

**Sahara Energy Ltd.**

**Financial Statements**

**For the years ended December 31, 2015 and 2014**

## Management's Responsibility

To the Shareholders of Sahara Energy Ltd.:

Management is responsible for the preparation and presentation of the accompanying financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. 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 the transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the financial statements.

The Board of Directors is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the financial report. The Board fulfils these responsibilities by reviewing the financial information prepared by management and discussing relevant matters with management, and external auditors. The Board is also responsible for recommending the appointment of the Company's external auditors.

MNP LLP, an independent firm of Chartered Professional 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, the Board of Directors and management to discuss their audit findings.

April 27, 2016

(Signed) "Yachao Peng"

Yachao Peng  
Chief Executive Officer

## Independent Auditors' Report

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To the Shareholders of Sahara Energy Ltd.

We have audited the accompanying financial statements of Sahara Energy Ltd., which comprise the statement of financial position as at December 31, 2015, the statements of loss and comprehensive loss, changes in equity and cash flows for the year 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 International Financial Reporting Standards, 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 audit. We conducted our audit 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 the auditors' 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, the auditor considers 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 audit 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 Sahara Energy Ltd. as at December 31, 2015, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### *Other Matter*

The financial statements of Sahara Energy Ltd. as at December 31, 2014 and for the year the ended, were audited by another auditor who expressed an unmodified opinion on those statements on April 3, 2015.

Calgary, Alberta  
April 27, 2016

*MNP LLP*  
Chartered Professional Accountants

**Sahara Energy Ltd.**  
**Statements of Financial Position**  
**As at December 31**  
**(in Canadian dollars)**

	2015	2014
<b>Assets</b>		
Current assets		
Cash and cash equivalents (Note 5)	\$ 6,682,584	\$ 9,019,033
Term deposits (Note 5)	5,090,069	5,025,068
Trade and other receivables	113,278	150,602
Prepaid expenses and deposits	598,432	295,298
	12,484,363	14,490,001
Exploration and evaluation assets (Note 6)	193,054	180,922
Property, plant and equipment (Note 7)	3,744,698	4,056,568
	\$ 16,422,115	\$ 18,727,491
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Trade and other payables	\$ 520,212	\$ 1,368,676
Decommissioning obligation (Note 8)	883,358	854,733
	1,403,570	2,223,409
Shareholders' equity		
Share capital (Note 9)	20,465,084	20,465,084
Contributed surplus	1,244,119	1,242,804
Accumulated deficit	(6,690,658)	(5,203,806)
	15,018,545	16,504,082
	\$ 16,422,115	\$ 18,727,491

Commitment (Note 14)

**Approved on behalf of the Board:**

(Signed) "Panwen (Michelle) Gao", Director

(Signed) "Gary Chang", Director

See the accompanying notes to these financial statements.

**Sahara Energy Ltd.**  
**Statements of Loss and Comprehensive Loss**  
**For the years ended December 31**  
**(in Canadian dollars)**

	2015	2014
<b>Revenue</b>		
Oil and natural gas sales	\$ 109,897	\$ 396,861
Royalties	(5,737)	(33,976)
	104,160	362,885
<b>Expenses</b>		
Production and operating	179,570	396,994
General and administrative	1,001,922	956,989
Depletion and depreciation	84,610	295,140
Impairment (Note 7)	440,000	-
Share-based payments (Note 10)	1,315	8,653
	1,707,417	1,657,776
<b>Loss from operating activities</b>	<b>(1,603,257)</b>	<b>(1,294,891)</b>
Interest income	125,744	54,390
Decommissioning obligation accretion	(9,339)	(11,920)
<b>Net loss and comprehensive loss</b>	<b>\$ (1,486,852)</b>	<b>\$ (1,252,421)</b>
<b>Net loss per share</b>		
Basic and diluted (Note 11)	\$ (0.01)	\$ (0.01)

See the accompanying notes to these financial statements.

**Sahara Energy Ltd.**  
**Statements of Changes in Equity**  
**For the years ended December 31**  
**(in Canadian dollars)**

	2015	2014
<b>Share capital</b>		
Balance, beginning of year	\$ 20,465,084	\$ 4,970,443
Private placement, net of issuance costs (Note 9)	-	15,494,641
Balance, end of year	20,465,084	20,465,084
<b>Contributed surplus</b>		
Balance, beginning of year	1,242,804	1,234,151
Share-based payments (Note 10)	1,315	8,653
Balance, end of year	1,244,119	1,242,804
<b>Deficit</b>		
Balance, beginning of year	(5,203,806)	(3,951,385)
Net loss	(1,486,852)	(1,252,421)
Balance, end of year	(6,690,658)	(5,203,806)
<b>Total Shareholders' Equity</b>	<b>\$ 15,018,545</b>	<b>\$ 16,504,082</b>

See the accompanying notes to these financial statements.

**Sahara Energy Ltd.**  
**Statements of Cash Flows**  
**For the years ended December 31**  
**(in Canadian dollars)**

	2015	2014
<b>Operating activities</b>		
Net loss	\$ (1,486,852)	\$ (1,252,421)
Add back (deduct) non-cash items:		
Depletion and depreciation	84,610	295,140
Impairment	440,000	-
Share-based payments	1,315	8,653
Decommissioning obligation accretion	9,339	11,920
Abandonment expenditures	(65,172)	(196,788)
Change in non-cash working capital		
Trade and other receivables	37,324	(67,583)
Prepaid expenses and deposits	(303,134)	(180,068)
Trade and other payables	(178,869)	265,840
Cash flows used by operating activities	(1,461,439)	(1,115,307)
<b>Financing activities</b>		
Private placement proceeds, net of share issue costs	-	15,494,641
Cash flows from financing activities	-	15,494,641
<b>Investing activities</b>		
Exploration and evaluation expenditures	(12,132)	(139,635)
Development and production asset expenditures	(117,637)	(1,185,790)
Furniture and equipment expenditures	(10,645)	(152,938)
Term deposit purchase	(5,054,397)	(5,025,068)
Term deposit redemption	4,989,396	-
Change in non-cash working capital		
Trade and other payables	(669,595)	674,715
Cash flows used by investing activities	(875,010)	(5,828,716)
<b>Change in cash and cash equivalents</b>	<b>(2,336,449)</b>	<b>8,550,618</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>9,019,033</b>	<b>468,415</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 6,682,584</b>	<b>\$ 9,019,033</b>

See the accompanying notes to these financial statements.

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**Sahara Energy Ltd.**  
**Notes to Financial Statements**  
**For the years ended December 31, 2015 and 2014**  
**(in Canadian dollars)**

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**1. Nature of operations**

Sahara Energy Ltd. (the "Company") was incorporated under the Business Corporations Act (Alberta) and is listed on the TSX Venture Exchange ("the Exchange"). The Company is a junior resource exploration company engaged in the acquisition, exploration and development of petroleum and natural gas reserves in Western Canada. The Company's registered address is 610, 700 – 4<sup>th</sup> Avenue SW, Calgary, Alberta.

As at December 31, 2015, JF Investment (Hong Kong) Co., Limited ("JF Investment") owned and controlled 69% of the Company's issued and outstanding shares.

**2. Basis of preparation**

(a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and the interpretations of the International Financial Reporting Interpretations Committee in effect at December 31, 2015.

These financial statements were authorized for issue by the Board of Directors on April 27, 2016.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis except for certain financial assets and liabilities which are measured at fair value.

The methods used to measure fair values are discussed in Note 4.

(c) Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

(d) Use of judgments and estimates

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

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

Critical judgments in applying accounting policies

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

*Cash-generating units*

The Company's assets are aggregated into a single cash-generating unit ("CGU") for the purpose of calculating impairment. CGUs are based on an assessment of a unit's ability to generate independent cash inflows. The determination of the Company's CGU was based on management's judgment in regards to shared infrastructure, geographical proximity, exposure to market risk and materiality.

*Joint arrangements*

Judgment is required to determine when the Company has joint control over an arrangement. In



establishing joint control, the Company considers whether unanimous consent is required to direct the activities that significantly affect the returns of the arrangement, such as the capital and operating activities of the arrangement.

Once joint control has been established, judgment is also required to classify as a joint arrangement. The type of joint arrangement is determined through analysis of the rights and obligations arising from the arrangement by considering its structure, legal form, and terms agreed upon by the parties sharing control. An arrangement where the controlling parties have rights to the assets and revenues and obligations for the liabilities and expenses is classified as a joint operation.

#### *Impairment indicators*

Judgments are required to assess when impairment indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of reserves, production rates, future oil and natural gas prices, future costs, discount rates, market value of land and other relevant assumptions.

#### *Provisions*

Judgments are required to assess the existence of obligations requiring a probable outflow of funds to settle the obligation and the requirement to recognize a related provision.

#### *Deferred taxes*

Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

#### *Contingencies*

Judgments are made by management to determine the existence of contingencies and the outcome of future events.

#### Key Sources of Estimation Uncertainty

The following are key estimates and their assumptions made by management affecting the measurement of balances and transactions in these financial statements.

#### *Recoverability of asset carrying values*

The recoverability of development and production asset carrying values are assessed at the CGU level. Determination of what constitutes a CGU is subject to management judgments. The asset composition of a CGU can directly impact the recoverability of the assets included therein. The key estimates used in the determination of cash flows from oil and natural gas reserves include the following:

- Reserves – Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs or recovery rates may change the economic status of reserves and may ultimately result in reserves being restated.
- Oil and natural gas prices – Forward price estimates are used in the cash flow model. Commodity prices can fluctuate for a variety of reasons including supply and demand fundamentals, inventory levels, exchange rates, weather, and economic and geopolitical factors.
- Discount rate – The discount rate used to calculate the net present value of cash flows is based on estimates of an approximate industry peer group weighted average cost of capital. Changes in the general economic environment could result in significant changes to this estimate.

*Depletion and depreciation*

Amounts recorded for depletion and depreciation and amounts used for impairment calculations are based on estimates of total proved and probable oil and natural gas reserves and future development capital. By their nature, the estimates of reserves, including the estimates of future prices, costs and future cash flows, are subject to measurement uncertainty. Accordingly, the impact to the financial statements in future periods could be material.

*Decommissioning obligation*

The amount recorded for the decommissioning obligation and the related accretion expense requires the use of estimates with respect to the amount and timing of decommissioning expenditures. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology. Other provisions are recognized in the period when it becomes probable that there will be a future cash outflow.

*Share-based compensation*

Compensation costs recognized for share-based compensation plans are subject to the estimation of what the ultimate payout will be using pricing models such as the Black-Scholes pricing model which is based on significant assumptions such as volatility, dividend yield and expected term.

*Deferred taxes*

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such income taxes are subject to measurement uncertainty. Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

*Contingencies*

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. Management must make estimates of amounts related to the outcome of future events.

### **3. Significant accounting policies**

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(a) Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise cash and cash equivalents, term deposits, trade and other receivables, deposits and trade and other payables. Non-derivative financial instruments are recognized initially at fair value net of any directly attributable transaction costs. Subsequent to initial recognition financial instruments are measured as described below.

Financial assets and liabilities at fair value through income or loss

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of loss and comprehensive loss. Gains and losses arising from changes in fair value are presented in income or loss within finance income or expense in the period in which they arise. Financial assets

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**Sahara Energy Ltd.**  
**Notes to Financial Statements**  
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**(in Canadian dollars)**

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and liabilities at fair value through income or loss are classified as current except for any portion expected to be realized or paid beyond twelve months of the statement of financial position date.

Cash and cash equivalents consists of cash in the bank and term deposits with maturities of three months or less, less outstanding cheques, and is classified as fair value through profit or loss.

Other

Other non-derivative financial instruments, such as term deposits with maturities longer than three months, trade and other receivables, deposits and trade and other payables are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Derivative financial instruments

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at "fair value through income or loss". Changes in the fair value of separable embedded derivatives are recognized immediately in income or loss. The Company does not hold any embedded derivatives.

(b) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of common shares are recognized as a reduction of equity.

(c) Jointly controlled operations and jointly controlled assets

The Company's petroleum and natural gas exploration activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities. Joint control exists for contractual arrangements governing the Company's assets whereby the Company has less than 100 per cent working interest, all of the partners have control of the arrangement collectively, and spending on the project requires unanimous consent of all parties that collectively control the arrangement and share the associated risks. The Company does not have any joint arrangements structured through joint venture arrangements.

(d) Property, plant and equipment and exploration and evaluation assets

(i) Recognition and measurement

Exploration and evaluation expenditures

Pre-license costs are recognized in the statement of loss and comprehensive loss as incurred. Exploration and evaluation costs, including the costs of acquiring undeveloped land and drilling costs are initially capitalized until the drilling of the well is complete and the results have been evaluated. The costs are accumulated in cost centres pending determination of technical feasibility and commercial viability. The technical feasibility and commercial viability is considered to be determinable when proved and/or probable reserves are determined to exist. If proved and/or probable reserves are found, the drilling costs and associated undeveloped land are transferred to property, plant and equipment. Any impairment recognized during a period, is charged as additional depletion and depreciation expense.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are allocated to CGUs.

Development and production costs

Property, plant and equipment, which includes oil and gas development and production assets, are initially measured at cost and subsequently carried at cost less accumulated depletion and depreciation and accumulated impairment losses.

The cost of development and production assets includes; transfers from exploration and evaluation assets, which generally include the cost to drill the well and the cost of the associated land upon determination of technical feasibility and commercial viability; the cost to complete and tie-in the wells; facility costs; the cost of recognizing provisions for future restoration and decommissioning; geological and geophysical costs; and directly attributable overheads.

Development and production assets are grouped into CGUs for impairment testing.

When significant parts of an item of property and equipment, including petroleum and natural gas properties, have different useful lives, they are accounted for as separate items (major components). Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized in the statement of loss and comprehensive loss.

(ii) Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in the statement of loss and comprehensive loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of periodic servicing of property, plant and equipment are recognized in operating expenses as incurred.

(iii) Depletion and depreciation

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the period to the related proved plus probable reserves, taking into account estimated future development costs necessary to bring those reserves into production and the estimated salvage value of the assets at the end of their useful lives. Future development costs are estimated taking into account the level of development required to produce the reserves.

Proved plus probable reserves are estimated annually by independent qualified reserve evaluators, in accordance with Canadian Securities Administration National Instrument 51-101, and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible.

For depletion 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.

Depreciation of furniture and equipment is based on estimated useful lives and is calculated using

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**Sahara Energy Ltd.**  
**Notes to Financial Statements**  
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**(in Canadian dollars)**

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the declining balance method at rates ranging from 20% - 45%. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(e) Impairment

(i) Financial assets

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

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

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

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

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

(ii) Non-financial assets

The carrying amounts of the Company's non-financial assets, other than exploration and evaluation assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Exploration and evaluation assets are assessed for impairment when they are transferred to property, plant and equipment, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

Fair value less costs to sell is determined as the amount that would be obtained from the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. The fair value less costs to sell of oil and gas assets is generally determined as the net present value of the estimated future cash flows expected to arise from the continued use of the CGU, including any expansion prospects, and its eventual disposal, using assumptions that an independent market participant may take into account. These cash flows are discounted by an appropriate discount rate which would be applied by such a market participant to arrive at a net present value of the CGU.

Value in use is determined as the net present value of the estimated future cash flows expected to arise from the continued use of the asset in its present form and its eventual disposal. Value in use is determined by applying assumptions specific to the Company's continued use and can only take into account approved future development costs. Estimates of future cash flows used in the evaluation of impairment of assets are made using management's forecasts of commodity prices and expected production volumes. The latter takes into account assessments of field reservoir performance and includes expectations about proved and unproved volumes, which are risk-weighted utilizing geological, production, recovery and economic projections.

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**Sahara Energy Ltd.**  
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**(in Canadian dollars)**

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An impairment loss is recognized if the carrying amount of a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in depletion and depreciation expense in the statement of loss and comprehensive loss. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis.

Impairment losses recognized in prior years are assessed at each reporting date, if facts and circumstances indicate that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized.

(f) Decommissioning obligation

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

The Company's decommissioning obligation is measured at the present value of management's best estimate of expenditure required to settle the present obligation at the balance sheet date at a risk-free rate. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time, revisions to the amount of the original estimate, changes in the discount rate or risk-free rate and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows and other assumptions are capitalized. Actual costs incurred upon settlement of the decommissioning obligation are charged against the provision to the extent the provision was established.

(g) Revenue recognition

Revenue from the sale of crude oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time volumes are delivered to customers at contractual delivery points and rates.

(h) Finance income and expenses

Finance expense comprises interest expense on borrowings, accretion of the discount on the decommissioning obligation and impairment losses recognized on financial assets. Interest income is recognized as it accrues in the statement of loss and comprehensive loss, using the effective interest method.

(i) Taxes

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

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

Deferred tax is recognized using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for

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**(in Canadian dollars)**

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

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

(j) Share-based payments

The Company grants options to purchase common shares to employees and directors under its stock option plan. Share-based payments to employees and directors are measured at the fair value of the options issued and amortized over the vesting periods. The amount recognized as a share based payment expense during a reporting period is adjusted to reflect the number of awards expected to vest. The offset to this recorded cost is to contributed surplus. A forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest.

(k) Per share amounts

Basic per share amounts are calculated by dividing the income attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted per share amounts are determined by adjusting the income (loss) attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as warrants and stock options granted. Anti-dilutive instruments are not included in the determination of diluted per share amounts.

(l) Changes in accounting standards

On January 1, 2015, the Company adopted amendments to *IFRS 3 Business Combinations* and *IFRS 24 Related Party Disclosures*. The adoption of these amendments had no impact on the amounts recorded in the financial statements for the year ended December 31, 2015.

(a) New and amended standards not yet adopted

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

*IFRS 9 Financial Instruments*

In July 2014, the IASB issued the final version of *IFRS 9 Financial Instruments* which replaces *IAS 39 Financial Instruments: Recognition and Measurement*. *IFRS 9* includes requirements for recognition and measurement, impairment, de-recognition and general hedge accounting. *IFRS 9* is effective for annual period beginning on or after January 1, 2018.

*IFRS 11 Joint Arrangements*

Amendments to *IFRS 11 Joint Arrangements* clarify the accounting for acquisitions of interests in joint operations. The amendments are effective for annual period beginning on or after January 1, 2016.

*IFRS 15 Revenue from Contracts with Customers*

In May 2014, the IASB issued *IFRS 15 Revenue from Contracts with Customers* which specifies how and when an entity will recognize revenue as well as requiring entities to provide users of financial statements with more informative, relevant disclosures. *IFRS 15* is effective for annual periods beginning on or after January 1, 2018.

*IFRS 16 Leases*

In January 2016, the IASB issued *IFRS 16 Leases* which replaces the previous leases standard, *IAS 17 Leases*. *IFRS 16* eliminates the classification of leases as either operating leases or finance leases as is required by *IAS 17* and, instead, introduces a single lessee accounting model. Lessors continue to classify leases as operating leases or finance leases, and account for those two types of leases differently. *IFRS 16* is effective for periods beginning on or after January 1, 2019.

The Company is currently assessing the impact of these standards and amendments on its financial statements.

**4. Determination of fair values**

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(a) Property, plant and equipment and exploration and evaluation assets

The fair value of property, plant and equipment and exploration and evaluation assets recognized in a business combination, is based on market values. The market value of property, plant and equipment and exploration and evaluation assets is the estimated amount for which the assets could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in property, plant and equipment) and intangible exploration assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

The market value of other items of property, plant and equipment is based on the quoted market prices for similar items.

(b) Cash and cash equivalents, term deposits, trade and other receivables, deposit and trade and other payables

The fair value of cash and cash equivalents, term deposits, trade and other receivables, deposits and trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2015 and 2014, the fair value of these balances approximated their carrying value due to their short term to maturity.

(c) Share-based compensation

The fair value of employee stock options is measured using a Black-Scholes pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate



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(based on government bonds).

(d) Fair value measurement information

The Company classifies the fair value of certain 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. Cash and cash equivalents are a Level 1 fair value measurement.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices 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.

**5. Cash and cash equivalents and term deposits**

	2015	2014
Cash and cash equivalents		
Cash in bank	\$ 724,174	\$ –
Term deposits with maturities of three months or less	5,958,410	9,019,033
	6,682,584	9,019,033
Term deposits		
Term deposits with maturities over three months	5,090,069	5,025,068
	\$ 11,772,653	\$ 14,044,101

**6. Exploration and evaluation assets**

As at December 31, 2013	\$ 41,287
Additions	139,635
As at December 31, 2014	180,922
Additions	12,132
As at December 31, 2015	\$ 193,054

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**7. Property, plant and equipment**

	Furniture and equipment	Development and production assets	Total
<b>Cost</b>			
As at December 31, 2013	\$ 54,215	\$ 3,207,421	\$ 3,261,636
Additions	152,938	1,185,790	1,338,728
Decommissioning revisions	–	272,711	272,711
As at December 31, 2014	207,153	4,665,922	4,873,075
Additions	10,645	117,637	128,282
Decommissioning revisions	–	84,458	84,458
As at December 31, 2015	\$ 217,798	\$ 4,868,017	\$ 5,085,815
<b>Accumulated depletion and depreciation</b>			
As at December 31, 2013	\$ 26,361	\$ 495,006	\$ 521,367
Depletion and depreciation	28,022	267,118	295,140
As at December 31, 2014	54,383	762,124	816,507
Depletion and depreciation	51,695	32,915	84,610
Impairment	–	440,000	440,000
As at December 31, 2015	\$ 106,078	\$ 1,235,039	\$ 1,341,117
<b>Net carrying amount</b>			
As at December 31, 2014	\$ 152,770	\$ 3,903,798	\$ 4,056,568
As at December 31, 2015	\$ 111,720	\$ 3,632,978	\$ 3,744,698

Depletion and depreciation:

The calculation of 2015 depletion and depreciation expense included an estimated \$4.5 million (2014 – \$4.5 million) for future development costs associated with proved plus probable reserves. The Company has not capitalized any directly attributable general and administrative expenses to development and production assets.

Impairment:

During the quarter ended June 30, 2015, the Company identified certain business risks related to its cash generating unit (“CGU”) such as a decline in forward commodity prices. As a result, the Company performed an impairment test at June 30, 2015 and recognized an impairment charge of \$440,000. Management estimated the recoverable amount of the Company’s CGU based on the ‘fair value less costs to sell’ using 15% discounted cash flows expected to be derived from the CGU’s proved plus probable reserves as reported in the Company’s December 31, 2014 externally prepared reserve report updated for June 30, 2015 commodity price estimates.

At December 31, 2015, due the continued decline in forward commodity prices, the Company tested its petroleum and natural gas cash generating unit (“CGU”) for impairment based on the net present value of cash flows from oil and natural gas reserves of the Company’s CGU at a discount rate of 15% as estimated by the Company’s independent reserves evaluator. As at December 31, 2015, the estimate of the ‘fair value less costs to sell’ of the Company’s petroleum and natural gas assets was sufficiently in excess of the carrying value of the CGU and therefore the Company did not recognize any additional impairment.

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The December 31, 2015 impairment test used the following commodity price estimates:

	AB Synthetic Crude (Light) Cdn\$/bbl	Western Canada Select (Heavy) Cdn\$/bbl
2016	60.81	45.00
2017	70.51	52.18
2018	80.25	59.38
2019	84.34	62.41
2020	88.24	65.29
2021	91.76	67.91
2022	95.29	70.52
2023	100.00	74.00
Escalation rate thereafter	+ 2% per year	+ 2% per year

A 1% increase in the assumed discount rate would result in \$18,000 of additional impairment and a 5% decrease in the forward commodity price estimates would result in \$406,000 of additional impairment in 2015.

**8. Decommissioning obligation**

As at December 31, 2015, the Company has estimated the total undiscounted inflation-adjusted amount of cash flows required to settle its decommissioning liabilities to be \$960,631. This amount will be substantially incurred over the next five years. The Company calculated the decommissioning liabilities using an average risk-free discount rate of 1.03% (2014 – 1.47%) per annum and an inflation rate of 2% (2014 – 2%) per annum.

	2015	2014
Balance, beginning of year	\$ 854,733	\$ 766,890
Accretion	9,339	11,920
Revisions	84,458	272,711
Expenditures	(65,172)	(196,788)
Balance, end of year	\$ 883,358	\$ 854,733

**9. Share capital**

a) Authorized

Unlimited number of common voting shares with no par value  
Unlimited number of preferred non-voting shares with no par value

b) Issued and outstanding common shares

	Number of shares	Amount
Balance, December 31, 2013	89,684,072	\$ 4,970,443
Non-refundable private placement deposit	200,000,000	15,600,000
Share issue costs	–	(105,359)
Balance, December 31, 2014 and 2015	289,684,072	\$ 20,465,084

On August 21, 2014, the Company closed a private placement of common shares with JF Investment for aggregate proceeds of \$16.2 million, of which \$0.6 million was received in June 2013, \$0.15 million

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was received in June 2014, \$0.15 million was received in July 2014 and the balance was received upon closing. Pursuant to the private placement, the Company issued 5,000,000 common shares at \$0.12 per share and 195,000,000 common shares at \$0.08 per share.

**10. Share-based payments**

The Company has an option plan (the "Option Plan") for its directors, officers, employees and consultants. Under the Option Plan, the Company has reserved for issuance a total of 10% of the issued and outstanding common shares. In addition, the aggregate number of shares so reserved for issuance to any one person shall not exceed 5% of the issued and outstanding shares. Under the Option Plan, options are exercisable at varying vesting periods for a maximum term of five years.

The following table provides a continuity of stock options outstanding:

	Number of options	Weighted-average exercise price
Balance, December 31, 2013	3,100,000	\$ 0.10
Expired	(700,000)	(0.10)
Balance, December 31, 2014 and 2015	2,400,000	\$ 0.10

During 2015, the Company recognized \$1,315 of share-based payments expense (2014 – \$8,653). As at December 31, 2015, the Company's remaining unvested share-based payments amount was \$nil.

The following table summarizes information about stock options outstanding as at December 31, 2015:

Exercise price	Number outstanding	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Number exercisable
\$ 0.10	2,400,000	0.4	\$ 0.10	2,400,000

**11. Per share amounts**

Basic net loss per share is calculated as follows:

	2015	2014
Net loss for the year:	\$ (1,486,852)	\$ (1,252,421)
Weighted average number of shares – basic and diluted:		
Issued common shares at January 1	289,684,072	89,684,072
Effects of shares issued	–	127,671,233
	289,684,072	217,355,305
Net loss per share – basic and diluted:	\$ (0.01)	\$ (0.01)

The effect of stock options is anti-dilutive in loss periods.

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**12. Taxes**

The provision for deferred taxes differs from the amount computed by applying the combined federal and provincial tax rates to the loss before taxes. The difference results from the following:

	2015	2014
Loss before income taxes	\$ (1,486,852)	\$ (1,252,421)
Combined federal and provincial statutory income tax rate	26.10%	25.10%
Expected income tax reduction	\$ (388,068)	\$ (314,358)
Non-deductible expenses	3,665	4,050
Effect of rate adjustments	(235,024)	–
Change in previously estimated tax pools	–	(25,403)
Effect of unrecognized deferred tax assets	619,427	335,711
	\$ –	\$ –

The statutory tax rate for the year ended December 31, 2015 increased from 25.1% to 26.1% due to an increase in the Alberta provincial tax rate on July 1, 2015. The statutory tax rate was unchanged in the year ended December 31, 2014.

**Unrecognized deferred tax assets**

Deferred tax assets have not been recognized for the following deductible temporary differences as it is not probable that future taxable profit will be available against which the Company can utilize the benefits:

	2015	2014
Non-capital loss carryforwards	\$ 11,865,657	\$ 10,156,012
Share issue costs	63,215	133,512
Reorganization costs	103,063	110,820
Decommissioning obligation	883,358	854,733
Other	59,567	59,567
	\$ 12,974,860	\$ 11,314,644

As at December 31, 2015, the Company has approximately \$3.7 million (2014 – \$4.3 million) of tax pools available for deduction against future taxable income. The Company also has non-capital tax losses of approximately \$11.9 million (2014 – \$10.2 million) available for deduction against future taxable income that begin to expire in 2027.

**13. Supplemental disclosures**

a) Employee compensation cost

The statement of loss and comprehensive loss is prepared primarily by nature of expense. During 2015, the Company incurred \$396,888 (2014 – \$444,652) of employee compensation cost which is included in general and administrative expenses.

b) Key management compensation

The Company considers its directors and executives to be key management personnel. As at December 31, 2015, key management personnel included nine individuals (2014 – nine individuals).

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Key management personnel compensation is comprised of the following:

	2015	2014
Salaries and wages	\$ 133,600	\$ 120,000
Short-term employee benefits	10,730	9,326
Share-based payments	1,315	8,653
	\$ 145,645	\$ 137,979

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#### **14. Commitment**

The Company is committed to lease rental payments and a proportionate share of operating costs pursuant to the terms of an office lease agreement in the amount of \$16,357 per month from January 1, 2016 to August 31, 2019.

#### **15. Financial instruments**

The Company holds various financial instruments as at December 31, 2015. The nature of these instruments and its operations expose the Company to market risk, credit risk and liquidity risks. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure. While management monitors and administers these risks, the Board of Directors has the overall responsibility for the establishment and oversight of the Company's risk management framework.

##### **(a) Market risk**

Market risks are generally those risks that are outside of the control of the Company. These are: commodity prices, foreign exchange rates and interest rates. The objective of the Company is to mitigate exposure to these risks, while maximizing returns to the Company.

##### **(i) Commodity price risk**

Due to the volatility of commodity prices, the Company is exposed to adverse consequences in the event of declining prices. The Company may enter into petroleum and natural gas price contracts in order to protect its cash flow on future sales. The contracts reduce the fluctuation in sales revenue by locking in prices with respect to future deliveries of petroleum and natural gas. The Company did not enter into any petroleum and natural gas price contracts in 2014 or 2015.

##### **(ii) Foreign currency exchange risk**

Although all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices for these commodities are impacted by the exchange rate between Canada and the United States. As at December 31, 2015 and 2014, the Company had no forward foreign exchange contracts in place.

##### **(iii) Interest rate risk**

The Company does not have any debt subject to floating rates and is therefore not exposed to fluctuations in the market rate of interest.

##### **(b) Credit risk**

Substantially all of the Company's trade and other receivables are with customers and joint venture partners in the petroleum and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and, therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk

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is mitigated by entering into transactions with long-standing, reputable counterparties and partners. Wherever possible, the Company requires cash calls from its partners on capital projects before they commence. Receivables related to the sale of the Company's petroleum and natural gas production are from major marketing companies who have excellent credit ratings. These revenues are normally collected on the 25th day of the month following delivery.

The maximum exposure to credit risk at is as follows:

	2015		2014	
Cash and cash equivalents	\$	6,682,584	\$	9,019,033
Term deposits		5,090,069		5,025,068
Trade and other receivables		113,278		150,602
	\$	11,885,931	\$	14,194,703

The Company does not anticipate any default or non-performance with respect to the above balances. As such a provision for doubtful accounts has not been recorded. As at December 31, 2015 and 2014, all of the Company's trade and other receivables are less than 60 days old except for approximately \$37,400 (2014 – \$32,500) which are greater than 60 days old .

Composition of trade and other receivables:

	2015		2014	
Production revenue receivable	\$	4,214	\$	8,645
Joint venture partner receivables		88,480		55,941
Goods and Services Tax and other receivables		20,584		86,016
	\$	113,278	\$	150,602

(c) Liquidity risk

Liquidity risk would occur if the Company is not able to meet its financial obligations as they come due. Historically, the Company has suffered substantial operating losses. As at December 31, 2015, the Company has an accumulated deficit of \$6,690,658 (2014 – \$5,203,806) and a working capital surplus of \$11,964,151 (2014 – \$13,121,325). The Company's goal continues to be prudent capital spending while improving its credit reputation amongst its suppliers.

The Company has sufficient cash resources to ensure its financial obligations, comprised of trade and other payables of \$520,212, are met on a current basis.

**16. Capital disclosures**

The Company considers its capital structure to include working capital and shareholders' equity. The Company will adjust its capital structure to manage its current and projected debt through the issuance of shares and/or adjusting its capital spending. The Company monitors its capital based on the current and projected ratios of net debt to cash flow. The Company's objectives in managing its capital structure are to create and maintain flexibility so that the Company can continue to meet its financial obligations; and finance its growth either through internally generated projects, joint venture relationships or asset/corporate acquisitions.

	2015		2014	
Working capital	\$	11,964,151	\$	13,121,325
Shareholders' equity	\$	15,018,545	\$	16,504,082

The Company does not have any externally imposed capital requirements as at December 31, 2015.