Emerald Bay Energy Inc.

Consolidated Financial Statements
June 30, 2014
(expressed in Canadian dollars)
(unaudited)

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 and six month period ended June 30, 2014 and 2013.

Emerald Bay Energy Inc.

Consolidated Statements of Financial Position

June 30, 2014 and December 31, 2013

(unaudited)

	June 30, 2014	December 31, 2013
	$	$
Assets		
Current assets		
Cash and cash equivalents	**103,130**	160,886
Short-term investments	**54,429**	54,256
Trade and other receivables (note 14(b))	**412,122**	461,087
Prepaid expenses and deposits	**37,616**	51,401
Due from related parties (note 12(a))	**13,710**	10,459
Total current assets	**621,007**	738,089
Non-current assets		
Equity investment in PRI (note 4)	**399,447**	332,678
Exploration and evaluation assets and other intangible assets (note 6)	**1,390,864**	1,235,329
Property and equipment (note 5)	**491,081**	462,210
Total assets	**2,902,399**	2,768,306
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 14(c))	**3,773,736**	3,463,919
Shareholder indemnity (note 14(c))	**333,551**	333,551
Loan (note 8)	**1,266,323**	1,200,000
Convertible debt (note 9)	**149,914**	159,540
Derivative liability (note 9)	**116,837**	-
Current portion of long-term debt (note 13(b))	**24,967**	26,109
Total current liabilities	**5,665,328**	5,183,119
Non-current liabilities		
Long-term debt (note 13(b))	**4,151**	15,869
Decommissioning obligations (note 7)	**616,376**	559,751
Total liabilities	**6,285,855**	5,758,739
Shareholders' deficit		
Share capital (note 10(b))	**11,410,774**	10,601,224
Warrants (note 10(c))	**(40,783)**	675,057
Contributed surplus (note 10(f))	**1,671,327**	1,664,311
Deficit	**(16,419,563)**	(15,929,544)
Accumulated other comprehensive loss	**(5,211)**	(1,481)
Total shareholders' deficit	**(3,383,456)**	(2,990,433)
Total liabilities and shareholders' deficit	**2,902,399**	2,768,306

Reporting entity and going concern (note 1)
Commitments (note 13)
Subsequent events (note 8 and note 16)

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 three and six months ended June 30, 2014 and 2013

(unaudited)

	Three months ended June 30, 2014 $	Three months ended June 30, 2013 $	**Six months ended June 30, 2014 $**	Six months ended June 30, 2013 $
Revenue				
Petroleum and natural gas revenue	**28,164**	54,748	**55,310**	77,384
Royalties	**(8,107)**	(6,386)	**(9,836)**	(6,128)
	20,057	48,362	**45,474**	71,256
Operating expenses				
Production and operating expenses	**23,141**	35,356	**52,968**	44,298
Depletion and depreciation (note 5)	**16,272**	27,808	**38,134**	46,781
General and administrative	**232,971**	315,429	**362,297**	525,409
Share-based payment expense (note 10(d))	**2,086**	-	**7,016**	-
	274,470	378,593	**460,415**	616,488
Results from operating activities	**(254,413)**	(330,231)	**(414,941)**	(545,232)
Finance expense				
Interest income	**1,706**	23,580	**3,322**	25,220
Interest expense	**(41,854)**	(35,503)	**(77,286)**	(70,991)
Foreign exchange gain (loss)	**-**	-	**987**	(472)
Accretion of decommissioning obligation (note 7)	**(4,417)**	(1,164)	**(8,837)**	(2,194)
Loan financing expense (note 8)	**(60,033)**	(31,443)	**(60,033)**	(62,540)
Accretion of convertible debt (note 9)	-	(33,267)	-	(66,027)
Gain on fair value derivative liability (note 9)	-	13,650	-	49,266
Net finance expense	**(104,598)**	(64,147)	**(141,847)**	(127,738)
Other income and expenses				
Equity income on investment in PRI (note 4)	**23,987**	32,136	**66,769**	88,064
Net other income and expenses	**23,987**	32,136	**66,769**	88,064
Net loss for the period	**(335,024)**	(362,242)	**(490,019)**	(584,906)
Other comprehensive income (loss)				
Foreign currency translation adjustment	**6,773**	-	**(3,730)**	-
Total comprehensive loss for the period	**(328,251)**	(362,242)	**(493,749)**	(584,906)
Basic and fully diluted loss per share (note 10(g))	**(0.00)**	(0.00)	**(0.00)**	(0.00)
Weighted average number of common shares outstanding during the period	**140,671,689**	140,409,601	**140,671,689**	136,586,882

The notes are an integral part of these Consolidated Financial Statements.

Emerald Bay Energy Inc.

Statements of Changes in Deficit

For the six months ended June 30, 2014 and 2013

(unaudited)

	Share capital	Warrants	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total deficit
Balance, December 31, 2012	9,806,332	1,274,721	1,135,960	(13,778,755)	(2,624)	(1,564,366)
Issuance of common shares	397,500	-	-	-	-	397,500
Issue of warrants	(141,188)	141,188	-	-	-	-
Share issue costs	(35,515)	(19,562)	16,818	-	-	(38,259)
Fair value reallocation on expiry of warrants	39,677	(39,677)	-	-	-	-
Loss for the period	-	-	-	(584,906)	-	(584,906)
Foreign exchange translation to presentation currency	-	-	-	-	8,553	8,553
Balance, June 30, 2013	10,066,806	1,356,670	1,152,778	(14,363,661)	5,929	(1,781,478)
Balance, December 31, 2013	**10,601,224**	**675,057**	**1,664,311**	**(15,929,544)**	**(1,481)**	**(2,990,433)**
Share-based payment expense	**-**	**-**	**7,016**	**-**	**-**	**7,016**
Loss for the period	**-**	**-**	**-**	**(490,019)**	**-**	**(490,019)**
Fair value reallocation on expiry of warrants	**809,550**	**(809,550)**	**-**	**-**	**-**	**-**
Issue of warrants	**-**	**93,710**	**-**	**-**	**-**	**93,710**
Foreign exchange translation to presentation currency	**-**	**-**	**-**	**-**	**(3,730)**	**(3,730)**
Balance, June 30, 2014	**11,410,774**	**(40,783)**	**1,671,327**	**(16,419,563)**	**(5,211)**	**(3,383,456)**

The notes are an integral part of these Consolidated Financial Statements.

Emerald Bay Energy Inc.

Consolidated Statements of Cash Flows

For the six months ended June 30, 2014 and 2013

(unaudited)

	June 30, 2014	June 30, 2013
	$	$
Cash (used in) provided by:		
Operating activities		
Net loss for the period	**(490,019)**	(584,906)
Adjustments for:		
Depletion and depreciation (note 5)	**38,134**	46,781
Accretion of decommissioning obligation (note 7)	**8,837**	2,194
Equity pick-up on investment in PRI (note 4)	**(66,769)**	(88,064)
Unrealized foreign exchange	**(7,136)**	17,682
Share-based payment expense	**7,016**	-
Loan financing expense (note 8)	**60,033**	62,540
Accretion of convertible debt (note 9)	**-**	66,027
Gain on removal of derivative liability (note 9)	**-**	(49,266)
	(449,904)	(527,012)
Change in accounts receivable	**48,965**	6,104
Change in prepaid expenses and deposits	**13,785**	(11,547)
Change in accounts payable and accrued liabilities	**(92,774)**	250,191
Change in due to related party	**(3,251)**	(3,251)
	(483,179)	(285,515)
Investing activities		
Property and equipment expenditures (note 5)	**(20,617)**	(24,397)
Exploration and evaluation expenditures (note 6)	**(150,219)**	(664,098)
Change in short-term investments	**(173)**	(2,845)
Change in accounts payable and accrued liabilities	**302,592**	334,808
	131,583	(356,532)
Financing activities		
Proceeds from issuance of common shares, net of issue costs	**-**	359,241
Repayment of long term debt	**(12,860)**	(12,160)
Receipt of loan (note 8 and note 9)	**206,700**	-
Change in accounts payable and accrued liabilities	**100,000**	-
	293,840	347,081
Change in cash and cash equivalents	**(57,756)**	(294,966)
Cash and cash equivalents, beginning of period	**160,886**	532,130
Cash and cash equivalents, end of period	**103,130**	237,164

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 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 June 30, 2014, the Company had not yet achieved profitable operations, had accumulated a deficit of $16,419,563 since its inception (December 31, 2013 - $15,929,544), had negative cash flows from operations of $483,179 (December 31, 2013 - $19,622) and had a working capital deficiency of $5,044,321 (December 31, 2013 - $4,445,030) (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. Subsequent to June 30, 2014, the Company successfully completed a private placement (note 16). All of these factors, together with weak natural gas prices and the current unstable economic conditions, indicate the existence of material uncertainies 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 Interim 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 Interim Consolidated Financial Statements if the Company ceases to be a going concern could be material. These Interim Consolidated Financial Statements are dated August 28, 2014.

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, 2013. These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2013 and exclude certain disclosures required to be included in annual consolidated financial statements.

b) Judgments and estimates:

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, 2013.

3 Recent accounting pronouncements

The following standard has been issued and is effective for annual periods beginning on or after January 1, 2018. The Company has not yet begun the process of assessing the impact that the new standard will have on its 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.

4 Equity investment in PRI

The Company has an ownership interest in Production Resources Inc ("PRI") of 25%. The Company has accounted for the investment using the equity method.

During the year ended December 31, 2011, the Company advanced an additional $215,906 to PRI, which was deemed to form part of the value of the Company's net investment in PRI. During the year ended December 31, 2013, PRI repaid the advanced funds in full, including accrued interest of $29,135; the intercompany portion was eliminated on consolidation. The Company maintains a 25% ownership in PRI based on the 25% ownership in the share capital of PRI.

The investment in PRI as at June 30, 2014 is as follows:

	CDN $
Net investment, December 31, 2012	568,306
Proportionate share of income for the period	(19,722)
Repayment of advanced funds	(215,906)
Net investment, December 31, 2013	332,678
Proportionate share of income for the period	66,769
Net investment, June 30, 2014	399,447

Summarized financial information for PRI as at and for the six months ended June 30, 2014, is presented in the following table. The amounts have been translated from PRI's reporting currency of USD to CAD at the June 30, 2014 exchange rate of $1.067 and the average rate for the six months ended June 30, 2014 of $1.097:

	USD $	CDN $
Current assets		
Cash	94,918	101,278
Other current assets	356,096	379,954
	451,014	481,232
Property and equipment	3,558,606	3,797,033
Total assets	4,009,620	4,278,265
Current liabilities		
Trade and other accounts payable	156,486	166,971
Other current liabilities	2,883	3,076
	159,369	170,047
Long-term debt	3,592,657	3,833,365
	3,752,026	4,003,412

	USD $	CDN $
Revenue	1,015,337	1,113,623
Operating expenses	(200,638)	(220,060)
Depletion and depreciation	(201,726)	(221,253)
Interest expense	(190,993)	(209,481)
General and administrative	(174,214)	(191,078)
Other expenses	(4,262)	(4,675)
Net income and comprehensive income	243,504	267,076

5 Property and equipment

	Oil and natural gas interests $	Corporate and Other $	Total $
Cost, December 31, 2013	4,306,882	317,297	4,624,179
Additions	20,617	-	20,617
Revisions in decommissioning liability	46,321	-	46,321
Foreign currency translation	-	43	43
Cost, June 30, 2014	4,373,820	317,340	4,691,160
Accumulated depletion, depreciation and impairment	(3,904,320)	(257,649)	(4,161,969)
Depreciation and depletion for the period	(30,024)	(8,110)	(38,134)
Foreign currency translation	-	24	24
Carrying value, June 30, 2014	439,476	51,605	491,081

	Oil and natural gas interests $	Corporate and Other $	Total $
Cost, December 31, 2012	4,241,901	307,436	4,549,337
Additions	10,552	9,322	19,874
Revisions in decommissioning liability	387,036	-	387,036
Disposal of oil and natural gas interests	(316,757)	-	(316,757)
Foreign currency translation	(15,850)	539	(15,311)
Cost, December 31, 2013	4,306,882	317,297	4,624,179
Accumulated depletion, depreciation and impairment	(3,541,276)	(236,167)	(3,777,443)
Depreciation and depletion for the period	(95,864)	(21,390)	(117,254)
Disposal of oil and natural gas interests	283,868	-	283,868
Impairment of oil and natural gas interests	(550,965)	-	(550,965)
Foreign currency translation	(83)	(92)	(175)
Carrying value, December 31, 2013	402,562	59,648	462,210

During the year ended December 31, 2013, the Company disposed of various US oil and gas interests to PRI for proceeds of $172,882. The proceeds received were greater than the carrying amount of the assets of $28,507, which was recorded to contribute surplus.

6 Exploration and evaluation and other intangible assets

	E&E assets $
Balance, December 31, 2012	397,668
Additions	849,813
Revisions in decommissioning liability	(13,093)
Foreign currency translation	941
Balance, December 31, 2013	1,235,329
Additions	150,219
Revisions in decommissioning liability	1,370
Foreign currency translation	3,946
Balance, June 30, 2014	1,390,864

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of technological feasibility and commercial viability. As at June 30, 2014, the Company has an E&E balance of 1,390,864 (December 31, 2013 - $1,235,329). 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 technological feasibility and commercial viability have been established. As at June 30, 2014, the Company did not identify any indicators of impairment on its E&E properties.

During the six months ended June 30, 2014, the Company recognized pre-production revenue of $18,031 and pre-production operating expenses of $37,916 against its E&E expenditures.

7 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 $616,376 as at June 30, 2014 (December 31, 2013 - $559,751) based on an undiscounted total future liability of $742,111 (December 31, 2013 - $700,853). These payments are expected to be made over the next 2 to 25 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 1.09% - 2.68% (December 31, 2013 – 2% and 1.68% - 2.77%, respectively).

	June 30, 2014	December 31, 2013
	$	$
Balance, beginning of period	**559,751**	182,278
Disposals	**-**	(42,344)
Liabilities incurred	**-**	35,124
Revisions (changes in estimates)	**47,692**	380,454
Accretion	**8,837**	2,846
Foreign currency translation	**96**	1,393
Balance, end of period	**616,376**	559,751

8 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 (the "Original Loan Agreement") with a maturity date of August 15, 2013. Interest on the loan is 10% per annum, payable monthly, on the outstanding principal amount. On August 15, 2013, the Original Loan with an outstanding balance of $1,200,000 was cancelled, and a new loan in the amount of $1,200,000 was issued with a maturity date of August 15, 2014 (the "New Loan"). During the six months ended June 30, 2014, the Lender advanced an additional $100,000 to the Company under the same terms as the New Loan. Included in the New Loan is a conversion feature, which at the option of the Lender, and subject to regulatory approval, the entire principal amount of the New Loan, or any portion outstanding, may be converted to shares in the Company at a price of $0.05 per common share until August 15, 2014. As of June 30, 2014 and up to the date of these Interim Consolidated Financial Statements, the conversion feature had not yet received regulatory approval.

The Company may, at any time, repay the loan in full without notice or penalty. If the Company is in default of the requirements included in the New Loan agreement or the Lender believes the Company's ability to repay the loan is impaired, the Lender may demand repayment of the loan or accelerate the date for payment. During the six months ended June 30, 2014, the Company incurred interest of $63,333 (December 31, 2013 - $120,000).

Pursuant to the Original Loan Agreement, the Company issued to the Lender 5,000,000 share purchase warrants (the "Original Warrants"). The Original Warrants were valued at $147,195 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 Original Warrants was recorded as a non-cash finance expense in the consolidated statement of comprehensive loss. On August 15, 2013, the Original Warrants expired unexercised. Pursuant to the New Loan agreement, the Company issued to the Lender 5,000,000 share purchase warrants (the "New Warrants"). Each New Warrant is 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

New Warrants received regulatory approval and accordingly were valued as of this date and treated consistently with the Original Warrants.

	Loan $
Balance, December 31, 2012	**1,121,565**
Accretion of transaction cost	78,435
Balance, December 31, 2013	**1,200,000**
Receipt of additional funds	100,000
Transaction costs	(93,710)
Accretion of transaction costs	60,033
Balance, June 30, 2014	**1,266,323**

Security for the loan consists of a $1,500,000 promissory note plus interest at the rate of 10% per annum, compounded monthly, 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.

Subsequent to June 30, 2014, the Company has applied with the Lender to extend the maturity date of the New Loan until August 15, 2015, with a 10% interest rate that compounds monthly (the "Extension"). Pursuant to the Extension, there would be no warrants offered, however a conversion feature would enable the Lender to 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. Any accrued interest thereon may also be converted in to common shares, in accordance with the regulatory policies. All other terms and conditions of the Extension remain unchanged. As of the date of the Interim Consolidated Financial Statements, neither the Lender nor the TSX has approved the Extension.

9 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, 2013 and January 1, 2014, it was mutually agreed upon between the Lender and the Company to extend the loan under the same terms for an additional year. During the six months ended June 30, 2014, the Lender advanced an additional loan amount of $100,000 USD to the Company under the same terms as the Loan Agreement. The proceeds of the loan were used to continue the Company's exploration program in Texas. Interest on the loan is 12% per annum, payable monthly, on the outstanding principal amount and compounds monthly. During the six months ended June 30, 2014, the Company incurred interest of $13,288 (December 31, 2013 - $19,726).

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. Accordingly, on the issuance and extension, the loan is split between the liability and the conversion feature, which is recorded on the statement of financial position as a derivative financial liability. The liability portion is determined by subtracting the fair value of the conversion feature from the principal amount of the loan. At January 1, 2013, the $150,000 loan resulted in $20,000 being classified as a liability and $130,000 being classified as a derivative financial liability. The fair value of the conversion feature is estimated at every statement of financial position date with changes in the fair value estimate between periods recognized in the consolidated statement of comprehensive loss as finance expense. The liability portion is measured at amortized cost and is accreted up to the principal balance at the maturity date. The accretion is expensed as a finance expense in the consolidated statement of comprehensive loss as finance expense.

At December 31, 2013, the loan had matured and the initial 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 comprehensive loss as finance expense. 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. All other terms and conditions remain the same. On June 30, 2014, the conversion feature received regulatory approval and accordingly, $109,000 of the principal amount of the loan was classified as a derivative financial liability.

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

	Liability $	Derivative Financial Liability $	Total $
Balance, at December 31, 2012	150,000	-	150,000
Renewal of debt	(130,000)	130,000	-
Accretion of debt	130,000	-	130,000
(Gain) on derivative financial liability	-	(130,000)	(130,000)
Balance, December 31, 2013	**150,000**	**-**	**150,000**
Receipt of additional funds	100,000	-	100,000
Derivative financial liability	(109,500)	109,500	-
Balance, June 30, 2014	**140,500**	**109,500**	**250,000**

The fair value of the derivative financial liability was determined using the Black-Scholes valuation model and the following assumptions were used:

	June 30, 2014	January 1, 2013
Risk-free interest rate	**1.09%**	1.17%
Expected life (years)	**0.5 years**	1 year
Expected volatility	**234.82%**	165.11%
Market price	**0.04**	0.040
Conversion price	**0.05**	0.030

10 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, 2012	132,721,689	9,806,332
Fair value reallocation on expiry of warrants (note 10(c))	-	574,096
Private placement (i)	7,950,000	397,500
Value of warrants issued pursuant to private placement (i)	-	(141,188)
Share issue costs (i)	-	(35,516)
Balance, December 31, 2013	140,671,689	10,601,224
Fair value reallocation on expiry of warrants (note 10(c))	-	809,550
Balance, June 30, 2014	140,671,689	11,410,774

(i) On April 3, 2013, the Company completed a private placement ("Placement A"), issuing 7,950,000 units. Each unit under Placement A was issued at $0.05 for total proceeds of $397,500. Each unit consists of one common share of the Company and one share purchase warrant ("Warrant A"). Each Warrant A entitles the holder to purchase one additional common share of the Company at $0.10 per share, exercisable for 1 year from the original issue date. The Company has allocated $141,188 of the unit value to warrants (note 10(c)).

Pursuant to Placement A, the Company incurred $38,259 in cash share issue costs, of which $24,672 was allocated to share capital and $13,587 was allocated to warrants. 645,000 finders options were issued, respectively, valued at $16,818 (note 10(e)), of which $10,844 was allocated to share capital and $5,974 was allocated to warrants.

c) **Warrants**

Warrants to acquire common shares outstanding at June 30, 2014 are as follows:

	Number of warrants issued and exercisable	Amount $	Weighted average exercise price $	Weighted average Remaining life (years)
Balance, December 31, 2012	59,995,730	1,274,721	0.10	0.06
Expiry of share purchase warrants	(25,315,730)	(574,096)	0.10	-
Expiry of share purchase warrants (note 8)	(5,000,000)	(147,195)	0.10	-
Share purchase warrants issued (note 10(b)(i))	7,950,000	141,188	0.10	0.06
Share issue costs (note 10(b)(i))	-	(19,561)	-	-
Balance, December 31, 2013	37,630,000	675,057	0.10	0.06
Expiry of share purchase warrants	(37,630,000)	(809,550)	-	-
Share purchase warrants issued (note 8)	5,000,000	93,710	0.05	0.13
Balance, June 30, 2014	5,000,000	(40,783)	0.05	0.13

The fair value of the share purchase warrants granted during the six months ended June 30, 2014 were 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:

	2014	2013
Risk-free rate	**1.07%**	1.01%
Expected life	**0.35**	1.00 years
Expected volatility	**239.29%**	140.95%
Fair value per warrant	**$0.019**	$0.018

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 three and six months ended June 30, 2014, there were no stock options granted, exercised, cancelled or stock options that expired unexercised. The following table summarizes information about the Company’s stock options outstanding at June 30, 2014:

	June 30, 2014		December 31, 2013	
	Number of options	**Weighted Average Exercise price $**	Number of options	Weighted Average Exercise price $
Stock options, beginning of period	**14,030,000**	**0.08**	7,380,000	0.10
Granted	-	-	6,700,000	0.05
Cancelled	-	-	(50,000)	0.10
Stock options outstanding, end of period	**14,030,000**	**0.08**	14,030,000	0.08

The total stock options outstanding at June 30, 2014 are as follows:

Exercise prices ($)	Options outstanding	Weighted average remaining term (years)	Weighted average exercise price ($)
0.05	6,700,000	4.30	0.05
0.10	7,330,000	1.70	0.10

As at June 30, 2014, 13,905,000 stock options have vested and are exercisable and 125,000 stock options have not yet vested.

The terms of the granted stock options granted during the year ended December 31, 2013 are consistent with the Plan and are all exercisable at $0.10 per option and expire 5 years after the grant date. The fair value of the options granted were estimated as at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used in the calculation are noted below:

	2013
Risk-free interest rate	**1.66%**
Expected life	**5 years**
Expected volatility	**389.29%**
Fair value per option	**$0.04**
Forfeiture rate	**9.23%**
Dividend	-

During the three and six months ended June 30, 2014, the Company recognized share-based payment expense of $2,086 and $7,016, respectively, in the consolidated statement of comprehensive loss (June 30, 2013 - $nil). Volatility was determined based on the Company's historical share prices.

e) **Finders Options**

During the year ended December 31, 2013, the Company issued 645,000 Finders Options, respectively, to the those who facilitated Placement A (note 10(b)(i)). Each Finders Option is 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 is exercisable into one common share of the Company at $0.10 per common share. The Finders Options expire one year from the original grant date. The Finders Options were valued at $16,818 (note 10(b)(i)). The warrant embedded within the Finders Options were not separately valued.

The following table summarizes information about the Company's Finder Options outstanding at June 30, 2014:

	June 30, 2014		December 31, 2013	
	Number of options	**Weighted Average Exercise price $**	Number of options	Weighted Average Exercise price $
Finders Options, beginning of period	**645,000**	**0.05**	3,113,000	0.05
Granted (note 10(b)(i))	-	-	645,000	0.05
Expired	**(645,000)**	**(0.05)**	(3,113,000)	(0.05)
Finders Options outstanding, end of period	-	-	645,000	0.05

The Finders Options issued during the year ended December 31, 2013 were valued at an aggregate of $16,818 (note 10(b)(i)). The fair value of the Finders Options granted were estimated as at the grant date using the Black-Scholes option pricing model. The assumptions used in the calculation are noted below:

	2013
Risk-free interest rate	**1.01%**
Expected life	**1 year**
Expected volatility	**140.95%**
Fair value per option	**0.03**

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

f) **Contributed surplus**

	June 30, 2014	December 31, 2013
	$	$
Balance, beginning of period	**1,664,311**	1,135,959
Share-based payment expense (note 10(d))	**7,016**	364,339
Finders options (note 10(b)(i))	**-**	16,818
Expiry of share purchase warrants (note 8)	**-**	147,195
Balance, end of period	**1,671,327**	1,664,311

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, finders 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.

11 Income tax

Significant components of the deferred tax liability are as follows:

	June 30, 2014	December 31, 2013
	$	$
Property and equipment	**423,639**	438,484
Non-capital loss carried forward	**1,821,269**	1,696,446
Decommissioning liabilities	**154,094**	139,938
Share issue costs	**24,993**	41,505
Equity investments	**(49,931)**	(14,215)
Flow-through share indemnity liability	**83,388**	83,388
Scientific research and experimental development	**150,663**	150,663
Financing fees	**30,100**	34,400
Investment tax credits	**195,000**	195,000
Deferred tax asset not recognized	**2,833,215**	2,765,609

The Company has estimated tax pools totaling:

	Rate of Claim	**June 30, 2014**
		$
Canadian exploration expenditures	100%	**1,204,141**
Canadian oil and gas property expense	10%	**31,090**
Foreign development expenditures	Various	**1,035,788**
Undepreciated capital cost	Various	**1,305,481**
Share issue costs	20%	**99,972**
Financing fee	20%	**120,400**
Scientific research and experimental development		**602,650**
Non-capital loss carry forward		**7,285,076**
		11,684,598

The accumulated non-capital loss carry forwards expire between 2014 and 2034.

12 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:

	June 30, 2014	December 31, 2013
	$	$
Note receivable from officer (i)	**247,970**	244,719
Fair value allowance (ii)	**(240,789)**	(240,789)
Net note receivable	**7,181**	3,930
Advance fees (iii)	**6,529**	6,529
	13,710	10,459

(i) A promissory note was issued to an officer of the Company bearing interest at 3% per annum and there is 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. The note is secured by 393,000 common shares of the Company which had a fair value of $3,930 at June 30, 2014 (December 31, 2013 - $3,930).

(ii) The fair value allowance was initially determined on December 31, 2013 based on the market value of the secured shares as the carrying value of the promissory note exceeded the fair value of the 393,000 common shares held as security.

(iii) During the year ended December 31, 2008, a director was advanced $59,473 in relation to efforts to finance and advance the Company's drilling technology. At June 30, 2014 $6,529 (December 31, 2013 - $6,529) remains outstanding. There is no guarantee that such efforts will be successful and if such efforts are not successful, the full balance will be repaid. The original repayment date of December 31, 2010 has been extended to December 31, 2014.

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

For the three months ended June 30, 2014:

(i) Aggregate fees of $nil (June 30, 2013 - $nil) were charged by directors of the Company, all of which was recorded in the statement of comprehensive loss.

(ii) Aggregate fees of $nil (June 30, 2013 - $12,000) were charged by a U.S. corporation, which is owned and controlled by an officer and a director of the Company for costs it incurred for operation of the Company's U.S. properties, all of was recorded in the statement of comprehensive loss.

(iii) Aggregate fees of $8,616 (June 30, 2013 - $8,718) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.

For the six months ended June 30, 2014:

(iv) Aggregate fees of $nil (June 30, 2013 - $3,150) were charged by directors of the Company, all of which was recorded in the statement of comprehensive loss.

(v) Aggregate fees of $nil (June 30, 2013 - $24,000) were charged by a U.S. corporation, which is owned and controlled by an officer and a director of the Company for costs it incurred for operation of the Company's U.S. properties, all of was recorded in the statement of comprehensive loss.

(vi) Aggregate fees of $17,233 (June 30, 2013 - $17,232) were charged by corporations, which are owned and controlled by other equity investors in PRI, and were all recorded as general and administrative costs.

(vii) Included in accounts payable at June 30, 2014 was $189,007 owing to officers of the Company (December 31, 2013 - $120,574).

All related party transactions are in the normal course of operations and have been measured at the agreed exchange amounts, which is the amount of consideration established and agreed to by the related parties and which is similar to those negotiated with third parties.

13 Commitments

a) On January 15, 2012, 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 January 31, 2015.

b) The Company has entered into various vehicle loan agreements with total annual principal repayments for fiscal years 2014 and 2015 as follows: $26,109 and $15,869.

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 $331,551 at June 30, 2014 (December 31, 2013 - $331,551). The Company has also estimated a potential liability for penalties and taxes on the amounts of $45,897 (December 31, 2013 - $45,897) 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.

14 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, due from related parties, accounts payable and accrued liabilities, the shareholder indemnity, the loan, the convertible debt, and long-term debt. The fair values of the Company's financial instruments approximate the carrying values.

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 June 30, 2014, 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 June 30, 2014, the Company's trade and other receivables have been aged as follows:

	June 30, 2014	December 31, 2013
Days outstanding	**$**	$
0-30 days	**67,116**	67,653
31-60 days	**11,959**	6,204
61-90 days	**16,054**	56,561
Greater than 90 days	**316,993**	330,669
Total	**412,122**	461,087

$316,993 of the Company's trade and other receivables are considered past due. However, the Company deems all amounts as collectible and as such, a provision for doubtful accounts has not been recorded at June 30, 2014 (December 31, 2013 - $nil).

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 June 30, 2014, the Company's maximum exposure to liquidity risk is the total current liabilities of $5,665,328 (December 31, 2013 - $5,183,119).

The current liabilities and commitments are due as follows:

Accounts payable and accrued liabilities	3,773,736	Due within 90 days
Loan (note 8)	1,266,323	Maturity date of August 15, 2014
Convertible debt and associated derivative liability (note 9)	266,751	Maturity date of December 31, 2014
Current portion of long-term debt (note 13(b))	24,967	Due within 12 months
Shareholder indemnities (note 13(c))	333,551	Due on demand

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.

(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 June 30, 2014, 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 $10,000 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 June 30, 2014, all of the Company's debt, including the loan and the convertible debt, 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 six months ended June 30, 2014.

(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.

15 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	Total
June 30, 2014 ($)	5,877	49,342	91	55,310
June 30, 2013 ($)	48,100	29,088	196	77,384

Geographical segmentation is as follows:

	Three months ended June 30, 2014 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	29,032	(868)	28,164
Equity income on investment in PRI	11,994	11,993	23,987
Depletion, depreciation and impairment	15,677	595	16,272
Net loss (income)	202,925	132,099	335,024
Property and equipment	482,580	8,501	491,081
Exploration and evaluation assets	-	1,390,864	1,390,864
Share of investment in PRI	199,724	199,723	399,447
Total liabilities	4,482,460	1,803,395	6,285,855

	Three months ended June 30, 2013 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	21,312	33,436	54,748
Equity income on investment in PRI	16,068	16,068	32,136
Depletion, depreciation and impairment	17,368	10,440	27,808
Net loss (income)	325,001	37,241	362,242
Property and equipment	661,975	81,665	743,640
Exploration and evaluation assets	-	1,061,766	1,061,766
Share of investment in PRI	328,185	328,185	656,370
Total liabilities	3,631,479	1,595,821	5,227,300

	Six months ended June 30, 2014 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	57,814	(2,504)	55,310
Equity income on investment in PRI	33,385	33,384	66,769
Depletion, depreciation and impairment	36,934	1,200	38,134
Net loss (income)	380,571	109,448	490,019
Property and equipment	482,580	8,501	491,081
Exploration and evaluation assets	-	1,390,864	1,390,864
Share of investment in PRI	199,724	199,723	399,447
Total liabilities	4,482,460	1,803,395	6,285,855

	Six months ended June 30, 2013 ($)		
	Canada	**United States**	**Total**
Petroleum and natural gas sales	31,872	45,512	77,384
Equity income on investment in PRI	88,064	-	88,064
Depletion, depreciation and impairment	33,264	13,517	46,781
Net loss (income)	509,991	74,915	584,906
Property and equipment	661,975	81,665	743,640
Exploration and evaluation assets	-	1,061,766	1,061,766
Share of investment in PRI	328,185	328,185	656,370
Total liabilities	3,631,479	1,595,821	5,227,300

16 Subsequent events

On August 22, 2014, the Company completed a private placement, issuing 14,175,000 units (the "Units) at $0.05 per Unit for aggregate gross proceeds of $708,750. Each Unit consisted of one common share of the Company and one common share purchase warrant, with each warrant entitling the holder thereof to purchase one common share of the Company for $0.05 per common share for a period of 12 months from issuance.

In connection with the private placement, the Company incurred cash commissions of $50,875 and issued 1,017,500 broker units. Each broker unit entitles the holder thereof to purchase one Unit of the Company for a period of 12 months, on the same terms and conditions as those received by the subscribers, at $0.05 per Unit.