and the related LC's are released.

Alvopetro has the ability to adjust its capital structure by issuing new equity or debt and making adjustments to its capital expenditure program, other than with respect to work commitments. The Company considers its capital structure at this time to include shareholders' equity which, at December 31, 2015 was $80.7 million (December 31, 2014 - $107.8 million). In the event that adjustments to the capital structure are necessary, the Company may consider issuing additional equity, raising debt or revising its capital investment programs.

The Company has not paid or declared any dividends since the date of incorporation.

NOTE 14 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Overview

The Company's financial instruments consist of cash and cash equivalents, restricted cash, trade and other receivables and accounts payable and accrued liabilities. The nature of Alvopetro's operations exposes the Company to credit risk, liquidity risk, and market risk. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and to monitor market conditions and the Company's activities. The Board of Directors has overall responsibility for establishment and oversight of the Company's risk management.

Credit Risk

Credit risk is the risk of financial loss to the Company if counterparties do not fulfill their contractual obligations. The Company has credit risk on cash and cash equivalents, restricted cash, and trade and other receivables.

At December 31, 2015, accounts receivable consisted of $0.06 million from crude oil customers with the remainder related to other trade and Brazil tax credit receivables. Crude oil production is sold to two counterparties, one of which represented 67 percent of the Company's oil sales revenues in 2015 compared to over 90 percent in 2014. Typically, the Company's maximum credit exposure to oil sales customers is one month's sales revenue. Alvopetro has assessed the risk of non-collection from these counterparties as minimal.

The Company closely monitors other trade receivables, specifically those outstanding for greater than 60 days. When collection does not seem reasonably attainable, an allowance is recorded. The accounts receivable balance at December 31, 2015 includes an allowance of $0.1 million (2014 - $0.07 million) relating to GST credits recorded from January 1, 2014 to December 31, 2015 and has been provided for based on correspondence with the Canada Revenue Agency. The carrying amount of accounts receivable represents the maximum credit exposure.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations when due, under both normal and unusual conditions without incurring unacceptable losses or jeopardizing the Company's business objectives. The Company manages this risk by preparing annual capital expenditure budgets, operating expense budgets and general and administrative expense budgets, which are monitored and updated as considered necessary. Alvopetro does not currently derive positive cash flow from its operations. Existing capital expenditures and ongoing production and G&A expenses have been funded from the Company's cash balances. Future capital expenditures may require additional funding in excess of current cash and cash equivalent balances and future cash flows from operations. In addition, $15.3 million of the LC's for work commitments are currently supported by EDC. This coverage is reviewed annually. To the extent some or all of the EDC coverage were limited in the future, the Company may be required to support the required amount from its existing cash balance which would limit its ability to fund future capital projects and further increase the need for additional financing. Future spending may be funded from a combination of asset sales, joint ventures, farmouts, debt financing or equity issuances. This may create a liquidity risk in the future to the extent current economic conditions persist and the Company is not able to secure the necessary funding to proceed with its capital and growth plans.

Market Risk

Market risk is the risk that changes in the foreign exchange rates, commodity prices and interest rates will affect the Company's cash flows, net income or loss or comprehensive income or loss. The objective of managing market risk is to maintain and control these risks within acceptable limits while maximizing returns.

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. All of the Company's oil sales are denominated in BRL based on a USD oil price and all operational and capital activities related to the Brazil properties are transacted primarily in BRL. In Canada the Company has expenditures in both CAD and USD. To minimize foreign currency risk, the Company's cash balances are held primarily in USD within Canada. Management transfers funds to Brazil only as needed to fund immediate capital and operational requirements in order to maintain minimal cash balances in BRL. In Canada, USD funds are converted to CAD periodically on an as-needed basis.

As at December 31, 2015 and 2014, the following financial instruments were denominated in currencies other than the USD:

	Year Ended December 31			
	2015		2014	
	CAD (000's)	**BRL (000's)**	CAD (000's)	BRL (000's)
Cash and cash equivalents	**197**	**1,482**	1,540	708
Restricted cash – current	**-**	**-**	354	-
Trade and other receivables	**10**	**933**	5	366
Accounts payable and accrued liabilities	**(54)**	**(7,315)**	(104)	(22,875)
Net exposure in foreign currency	**153**	**(4,900)**	1,795	(21,801)
Net exposure in USD ($000s)	**111**	**(1,255)**	1,547	(8,209)

The Company had no forward exchange rate contracts in place as at or during the years ended December 31, 2015 and 2014.

Commodity Price Risk

Although the Company is not dependent on cash flows derived from its oil sales, changes in commodity prices may have a significant impact on the assessment of the carrying value of the Company's properties and any impairment losses recorded as a result of a decline in those values would increase the Company's net loss. Fluctuations in commodity prices can also affect the Company's ability to obtain future financings and the capacity of those future financings. Given its level of oil sales, the Company did not have any forward contracts in place as at or during the years ended December 31, 2015 and 2014. To the extent oil sales increase in the future, the Company may consider a hedging program to protect cash flows and manage commodity price risk.

Interest Rate Risk

The Company is exposed to interest rate cash flow risk on cash and cash equivalents and restricted cash due to fluctuations in market interest rates applied to cash balances. As the Company does not rely on its cash flows from interest the effect of this risk on the Company is minimal.

Fair Value of Financial Instruments

The Company classifies the fair value of financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument:

> Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
>
> Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
>
> Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Assessment of the significance of a particular input to the fair value measurement requires judgment that may affect the placement within the fair value hierarchy level. Due to the short-term nature of accounts receivable and accounts payable and accrued liabilities, their carrying value approximates their fair value. The carrying values and respective fair values of Alvopetro's financial instruments at December 31, 2015 and 2014 is set forth in the table below. The Company does not currently have any financial instruments classified as Level 2 or Level 3.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

	December 31, 2015		December 31, 2014	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Carried at fair value through profit or loss				
Cash and cash equivalents(1)	**28,733**	**28,733**	40,920	40,920
Restricted cash – current and non-current(1)(2)	**2,288**	**2,288**	13,122	13,122
	31,021	**31,021**	54,042	54,042
Carried at amortized cost				
Trade and other receivables	**247**	**247**	154	154
Accounts payable and accrued liabilities	**(2,143)**	**(2,143)**	(9,031)	(9,031)
	(1,896)	**(1,896)**	(8,877)	(8,877)

(1) Level 1
(2) Restricted cash balances include amounts pledged as collateral for work commitments (Note 5).

NOTE 15 – CHANGES IN NON-CASH WORKING CAPITAL

	Year ended December 31,	
Change in:	**2015**	2014
Trade and other receivables	**(144)**	144
Prepaid expenditures	**46**	(303)
Accounts payable and accrued liabilities	**(4,826)**	6,943
	(4,924)	6,784
Changes relating to:		
Operating activities	**(1,267)**	854
Investing activities	**(3,657)**	5,930
	(4,924)	6,784

NOTE 16 – NATURE OF EXPENSES

Production expenses by nature were as follows:

	Year Ended December 31,	
Production expenses:	**2015**	**2014**
Personnel	**488**	504
Production facilities rental	**22**	-
Other fixed	**141**	363
Variable	**218**	274
Workover	**3**	292
Production expenses	**872**	1,433

The majority of the Company's production expenses relate to personnel costs. The production facilities rental costs relate to equipment rental for the 182(B1) well which was brought on production in December 2015.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

General and administrative expenses ("G&A") by nature were as follows:

	Year Ended December 31,	
G&A expenses:	**2015**	**2014**
Personnel	**3,345**	4,198
Travel	**396**	763
Office and IT costs	**602**	682
Professional fees	**741**	698
General corporate	**607**	924
Gross G&A expenses	**5,691**	7,265
Capitalized to E&E and PP&E	**(1,130)**	(1,952)
Net G&A expenses	**4,561**	5,313

The majority of the Company's G&A relates to personnel costs. General corporate expenses include public company costs, corporate insurance, directors' fees, rental vehicle costs, cell phones and other miscellaneous expenses. G&A expenses that are directly attributable to exploration and development projects are capitalized. The majority of capitalized costs relate to personnel. Of the total capitalized G&A, $1.0 million was capitalized to E&E in 2015 (2014 - $1.8 million) and $0.1 million was capitalized to PP&E (2014 - $0.2 million).

NOTE 17 – RELATED PARTY TRANSACTIONS

Alvopetro is party to non-material office-related administrative transactions with Touchstone Exploration Inc., a related party of the Company due to common directors. These transactions include administrative consulting fees and office sub-lease expenses charged to Alvopetro, summarized as follows:

	Year Ended December 31,	
	2015	**2014**
Office rent and related costs	**190**	225
Administrative consulting fees	**-**	6
Total	**190**	231

As at December 31, 2015 and 2014, the Company owed Touchstone $nil.

Key management personnel are comprised of Alvopetro's directors and officers, compensation for these individuals is set forth as follows:

	Year ended December 31,	
	2015	**2014**
Short-term benefits(1)	**732**	918
Share-based compensation(1)	**286**	576
Total	**1,018**	1,494

Notes:

(1) Before capitalization of any directly attributable compensation to E&E or PP&E.

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

NOTE 18 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at December 31, 2015:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments(1)				
Block 182(2)	780	-	-	780
Block 183	-	854	-	854
Block 170	768	-	-	768
Block 106	292	-	-	292
Block 107	1,947	-	-	1,947
Block 177	1,842	-	-	1,842
Block 169	-	973	-	973
Block 198	-	973	-	973
Block 255	-	1,165	-	1,165
Block 256	-	259	-	259
Block 57(3)	-	-	227	227
Block 62(3)	-	-	227	227
Block 71(3)	-	-	155	155
Block 145(3)	-	-	227	227
Bom Lugar	-	-	90	90
Jiribatuba	-	-	90	90
Total minimum work commitments	**5,629**	**4,224**	**1,016**	**10,869**
Production facilities contract(4)	**361**	**-**	-	**361**
Office leases(5)	**117**	**53**	-	**170**
Total commitments	6,107	4,277	1,016	11,400

Notes:

(1) Under the terms of the ANP concession contracts for each of our exploration blocks, the Company has commitments which must be completed prior to the applicable phase expiry date. The Company is required to post a performance guarantee with the ANP for all commitments in the table above. The performance guarantee associated with Block 196 has been included in accounts payable and accrued liabilities as at December 31, 2015 and is therefore excluded from the table above.

(2) In 2015 the Company completed drilling the first well on Block 182, which, subject to ANP approval, fulfils the commitment included in the table above. ANP approval was received in February 2016.

(3) In October 2015, in partnership with ENGIE (GDF SUEZ E&P Brasil Participações Limitada), Alvopetro was awarded four additional blocks in the Recôncavo Basin in Brazil's 13th Bid Round (Blocks 57, 62, 71, and 145). Alvopetro will operate these four additional blocks and hold a 65% participating interest in each block with the remaining 35% held by ENGIE. The amounts provided in the table above represent Alvopetro's share of the commitments for these blocks.

(4) The Company is committed to future payments under the terms of an equipment rental contract for production facilities in respect of the 182(B1) well.

(5) The Company is committed to future minimum payments for office space in Canada and Brazil. In Brazil, the Company is required to provide a guarantee for certain office rental payments. The total amount of the guarantee provided as at December 31, 2015 was approximately $0.1 million.

As is customary in the oil and gas industry, we may at times have work plans in place to reserve or earn certain acreage positions or wells. If we do not complete such work plans in a timely manner, the acreage positions or wells may be lost, or penalties may be applied.

The Company currently has no contingent liabilities recorded; however, in the normal course of operations, we may have disputes with industry participants for which we currently cannot determine the ultimate results. The Company has a policy to record contingent liabilities as they become determinable and the probability of loss is more likely than not.

Alvopetro's activities in Brazil are subject to minimum local content requirements with respect to materials and supplies utilized. The specific local content requirements for the exploration phase were determined during the bidding process for each particular block and are assessed at the phase expiry date. Management undertakes considerable effort to adhere to these requirements;

however, there may be circumstances when it is not advantageous, cost-effective or reasonably possible for the Company to do so. If the Company does not meet the local content requirements for a particular phase as specified according to the respective concession contract, a fine, which varies by concession depending on exploration phase and type of cost, will be incurred. The Company is continually monitoring its local content compliance and actual or potential fines and, as of December 31, 2015, the potential estimated fine was $0.1 million (December 31, 2014 - $0.1 million), which is included in accounts payable and accrued liabilities in the respective consolidated statements of financial position.