

Consolidated Financial Statements of

**ENHANCED OIL RESOURCES INC.**

Years ended December 31, 2014 and 2013

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
Enhanced Oil Resources Inc.

We have audited the accompanying consolidated balance sheet of Enhanced Oil Resources Inc. and subsidiaries as of December 31, 2014, and the related consolidated statements of net operations and comprehensive loss, shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated 2014 financial statements referred to above present fairly, in all material respects, the financial position of Enhanced Oil Resources Inc. and subsidiaries as of December 31, 2014, and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards.

The financial statements of Enhanced Oil Resources Inc. for the year ended December 31, 2013 were audited by another auditor; whose report dated April 30, 2014 expressed an unmodified opinion on those statements. Their opinion however included an emphasis-of-matter paragraph that described conditions that indicated the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

A handwritten signature in blue ink, reading "Hein & Associates LLP".

Hein & Associates LLP  
Houston, Texas

April 30, 2015

# ENHANCED OIL RESOURCES INC.

## Consolidated Balance Sheets

(all amounts expressed in thousands of US dollars)

|                                             | Notes | As of December 31,<br>2014 | As of December 31,<br>2013 |
|---------------------------------------------|-------|----------------------------|----------------------------|
| <b>Assets</b>                               |       |                            |                            |
| Current assets                              |       |                            |                            |
| Cash and cash equivalents                   |       | \$ 4,079                   | \$ 1,249                   |
| Restricted cash                             | 5     | -                          | 44                         |
| Receivables                                 | 6     | 503                        | 1,438                      |
| Prepaid expenses                            |       | 419                        | 555                        |
|                                             |       | <u>5,001</u>               | <u>3,286</u>               |
| Non-current assets                          |       |                            |                            |
| Exploration and evaluation assets, net      | 7     | 10,889                     | 42,121                     |
| Property and equipment, net                 | 8     | 37,090                     | 14,485                     |
| Restricted cash                             | 5     | 5,502                      | 5,501                      |
| Other                                       |       | 106                        | 182                        |
|                                             |       | <u>58,588</u>              | <u>65,575</u>              |
| Total Assets                                |       | \$ 58,588                  | \$ 65,575                  |
| <b>Liabilities And Shareholders' Equity</b> |       |                            |                            |
| Current liabilities                         |       |                            |                            |
| Accounts payable and accrued liabilities    | 10    | \$ 951                     | \$ 3,426                   |
| Derivative financial instrument             | 16    | 39                         | -                          |
| Asset retirement obligations                | 9     | 638                        | 648                        |
|                                             |       | <u>1,628</u>               | <u>4,074</u>               |
| Asset retirement obligations                | 9     | 24,972                     | 23,074                     |
| Shareholders' equity                        |       |                            |                            |
| Equity instruments                          | 12    | 124,166                    | 124,166                    |
| Contributed surplus                         |       | 9,364                      | 9,364                      |
| Treasury stock, at cost                     |       | (108)                      | (108)                      |
| Deficit                                     |       | (101,434)                  | (94,995)                   |
|                                             |       | <u>31,988</u>              | <u>38,427</u>              |
| Total Liabilities and Shareholders' Equity  |       | \$ 58,588                  | \$ 65,575                  |
| Commitments                                 | 15    |                            |                            |
| Subsequent events                           | 21    |                            |                            |

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors:

/s/ Al Denson

Al Denson  
Director

/s/ Andrew Hromyk

Andrew Hromyk  
Director

# ENHANCED OIL RESOURCES INC.

Consolidated Statements of Operations and Comprehensive Loss  
(all amounts expressed in thousands of US dollars)

|                                                      |       | Year Ended<br>December 31, |            |
|------------------------------------------------------|-------|----------------------------|------------|
|                                                      | Notes | 2014                       | 2013       |
| Revenues                                             |       |                            |            |
| Oil and gas gross sales                              |       | \$ 8,001                   | \$ 13,136  |
| Less: Royalties                                      |       | (1,665)                    | (2,804)    |
|                                                      |       | 6,336                      | 10,332     |
| Expenses                                             |       |                            |            |
| Production costs and taxes                           |       | 2,422                      | 3,307      |
| Workover expenses                                    |       | 3,464                      | 1,182      |
| Field expenses                                       |       | 1,366                      | 1,389      |
| General and administrative                           |       | 3,752                      | 3,314      |
| Gain on disposition of assets                        | 7, 8  | (106)                      | -          |
| Depreciation, depletion, and amortization            | 7, 8  | 1,509                      | 2,026      |
| Financing costs and other, net                       | 9     | 631                        | 708        |
| Stock-based compensation                             | 12    | -                          | 125        |
| (Gain) loss on derivative financial instruments, net | 16    | (256)                      | 367        |
| Foreign currency translation (gain) loss             |       | (7)                        | 45         |
|                                                      |       | 12,775                     | 12,463     |
| Loss before income taxes                             | 11    | (6,439)                    | (2,131)    |
| Income tax provision                                 |       | -                          | -          |
| Net comprehensive loss for the year                  |       | \$ (6,439)                 | \$ (2,131) |
| Loss per share - basic and diluted                   |       | \$ (0.04)                  | \$ (0.01)  |

See accompanying notes to consolidated financial statements.

# ENHANCED OIL RESOURCES INC.

## Consolidated Statements of Shareholders' Equity

(all amounts, except common shares, expressed in thousands of US dollars)

|                                                       | Number of Common Shares |             | Year Ended       |                  |
|-------------------------------------------------------|-------------------------|-------------|------------------|------------------|
|                                                       | December 31,            |             | December 31,     |                  |
|                                                       | 2014                    | 2013        | 2014             | 2013             |
| <b>Total Shareholders' Equity, beginning balances</b> |                         |             | <b>\$ 38,427</b> | <b>\$ 40,433</b> |
| <b>Equity Instruments (Common Shares)</b>             |                         |             |                  |                  |
| Balance, January 1                                    | 160,186,319             | 160,186,319 | 124,166          | 124,166          |
| Balance, December 31                                  | 160,186,319             | 160,186,319 | 124,166          | 124,166          |
| <b>Contributed Surplus</b>                            |                         |             |                  |                  |
| Balance, January 1                                    |                         |             | 9,364            | 9,239            |
| Fair value of stock option grants                     |                         |             | -                | 125              |
| Balance, December 31                                  |                         |             | 9,364            | 9,364            |
| <b>Deficit</b>                                        |                         |             |                  |                  |
| Balance, January 1                                    |                         |             | (94,995)         | (92,864)         |
| Net loss                                              |                         |             | (6,439)          | (2,131)          |
| Balance, December 31                                  |                         |             | (101,434)        | (94,995)         |
| <b>Treasury Stock, at Cost</b>                        |                         |             |                  |                  |
| Balance, January 1                                    |                         |             | (108)            | (108)            |
| Balance, December 31                                  |                         |             | (108)            | (108)            |
| <b>Total Shareholders' Equity</b>                     |                         |             | <b>\$ 31,988</b> | <b>\$ 38,427</b> |

See accompanying notes to consolidated financial statements.

# ENHANCED OIL RESOURCES INC.

## Consolidated Statements of Cash Flows

(all amounts expressed in thousands of US dollars)

|                                                     | Notes | Year Ended<br>December 31, |            |
|-----------------------------------------------------|-------|----------------------------|------------|
|                                                     |       | 2014                       | 2013       |
| Cash provided by (used in):                         |       |                            |            |
| Operating activities                                |       |                            |            |
| Net loss for the year                               |       | \$ (6,439)                 | \$ (2,131) |
| Add (deduct) noncash and other items:               |       |                            |            |
| Depreciation, depletion, and amortization           | 7, 8  | 1,509                      | 2,026      |
| Accretion of asset retirement costs                 | 9     | 608                        | 595        |
| Gain on disposition of assets                       | 7, 8  | (106)                      | -          |
| Stock-based compensation expense                    | 12    | -                          | 125        |
| Unrealized loss on derivative financial instruments | 16    | 39                         | 38         |
| Foreign currency translation (gain) loss            |       | (7)                        | 45         |
| Remeasurement of warrant liability                  |       | -                          | (15)       |
| Other income                                        |       | -                          | (34)       |
|                                                     |       | (4,396)                    | 649        |
| Asset retirement expenditures                       | 9     | (158)                      | (947)      |
| Changes in non-cash working capital                 | 19    | (1,611)                    | (1,415)    |
| Cash used in operations                             |       | (6,165)                    | (1,713)    |
| Investing activities                                |       |                            |            |
| Exploration and evaluation expenditures             | 7     | (130)                      | (2,529)    |
| Property and equipment expenditures                 | 8     | (816)                      | (1,960)    |
| Decreases in restricted cash, net                   | 5     | 43                         | (999)      |
| Proceeds from sale of assets                        | 7, 8  | 9,851                      | -          |
| Transfers to workover expense                       | 7     | 46                         | -          |
| Cash provided (used) in investing activities        |       | 8,995                      | (5,488)    |
| Financing activities                                |       |                            |            |
| Long-term deposits & deferred loan costs            |       | -                          | (85)       |
| Cash used in financing activities                   |       | -                          | (85)       |
| Change in cash and cash equivalents                 |       | 2,830                      | (7,286)    |
| Cash and cash equivalents, beginning of the year    |       | 1,249                      | 8,535      |
| Cash and cash equivalents, end of year              |       | \$ 4,079                   | \$ 1,249   |

See accompanying notes to consolidated financial statements.

# ENHANCED OIL RESOURCES INC.

Notes to Consolidated Financial Statements  
(all amounts in thousands of US dollars unless otherwise indicated)

Year ended December 31, 2014 and 2013

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## 1. Reporting Entity and Description of Business

Enhanced Oil Resources Inc. is a company incorporated in British Columbia, Canada and is engaged, through its wholly owned U.S. subsidiaries (collectively referred to as the “Company”) in the acquisition, development, operation and exploitation of crude oil and natural gas properties, including enhanced oil recovery projects, in the Permian Basin in eastern New Mexico. Common shares of the Company are listed on the TSX – Venture Exchange under the symbol “EOR” and on the OTCQX (“Over the Counter” qualified stock exchange) under the symbol “EORIF”. The registered address of the office is 1710-1177 West Hastings St. Vancouver, BC V6E 2LE. These financial statements were approved and authorized for issuance by the Board of Directors on April 30, 2015.

## 2. Summary of Significant Accounting Policies

### Statement of Compliance

These consolidated financial statements represent the consolidated financial statements of the Company prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value through profit or loss. The accounting policies set out in this note have been applied in preparing the consolidated financial statements for the years ended December 31, 2014 and 2013.

### Basis of Preparation

The preparation of consolidated financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in this note.

**Functional Currency** - These consolidated financial statements are presented in United States dollars, unless otherwise indicated. All references to US\$ or to \$ are to United States dollars and references to C\$ are to Canadian dollars.

**Basis of Measurement and Measurement Uncertainty** – The consolidated financial statements are prepared on a historical cost basis except as detailed in the Company’s accounting policies disclosed in this note. The timely preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the consolidated financial statements, and the amount of revenues and expenses. Accordingly, actual results may differ from these estimates.

**Principles of consolidation and presentation** - The consolidated financial statements of the Company include the financial information of Enhanced Oil Resources Inc. (the “Parent Company”) and its wholly-owned subsidiary, Ridgeway Petroleum (Florida), Inc. (“RF”). RF includes the results of its wholly-owned subsidiary, Arizona Resources Industries, Inc. and its wholly-owned subsidiaries, Ridgeway Arizona Oil Corp., EOR Operating Company, Enhanced Oil Resources US, Inc., St. Johns Dome Operating Company and Phoenix Energy Inc. All intercompany amounts have been eliminated upon consolidation.

**Reclassifications** – Certain reclassifications have been made to the 2013 consolidated financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or accumulated deficit.

# ENHANCED OIL RESOURCES INC.

## Notes to Consolidated Financial Statements

(all amounts in thousands of US dollars unless otherwise indicated)

Year ended December 31, 2014 and 2013

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**Foreign currency translation** – These consolidated financial statements are presented in United States dollars, unless otherwise indicated. Items included in the consolidated financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). Foreign currency transactions are translated into the functional currency using the exchange rates that are prevailing at the dates of the transaction. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year end exchange rates for monetary assets and liabilities denominated in currencies other than the entities functional currency are recognized in the statement of operations. Revenues and expenses are translated at average exchange rates prevailing during the period.

**Revenue recognition** – Revenue is measured at the fair value of consideration received or receivable, and represents the amounts receivable for commodities supplied, stated net of royalties, when the amount of revenue can be reliably measured and when it is probable that future economic benefits will flow to the Company.

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

**Restricted cash** - Restricted cash is comprised of cash escrowed and certificates of deposit at banks which are pledged either to secure contractual obligations of the Company or to secure the asset retirement obligations of properties operated by the Company.

**Exploration and evaluation assets** – The costs to acquire oil and gas properties or leases to explore, exploratory well expenditures, estimated cost of asset retirement obligations, delay rentals, lease bonus payments and the costs to evaluate the commercial potential of underlying resources, including related borrowing costs, are initially capitalized as exploration and evaluation assets. In addition, the costs to maintain and evaluate major development costs, such as tertiary recovery projects or costs related to proposed pipelines or other proposed facilities are capitalized as exploration and evaluation assets.

Exploration and evaluation assets are subject to technical, commercial and management review to confirm the continued intent to develop and extract the underlying resources. If an area or exploration well is not considered commercially viable, the related capitalized costs are charged to net earnings. The Company intends to conduct reactivation and development operations in reservoirs that have already produced significant amounts of oil over many years. In accordance with the rules for recording proved reserves, no proved reserves associated with enhanced recovery techniques (EOR), such as CO<sub>2</sub> injection, can be recognized until there is a production response to the injected CO<sub>2</sub> or unless the field is analogous to an existing CO<sub>2</sub> flood project. Once CO<sub>2</sub> injections commence, injection costs will be capitalized, as project development costs, in fields that are in their development stage, which means no incremental oil production has been observed due to the CO<sub>2</sub> injections (i.e. a production response). After confirming a production response to the CO<sub>2</sub> injections (i.e. the production stage), injection costs will be expensed as incurred and any previously deferred project development costs will move to property and equipment and become subject to depletion upon recognition of proved tertiary reserves. When management determines with reasonable certainty that an exploration and evaluation asset is technically feasible and commercially viable, as evidenced by the existence of proved or probable reserves and the appropriate internal and external approvals have been met, the asset is transferred to property and equipment.

Once commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development oil and gas assets within property and equipment assets. No depletion is charged during the exploration and evaluation phase, with the exception of assets that are held by production. The Company has no economic oil and gas reserves attributed to its exploration and evaluation assets.

# ENHANCED OIL RESOURCES INC.

Notes to Consolidated Financial Statements

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**Property and equipment** - Property and equipment include costs directly attributable to oil and natural gas development and production and office furniture and equipment. Property and equipment is recorded at cost less accumulated depletion, depreciation, and impairment losses net of recoveries.

The costs to acquire developed or producing oil and gas properties and to develop oil and gas properties, including land acquisitions, the acquisition of producing petroleum and natural gas assets, drilling of productive and nonproductive wells, completing geological and geophysical surveys, costs to construct and install dedicated infrastructure, such as wellhead and production equipment, water handling facilities and equipment, and supporting assets, are capitalized as oil and gas properties within property and equipment.

The costs to construct, install and commission, or acquire, oil and gas production equipment, tertiary recovery facilities, pipeline and transport facilities, and costs related to asset retirement obligations, are capitalized as property and equipment. Where an asset or part of an asset that was separately depreciated is replaced and it is probable that future economic benefits associated with the item will flow to the Company, the expenditure is capitalized and the carrying amount of the replaced asset is derecognized.

**Depreciation and depletion** – Exploration and evaluation assets are not subject to depreciation and depletion. Once transferred to property and equipment, these costs along with estimated future capital expenditures to be incurred in order to develop proved reserves are depleted on a unit-of-production basis on the cost generating unit (“CGU”) level using estimated proved oil and natural gas reserves as evaluated by independent engineers.

Depreciation of office equipment and vehicles are depreciated using the straight-line method over five years, office furniture and leasehold improvements are depreciated using the straight-line method over seven years, and computer software is depreciated using the straight-line method over three years.

## **Impairment of assets -**

### *Exploration and evaluation assets*

Exploration and evaluation assets are tested for impairment when reclassified to development oil and gas assets or whenever the facts and circumstances indicate impairment. As impairment loss is recognized for the amount by which the exploration and evaluation asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs of disposal and value-in-use. For the purpose of assessing impairment, the exploration and evaluation assets subject to testing are grouped within existing CGUs of production fields that are located in the same geographical region.

### *Oil and gas properties*

Oil and gas properties are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. In evaluating for possible impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. An impairment loss is recognized for the amount by which the carrying amount of the individual asset or CGU exceeds its recoverable amount. The recoverable amount is the higher of the fair value less costs of disposal or the value-in-use. In determining the fair value less costs of disposal, recent market transactions are taken into account, if available. In the absence of such transactions, an appropriate valuation model is used. Value-in-use is determined by estimating the present value of the future net cash flows to be derived from the continued use of the CGU in its present form. These cash flows are discounted at a rate based on the time value of money and risks specific to the CGU.

# ENHANCED OIL RESOURCES INC.

## Notes to Consolidated Financial Statements

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Impairments can be reversed for all CGUs and individual assets, other than goodwill, to the extent that events or circumstances give rise to changes in the estimate of the recoverable amount since the period the impairment was recorded. The Company recognized no impairments for the two years ended December 31, 2014.

**Asset retirement obligations** – Provisions are recognized for asset retirement obligations associated with tangible long-lived assets, such as well sites and facilities. Provisions for asset retirement obligations are recognized when the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligations; and the amount can be reliably estimated. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that represents the current market assessment of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognized as accretion.

Costs associated with the provision for asset retirement obligations are recognized as part of the cost of the related asset. Changes in the measurement of existing retirement obligations are added to or deducted from the cost of the related asset.

**Provisions and contingencies** – Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value when the effect is material.

When a contingency, substantiated by confirming events, can be reliably measured and will likely result in an economic outflow, a liability is recognized in the consolidated financial statements as the best estimate required to settle the obligation. A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events, or where the amount of a present obligation cannot be measured reliably or will likely not result in an economic outflow. Contingent assets are only disclosed when the inflow of economic benefits is probable. When the economic benefit becomes virtually certain, the asset is no longer contingent and is recognized in the consolidated financial statements.

**Current and Deferred Taxes** – The tax expense for the period comprises current and deferred tax. Tax expense is recognized in the statement of operations, except to the extent that it relates to items recognized in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the consolidated balance sheet date in the countries where the Company operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the balance sheet method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognized if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the

# ENHANCED OIL RESOURCES INC.

## Notes to Consolidated Financial Statements

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balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxing authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

**Stock-based compensation** - The Company operates a stock based compensation plan, under which the Company receives services from directors, employees, and consultants as consideration for equity instruments (options) of the Company. The fair value of the employee services received in exchange for the grant of options is recognized as an expense. The fair value of stock option grants is determined using the Black-Scholes option pricing model.

The total expense is recognized over the vesting period of each separate tranche of options granted. At the end of each reporting period, the Company revises its estimates of the number of options that are expected to vest. It recognizes the impact of the revision to the original estimate, if any, in the statement of operations, with a corresponding adjustment to equity.

When options are exercised, the Company issues new shares. The proceeds received, net of any directly attributable transaction costs, are credited to share capital. There no issuances of shares in connection with options in the two years ended December 31, 2014.

### **Financial instruments –**

#### *Financial assets*

The Company classifies its financial assets into the following categories: “fair value through profit or loss”, “available-for-sale”, or “loans and receivables”. Financial assets are recognized on the date that the Company commits to purchase or sell the asset. Financial assets are derecognized when the rights to receive cash flows from the instrument have expired or substantially all the risk and rewards of ownership have been transferred.

Financial assets classified at fair value through profit and loss are initially recognized at fair value and transaction costs are expensed in the consolidated statements of operations. They are subsequently carried at fair value. Gains and losses arising from changes in the fair value are presented in the consolidated statements of operations in the period in which they arise. Assets in this category are classified as current assets if expected to be settled within 12 months, otherwise they are classified as non-current. The Company’s derivative financial instruments are classified as fair value through profit and loss. In addition, the Company’s cash and cash equivalents and restricted cash are classified at fair value through profit and loss. The Company currently has no assets designated as ‘available for sale’.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Company’s loans and

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## Notes to Consolidated Financial Statements

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receivables comprise 'receivables' in the consolidated balance sheet.

### *Financial liabilities*

The Company classifies its financial liabilities as "Other financial liabilities". Other financial liabilities include accounts payable and accrued liabilities. Other financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method.

### *Derivative financial instruments*

Derivative financial instruments are initially recognized at fair value on the date a derivative contract was entered into and are subsequently re-measured at their fair value with changes in the fair value immediately recognized in the statement of operations.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract. Contracts are assessed for embedded derivatives when the Company becomes a party to them, including at the date of a business combination. The Company has not identified any embedded derivatives.

**Share capital** – Common shares are classified as equity. Incremental costs directly attributable to the issue of new common shares or options are shown in equity as a deduction, net of tax, from the proceeds.

**Earnings per share** – Earnings per share is calculated by dividing net income (loss) for the period attributable to equity owners of the Company by the weighted average number of common shares outstanding during the period. Diluted per share information is calculated using the treasury stock method. The treasury stock method assumes the notional exercise of all in-the-money stock options, warrants and agency options and that all notional proceeds to the Company are used to repurchase the Company's common shares at the average market price during the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

### **3. Significant Judgments and Estimates**

**Estimates** - Estimates and underlying assumptions are reviewed on an ongoing basis and involve significant estimation uncertainty which have a significant risk of causing adjustments to the carrying amounts of assets and liabilities. Revisions to accounting estimates are recognized in the year in which the estimates are reviewed and for any future years affected. Significant judgments, estimates and assumptions made by management in these consolidated financial statements are outlined below:

*Oil and natural gas reserves* - Certain depletion, depreciation, impairment and asset retirement obligation charges are measured based on the Company's estimate of proved and probable oil and gas reserves and resources. The estimation of proved and probable reserves and resources is an inherently complex process and involves the exercise of professional judgment. Oil and natural gas reserves have been evaluated at December 31, 2014 and December 31, 2013 by independent petroleum engineers in accordance with National Instruments 51-101 "Standards of Disclosure for Oil and Gas Activities".

Oil and natural gas reserve estimates are based on a range of geological, technical and economic factors, including projected future rates of production, estimated commodity prices, engineering data, and the timing and amount of future expenditures, all of which are subject to uncertainty. Assumptions reflect market and regulatory conditions existing at the reporting date, which could differ significantly from other points in time throughout the year, or future

# ENHANCED OIL RESOURCES INC.

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periods. Changes in market and regulatory conditions and assumptions can materially impact the estimation of net reserves and resources.

*Impairment of assets* - The Company evaluates its assets for possible impairment at the CGU level. The determination of CGUs requires judgment in defining the smallest grouping of integrated assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The allocation of assets into CGUs have been determined based on similar geological structure, shared infrastructure, geographical proximity, commodity type, the existence of active markets, similar exposure to market risks, and the way in which management monitors the operations.

The recoverable amounts of CGUs and individual assets have been determined based on the higher of fair value less costs of disposal model and value in-use model. The key assumptions the Company uses in estimating future cash flows for recoverable amounts are: anticipated future commodity prices, expected production volumes, future operating and development costs, estimates of inflation on costs and expenditures, expected income taxes and discount rates. In addition, the Company considers the current environmental, social and governance issues affecting its property interests and operations, including the current legislative and regulatory activity affecting the permitting and approval of its projects and operations. Changes to these assumptions will affect the estimated recoverable amounts attributed to a CGU or individual assets and may then require a material adjustment to their related carrying value.

The decision to transfer exploration and evaluation assets to property and equipment is based on management's determination of a property's technical feasibility and commercial viability based on proved and probable reserves as well as related future cash flows.

*Asset retirement obligations* - The Company estimates and recognizes liabilities for future asset retirement obligations and restoration of exploration and evaluation assets, and for oil and gas development and producing assets. These provisions are based on estimated costs, which take into account the anticipated method and extent of restoration, technological advances and the possible future use of the asset. Actual costs are uncertain and estimates can vary as a result of changes to relevant laws and regulations, the emergence of new restoration techniques, operating experience and prices. The expected timing of future retirement and restoration may change due to these factors, as well as affect the estimates of reserve life. Changes to assumptions related to future expected costs, discount rates and timing may have a material impact on the amounts presented. The Company has chosen to use a risk-free rate for discounting asset retirement obligations.

#### 4. Recently Announced Accounting Pronouncements

During the year ended December 31, 2014, the Company adopted the following new and revised accounting standards, including any consequential amendments thereto. Changes in accounting policies adopted by the Company were made in accordance with the applicable transitional provisions as provided in those standards and amendments.

##### IAS 36 Impairment of Assets

On January 1, 2014, the Company implemented certain amendments to IAS 36 which require that the Company disclose, if appropriate, the recoverable amount of an asset or cash generating unit, and the basis for the determination of fair value less costs of disposal or value-in-use of the asset, when an impairment loss is recognized or when an impairment loss is subsequently reversed. These amendments will result in the Company including additional disclosures in respect of any recognition of impairments related to its oil and gas properties.

# ENHANCED OIL RESOURCES INC.

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### **IFRIC 21 Levies**

On January 1, 2014, the Company implemented IFRIC 21 which provides an interpretation on IAS 37, "Provisions, Contingent Liabilities and Contingent Assets" ("IAS 37"), with respect to the accounting for levies imposed by governments. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event. The interpretation clarifies that the obligating event is the activity described in the relevant legislation that triggers the payment of the levy and is to be accrued prospectively only if the activity triggers payment occurs over a period of time. The implementation of IFRIC 21 had no impact to the Company's 2014 consolidated financial statements.

### **IAS 1 Presentation of Financial Statements**

In December 2014, the IASB issued amendments to IAS 1, clarifying guidance on the concepts of materiality and aggregation of items in the financial statements, the use and presentation of subtotals in the statement of operations and the statement of comprehensive income or loss, and providing additional flexibility in the structure and disclosures of the financial statements to enhance understandability. The amendments to IAS 1 may be applied immediately, and become mandatory for annual periods beginning on or after January 1, 2016. The Company does not expect the impact of the amendments to IAS 1 will have a material effect on the Company's consolidated financial statements.

### **IFRS 9 Financial Instruments**

IFRS9 provides a comprehensive new standard for accounting for all aspects of financial instruments. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, and replaces the multiple category and measurement models in IAS 39. The approach in IFRS 9 focuses on how an entity manages its financial instruments in the context of its business model, as well as the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods currently provided in IAS 39.

Requirements for financial liabilities were added to IFRS 9 in October 2010. Although the classification criteria for financial liabilities did not change under IFRS 9, the fair value option requires different accounting for changes to the fair value of a financial liability resulting from changes to an entity's own credit risk.

In December 2013, new hedge accounting requirements were incorporated into IFRS 9 that increase the scope of items that can qualify as a hedged item and change the requirements of hedge effectiveness testing that must be met to use hedge accounting.

In July 2014, the IASB issued final amendments to IFRS 9, replacing earlier versions of IFRS 9. These amendments to IFRS 9 introduce a single, forward-looking 'expected loss' impairment model for financial assets which will require more timely recognition of expected credit losses, and a fair value through other comprehensive income category for financial assets that are debt instruments.

The amendments to IFRS 9 are effective for annual periods beginning on or after January 1, 2018 and are available for earlier adoption. The Company is currently reviewing the implementation of IFRS 9 and the effect it may have on the Company's consolidated financial statements.

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### IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15. IFRS 15 provides a single model to determine how and when an entity should recognize revenue, as well as requiring entities to provide more informative, relevant disclosures in respect of its revenue recognition criteria. IFRS 15 is to be applied prospectively and is effective for annual periods beginning on or after January 1, 2017, with earlier application permitted. The Company is in the process of evaluating the impact that IFRS 15 may have on the Company's financial statements.

### 5. Restricted Cash

Restricted cash is comprised of bank deposits which are pledged either to secure contractual obligations (see Note 15 – Commitments – contingent future appraisal drilling obligations) or to secure plugging and abandonment obligations for properties operated by the Company's subsidiaries. In December 2013, the Company pledged cash bank deposits of \$3.0 million to collateralize a surety bond issued in connection with certain statutory bonds for asset retirement obligations in New Mexico.

The following table summarizes restricted cash balances:

|                                                                        | December 31,<br>2014 | December 31,<br>2013 |
|------------------------------------------------------------------------|----------------------|----------------------|
| Escrow deposit for St. Johns Dome contingent obligations               | \$ 2,500             | \$ 2,500             |
| Bank deposits pledged to secure statutory plugging & abandonment bonds | 3,002                | 3,045                |
| Balance, end of year                                                   | \$ 5,502             | \$ 5,545             |
| Short-term                                                             | \$ -                 | \$ 44                |
| Long-term                                                              | \$ 5,502             | \$ 5,501             |

### 6. Receivables

The Company's receivables at December 31, 2014 and 2013 were comprised of amounts due from crude oil purchasers of \$0.1 million and \$0.9 million, respectively, and other receivables of \$0.1 million and \$0.5 million for the same periods, respectively, which had been outstanding for less than 30 days and more than 90 days, respectively. Management does not consider any of the receivable balances to be impaired. The carrying amount of receivables approximates the fair value due to the short term nature of the financial instrument.

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## 7. Exploration and Evaluation Assets

Exploration and evaluation asset activity for the years ended December 31, 2014 and 2013 was as follows:

|                                                     | Notes | Oil and Gas<br>Properties |
|-----------------------------------------------------|-------|---------------------------|
| Balance, December 31, 2012                          |       | \$ 42,326                 |
| Additions                                           |       | 2,529                     |
| Changes in estimate of asset retirement obligations | 9     | (2,298)                   |
| Transfer to property and equipment                  | 8     | (219)                     |
| Depletion                                           |       | (217)                     |
| Balance, December 31, 2013                          |       | \$ 42,121                 |
| Additions                                           |       | 130                       |
| Dispositions                                        |       | (3,957)                   |
| Changes in estimate of asset retirement obligations | 9     | 1,790                     |
| Transfer to property and equipment                  | 8     | (28,995)                  |
| Transfers to workover expense                       |       | (46)                      |
| Depletion                                           |       | (155)                     |
| Balance, December 31, 2014                          |       | \$ 10,889                 |
| <b>Net book value:</b>                              |       |                           |
| December 31, 2013                                   |       | \$ 42,121                 |
| December 31, 2014                                   |       | \$ 10,889                 |

**Exploration and Evaluation Oil and Gas Properties.** Exploration and evaluation assets include lands and assets that management has not fully evaluated for technical feasibility and commercial viability. Transfers to property plant and equipment are made when technical feasibility and commercial viability are determined to exist.

In 2007, the Company initiated crude oil and natural gas operations with property acquisitions of minimally producing property interests located in New Mexico. These acquisitions represented essentially unproved properties with unevaluated potential for enhanced oil recovery projects for which the Company initiated evaluation processes during 2008. These properties were acquired for exploration and evaluation undertakings for which the Company has been evaluating the feasibility and amount of tertiary crude oil recovery projects. The Company has incurred costs to determine the amount of future development costs, including the cost of pipelines, production handling facilities related to CO<sub>2</sub> injection and related engineering and design requirements, and until such projects commence, all the costs related to these properties were carried as project costs pending commercial viability and technical feasibility for development. These costs have been excluded from costs subject to depletion and depreciation (except those related to the Chaveroo field) until proved or probable reserves have been attributed to the properties.

In 2014, proved and probable reserves were attributed to the Chaveroo field and exploration and evaluation costs of \$22.7 million were transferred to property and equipment. Also in 2014, probable reserves were also identified with the Milnesand field and exploration and evaluation costs of \$6.0 million were transferred to property and equipment. These property interests were tested for impairment prior to the transfer of these costs to property and equipment in 2014 in accordance with IAS 16, Property Plant & Equipment. These tests estimated on a value-in-use basis of the recoverable amounts of the future net cash flows of proved and probable reserves using discount rates of 12% and 15%, respectively for the Chaveroo interest and 10% and 10%, respectively for the Milnesand interests.

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In February 2014, the Company disposed of certain property interests located in three counties in Texas for cash consideration of \$0.4 million, net of selling costs and assumption of asset retirement obligations of \$0.3 million the Company recorded a loss of \$1.1 million on the property disposition.

For the years ended December 31, 2014 and 2013, Company was not required under IFRS 6, Exploration for and Evaluation of Mineral Resources, to record an impairment of the carrying amount of exploration and evaluation assets.

### 8. Property and Equipment

Property and equipment activity for the year ended December 31, 2014 and 2013 were as follows:

|                                                     | Notes | Oil and Gas<br>Properties | Other    | Total     |
|-----------------------------------------------------|-------|---------------------------|----------|-----------|
| Balance, December 31, 2012                          |       | \$ 19,977                 | \$ 1,045 | \$ 21,022 |
| Additions                                           |       | 1,548                     | 412      | 1,960     |
| Dispositions                                        |       | -                         | (37)     | (37)      |
| Changes in estimate of asset retirement obligations | 9     | (1,089)                   | -        | (1,089)   |
| Balance, December 31, 2013                          |       | \$ 20,436                 | \$ 1,420 | \$ 21,856 |
| Additions                                           |       | 796                       | 20       | 816       |
| Dispositions                                        |       | (12,456)                  | (31)     | (12,487)  |
| Transfer from exploration and evaluation assets     | 7     | 28,995                    | -        | 28,995    |
| Changes in estimate of asset retirement obligations | 9     | 1,202                     | -        | 1,202     |
| Balance, December 31, 2014                          |       | \$ 38,973                 | \$ 1,409 | \$ 40,382 |

#### Accumulated depreciation and depletion:

|                            |  |            |            |            |
|----------------------------|--|------------|------------|------------|
| Balance, December 31, 2012 |  | (4,783)    | (824)      | (5,607)    |
| Depreciation and depletion |  | (1,609)    | (182)      | (1,791)    |
| Dispositions               |  | -          | 27         | 27         |
| Balance, December 31, 2013 |  | \$ (6,392) | \$ (979)   | \$ (7,371) |
| Depreciation and depletion |  | (1,164)    | (190)      | (1,354)    |
| Dispositions               |  | 5,408      | 25         | 5,433      |
| Balance, December 31, 2014 |  | \$ (2,148) | \$ (1,144) | \$ (3,292) |

#### Net book value:

|                   |  |           |        |           |
|-------------------|--|-----------|--------|-----------|
| December 31, 2013 |  | \$ 14,044 | \$ 441 | \$ 14,485 |
| December 31, 2014 |  | \$ 36,825 | \$ 265 | \$ 37,090 |

The Company sold its interest in the Crossroads New Mexico field on October 16, 2014, with an effective date of September 1, 2014, for \$10.0 million and realized net proceeds of \$9.7 million after consideration of normal effective date to close date adjustments. In connection with the sale, the Company recorded a gain of \$1.2 million on the transaction, net of liabilities assumed by the purchaser.

The Company included \$133.5 million in 2014 (\$78.0 million in 2013) of future development costs in the computation of depletion expense. No general and administrative costs have been capitalized with regard to property and equipment. Impairment reviews were conducted for the years presented and no impairments were recorded.

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For the year ended December 31, 2014, the Company conducted an assessment of the impairment indicators for the Company's CGU's. In performing the review, management noted the recent decline in oil prices and the impact to operating performance and financial condition justified the calculation of the recoverable amounts of all CGU's. In addition, as at December 31, 2014, the carrying amount of the net assets of the Company is more than its market capitalization. Fair value less costs of disposal was established using a discounted cash flow analysis. These calculations require the use of estimates. The present value of future cash flows was computed on a post-tax basis by applying forecast prices of reserves to estimate future production, less the future estimated expenditures to be incurred in developing and producing reserves. The present value of future cash flows was computed by the Company's independent reserves evaluators using a discount rate of 10% for the Milnesand field CGU and 12% and 15% for the Chaveroo field CGU. The selection of discount rate reflects estimates of the specific risks related to the underlying CGU. There were no impairment losses recorded as at December 31, 2014 and 2013.

The fair value less costs of disposal used to determine the recoverable amounts of property, plant and equipment and exploration and evaluation assets are classified at Level 3 fair value measurements, as they are not based on observable market data.

### 9. Asset Retirement Obligations

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the estimated future obligations associated with the retirement of resource properties and oil and gas properties:

|                                                          |       |    |         |
|----------------------------------------------------------|-------|----|---------|
| Balance, December 31, 2012                               | Notes | \$ | 27,461  |
| Decrease in provision due to change in discount rates    | 7, 8  |    | (3,387) |
| Increase in provision due to passage of time (accretion) |       |    | 595     |
| Asset retirement costs incurred                          |       |    | (947)   |
| Balance, December 31, 2013                               |       | \$ | 23,722  |
| Increase in provision due to change in discount rates    | 7, 8  |    | 2,992   |
| Increase in provision due to passage of time (accretion) |       |    | 608     |
| Decrease related to asset dispositions                   |       |    | (1,554) |
| Asset retirement costs incurred                          |       |    | (158)   |
| Balance, December 31, 2014                               |       | \$ | 25,610  |

The total undiscounted amount of estimated future cash flows required to settle the obligations as of December 31, 2014 is \$34.7 million (2013 - \$41.3 million), which has been discounted using risk free rates from 0.25% to 2.64% and assumes inflation rates from 1.25% to 2.00%. These obligations are expected to be settled over the next thirty years and will be funded from general Company resources at the time of retirement.

### 10. Accounts Payable and Accrued Liabilities

The Company's trade payables at December 31, 2014 and 2013 were \$0.5 million and \$2.7 million respectively. The Company's accrued liabilities at December 31, 2014 and 2013 were \$0.4 million and \$0.7 million, respectively.

### 11. Income Taxes

Total income tax expense differed from the amount computed by applying the Canadian statutory tax rate of 25.0% (25.0% - 2013) to loss before income taxes as a result of the following:

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|                                                                 | December 31,<br>2014 | December 31,<br>2013 |
|-----------------------------------------------------------------|----------------------|----------------------|
| Statutory tax rate                                              | 25.00%               | 25.00%               |
| Loss for the year before income taxes                           | \$ 6,439             | \$ 2,131             |
| Expected income tax benefit                                     | (1,610)              | (533)                |
| Adjustments to reconcile expected income tax benefit to actual: |                      |                      |
| Unrecognized benefit of losses                                  | 2,552                | 761                  |
| Stock-based compensation                                        | -                    | 31                   |
| Differences between statutory and expected tax rate             | (942)                | (259)                |
| Actual income tax benefit                                       | \$ -                 | \$ -                 |

The Company recognized no net deferred tax assets in respect of the following temporary differences and tax losses as it is not probable that there would be sufficient future taxable profits for their utilization, since there is no assurance that a benefit will be realized.

|                             | December 31,<br>2014 | December 31,<br>2013 |
|-----------------------------|----------------------|----------------------|
| Tax loss carry forwards     | \$ 33,351            | \$ 30,770            |
| Asset retirement obligation | 9,811                | 9,320                |
| Share issue costs           | -                    | 8                    |
| Tax assets not recognized   | (43,162)             | (40,098)             |
|                             | \$ -                 | \$ -                 |

The Company has net operating loss carryforwards of approximately \$73.6 million available in the United States, of which approximately \$61.0 million do not begin to expire until 2032.

## 12. Equity Instruments

**Authorized Shares** - There are an unlimited number of authorized common shares of no par value and up to 25 million preference shares of no par value (1,000 shares issued to a wholly owned subsidiary of the Company).

**Issued and Outstanding** - The Company has 160,186,319 shares of common stock outstanding at December 31, 2014 and 2013.

**Share Consolidation** - Effective January 15, 2015, the Directors of the Company authorized the implementation of a share consolidation of one new common share for 10 old shares of the Company's common shares. The Company's shares began trading on the post-consolidation basis on January 21, 2015 (see Footnote 21 - Subsequent Events).

**Stock option plan** - The Company has a stock option plan under which an amount is reserved for issuance of up to 10% of the outstanding common shares as of any particular grant date. These options have been granted with a five-year expiry. The option prices for all outstanding options are denominated in Canadian dollars, the trading currency of the Company's common shares. Upon the effectiveness of the Share Consolidation on January 21, 2015 (see above), all option amounts will be adjusted for the 1 for 10 consolidation, including a corresponding adjustment of option exercise prices related to individual unexercised grants outstanding.

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Option activity for the years ended December 31, 2014 and 2013 are as follows (option shares in thousands and exercise price in Canadian Dollars):

|                                | Number of<br>Options | Weighted-Average<br>Exercise Price (C\$) |
|--------------------------------|----------------------|------------------------------------------|
| Outstanding, December 31, 2012 | 12,530               | \$0.35                                   |
| Granted                        | 2,515                | \$0.10                                   |
| Expired                        | (3,585)              | \$0.55                                   |
| Forfeited                      | (375)                | \$0.16                                   |
| Outstanding, December 31, 2013 | 11,085               | \$0.24                                   |
| Granted                        | 2                    | \$0.00                                   |
| Expired                        | (3,745)              | \$0.30                                   |
| Forfeited                      | (3,290)              | \$0.20                                   |
| Outstanding, December 31, 2014 | 4,050                | \$0.21                                   |

The following table summarizes information about stock options as at December 31, 2014 (number of option shares in thousands):

| Range of Prices<br>C\$ |         | Options Outstanding   |                                                             |                                             | Options Exercisable   |                                             |  |
|------------------------|---------|-----------------------|-------------------------------------------------------------|---------------------------------------------|-----------------------|---------------------------------------------|--|
|                        |         | Number<br>Outstanding | Weighted-Average<br>Remaining<br>Contractual<br>Life (Yrs.) | Weighted-Average<br>Exercise<br>Price (C\$) | Number<br>Exercisable | Weighted-Average<br>Exercise<br>Price (C\$) |  |
| Low                    | High    |                       |                                                             |                                             |                       |                                             |  |
| \$ 0.30                | \$ 0.30 | 1,750                 | 2.70                                                        | \$ 0.12                                     | 1,750                 | \$ 0.12                                     |  |
| 0.20                   | 0.25    | 1,300                 | 1.22                                                        | 0.24                                        | 1,300                 | 0.24                                        |  |
| 0.10                   | 0.16    | 1,000                 | 0.43                                                        | 0.30                                        | 1,000                 | 0.30                                        |  |
| \$ 0.10                | \$ 0.30 | 4,050                 | 1.67                                                        | \$ 0.21                                     | 4,050                 | \$ 0.21                                     |  |

**Earnings per share.** Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the year excluding ordinary shares purchased by the Company and held as treasury shares. The weighted average number of shares outstanding during the years ended December 31, 2014 and 2013, respectively, which were used for purposes of the computation of basic per share data, were 160,186,319 and 160,186,319. Since the Company incurred a net loss for each of the years ended December 31, 2014 and 2013, no common stock equivalents were included in the computation of diluted earnings per share as their inclusion would have been anti-dilutive.

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**Stock-based compensation.** The Company records stock-based compensation expense in the consolidated financial statements for stock options granted using the fair value method. Depending on the terms of vesting for each option, compensation expense is recognized over the vesting period, which ranges from vesting immediately to vesting after six months. No stock-based compensation expense recognized during the year ended December 31, 2014, as no options were granted. Compensation costs of \$0.1 million for the year ended December 31, 2013 was recorded based on the estimated fair value of the 2,515,000 options granted in 2013. The fair value of stock option grants in 2013 were estimated on the grant date using the Black Scholes option-pricing model with the following weighted average assumptions for 2013:

|                                                 |         |
|-------------------------------------------------|---------|
| Risk-free interest rate                         | 1.16%   |
| Expected option life                            | 5 years |
| Volatility in the price of the Company's shares | 91.51%  |
| Estimated forfeiture rate                       | 14.36%  |
| Dividend yield                                  | nil     |
| Fair value per option                           | \$0.06  |
| Stock price on grant date                       | \$0.08  |

### 13. Related Party Transaction

During 2014, the Company paid a \$50,000 due diligence fee to a company controlled by a director of the Company in connection with a proposed credit facility. There were no related party transactions for the year ended December 31, 2013.

### 14. Key Management Compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. The following table summarizes compensation paid or payable to officers and directors of the Company, including the Board of Directors, the Chief Executive Officer, Chief Operating Officer and the Chief Financial Officer:

|                                                          | December 31,<br>2014 | December 31,<br>2013 |
|----------------------------------------------------------|----------------------|----------------------|
| Salaries, bonuses and benefits                           | \$ 1,070             | \$ 1,037             |
| Severance related to settlement of employment agreements | 496                  | -                    |
| Management fees                                          | 60                   | -                    |
| Share based compensation                                 | -                    | 104                  |
| Total compensation                                       | \$ 1,626             | \$ 1,141             |

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### 15. Commitments

The Company is committed to the following non-cancellable future payments, principally related to one remaining office lease, at December 31, 2014 (in thousands):

|       |        |
|-------|--------|
| 2015  | \$ 274 |
| 2016  | 278    |
| 2017  | 164    |
| Total | \$ 716 |

During February 2015, the Company negotiated the sublease of the remaining term of its office lease in Houston, Texas, effective April 1, 2015, which will reduce the remaining future commitments to approximately \$158,000.

In February 2014, the Company amended its CO<sub>2</sub> Purchase Agreement with Kinder Morgan CO<sub>2</sub> Company, L.P. (Kinder Morgan), which would provide the source of CO<sub>2</sub> for use in tertiary oil recovery projects in the Permian Basin. The contract, as amended, requires the Company to take or pay for the purchase of 27.4 billion cubic feet of CO<sub>2</sub> over a five-year period commencing no later than January 1, 2018. The maximum daily rate to be purchased under the contract is 20 million cubic feet per day during year three and the cost of CO<sub>2</sub> will fluctuate based on the price of oil and transportation tariffs. The Company would be required to construct a pipeline, currently estimated to be a distance of approximately 32 miles, to the pipeline operated by Kinder Morgan. The purchase commitment and obligation to pay, as amended, is cancellable before January 1, 2017, with no termination penalty.

In connection with the sale of certain assets to Kinder Morgan in 2011, as a condition of closing, the Company created an escrow fund for certain contingent obligations. The Company and Kinder Morgan agreed to be contingently responsible for and to share in the costs of up to \$5.0 million of future appraisal drilling costs to evaluate helium in certain areas of the St. Johns Dome field, only when and if a new CO<sub>2</sub> pipeline is ultimately committed by Kinder Morgan. Kinder Morgan released \$2.0 million of the escrowed amount to the Company on January 31, 2013 (see Note 5 - Restricted Cash).

### 16. Financial Instruments- Commodity Contracts

The following table sets forth the specifics related to the financial instrument in place for future crude oil settlements (NYMEX WTI) at December 31, 2014.

| Barrels | Commodity                        | Type | Price    | Term               |
|---------|----------------------------------|------|----------|--------------------|
| 36,500  | WTI Midland-Cushing Differential | Swap | (\$3.50) | Jan 2015- Dec 2015 |

In March 2014, the Company executed a derivative collar agreement with a crude oil purchaser, Shell Trading Risk Management LLC, for settlements aggregating approximately 72,000 net barrels of crude oil through April 2015 at an average monthly NYMEX settlement price of between approximately \$88.00 (put) and \$97.50 (call) per barrel. The Company realized gains of \$0.3 million on all derivative agreements for the year ended December 31, 2014, including a gain of \$0.3 million in connection with the termination of this collar derivative in October 2014 following the sale of the Crossroads field. Realized gains during 2014 were \$0.1 million on the remaining swap derivative, but which had an unrealized estimated fair value loss of \$39,000 at December 31, 2014. Realized derivative losses on contract settlements for the year ended December 31, 2013 were \$0.3 million.

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### 17. Fair Value Measurements

Fair value estimates are made at a specific point in time, using available information about the financial instrument. These estimates are subjective in nature and often cannot be determined with precision. The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 – Values are based on unadjusted quoted prices available in active markets for identical assets or liabilities as of the reporting date.
- Level 2 – Values 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. Prices in level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 – Values are based on prices or valuation techniques that are not based on observable market data.

The Company has determined that the carrying value of its short-term financial assets and liabilities (cash and cash equivalents, restricted cash, receivables, prepaid assets, accounts payable and accrued liabilities) approximates fair value at the consolidated balance sheet dates due to the short-term maturity of these instruments.

The fair values of the derivatives are determined by a Level 2 valuation model, where pricing inputs other than quoted prices in an active market are used. These pricing inputs include quoted forward prices for commodities, foreign exchange rates, volatility and risk-free rate discounting, all of which can be observed or corroborated in the marketplace. The actual gains and losses realized on eventual cash settlement can vary materially due to subsequent fluctuations in commodity prices and foreign exchange rates as compared to the valuation assumptions.

### 18. Risk management

Disclosures relating to exposure to risks, in particular credit risk, liquidity risk, foreign currency risk, interest rate risk and equity price risk are provided below.

**Risks Associated with Financial Assets and Liabilities:** The Company is exposed to financial risks arising from its financial assets and liabilities. Financial risks include market risks (such as commodity prices, foreign exchange and interest rates), credit risk and liquidity risk. The future cash flows of financial assets or liabilities may fluctuate due to movements in market prices and the exposure to credit and liquidity risks.

#### Credit risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company's financial instruments that are exposed to concentrations of credit risk are primarily cash and cash equivalents, including restricted cash, accounts receivable and counterparty risk on derivative contracts. The Company limits its exposure to credit risk with respect to cash equivalents by investing available cash in short-term deposits with Canadian and US banks, principally in overnight money market funds investing in government treasury instruments. The Company's receivables mainly consist of amounts due from sales of its crude oil and natural gas production.

With respect to its crude oil and natural gas production receivables, the Company is the operator of all its property interests and owns the significant majority of the working interest in producing and non-producing properties.

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(all amounts in thousands of US dollars unless otherwise indicated)

Year ended December 31, 2014 and 2013

Receivables related to the sale of crude oil production are with two major reputable marketers and proceeds are collected within approximately 25 days following the month of delivery. The Company produces a limited amount of natural gas which is sold to a reputable purchaser and collections occur within approximately 55 days of the end of any monthly period. The Company with respect to the majority of operated production remits royalty and severance taxes to the other royalty and working interest owners of the leaseholds interests.

The Company's exposure to credit risk for these consolidated financial instruments was as follows (all amounts in thousands)

|                           | December 31,<br>2014 | December 31,<br>2013 |
|---------------------------|----------------------|----------------------|
| Cash and cash equivalents | \$ 4,079             | \$ 1,249             |
| Receivables               | 503                  | 1,438                |
| Restricted cash           | 5,502                | 5,545                |

### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will always have sufficient liquidity to meet liabilities when due. Currently, the Company does not have a credit facility to facilitate the management of liquidity risk. At December 31, 2014, the Company had cash of \$4.1 million, excluding restricted cash of \$5.5 million, and no outstanding funded indebtedness. The Company believes it can meet its current obligations, but currently has negative cash flows due to declining oil prices and production. The Company is still dependent on raising funds by borrowings, equity issues, or asset sales to finance its ongoing operations, capital expenditures and acquisitions. The contractual maturity of the majority of accounts payable is within three months or less. Management has delayed capital certain projects until the oil commodity pricing environment improves and has reduced general and administrative and operating costs subsequent to December 31, 2014. The Company has historically financed its expenditures and working capital requirements through the sale of common stock or, on occasion, through the issuance of short-term debt.

### Foreign exchange risk

Substantially all of the Company's expenditures are either denominated in or made with US dollars. As a result, the Company has very limited exposure to foreign exchange risk in relation to drilling commitments and related resource properties on cash flows related to these purchases. The Company has chosen not to enter into any foreign exchange contracts as its Canadian dollar working capital balances are not deemed significant to the consolidated entity.

### Interest rate risk

The Company is exposed to interest rate risk to the extent that changes in the market interest rates impact the Company's short-term deposits that have floating interest rates. The Company's exposure to interest rate fluctuations at December 31, 2014, is primarily related to cash deposits denominated in Canadian or US dollars invested in short-term (less than 90 days) money market funds through its bank accounts and interest earned on its cash and cash equivalents.

# ENHANCED OIL RESOURCES INC.

Notes to Consolidated Financial Statements

(all amounts in thousands of US dollars unless otherwise indicated)

Year ended December 31, 2014 and 2013

## Commodity price risk

The Company is constantly exposed to fluctuations in the world commodity prices for its products with a corresponding impact to cash flow. Reduced cash flow may result in lower levels of capital being available for field activity, thus compromising the Company's capacity to grow production while at the same time replacing continuous production declines from existing properties. When debt levels are forecast to increase due to capital expenditures exceeding cash flow, the Company may enter into oil and natural gas hedging contracts in order to provide stability of future cash flow, and thus predictable debt reduction. The Company enters derivative financial instruments to manage commodity price risk exposure relative to actual commodity production and does not utilize derivative instruments for speculative purposes.

In connection with the crude oil derivative contract outstanding at December 31, 2014, a \$1.00 per barrel increase/decrease in commodity price s would have a negative/positive impact on net loss of \$0.2 million (nil for 2013).

## 19. Supplemental Cash Flow Information

The (increase)/decrease in non-cash working capital from continuing operations is comprised of:

|                                  | December 31,<br>2014 | December 31,<br>2013 |
|----------------------------------|----------------------|----------------------|
| Receivables                      | \$ 935               | \$ (196)             |
| Other current assets             | 120                  | 215                  |
| Other non current assets         | 76                   | -                    |
| Accounts payable                 | (2,742)              | (1,434)              |
| Non-cash working capital changes | \$ (1,611)           | \$ (1,415)           |
| Relating to:                     |                      |                      |
| Operating activities             | \$ (1,611)           | \$ (1,415)           |

The Company paid interest of nil in 2014 and \$0.2 million in 2013.

## 20. Capital Management Disclosures

The Company attempts to manage its capital to maintain its ability to continue as a going concern, complete its development projects, to adjust to changing market conditions, to maintain flexibility while pursuing objectives, and ultimately to provide returns to shareholders and benefits to other stakeholders. To manage the capital structure, the Company may adjust capital spending, issue new shares, issue new debt or sell assets. The Company's objectives in managing its capital structure are to maintain a flexible financial structure, to preserve the Company's access to capital markets, and to finance the Company's growth and continue to meet its financial obligations. Until December 31, 2013, the Company had externally imposed capital restrictions through debt covenants associated with its borrowings from a financial institution through a bank credit facility, which expired in 2013.

# ENHANCED OIL RESOURCES INC.

## Notes to Consolidated Financial Statements

(all amounts in thousands of US dollars unless otherwise indicated)

Year ended December 31, 2014 and 2013

At December 31, 2014 and 2013, total capitalization of the Company is as follows:

|                                                                         | December 31,<br>2014 | December 31,<br>2013 |
|-------------------------------------------------------------------------|----------------------|----------------------|
| Accounts payable and accrued liabilities (excluding commodity contract) | \$ 951               | \$ 3,426             |
| Debt                                                                    | -                    | -                    |
| Total Shareholders' Equity                                              | 31,988               | 38,427               |
| Total Capitalization                                                    | \$ 32,939            | \$ 41,853            |
| Debt to Capitalization Ratio                                            | 3%                   | 8%                   |

The Company manages its capital structure and makes adjustments to it in light of market and economic conditions as well as the risk characteristics of the Company's underlying assets. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issues, the use of credit facilities, adjusting capital spending or by undertaking other strategies as deemed appropriate under the specific circumstances.

The Company monitors capital and its financing requirements through an annual budget process and updates to the budget forecast and working capital projections. There were no changes to the Company's capital management policies during the year ended December 31, 2014.

### 21. Subsequent Events

*Share Consolidation* - Effective January 15, 2015, the Directors of the Company authorized the implementation of a share consolidation of one new common share for 10 old shares of the Company's common shares. The Company's shares began trading on the post-consolidation basis on January 21, 2015 (see Note 12 – Equity Instruments).

*Private Placement* – On April 9, 2015, the Company announced a private placement of up to US \$5.5 million at a price of C\$0.05 per share. The use of proceeds is for operating expenditures and general working capital. The completion of the private placement is subject to the approval of the TSX Venture Exchange.