

Emerald Bay Energy Inc.

Consolidated Financial Statements
For the three months ended March 31, 2016
(expressed in Canadian dollars)

NOTICE OF NO AUDITOR REVIEW

In accordance with National Instrument 51-102 Section 4.3(3)(a) released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited Interim Consolidated Financial Statements for the three month period ended March 31, 2016 and 2015.

Emerald Bay Energy Inc.

Consolidated Statements of Financial Position

March 31, 2016 and December 31, 2015

	March 31, 2016	December 31, 2015
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	36,164	403,511
Short-term investments	66,248	70,600
Trade and other receivables (note 17(b))	214,509	127,901
Subscription proceeds receivable (note 14(b))	200,000	-
Prepaid expenses and deposits	80,756	84,118
Total current assets	597,677	686,130
Non-current assets		
Investment in PRI (note 4)	281,403	343,049
Investment in partnership (note 6)	433,123	442,311
Exploration and evaluation assets and other intangible assets (note 7)	1,925,173	1,940,471
Property and equipment (note 8)	52,780	60,860
Total assets	3,290,156	3,472,821
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 17(c))	4,273,140	4,432,878
Shareholder deposit (note 14(b))	-	800,000
Shareholder indemnity (note 16(c))	324,380	332,388
Loan (note 11)	1,025,000	1,025,000
Convertible debt (note 12)	369,805	421,000
Demand loan (note 13)	123,000	123,000
Other liabilities (note 16(d))	32,879	32,879
Total current liabilities	6,148,204	7,167,145
Non-current liabilities		
Other liabilities (note 16(d))	48,068	57,062
Decommissioning obligations (note 9)	453,834	446,649
Total liabilities	6,650,106	7,670,856
Shareholders' deficit		
Share capital (note 14(b))	11,789,518	11,447,478
Warrants (note 14(c))	1,169,446	528,898
Contributed surplus (note 14(f))	1,886,474	1,886,474
Share purchase loan (note 15(i))	(247,970)	(247,970)
Deficit	(18,197,818)	(18,084,385)
Accumulated other comprehensive income (loss)	240,400	271,470
Total shareholders' deficit	(3,359,950)	(4,198,035)
Total liabilities and shareholders' deficit	3,290,156	3,472,821
Reporting entity and going concern (note 1)		
Commitments (note 16)		
Subsequent events (note 20)		

Approved on behalf of the Board of Directors

Signed "Shelby D. Beattie"

Director

Signed "Gibson C. Scott"

Director

Emerald Bay Energy Inc.

Consolidated Statements of Comprehensive Loss For the three months ended March 31, 2016 and 2015

	March 31, 2016	March 31, 2015
	\$	\$
Revenue		
Petroleum and natural gas revenue	3,080	4,637
Royalties	(320)	(473)
	<u>2,760</u>	<u>4,164</u>
Operating expenses		
Production and operating expenses	4,370	9,356
Depletion and depreciation (note 5)	7,414	4,932
General and administrative	50,348	160,093
Foreign exchange gain (loss)		(5,139)
	<u>62,132</u>	<u>169,242</u>
Results from operating activities	<u>(59,372)</u>	<u>(165,078)</u>
Finance expense		
Interest income		
Interest expense	(45,770)	(42,121)
Accretion of decommissioning obligation (note 9)	(852)	(1,505)
Accretion of other liabilities (note 16(d))	(7,439)	-
Net finance expense	<u>(54,061)</u>	<u>(43,626)</u>
Other income and expenses		
Equity loss on investment in PRI (note 4)	-	(50,354)
Net other income and expenses	<u>-</u>	<u>(50,354)</u>
Net loss for the period	<u>(113,433)</u>	<u>(259,058)</u>
Other comprehensive income (loss)		
Foreign currency translation adjustment	39,764	(24,292)
Net loss on available for sale financial assets	(70,834)	-
Total comprehensive loss for the period	<u>(144,503)</u>	<u>(283,350)</u>
Basic and fully diluted loss per share(note 14(g))		
Weighted average number of common shares outstanding during the period		

Emerald Bay Energy Inc.

Statements of Changes in Deficit

For the period ended March 31, 2016

	Share capital	Warrants	Contributed surplus	Share purchase loan	Deficit	Accumulated other comprehensive loss	Total deficit
	\$	\$	\$	\$	\$	\$	\$
				(Restated – note 19)			(Restated – note 19)
Balance, December 31, 2014	11,341,263	635,113	1,824,074	(247,970)	(17,420,929)	(5,025)	(3,873,474)
Loss for the period	-	-	-	-	(259,058)	-	(259,058)
Foreign exchange translation to presentation currency	-	-	-	-	-	(24,292)	(24,292)
Balance, March 31, 2015	11,341,263	635,113	1,824,074	(247,970)	(17,679,987)	(29,317)	(4,156,824)
Balance, December 31, 2015	11,447,478	528,898	1,886,474	(247,970)	(18,084,385)	271,470	(4,198,035)
Proceeds received pursuant to private placements	348,101	651,899	-	-	-	-	1,000,000
Cash share issue costs	(6,061)	(11,351)	-	-	-	-	(17,412)
Loss for the period	-	-	-	-	(113,433)	-	(113,433)
Movement in available for sale assets	-	-	-	-	-	(70,834)	(70,834)
Foreign exchange translation to presentation currency	-	-	-	-	-	39,764	39,764
Balance, March 31, 2016	11,789,518	1,169,446	1,886,474	(247,970)	(18,197,818)	240,400	(3,359,950)

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Consolidated Statements of Cash Flows

For the three months ended March 31, 2016 and 2015

	March 31, 2016	March 31, 2015
	\$	\$
Cash (used in) provided by:		
Operating activities		
Net loss for the period	(113,433)	(259,058)
Adjustments for:		
Depletion and depreciation (note 5)	7,414	4,932
Accretion of other liabilities (note 16(d))	7,439	-
Accretion of decommissioning obligation (note 9)	852	1,505
Equity pick-up on investment in PRI (note 4)	-	50,354
Unrealized foreign exchange (gain) loss	104,847	(59,505)
	<u>7,119</u>	<u>(261,772)</u>
Change in accounts receivable	(86,608)	53,740
Change in prepaid expenses and deposits	3,362	7,897
Change in accounts payable and accrued liabilities	(159,738)	(80,189)
Change in shareholder indemnity (note 16(c))	(8,008)	-
	<u>(243,873)</u>	<u>(280,324)</u>
Investing activities		
Property and equipment expenditures (note 5)	-	(6,878)
Exploration and evaluation expenditures (note 7)	(93,981)	(32,681)
Change in short-term investments	4,352	(5,433)
Change in accounts payable and accrued liabilities	-	136,565
	<u>(89,629)</u>	<u>91,573</u>
Financing activities		
Share issue costs (note 14(b))	(17,412)	-
Repayment of long term debt	-	(6,758)
Receipt of loan (note 12)	-	75,000
Repayment of other liabilities (note 16(d))	(16,433)	-
Repayment of bank loan (note 10)	-	(3,740)
	<u>(33,845)</u>	<u>64,502</u>
Change in cash and cash equivalents	(367,347)	(124,249)
Cash and cash equivalents, beginning of period	403,511	169,556
Cash and cash equivalents, end of period	36,164	45,307

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements
For the three months ended March 31, 2016 and 2015

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 and Texas. 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 March 31, 2016, the Company had not yet achieved profitable operations, had an accumulated a deficit of \$18,197,818 since its inception (December 31, 2015 - \$18,084,385), had negative cash flows from operations of \$243,873 (December 31, 2015 - \$289,182) and had a working capital deficiency of \$5,550,527 (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 have been 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.

Emerald Bay Energy Inc.

Notes to the Consolidated Financial Statements For the three months ended March 31, 2016 and 2015

2 Basis of presentation

a) Statement of compliance:

The interim condensed consolidated financial statement have been prepared in accordance with International Accounting Standards (“IAS”) 34 – *“Interim Financial Reporting”* as issued by the International Accounting Standards Board (“IASB”) using the accounting policies and methods of computation disclosed in the Company’s audited consolidated financial statements for the year ended December 31, 2015. These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2015 and exclude certain disclosures required to be included in annual consolidated financial statements.

The Board of Directors approved the consolidated financial statements on August 3, 2016.

b) Basis of measurement:

The interim consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments, which are measured at fair value, as explained in note 3 – Significant Accounting Policies included in the Company’s audited consolidated financial statements for the year ended December 31, 2015.

c) Basis of consolidation:

These consolidated financial statements include the accounts of the Company and its US 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 ‘Accumulated Deficit’.

‘Contributed Surplus’ is used to recognize the value of stock options and broker warrants prior to exercise.

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Notes to the Consolidated Financial Statements For the three months ended March 31, 2016 and 2015

'Accumulated Other Comprehensive Loss' is the foreign exchange gain or loss resulting from the translation of the Corporation's foreign subsidiary.

'Accumulated 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:

In preparing these interim condensed consolidated financial statements, management makes judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

The significant judgments made by management in applying the accounting policies and the key sources of estimation uncertainty were the same as those that applied to the audited annual consolidated financial statements as at and for the year ended December 31, 2015.

3 Recent accounting pronouncements

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

IFRS 15 – "Revenue from contracts with customers", replaces International Accounting Standard 11, "Construction Contracts" ("IAS 11"), IAS 18, "Revenue" ("IAS 18"), and several revenue-related interpretations. IFRS 15 establishes a single revenue recognition framework that applies to contracts with customers. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. Disclosure requirements have also been expanded. This IFRS becomes effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted. The standard may be applied retrospectively or using a modified retrospective approach. The Company is currently evaluating the impact of adopting IFRS 15 on the consolidated financial statements.

IFRS 9 – "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39 – "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. This IFRS becomes effective for periods beginning on or after January 1, 2018. The Company has not yet begun the process of assessing the impact of the new standard on the consolidated financial statements.

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IFRS 16 – “Leases” was issued January 2016 and replaces IAS 17 Leases. The standard introduces a single lessee accounting model for leases with required recognition of assets and liabilities for most leases. The standard is effective for fiscal years beginning on or after January 1, 2019 with early adoption permitted if the Company is also applying IFRS 15 – “Revenue from Contracts with Customers”. IFRS 16 will be adopted by the Company on January 1, 2019 and the Company is currently evaluating the impact of the standard on the consolidated financial statements.

4 Equity investment in PRI

On June 29, 2015, the Company disposed of 60% of its ownership in Production Resources Inc. (“PRI”) for proceeds of \$1,291,500 to a party with an existing shareholding in PRI, and whose President is the Lender (note 11). The proceeds received were used to settle working capital and debt commitments. A gain was recorded in the statement of comprehensive income for \$526,799 for the difference between the proceeds received and the cost of the investment. This difference was recorded as a gain in the income statement. The disposition reduced the Company’s interest in the share capital of PRI from 25% to 10%, and accordingly the Company no longer accounts for the investment using the equity investment.

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

	CDN \$
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 March 31, 2016	(61,646)
Net investment, March 31, 2016	281,403

The investment in PRI is designated an available for sale financial instrument. The investment was fair valued at the date of the sale, again at December 31, 2015 and at March 31, 2016 with the change in fair value being taken to other comprehensive income.

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5 Property and equipment

	Oil and natural gas interests	Corporate and Other	Total
	\$	\$	\$
Cost, December 31, 2015	4,227,898	327,434	4,555,332
Revisions in decommissioning liability	(72)	-	(72)
Foreign currency translation	-	(1,152)	(1,152)
Cost, March 31, 2016	4,227,826	326,282	4,554,108
Accumulated depletion, depreciation and impairment, beginning of period	(4,192,339)	(302,133)	(4,494,472)
Depreciation and depletion for the period	(1,225)	(6,189)	(7,414)
Foreign currency translation	-	558	558
Carrying value, March 31, 2016	34,262	18,518	52,780

	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)	-	(825,651)
Foreign currency translation	-	-	3,392	3,392
Cost, December 31, 2015	4,227,898	-	327,434	4,555,332
Accumulated depletion, depreciation and impairment, beginning of period	(4,300,633)	-	(275,053)	(4,575,686)
Disposal of oil and natural gas interests	203,938	4,427	-	208,365
Depreciation and depletion for the period	(17,997)	(4,427)	(25,637)	(48,061)
Impairment of oil and natural gas interests (note 8)	(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

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Notes to the Consolidated Financial Statements For the three months ended March 31, 2016 and 2015

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 6).

6 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 10), which was also transferred to the Partnership), resulting in a gain on disposition of \$45,269.

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

	CDN \$
Net investment, December 31, 2015	\$442,311
Fair value adjustment at March 31, 2016	(9,188)
Net investment, March 31, 2016	<u>433,123</u>

7 Exploration and evaluation assets

	E&E assets \$
Balance, December 31, 2014	<u>1,571,666</u>
Additions	329,087
Revisions in decommissioning liability	11,376
Impairment (note 8)	(245,352)
Foreign currency translation	273,694
Balance, December 31, 2015	<u>1,940,471</u>
Additions	103,904
Revisions in decommissioning liability	396
Foreign currency translation	(119,598)
Balance, March 31, 2016	<u>1,925,173</u>

E&E assets consist of the Company's exploration projects which are pending the determination of technological feasibility and commercial viability. As at March 31, 2016, the Company incurred an amount of \$103,904 of E&E expenditures (December 31, 2015 - \$329,087). The

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additions represent the acquisition of undeveloped land and drilling activity within Texas. These E&E assets will be transferred to property and equipment when technological feasibility and commercial viability have been established. During the year ended December 31, 2015 indicators of impairment were identified and an impairment test was completed. Impairment of \$245,352 was recognized in the year.

8 Impairment loss

As at December 31, 2015, the Company reviewed its oil and gas assets for indicators of impairment such as changes in future prices, future costs and reserves. Based on this review, certain of the Company's CGUs were tested for impairment. The recoverable amount of each CGU was estimated based on the higher of the value in use and the FVLCTS. The estimate of FVLCTS was determined using a discount rate of 15% and forecasted cash flows, with escalating prices and future development costs, as obtained from the reserve report. The prices used to estimate the FVLCTS are those used by independent industry reserve engineers.

In light of a decline in natural gas prices, impairment tests were conducted at December 31, 2015 on the Company's oil and gas properties CGUs. The estimated recoverable amounts were determined using fair value less cost to sell. In determining the recoverability of gas interests and making these evaluations, the Company used the net present value of the cash flows from the proved plus probable reserves of oil and gas properties CGU as estimated by the Company's independent reserve evaluator.

Key input estimates used in the determination of cash flows from the oil and gas reserves include the following:

- a) 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.
- b) Natural gas prices – Forward price estimates of the crude oil and natural gas prices are used in the cash flow model. Commodity prices have fluctuated widely in recent years due to global and regional factors including supply and demand fundamentals, inventory levels, exchange rates, weather, economic and geopolitical factors.
- c) Discount rate – The discount rate used to calculate the net present value of cash flows is 15% pre-tax.

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Notes to the Consolidated Financial Statements For the three months ended March 31, 2016 and 2015

For the year ended December 31, 2015, the Company recorded an impairment of \$77,647 on its oil and gas properties CGU. The impairment was recognized because the carrying value exceeded the recoverable amount. The fair value less cost to sell values used to determine the recoverable amounts of the impaired PP&E assets are classified as Level 3 fair value measurements.

The E&E asset impairment is \$245,352 for the year ended December 31, 2015. 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.

9 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 \$453,834 as at March 31, 2016 (December 31, 2015 - \$446,649) based on an undiscounted total future liability of \$463,318 (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 0.54% -1.86% (December 31, 2015 – 2% and 0.48% - 2.03%, respectively).

	March 31, 2016	December 31, 2015
	\$	\$
Balance, beginning of period	446,649	510,604
Disposals	-	(94,803)
Liabilities incurred	9,923	12,183
Revisions (changes in estimates)	323	(1,498)
Accretion	852	6,032
Foreign currency translation	(3,913)	14,131
Balance, end of period	453,834	446,649

During the year ended December 31, 2015, the Alberta Energy Regulators transferred certain licenses to a third party corporation. The Company had previously impaired these licenses to \$nil and as such recorded a gain of \$76,840 within the statement of loss and comprehensive loss representing the removal of the decommissioning liability.

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Notes to the Consolidated Financial Statements For the three months ended March 31, 2016 and 2015

10 Bank loan

On July 10, 2014, the Company and its joint venture 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 was to mature on June 14, 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 6).

11 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 until 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 that compounds monthly (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 the 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 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

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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 the three months ended March 31, 2016, the Company incurred interest of \$25,625 (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 4) to repay \$500,000 to the Lender.

The following table summarizes the accounting of the Loan:

	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 March 31, 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 US 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.

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12 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 loan with a maturity date of one year. Pursuant to the Loan Agreement, if it is mutually agreed upon by both parties, the maturity date can be extended by an additional year. On January 1, 2014 and March 31, 2015, it was mutually agreed upon between the Lender and the Company to extend the loan under the same terms for an additional year to December 31, 2014 and December 31, 2015, respectively. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount monthly.

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, or any portion outstanding, may be 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 is treated consistently with the conversion feature included on the Loan (note 11). Any accrued interest thereon may also be converted in to common shares, in accordance with the regulatory policies.

On the January 1, 2014 extension, the terms of the conversion feature were changed to establish the conversion price to be \$0.05 per common share, and accordingly, \$72,572 of the principal amount of the loan was classified as a derivative financial liability. All other terms and conditions remain the same. At December 31, 2014, the loan had matured and the derivative liability that was recognized was removed and recorded as a gain on the derecognition of the derivative financial liability in the consolidated statement of loss as finance expense. As at December 31, 2015, the conversion feature on the March 26, 2015 extension had not yet received regulatory approval and accordingly no value has been assigned to this feature. All other terms and conditions of the extension remain unchanged.

On March 26, 2015, the Lender advanced an additional loan amount of \$54,191USD (December 31, 2014 – additional amount of \$100,000 USD) to the Company under the same terms as the Loan Agreement. However, the additional advances were not included in the conversion feature. 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 three months ended March 31, 2016, the Company incurred interest of \$12,869 (December 31, 2015 - \$94,236) on the aggregate amount owing under the convertible debt.

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The following table summarizes the accounting of the promissory note in USD:

	Total \$
Balance, December 31, 2014	250,000
Receipt of additional funds	54,191
Balance, December 31, 2015	304,191
Foreign currency translation	(19,441)
Balance, March 31, 2016	284,750

13 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 will be 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 March 31, 2016, the Company has drawn \$123,000 against the Demand Loan and has accrued interest of \$7,635. The Company may repay the Demand Loan in full at any time prior to demand without notice or penalty.

14 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 14(c))	-	127,007
Issue costs for expired warrants	-	(20,792)
Balance, December 31, 2015	158,610,189	11,447,478
Private placement (i)	50,000,000	1,000,000
Value of warrants issued pursuant to private placement (i)	-	(651,899)
Share issue costs (i)	-	(6,061)
Balance, March 31, 2016	208,610,189	11,789,518

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- (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”). 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 \$651,899 of the unit value to warrants (note 14(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.

As at March 31, 2016, the Company has not collected \$200,000 of the proceeds pursuant to the Private Placement.

c) Warrants

Warrants to acquire common shares outstanding at March 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
Share purchase warrants issued (note 14(b)(i))	50,000,000	651,899	0.05	0.89
Share issue costs (note 14(b)(i))	-	(11,351)	-	-
Balance, March 31, 2016	64,938,500	1,169,446	0.05	0.78

During the year ended December 31, 2015, the expiry date of 11,175,000 and 3,763,500 of the outstanding warrants was extended from August 22, 2015 and September 3, 2015, respectively, to August 22, 2016 and September 3, 2016.

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’ equity. 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	240.00%
Fair value per warrant	\$0.013

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

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Notes to the Consolidated Financial Statements For the three months ended March 31, 2016 and 2015

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 three months ended March 31, 2016, there were no stock options granted, cancelled, exercised or expired unexercised. The following table summarizes information about the Company's stock options outstanding at March 31, 2016:

	March 31, 2016		December 31, 2015	
	Number of options	Weighted Average Exercise price \$	Number of options	Weighted Average Exercise price \$
Stock options, beginning of period	11,625,000	0.07	14,030,000	0.08
Expired	-	-	(2,405,000)	-
Stock options outstanding, end of period	11,625,000	0.07	11,625,000	0.07

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

Exercise prices (\$)	Options outstanding	Weighted average remaining term (years)	Weighted average exercise price (\$)
0.05	6,700,000	2.55	0.05
0.10	4,925,000	0.40	0.10

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

During the three months ended March 31, 2016, the Company recognized share-based payment expense of \$nil in the statement of comprehensive loss (March 31, 2015 - \$nil). Volatility was determined based on the Company's historical share prices.

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e) Finders options

During the year ended December 31, 2014, the Company issued 1,385,500 finders options (the "Finders Options") to the those who facilitated a private placement. Each Finders Options was exercisable into one unit consisting of one common share and one common share purchase warrant ("Finder Warrant") of the Company at \$0.05 per unit. Each Finder Warrant was exercisable into one common share of the Company at \$0.05 per common share. The Finders Options expired one year from the original grant date. The Finders Options were valued at \$58,656, and expired during the year ended December 31, 2015. The warrant embedded within the Finders Options B were not separately valued.

f) Contributed surplus

	March 31, 2016	December 31, 2015
	\$	\$
Balance, beginning of period	1,886,474	1,824,074
Expiry of conversion feature debt (note 11)	-	62,400
Balance, end of period	<u>1,886,474</u>	<u>1,886,474</u>

g) Per share data

Basic earnings per share are calculated based on the weighted average number of shares outstanding during the period. 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 period.

All warrants 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.

15 Related party transactions

Related party transactions not disclosed elsewhere in these Consolidated Financial Statements are as follows:

- (i) 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

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these common shares since the inception of the promissory note would offset the amount payable. 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 will commence December 31, 2015, and will 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, 2015, the officer had not yet paid the initial instalment, and the term of the initial payment has been extended until December 31, 2016. 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.

Additional related party transactions not disclosed elsewhere in these Consolidated Financial Statements are as follows:

- (i) Aggregate fees of \$nil (March 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.
- (ii) Included in accounts payable at March 31, 2016 was \$239,419 owing to officers of the Company (December 31, 2015 - \$215,229).

16 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 has committed to monthly payments of \$2,771 for the lease of its office space until November 30, 2016.
- b) The Company has entered into various vehicle loan agreements and as at December 31, 2015, the Company has operating lease commitments of \$18,374 in each of 2016, 2017 and 2018, and \$17,311 in 2019.
- c) 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 \$324,380 at March 31, 2016 (December 31, 2015 - \$332,388). The Company has also estimated a potential liability for penalties and taxes on

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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.

- d) 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 2 valuation techniques with a discount rate of 25%. The Company is required to make 35 monthly payment of \$4,300 starting July 1, 2015 to May 1, 2018 and a final installment of \$3,800 to be paid on June 1, 2018.

17 Financial risk management

The Board of Directors oversees managements' 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, trade and other receivables, subscription proceeds receivable, investment in PRI, investment in the partnership, accounts payable and accrued liabilities, the shareholder indemnity, the loan, the convertible debt, demand loan and other liabilities.

Financial Instrument	Classification	Carrying Value \$	Fair Value \$
Cash and cash equivalents	Fair value through profit and loss	36,164	36,164
Short-term investments	Fair value through profit and loss	66,248	66,248
Trade and other receivables	Loans and receivables	214,509	214,509
Subscription proceeds receivable	Loans and receivables	200,000	200,000
Investment in PRI	Available for sale	281,403	281,403
Investment in partnership	Available for sale	433,123	433,123
Accounts payable and accrued liabilities	Other financial liabilities	4,273,140	4,273,140
Shareholder indemnity	Other financial liabilities	324,380	324,380
Loan	Other financial liabilities	1,025,000	1,025,000
Convertible debt	Other financial liabilities	369,805	369,805

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Demand loan	Other financial liabilities	123,000	123,000
Other liabilities	Other financial liabilities	80,947	80,947

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 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

At March 31, 2016, the Company's cash and cash equivalents and short-term investments have been subject to Level 1 valuation.

(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 venture 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 venture 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 petroleum 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 petroleum and natural gas marketers or others in the event of non-payment.

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

	March 31, 2016	December 31, 2015
Days outstanding	\$	\$
0-30 days	14,786	20,721
31-60 days	1,204	22,283
61-90 days	7,397	1,093
Greater than 90 days	191,122	83,804
Total	214,509	127,901

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Amounts outstanding for more than 90 days are considered past due. During the three months ended March 31, 2016, the Company wrote off \$nil of trade and other receivables (December 31, 2015 - \$49,743). As at March 31, 2016, a provision for doubtful accounts of \$101,833 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 March 31, 2016, the Company's maximum exposure to liquidity risk is the total current liabilities of \$6,148,204 (December 31, 2015 - \$7,167,145).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	4,273,140	Due within 90 days
Loan (note 11)	1,025,000	Due on demand
Convertible debt (note 12)	369,805	Maturity date of December 31, 2016
Demand loan (note 13)	123,000	Due on demand
Shareholder indemnities (note 16(c))	324,380	Due on demand
Other liabilities (note 16(d))	32,879	Due within 12 months

The Company has entered into lease agreements on office premises for its various locations. Future minimum annual lease payments under the lease agreement are as follows:

2017	\$30,481
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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

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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 March 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 US 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 US dollar, including cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities. As at March 31, 2016, an increase or decrease of 10% to the foreign exchange rate between the US dollar and the Canadian dollar applied to the average level of US denominated cash and cash equivalents would have had approximately a \$2,000 impact on the Company's comprehensive loss for the period.

(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 March 31, 2016, all of the Company's debt, including the the loan, the convertible debt and the demand 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 three months ended March 31, 2016.

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Notes to the Consolidated Financial Statements For the three months ended March 31, 2016 and 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 period.

18 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:

	Oil	Natural Gas	NGL's	Electricity	Total
March 31, 2016 (\$)	-	3,080	-	-	3,080
March 31, 2015 (\$)	1,221	-	19	3,397	4,637

Geographical segmentation is as follows:

	March 31, 2016 (\$)		
	Canada	United States	Total
Petroleum and natural gas sales	3,080	-	3,080
Depletion, depreciation and impairment	6,798	616	7,414
Net loss	136,767	(23,334)	113,433
Property and equipment	43,789	8,991	52,780
Exploration and evaluation assets	-	1,925,173	1,925,173
Share of investment in PRI	140,702	140,701	281,403
Total liabilities	4,398,755	2,251,351	6,650,106

	March 31, 2015 (\$)		
	Canada	United States	Total
Petroleum and natural gas sales	4,637	-	4,637
Equity income (loss) on investment in PRI	25,177	25,177	50,354
Depletion, depreciation and impairment	4,165	767	4,932

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Net loss	236,235	22,823	259,058
Property and equipment	247,961	11,688	259,649
Exploration and evaluation assets	-	1,740,030	1,740,030
Share of investment in PRI	123,695	123,695	247,390
Total liabilities	4,592,651	2,137,476	6,730,127

19 Restatement

During the preparation of the December 31, 2015 Consolidated Financial Statements, it was determined that the Company's prior year Consolidated Financial Statements required correction for the following reason:

Previously, the Company had recognized an amount due from a related party to a share purchase loan. The terms of the loan agreement do not provide the Company with recourse to ensure repayment. Thus, the share purchase loan receivable should have been presented as a deduction from equity. The summary of the adjustments to the three months ended March 31, 2015 is as follows:

	As Previously Reported	Adjustments	As Restated
March 31, 2015	\$	\$	\$
Share purchase loan	-	247,970	247,970
Shareholder deficit	(3,908,854)	(247,970)	(4,156,824)

The impact on the annual Consolidated Financial Statements for the year ended December 31, 2015 and 2014 is as follows:

	As Previously Reported	Adjustments	As Restated
January 1, 2014	\$	\$	\$
Due from related parties	10,459	(10,459)	-
Share purchase loan	-	247,970	247,970
Deficit	15,929,544	(237,511)	15,692,033
December 31, 2014			
Due from related parties	247,970	(247,970)	-
Share purchase loan	-	247,970	247,970
Opening deficit	15,929,544	237,511	16,167,055
Recovery of due from related parties	(237,511)	(237,511)	-