Emerald Bay Energy Inc.

Consolidated financial statements

For the Years Ended December 31, 2016 and 2015

(expressed in Canadian dollars)

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Independent Auditor's Report

To the Shareholders of Emerald Bay Energy Inc.

We have audited the accompanying consolidated financial statements of Emerald Bay Energy Inc., which comprise the consolidated balance sheets as at December 31, 2016 and December 31, 2015 and the consolidated statements of comprehensive loss, changes in deficit, and 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 Emerald Bay Energy Inc. as at December 31, 2016 and December 31, 2015 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company will not generate significant revenues or profitable operations in the near future and there can be no assurance that it will achieve profitability in the future, as it incurred a loss of $1,069,880 (2015: $663,456) negative operating cash flow of $265,603 (2015: $289,182) for the year ended December 31, 2016, had a working capital deficiency of $6,670,480 (2015: $6,481,015) and has accumulated $19,154,265 of losses as at December 31, 2016 (2015: $18,084,385). These conditions indicate the existence of a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.

BDO Canada LLP

Chartered Professional Accountants

Calgary, Alberta
May 10, 2017

Emerald Bay Energy Inc.

Consolidated Statements of Financial Position

December 31, 2016 and 2015

	December 31, 2016 $	December 31, 2015 $
Assets		
Current assets		
Cash and cash equivalents	**180,642**	403,511
Short-term investments	**68,493**	70,600
Trade and other receivables (note 22(b))	**81,159**	127,901
Prepaid expenses and deposits	**26,189**	84,118
Total current assets	**356,483**	686,130
Non-current assets		
Investment in PRI (note 6)	**314,850**	343,049
Investment in Partnership (note 8)	**442,311**	442,311
Exploration and evaluation assets and other intangible assets (note 9)	**1,799,531**	1,940,471
Property and equipment (note 7)	**43,574**	60,860
Total assets	**2,956,749**	3,472,821
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 22(c))	**4,804,713**	4,432,878
Shareholder deposit	**-**	800,000
Shareholder indemnity (note 20(c))	**332,388**	332,388
Loan (note 13)	**1,025,000**	1,025,000
Convertible debt (note 14)	**376,000**	421,000
Demand loan (note 15)	**123,000**	123,000
Short-term loan (note 16)	**314,262**	-
Other liabilities (note 20(c))	**51,600**	32,879
Total current liabilities	**7,026,963**	7,167,145
Non-current liabilities		
Decommissioning obligations (note 11)	**426,314**	446,649
Other liabilities (note 20(c))	**20,338**	57,062
Total liabilities	**7,473,615**	7,670,856
Shareholders’ deficit		
Share capital (note 17(b))	**12,248,793**	11,447,478
Warrants (note 17(c))	**510,171**	528,898
Contributed surplus (note 17(e))	**1,886,474**	1,886,474
Share purchase loan (note 19(a))	**(247,970)**	(247,970)
Deficit	**(19,154,265)**	(18,084,385)
Accumulated other comprehensive income	**239,931**	271,470
Total shareholders’ deficit	**(4,516,866)**	(4,198,035)
Total liabilities and shareholders’ deficit	**2,956,749**	3,472,821

Reporting entity and going concern (note 1)
Commitments (note 20)

Approved on behalf of the Board of Directors

Signed “Shelby D. Beattie”
Director

Signed “Gibson C. Scott”
Director

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

Emerald Bay Energy Inc.

Consolidated Statements of Comprehensive Loss

For the years ended December 31, 2016 and 2015

	December 31, 2016	December 31, 2015
	$	$
Revenue		
Petroleum and natural gas revenue	**13,440**	37,159
Other revenue	**23,000**	-
Royalties	**(2,156)**	(3,106)
	34,284	34,053
Operating expenses		
Production and operating expenses	**16,165**	55,328
Depletion and depreciation (note 7)	**16,527**	48,061
Impairment of property and equipment (note 10)	**-**	77,647
Impairment of exploration and evaluation assets (note 9)	**306,159**	245,352
Gain on disposal of PRI (note 6)	**-**	(1,143,066)
Loss on disposal of property and equipment (note 7 and 8)	**-**	127,288
General and administrative (note 19 (b))	**645,035**	927,735
Bad debt (recovery) expense (note 22(b))	**(52,869)**	49,743
Foreign exchange (gain) loss	**(29,572)**	55,568
	901,445	443,656
Results from operating activities	**(867,161)**	(409,603)
Finance expense		
Interest expense	**(211,908)**	(241,736)
Accretion of decommissioning obligations (note 11)	**(3,438)**	(6,032)
Accretion of other liabilities (note 20(c))	**(16,268)**	(7,771)
Loan financing expense (note 13)	**-**	(62,400)
Gain on other liabilities (note 20(c))	**-**	37,600
Net finance expense	**(231,614)**	(280,339)
Other income and expenses		
Gain on abandonment and reclamation (note 11)	**28,895**	76,840
Equity loss on investment in PRI (note 6)	**-**	(50,354)
Net other income and expenses	**28,895**	26,486
Net loss for the year	**(1,069,880)**	(663,456)
Other comprehensive loss		
Net gain (loss) on available for sale financial assets (note 6)	**(28,199)**	244,093
Foreign currency translation adjustment	**(3,340)**	27,334
Total comprehensive loss for the year	**(1,101,419)**	(392,029)
Basic and fully diluted loss per share (note 17(f))	**(0.01)**	(0.00)
Weighted average number of common shares outstanding during the year	**193,145,708**	158,610,189

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

Emerald Bay Energy Inc.

Statements of Changes in Deficit

For the years ended December 31, 2016 and 2015

	Share capital $	Warrants $	Contributed surplus $	Share purchase loan $	Deficit $	Accumulated other comprehensive loss $	Total deficit $
Balance, December 31, 2014	11,341,263	635,113	1,824,074	(247,970)	(17,420,929)	43	(3,868,406)
Reallocation expiry of warrants	127,007	(127,007)	-		-	-	-
Issue costs for expired warrant	(20,792)	20,792	-		-	-	-
Loss for the year	-	-	-		(663,456)	-	(663,456)
Convertible debenture	-	-	62,400		-	-	62,400
Movement in available for sale investment	-	-	-		-	244,093	244,093
Foreign exchange translation to presentation currency	-	-	-		-	27,334	27,334
Balance, December 31, 2015	11,447,478	528,898	1,886,474	(247,970)	(18,084,385)	271,470	(4,198,035)
Reallocation expiry of warrants	632,428	(632,428)	-	-	-	-	-
Issue costs for expired warrant	(103,533)	103,533	-	-	-	-	-
Loss for the year	-	-	-	-	(1,069,880)	-	(1,069,880)
Private placement, net of issue costs	272,420	510,168	-	-	-	-	782,588
Movement in available for sale investment	-	-	-	-	-	(28,199)	(28,199)
Foreign exchange translation to presentation currency	-	-	-	-	-	(3,340)	(3,340)
Balance, December 31, 2016	**12,248,793**	**510,171**	**1,886,474**	**(247,970)**	**(19,154,265)**	**239,931**	**(4,516,866)**

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

Emerald Bay Energy Inc.

Consolidated Statements of Cash Flows

For the years ended December 31, 2016 and 2015

	December 31, 2016	December 31, 2015
	$	$
Cash (used in) provided by:		
Operating activities		
Net loss for the year	**(1,069,880)**	(663,456)
Adjustments for:		
Depletion and depreciation (note 7)	**16,527**	48,061
Impairment of property and equipment (note 10)	**-**	77,647
Impairment of exploration and evaluation assets (note 9)	**306,159**	245,352
Gain on disposal of PRI (note 6)	**-**	(1,143,066)
Accretion of convertible debt (note 13)	**-**	62,400
Accretion of decommissioning obligation (note 11)	**3,438**	6,032
Accretion of other liabilities (Note 20(c))	**16,268**	7,771
Gain on abandonment and reclamation (note 11)	**(28,895)**	(76,840)
Loss on disposal of property and equipment (note 7 and 8)	**-**	127,289
Equity pick-up on investment in PRI (note 6)	**-**	50,354
Unrealized foreign exchange gain	**14,274**	(189,885)
	(742,109)	(1,448,341)
Change in trade and other receivables	**46,742**	148,742
Change in prepaid expenses and deposits	**57,929**	(48,089)
Change in accounts payable and accrued liabilities	**371,835**	1,059,669
Change in shareholder indemnity (note 20(b))	**-**	(1,163)
	(265,603)	(289,182)
Investing activities		
Property and equipment expenditures (note 7)	**(15,914)**	(502,050)
Exploration and evaluation expenditures (note 9)	**(220,564)**	(329,087)
Proceeds of disposition of corporate assets (note 7)	**16,633**	-
Proceeds of disposition of interest in PRI (note 6)	**-**	158,000
	(219,845)	(673,137)
Financing activities		
Proceeds from issuance of common shares, net of issue costs (note 17(b))	**(17,412)**	-
Repayment of long term debt (note 20(c))	**(34,271)**	(14,988)
Receipt of short-term loan (note 16)	**314,262**	-
Receipt of loan (note 13)	**-**	225,000
Receipt of convertible debt (note 14)	**-**	75,000
Receipt of demand loan (note 15)	**-**	123,000
Repayment of bank loan (note 12)	**-**	(11,738)
Shareholder deposit	**-**	800,000
	262,579	1,196,274
Change in cash and cash equivalents	**(222,869)**	233,955
Cash and cash equivalents, beginning of year	**403,511**	169,556
Cash and cash equivalents, end of year	**180,642**	403,511

Supplemental cash flow information (note 21)

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

1 Reporting entity and going concern

Emerald Bay Energy Inc. (the "Company") was incorporated under the Business Corporations Act of Alberta on May 9, 1997 and is listed on the TSX Venture exchange. The Company is engaged in the exploration for and development of petroleum and natural gas properties, principally in Alberta, Canada and Texas, USA. The Company is listed on the TSX Venture exchange under the symbol "EBY.V". The Company's registered head office is located at #3A, 4015 – 1 Street South East, Calgary, Alberta, Canada T2G 4X7.

At December 31, 2016, the Company had not yet achieved profitable operations, had an accumulated deficit of $19,154,265 since its inception (December 31, 2015 - $18,084,385), had negative cash flows from operations of $265,603 (December 31, 2015 - $289,182) and had a working capital deficiency of $6,670,480 (December 31, 2015 - $6,481,015) (defined as current assets less current liabilities), and expects to incur further losses in the development of its business. The ability to continue as a going concern is dependent on obtaining continued financial support, completing public equity financing or generating profitable operations in the future. Management is committed to raising additional capital to meet its exploration and operating obligation, however, additional equity financing is subject to the global financial markets and economic conditions, which have recently been disrupted and are volatile, and the debt and equity markets, which are distressed, particularly for junior petroleum and natural gas companies. All of these factors, together with weak natural gas prices and the current unstable economic conditions, indicate the existence of material uncertainties related to events or conditions that may cast significant doubt as to whether the Company can continue as a going concern and, therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business. These consolidated financial statements do not reflect the adjustments to the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications that would be necessary if the going concern assumption was not appropriate. Any adjustments necessary to the consolidated financial statements if the Company ceases to be a going concern could be material.

2 Basis of presentation

a) Statement of compliance:

These annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The Board of Directors approved the consolidated financial statements on May 10, 2017.

b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments and available for sale financial investments which are measured at fair value, as explained in note 3 – Significant accounting policies.

c) Basis of consolidation:

These consolidated financial statements include the accounts of the Company and its United States branch, and Emerald Bay Texas Inc., its wholly-owned and controlled subsidiary. Control exists when the Company has the power over the investee, exposure or rights to variable returns from its involvement and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries, including entities which the Company controls, are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. All intercompany transactions and balances have been eliminated.

d) Nature and purpose of equity and reserves:

The reserves recorded in equity on the Company's consolidated statement of financial position include 'contributed surplus', 'Accumulated other comprehensive loss', and 'Deficit'.

'Contributed surplus' is used to recognize the value of stock options and broker warrants prior to exercise.

'Accumulated other comprehensive loss' is the foreign exchange gain or loss resulting from the translation of the Corporation's foreign subsidiary.

'Deficit' is used to record the Corporation's change in deficit from profit or loss from year to year.

e) Use of estimates and judgments:

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future periods could be significant.

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

Significant judgments

Determination of cash-generating units ("CGU")

Property and equipment are aggregated into CGUs based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company's CGUs is subject to management's judgment.

Investment in Partnership and Production Resources Inc. ("PRI")

The Company does not have significant voting power, participation in policy making decisions, or Board representation, and accordingly, the two investments were determined to constitute financial assets. The determination of the classification of the Company's investments is subject to management judgment.

Significant estimates and assumptions

Financial instrument fair values

During the year ended Dec. 31, 2016, the Company entered into financial instruments that are accounted for at fair value, with the initial and subsequent changes in fair value affecting other comprehensive income in the period the change occurs. The fair values of financial instruments are classified within three levels, with Level III fair values determined using inputs for the asset or liability that are not readily observable. Some of the Company's fair values are included in Level III because they require the use of internal valuation techniques or models to determine fair value. The determination of the fair value of these instruments can be complex and relies on judgments and estimates. These fair value estimates may not necessarily be indicative of the amounts that could be realized or settled, and changes in these assumptions could affect the reported fair value of the financial instruments.

Fair values can fluctuate significantly and can be favourable or unfavourable depending on current market conditions.

Decommissioning obligations

The Company estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require estimates regarding removal date, future environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating costs, future removal technologies in determining the removal costs, and discount rates to determine the present value of these cash flows.

Exploration and evaluation ("E&E") assets

The accounting policy for E&E assets is described in note 3. The application of this policy requires management to make certain estimates and assumptions as to future events and circumstances as to whether economic quantities of reserves will be found.

Recoverability of assets

The Company assesses impairment on its assets that are subject to amortization when it has determined that a potential indicator of impairment exists. Impairment exists when the carrying value of a non-financial asset or CGU exceeds its recoverable amount, which is the higher of its fair value less costs to sell ("FVLCTS") and its value in use. The Company used the calculation of FVLCTS to determine the fair value of its CGUs. In determining the FVLCTS, the amount is most sensitive to the future commodity prices, discount rates, and estimates of proved and probable reserves, to determine an implied fair value of the CGU being tested.

3 Significant accounting policies

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

Cash and cash equivalents

Cash and cash equivalents include cash on hand and deposits held with banks. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management, whereby management has the legally enforceable right and ability and intent to net bank overdrafts against cash, are included as a component of cash for the purpose of the consolidated statement of cash flows. Cash equivalents comprise term deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

Financial instruments

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

Common shares are classified as equity. Incremental costs directly attributable to the issuance of common shares are recognized as a deduction from equity, net of any tax effects.

Non-derivative financial instruments:

Non-derivative financial instruments are recognized initially at fair value. Subsequent to the initial recognition, non-derivative financial instruments are designated into one of the following categories and measured as described below:

(i) Financial assets and liabilities at fair value through profit or loss: Financial assets and liabilities at fair value though profit or loss are either "held for trading" or have been "designated at fair value through profit or loss". In both cases the financial assets and financial liabilities are measured at fair value with changes in fair value recognized in the consolidated statement of comprehensive 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. Transaction costs are expensed in the consolidated statement of comprehensive loss.

(ii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of trade and other receivables and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received, less when material, a discount to reduce the loans and receivables to fair value. Transaction costs pertaining to these financial instruments are added to the financial instrument. Subsequently, loans and receivables are measured at amortized cost using the effective interest rate method less a provision for impairment.

(iii) Available-for-sale financial assets: Available-for-sale financial assets are those non-derivative financial assets that are designated as such or that have not been classified as another type of financial asset, and are measured at fair value through Other Comprehensive Loss. Available-for-sale financial assets are measured at cost if fair value is not reliably measurable.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, shareholder indemnity, loan, and the convertible debt. Accounts payable and accrued liabilities and the shareholder indemnity are initially recognized at the amount required to be paid, less when material, a discount to reduce the payables to fair value. Subsequently, accounts payable and accrued liabilities and the shareholder indemnity are measured at amortized cost using the effective interest rate method. The loan, the convertible debt (excluding the derivative relating to the conversion option) are recognized initially at fair value and subsequently at amortized cost using the effective interest rate method. The fair value of transaction costs to acquire debt are netted against the debt instrument, and through a non-cash finance expense, the debt is accreted back to the principal balance over the life of the debt.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

Derivative financial instruments:

The Company may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the consolidated statement of financial position at fair value. Transaction costs are recognized in the consolidated statement of comprehensive loss when incurred.

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. Conversion features that are accounted for as derivative liabilities are accounted for separately from the host instrument as the fair value of the conversion feature is affected by changes in the fair value of the Company’s shares, and the fair value of the host instrument is not. Changes in the fair value of separable embedded derivatives are recognized immediately in the consolidated statement of comprehensive loss.

Property and equipment and exploration and evaluation assets

Recognition and measurement:

(i) E&E expenditures:

Pre-license costs are recognized in the consolidated statement of comprehensive loss as incurred.

All costs associated with the exploration and evaluation of oil and natural gas reserves are initially capitalized. Exploration and evaluation costs are those expenditures for an area where technical feasibility and commercial viability has not yet been determined. These costs include unproven property acquisition costs, exploration costs, geological and geophysical costs, decommissioning costs, E&E drilling, and sampling and appraisals.

When an area is determined to be technically feasible and commercially viable, the accumulated costs are tested for impairment and transferred to property and equipment. When an area is determined not to be technically feasible and commercially viable or the Company decides not to continue with its activity, the unrecoverable costs are charged to the consolidated statement of comprehensive loss as E&E expense.

(ii) Property and equipment:

All costs directly associated with the development of oil and gas reserves are capitalized on an area-by-area basis. Development costs include expenditures for areas where technical feasibility and commercial viability has been determined. These costs include proven property acquisitions, development drilling, completion, gathering and infrastructure, decommissioning costs and transfers of E&E assets.

Costs accumulated within each area are depleted using the unit-of-production method based on proven reserves incorporating estimated future prices and costs. Costs subject to depletion include estimated future costs to be incurred in developing proven reserves. Costs of major development projects are excluded from the costs subject to depletion unless they are available for use.

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized within “operating expenses” in consolidated statement of comprehensive loss.

(iii) Property and equipment – corporate and other:

Property and equipment – corporate and other is carried at cost and amortized over the estimated useful lives of the assets at various rates per annum calculated on a declining balance basis. Amortization is charged at half rates in the year of acquisition.
The Company uses the following rates:

Asset class	Rate
Furniture and equipment and leasehold improvements	20%
Computer Hardware	30%
Automotive	30%

Subsequent costs:

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property 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 consolidated statement of 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 the day-to-day servicing of property and equipment are recognized in the consolidated statement of comprehensive loss as incurred.

Impairment

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. Objective evidence that financial assets are impaired can include: significant financial difficulty of the issuer or counterparty; the potential for loss is significant; a prolonged decline in value (defined as a decline in value lasting longer than one year); default or delinquency of payments; or it is probable that the borrower will enter bankruptcy or financial re-organization.

(i) Financial assets carried at amortized cost: 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. The carrying amount of the asset is reduced by this amount and losses are recognized in the consolidated statement of comprehensive loss and through the use of an allowance account.

(ii) Available for sale financial assets: The impairment loss in respect of an available for sale financial asset is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the consolidated statement of comprehensive loss. This amount represents the cumulative loss in Accumulated other comprehensive loss that is reclassified to the consolidated statement of comprehensive loss.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the reversal can be related objectively to an event occurring after the impairment loss was recognized. The reversal is recognized in the consolidated statement of comprehensive loss or credited against the allowance account. Impairment losses on available for sale equity instruments are not reversed.

Non-financial assets:

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

The Company considers its Canadian assets as a CGU and its Texas assets as a separate CGU.

The recoverable amount of an asset or a CGU is the greater of its value in use and its FVLCTS. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU. FVLCTS is based on available market information, where applicable. In the absence of such information, FVLCTS is determined using discounted future net cash flows of proved and probable reserves using forecast prices and costs.

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

Share-based payments

The Company issues stock options to directors, officers and other consultants, which are deemed employees. The fair value of options granted to employees is measured at grant date, using the Black-Scholes option pricing model, and is recognized over the vesting period, using a graded vesting model. The fair value is recognized as an expense within operations with a corresponding increase in contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

The fair value of warrants issued as part of the private placements is measured at the closing date of the private placement using the Black-Scholes option pricing model. The fair value is recognized as a deduction against share capital with a corresponding increase in contributed surplus.

If and when the stock options and/or warrants are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

Provisions

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

Decommissioning obligations

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

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

Revenue

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product are transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time product enters the pipeline.

Finance income and expenses

Finance expense comprises interest expense on borrowings and accretion of the discount on provisions.

Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the consolidated statement of 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 as at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

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

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

Earnings per share

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

Currency translation

Functional and presentation currency

The functional currency for each branch within the Company is the currency of the primary economic environment in which it operates. The functional currency for the United States branch is the United States dollar. The functional currency for the Canadian branch is the Canadian dollar. These consolidated financial statements are presented in Canadian dollars. Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

The results and financial position of the subsidiaries that have a functional currency different from the presentation currency are translated into Canadian dollars, the presentation currency, as follows:

- Assets and liabilities are translated at the closing exchange rate at the date of the consolidated statement of financial position;
- Income and expenses are translated at the average exchange rates during the period; and
- All resulting exchange differences are charged/credited to the currency translation adjustment in Other Comprehensive Loss.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation of monetary assets and liabilities, within the United States branch, denominated in currencies other than an entity's functional currency are recognized in the consolidated statement of comprehensive loss.

Flow-through shares

From time to time the Company will issue flow-through common shares to finance a portion of its exploration program. These shares transfer the tax deductibility of qualifying resource expenditures to investors. On issuance, the Company splits the flow-through shares into i) a flow-through share premium, equal to the estimated premium, if any, investors pay for the flow-through feature, which is recognized as a liability, and ii) share capital. When expenses are renounced, the Company derecognizes the liability and recognizes a deferred tax liability for the amount of tax reduction renounced to the shareholders. The premium is recognized as other income and the related deferred tax is recognized as a tax provision.

Proceeds received from the issuance of flow-through shares are restricted to be used only for Canadian resource property exploration expenditures. The Company may also be subject to a Part XII.6 tax on flow-through proceeds renounced under the Look-back Rule, in accordance with Government of Canada flow-through regulations. When applicable, this tax is accrued as a financial expense until paid.

Joint operations

Many of the Company's oil and natural gas activities involve joint operations. A joint operation is a type of arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the joint operation. The consolidated financial statements include the Company's share of these joint operations and a proportionate share of the relevant revenue and related costs.

4 Recent accounting pronouncements

Certain pronouncements were issued by "IASB" or International Financial Reporting Interpretation Committee ("IFRIC") that are mandatory for accounting periods beginning after January 1, 2017 or later periods.

The following new accounting standards, amendments to accounting standards and interpretations, have not been early adopted in these consolidated financial statements. The Company is currently assessing the impact, if any, of this new guidance on the Company's future results and financial position:

IFRS 9, "Financial Instruments": In July 2014, the IASB completed the final phase of its project to replace IAS 39, the current standard on the recognition and measurement of financial instruments. IFRS 9 is now the new standard which sets out the recognition and measurement requirements for financial instruments and some contracts to buy or sell non-financial items. IFRS 9 provides a single model of classifying and measuring financial assets and liabilities and provides for only two classification categories: amortized cost and fair value. Hedge accounting requirements have also been updated in the new standard and are now more aligned with the risk management activities of an entity. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Early adoption is permitted; however, if an entity elects to apply this standard early, it must disclose that fact and apply all of the requirements in this standard at the same time. It is anticipated that the adoption of IFRS 9 will not have a material impact on the Company's consolidated financial statements.

IFRS 15, "Revenue from Contracts with Customers:" IFRS 15 was issued in May 2014 and applies to contracts with customers, excluding, most notably, insurance and leasing contracts. IFRS 15 prescribes a framework in accounting for revenues from contracts within its scope, including (a) identifying the contract, (b) identify separate performance obligations in the contract, (c) determine the transaction price of the contract, (d) allocate the transaction price to the performance obligations and (e) recognize revenues when each performance obligation is satisfied. This standard comes into effect January 1, 2018 and is applied retrospectively. IFRS 15 also prescribes additional financial statement presentations and disclosures. The Company's evaluation of IFRS 15 is ongoing and not complete. The IASB has issued and may issue in the future, interpretative guidance, which may cause its evaluation to change. The Company does not currently believe IFRS 15 will have a material effect on its consolidated financial statements.

IFRS 16, "Leases": In January 2016, the IASB issued the standard to replace IAS 17 "Leases". For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. The Company does not currently believe IFRS 16 will have a material effect on its consolidated financial statements.

5 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.

Property and equipment and E&E assets:

The fair value of property and equipment and E&E assets is the estimated amount for which property and equipment and E&E 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 each acted knowledgeably, prudently and without compulsion. The fair value of oil and natural gas assets (included in property and equipment) 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.

Cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities:

At December 31, 2016 and December 31, 2015, the fair value of these balances approximated their carrying value due to their short term to maturity.

Share-based payments, warrants and finder's options:

The fair value of employee stock options, warrants and the finder's options are measured using a Black-Scholes option 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 (based on government bonds).

Investments:

Fair values are determined using inputs (Level III) for the asset or liability that are not readily observable.

In estimating the fair value of such investments, the Company uses a discounted cash flow method, and makes estimates and assumptions about forward reserve prices, production, capital expenditures, asset retirement costs, and other related cash inflows and outflows over the life of the assets, as well as the remaining life of the facilities.

Appropriate discount rates reflecting the risks specific to the investment are used in the valuations. These estimates and assumptions are susceptible to change from period to period and actual results can, and often do, differ from the estimates, and can have either a positive or negative impact on the estimate of the fair value of the instrument, and may be material.

6 Equity investment in PRI

On June 29, 2015, the Company disposed of 60% of its ownership in PRI for proceeds of $1,291,500 to a party with an existing shareholding in PRI, and whose President is the Lender (note 13). The proceeds received were used to settle working capital and debt commitments. A gain was recorded in the statement of comprehensive loss for $1,143,066 for the difference between the proceeds received and the carrying value of the investment. The gain consists of a $282,706 gain on the disposal of assets and $860,360 forgiveness of certain working capital and debt obligations, of which $253,000 was due to PRI. The investment was previously accounted for using the equity method. However, the Company's interest in the share capital of PRI is 10% at December 31, 2016, and accordingly the Company accounts for the investment as an available for sale investment.

The investment in PRI as at December 31, 2016 is as follows:

	$
Net investment, December 31, 2014	**$297,744**
Proportionate share of loss for the period up to the disposition	(50,354)
Disposition of ownership in the share capital	(148,434)
Fair value adjustment at date of disposition	254,578
Net investment, June 30, 2015	**353,534**
Fair value adjustment at December 31, 2015	(10,485)
Net investment, December 31, 2015	**$343,049**
Fair value adjustment at December 31, 2016	(28,199)
Net investment, December 31, 2016	**$314,850**

The investment in PRI is designated as an available for sale financial instrument. The investment was fair valued at December 31, 2016 with the change in fair value being taken to other comprehensive income.

The fair value of the investment in PRI is a Level 3 valuation of the fair value measurement hierarchy as the value been determined using unobservable inputs. Fair value is based on a present value technique involving expected cash flows and discount rates using assumptions that market participants would use when pricing such an investment. As the fair value of the investment relates to the fair value of the underlying operations of the investment, the present value of the investment is primarily based on the net present valuing of the cash flows from the proved and probable reserves at a discounted at market rate.

Proved and probable reserves were based on a third party reserve report and an assumed discount rate of 9.1% (2015 – 8.9%) reflecting the economic conditions existing at the time. A 1% increase or decrease in the discount rate would result in a $48,000 (2015 - $43,000) change in the fair value of the investment in PRI.

7 Property and equipment

	Oil and natural gas interests $	Corporate and other $	Total $
Cost, December 31, 2015	**4,227,898**	**192,388**	**4,420,286**
Additions	-	15,914	15,914
Dispositions	-	(16,633)	(16,633)
Foreign currency translation	-	(673)	(673)
Cost, December 31, 2016	**4,227,898**	**190,996**	**4,418,894**
Accumulated depletion, depreciation and impairment, beginning of year	(4,192,339)	(167,087)	(4,359,426)
Depreciation and depletion for the year	(4,489)	(12,038)	(16,527)
Foreign currency translation	-	633	633
Carrying value, December 31, 2016	**31,070**	**12,504**	**43,574**

	Oil and natural gas interests $	Power plant interests $	Corporate and other $	Total $
Cost, December 31, 2014	**4,385,626**	**120,389**	**323,175**	**4,829,190**
Additions	47,564	501,324	867	549,755
Revisions in decommissioning liability	(1,354)	-	-	(1,354)
Disposal of oil and natural gas interests	(203,938)	(621,713)	(135,046)	(960,697)
Foreign currency translation	-	-	3,392	3,392
Cost, December 31, 2015	**4,227,898**	**-**	**192,388**	**4,420,286**
Accumulated depletion, depreciation and impairment, beginning of year	(4,300,633)	-	(275,053)	(4,575,686)
Disposal of oil and natural gas interests	203,938	4,427	135,046	343,411
Depreciation and depletion for the year	(17,997)	(4,427)	(25,637)	(48,061)
Impairment of oil and natural gas interests (note 10)	(77,647)	-	-	(77,647)
Foreign currency translation	-	-	(1,443)	(1,443)
Carrying value, December 31, 2015	**35,559**	**-**	**25,301**	**60,860**

During the year ended December 31, 2014, the Company entered into an agreement (the “Agreement”) to develop a natural gas fired electrical power generation plant (the “Power Plant”). Pursuant to the Agreement, the existing partners of certain wells agreed to contract all of their working interest shares of gas production from these wells as fuel for the Power Plant, and the Company disposed of a portion of their working interest to the operator through a non-cash transaction in lieu of paying its portion of capital costs to develop the Power Plant.

During the year ended December 31, 2015, the Company closed an acquisition of an additional 24.23% working interest in the Power Plant for $500,000. The acquisition was accounted for as a held for sale asset and was recognized at the lower of the carrying amount and fair value less costs to sell. The working interest acquired was deemed to have fair value of $327,442 which resulted in a fair value loss on acquisition of $172,557. The Power Plant assets and certain oil and gas interests were sold to Horseshoe LP for a 16.14% equity stake in Horseshoe LP (note 8).

8 Investment in Partnership

On November 15, 2015, the parties involved in the Power Plant Agreement established a partnership (the "Partnership") whereby each party would transfer their working interest in the Power Plant into the Partnership in exchange for a proportional interest in the Partnership. In addition to transferring its working interest in the Power Plant to the Partnership, the Company transferred its remaining working interest in the wells used as fuel for the Power Plant to the Partnership. The fair value of the Company's share in the Partnership was $442,311, which was based on third parties acquiring units of the partnership for cash. The carrying value of the assets surrendered was $397,042 (including decommissioning liability of $17,963 and the bank loan of $25,264 (note 12), which was also transferred to the Partnership), resulting in a gain on disposition of $45,269.

Horseshoe LP is a privately held partnership with no active public market and no observable outputs as the partnership only recently began operating and has no extensive history of activity. The Company assessed the value of its initial partnership purchase using the price at which third parties were willing to purchase a partnership interest. For subsequent quarterly and annual reporting, unless additional partnership units are sold to a third party, the Company determines the fair value of its investment in Horseshoe based on the costs incurred as there is insufficient recent information available to measure fair value. During the year ended December 31, 2016, additional shares in the Partnership were sold to third parties for cash, and the price per share reflected the existing fair value of units held by the Company. There also have been no indicators to suggest that the unit issuance by the Partnership is not representative of fair value.

The investment in Partnership as at December 31, 2016 is as follows:

Net investment, December 31, 2014	**$ -**
Carrying value of the net assets surrendered	397,042
Gain on disposition	45,269
Net investment, December 31, 2015	**$442,311**
Fair value adjustment at December 31, 2016	-
Net investment, December 31, 2016	**$442,311**

9 Exploration and evaluation assets

	E&E assets
	$
Balance, December 31, 2014	**1,576,166**
Additions	329,087
Revisions in decommissioning liability	11,376
Impairment	(245,352)
Foreign currency translation	269,194
Balance, December 31, 2015	**1,940,471**
Additions	220,564
Revisions in decommissioning liability	7,002
Impairment	(306,159)
Foreign currency translation	(62,347)
Balance, December 31, 2016	**1,799,531**

E&E assets consist of the Company's exploration projects which are pending the determination of technical feasibility and commercial viability. As at December 31, 2016, the Company incurred an amount of $220,564 on E&E expenditures (December 31, 2015 - $329,087). The additions represent the acquisition of undeveloped land and drilling activity within Texas. These E&E assets will be transferred to property and equipment when technical feasibility and commercial viability have been established. The E&E asset impairment is $306,159 for the year ended December 31, 2016 (December 31, 2015 - $245,352). The impairment was recognized upon a review of each exploration license or field, carried out, at least annually, to confirm whether the Company intends further appraisal activity or to otherwise extract value from the property.

10 Impairment loss

As at December 31, 2016 and 2015, the Company reviewed its oil and natural gas assets, the Canadian CGU, for indicators of impairment such as changes in future prices, future costs and reserves. The Company determined the recoverable amount of the CGU based FVLCTS measured using the discounted cash flow approach. The cash flow projection was taken from the reserve report, using a discount of 15% (pre-tax) and it was determined that there was no impairment at December 31, 2016 (December 31, 2015 - $77,647).

11 Decommissioning obligations

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning obligations to be $426,314 as at December 31, 2016 (December 31, 2015 -

$446,649) based on an undiscounted total future liability of $447,124 (December 31, 2015 - $456,339). These payments are expected to be made over the next 2 to 24 years. The obligations have been calculated using an inflation rate of 2% and a discount factor, being the risk-free rate related to the liability, of 0.73% - 2.21% (December 31, 2015 – 2% and 0.48% - 2.03%, respectively).

	December 31, 2016	December 31, 2015
	$	$
Balance, beginning of year	**446,649**	510,601
Disposals	-	(17,297)
Liabilities incurred	16,626	11,376
Abandonments	(28,895)	(76,840)
Revisions / changes in estimates	(9,624)	(1,354)
Accretion	3,438	6,032
Foreign currency translation	(1,880)	14,131
Balance, end of year	**426,314**	446,649

During the year ended December 31, 2016, the Orphan Well Society abandoned and reclaimed certain wells owned by the Company. As a result, the Company derecognized decommissioning obligation of $28,895 (December 31, 2015 - $76,840) and recorded it as a gain in the Company's consolidated statement of comprehensive loss.

12 Bank loan

On July 10, 2014, the Company and its joint interest partners ("Partners") on the Electric Generation Pilot Project ("Project") entered into a loan agreement (the "Loan") with a Canadian Chartered Bank (the "Lender") in the amount of $500,000, of which the Company was liable for $42,500. The proceeds of the Loan were used towards the purchase of equipment utilized in the Project. Principal repayments were required monthly until maturity and interest was calculated at 5.75% per annum, payable monthly. During the year ended December 31, 2015, the Company made principal repayments of $11,738 and interest payments of $1,403. The Loan matures on May 31, 2017 and was secured against certain assets as collateral of the Company and Partners. On November 15, 2015, the Loan was transferred into the Partnership (note 8).

13 Loan

On June 15, 2012, a corporation owned by a party who has a common significant shareholding (the "Lender") advanced $1,500,000 to the Company under a loan agreement with a maturity date of August 15, 2013, which was later extended August 15, 2014, with the same terms and conditions (the "Loan"). Interest on the Loan is 10% per annum, payable monthly, on the outstanding principal amount.

Pursuant to the Loan agreement, the Company issued to the Lender 5,000,000 share purchase warrants (the "Warrants"). Each Warrant was exercisable into one common share of the Company at a price of $0.05 per common share until the expiry date of August 15, 2014. On April 9, 2014, the Warrants received regulatory approval and accordingly were valued as of this date at $40,241 and were treated as a transaction cost, and were netted against the principal balance of the loan, which was accreted back up to the principal balance at the maturity date. The accretion of the Warrants was recorded as a non-cash finance expense in the consolidated statement of comprehensive loss. On August 15, 2014, the Warrants expired unexercised.

On October 2, 2014, the Company received approval to extend the maturity date of the Loan until August 15, 2015, with a 10% interest rate on the outstanding principal amount (the "Extension"). Pursuant to the Extension, no warrants were offered, however a conversion feature enabling the Lender to convert any or all of the outstanding Extension into common shares of the Company at a conversion price of $0.05 per common share at any time prior to August 15, 2015, subject to regulatory approval. On April 17, 2015, the conversion feature on the extension received regulatory approval and accordingly, on the issuance and extension, the loan was split between the liability and the conversion feature, which was recorded on the consolidated statement of financial position within equity. The liability portion was determined by subtracting the fair value of the conversion feature from the principal amount of the loan. The liability portion was measured at amortized cost and was accreted up to the principal balance at the maturity date. The accretion was expensed as a finance expense in the consolidated statement of comprehensive loss as finance expense. On August 15, 2015, the conversion feature expired unexercised. All other terms and conditions of the Extension remain unchanged. During the year ended December 31, 2015, the Lender advanced an additional $225,000 to the Company under the same terms as the Loan. However, the additional advance was not included in the conversion feature.

The Company may, at any time, repay the Extension in full without notice or penalty. If the Company is in default of the requirements included in the Extension agreement or the Lender believes the Company's ability to repay the loan is impaired, the Lender may demand repayment of the Extension or accelerate the date for payment. During year ended December 31, 2016, the Company incurred interest of $102,492 (December 31, 2015 - $105,208).
On June 29, 2015, the Company used part of the proceeds received from the disposition of a portion of its interest in PRI (note 6) to repay $500,000 to the Lender.

The following table summarizes the accounting of the Loan:

	$
Balance, December 31, 2014	**1,300,000**
Transaction costs	(62,400)
Accretion of debt	62,400
Re-payment of Loan	(500,000)
Receipt of additional funds	225,000
Balance, December 31, 2015 and 2016	**1,025,000**

Security for the new Loan consists of a General Security Agreement in favour of the Lender to include a specific assignment of production proceeds, and security over the United States assets of the Company. The Lender has required the Company to submit to them certain reports including monthly production reports.

On June 29, 2015, the maturity date of the Extension was renewed until August 15, 2017 under the same terms and conditions, and included a new conversion feature with an expiry date of August 15, 2017. The new extension has not yet received regulatory approval. Thus, the Loan has been recognized as due on demand as the terms of the extension are not in effect until regulatory approval is received.

14 Convertible debt

On January 1, 2012, the Company entered into a loan agreement (the "Loan Agreement") with a corporation owned and controlled by a party who is also a significant shareholder of the Company (the "Lender") whereby the Company received a $150,000 USD ($201,000 CAD) loan with a maturity date of one year (the "Original Loan"). Pursuant to the Loan Agreement, if it is mutually agreed upon by both parties, the maturity date can be extended by an additional year. During the years ended December 31, 2016, 2015 and 2014, the Lender advanced an additional loan amount of $75,000 and $100,000 (the "Advances"), respectively, to the Company under the same terms as the Original Loan. At each maturity date, the Company and the Lender mutually agreed to extend the Original Loan and the Loan advances by an additional year. As at December 31, 2016, the Company has not received demand from the Lender for repayment, and the Company is currently negotiating an extension of the short-term loan with the Lenders. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount. Security for the loan consists of a $150,000 promissory note and monthly production from certain Texas assets equivalent to the principal portion of the loan and any unpaid interest.

At the option of the Lender, and subject to regulatory approval, the entire principal amount of the Original Loan, or any portion outstanding, may have been converted to shares in the Company with a discount of 25% to the market trading price at the time of conversion, at any time during the term. The conversion feature was to be treated consistently with the conversion feature included on the Loan (note 13). The conversion feature on the Original Loan expired unexercised on December 31, 2014 and the conversion features on the Advances did not receive regulatory approval before the conversion features expired.

The modifications did not result in an extinguishment of the old convertible debt instrument and recognition of a new convertible debt instrument. The proceeds of the loan were used to continue the Company's exploration program in Texas. During the year ended December 31, 2016, the Company incurred interest of $48,632 (December 31, 2015 - $94,236) on the aggregate amount owing under the convertible debt.

15 Demand loan

On May 12, 2015, the Company entered into a loan agreement (the "Demand Loan") with a corporation owned and controlled by a party who is also a significant shareholder of the Company (the "Lender") for up to an amount of $150,000. The proceeds of the Demand Loan were used for the continued operation of the Company. The Demand Loan is due on the demand of the Lender and bears interest of 8.00% per annum, compounded monthly. At December 31, 2016, the Company has drawn $123,000 against the Demand Loan (December 31, 2015 - $123,000) and has accrued interest of $15,299 (December 31, 2015 - $2,516). The Company may repay the Demand Loan in full at any time prior to demand without notice or penalty.

16 Short-term loan

During the year ended December 31, 2016, the Company received a short-term loan (the "Short-term Loan") from the Lenders associated with the Loan (note 13) and the Convertible debt (note 14), collectively, the Lenders (the "Lenders") in the maximum available amount of $350,000. A set-up fee of $6,000 was charged by the Lenders, and is included in general and administrative expenses. Interest on the Short-term Loan is 10% per annum, compounded monthly. The Short-term Loan matured December 1, 2016. The proceeds of the Short-term Loan were to provide capital for on-going operational and administrative costs of the Company. The Company may re-pay some or all of the outstanding balance of Short-term Loan without notice or penalty.

As security for the total Short-term Loan, if the Short-term Loan is not repaid by the maturity date, at the option of the Lenders (the "Option"), the Lenders may acquire the 10% equity investment in PRI (note 6). If the option is exercised by the Lenders, the Lenders have granted the Company the ability to re-acquire the 10% equity investment in PRI for a period of 9 months from Option exercise date insofar as the Short-term Loan is fully repaid. As at December 31, 2016, the Company has not received demand from the Lenders for repayment, nor have they exercised their Option, and the Company is currently negotiating an extension of the Short-term Loan with the Lenders.

At December 31, 2016, the total amount outstanding under the Short-term Loan is $314,262, and accrued interest incurred pursuant to the Short-term loan of $15,366.

17 Share capital

a) Authorized

Unlimited number of common shares with voting rights
Unlimited number of preferred shares, issuable in series

b) Issued

	Number of Common Shares	Amount $
Balance, December 31, 2014	**158,610,189**	**11,341,263**
Expiry of warrants (note 17(c))	-	127,007
Issue costs for expired warrants	-	(20,792)
Balance, December 31, 2015	**158,610,189**	**11,447,478**
Private placement (i)	40,000,000	800,000
Value of warrants issued pursuant to private placement (i)	-	(521,519)
Share issue costs (i)	-	(6,061)
Expiry of warrants (note 17(c))	-	632,428
Share issuance costs for expired warrants	-	(103,533)
Balance, December 31, 2016	**198,610,189**	**12,248,793**

(i) On February 19, 2016, the Company completed a private placement (the "Private Placement"), issuing 50,000,000 units (the "Unit). Each Unit was issued at $0.02 for total proceeds of $1,000,000, and consists of one common share of the Company and one share purchase warrant (the "Warrant"). As at December 31, 2016, the Company has not collected $200,000 of the proceeds pursuant to the Private Placement. This amount has been determined to be uncollectible and subsequent to December 31, 2016, 10,000,000 Units were returned to treasury. Each Warrant entitles the holder to purchase one additional common share of the Company at $0.05 per share, exercisable for 1 year from the original issue date. The Company has allocated $521,519 of the unit value to warrants (note 17(c)). Pursuant to the Private Placement, the Company incurred $17,412 in cash share issue costs, of which $6,061 was allocated to share capital and $11,351 was allocated to warrants.

c) Warrants

Warrants to acquire common shares outstanding at December 31, 2016 are as follows:

	Number of warrants issued and exercisable	Amount $	Weighted average exercise price $	Weighted average Remaining life (years)
Balance, December 31, 2014	**17,938,500**	**635,113**	**0.05**	**0.63**
Expiry of share purchase warrants	(3,000,000)	(127,007)	-	-
Issue costs for expired warrants	-	20,792	-	-
Balance, December 31, 2015	**14,938,500**	**528,898**	**0.05**	**0.65**
Expiry of share purchase warrants	(14,938,500)	(632,428)	-	-
Share issuance costs for expired warrants	-	103,533	-	-
Share purchase warrants issued (note 17(b)(i))	40,000,000	521,519	0.05	0.14
Share issue costs (note 17(b)(i))	-	(11,351)	-	-
Balance, December 31, 2016	**40,000,000**	**510,171**	**0.05**	**0.14**

The fair value of the share purchase warrants granted during the year are estimated at the grant date using the Black-Scholes option pricing model and have been credited to warrants within shareholders' deficit. A weighted average of the assumptions used in the calculation is noted below:

	2016
Risk-free rate	**0.45%**
Expected life	**1 year**
Expected volatility	**240%**
Fair value per warrant	**$0.013**

Volatility was determined based on the Company's historical share prices.

d) Stock options

The Company established a share option plan (the "Plan") for the benefit of officers, directors, employees and consultants of the Company. Under the Plan, the number of common shares to be reserved and authorized for issuance pursuant to options granted under the Plan cannot exceed 10% of the total number of issued and outstanding shares of the Company. The term, the vesting period and the exercise price are determined at the discretion of the Board of Directors. However, the maximum option term shall not exceed five years.

During the year ended December 31, 2016, there were no stock options granted, cancelled or exercised, and 4,925,000 stock options expired unexercised. The following table summarizes information about the Company's stock options outstanding at December 31, 2016:

	December 31, 2016		December 31, 2015	
	Number of options	**Weighted average exercise price $**	Number of options	Weighted average exercise price $
Stock options, beginning of year	**11,625,000**	**0.07**	14,030,000	0.08
Expired	**(4,925,000)**	**-**	(2,405,000)	-
Stock options outstanding, end of year	**6,700,000**	**0.05**	11,625,000	0.07

The total stock options outstanding at December 31, 2016 are as follows:

Exercise price ($)	Options outstanding	Weighted average remaining term (years)	Weighted average exercise price ($)
0.05	6,700,000	1.80	0.05

As at December 31, 2016, all stock options have vested and are exercisable.

During the year ended December 31, 2016 and 2015, the Company did not recognized any share-based payment expense.

e) Contributed surplus

	December 31, 2016	December 31, 2015
	$	$
Balance, beginning of year	**1,886,474**	1,824,074
Convertible debt (note 13)	**-**	62,400
Balance, end of year	**1,886,474**	1,886,474

f) Per share data

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. The treasury stock method is used for the calculation of diluted loss per share. Under this method, it is assumed that proceeds from the exercise of dilutive securities are used by the Company to repurchase Company shares at the average price during the year.

All warrants, finder's options and stock options have been excluded from the calculation of diluted shares outstanding as they would be anti-dilutive due to the loss position of the Company.

18 Income tax

The provision for income taxes varies from the amount that would be computed by applying the expected tax rate to income (loss) before income taxes. The principle reasons for differences between such "expected" income tax expense and the amount actually recorded are as follows:

	December 31, 2016	December 31, 2015
	$	$
Loss before income taxes	**(1,069,880)**	(663,456)
Statutory income tax rate	**27.00%**	26.00%
Expected income tax provision	**(288,868)**	(172,499)
Share-based payments	**-**	-
Investments	**11,280**	(109,100)
Non-deductible expenses	**5,322**	36,314
Change in tax rates	**-**	(263,624)
Other	**(22,466)**	(2,311)
Foreign exchange translation	**(32,252)**	71,482
Other non-taxable accounting gain	**(7,802)**	(19,979)
Change in deferred tax asset not recognized	**334,786**	459,717
Income tax provision (recovery)	**-**	-

Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

	December 31, 2016	December 31, 2015
	$	$
Property and equipment	**1,018,628**	907,261
Flow-through share indemnity liability	**89,745**	89,745
Finance fees	**10,799**	21,780
Share issuance costs	**11,570**	26,818
Scientific research and experimental development	**162,716**	162,716
Investment tax credits	**210,600**	210,600
Non-capital losses	**2,492,427**	2,231,499
Total	**3,996,485**	3,650,419
Net of deferred tax liability:		
Equity investments	**(45,768)**	(34,488)
Net deferred tax assets	**3,950,717**	3,615,931
Valuation allowance	**(3,950,717)**	(3,615,931)
Recognized deferred tax assets	**-**	-

As at December 31, 2016, the Company has estimated non-capital losses for Canadian income tax purposes that may be carried forward to reduce taxable income in future years. A summary of these tax losses is provided below.

The accumulated non-capital loss carry forwards expire as follows:

2027	178,670
2028	402,658
2029	1,185,990
2030	1,093,230
2031	1,253,052
2032	1,330,426
2033	958,018
2034	1,139,430
2035	723,338
2036	966,400
	$9,231,212

19 Related party transactions

Related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

a) The following amounts are due from related parties:

During the year ended December 31, 1999, a promissory note was issued to an officer of the Company bearing interest at 3% per annum with no fixed maturity date, unless the officer's employment is terminated or he is petitioned into bankruptcy wherein the note and accrued interest becomes immediately payable. During the year ended December 31, 2014, the Company revised the terms of the loan (the "Revised Promissory Note"), including fixed repayment terms and removing the term securing the note with 393,000 common shares of the Company. Historically the aggregate decline in the fair value of these common shares since the inception of the promissory note would offset the amount payable (December 31, 2013 – fair value allowance $240,789). Under the Revised Promissory Note, a balance of $247,970, including the principal of $218,500 and accrued interest, is payable by the officer to the Company. The payments were to commence on December 31, 2015, and be paid annually in $50,000 tranches until December 31, 2018, with the final payment of $47,970 due on December 31, 2019. Interest is calculated at 1% per annum, and is payable annually commencing December 31, 2015, concurrently with each principal payment. The officer may repay the principal amount in whole or in part at any time. As at December 31, 2016, the officer had not yet paid the initial instalment or the second instalment, and the terms of the payments has been extended to begin on December 31, 2017. The terms of the loan agreement do not provide the Company with recourse to ensure repayment. Thus, the share purchase loan has been presented as a deduction from equity.

b) Additional related party transactions not disclosed elsewhere in these consolidated financial statements are as follows:

(i) Aggregate fees of $22,500 (December 31, 2015 - $30,000) were charged by directors of the Company all of which was recorded in the consolidated statement of comprehensive loss.

(ii) Aggregate fees of $nil (December 31, 2015 - $8,616) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.

(iii) Included in accounts payable at December 31, 2016 was $352,412 owing to officers of the Company (December 31, 2015 - $215,229).

Key management compensation

During the year ended December 31, 2016, $367,023 (December 31, 2014 - $465,276) in management compensation was incurred and charged to general and administrative expense in the consolidated statement of comprehensive loss.

20 Commitments

a) On March 5, 2014, the Company entered into a lease agreement with a related party for the lease of office space. Under a lease agreement, the Company committed to monthly payments of $2,771 for the lease of its office space until November 30, 2016. On December 1, 2016, the Company agreed to continue paying $2,771 on a month to month basis.

b) The Company raised capital through the issuance of flow-through shares in 2009, 2010 and 2011 which provided indemnity to the subscriber for additional taxes payable if the Company was unable to, or failed to, renounce the qualifying expenditures as agreed. The Company was not able to spend $824,338 of the flow-through funds raised. The Company is exposed to costs for the indemnification of the subscribers. The Company has estimated a potential liability on the amount of $332,388 at December 31, 2016 (December 31, 2015 - $332,388). The Company has also estimated a potential liability for penalties and taxes in the amounts of $107,500 (December 31, 2015 - $107,500) and is included in accounts payable and accrued liabilities. The accrued amount is subject to measurement uncertainty due to the tax filing positions of the subscribers, their tax rates and the amount of personal taxes that may be payable and the interpretation of the indemnity agreement, which will not be known until potentially affected subscribers are reassessed for their tax positions by the Canada Revenue Agency and these amounts become known to the Company.

c) During the year ended December 31, 2015, the Company settled a contingent liability totaling $145,512 with a third party who performed oil field services for the Company. The obligation is secured by a take in kind revenue arrangement from one of its gas wells to and in favor of the third party in case of default. The settlement was fair valued at $107,912 using Level II valuation techniques with a discount rate of 25%. The Company is required to make 35 monthly payments of $4,300 starting July 1, 2015 to May 1, 2018 and final installment of $3,800 to be paid on June 1, 2018. As of December 31, 2016, the Company has made 8 payments of $4,300 for total amount paid of $34,271 (December 31, 2015 - $14,988).

21 Supplemental cash flow information

	December 31, 2016	December 31, 2015
	$	$
The Company had the following non-cash transactions:		
Change in estimates in decommissioning obligations (note 11)	**7,002**	10,022
Fair value gain (loss) on available-for-sale investment (note 6)	**(28,199)**	244,093
Other liabilities (note 19)	-	89,941
Carrying value of assets disposed (note 7)	-	(617,288)
Consideration received on sale of PRI (note 6)	-	1,133,500
Shareholder deposit	**800,000**	
Cash interest paid	-	193,539

22 Financial risk management

The Board of Directors oversees management’s establishment and execution of the Company’s risk management framework. Management has implemented and monitors compliance with risk management policies. The Company’s risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company’s activities.

a) Fair values

The Company's financial instruments consist of cash and cash equivalents, short-term investments, available for sale investments, trade and other receivables, accounts payable and accrued liabilities, the shareholder indemnity, the loan, the convertible debt and the demand loan.

Financial instrument	Classification	Carrying value $	Fair value $
Cash and cash equivalents	Fair value through profit and loss	180,642	180,642
Short-term investments	Fair value through profit and loss	68,493	68,493
Trade and other receivables	Loans and receivables	81,159	81,159
Investment in PRI	Available for sale	314,850	314,850
Investment in partnership	Available for sale	442,311	442,311
Accounts payable and accrued liabilities	Other financial liabilities	4,804,713	4,804,713
Shareholder indemnity	Other financial liabilities	332,388	332,388
Loan	Other financial liabilities	1,025,000	1,025,000
Convertible debt	Other financial liabilities	376,000	376,000
Demand loan	Other financial liabilities	123,000	123,000
Short-term loan	Other financial liabilities	314,262	314,262
Other liabilities	Other financial liabilities	71,938	71,938

The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level I are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level II include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level III valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

At December 31, 2016, the Company's cash and cash equivalents and short-term investments have been subject to Level I valuation. The investment held in PRI is level III and the investment in the Partnership is level II.

b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint interest partners and oil and natural gas marketers.

Virtually all of the Company's trade and other receivables are from companies in the oil and gas industry and are subject to normal industry credit risks. Credit risks arise principally from the amounts owing to the Company from oil and natural gas marketers and joint interest partners. Management does not believe that any significant concentration of trade and other receivables exists that will result in any loss to the Company based on past payment experience. Receivables from oil and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish relationships with large marketers. However, the receivables are from participants in the petroleum and natural gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations and escalating costs. The Company does not typically obtain collateral from oil and natural gas marketers or others in the event of non-payment.

At December 31, 2016, the Company's trade and other receivables have been aged as follows:

	December 31, 2016	December 31, 2015
Days outstanding	**$**	$
0-30 days	**1,179**	20,721
31-60 days	**2,185**	22,283
61-90 days	**1,129**	1,093
Greater than 90 days	**76,666**	83,804
Total	**81,159**	127,901

Amounts outstanding for more than 90 days are considered past due. During the year ended December 31, 2016, the Company recovered $52,869 of previously written off trade and other receivables (December 31, 2015 – write off of $49,743). As at December 31, 2016, a provision for doubtful accounts of $48,964 has been recorded by the Company (December 31, 2015 - $101,833).

Cash and cash equivalents consist of cash bank balances held in both interest and non-interest bearing accounts. The Company manages credit exposure of cash by selecting financial institutions with high credit ratings.

c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. At December 31, 2016, the Company's maximum exposure to liquidity risk is the total current liabilities of $7,026,963 (December 31, 2015 - $7,167,145).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	4,804,713	Due within 90 days
Convertible debt (note 14)	376,000	Maturity date of December 31, 2017
Demand loan (note 15)	123,000	Due on demand
Loan (note 13)	1,025,000	Due on demand
Shareholder indemnities (note 20(b))	332,388	Due on demand
Short-term loan (note 16)	314,262	Due on demand
Other liabilities (note 20 (c))	71,938	Maturity date of June 30, 2018

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

To achieve this objective, the Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non operated projects to further manage capital expenditures. The Company also attempts to match its payment cycle with collection of oil and natural gas revenue on the 25th of each month.

d) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's loss or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while maximizing returns.

(i) Commodity price risk:

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar but also world economic events that dictate the levels of supply and demand. All of the Company's oil and gas production is sold at spot rates exposing the Company to the risk of price movements.

The Company had no commodity call options outstanding as at December 31, 2016.

(ii) Currency risk:

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada and the United States and a portion of its expenses are incurred in United States dollars. The Company does not hedge its exposure to fluctuations in the exchange rate. Future changes in exchange rates could have a material effect on the Company's business including its intended capital plans, its financial condition and results of operations.

Certain of the Company's financial instruments are exposed to fluctuations in the United States dollar, including cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities. As at December 31, 2016, an increase or decrease of 10% to the foreign exchange rate between the United States dollar and the

Canadian dollar applied to the average level of United States denominated cash and cash equivalents would have had approximately a $16,100 (December 31, 2015 - $32,800) impact on the Company's comprehensive loss for the year.

(iii) Interest rate risk:

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. As at December 31, 2016, all of the Company's debt, including the loan, the convertible debt, the demand loan and the short-term loan, bears fixed interest rates and accordingly, is not subject to market interest rate fluctuations.

The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2016 or 2015.

e) Capital management

The Company's capital consists of shareholders' deficit, the loan, the convertible debt and working capital. The Company will adjust its capital structure to manage its current and future debt, drilling programs and potential corporate acquisitions through the issuance of shares, sourcing additional debt financing and adjustments to capital spending. The Company's objective for managing capital is to maximize long-term shareholder value by ensuring adequate capital to achieve the Company's objectives. The Company is not subject to any external capital requirements.

Management reviews its capital management approach on an ongoing basis and believes its current approach is reasonable given the size of the Company. There has been no change in management's approach to capital management during the year.

23 Segmented information

The Company's primary operations are limited to a single industry being the acquisition, exploration for and development of petroleum and natural gas.

Product segmentation is as follows:

Revenue	Oil	Natural Gas	NGL's	Electricity	Total
December 31, 2016 ($)	-	13,440	-	-	13,440
December 31, 2015 ($)	-	24,999	-	12,160	37,159

Geographical segmentation is as follows:

	December 31, 2016 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	13,440	-	13,440
Depletion, depreciation and impairment	11,701	310,985	322,686
Net loss	699,700	370,180	1,069,880
Property and equipment	38,958	4,616	43,574
Exploration and evaluation assets	-	1,799,531	1,799,531
Share of investment in PRI	157,425	157,425	314,850
Investment in Partnership	221,156	221,155	442,311
Total liabilities	4,787,352	2,686,263	7,473,615

	December 31, 2015 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	37,159	-	37,159
Equity loss on investment in PRI	25,177	25,177	50,354
Depletion, depreciation and impairment	125,708	245,352	371,060
Net loss	221,152	442,304	663,456
Property and equipment	50,657	10,203	60,860
Exploration and evaluation assets	-	1,940,471	1,940,471
Investment in PRI	171,525	171,524	343,049
Investment in Partnership	221,156	221,155	442,311
Total liabilities	4,920,739	2,750,117	7,670,856