Consolidated Financial Statements of

ARSENAL ENERGY INC.

Years ended December 31, 2014 and 2013

MANAGEMENT'S REPORT

Management, in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board, has prepared the accompanying consolidated financial statements of Arsenal Energy Inc. (the "Company"). Financial and operating information presented throughout this report is consistent with that shown in the consolidated financial statements. The consolidated financial statements have been prepared in accordance with the accounting policies detailed in the notes thereto.

Management is responsible for the integrity of the financial statements by selecting and training qualified personnel and by ensuring that the organizational structure provides appropriate delegation of authority and segregation and division of responsibilities and authority. Internal control systems are designed and maintained to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for financial reporting purposes.

KPMG LLP was appointed by the Company's shareholders to conduct an audit of the consolidated financial statements so as to express an opinion on the consolidated financial statements. Their examination included such tests and procedures, as they considered necessary, to provide reasonable assurance that the financial statements are presented fairly in accordance with IFRS.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee, with assistance from the Reserve Committee regarding the annual evaluation of our petroleum and natural gas reserves. The Audit Committee, which is composed of completely independent directors all of which have financial expertise, meets regularly with management and the independent auditors to ensure that management's responsibilities are properly discharged, to review the consolidated financial statements and recommend that the consolidated financial statements be presented to the Board of Directors for approval. The Audit Committee also considers the independence of the external auditors and reviews their fees. The external auditors have access to the Audit Committee without the presence of management.

"Signed" Tony van WInkoop
President and Chief Executive Officer

"Signed" J. Paul Lawrence
Vice President Finance and Chief Financial Officer

March 9, 2015

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Arsenal Energy Inc.

We have audited the accompanying consolidated financial statements of Arsenal Energy Inc. which comprise the consolidated statements of financial position as at December 31, 2014 and December 31, 2013, the consolidated statements of income (loss) and comprehensive income (loss), changes in shareholders' 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 Arsenal Energy Inc. as at December 31, 2014 and December 31, 2013, 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 Accountants

March 9, 2015
Calgary, Canada

Arsenal Energy Inc.

Consolidated Statements of Financial Position
As at December 31,

(thousands of $Cdn)		2014		2013
Assets				
Current assets:				
Cash	$	2,573	$	1,219
Accounts receivable		10,553		10,611
Other receivable (note 6)		-		1,875
Inventory		570		364
Risk management contracts (note 12)		11,946		-
Prepaid expenses and deposits		649		772
		26,291		14,841
Reclamation deposit		174		160
Exploration and evaluation assets (note 6)		3,639		10,259
Property, plant and equipment (notes 7 and 8)		206,320		166,662
	$	236,424	$	191,922
Liabilities and Shareholders' Equity				
Current liabilities:				
Accounts payable and accrued liabilities	$	16,700	$	13,991
Current tax payable		522		325
Current portion of decommissioning obligations (note 10)		750		1,000
Incentive compensation liability (note 11(b))		1,571		809
Risk management contracts (note 12)		57		3,710
		19,600		19,835
Bank loan (note 9)		60,000		69,100
Flow-through share premium (note 11(a))		1,628		38
Risk management contracts (note 12)		139		194
Decommissioning obligations (note 10)		43,979		35,321
Deferred taxes (note 14)		20,386		14,562
		145,732		139,050
Shareholders' Equity:				
Common shares (note 11(a))		151,434		137,705
Contributed surplus		11,388		10,940
Accumulated other comprehensive income		3,182		802
Deficit		(75,312)		(96,575)
		90,692		52,872
	$	236,424	$	191,922

Subsequent events (notes 11(a) and12)
Segmented information (note 16)
Commitments and contingencies (note 17)

Approved by the Board of Directors:

"Signed" R. Neil MacKay
Director and Chairman of the Board of Directors

"Signed" William Hews
Director and Chair of the Audit Committee

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

Arsenal Energy Inc.

Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)
For the years ended December 31,

(thousands of $Cdn, except per share amounts)		**2014**		**2013**
Revenue				
Oil and natural gas	$	117,114	$	97,811
Royalties		(25,317)		(21,067)
Net revenue		91,797		76,744
Realized gain (loss) on risk management contracts (note 12(a))		1,227		(3,214)
Unrealized gain (loss) on risk management contracts (note 12(a))		15,654		(4,091)
Net revenue after risk management		108,678		69,439
Expenses				
Operating and transportation		30,767		28,711
General and administrative		4,026		4,180
Exploration and evaluation expenses		4,010		257
Depletion and depreciation (note 7)		30,853		25,906
Exploration and evaluation impairment (note 6)		5,199		2,228
Property, plant and equipment impairment (note 7)		-		1,000
Interest and other financing charges		2,775		2,576
Accretion (note 10)		1,753		1,705
Share-based compensation (note 11 (b))		1,797		656
Transaction costs		-		134
Gain on sale of property (note 7)		-		(157)
Foreign exchange gain		(2,770)		(1,588)
		78,410		65,608
Income before income tax		30,268		3,831
Provision for income taxes (note 14)				
Current		969		325
Deferred		3,658		6,220
		4,627		6,545
Net income (loss) for the year	**$**	**25,641**	**$**	**(2,714)**
Other comprehensive income				
Translation gain on foreign operations		2,380		1,134
Comprehensive income (loss)	**$**	**28,021**	**$**	**(1,580)**
Net income (loss) per share (note 11(c))				
Basic	$	1.55	$	(0.17)
Diluted	$	1.54	$	(0.17)

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

Arsenal Energy Inc.

Consolidated Statements of Changes in Shareholders' Equity

(thousands)	Number of Shares	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Deficit	Total Shareholders' equity
Balance December 31, 2012	15,595	$135,646	$11,646	$(332)	$(91,933)	$55,027
Net loss for the year	-	-	-	-	(2,714)	(2,714)
Issue of shares, net of costs and premium	635	2,725	-	-	-	2,725
Share-based compensation expensed	-	-	656	-	-	656
Share-based compensation capitalized	-	-	159	-	-	159
Transfer of share-based compensation on exercise of options	-	961	(961)	-	-	-
Issued on exercise of options (note 11 (b))	75	166	-	-	-	166
Purchase of puts	-	-	(409)	-	-	(409)
Repurchase of shares (note 11 (d))	(207)	(1,793)	658	-	-	(1,135)
Adjustment to record cash settled equity instruments	-	-	(809)	-	-	(809)
Dividends	-	-	-	-	(1,928)	(1,928)
Cancelled on expiration of amalgamation exchange provision	(18)	-	-	-	-	-
Translation gain on foreign operations	-	-	-	1,134	-	1,134
Balance December 31, 2013	16,080	$137,705	$10,940	$802	(96,575)	$52,872
Balance December 31, 2013	16,080	$137,705	$10,940	$802	$(96,575)	$52,872
Net income for the year	-	-	-	-	25,641	25,641
Issue of shares, net of costs and premium	1,712	12,843	-	-	-	12,843
Issued on exercise of options (note 11 (b))	101	877	-	-	-	877
Share-based compensation expensed	-	-	395	-	-	395
Repurchase of shares (note 11 (d))	(41)	(349)	53	-	-	(296)
Dividends	42	358	-	-	(4,378)	(4,020)
Cancelled on expiration of amalgamation exchange provision	(17)	-	-	-	-	-
Translation gain on foreign operations	-	-	-	2,380	-	2,380
Balance December 31, 2014	17,877	$151,434	$11,388	$3,182	$(75,312)	$90,692

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

Arsenal Energy Inc.

Consolidated Statements of Cash flows

For the years ended December 31,

(thousands of $Cdn)		2014		2013
Operating Activities:				
Net income (loss) for the year	$	25,641	$	(2,714)
Items not affecting cash:				
Unrealized (gain) loss on risk management contracts		(15,654)		4,091
Depletion and depreciation		30,853		25,906
Accretion of decommissioning obligations (note 10)		1,753		1,705
Deferred tax expense		3,658		6,220
Exploration and evaluation and property impairment (note 6)		5,199		2,228
Property, plant and equipment impairment (notes 7 and 8)		-		1,000
Share-based compensation expensed (note 11(b))		1,797		656
Unrealized foreign exchange gain		(2,694)		(1,467)
Gain on sale of property and equipment		-		(157)
Decommissioning obligations settled (note 10)		(1,987)		(1,039)
Net change in non-cash working capital (note 15)		(291)		(1,116)
Net cash from operating activities		48,275		35,313
Financing Activities:				
Bank loan (payments) advances		(9,100)		6,380
Issue of shares for cash, net of share issue costs		15,025		2,950
Dividends paid		(4,020)		(1,928)
Issue of shares on exercise of stock options		583		166
Purchase of put options		(343)		(409)
Repurchase of shares		(296)		(1,135)
Net change in non-cash working capital items (note 15)		153		(522)
Net cash from financing activities		2,002		5,502
Investing Activities:				
Property, plant and equipment		(53,047)		(33,475)
Exploration and evaluation asset expenditures		(487)		(6,268)
Acquisition of properties		(152)		-
Disposition of property, plant and equipment		100		4,230
Net change in non-cash working capital items (note 15)		4,616		(3,797)
Net cash (used in) investing activities		(48,970)		(39,310)
Foreign exchange gain (loss) on cash held in foreign currency		47		(286)
Change in cash during the year		1,354		1,219
Cash, beginning of year		1,219		-
Cash, end of year	$	2,573	$	1,219
The following are included in cash flow from operating activities:				
Interest paid in cash	$	2,603	$	2,387
Income taxes paid in cash	$	818	$	-

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

1. Reporting entity:

Arsenal Energy Inc. ("Arsenal" or the "Company") is an oil and gas exploration, development and production Company based in Calgary, Alberta, Canada. The Company conducts its operations in the Western Canadian Sedimentary basin in Canada and the Williston basin in the United States. The consolidated financial statements of the Company as at December 31, 2014 comprise the Company and its wholly owned subsidiaries, Arsenal Energy USA Ltd. and Arsenal Energy Holdings Ltd.; which were incorporated in the USA and Canada respectively. Arsenal's principle place of business is located at Suite 1900, 639 – 5th Avenue SW, Calgary Alberta, Canada, T2P 0M9.

2. Basis of preparation:

(a) Statement of compliance:

These consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and were prepared using accounting policies consistent with IFRS.

The consolidated financial statements were authorized for issue by the Board of Directors on March 9, 2015.

(b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis except for the derivative financial instruments, short term incentive compensation liability and decommissioning obligations which are measured at fair value. The methods used to measure fair value are discussed in notes 5 and 12.

(c) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is the parent company's functional currency. Arsenal's subsidiary Arsenal Energy USA Ltd. has a U.S. dollar functional currency.

(d) Use of estimates, judgments and assumptions:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts regarding assets, liabilities, revenue, and expenses. Actual results may differ from estimated amounts as future confirming events occur.

Reserve estimates including production profiles, future development costs, and discount rates are a critical part of many of the estimated amounts and calculations contained in the financial statements. These estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations. These determinations are updated at least on an annual basis.

Significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognized in the consolidated financial statements include:

- Impairment testing – estimates of reserves, future commodity prices, future costs, production profiles, discount rates, market value of land.
- Depletion and depreciation - oil and natural gas reserves, including future prices, costs and reserve base to use on calculation of depletion.
- Decommissioning obligations – estimates relating to amounts, likelihood, timing, inflation and discount rates.

- Short-term incentive compensation – forfeiture rates, volatility and multiplier rate.
- Risk management contracts – expected future oil and natural gas prices and expected volatility in these prices.
- Deferred tax – estimates of reversal of temporary differences, tax rates substantively enacted, and likelihood of assets being realized.
- Determinations of cash generating units ("CGU's").
- Determining the status and viability of exploration and evaluation assets.

3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Company and its subsidiaries. Certain comparative amounts have been reclassified to conform with the current year's presentation.

(a) Basis of 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 the consolidated financial statements from the date that control commences until the date that control ceases.

(ii) *Jointly controlled operations and jointly controlled assets:*
Many of the Company's oil and natural gas activities involve jointly controlled assets. The consolidated 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:*
Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency:

(i) Transactions in foreign currencies are generally translated to Canadian dollars at the average exchange rate for the period. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the period end exchange rate. Foreign currency differences arising on translation are recognized in earnings in the period in which they arise.

(ii) Assets and liabilities of Arsenal's U.S. operations are translated into Canadian dollars at period end exchange rates while revenues and expenses are translated using average rates for the period. Gains and losses from the translation are deferred and included in accumulated other comprehensive income ("AOCI").

(c) Financial instruments:

(i) Non-derivative financial instruments:

Non-derivative financial instruments comprise account receivable, cash and cash equivalents, bank loans, and accounts payables and accrued liabilities. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash on hand, term deposits held with banks, other short-term highly liquid investments with original maturities of three months or less.

Financial assets at fair value through profit or loss:

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition attributable transaction costs are recognized in profit or loss when incurred. Financial instruments are measured at fair value and changes therein are recognized in profit or loss.

Other non-derivative financial instruments, such as cash and cash equivalents, accounts receivable, bank loans, accounts payables and accrued liabilities, are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Derivative financial instruments:

The Company has entered into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the balance sheet at fair value. Transaction costs are recognized in earnings when incurred.

The Company accounts for any forward physical delivery sales contracts, which are entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts. As such, these contracts are not considered to be derivative financial instruments and are not recorded at fair value on the balance sheet. Settlements on these physical sales contracts are recognized in oil and natural gas revenue.

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

(iii) Share capital:

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any deferred taxes.

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

(i) Recognition and measurement:

Exploration and evaluation expenditures:

Pre-license costs, dry holes, seismic and lease rentals are recognized in the statement of operations as incurred.

Exploration and evaluation costs, include costs of land and exploratory drilling and testing, are capitalized as exploration and evaluation assets according to the expenditure. Tangible assets acquired which are consumed in developing an intangible exploration and evaluation asset are recorded as part of the costs of the exploration and evaluation asset.

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

The technical feasibility and commercial viability is considered to be determinable when proved and or probable reserves are determined to exist. A review is carried out, at least annually, to ascertain whether proved and or probable reserves have been discovered. Upon determination of proved and or probable reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within tangible assets referred to as property, plant and equipment.

Development and production costs:

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment. Development and production assets are grouped into Cash Generating Units ("CGU's") for impairment testing. When significant parts of an item of property, plant and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized in profit or loss.

(ii) Subsequent costs:

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

(iii) Depletion and depreciation:

The net carrying value of development or production assets is depleted using the unit of production method by reference to the ratio of production in the period to the related proved and probable reserves, taking into account estimated future development and decommissioning costs necessary to bring those reserves into production. Future development and decommissioning costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

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

For depletion purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

The estimated useful lives for certain production assets for the current and comparative years are as follows:

Pipeline facilities	Unit of production
Turnaround and work over costs	Expensed as incurred

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment.

Leased 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. Land is not depreciated.

The estimated useful lives for other assets for the current and comparative years are as follows:

Office equipment	5 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(d) Leased assets:

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Company's statement of financial position.

Payments made under operating leases are recognized in earnings on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(e) Business combinations:

The acquisition 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 the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. The recognized amount of identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured mostly at fair value at the acquisition date. The excess of the cost of acquisition over the recognized amount of identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the recognized amount of the net assets of the subsidiary acquired, the difference is recognized immediately in earnings.

(f) Inventory:

Crude oil inventory consists of amounts produced and in storage tanks or in transit, and is recorded at the lower of the average cost of production and estimated net realizable value. Net realizable value is the estimated selling price in the normal course of business less applicable selling expenses.

(g) Impairment:

(i) *Financial assets:*

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

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

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

All impairment losses are recognized in earnings.

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

(ii) *Non-financial assets:*

The carrying amounts of the Company's non-financial assets net of decommissioning obligations, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. Geological formation, product type, geography and internal management are key factors considered when grouping the Company's oil and natural gas assets into CGU's. The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows 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. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

E&E assets are allocated to related CGU's when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to property, plant and equipment.

An impairment loss is recognized if the carrying amount of an asset or its CGU net of decommissioning obligations exceeds its estimated recoverable amount. Impairment losses are recognized in earnings.

An impairment loss in respect of property, plant and equipment and E&E assets recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

(h) Share based payments:

The Company has the right, but not the obligation to settle options in cash upon the exercise of options. Prior to December 31, 2013, the Company accounted for options as equity-settled, where by the grant date fair value of options granted to employees was recognized as compensation expense over the period that the employees became entitled to the awards. Amounts charged were included in profit or loss as stock-based compensation expense with a corresponding increase in contributed surplus.

At December 31, 2013 the Company determined that it would cash settle options outstanding in certain circumstances. Upon determination of the change in classification of options from equity-settled to cash-settled, the Company adopted a policy whereby the fair value of options, to the extent vested, were recorded as a liability with a corresponding charge to equity. No gain or loss was recorded on the date of classification change. Obligations are accrued over the vesting period and the share-based compensation liability is remeasured at fair value, which is estimated using the Black-Scholes option pricing model, at the end of each reporting period. Changes in fair value are recognized in earnings. When options are surrendered for cash, the share-based compensation liability is reduced. When options are exercised for shares, the accrued liability is transferred to share capital.

In 2014 the Company cancelled any further issuances under the stock option plan and initiated the share award incentive plan ("Awards"). The portion of the Awards related to the taxable portion of the payment is recorded as a liability and is estimated using the Black-Scholes option pricing model at the end of each reporting period. The portion of the Awards to be settled in common shares of the Company is accounted for as equity settled and is valued at the closing price immediately preceding the time of grant and are not revalued.

In both situations, a forfeiture rate is estimated on grant date and is adjusted to reflect the actual number of options that vest.

(i) Provisions:

Decommissioning obligations:

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

Decommissioning obligations are measured at the present value of the expected expenditures required to settle the present obligation at the balance sheet date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows and discount rate underlying the obligation. The increase in the provision due to the passage of time is recognized as finance expense whereas increases/decreases due to changes in the estimated future cash flows and discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(j) Revenue:

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

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(k) Finance income and expenses:

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

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method.

Finance income is recognized as it accrues in profit or loss, using the effective interest method.

(l) Income tax:

Income tax expense comprises current and deferred tax. Deferred tax expense is recognized in earnings except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

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

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally

enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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

(m) Per share amounts:

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options and awards granted to employees. The calculation assumes that the proceeds on exercise of options and awards are used to repurchase shares at the current market price.

(n) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. On issuance the premium received on the flow-through shares, being the difference in price over a common share with no tax attributes is recognized on the statement of financial position. As expenditures are incurred the deferred tax liability associated with the renounced tax deductions are recognized through profit and loss along with a pro-rata portion of the deferred premium.

4. New accounting policies:

(a) Change in Accounting Policies

On January 1, 2014 the Company implemented IAS 32 “Financial Instruments: Presentation”, which clarifies the requirements for offsetting financial assets and liabilities. The amendments clarify when an entity has a legally enforceable right to offset and certain other requirements that are necessary to present a net financial asset or liability. The adoption of this standard had no impact on the financial statements of the Company.

On January 1, 2014 the Company implemented the IASB issued IFRIC 21 "Levies", which was developed by the IFRS Interpretations Committee ("IFRIC"). IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. The interpretation also clarifies that no liability should be recognized before the specified minimum threshold to trigger that levy is reached. The adoption of this standard had no impact on the financial statements of the Company.

The Company implemented a share award incentive plan (see Note 11). The Company determines the fair value of incentives issued under the share award incentive plan at the date of grant. The value is recognized as share-based compensation, with a corresponding increase in contributed surplus over the vesting periods of the awards. A forfeiture rate is estimated at the grant date and is adjusted to reflect the actual number of share awards that vest. Performance awards are subject to a performance multiplier.

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

(a) IFRS 11 – Acquisitions of Interests in Joint Operations

The amendments require business combination accounting to be applied to acquisitions of interests in a joint operation that constitute a business. The Company intends to adopt the amendments to IFRS 11 in its financial statements for the annual period beginning on January 1, 2016. The extent of the impact of adoption of the amendments has not yet been determined.

(b) IFRS 15 – Revenue from Contracts and Customers

The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The Company intends to adopt IFRS 15 in its financial statements for the annual period beginning on January 1, 2017. The Company does not expect the standard to have a material impact on the financial statements.

(c) IFRS 9 – Financial Instruments

IFRS 9 (2014) introduces new requirements for the classification and measurement of financial assets. Under IFRS 9 (2014), financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows.

The standard introduces additional changes relating to financial liabilities.

It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

IFRS 9 (2014) also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship.

Special transitional requirements have been set for the application of the new general hedging model.

The Company is currently evaluating the impact of adopting IFRS 9 on its consolidated financial statements.

5. Determination of fair values:

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

(i) Property, plant and equipment and exploration and evaluation assets:

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

(ii) Cash and cash equivalents, accounts receivables, bank loans and accounts payables:

The fair value of cash and cash equivalents, accounts receivables, bank loans and accounts payable is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2014 and December 31, 2013, the fair value of these balances approximated their carrying value due to their short term to maturity. Bank loans bear a floating rate of interest therefore carrying value approximates fair value.

(iii) Derivatives:

The fair value of forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate (based on published government rates). The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

(i) Stock options:

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 instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends and the risk-free interest rate (based on government bonds).

6. Exploration and evaluation assets:

Cost or deemed cost		Total
Balance at December 31, 2012	$	10,754
Additions		6,268
Divestitures		(3,856)
Impairment		(2,228)
Transfer to property, plant and equipment		(679)
Balance at December 31, 2013	$	10,259
Additions		487
Impairment		(5,199)
Transfer to property, plant and equipment		(1,908)
Balance at December 31, 2014	$	3,639

The Company's exploration and evaluation assets are located in Canada.

On April 18, 2013, the Company sold 50% of its interest in its Columbia deep basin exploration prospect area for $3.9 million. Half of the proceeds from the sale were received in April 2013 and half ($1.9 million) in January 2014.

In Q2 2013, due to operational issues impeding the Company's ability to evaluate and drill on exploratory lands acquired in 2011, the Company recognized an impairment of $1.3 million related to a portion of the affected lands. In Q4 2013, due to the Company electing not to drill on certain lands purchased in prior years, the Company recognized an impairment on these lands of $947,493.

In Q4 2014, the Company determined that certain land and exploratory drilling costs were uneconomical due to a decision to not explore certain tracts of land in the Princess area and due to low prices and the lack of associated reserves added in an exploratory drill program in the Columbia field. An impairment of $5.2 million (2013 $2.2 million) was taken to reflect the impaired costs.

7. Property, plant and equipment:

Cost or deemed cost		Total
Balance at December 31, 2012	$	219,213
Additions		32,905
Transfer from exploration and evaluation assets		679
Divestitures		(329)
Capitalized share-based compensation		159
Capitalized general and administration		570
Decommissioning obligations acquired and incurred		602
Impairment		(1,000)
Change in decommissioning obligations		(2,503)
Foreign currency translation		5,482
Balance at December 31, 2013	$	255,778
Additions		52,187
Acquisitions		152
Transfer from exploration and evaluation assets		1,908
Divestitures		(259)
Capitalized general and administration		860
Decommissioning obligations incurred		646
Change in decommissioning obligations		7,601
Foreign currency translation		10,520
Balance at December 31, 2014	$	329,393

Accumulated depreciation		Total
Balance at December 31, 2012	$	62,074
Depletion and depreciation provision		25,834
Divestitures		(85)
Foreign currency translation		1,293
Balance at December 31, 2013	$	89,116
Depletion and depreciation provision		31,003
Divestitures		(100)
Foreign currency translation		3,054
Balance at December 31, 2014	$	123,073

NBV		Total
Balance, at December 31, 2013	$	166,662
Balance, at December 31, 2014	$	206,320

The calculation of depletion for the year ended December 31, 2014 included estimated future development and decommissioning costs of $100.3 million (December 31, 2013 - $98.7 million) associated with the development and decommissioning of the Company's proved plus probable reserves and excludes salvage value of $8.4 million (December 31, 2013 - $11.0 million).

During 2014, the Company did not enter into any significant property acquisitions or dispositions (December 31, 2013 disposition proceeds of $4.2 million resulted in a gain of $157,000).

8. Impairment loss:

As at December 31, 2013, an impairment test on one of the Company's oil properties indicated that based on declining production and increased operating expenses, the carrying value exceeded the estimated recoverable amount and accordingly, an impairment provision of $1.0 million was recognized.

As at December 31, 2014, there were no impairments indicated based on a review of developed and producing properties.

9. Bank loan:

The $90 million facility was reviewed at May 31, 2014 and again on November 30, 2014 and all terms and conditions were renewed and confirmed. The next review date is May 31, 2015.

The credit facility has a revolving period of 364 days plus one year and is extendible annually. If the facility is reduced the Company has 60 days to repay any shortfall, if any, resulting from the decrease. If the facility is not extended, the amount outstanding under the credit facility will automatically convert to a one year non-revolving term loan and all obligations under the credit facility shall be repaid or paid at the end of the one year period.

The credit facility is secured by an unlimited liability guarantee to the lenders, a ISDA Master Agreement, a demand debenture in the amount of $300 million granting a first priority security interest over all present and after acquired personal property and a first floating charge over all present and after acquired petroleum and natural gas interests and mortgages creating specific fixed charges on some of the oil and gas properties of the Company in North Dakota. The credit facility is also subject to certain positive and negative covenants including a covenant not to dispose of assets or property having an aggregate fair value exceeding 5% of the borrowing base without the review and approval of the borrowing base and the facility and not to make distributions (as defined to include dividends) in excess of $5 million annually. The credit facility is subject to a semi-annual borrowing base review based on an independent reserve evaluation in May and on an internally generated engineering evaluation and operational update in November, or in the event of a material adverse effect.

At December 31, 2014, debt under the credit facility amounted to $60.0 million (December 31, 2013 – $69.1 million). At December 31, 2014 there were no US dollar denominated borrowings under the credit facility (December 31, 2013 – nil).

The Company's credit facility has a financial covenant that, without the written consent of the lenders, would result in a breach of the agreement. The Company cannot permit:

> The adjusted working capital ratio (as defined in the agreement to include the unutilized portion of the facility and to exclude the value of any risk management contracts) to fall to below 1:1.

At December 31, 2014, the Company was in compliance with its working capital covenant.

10. Decommissioning obligations:

		Year ended December 31, 2014		Year ended December 31, 2013
Beginning of year	$	36,321	$	37,373
Obligations settled		(1,987)		(1,039)
Obligations disposed		(36)		(32)
Obligations incurred		646		602
Change in estimates		7,601		(2,503)
Foreign currency translation		431		215
Accretion expense		1,753		1,705
End of year	$	44,729	$	36,321

Expected to be incurred within one year	$	750	$	1,000
Expected to be incurred beyond one year	$	43,979	$	35,321

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites, facilities and gathering systems. The total decommissioning obligations are estimated based on the Company's net ownership interest in all wells, facilities and pipelines, estimated costs to reclaim and abandon these wells, facilities and pipelines 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 $44.7 million as at December 31, 2014 (December 31, 2013 - $36.3 million) based on an undiscounted inflation adjusted total future liability of $65.2 million (December 31, 2013 - $53.0 million). These payments are expected to be made over the next 25 years. The discount factor, being the risk free rate related to the liability, is 2.5% in both Canada and the U.S. (December 31, 2013 – 3.0% in Canada and 3.5% in the U.S.).

11. Share capital:

At December 31, 2014, the Company was authorized to issue an unlimited number of common shares with the holders of common shares being entitled to one vote per share.

(a) Issued:

	Year ended December 31, 2014		Year ended December 31, 2013	
	Number of Shares	Share capital	Number of Shares	Share Capital
Balance, beginning of year	16,080	$137,705	15,595	$135,646
Issue of shares, net of costs and premium	1,712	12,843	635	2,725
Transfer from contribute surplus on exercise of options	-	-	-	961
Issued on exercise of options	101	877	75	166
Issued on share dividend	42	358		
Repurchase of shares	(41)	(349)	(207)	(1,793)
Cancelled on expiration of exchange provision	(17)	-	(18)	-
Balance, end of year	17,877	$151,434	16,080	$137,705

Common shares

On March 13, 2013, the Company completed a private placement and issued 260,417 common shares at $4.80 per share for gross proceeds of $1,250,000.

On August 6, 2013, the common shares of the Company were consolidated on a ten for one basis. After giving effect to the consolidation, the Company had 16,069,586 common shares outstanding. The share consolidation was treated retroactively for common shares and stock options.

Flow-through Shares

On July 3, 2014, the Company completed a bought deal financing and issued 799,400 flow-through common shares at $9.35 per flow-through share for gross proceeds of $7.5 million.

On December 8, 2014, the Company completed a bought deal financing and issued 912,950 flow-through common shares at $9.95 per flow-through share for gross proceeds of $9.1 million.

The terms of the flow-through shares issued require the Company to incur and renounce to investors Canadian Exploration Expenses in the total amount of $16.6 million by December 31, 2015. As at December 31, 2014, approximately $4.6 million has been incurred.

Dividends

During the year ended December 31, 2014, the Company declared quarterly dividends totaling $0.265 per share that resulted in cash dividend payments of $4.0 million and share dividends of $358,000. As at December 31, 2014, there were no dividends payable to shareholders (December 31, 2013 - $ nil).

At the Company's Board of Directors meeting on February 9, 2015, the Directors declared a quarterly dividend of $0.03 per common share ($0.12 annualized) to shareholders of record on February 17, 2015 resulting in a cash payment of $465,000 and a share dividend of $71,000 on February 27, 2015.

(b) Share based payments:

Share award incentive plan

During 2014 the Company implemented a share award incentive plan and discontinued any further grants under the option plan. Under the share award incentive plan the Company may issue restricted awards and/or performance awards to participants to a maximum of 4.5% of the Company's issued and outstanding common shares.

Restricted awards entitle the participant to one common share of the Company for each restricted award issued. Performance awards entitle the participant to common shares of the Company based on a payout multiplier based on pre-determined corporate performance measures of from 0 to 2 times the number of performance awards issued. For purposes of stock-based compensation a forfeiture rate of 5% on all awards and a payout multiplier of 1.0 for the performance awards were utilized.

Awards vest one-third annually on each of the first, second and third anniversaries from the date of grant. All awards are adjusted to include dividends from the date of grant to the date of vesting. The Company has the option of settling the notional value of the common shares underlying the award by payment in common shares issued from treasury or by payment in cash. The Company has determined that a portion of the settlement will be in cash and a portion of the settlement will be in common shares. The cash portion of these awards is accounted for as a liability and the common share component of these awards has been accounted for as equity.

The share award incentives are summarized in the following table:

	Number of restricted awards	Weighted average fair market value	Number of performance awards	Weighted average fair market value
Balance, beginning of period	-	$ -	-	$ -
Granted	127	8.41	115	8.41
Balance, end of period	127	$ 8.41	115	$ 8.41

Stock option plan

The Company had a stock option plan under which the Company granted options to its directors, officers, employees and consultants for up to 10% of its outstanding common shares. The exercise price of each option granted was not less than the market price of the Company's common shares on the date the option was granted and the contractual term of each option did not exceed five years. The stock option plan was discontinued with the implementation of the share award incentive plan.

The following table summarizes changes in options outstanding under the Company's stock option plan:

	Number of options	Weighted average exercise price
Balance, December 31, 2012	1,529	$ 6.35
Granted	286	4.03
Exercised	(75)	2.23
Cancelled – cash settled	(237)	3.88
Expired	(235)	7.04
Balance, December 31, 2013	1,268	$ 6.41
Exercised	(101)	5.76
Cash settled	(148)	5.48
Forfeited	(5)	5.89
Balance, December 31, 2014	1,014	$ 6.61

The following table summarizes information about the stock options outstanding and exercisable at December 31, 2014:

	Options outstanding			Options exercisable	
Range of exercise prices	Number of options	Weighted average exercise price	Weighted average remaining life (years)	Number of options	Weighted average exercise price
$4.00 to $6.00	354	$ 4.30	3.15	140	$ 4.51
$6.01 to $8.00	319	6.58	1.46	314	6.57
$8.01 to $10.00	341	9.03	0.50	341	9.03
Total	1,014	$ 6.61	1.73	795	$ 7.26

As a result of the conversion of the option plan from an equity settled plan to a cash settled plan, the obligation associated with the cash settled vested options is recorded as a liability. The fair value of the liability is measured at the reporting date using the Black-Scholes option pricing model based on the closing price of the Company's common shares at year end and assumptions for the expected life of the option, market volatility, the expected dividend, expected forfeitures and the risk free interest rate. Any changes in the fair value over the reporting periods is recognized in net income for the period. The fair value of the liability was determined at December 31, 2014 using the closing price of $6.77 for the common shares using the Black Scholes option pricing model with the following assumptions:

	Year ended December 31, 2014	Year ended December 31, 2013
Risk free interest rate	1.03%	1.07 - 1.51%
Expected life	3 years	4 years
Expected volatility	55%	57 – 60%
Expected dividend	0.26	0.24
Weighted average fair value per option/award	$1.42	$0.88

(c) Income (loss) per share:

The following table shows the weighted average number of common and diluted shares.

	Year ended December 31, 2014	Year ended December 31, 2013
Income (loss) per share:		
Basic	$ 1.55	$ (0.17)
Diluted	$ 1.54	$ (0.17)
Weighted average shares outstanding:		
Basic	16,565	15,905
Diluted	16,959	15,905

In computing diluted loss per share for the year ended December 31, 2014, 1,014,000 (2013- 1,268,000) options were excluded from the dilution calculations as they were anti-dilutive.

(d) Normal course issuer bid:

For the year ended December 31, 2013, the Company purchased and cancelled 206,500 common shares at a cost of $1,134,591 or $5.49 per share plus expenses.

On March 27, 2014, the Company announced its intention to make a normal course issuer bid ("NCIB") that commenced April 1, 2014 and ending March 31, 2015. A total of 804,506 common shares may have been acquired under the bid representing 5% of the 16,090,119 common shares outstanding as of March 26, 2014. To December 31, 2014, the Company had purchased and cancelled 40,900 common shares at a cost of $296,164 or $7.24 per share plus expenses. The stated value of these shares exceeded the cost by $52,953 and has been recorded to contributed surplus.

12. Risk management and financial instruments:

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

- market risk
- credit risk
- liquidity risk

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 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) Market Risk:

Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. Canadian commodity prices are influenced by fluctuations in the Canadian to U.S. dollar exchange rate. As at December 31, 2014, the Company does not have any foreign currency exchange contracts in place. A $0.01 change in the CAD/US dollar exchange rate is estimated to result in a change to the 2014 net income by $369,000.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank loan which bears a floating rate of interest. Average bank debt outstanding during the year ended December 31, 2014 was $71.6 million (2013 - $65.3 million). For the year ended December 31, 2014, a 1.0 percent change to the effective interest rate would have a $716,000 impact on net income (2013 - $653,000).

The Company has attempted to mitigate the impact of future fluctuations in interest rates on its outstanding through an existing swap contract fixing the base interest rate on banker's acceptance borrowings ("BA's") as outlined below. In 2014 the Company entered into a swap contract fixing the base interest rate which expires in 2018 as outlined below. The rates for BA's, under the Company's credit facility, are subject to additional stamping fees from 2.00% to 3.50% depending on the debt to cash flow ratio, as defined, and as calculated based on the Company's two most recent quarter ends. For the year ended December 31, 2014, the Company recorded a realized interest rate hedging loss of $55,000 (2013 - $51,000 loss) and an unrealized interest rate loss of $141,000 (2013 - $17,000).

Subject of Contract	Remaining Term	National Quantity	Reference	Strike Price	Option Traded	Fair Value
30 day BA rate	January 1, 2015 – February 13, 2015	$20,000,000	CAD- – BA- – CDOR	1.50%	Swap	(6)
30 day BA rate	February 13, 2015 – February 13, 2018	$30,000,000	CAD- – BA- – CDOR	1.80%	Swap	(190)

Commodity price risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by the relationship between the Canadian and U.S. dollar as well as global economic events that dictate the levels of supply and demand. The Company has attempted to mitigate a portion of the commodity price risk through the use of commodity price contracts.

As at December 31, 2014, the Company had five crude oil swaps in-place fixing the price of future production for a specific period of time with all contracts being denominated in Canadian dollars. For the year ended December 31, 2014, the Company recorded a realized commodity contract gain of $1.2 million (December 31, 2013 - $3.2 million loss) and an unrealized commodity contract gain of $15.8 million (December 31, 2013 - $4.1 million loss).

In January 2015 the Company terminated all crude oil swap contracts outstanding at December 31, 2014, which resulted in the realization of cash proceeds of $13.0 million.

In February 2015 the Company entered into a crude oil swap contract of 500 barrels per day for the period October 1, 2015 – December 31, 2015 at a price of $60.80 U.S. per barrel.

The following table details the mark-to–market risk management contract presentation of commodity price contracts in the financial statements at the dates indicated:

(thousands $Cdn.)	December 31, 2014	December 31, 2013
Total fair value consists of the following:		
Fair value, end of year – current portion	$ 11,946	$ (3,655)
Fair value, end of year – long-term portion	-	(194)
Total fair value, end of year	$ 11,946	$ (3,849)

The following table reconciles the changes in the fair value of commodity price risk management contracts outstanding at the dates indicated:

(thousands $Cdn.)	December 31, 2014	December 31, 2013
Fair value, beginning of year	$ (3,849)	$ 256
Changes in fair value	17,076	(7,267)
Settlement paid (received)	(1,281)	3,162
Fair value, end of year	11,946	$ (3,849)

The Company had the following commodity risk management contracts outstanding as at December 31, 2014.

($Cdn. unless otherwise noted)

Commodity Sold	Volume Sold	Remaining Term	Pricing	Fair Value
Oil	1,400 bbl per day	January 1, 2015 – March 31, 2015	$107.50 per bbl	$ 5,638
Oil	1,000 bbl per day	April 1, 2015 – June 30, 2015	$102.25 per bbl	3,372
Oil	500 bbl per day	July 1, 2015 – September 30, 2015	$101.90 per bbl	1,573
Oil	150 bbl per day	July 1, 2015 – September 30, 2015	$101.90 per bbl	472
Oil	500 bbl per day	October 1, 2015 – December 31, 2015	$89.22 per bbl	891
				$ 11,946

Commodity price sensitivity:

Commodity Price		
Oil production sold under risk management contract (barrels)		322,800
Price Change (Cdn. per bbl)	$	1.00
Sensitivity – change before income tax	$	322,800

Offsetting financial assets and liabilities:

The following table shows the Company's net risk management assets and liabilities:

	December 31, 2014			December 31. 2013		
	Gross Amount	Offset	Net Amount	Gross Amount	Offset	Net Amount
Risk Management Assets						
Current Asset	$ 11,946	$ -	$ 11,946	$ -	$ -	$ -
	11,946	-	11,946	-	-	-
Risk Management Liabilities						
Current Liability	57	-	57	3,710	-	3,710
Long-Term Liability	139	-	139	194	-	194
	196	-	196	3,904	-	3,904
Net Risk Management Asset (Liability)	$ 11,750	$ -	$ 11,750	$ (3,904)	$ -	$ (3,904)

Fair value of financial instruments:

The Company's exposure under its financial instruments is limited to financial assets and liabilities, all of which are included in these financial statements. Financial instruments include cash, accounts receivable, accounts payable and accrued liabilities, risk management contracts and bank debt. The fair values of financial assets and liabilities that are included in the balance sheet approximate their carrying amounts. Certain of these financial instruments including risk management contracts are measured in the financial statements at fair value. These financial instruments require disclosure about how fair value was determined based on significant levels of inputs described in the following hierarchy:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and value to provide pricing information on an ongoing basis.

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3: Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Risk management assets and liabilities are recorded at their estimated fair value based on the difference between the contracted price and the period end forward price for the same commodity, using quoted market prices (Level 2).

(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 meets its contractual obligations, and arises principally from the Company's receivables from joint interest partners and petroleum and natural gas marketers. The maximum exposure to credit risk at year end is as follows:

	December 31, 2014	December 31, 2013
Accounts and other receivables	$ 10,553	$ 12,486

A substantial portion of the Company's accounts receivable are with marketers, customers and joint interest partners in the oil and gas industry and are subject to normal market and industry credit risks.

As at December 31, 2014 the Company's receivables consisted of $2.7 million (2013 - $5.1 million) from joint interest partners the majority of which has either been collected or is expected to be collected within 60 days, $5.8 million (2013 - $7.3 million) of receivables from petroleum and natural gas marketers, which have been collected and $2.1 million (2013 - $0.1 million) of receivables related to commodity hedge contracts. At December 31, 2014, Arsenal had approximately $0.5 million (2013 - $0.2 million) of receivables that are considered past due and collection efforts, including the taking of production and consideration and taking of legal action have commenced.

Receivables from petroleum and natural gas marketers are normally collected on the 20th day of the month following production in the U.S. and on the 25th day of the month following production in Canada. The Company's policy is to mitigate credit risk associated with these balances by establishing marketing relationships with large creditworthy purchasers. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. The Company currently transacts all of its risk management contracts with major financial institutions. Payments under these contracts are typically remitted on the 25th of the month following production. Joint interest receivables are typically collected within one to three months of the joint interest bill being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital

expenditures and payment of cash advances prior to expenditures. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances are dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint interest partners as disagreements occasionally arise that increase the potential for non-collection. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however the Company does have the ability to request deposits and to withhold production from joint interest partners in the event of non-payment.

b) Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with the financial liabilities. The Company's financial liabilities consist of accounts payable, financial instruments and the bank loan. Accounts payable consists of invoices payable to trade suppliers for office, field operating activities and capital expenditures. The Company processes invoices within a normal payment period. The Company maintains a revolving credit facility, as outlined in note 9, that is based on proved and producing reserves and is subject to review semi-annually by the lenders. The Company also maintains and monitors a certain level of cash flow which is used to partially finance all operating expenses, capital expenditures and the payment of dividends. The level of cash flow is updated regularly for updated forward strip prices and decisions on the future use of capital are adjusted to reflect changes in the commodity prices and the costs of operations, exploration and development.

13. Capital management:

The Company considers shareholder's equity, its credit facility and working capital (excess or deficiency) as components of its capital base. The Company can access or increase its capital base through the issuance of shares and through bank borrowings that are based on reserves. The Company can safeguard its capital base by stabilizing its funds from operations, by fixing, or reviewing the advisability of fixing, interest rates and commodity prices on a portion of the Company's debt and production, by closely monitoring expenses and by closely monitoring and scrutinizing the results of its capital expenditure program and adjusting capital expenditures as required based on economic conditions and drilling results.

The Company monitors its capital base based primarily on its debt to annualized funds flow ratio and its debt to equity ratio. Debt includes bank borrowings, plus or minus working capital and excludes long term decommissioning obligations and risk management contracts whether an asset or an obligation and whether current or long term. Annualized funds flow is calculated as cash flow from operations, before changes in non-cash working capital, exploration and evaluation expenses, transaction costs and decommissioning obligations settled from the Company's most recent quarter multiplied by four adjusted, if required, by increasing or decreasing commodity price expectations, future production profiles, the Company's risk management position and other non-recurring operational items.

The Company's target net debt to annualized funds flow ratio is 1.50:1 but the ratio can and will fluctuate based on the timing of property transactions, commodity prices and on the mix of exploratory and development drilling and the timing to bring these projects to the production stage. During periods of extreme commodity price declines, (low WTI prices or wide differentials), high drilling activity or after large property or corporate acquisitions, it is expected that the ratio would increase and during periods of high commodity prices and low activity levels, it is expected that the ratio would decrease. The Company's focus in these instances and any other instance when the ratio is not within the target range is to concentrate on bringing the ratio back into the target range. The ratio represents the time period it would take to pay off the debt if no further capital expenditures were incurred and if funds from operations remained constant. The Company prepares an annual operating and capital expenditure budget. The budget is updated quarterly when actual results are realized and compared to budget and when critical factors change. Critical factors include economic factors such as the state of equity markets, changes to commodity prices, interest rates and foreign exchange rates and non-economic factors such as drilling results and production profiles. The Company's board of directors approves the budget and reviews changes thereto. The Company has targeted a net debt to equity ratio of 1.25:1. This ratio will also fluctuate over time depending on the state of equity markets and the results of operations.

There were no changes in the Company's approach to capital management during the year.

The following table summarizes the Company's capital position:

Net debt		2014		2013
Cash	$	2,573	$	1,219
Accounts receivable, prepaids and inventory		11,772		13,622
Accounts payable and other liabilities		(19,543)		(16,125)
Adjusted working capital deficiency		(5,198)		(1,284)
Bank loan		(60,000)		(69,100)
Net debt [4]		(65,198)		(70,384)
Annualized funds from operations [1,2,3]	$	55,127	$	36,054
Net debt to annualized funds from operations ratio [5]		1.18		1.95
Shareholders' equity	$	90,692	$	52,872
Net debt to equity		0.72		1.33

[1] Excludes significant realized gains and losses on commodity contracts and exploration and evaluation expenses.
[2] Based on the last quarter's funds from operations annualized.
[3] Management uses funds from operations before changes in non-cash working capital ("funds flow"), funds flow per common share and annualized funds flow to analyze operating performance and leverage. Funds flow as presented does not have any standardized meaning prescribed by IFRS and therefore it may not be comparable to the calculation of similar measures for other entities. Funds flow as presented is not intended to represent operating cash flow or operating profits for the period nor should it be viewed as an alternative to cash flow provided by operating activities, net earnings or loss or other measures of financial performance calculated in accordance with IFRS.
[4] Net debt is used by Management to analyze leverage. Net debt does not have any standardized meaning prescribed by IFRS and therefore these terms may not be comparable with the calculation of similar measures for other entities.
[5] Net debt to annualized funds from operations ratio is not comparable with the calculation of the Corporation's ratios of twelve months trailing earnings before interest, taxes and depletions and depreciation to consolidated debt

14. Income tax expense:

The tax provision differs from the amount computed by applying the combined Canadian federal and provincial income tax statutory rates to loss before income taxes as follows:

		2014		2013
Income before income tax	$	30,268	$	3,831
Combined federal and provincial tax rate		25.0%		25.0%
Expected tax provision		7,576		958
Increase (decrease) in taxes resulting from:				
Tax impact of foreign jurisdictions		1,437		1,761
Effect of alternative minimum tax		1,303		-
Share based compensation		450		165
Flow through shares		678		187
Rate change		(529)		-
Other		(1,158)		(26)
Unrecognized tax benefits		(5,130)		3,500
	$	4,627	$	6,545

For the year ended December 31, 2014, the Company has recorded income tax expense of $4.6 million (December 31, 2013 – $6.5 million). In the US, the Company has recorded an income tax provision of $5.2 million (December 31, 2013 - $4.9 million) of which $1.0 million (December 31, 2013 - $325,000) relates to Alternate Minimum Tax ("AMT" see below). In Canada, the Company has recorded income tax recovery of $591,000 which represents a reduction of the flow through share premium (December 31, 2013 - $1.6 million expense of which $1.8 million is the reversal of a deferred tax asset that was derecognized in the year and a credit of $187,000 relating to reduction of the flow through share premium).

The AMT attempts to ensure that corporations that benefit from certain deductions (such as intangible drilling costs, accelerated depreciation and non-capital losses) pay at least a minimum tax. In calculating the AMT, these deductions are reduced from the amounts allowed under the calculation of regular income tax. The tax credit for AMT payments can be used to offset future regular tax liability. The Company does not recognize any asset related to the potential future recovery of AMT.

The components of the deferred income tax asset and liability are as follows:

	December 31, 2014	
	Canadian Operations	US Operations
Deferred tax assets:		
Non-capital losses	$ 464	$ 9,371
Decommissioning obligation	9,506	2,480
Other	666	-
Deferred tax liabilities:		
Property, plant and equipment	(7,698)	(32,160)
Unrealized hedging gain	(2,938)	-
Other	-	(77)
	$ -	$ (20,386)

	December 31, 2013	
	Canadian Operations	US Operations
Deferred tax assets:		
Non-capital losses	$ 542	$ 5,748
Decommissioning obligation	8,323	1,160
Other	-	1,162
Deferred tax liabilities:		
Property, plant and equipment	(7,827)	(22,632)
Other	(1,038)	-
	$ -	$ (14,562)

The Company's assets have a tax basis of $141.0 million at December 31, 2014 (December 31, 2013 - $136.9 million) available for deduction against future taxable income. The non-capital loss carry forwards in Canada of $18.5 million (December 31, 2013 - $29.9 million) expire between 2025 and 2034. The following table summarizes the estimated tax pools:

	December 31, 2014	
	Canada	US
Cumulative Canadian Oil and Gas Property Expense	$ 30,583	$ -
Cumulative Canadian Development Expense	21,701	-
Undepreciated Capital Cost	28,804	10,167
Share Issue Costs	1,759	-
Non-capital Losses	18,540	25,340
Capital Losses and Other	4,059	-
	$ 105,446	$ 35,507

The following table summarizes the unrecognized temporary differences for which no tax asset has been recorded:

	December 31, 2014	December 31, 2013
Non-capital losses	$ 16,684	$ 27,700
Share issue costs	-	1,245
Capital losses	3,780	3,837
Other	-	2,042
	$ 20,464	$ 34,824

The following tables provide a continuity of the deferred income tax asset (liability):

	December 31, 2012	Recognized in profit and loss	Recognized in equity and other	December 31, 2013
Decommissioning obligation	$ 9,381	$ 24	$ 78	$ 9,483
Non-capital losses	8,142	(2,136)	284	6,290
Property, plant and equipment	(24,021)	(5,073)	(1,365)	(30,459)
Other	(871)	965	30	124
	$ (7,369)	$(6,220)	$ (973)	$ (14,562)

	December 31, 2013	Recognized in profit and loss	Recognized in equity and other	December 31, 2014
Decommissioning obligation	$ 9,483	$ 2,329	$ 174	$ 11,986
Non-capital losses	6,290	2,849	696	9,835
Property, plant and equipment	(30,459)	(6,922)	(2,477)	(39,858)
Other	124	(1,914)	(559)	(2,349)
	$ (14,562)	$ (3,658)	$ (2,166)	$ (20,386)

15. Supplemental cash flow information:

	December 31, 2014	December 31, 2013
Change in non-cash working capital items:		
Accounts receivable	$ 1,939	$ (1,561)
Prepaid expenses and deposits	(343)	31
Inventory	(26)	59
Accounts payable and accrued liabilities	2,908	(3,964)
	$ 4,478	$ (5,435)
Amounts relating to operating activities	$ (291)	$ (1,116)
Amounts relating to financing activities	153	(522)
Amounts relating to investing activities	4,616	(3,797)
	$ 4,478	$ (5,435)

16. Segmented information:

A portion of the Company's assets and revenues are earned in the United States and Canada, and are monitored as an identifiable reporting segment by management. Business risks and economic indicators are similar across both geographical regions.

Year ended December 31, 2014 (000's Cdn. $)	Canada	U.S.	Total
Oil and gas revenue	66,121	50,993	117,114
Operating income (1)	29,653	31,377	61,030
Funds from operations (2)	31,590	22,974	54,563
Income before income taxes	17,924	12,344	30,268
Income after income taxes	18,516	7,125	25,641
Exploration and evaluation assets (as at December 31, 2014)	3,639	-	3,639
Property, plant and equipment (as at December 31, 2014)	109,194	97,126	206,320
Property, plant and equipment expenditures	24,183	28,864	53,047
Exploration and evaluation expenditures	4,010	-	4,010
Property dispositions	(100)	-	(100)
Property acquisitions	152	-	152

Year ended December 31, 2013 (000's Cdn. $)	Canada	U.S.	Total
Oil and gas revenue	47,214	50,597	97,811
Operating income (1)	15,845	32,188	48,033
Funds from operations (2)	11,770	26,089	37,859
Income (loss) before income taxes	(9,411)	13,242	3,831
Income (loss) after income taxes	(11,000)	8,286	(2,714)
Exploration and evaluation assets (as at December 31, 2013)	10,259	-	10,259
Property, plant and equipment (as at December 31, 2013)	95,892	70,770	166,662
Property, plant and equipment expenditures	13,403	20,072	33,475
Exploration and evaluation expenditures	6,268	-	6,268
Property dispositions	(4,230)	-	(4,230)

(1) Defined as oil and gas revenues less royalties, operating costs and transportation. Operating income does not have any standardized meaning prescribed by IFRS and therefore this term may not be comparable with the calculation of for other entities.
(2) Defined as operating income less general and administrative expenses, interest and financing, plus or minus realized foreign exchange gains or losses expenses. Funds from operations does not have any standardized meaning prescribed by IFRS and therefore this terms may not be comparable with the calculation for other entities.

17. Commitments and contingencies:

a) Office premises, equipment leases and firm service transportation:

The Company leases its office premises, computer and office equipment and field vehicles through operating leases for accounting purposes.

The total estimated operating lease commitments are summarized as follows:

(000's Cdn. $)	2015	2016	2017	2018	2019	2020
Flow-through share commitments	12,000	-	-	-	-	-
Lease of office premises	550	550	319	-	-	-
Computer equipment and support lease	114	86	-	-	-	-
Other equipment leases and software licenses	114	68	42	-	-	-
Total	12,778	704	361	-	-	-

b) Outstanding lawsuits:

Various lawsuits have been filed against the Company for incidents which arose in the ordinary course of business. In the opinion of management, the outcome of any of the lawsuits, now pending, are not determinable and in total not material to the Company's operations. Should any loss result from the resolution of these claims, such loss will be charged to earnings in the year of resolution.

18. Personnel expenses:

The aggregate compensation expense of all employees included in operating and transportation expenses, in general and administrative expenses, and in property, plant and equipment was as follows:

		2014		2013
Salaries, wages and benefits	$	4,972	$	4,839
Share based compensation		1,797		814
	$	6,769	$	5,653

Personnel expenses directly attributed to capital activities have been capitalized and included in property, plant and equipment and intangible exploration assets.

The Company has determined that the key management personnel consist of its officers and directors. Key management personnel compensation is comprised of the following:

		2014		2013
Salaries, wages and benefits	$	1,742	$	1,606
Director fees		100		93
Share-based compensation		1,009		321
	$	2,851	$	2,020