

Consolidated Financial Statements

As at December 31, 2015
and for the years ended December 31, 2015 and 2014

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of PetroShale Inc.

We have audited the accompanying consolidated financial statements of PetroShale Inc., which comprise the consolidated statements of financial position as at December 31, 2015 and December 31, 2014, the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

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

KPMG LLP

Chartered Professional Accountants

April 14, 2016
Calgary, Canada

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at December 31, (thousands of Canadian dollars)	NOTE	2015	2014
ASSETS			
Current assets			
Cash and cash equivalents		$ 822	$ 339
Accounts receivable		3,461	2,743
Prepaid expenses		222	160
		4,505	3,242
Non-current assets			
Restricted cash	15	104	157
Property, plant and equipment	6,8	123,943	75,036
		124,047	75,193
		$128,552	$ 78,435
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		$ 18,212	$ 19,329
Senior loan	10	30,082	11,363
Subordinated loan	10	75,408	-
		123,702	30,692
Non-current liabilities			
Subordinated loan	10	-	36,568
Decommissioning obligation	9	834	892
		834	37,460
Total liabilities		124,536	68,152
SHAREHOLDERS' EQUITY			
Share capital	12	35,658	35,658
Contributed surplus		3,344	3,111
Deficit		(39,114)	(30,167)
Accumulated other comprehensive income		4,128	1,681
		4,016	10,283
Commitments	15		
Subsequent Events	10,12		
		$128,552	$ 78,435

See accompanying notes to the consolidated financial statements.

Approved by Board of Directors

(Signed) "Brett Herman"
Director

(Signed) "M. Bruce Chernoff"
Chairman

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CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(thousands of Canadian dollars, except per share amounts)	NOTE	Year Ended December 31, 2015	2014
Revenue			
Oil and natural gas revenue		$ 22,965	$ 9,264
Royalties		(5,039)	(2,030)
		17,926	7,234
Realized loss on financial derivatives	5,11	-	(53)
Unrealized loss on financial derivatives	5,11	-	(17)
		-	(70)
		17,926	7,164
Expenses			
Production and operating		5,415	1,811
General and administrative		2,846	2,706
Exploration and evaluation	7	7	-
Depletion and depreciation	8	9,906	2,407
Finance	10	9,568	3,184
Gain on disposition of property	8	(1,216)	-
Impairment of exploration and evaluation assets	7	-	680
Impairment of property, plant and equipment	8	114	906
Share-based compensation	12	233	524
		26,873	12,218
Net loss for the year		(8,947)	(5,054)
Currency translation adjustment		2,447	727
Comprehensive loss for the year		$ (6,500)	$(4,327)
Net loss per share, basic and diluted	13	**$ (0.26)**	**$ (0.16)**

See accompanying notes to the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the years ended December 31, 2015 and 2014

(thousands of Canadian dollars, except share amounts)

	Non Voting Common Shares		Voting Common Shares				Accumulated Other	
	Shares	Amount	Shares	Amount	Contributed Surplus	Deficit	Comprehensive Income	Total
Balances, December 31, 2013	6,700,000	$ -	22,307,574	$ 28,948	$ 2,587	$ (25,113)	$ 954	$ 7,376
Share-based compensation	-	-	-	-	524	-	-	524
Issuance of common shares for cash, net	-	-	5,000,000	6,442	-	-	-	6,442
Issuance of common shares for acquisition	-	-	200,000	268	-	-	-	268
Net loss for the year	-	-	-	-	-	(5,054)	-	(5,054)
Other comprehensive income for the year	-	-	-	-	-	-	727	727
Balances, December 31, 2014	6,700,000	$ -	27,507,574	$ 35,658	$ 3,111	$ (30,167)	$ 1,681	$ 10,283
Share-based compensation	-	-	-	-	233	-	-	233
Net loss for the year	-	-	-	-	-	(8,947)	-	(8,947)
Other comprehensive income for the year	-	-	-	-	-	-	2,447	2,447
Balances, December 31, 2015	6,700,000	$ -	27,507,574	$ 35,658	$ 3,344	$ (39,114)	$ 4,128	$ 4,016

See accompanying notes to the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(thousands of Canadian dollars)	Year Ended December 31, 2015	2014
Operating Activities		
Net loss for the year	$ (8,947)	$ (5,054)
Items not affecting cash:		
Depletion and depreciation	9,906	2,407
Impairment of exploration and evaluation assets	-	680
Impairment of property, plant and equipment	114	906
Accretion of decommissioning obligation	6	7
Amortization of loan fees	1,088	552
Unrealized loss on financial derivatives	-	17
Gain on disposition of property	(1,216)	-
Share-based compensation	233	524
Decommissioning expenditures	(3)	(84)
Change in non-cash working capital (note 19)	489	(802)
	1,670	(847)
Investing Activities		
Acquisition of property, plant and equipment	(23,000)	(34,787)
Additions to property, plant and equipment	(17,134)	(27,713)
Proceeds from disposition of property, plant and equipment	3,264	-
Additions to exploration and evaluation assets	-	(136)
Change in non-cash working capital (note 19)	(15,043)	14,295
	(51,913)	(48,341)
Financing Activities		
Proceeds from subordinated loan, net	28,000	34,251
Proceeds from senior loan, net	16,457	9,727
Proceeds from share issuance, net	-	6,442
Repayment of note payable	-	(2,316)
Restricted cash	-	(87)
Change in non-cash working capital (note 19)	6,194	-
	50,651	48,017
Change in cash and cash equivalents	408	(1,171)
Effect of foreign exchange rates	75	198
Cash and cash equivalents, beginning of year	339	1,312
Cash and cash equivalents, end of year	$ 822	$ 339

See accompanying notes to the consolidated financial statements.

1. BUSINESS AND NATURE OF OPERATIONS

PetroShale Inc. (the "Company") is an oil company engaged in the acquisition, development and consolidation of interests in the North Dakota Bakken.

The Company's head office is located at Suite 3900, 350-7th Avenue SW, Calgary, Alberta.

2. BASIS OF PREPARATION

These consolidated financial statements have been prepared by management in accordance with the International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and were authorized for issue by the Board of Directors on April 14, 2016.

These financial statements have been prepared using the historical cost basis, except for financial derivative instruments which are measured at fair value.

The Company's reporting and measurement currency is the Canadian dollar. The functional currency of the Company's US subsidiary is the US dollar, and its results and balance sheet items are translated to Canadian dollars for purposes of these consolidated financial statements, in accordance with the Company's foreign currency translation accounting policy.

Critical judgments in applying accounting policies

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

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

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

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

Key sources of estimation uncertainty

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

Estimation of recoverable quantities of proven and probable oil and natural gas reserves include estimates and assumptions regarding future commodity prices, currency exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the estimation of decommissioning obligations, the economic feasibility of exploration and evaluation assets

and the amounts reported for depletion and depreciation of property, plant and equipment. These reserve estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations in accordance with National Instrument 51-101.

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

In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of oil and natural gas properties based upon the estimation of recoverable quantities of proven and probable reserves being acquired as well as estimating the associated decommissioning obligation.

The Company's estimate of share-based compensation expense is dependent upon estimates of expected volatility of the Company's share price and anticipated forfeiture rates of the related share purchase options.

The Company's deferred tax asset or liability is based on estimates as to the timing of the reversal of temporary differences, substantively enacted tax rates and the likelihood of assets being realized.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

a) Business Combinations and Consolidation

i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of an acquisition over the fair value of the identifiable assets acquired net of liabilities assumed is recorded as goodwill. If the cost of an acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of operations and comprehensive income.

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, PetroShale (US), Inc. During the year ended December 31, 2015, the Company sold its investment in GEL Exploration Limited. During the year ended December 31, 2014, the Company merged two of its wholly-owned subsidiaries, PetroShale (US) Production LLC and PetroShale (US) Land 1 LLC, into PetroShale (US), Inc.

ii) Jointly controlled operations and jointly controlled assets

The Company's oil and natural gas activities involve jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

iii) Transactions eliminated on consolidation

All intercompany balances and transactions have been eliminated upon consolidation.

b) Revenue Recognition

Revenues associated with the production and sale of petroleum products owned by the Company are recognized when the significant risks and rewards of ownership are transferred to the buyer, which is typically when the production enters a third party pipeline or loading facility, and provided the amount to be received can be reasonably estimated and collection is reasonably assured.

Royalty payments received from projects in which the Company has an interest are recorded when received or receivable if the amount to be received can be reasonably estimated and collection is reasonably assured.

c) Foreign Currency Translation

The Company's consolidated financial statements are reported in Canadian dollars, which is the Company's presentation currency. Transactions of the Company's US subsidiary are recorded in US dollars, as this is the primary economic environment in which this subsidiary operates. The US subsidiary has a US dollar functional currency. In translating the financial results from US dollars to Canadian dollars, the Company uses the following method: assets and liabilities are translated at the exchange rate in effect as at the date of the consolidated statement of financial position; revenues and expenses are translated at the rate effective at the time of the transaction or the average rate for the period; and changes in shareholders' equity are translated at the rate effective at the time of the transaction. Unrealized gains and losses resulting from the translation to the Canadian dollar presentation currency are included in other comprehensive income.

d) Exploration and Evaluation of Oil and Gas Assets

i) Capitalization

Under the method of accounting for Exploration and Evaluation ("E&E") costs, expenditures made on the exploration for and evaluation of oil and gas properties are capitalized on a cost center basis from the time the Company obtains the legal rights to explore in an area until completion of the evaluation of the property. Such costs include costs of drilling, land acquisition and annual lease costs, geological consulting and the cost of equipment and general and administrative overhead charges directly related to the exploration and evaluation of the properties. Costs that qualify for capitalization are

recorded as an intangible E&E asset until a determination is made about the future of the asset. E&E assets are not depleted until the exploration phase is complete and are subject to impairment testing described below. Costs incurred prior to obtaining the legal right to explore an area are expensed immediately. Costs incurred by the operator on a non-operated property, where the Company has previously determined such property has limited value are expensed immediately. Upon completion of the exploration phase, and when technically feasible and commercially viable reserves are discovered, the capitalized assets are reclassified to property, plant and equipment in the statement of financial position after being tested for impairment. The technical feasibility and commercial viability are considered to be determinable when proven and/or probable reserves are determined to exist. Any impairment loss would be immediately recognized as a charge to income prior to reclassification. Depletion and depreciation of the assets would commence subsequent to this date. The cost of undeveloped land that expires is charged as additional depletion expense.

ii) Impairment

As facts and circumstances suggest, the Company tests its E&E assets for impairment by comparing the carrying amount against the assets' recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell ("FVLCS") and its value in use ("VIU"). If the carrying value exceeds the recoverable amount, the difference is written off to the statement of operations in that period. E&E assets are aggregated within the associated CGU for purposes of impairment testing. In addition, once technical feasibility and commercial viability of production are demonstrated, E&E assets are tested for impairment and any net amounts are reclassified to property, plant and equipment.

e) Property, Plant and Equipment

There are two categories of Property, Plant and Equipment ("PP&E"): Developed and Producing ("D&P") assets and Other PP&E assets.

D&P assets include capital costs (i) related to drilling projects where the drilling location is already determined to hold proven and/or probable reserves, (ii) that have been reclassified from E&E assets because proven and/or probable reserves have been determined, and (iii) incurred to improve an already technically feasible and commercially viable well.

Other PP&E assets typically include furniture, fixtures, leasehold improvements and office equipment.

For statement of financial position presentation, both D&P assets and Other PP&E assets are included in the PP&E category.

i) Recognition and measurement

PP&E is measured at cost less accumulated depletion and depreciation and accumulated impairment losses. For purposes of determining depletion and depreciation expense, when significant parts of PP&E have different useful lives, they are accounted for separately so that depletion and depreciation rates appropriately reflect useful lives.

Gains and losses on disposal of PP&E, property swaps and farm-outs, are determined by comparing the proceeds from disposal with the carrying amount of the PP&E sold, and are recognized on a net basis in profit or loss.

The net carrying value of D&P assets is depleted using the unit-of-production method by calculating the ratio of production in the period to the related proven and probable reserves. The net carrying value to be depleted includes an estimate of future development costs required to produce the related reserves, which may include the costs of drilling and completing wells. These estimates are reviewed at least annually by independent engineers in conjunction with their review of the Company's proven and probable reserves.

For Other PP&E assets, depreciation is recognized in the statement of operations and comprehensive income on a straight-line basis over their estimated useful lives. Finance lease assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

ii) Impairment

An assessment is made at each reporting period as to whether there are any facts or circumstances which suggest there may be an impairment of D&P assets. If such facts and circumstances exist, the Company would compare the carrying amount of D&P assets to their recoverable amount, on a CGU by CGU basis. The recoverable amount of a CGU is the greater of (i) its value in use, and (ii) its fair value less selling costs. In assessing value in use for D&P assets, the estimated future cash flows from the production of proven and probable reserves are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses recognized in prior periods are assessed at each reporting date to evaluate if those losses have decreased or no longer exist. If those impairment losses have decreased or no longer exist (recovered), they are reversed accordingly. Previously recognized impairment losses may be recovered in future reporting periods due to changes in estimates used to determine the recoverable amount. An impairment loss recovery is recorded only to the extent that the D&P asset carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation expense, if no impairment loss had been recognized. Impairment losses and recoveries are recorded in the statement of operations and comprehensive income.

iii) Subsequent costs

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

f) Decommissioning Obligation

An obligation is recognized if, as a result of a past event, the Company has a future legal or constructive obligation resulting from the retirement and reclamation of tangible long-lived assets and this obligation can be reliably estimated. The obligation is measured at the present value of management's best estimate of the expected expenditures required to settle this obligation and is recorded in the period the related assets are put into use with a corresponding increase to the carrying amount of the

related assets. This increase in capitalized costs is depleted and depreciated on a basis consistent with the underlying assets. Subsequent changes in the estimated fair value of the provision are capitalized and depleted over the remaining useful life of the underlying asset.

The obligation is carried in the statement of financial position at its discounted present value and is accreted over time for the change in its present value. The obligation is discounted at a rate that reflects the current market assessments of the time value of money and the risks specific to the obligation.

g) Income Taxes

Current income taxes are measured at the amount expected to be payable on taxable income for the period, using tax rates enacted or substantively enacted at the end of the reporting period.

The Company follows the asset and liability method of accounting for deferred income taxes. Under this method, deferred income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of statement of financial position items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to reverse.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is not probable that the related tax benefit will be realized.

h) Share-based Payments

The Company uses the fair value method to recognize the cost associated with stock options granted to employees, directors and other service providers. The fair value of the stock options granted is measured using the Black-Scholes option pricing model. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Under the fair value method, the Company recognizes estimated compensation expense related to stock options over the vesting period of the options granted, with the related credit being charged to contributed surplus. Fair value is measured at the grant date and each tranche is recognized using the graded vesting method over the period during which the options vest. At each reporting date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest. Upon exercise of any stock options, amounts previously credited to contributed surplus are reversed and credited to share capital.

i) Earnings per Share

Basic earnings per common share are calculated by dividing the net earnings for the period by the weighted average number of common shares outstanding in each respective period. Diluted earnings per common share reflect the maximum possible dilution from other securities, if dilutive.

j) Financial Instruments

i) Non-derivative financial instruments

These comprise cash and cash equivalents including bank overdrafts, accounts receivable, accounts payable and loans and borrowings. Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

a. Cash and cash equivalents in the statement of financial position comprise cash at banks and on hand and short term deposits with an original maturity of three months or less.

   For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents defined above, net of outstanding bank overdrafts. These balances are reflected at cost.

b. Other non-derivative financial instruments, such as loans and borrowings, accounts receivable and accounts payable, are measured at amortized cost using the effective interest method, less any impairment losses.

ii) Derivative financial instruments

The Company may enter into certain financial derivative contracts in order to manage its exposure to market risks from fluctuations in commodity prices, interest rates and foreign exchange rates. These instruments are not used for trading or speculative purposes. The Company will not designate its financial derivative contracts as effective accounting hedges, and thus will not apply hedge accounting, even though the Company considers all commodities contracts to be economic hedges. As a result, all financial derivative contracts will be classified as fair value through profit and loss and recorded in the statement of financial position at fair value. Related transaction costs such as trading commissions will be recognized in the statement of operations and comprehensive income when incurred.

Forward physical delivery and sales contracts of oil and natural gas products are entered into under the normal course of business and therefore not recorded at fair value in the statement of financial position. These physical delivery contracts are not considered to be derivative financial instruments or hedges. Settlements on these physical delivery contracts are recognized in oil and natural gas revenue in the statement of operations and comprehensive income. Unrealized gains and losses are recorded based on the changes in the fair values of the derivative instruments. Both the unrealized and realized gains and losses resulting from the contract settlement of derivatives are recorded in the statements of operations.

iii) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares, warrants and stock options are recognized as a reduction from equity, net of any tax effects.

4. FUTURE ACCOUNTING PRONOUNCEMENTS

Certain new accounting standards, interpretations and amendments to existing standards, with future effect, have been issued by the IASB or the International Financial Reporting Interpretation Committee ("IFRIC"). The standards that are applicable to the Company are as follows:

IFRS 9 - "Financial Instruments", 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. The standard will come into effect on January 1, 2018 with early adoption permitted. The extent of the impact of the adoption of IFRS 9 has not yet been determined.

IFRS 11 – "Accounting for Acquisitions of Interests in Joint Operations" has been amended to provide guidance on accounting for acquisitions of an interest in a joint operation that constitutes a business. IFRS 11 is effective for annual periods beginning on or after January 1, 2016 with early adoption permitted. The Company has determined that this amended accounting standard will not have a significant impact on its consolidated financial statements.

IFRS 15 – "Revenue from Contracts with Customers" was issued in May 2014 to replace IAS11 – "Construction Contracts" and IAS 18 – "Revenue" and related interpretive guidance. IFRS 15 provides a single, principles based model to be applied to all contracts with customers as well as new disclosure requirements with the objective of a more structured approach, improving comparability across entities and industries. Under IFRS 15, an entity will recognize revenue at the amount to which it expects to be entitled in exchange for goods or services on their transfer. IFRS 15 is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted and is to be applied retrospectively. The extent of the impact of the adoption of IFRS 15 on the Company has not yet been determined.

5. FAIR VALUE HIERARCHY

Several of the Company's accounting policies require a determination of fair value for certain assets and liabilities. Fair value for measurement or disclosure purposes is determined on the following basis.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Valuation techniques include the market, income and cost approach. The market approach uses information generated by market transactions involving identical or comparable assets or liabilities; the income approach converts estimated future amounts to a present value; and the cost approach is based on the amount that currently would be required to replace an asset.

The Company is required to classify its financial instruments within a hierarchy that prioritizes the inputs to fair market value. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in an active market for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and,

Level 3 – Inputs that are not based on observable market data.

a) Exploration and evaluation assets, and property, plant and equipment

The fair value of exploration and evaluation assets and property, plant and equipment recognized in a business combination, is based on market value. The market value of E&E assets and PP&E is the estimated amount for which E&E assets and PP&E could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the

parties had each acted with knowledge and prudence and without compulsion. The market value of oil and natural gas interests included in E&E assets and PP&E is estimated with reference to the discounted future cash flows expected to be derived from oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

b) Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, senior loan and subordinated loan.

The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, senior loan and subordinated loan are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. As at December 31, 2015 and 2014, the fair value of cash and cash equivalents, accounts receivable, and accounts payable approximated their carrying value due to their short term maturity. The fair value of the senior and subordinated loans approximated their carrying values as their interest rates reflect current market conditions.

c) Share-based compensation

The fair value of employee stock options is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the option, expected volatility of the underlying share price (based on historical experience), weighted average expected life of the option (based on historical experience and general option holder behavior), expected dividends, forfeiture rate and the risk-free interest rate (based on government bonds).

6. ACQUISITIONS

2015 Non-Producing Property Acquisitions

During the year ended December 31, 2015, through various transactions, the Company purchased oil and gas leases in its focus area in North Dakota. This represents various working interests in potential drilling units with associated proved undeveloped and probable reserves. The aggregate consideration for these leases was approximately US$9.6 million. There were no assumptions of liabilities associated with these purchases.

2015 Producing Property Acquisitions

In August 2015, the Company acquired certain leases with associated proved undeveloped and probable reserves and oil and natural gas producing properties. The Company has treated the transaction as a business combination and has accounted for it using the acquisition method to reflect the fair value of the assets acquired and liabilities assumed. The decommissioning obligation was determined using the Company's estimated timing and costs to remediate, reclaim and abandon the related wells and production infrastructure. Results of operations from the assets acquired were included in the financial statements from the closing date of the transaction. The total purchase price of US$6.6 million was settled with cash funded through the Company's credit facilities.

The aggregate purchase price was allocated as follows:

CONSIDERATION (US$6,600)	$	8,580
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	12,175
Accounts receivable		368
Accounts payable		(3,900)
Decommissioning obligation		(63)
	$	8,580

The following reflects selected pro forma financial information for the year ended December 31, 2015 as if the acquisition had occurred on January 1, 2015 instead of the closing date of the transaction:

		Year Ended December 31, 2015
Oil and natural gas revenue, net of royalties	$	925
Production and operating		(227)
Depletion and depreciation		(518)
Finance		(640)
		(460)
Net loss for the year		(8,947)
Adjusted net loss for the year	$	(9,407)
Adjusted basic and diluted net loss per share	$	(0.27)

Further, In November 2015, the Company acquired certain leases with associated proved undeveloped and probable reserves and oil and gas producing properties. The Company has treated the transaction as a business combination and has accounted for it using the acquisition method to reflect the fair value of the assets acquired and liabilities assumed. The decommissioning obligation was determined using the Company's estimated timing and costs to remediate, reclaim and abandon the related wells and production infrastructure. Results of operations from the assets acquired were included in the financial statements from the closing date of the transaction. The total purchase price of US$1.6 million was settled with cash funded through the Company's credit facilities.

The aggregate purchase price was allocated as follows:

CONSIDERATION (US$1,600)	$	2,128
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	2,135
Decommissioning obligation		(7)
	$	2,128

The following reflects selected pro forma financial information for the year ended December 31, 2015 as if the acquisition had occurred on January 1, 2015 instead of the closing date of the transaction:

	Year Ended December 31, 2015
Oil and natural gas revenue, net of royalties	$ 413
Production and operating	(87)
Depletion and depreciation	(245)
Finance	(223)
	(142)
Net loss for the year	(8,947)
Adjusted net loss for the year	$ (9,089)
Adjusted basic and diluted net loss per share	$ (0.27)

2014 Non-Producing Property Acquisitions

During the year ended December 31, 2014, through various transactions, the Company purchased oil and gas leases in North Dakota. This represents various working interests in potential drilling units, as well as Federal land, with associated proved undeveloped and probable reserves. There were no producing wells or other facilities associated with these purchases. The Company paid an aggregate consideration of approximately US$26.8 million for these leases, funded through a combination of credit facilities, existing cash resources and the issuance of 200,000 common shares. There were no assumptions of liabilities associated with these purchases.

In addition to the oil and gas lease purchases described above, the Company also purchased working interests in wells, which were in the process of being drilled, and assumed capital obligations related to drilling and completion of these wells for consideration of approximately US$1.3 million which includes assumption of decommissioning liabilities.

In aggregate for these transactions, which have been accounted for as business combinations, total consideration paid and the net assets acquired is as follows:

CONSIDERATION		***NET ASSETS ACQUIRED***	
Cash	$ 29,609	Developed and producing assets	$ 31,060
Shares issued	268	Decommissioning obligations assumed	(17)
Accounts payable assumed	1,166		
	$ 31,043		$ 31,043

2014 Producing Property Acquisitions

The Company acquired certain oil and gas producing properties during the fourth quarter of 2014. The Company has treated these transactions as business combinations and has accounted for them using the acquisition method to reflect the fair value of the assets acquired and liabilities assumed. Results of operations from the assets acquired were included in the financial statements from the closing date of the transactions. The total purchase price of US$4.7 million was settled with cash funded through credit facilities.

The aggregate purchase price was allocated as follows:

CONSIDERATION (US$4,710)	$	5,201
NET ASSETS ACQUIRED AT FAIR VALUE		
Developed and producing assets	$	5,188
Accounts receivable		27
Accounts payable		(4)
Decommissioning obligation		(10)
	$	5,201

The following reflects selected pro forma financial information for the year ended December 31, 2014 as if the acquisitions had occurred on January 1, 2014 instead of the closing date of each transaction:

		Year Ended December 31, 2014
Oil and natural gas revenue, net of royalties	$	3,053
Production and operating		(360)
Depletion and depreciation		(689)
Finance		(499)
		1,505
Net loss for the year		(5,054)
Adjusted net loss for the year	$	(3,549)
Adjusted basic and diluted net loss per share	$	(0.11)

7. EXPLORATION AND EVALUATION ASSETS

Balance as at December 31, 2013	$	527
Additions		136
Impairment		(680)
Effect of foreign exchange rate		17
Balance as at December 31, 2014 and 2015	$	-

For the year ended December 31, 2014, the Company recognized $0.7 million of impairment expense related to one of its CGUs located in the United States. The Company no longer has any development plans within this CGU, therefore, all of the leases and related costs were written down to nil during the year ended December 31, 2014.

8. PROPERTY, PLANT AND EQUIPMENT

	Other	Developed and Producing Assets	Total
Balance as at December 31, 2013	$ 34	$ 10,297	$ 10,331
Acquisitions	-	36,248	36,248
Additions	30	28,047	28,077
Impairment	-	(906)	(906)
Depletion and depreciation	(11)	(2,396)	(2,407)
Effect of foreign exchange rate	4	3,689	3,693
Balance as at December 31, 2014	57	74,979	75,036
Acquisitions	-	26,602	26,602
Additions	-	17,338	17,338
Impairment	-	(114)	(114)
Dispositions	-	(2,378)	(2,378)
Depletion and depreciation	(19)	(9,887)	(9,906)
Effect of foreign exchange rate	9	17,356	17,365
Balance as at December 31, 2015	$ 47	$ 123,896	$ 123,943

Depletion, Depreciation, and Future Development Costs

For the years ended December 31, 2015 and 2014, the Company recorded $9.9 million and $2.4 million, respectively, of depletion and depreciation expense, which reflected an estimated US$204.0 million and US$118.7 million, respectively of future development costs associated with proven plus probable reserves.

Impairment Charges

As at December 31, 2015 the Company determined that indicators of impairment existed for its CGUs due to the recent further decline in current and forward commodity prices for both oil and natural gas. The Company performed an impairment test on each of its CGUs as at December 31, 2015, using a discount rate of 10% and the following future commodity price estimates from the Company's independent reserve evaluators in respect of its US CGUs:

	Oil (WTI - US$) ($/bbl)	Natural Gas (Henry Hub - US$) ($/mmbtu)
2016	44.67	2.450
2017	55.20	3.017
2018	63.47	3.400
2019	71.00	3.733
2020	74.77	3.950
2021	78.24	4.121
2022	81.75	4.276
2023	85.37	4.448
2024	87.32	4.570
2025	88.90	4.659
2026	90.54	4.746
2027	92.22	4.834
2028	93.90	4.923
2029 (escalated 2% thereafter)	95.62	5.013

For the year ended December 31, 2015, the Company recognized an impairment of $0.1 million on its non-core Montana CGU based on the higher of VIU and FVLCS. No impairment was recognized in relation to the Company's core middle Bakken CGU or its Canadian CGU.

At December 31, 2014, the Company determined that indicators of impairment existed for all of its CGUs due to the decline in forward commodity prices for oil and natural gas. The Company performed an impairment test on each of its CGUs as at December 31, 2014 using a discount rate of 10 percent on its U.S. CGUs and 15 percent on its Canadian non-core CGU and future commodity price estimates applicable at the time (see Note 8 to the Company's December 31, 2014 Consolidated Financial Statements.) This resulted in an impairment expense recorded in the year ended December 31, 2014 of $0.9 million.

Dispositions

During the year ended December 31, 2015, the Company disposed of the working interest oil and gas properties which had been included in its Canadian non-core CGU for non-cash proceeds of $447,000, on the assumption of the decommissioning liability by the purchaser.

In addition, the Company sold certain US assets related to interests in lease acreage and well bores for cash proceeds of US$2.6 million and recorded a net gain of $1.2 million in the statement of operations.

9. DECOMMISSIONING OBLIGATION

Balance as at December 31, 2013	$	552
Acquisition of petroleum and natural gas properties		27
Additions		198
Obligations Settled		(84)
Revisions of estimated cash flows		166
Accretion		7
Effect of foreign exchange rate		26
Balance as at December 31, 2014		892
Acquisition of petroleum and natural gas properties		70
Additions		97
Obligations Settled		(3)
Dispositions		(447)
Revisions of estimated cash flows		107
Accretion		6
Effect of foreign exchange rate		112
Balance as at December 31, 2015	$	834

The Company's decommissioning obligation consists of remediation obligations resulting from its ownership interests in petroleum and natural gas assets. The total obligation is estimated based on the Company's net working interest in wells and related facilities, estimated costs to return these sites to their original condition, costs to plug and abandon the wells and the estimated timing of the costs to be incurred in future years.

As at December 31, 2015, the Company had disposed of all of its Canadian working interest assets and, as a result, has reflected a disposition of the related decommissioning obligation.

The total undiscounted amount of estimated future cash flows required to settle the obligation as at December 31, 2015 is $1.6 million (December 31, 2014 – $1.4 million) which includes an inflation factor of 1.7% (December 31, 2014 – 1.7% to 2.0%) on the costs of decommissioning and assumes that the liabilities are settled over approximately the next 35 years in accordance with estimates prepared by independent engineers. The estimated future cash flows as at December 31, 2015 have been discounted at the risk-free interest rate of 2.8% (December 31, 2014 – 2.4% to 2.8%).

10. DEBT

Senior Loan

The Company's senior loan is a revolving credit facility with a borrowing base of US$22.5 million (Cdn$31.3 million, assuming the December 31, 2015 foreign exchange rate) as at December 31, 2015. This facility is due on demand, but has a renewal date of July 16, 2016, at which point, at the bank's option, it may be renewed on terms to be agreed upon at that time, or converted to a non-revolving term facility for a term to be determined by the bank. This facility is secured by all of the Company's assets and bears interest at the bank's prime lending rate plus 1% or the relevant bankers acceptance fee plus 2.75% if drawn in Canadian dollars, or the bank's U.S. dollar base rate plus 0.50% or U.S. dollar LIBOR rate plus 3.75% if drawn in U.S. dollars. A standby fee of 0.50% per annum is applied to any undrawn balance. The borrowing base is subject to a borrowing base test performed at least twice annually by the bank, based on reserve reports associated with the Company's U.S. petroleum and natural gas properties. A decrease in the borrowing

base could result in a repayment to the bank. The next borrowing base review is scheduled prior to the current renewal date.

The credit facility is subject to financial and non-financial covenants applied to the Company, on a consolidated basis. The financial covenants consist of: (i) a consolidated cash flow to interest expense ratio, as defined in the loan agreement, which is not to be less than 2.50 to 1 on a rolling four-quarter basis, with any equity injections included in the calculation of consolidated cash flow and interest expense excluded from the definition of consolidated cash flow; and (ii) a requirement that total debt not exceed the borrowing base by more than 133%, while excluding the subordinated loan from the definition of total debt. The facility was drawn approximately US$21.6 million as at December 31, 2015.

In 2015, management obtained a waiver from the consolidated cash flow to interest expense covenant from the senior lender on the condition that interest payments under the subordinated loan are deferred until such time as the covenant is back in compliance, or until April 1, 2016, whichever is earlier. Interest payments under the subordinated loan have been deferred commencing April 1, 2015. The consolidated cash flow to interest expense ratio at December 31, 2015 was 4.8 to 1, and therefore the Company is in compliance with this covenant as at that date, and is also in compliance with all of its other covenants under the senior loan as at December 31, 2015.

Subordinated Loan

The Company has a secured, subordinated, revolving credit facility which may be drawn in US dollars and which has a capacity of US$60.0 million (Cdn$83.4 million, assuming the December 31, 2015 foreign exchange rate). The maturity date of the facility is December 31, 2016. The credit facility bears interest at a rate of 12% per annum, with interest payments due monthly, and includes a 2.5% loan origination fee. The credit facility is provided by two significant shareholders of the Company, one of whom is also a director and the CEO. This loan is secured by all of the assets of the Company, but subordinated to the senior loan facility. Among certain non-financial covenants, the subordinated loan requires the Company to comply with the financial covenants required by the senior loan agreement. Thus, a default under the terms of the senior loan would create a default under the subordinated loan agreement. Loan origination fees in total of US$1.5 million have been reflected net of the outstanding debt balance on the statement of financial position and are being amortized over the term of the credit facility and charged to finance expense using the effective interest rate method. Total fees amortized to finance expense for the year ended December 31, 2015 were approximately US$850,000 (December 31, 2014 – US$500,000). This facility was drawn approximately US$32.3 million as at December 31, 2014 and as at December 31, 2015 was drawn US$54.4 million.

Accrued liabilities as at December 31, 2015 includes deferred interest payable and origination fees of US$4.8 million.

Subsequent to December 31, 2015, the subordinated lenders have agreed with the Company to make the following amendments to the terms of the subordinated loan. The loan capacity has been increased to US$80.0 million and the maturity date has been extended to December 31, 2017. In consideration for the increase in capacity, the extension of the term and the continued deferral of interest payments (for the term of the subordinated loan or until such time as the bank permits cash interest to be paid, if earlier), the Company has agreed to issue 2.0 million common share purchase warrants to the subordinated lenders, pro rata to their participation in the revised commitment amount. Each warrant will entitle the holder to exercise and purchase one common share of the Company at $0.75 for a period of two years from the date the subordinated loan terms are amended and are subject to the acceptance of the TSX Venture Exchange.

The previously agreed 2.5% loan origination fee will also be paid on the increased commitment amount under the facility.

11. FINANCIAL DERIVATIVE INSTRUMENTS

The Company had utilized commodity price swaps in 2014 as part of its former senior loan facility. A swap requires the Company to pay the counterparty if the settlement price exceeds the strike price, and the same counterparty is required to pay the Company if the settlement price is less than the strike price. The Company does not enter into derivative contracts for speculative purposes.

The amount of loss recognized in the statements of operations related to the Company's derivative financial instruments are as follows:

	Year Ended December 31, 2014
Realized loss on financial derivatives	$ (53)
Unrealized loss on financial derivatives	(17)
Loss on commodity price risk management activities	$ (70)

The Company has no commodity derivative contracts outstanding currently or as at December 31, 2015.

12. SHARE CAPITAL

a) Share capital

The Company's authorized share capital includes unlimited Class A preferred shares with rights and privileges to be determined by the Board of Directors prior to issuance, unlimited common non-voting shares, convertible into common voting shares on a 1 for 1 basis, and unlimited common voting shares. As at December 31, 2015 and 2014, the Company had 27,507,574 common shares and 6,700,000 non-voting common shares issued and outstanding.

The following table reflects the Company's outstanding common shares as at December 31, 2015 and 2014:

	Number of Voting and Non-Voting Shares	Share Capital
Balance as at December 31, 2013	29,007,574	$ 28,948
Issuance of common shares for cash, net of issuance costs	5,000,000	6,442
Issuance of common shares - acquisition of property (Note 6)	200,000	268
Balance as at December 31, 2014 and 2015	34,207,574	$ 35,658

In June 2014, the Company closed a non-brokered private placement of 5 million voting common shares at $1.30 per share for gross proceeds of $6.5 million with 3.4 million shares subscribed for by directors and officers of the Company.

b) Stock options

In the year ended December 31, 2015, the Company issued 20,000 (December 31, 2014 – 275,000) stock options to employees. The stock options are exercisable for a five year term at an exercise price of $1.11 (December 31, 2014 - $1.40) per share. The options vest in three equal tranches beginning one year from the effective date and then on each of the two following anniversaries.

The following table presents stock option transactions for the years ended December 31, 2015 and 2014:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Balance as at December 31, 2013	2,000,205	$ 1.12	4.01
Granted	275,000	1.40	5.00
Balance as at December 31, 2014	2,275,205	1.16	3.15
Granted	20,000	1.11	4.70
Balance as at December 31, 2015	2,295,205	$ 1.16	2.16

As at December 31, 2015, the following stock options were outstanding:

Exercise Prices	Weighted Average Remaining Contractual Term	Number of Outstanding Options	Number of Options Exercisable	Weighted Average Exercise Price
$0.70	2.90	943,264	628,838	$0.70
$1.11	3.75	20,000	6,667	$1.11
$1.40	3.20	275,000	91,666	$1.40
$1.50	1.21	1,056,941	1,056,941	$1.50
	2.16	2,295,205	1,784,112	$1.16

The Company uses the fair value method to account for all share-based awards granted to employees, officers and directors. The estimated fair value of stock option grants was determined using the Black-Scholes option pricing model and is recorded as a charge to income over the vesting period with a corresponding increase to contributed surplus.

During the years ended December 31, 2015 and 2014, the Company recorded $233,000 and $524,000, respectively in share-based compensation expense.

The fair value of the stock options granted has been estimated on the date of grant using the following assumptions:

	Year ended December 31, 2015	Year ended December 31, 2014
Expected volatility	122%	115%
Option life	5 years	5 years
Expected dividends	nil	nil
Risk-free interest rate	2.80%	1.57% to 1.73%
Forfeiture rate	0% to 20%	0% to 20%
Fair value of option	$ 0.92	$ 1.12

The expected volatility used in the Black Scholes option pricing model is based on the historic volatility of the Company's share price.

c) Warrants

Subsequent to December 31, 2015, the Company agreed to issue 2.0 million common share purchase warrants to the Company's subordinated lenders (see Note 10). Each warrant will entitle the holder to exercise and acquire one common share for $0.75 for a period of two years from the date of grant, which will be the date on which the terms of the subordinated loan are amended.

13. NET LOSS PER COMMON SHARE

The following table presents the Company's net loss per common share:

(thousands, except for share and per share data)	Year ended December 31, 2015	Year ended December 31, 2014
Net loss for the period	$ (8,947)	$ (5,054)
Weighted average number of basic common shares	34,207,574	32,102,917
Net loss per weighted average basic and diluted common share	$ (0.26)	$ (0.16)

14. INCOME TAXES

The provision for income taxes recorded in the financial statements varies from the amount that would be computed by applying the Canadian statutory income tax rate of 26.50% as a result of the following:

	Year ended December 31, 2015	Year ended December 31, 2014
Loss before income tax provision	$ (8,947)	$ (5,054)
Statutory rate	26.50%	26.50%
Income tax recovery at statutory rate	(2,371)	(1,339)
Tax effect on the following:		
Effect of higher corporate tax rate in US	(912)	(333)
Nondeductible expense	66	140
Impact of rate change and other	96	(343)
Change in unrecognized deferred tax asset	3,121	1,875
Provision for income taxes	$ -	$ -

The components of the Company's deferred tax liability are as follows:

	December 31, 2015	December 31, 2014
Exploration and evaluation assets and property, plant and equipment	$ (7,888)	$ (3,957)
Non-capital losses (Federal)	7,888	3,957
	$ -	$ -

The deductible temporary differences included in the Company's unrecognized deferred income tax assets are as follows:

	December 31, 2015	December 31, 2014
Decommissioning obligation	$ 834	$ 892
Accrued interest	6,726	-
Non-capital losses (Federal)	41,262	33,095
Non-capital losses (State)	36,146	24,279
Share issue costs	376	790
Share-based compensation	1,011	742
Other	30	1
	$ 86,385	$ 59,799

The unused tax losses that have not been recognized are as follows:

	December 31, 2015	Expiration Dates
Non-capital losses (U.S.)	$ 57,357	2031 to 2035
Non-capital losses (CAN)	$ 4,760	2030 to 2035
Non-capital losses (Montana)	$ 9,440	2018 to 2021
Non-capital losses (North Dakota)	$ 26,706	2031 to 2034

15. COMMITMENTS

The Company has an outstanding letter of credit in favor of an energy regulator in North Dakota in the amount of US$75,000. As security, the Company has set aside an equivalent amount in cash at the financial institution that issued the letter of credit.

The Company is committed to monthly rental payments for office space of an average of US$7,500 until August 2017.

16. RELATED PARTY TRANSACTIONS

Related party transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Compensation of key management personnel

Key management personnel include the Chief Executive Officer of the Company, the President of PetroShale (U.S.), Inc., the Chief Financial Officer and the directors and other officers of the Company.

	Year Ended December 31, 2015	Year Ended December 31, 2014
Salaries and other short-term benefits	$ 421	$ 287
Consulting fees	384	330
Share-based compensation	154	422
	$ 959	$ 1,039

The Company has a secured, subordinated, revolving credit facility which may be drawn in US dollars and which has a capacity of US$80.0 million (increased from US$60.0 million subsequent to December 31, 2015) and a revised maturity date of December 31, 2017. The credit facility is provided by two significant shareholders of the Company, one of whom is also a director and the CEO. See further details in Note 10 – Debt - Subordinated loan. During 2015, fees related to this facility were amortized to finance expense in the amount of US$850,000 (December 31, 2014 – US$500,000). During 2015, the Company paid US$1.3 million (2014 - US$3.4 million) in cash interest and origination fees on the subordinated loan and accrued an additional US$4.8 million of interest which is reflected in accounts payable at December 31, 2015. As partial consideration for extending the term of the subordinated loan, increasing the facility capacity and agreeing to continue to defer cash interest payments, the Company granted 2.0 million common share purchase warrants to the subordinated lenders, pro rata to their participation in the revised commitment

amount, subsequent to December 31, 2015. Each warrant entitles the holder to acquire one common share at $0.75 for a period of two years from the date the subordinated loan terms were amended and are subject to the acceptance of the TSX Venture Exchange. See Note 12 – Warrants.

17. RISK MANAGEMENT

a) Overview

The Company's activities expose it to a variety of financial risks such as credit risk, liquidity risk and market risk that arise as a result of its exploration, development, production and financing activities.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

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

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.

The carrying amount of the Company's cash and cash equivalents, accounts receivable, and financial derivative contract assets represent the maximum credit exposure.

With respect to accounts receivable, the Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

As the majority of the Company's current oil and natural gas operations are conducted on a non-operated basis, its accounts receivable mainly reflect joint venture receivables from the operators of each of its respective properties. The Company attempts to mitigate the risk from joint venture receivables by working with large reputable industry operators. 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, escalating costs and the risk of unsuccessful drilling. Further risk exists with joint venture partners as disagreements occasionally arise, increasing the risk of non-collection.

The Company does not typically obtain collateral from joint venture partners and believes that operators of its properties, who are responsible for marketing the production from those properties, do not typically obtain collateral from petroleum and natural gas marketers they may utilize. However, the Company mitigates this risk by working with large reputable operators.

With respect to its operated assets, the Company does not anticipate any default on collection of accounts receivable as it transacts with credit-worthy customers. As such, a provision for doubtful accounts has not been recorded as at December 31, 2015 or December 31, 2014.

All of the Company's accounts receivable are from the production of oil and natural gas. There are no receivables that are greater than 90 days outstanding.

The Company currently has no financial derivative contracts outstanding.

c) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting its financial obligations as they come due. The financial liabilities in the statement of financial position consist of accounts payable, which are all considered due within one year, and the senior and subordinated loans. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities as they come due. The Company forecasts its cash flows from operating activities as well as obligations related to capital spending and settlement of accounts payable in relation to available liquidity from its revolving credit facilities. The Company's accounts payable and accrued liabilities balance at December 31, 2015 is approximately $16.8 million (December 31, 2014 - $19.3 million). It is the Company's practice to pay suppliers within 45-90 days. As at December 31, 2015, substantially all of the account balances were less than 90 days, with the exception of deferred interest on the subordinated loan of US$4.8 million (Cdn$6.7million) as at December 31, 2015.

The following are the contractual maturities of the Company's debt obligations and anticipated timing of settlements of its other financial liabilities as at December 31, 2015, including estimated interest payments:

(in thousands)	Contractual Cash Flow	Less than 1 Year	1-2 Years	3-5 Years	Thereafter
Accounts payable and accrued liabilities[(1)]	$ 16,778	$ 16,778	$ -	$ -	$ -
Senior loan [(2)]	30,751	30,751	-	-	-
Subordinated loan[(3)]	84,690	84,690	-	-	-
Total	$ 132,219	$ 132,219	$ -	$ -	$ -

[(1)] The amount includes deferred interest and fees payable of $6.7 million on the subordinated loan reflected in the financial statements.

[(2)] Includes interest expense at the rate of 4.1% being the rate applicable at December 31, 2015.

[(3)] The amount differs from that presented on the statement of financial position due, in part, to the unamortized portion of loan origination fees and future interest expense at the fixed rate of 12.0% as at December 31, 2015. Although interest expense on this loan is currently deferred, the table reflects the full interest obligation to the maturity date of December 31, 2016 which was in place as at December 31, 2015. Subsequent to December 31, 2015, the subordinated loan maturity was extended to December 31, 2017.

d) Market risk

Market risk is the risk that changes in market prices relating to currency, commodity prices and interest rates will affect the Company's net earnings, future cash flows, the value of financial instruments, or the fair value of its assets and liabilities. The objective of market risk management is to manage and control market risk exposure within acceptable parameters.

Although the Company does not generally sell or transact in foreign currencies, its US subsidiaries conduct their operations primarily in US dollars. Furthermore, exchange rate fluctuations can affect the

fair value and cash flow from derivative contracts. For the years ended December 31, 2015 and December 31, 2014, the Company did not enter into any foreign currency derivative contracts.

Commodity prices for crude oil, natural gas liquids and natural gas are also impacted by political events, meteorological conditions and changes in supply and demand. The Company may enter into commodity derivative contracts that provide downside price protection in order to provide some stability of cash flows for capital spending and planning purposes. The Company's risk management activities are conducted pursuant to its risk management policies approved by the Board of Directors.

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in interest rates. The Company's interest rate risk arises from its floating rate senior loan. For the periods ended December 31, 2015 and 2014, the Company did not enter into any interest rate derivative contracts. The impact of a 1% increase in the interest rate associated with the senior loan for the year ended December 31, 2015, would have been an increase in net loss of approximately $0.2 million (December 31, 2014 - $50,000.)

18. CAPITAL MANAGEMENT

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute on its capital expenditure program, which includes expenditures on oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions, including: current economic conditions; the risk characteristics of the Company's petroleum and natural gas assets; the depth of its investment opportunities; current and forecasted net debt levels; current and forecasted commodity prices; and other factors that influence realized commodity prices and funds flow from operations such as quality and basis differential, royalties, operation costs and transportation costs. The Company considers its capital structure to include working capital, any debt and shareholders' equity. The Company monitors capital based on current funds flow from operations compared to forecasted capital and operating requirements.

In order to maintain or adjust the capital structure, the Company will consider: its forecasted funds flow from operations while attempting to finance an acceptable capital expenditure program which may in the future include acquisition opportunities; the current level of credit available from its lenders; the level of credit that may become available from its lenders as a result of oil and gas reserve growth; the availability of other sources of debt with different characteristics than bank debt or the existing subordinated loan; the sale of assets; limiting the size of the capital expenditure program and new equity if available on favorable terms. The Company's share capital is not subject to external restrictions. Access to any bank credit facility is determined by the lenders and is generally based upon the lenders' borrowing base models which are based upon the Company's petroleum and natural gas reserves. The Company's subordinated loan is provided by two parties being its largest shareholders, including the CEO and Executive Chairman.

19. SUPPLEMENTAL CASH FLOW DISCLOSURES

Changes in non-cash working capital is comprised of:

	Years ended December 31, 2015	2014
Source/(use) of cash:		
Accounts receivable	$ (718)	$ (2,121)
Prepaid expenses	(62)	(108)
Accounts payable	(1,117)	17,627
	$ (1,897)	$ 15,398
Related to operating activities	$ 489	$ (802)
Related to investing activities	(15,043)	14,295
Related to financing activities	6,194	-
Assumed accounts receivable and payable on acquisition of assets	3,532	1,166
Difference due to foreign exchange	2,931	739
	$ (1,897)	$ 15,398
Interest paid	$ 1,748	$ 2,625
Income taxes paid	nil	nil

20. SEGMENT DISCLOSURES

The Company operates in one industry segment, the production of petroleum and natural gas and the exploration for and development of oil and natural gas properties.

The Company and its subsidiaries operated in two geographical segments during the periods reported below, Canada and the United States. The Company disposed of the majority of its Canadian assets as at June 30, 2015.

	Years ended December 31,	
	2015	**2014**
Revenue, net of royalties		
United States	$ 17,700	$ 6,575
Canada	226	659
	$ 17,926	$ 7,234
Net loss for the period		
United States	$ (8,321)	$ (3,065)
Canada	(626)	(1,989)
	$ (8,947)	$ (5,054)

	December 31,	
	2015	**2014**
Property, plant and equipment		
United States	$ 123,241	$ 73,920
Canada	702	1,116
	$ 123,943	$ 75,036