# STRIKEWELL ENERGY CORP.

## Consolidated Financial Statements
## December 31, 2013 and 2012
**(Expressed in Canadian Dollars)**

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**SmytheRatcliffe**
CHARTERED ACCOUNTANTS

# INDEPENDENT AUDITORS' REPORT

## TO THE SHAREHOLDERS OF STRIKEWELL ENERGY CORP.

We have audited the accompanying consolidated financial statements of Strikewell Energy Corp., which comprise the consolidated statements of financial position as at December 31, 2013 and 2012, and the consolidated statements of comprehensive loss, changes in shareholders' deficiency and cash flows for the years then ended, and 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 the auditors' 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, the auditor considers 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 financial position of Strikewell Energy Corp. as at December 31, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

*Emphasis of Matter*
Without qualifying our opinion, we draw attention to note 1 in the consolidated financial statements, which describes matters and conditions that indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern.

Smythe Ratcliffe LLP

Chartered Accountants

Vancouver, British Columbia
April 22, 2014



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## Strikewell Energy Corp.
### Consolidated Statements of Financial Position
*(Expressed in Canadian dollars)*

| | Notes | As at December 31, 2013 | As at December 31, 2012 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current Assets** | | | |
| Cash | | **$ 9,633** | $ 4,547 |
| Accounts receivable | | **24,028** | 16,118 |
| | | **33,661** | 20,665 |
| **Non-Current Assets** | | | |
| Petroleum and natural gas interests | 7 | **159,272** | 257,622 |
| | | **$ 192,933** | $ 278,287 |
| **LIABILITIES AND EQUITY** | | | |
| **Current Liabilities** | | | |
| Accounts payable and accrued liabilities | 8, 14 | **$ 2,294,230** | $ 1,606,387 |
| Current portion of notes payable | 10 | **4,270,666** | - |
| Current portion of loans payable | 9 | **1,410,207** | - |
| | | **7,975,103** | 1,606,387 |
| **Non-Current Liabilities** | | | |
| Loans payable | 9 | **39,724** | 1,195,091 |
| Notes payable | 10 | **-** | 4,378,456 |
| Decommissioning obligations | 11 | **6,128** | 6,128 |
| | | **8,020,955** | 7,186,062 |
| **SHAREHOLDERS' DEFICIENCY** | | | |
| Capital stock | 12 | **16,771,855** | 16,771,855 |
| Contributed surplus | | **264,686** | 252,608 |
| Deficit | | **(24,864,563)** | (23,932,238) |
| | | **(7,828,022)** | (6,907,775) |
| | | **$ 192,933** | $ 278,287 |

**Approved on behalf of the Board:**

*"Alistair Palmer"* **Director**

*"Peter Bryant"* **Director**

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

## Strikewell Energy Corp.
### Consolidated Statements of Comprehensive Loss
### Years Ended December 31
*(Expressed in Canadian dollars)*

| | Notes | 2013 | 2012 |
|---|---|---|---|
| **Revenue** | | | |
| Petroleum and natural gas | | **$ 147,130** | $ 119,599 |
| Royalties | | **(56,431)** | (40,098) |
| | | **90,699** | 79,501 |
| **Direct expenses** | | | |
| Production | | **38,541** | 25,082 |
| Depletion and accretion | | **5,641** | 7,087 |
| | | **44,182** | 32,169 |
| **Operating income** | | **46,517** | 47,332 |
| **General and administrative expenses** | | | |
| Administration fees | 14(c) | **60,000** | 60,000 |
| Directors' and officers' fees | 14(a) | **18,000** | 18,000 |
| Filing and transfer agent fees | | **16,441** | 15,781 |
| Impairment of petroleum and natural gas interests | 7 | **96,848** | 211,550 |
| Interest on long-term debt | | **753,209** | 690,923 |
| Office and miscellaneous | | **5,833** | 2,590 |
| Professional fees | | **28,511** | 32,601 |
| | | **978,842** | 1,031,445 |
| **Net loss and total comprehensive loss for the year** | | **$ (932,325)** | $ (984,113) |
| **Basic and diluted loss per share** | | **$ (0.11)** | $ (0.11) |
| **Weighted average number of common shares outstanding** | | **8,626,862** | 8,626,862 |

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

## Strikewell Energy Corp.

### Consolidated Statements of Changes in Shareholders' Deficiency

### For the years ended December 31, 2013 and 2012

*(Expressed in Canadian dollars)*

| | Number of Shares | Captial Stock | Contributed Surplus | Deficit | Total |
|---|---|---|---|---|---|
| **Balance as at January 1, 2012** | 8,626,862 | $ 16,771,855 | $ - | $ (22,948,125) | $ (6,176,270) |
| Extinguishment of debt (note 9) | - | - | 252,608 | - | 252,608 |
| Total comprehensive loss for the year | - | - | - | (984,113) | (984,113) |
| **Balance as at December 31, 2012** | **8,626,862** | **$ 16,771,855** | **$ 252,608** | **$ (23,932,238)** | **$ (6,907,775)** |

| | Number of Shares | Captial Stock | Contributed Surplus | Deficit | Total |
|---|---|---|---|---|---|
| **Balance as at January 1, 2013** | 8,626,862 | $ 16,771,855 | $ 252,608 | $ (23,932,238) | $ (6,907,775) |
| Extinguishment of debt (note 9) | - | - | 12,078 | - | 12,078 |
| Total comprehensive loss for the year | - | - | - | (932,325) | (932,325) |
| **Balance as at December 31, 2013** | **8,626,862** | **$ 16,771,855** | **$ 264,686** | **$ (24,864,563)** | **$ (7,828,022)** |

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

# Strikewell Energy Corp.
## Consolidated Statements of Cash Flows
### Years ended December 31
*(Expressed in Canadian dollars)*

| | | 2013 | | 2012 |
|---|---|---|---|---|
| **Operating activities** | | | | |
| Net loss for the year | **$** | **(932,325)** | $ | (984,113) |
| Items not involving cash: | | | | |
| Depletion and accretion | | **5,641** | | 7,087 |
| Accretion of discount on notes payable | | **(107,790)** | | (95,748) |
| Accrued interest on long term debt | | **220,418** | | 146,071 |
| Impairment of petroleum and natural gas interests | | **96,848** | | 211,550 |
| | | **(717,208)** | | (715,153) |
| Changes in non-cash working capital: | | | | |
| Accounts receivable | | **(7,910)** | | 8,727 |
| Accounts payable and accrued liabilities | | **687,843** | | 718,814 |
| | | **679,933** | | 727,541 |
| **Cash provided by (used in) operating activities** | | **(37,275)** | | 12,388 |
| **Investing activities** | | | | |
| Petroleum and natural gas interests | | **(4,139)** | | (31,839) |
| **Financing activities** | | | | |
| Proceeds from loan | | **46,500** | | - |
| **Inflow (outflow) of cash** | | **5,086** | | (19,451) |
| **Cash, beginning of year** | | **4,547** | | 23,998 |
| **Cash, end of year** | **$** | **9,633** | $ | 4,547 |

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

## 1. NATURE OF OPERATIONS AND GOING CONCERN

Strikewell Energy Corp. (the "Company" or "Strikewell") is a petroleum and natural gas producer engaged in the exploration and development of natural gas properties in Alberta, Canada.

Strikewell is a publicly listed company incorporated in Canada with limited liability under the legislation of the province of British Columbia. The Company's shares are listed on the TSX Venture Exchange.

The principal mailing address of the Company is RPO Box 60610 Granville Park, Vancouver, British Columbia, Canada, V6H 4B9. The records of the Company are located at 1500 West 16 Avenue, Vancouver, British Columbia, Canada V6K 2L6. The Company's registered office address is 885 West Georgia Street, Suite 900, Vancouver, British Columbia, Canada, V6H 3H1.

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

The Company has incurred a net loss of $932,325 (2012 - $984,113), is currently unable to self-finance operations, has a working capital deficiency of $7,941,442 (2012 - $1,585,722) an accumulated deficit of $24,864,563 (2012 - $23,932,238), limited resources, no significant source of operating cash flow and no assurances that sufficient funding will be available to conduct further exploration and development of its petroleum and natural gas interests. The Company will require additional equity financing to meet its administrative overhead costs, and to continue exploration work on its petroleum and natural gas interests in 2014.

The application of the going concern concept is dependent upon the Company's ability to generate future profitable operations, raise additional capital through debt and/or equity financing and its debtors' continued forbearance on the Company's outstanding debt. Management is actively seeking to raise the necessary capital to meet its funding requirements and has undertaken available cost cutting measures. There can be no assurance that management's plan will be successful.

These matters indicate material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern. These consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

## 2. BASIS OF PREPARATION

(a) Statement of compliance:

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

## 2. BASIS OF PREPARATION (continued)

(a) Statement of compliance (continued):

These consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments, which are measured at fair value, and held-for-trading financial assets, which are measured at fair value with changes in fair value recorded in net loss. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

The accounting policies set out below have been applied consistently to all periods presented by the Company and its subsidiary.

(b) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional and reporting currency.

(c) Use of estimates and judgments:

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that may affect the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Following are the accounting policies subject to such judgments and the key sources of estimation uncertainty that the Company believes could have the most significant impact on the reported results and financial position.

Reserves

The estimate of oil and natural gas reserves is integral to the calculation of the amount of depletion charged to the statements of loss and comprehensive loss and is also a key determinant in assessing whether the carrying value of any of the Company's development and production assets have been impaired. Changes in reported reserves can impact asset carrying values and the decommissioning provision due to changes in expected future cash flows. The Company's reserves are evaluated and reported on by independent reserve engineers at least annually in accordance with Canadian Securities Administrators' National Instrument 51-101 *Standards of Disclosure of Oil and Gas Activities*. Reserve estimation is based on a variety of factors including engineering data, geological and geophysical data, projected future rates of production, commodity pricing and timing of future expenditures, all of which are subject to significant judgment and interpretation.

**2. BASIS OF PREPARATION** (continued)

(c) Use of estimates and judgments (continued):

Carrying value of petroleum and natural gas interests

The Company assesses at each reporting date whether there is an indication that an asset or cash-generating unit ("CGU") may be impaired. A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretation with respect to the way in which management monitors operations. If any indication exists that an asset or CGU may be impaired, the Company estimates the recoverable amount. The recoverable amounts of individual assets and CGUs have been determined based on the higher of value-in-use calculations and fair value less costs to sell. These calculations require the use of estimates and assumptions, such as estimates of proved plus probable reserves, future production rates, oil and natural gas prices, future costs and other relevant assumptions, all of which are subject to change.

A material adjustment to the carrying value of the Company's petroleum and natural gas interests could arise as a result of changes to these estimates and assumptions.

*Critical accounting estimates*

Decommissioning obligations

Amounts recorded for decommissioning obligations require the use of management's best estimates of future decommissioning expenditures, expected timing of expenditures and future inflation rates. The estimates are based on internal and third party information and calculations are subject to change over time and may have a material impact on profit or loss or financial position. For more information on the Company's decommissioning obligations see note 11.

Income taxes

Related assets and liabilities are recognized for the estimated tax consequences between amounts included in the consolidated financial statements and their tax base using substantively enacted future income tax rates. Timing of future revenue streams and future capital spending changes can affect the timing of any temporary differences, and accordingly, affect the amount of the deferred tax asset or liability calculated at a point in time. These differences could materially impact earnings.

(d) Approval of the consolidated financial statements

These consolidated financial statements were approved and authorized for issue by the Board of Directors on April 22, 2014.

## 3. SIGNIFICANT ACCOUNTING POLICIES

(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 are currently exercisable are taken into account. The financial statements of the Company's wholly-owned subsidiary, Strikewell Capital Corp. ("Strikewell Capital"), are included in the consolidated financial statements since the date that control commenced.

(ii) Jointly controlled operations and jointly controlled assets

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) Financial instruments:

(i) Financial assets

The Company classifies its financial assets in the following categories: financial assets at fair value through profit or loss ("FVTPL"), loans and receivables, held-to-maturity and available-for-sale ("AFS"). The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of financial assets at recognition.

Financial assets at fair value through profit or loss

An instrument is classified at FVTPL if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at FVTPL 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 at FVTPL are measured at fair value, and changes therein are recognized in profit or loss.

**3. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(b) Financial instruments (continued):

(i) Financial assets (continued)

Loans and receivables

Trade receivables, loans and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest rate method, less any impairment losses. The impairment loss on receivables is based on a review of all outstanding amounts at period-end. Bad debts are written off during the year in which they are identified. Interest income is recognized by applying the effective interest rate method.

Held-to-maturity

Held-to-maturity financial assets are recognized on a trade-date basis and are initially measured at fair value using the effective interest rate method.

Available-for-sale

AFS financial assets are non-derivatives that are either designated as available-for-sale or not classified in any of the other financial assets categories. Changes in the fair value of AFS financial assets other than impairment losses are recognized as other comprehensive loss and classified as a component of equity.

(ii) Financial liabilities

The Company classifies its financial liabilities as FVTPL or other financial liabilities.

Fair value through profit or loss

Financial liabilities classified as FVTPL include financial liabilities held for trading and financial liabilities designated upon initial recognition as FVTPL. Fair value changes on financial liabilities classified as FVTPL are recognized in profit or loss.

Other financial liabilities

Other financial liabilities are non-derivatives and are recognized initially at fair value, net of transaction costs incurred, and are subsequently stated at amortized cost using the effective interest rate method. Any difference between the amounts originally received, net of transaction costs, and the redemption value is recognized in profit or loss over the period to maturity using the effective interest method. Other financial liabilities are classified as current or non-current based on their maturity date.

**3. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(b) Financial instruments (continued):

(iii) Effective interest method

The effective interest method calculates the amortized cost of a financial asset and allocates interest income over the corresponding period. The effective interest rate is the rate that discounts estimated future cash receipts over the expected life of the financial asset or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

(iv) Fair value hierarchy

The Company provides information about its financial instruments measured at fair value at one of three levels according to the relative reliability of the inputs used to estimate the fair value:

Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(c) Revenue recognition:

Revenue from the sale of petroleum and natural gas is recorded when title passes to an external party and is based on volumes delivered to customers at contractual delivery points, and rates and collectability are reasonably assured. Delivery is generally at the time the product enters the pipeline. The costs associated with the delivery, including operating and maintenance costs, transportation and production-based royalty expenses, are recognized during the same period in which the related revenue is earned and

(d) Petroleum and natural gas interests:

Items of property, plant and equipment included in petroleum and natural gas interests, which include oil and gas development assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development assets are grouped into CGUs for impairment testing. As at December 31, 2013 the Company has one CGU, which consists of the Garrington property held by Strikewell Capital.

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

**3. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(d) Petroleum and natural gas interests (continued):

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 petroleum 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 profit or loss as incurred. Such capitalized petroleum 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 day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

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 year to the related proven reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proven reserves are estimated using independent reserve engineer reports and represent the estimated quantities of 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. There should be a minimum of 90 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and a maximum 10 percent statistical probability that it will be less. Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered proven if future economic feasibility is supported by either actual production or conclusive formation test. The area of reservoir considered proven includes (a) that portion delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, or both, and (b) the immediately adjoining portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geophysical, geological and engineering data. In the absence of information on fluid contacts, the lowest known structural occurrence of oil and natural gas controls the lower proved limit of the reservoir.

**3. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(e) Impairment:

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 amortized cost is the present value of the estimated future cash flows discounted at the asset's original 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 profit or loss.

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 profit or loss.

Non-financial assets

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 (the CGU). 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 proven and probable reserves.

An impairment loss would be recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

Impairment losses recognized in prior periods 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, if no impairment loss had been recognized.

**3. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(f) Income taxes:

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss, except to the extent that if the income tax expense related to items recognized directly in equity, the income tax expense would also be recognized in equity.

Current tax is the expected tax payable on the taxable income for the period, 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 asset and liability 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 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.

(g) Earnings (loss) per share:

Basic earnings (loss) per share is calculated by dividing net income (loss) attributable to common shareholders of the Company by the weighted average number of shares outstanding during the period. Diluted earnings (loss) per share is computed using the treasury stock method. In accordance with the treasury stock method, the weighted average number of common shares outstanding is increased to include additional shares for the assumed exercise of stock options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options and warrants were exercised and that the proceeds from such exercises were used to acquire common stock at the average market price during the reporting periods.

(h) Share-based payments:

The Company may grant share options to acquire common shares of the Company to directors, officers, employees and consultants. The fair value of share-based payments to employees is measured at grant date, using the Black-Scholes option pricing model, and is recognized over the vesting period for employees using the graded vesting method. Fair value of share-based payments to non-employees is recognized and measured at the date the goods or services are received based on the fair value of such goods or services. If it is determined that the fair value of goods and services received cannot be reliably measured the share-based payment is measured at the fair value of the equity instruments issued using the Black-Scholes option pricing model.

**3. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(h) Share-based payments (continued):

For both employees and non-employees, the fair value of share-based payments is recognized as either an expense or as petroleum and natural gas interests with a corresponding increase in contributed surplus. The amount recognized as expense is adjusted to reflect the number of share options expected to vest. Consideration received on the exercise of stock options is recorded in capital stock and the related share-based payment in contributed surplus is transferred to capital stock. For those options that expire or are forfeited after vesting, the recorded value is transferred to deficit.

(i) Decommissioning obligations:

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. 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 management's best estimate of expenditure required to settle the present obligation at the consolidated statement of financial position 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 underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(j) Provisions:

A provision is recognized if, as a result of a past event, the Company has a present obligation (legal or constructive) that can be estimated reliably, and it is probable that expenditure will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

(k) Operating segment:

The Company has only one operating segment, the exploration and development of petroleum and natural gas interests in Alberta.

**3. SIGNIFICANT ACCOUNTING POLICIES** (continued)

(l) New accounting pronouncements:

All of the new and revised standards described below may be early-adopted.

IFRS 9 *Financial Instruments* (2009)

IFRS 9 introduces new requirements for classifying and measuring financial assets, as follows:

- Debt instruments meeting both a “business model” test and a “cash flow characteristics” test are measured at amortized cost (the use of fair value is optional in some limited circumstances)
- Investments in equity instruments can be designated as “fair value through other comprehensive income” with only dividends being recognized in profit or loss
- All other instruments (including all derivatives) are measured at fair value with changes recognized in the profit or loss.

The concept of “embedded derivatives” does not apply to financial assets within the scope of the standard and the entire instrument must be classified and measured in accordance with the above guidelines.

The adoption of this standard has been postponed indefinitely by the IASB.

IFRS 9 *Financial Instruments* (2010)

This is a revised version incorporating revised requirements for the classification and measurement of financial liabilities, and carrying over the existing de-recognition requirements from IAS 39 *Financial Instruments: Recognition and Measurement*.

The revised financial liability provisions maintain the existing amortized cost measurement basis for most liabilities. New requirements apply where an entity chooses to measure a liability at FVTPL; in these cases, the portion of the change in fair value related to changes in the entity's own credit risk is presented in other comprehensive income rather than within profit or loss.

The adoption of this standard has been postponed indefinitely by the IASB.

There are no other IFRS or International Financial Reporting Interpretations Committee interpretations that are not yet effective that would be expected to have a material impact on the Company.

## 4. FINANCIAL INSTRUMENTS

Fair value:

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. All financial instruments measured at fair value are categorized into a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

The carrying values of cash, accounts receivable, and accounts payable and accrued liabilities approximate their fair values due to the short-term maturity of these financial instruments.

The notes and loans payable are carried at amortized cost using the effective interest method.

Classification:

The Company classifies its financial instruments as follows: cash is classified as a financial asset at FVTPL; accounts receivable, as loans and receivables; accounts payable, loan payable and notes payable, as other financial liabilities.

## 5. FINANCIAL RISK MANAGEMENT

(a) Overview:

The Company has exposure to the following risks from its use of financial instruments:

- Market risk;
- Credit risk; and
- Liquidity risk

(b) Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk comprises three types of risk: interest rate risk, foreign currency risk and other price risk.

(i) Interest rate risk

The Company's cash is held in bank accounts and, due to the short-term nature of these financial instruments, fluctuations in market interest rates do not have an impact on the fair value as at December 31, 2013.

The Company's loans and notes payable are at fixed interest rates, and therefore, the Company's exposure to interest rate cash flow risk is minimal.

(ii) Foreign currency risk

The Company is not exposed to significant foreign currency risk.

**5. FINANCIAL RISK MANAGEMENT** (continued)

(b) Market risk (continued):

(iii) Other price risk

Other price risk is the risk that the fair or future cash flows of a financial instrument will fluctuate due to changes in market prices, other than those arising from interest rate risk. The Company is not exposed to significant other price risk.

(c) Credit risk:

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its payment obligations. The Company is exposed to credit risk with respect to its cash and accounts receivable. The credit risk associated with cash is minimized substantially by ensuring these financial assets are placed with a major financial institution with a high credit rating.

Accounts receivable primarily consists of revenues from the sale of oil and gas. To reduce credit risk, the Company regularly reviews the collectability of accounts receivable.

Concentration of credit risk exists with the Company's accounts receivable. The Company's concentration of credit risk and maximum exposure thereto is as follows:

| | | **December 31, 2013** | | **December 31, 2012** |
|---|---|---|---|---|
| Trade receivables | $ | 23,168 | $ | 11,121 |

(d) Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in satisfying obligations as they become due. The Company assesses its liquidity risk by forecasting cash flows required by operations and anticipated financing activities.

The Company has a cash balance at December 31, 2013 of $9,633 (2012 - $4,547) and accounts receivable of $24,028 (2012 - $16,118). At December 31, 2013, the Company had accounts payable and accrued liabilities of $2,294,230 (2012 - $1,606,387) and a working capital deficiency of $7,941,442 (2012 - $1,585,722). Based on the current funds held, the Company will need to rely upon financing from shareholders and/or debt holders to obtain sufficient working capital. There is no assurance that such financing will be available on terms and conditions acceptable to the Company.

## 5. FINANCIAL RISK MANAGEMENT (continued)

(d) Liquidity risk(continued):

The amounts listed below are the remaining undiscounted contractual maturities for financial liabilities held by the Company as at December 31, 2013:

| Due Date | Accounts Payable and Accrued Liabilities | Loans Payable | Notes Payable | Total |
|---|---|---|---|---|
| | | (note 9) | (note 10) | |
| 0 – 30 days | $ 135,795 | $ - | $ - | $ 135,795 |
| 30 days – 1 year | 2,158,435 | 1,410,207 | 6,532,149 | 10,100,791 |
| 1 to 5 years | - | 46,500 | - | 46,500 |
| | $ 2,294,230 | $ 1,456,707 | $ 6,532,149 | $ 10,283,086 |

The amounts listed below are the remaining undiscounted contractual maturities for financial liabilities held by the Company as at December 31, 2012:

| Due Date | Accounts Payable and Accrued Liabilities | Loans Payable | Notes Payable | Total |
|---|---|---|---|---|
| | | (note 9) | (note 10) | |
| 0 – 30 days | $ 324,434 | $ - | $ - | $ 324,434 |
| 30 days– 1 year | 1,281,953 | - | - | 1,281,953 |
| 1 year – 5 years | - | 1,195,091 | 6,532,149 | 7,727,240 |
| | $ 1,606,387 | $ 1,195,091 | $ 6,532,149 | $ 9,333,627 |

## 6. CAPITAL MANAGEMENT

The Company defines its capital as debt and shareholders' deficiency. Capital requirements are driven by the Company's exploration activities on its petroleum and natural gas interests. Management's objective is to ensure there are adequate capital resources to safeguard the Company's ability to continue as a going concern. Management reviews its capital management approach on an on-going basis and believes its approach given the relative size of the Company is reasonable.

Although the Company has been successful at raising funds in the past through obtaining debt financing from current shareholders, it is uncertain whether it can continue this financing methodology.

The Board of Directors does not establish a quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. The Company's capital stock and debt is not subject to any externally imposed capital requirements and the Company did not change its approach to capital management during the year.

## 7. PETROLEUM AND NATURAL GAS INTERESTS

| Cost | Well Equipment | Acquisition and Lease | Asset Retirement | Total |
|---|---|---|---|---|
| Balance at December 31, 2011 | $ 90,000 | $ 363,880 | $ 1,744 | $ 455,624 |
| Additions | - | 31,839 | 4,384 | 36,223 |
| Balance at December 31, 2012 | 90,000 | 395,719 | 6,128 | 491,847 |
| Additions | - | 4,139 | - | 4,139 |
| Balance at December 31, 2013 | $ 90,000 | $ 399,858 | $ 6,128 | $ 495,986 |

| Accumulated Depletion, Accretion and Impairment | Well Equipment | Acquisition and Lease | Asset Retirement | Total |
|---|---|---|---|---|
| Balance at December 31, 2011 | $ 3,078 | $ 12,447 | $ 63 | $ 15,588 |
| Additions | 1,310 | 5,685 | 92 | 7,087 |
| Impairment | 39,100 | 172,450 | - | 211,550 |
| Balance at December 31, 2012 | 43,488 | 190,582 | 155 | 234,225 |
| Additions | 1,114 | 4,504 | 23 | 5,641 |
| Impairment | 17,575 | 79,273 | - | 96,848 |
| Balance at December 31, 2013 | $ 62,177 | $ 274,359 | $ 178 | $ 336,714 |

| Carrying amounts | Well Equipment | Acquisition and Lease | Asset Retirement | Total |
|---|---|---|---|---|
| December 31, 2012 | $ 46,512 | $ 205,137 | $ 5,973 | $ 257,622 |
| December 31, 2013 | $ 27,823 | $ 125,499 | $ 5,951 | $ 159,272 |

During the year ended December 31, 2013, the Company performed an impairment test on its petroleum and natural gas assets. It was determined that the carrying amount of a CGU exceeded its recoverable amount due to a decline in estimated reserve volumes. Accordingly, the Company recognized an impairment charge of $96,848 (2012 - $211,550). The impairment test was performed by comparing the estimated net present value of future cash flows from wells classified as proved and probable against their respective carrying amounts. The discounted cash flows were estimated using a discount rate of 10% (2012 - 10%) with escalating prices and future development costs, as obtained from the reserve report. The prices used are those used by independent reserve engineers.

## 7. PETROLEUM AND NATURAL GAS INTERESTS (continued)

Security:

At December 31, 2013 and 2012, all of the Company's properties are pledged as security for the loan and notes payable.

Contingencies:

Although the Company believes that it has title to its petroleum and natural gas interests, it cannot control or completely protect itself against the risk of title disputes or challenges.

## 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| | | December 31, 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Trade payables | $ | 332,512 | $ | 283,934 |
| Interest payable | | 1,922,554 | | 1,281,954 |
| Other payables | | 7,999 | | 7,999 |
| Accrued liabilities | | 31,165 | | 32,500 |
| | $ | 2,294,230 | $ | 1,606,387 |

## 9. LOANS PAYABLE

(a) Lender 1 – Loan payable to a significant shareholder of the Company:

| | | Total |
|---|---|---|
| Carrying amount, December 31, 2011 | $ | 1,301,628 |
| Gain on extinguishment of debt | | (252,608) |
| Accrued interest | | 146,071 |
| Carrying amount, December 31, 2012 | | 1,195,091 |
| Accrued interest | | 215,116 |
| Carrying amount, December 31, 2013 | $ | 1,410,207 |

This loan has a principal balance of $865,924, is secured by the assets of the Company and bears interest at 10% per annum payable semi-annually. On June 1, 2012, the terms of the original loan agreement were amended to reflect an update to the maturity date of the loan from June 1, 2012 to June 1, 2014. There were no other changes to the pre-existing terms of the loan.

As part of the amendment the loan was revalued to account for current comparable market interest rates. As a result the effective interest rate was determined to be 16% per annum and a gain of $252,608 was deemed to have been received upon extension of the due date of the loan as the modification has resulted in an extinguishment under IAS 39. This gain was recorded in contributed surplus to reflect the benefit having been received.

Included in the loan payable is accrued interest of $544,283 (2012 - $329,167).

## 9. LOANS PAYABLE (continued)

(b) Lender 2 – Loan payable to a company controlled by a significant shareholder of the Company:

| | | Total |
|---|---|---|
| Loan received during the year | $ | 46,500 |
| Gain on extinguishment of debt | | (12,078) |
| Accrued interest | | 5,302 |
| Carrying amount, December 31, 2013 | $ | 39,724 |

On February 1, 2013, the Company entered into a promissory note with Caravel Management Corp. ("Caravel") for an amount of up to $200,000 which bears interest calculated quarterly at a rate of 15% per annum for a period of five years (the "Caravel Promissory Note"). According to the Caravel Promissory Note, as of December 31, 2013, the Company owes Caravel the principal sum of $46,500 and $5,302 in accrued interest.

The loan was revalued to account for current comparable market interest rates. As a result the effective interest rate was determined to be 18% per annum and a gain of $12,078 was deemed to have been received upon extension of the due date of the loan, as this resulted in an extinguishment of the debt under IAS 39. This gain was recorded in contributed surplus to reflect the benefit having been received.

## 10. NOTES PAYABLE

| | | Vendor Note | | Second Note | | Total |
|---|---|---|---|---|---|---|
| Face value of notes payable | $ | 2,715,295 | $ | 3,816,854 | $ | 6,532,149 |
| Carrying amount, December 31, 2011 | | 2,856,424 | | 1,617,780 | | 4,474,204 |
| Accretion of discount | | (66,461) | | (29,287) | | (95,748) |
| Carrying amount, December 31, 2012 | | 2,789,963 | | 1,588,493 | | 4,378,456 |
| Accretion of discount | | (74,674) | | (33,116) | | (107,790) |
| Carrying amount, December 31, 2013 | $ | 2,715,289 | $ | 1,555,377 | $ | 4,270,666 |

Notes payable consists of two notes arising from the purchase consideration for the acquisition of Strikewell Capital and the restructuring of certain accounts payable and loans payable of the Company. The notes were issued January 1, 2006.

The principal owing under the Vendor Note and the Second Note are due for repayment January 1, 2014 and bear interest at 2% for years one and two, 3% for years three and four, 4% for year five and 15% for years six through eight, compounded and payable semi-annually.

The interest rates on the notes payable for years one through five are considered to be below market for financial instruments with similar risk profile and above market for years six through eight. Management has determined that an interest rate of 12% per annum over the term of the loan would be a closer approximation to a fair value interest rate. Accordingly, the carrying value of the promissory notes has been valued to reflect an interest rate of 12%.

## 10. NOTES PAYABLE (continued)

All assets of the Company have been pledged as security for the notes payable. The Vendor Note is due to a significant shareholder of the Company. The Second Note is due to Caravel. Both notes are carried at amortized cost using the effective interest method.

Included in accounts payable and accrued liabilities is accrued interest of $1,922,554 (2012 - $1,281,954).

Effective January 1, 2014, the promissory notes were renewed and are now due for repayment on December 31, 2018 and bear interest at 15% per annum.

## 11. DECOMMISSIONING OBLIGATIONS

A reconciliation of the decommissioning obligations is provided below:

| | | |
|---|---|---|
| Balance, December 31, 2011 | $ | 1,744 |
| Increase in estimated future obligations | | 4,384 |
| Balance, December 31, 2013 and 2012 | $ | 6,128 |

The Company's decommissioning obligations are based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company estimates the total undiscounted amount of cash flows required to settle its decommissioning obligations is approximately $9,900. The majority of the costs will be incurred after 2027. An inflation factor of 0.90% has been applied to the estimated asset retirement cost. A risk-free rate of 2.84% was used to calculate the fair value of the decommissioning obligations.

## 12. CAPITAL STOCK

(a) Authorized

Unlimited number of common shares without par value
Unlimited number of Class A preferred shares without par value

(b) The Class A preferred shares are issuable in series; each series to have rights and restrictions as determined by the Board of Directors. The issuance of preferred shares of any series is subject to regulatory approval. There are no preferred shares outstanding.

(c) During 2007, the Company adopted a new incentive stock option plan under which the Company may issue up to a maximum of 10.00% of the issued shares of the Company as stock options to acquire common shares in the capital of the Company as an incentive to officers, directors, employees and consultants. There were no stock options issued or outstanding during the years ending December 31, 2013 and 2012.

## 13. INCOME TAXES

Income tax expense differs from the amount that would be computed by applying the Canadian statutory income tax rate of 25.75% (2012 – 25.00%) to loss before income taxes. The reasons for the differences are as follows:

| | | **2013** | | **2012** |
|---|---|---|---|---|
| Loss before income taxes | $ | (932,325) | $ | (984,113) |
| Statutory income tax rate | | 25.75% | | 25.00% |
| Expected income tax benefit | | (240,074) | | (246,028) |
| Items not deductible (taxable) for income tax purposes | | 33,095 | | (9,067) |
| Change in timing differences | | (262) | | - |
| Effect of change in tax rate | | (141,228) | | - |
| Unused tax losses and tax offsets not recognized | | 348,469 | | 255,095 |
| Deferred income tax expense | $ | - | $ | - |

Effective April 1, 2013, the British Columbia provincial tax increased from 10.00% to 11.00%. The overall increase in tax rates has resulted in an increase in the Company's statutory tax rate from 25.00% to 25.75%.

The Company recognizes tax benefits on losses or other deductible amounts generated in countries where the probable criteria for the recognition of deferred tax assets has been met. The Company's unrecognized deductible temporary differences and unused tax losses for which no deferred tax asset is recognized consist of the following amounts:

| | | **2013** | | **2012** |
|---|---|---|---|---|
| Excess of unused exploration expenditures for Canadian tax purposes over carrying value of mineral property interests | $ | 5,918,519 | $ | 5,912,879 |
| Excess of undepreciated capital cost over carrying value of fixed assets | | 2,487,588 | | 2,487,588 |
| Share issuance costs | | - | | 766 |
| Non-capital losses carried forward | | 5,802,773 | | 5,100,074 |
| Net capital losses carried forward | | 446,764 | | 446,764 |
| Unrecognized deductible temporary differences | $ | 14,655,644 | $ | 13,948,071 |

## 13. INCOME TAXES (continued)

The Company has accumulated non-capital losses for income tax purposes of $5,802,773. These losses expire as follows:

| | | |
|---|---|---|
| 2014 | $ | 319,226 |
| 2015 | | 441,042 |
| 2026 | | 407,829 |
| 2027 | | 566,158 |
| 2028 | | 729,517 |
| 2029 | | 104,242 |
| 2030 | | 885,206 |
| 2031 | | 844,341 |
| 2032 | | 802,513 |
| 2033 | | 702,699 |
| | $ | 5,802,773 |

The Company has cumulative capital losses of $893,527 that may be carried forward indefinitely. Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profit will be available against which the Company can utilize these benefits.

## 14. RELATED PARTY TRANSACTIONS

As at December 31, 2013, the transactions made with related parties to the Company not otherwise disclosed consist of the following:

(a) Directors' fees of $18,000 (2012 - $18,000) were paid to key management and personnel. Key management personnel were not paid any share-based payments, post-employment benefits, termination benefits or other long-term benefits during the years ended December 31, 2013 and 2012.

(b) Included in accounts payable is $7,999 (2012 - $7,999) in trade payables due to a significant shareholder of the Company.

(c) Administration fees of $60,000 (2012 - $60,000) were paid or payable to Caravel. Included in accounts payable and accrued liabilities is $127,586 (2012 - $59,290) in trade payables due to Caravel.

The amounts due to related parties (aside from the loans and notes payable, as stated in notes 9 and 10) are non-interest-bearing, unsecured and due on demand.

## 15. SUBSEQUENT EVENTS

On January 1, 2014, the Vendor Note (described in note 10) was renewed for the amount of $4,018,637 consisting of the principal amount of the Vendor Note of $2,715,295 plus accrued interest (the "New Vendor Note"). The New Vendor Note is due for repayment on December 31, 2018 and bears interest calculated quarterly at a rate of 15.00% per year.

On January 1, 2014, the Second Note (described in note 10) was renewed for the amount of $4,436,066 consisting of the principal amount of the Second Note of $3,816,854 plus accrued interest (the "New Second Note"). The New Second Note is due for repayment on December 31, 2018 and bears interest calculated quarterly at a rate of 15.00% per year.