Vital Energy Inc.

Financial Statements

December 31, 2017 and 2016

(Expressed in Canadian Dollars)

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Independent Auditor's Report

To the Shareholders of
Vital Energy Inc.

We have audited the accompanying financial statements of Vital Energy Inc., which comprise the balance sheets as at December 31, 2017 and December 31, 2016, and the statements of comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

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

Auditor's Responsibility
Our responsibility is to express an opinion on these 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements present fairly, in all material respects, the financial position of Vital Energy Inc. as at December 31, 2017 and December 31, 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter
Without modifying our opinion, we draw attention to Note 1 to the financial statements which describes the material uncertainty that may cast significant doubt about the ability of Vital Energy Inc. to continue as a going concern.

Calgary, Alberta
April 26, 2018

"Crowe MacKay LLP"
Chartered Professional Accountants

Vital Energy Inc.

Balance Sheets
(Expressed in Canadian Dollars)

December 31,	Notes		2017		2016
Assets					
Current					
Cash and cash equivalents	5	$	2,068,361	$	854,264
Trade and other receivables	6		493,725		277,359
Prepaid expenses			29,906		18,715
			2,591,992		1,150,338
Deposits	12		536,437		531,607
Property and equipment	7		10,460,582		11,348,644
		$	13,589,011	$	13,030,589
Liabilities					
Current					
Accounts payable and accrued liabilities		$	1,700,105	$	367,057
Current portion of note payable and debentures payable	9,10		2,175,000		2,150,000
			3,875,105		2,517,057
Decommissioning liabilities	12		1,115,435		1,051,507
			4,990,540		3,568,564
Shareholders' Equity					
Share capital	13		29,565,885		29,565,885
Contributed surplus			1,406,451		1,401,201
Deficit			(22,373,865)		(21,505,061)
			8,598,471		9,462,025
		$	13,589,011	$	13,030,589

General information and going concern (note 1)
Commitments (note 21)

Approved by the Board:

(Signed) *"Jeffrey L. Standen",* Director (Signed) *"Zhouliang (Nick) Zhang",* Director

Vital Energy Inc.

Statements of Comprehensive Loss
(Expressed in Canadian Dollars)

Years ended December 31,	Note		2017		2016
Revenue					
Oil and gas sales		$	**3,236,022**	$	2,886,166
Less: Crown royalties			**(350,409)**		(269,547)
			2,885,613		2,616,619
Other income					
Interest			**5,344**		5,231
			2,890,957		2,621,850
Expenses					
Operating expenses			**1,508,618**		1,470,872
General and administrative	**18**		**830,951**		1,241,221
Share-based payments	**14**		**5,250**		17,500
Finance charges	**18**		**231,127**		310,707
Accretion of decommissioning liabilities	**12**		**27,399**		43,581
Depletion and depreciation	**7**		**1,156,416**		1,458,681
Impairments	**8**		**-**		421,125
			3,759,761		4,963,687
Net loss and comprehensive loss for the year		**$**	**(868,804)**	$	(2,341,837)
Basic loss per share	**15**	**$**	**(0.01)**	$	(0.04)

Vital Energy Inc.

Statements of Changes in Shareholders' Equity
(Expressed in Canadian Dollars)

	Notes	Share capital	Contributed surplus	(Deficit)	Total shareholders' equity
Balance, December 31, 2016		**$ 29,565,885**	**$ 1,401,201**	**$ (21,505,061)**	**$ 9,462,025**
Share-based payments	14	**-**	**5,250**	**-**	**5,250**
Net and comprehensive loss		**-**	**-**	**(868,804)**	**(868,804)**
Balance, December 31, 2017		**$ 29,565,885**	**$ 1,406,451**	**$ (22,373,865)**	**$ 8,598,471**
Balance, December 31, 2015		$ 29,565,885	$ 1,383,701	$ (19,163,224)	$ 11,786,362
Share-based payments	14	-	17,500	-	17,500
Net and comprehensive loss		-	-	(2,341,837)	(2,341,837)
Balance, December 31, 2016		$ 29,565,885	$ 1,401,201	$ (21,505,061)	$ 9,462,025

Vital Energy Inc.

Statements of Cash Flows
(Expressed in Canadian Dollars)

Years ended December 31,	**2017**	2016
Operating activities		
Net and comprehensive loss for the year	**$ (868,804)**	$ (2,341,837)
Non-cash items:		
Depletion and depreciation	**1,156,416**	1,458,681
Impairments	**-**	421,125
Accretion of decommissioning liabilities	**27,399**	43,581
Share-based payments	**5,250**	17,500
	320,261	(400,950)
Changes in non-cash working capital		
Trade and other receivables	**(216,366)**	59,198
Prepaid expenses	**(11,191)**	9,129
Accounts payable and accrued liabilities	**77,434**	(181,940)
	170,138	(514,563)
Investing activities		
Deposits (paid) refunded	**(4,830)**	99,018
Expenditures on property and equipment	**(231,825)**	(227,459)
Changes in accounts payable and accrued liabilities	**(15,387)**	(502,448)
	(252,042)	(630,889)
Financing activities		
Carried interest funds received (note 22)	**1,565,840**	-
Carried interest expenditures paid (note 22)	**(294,839)**	-
Repayment of note payable and debenture	**(75,000)**	-
Debenture proceeds	**100,000**	-
	1,296,001	-
Increase (decrease) in cash	**1,214,097**	(1,145,452)
Cash and cash equivalents, beginning of year	**854,264**	1,999,716
Cash and cash equivalents, end of year (note 5)	**$ 2,068,361**	$ 854,264
Supplemental cash flow information:		
Interest paid	**171,868**	171,027
Increase in accounts payable related to carried interest (note 22)	**1,271,001**	-

1. General information and going concern

Vital Energy Inc. ("the Company") is an oil and gas exploration and development company incorporated in the province of Alberta on November 14, 2006 with its head and registered office at Suite 888, 940 - 6th Avenue SW, Calgary, Alberta, T2P 3T1. The Company is engaged in the acquisition of, exploration for and development of crude oil and natural gas in Western Canada.

The Company continues to incur losses from operations and has a working capital deficiency of $1,283,113 (2016 - $1,366,719) and which includes $2,175,000 (2016 - $2,125,000) owing to directors pursuant to debentures which mature in December 2018. These amounts are classified as current liabilities in the 2017 financial statements. If the Company is unable to repay the debentures at maturity, it will need to re-negotiate the terms of the debt which will require the continued support and forbearance from the directors.

There can be no assurance that the Company will be able to repay or re-negotiate the debentures when they become due. If that were to occur, the Company may not be able to continue its operations and the amounts realizable for the assets could be less than the amounts reflected in these financial statements.

These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported amounts of revenues and expenses and the classification of the statement of financial position items if the going concern assumption is inappropriate and these adjustments could be material.

2. Basis of preparation, significant estimates and judgments

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board as of December 31, 2017. The financial statements were authorized for issue by the Board of Directors on April 24, 2018.

The financial statements have been prepared on the historical cost basis except where otherwise noted.

The financial statements are presented in Canadian dollars. At the present time and development of the Company, the functional currency is the Canadian dollar.

Use of estimates and judgments

The preparation of the financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, shareholder's equity, income and expenses. Actual amounts may differ from these estimates. Estimates and underlying assumptions are continually reviewed. Changes to accounting estimates are recognized in the period in which the estimates are revised.

2. Basis of preparation, significant estimates and judgments (continued)

Information about critical judgments and estimates in applying accounting policies that have the most significant effect on the amounts recognized in these financial statements are outlined below:

a. Reserve estimate

Petroleum and natural gas assets are depleted on a unit-of-production basis at a rate calculated by reference to proved and probable reserves determined in accordance with National Instrument 51-101, Standards of disclosure for Oil and Gas Activities ("NI51-101") and incorporating the estimated future cost of developing and extracting those reserves. Proved and probable reserves are estimated using independent reservoir engineering reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids, which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. Reserves estimates, although not reported as part of the Company's financial statements, can have a significant effect on net income (loss), assets and liabilities as a result of their impact on depreciation and depletion, decommissioning liabilities, deferred taxes and asset impairments. Independent reservoir engineers perform evaluations of the Company's oil and gas reserves on an annual basis. The estimation of reserves is an inherently complex process requiring significant judgment. Estimates of economically recoverable oil and natural gas reserves are based upon a number of variables and assumptions such as geoscientific interpretation, production forecast, commodity prices and costs and related future cash flows, all of which may vary considerably from actual results. These estimates are expected to be revised upward or downward over time, as additional information such as reservoir performance becomes available or as economic conditions change.

b. Impairment indicators and discount rate

For purposes of impairment testing, petroleum and natural gas assets are grouped into cash generating units ("CGU's"), based on separately identifiable and largely independent cash flows. The determination of the Company's CGU's is subject to judgment.

The recoverable amounts of CGU's and individual assets are based on the higher of their value-in-use and fair values less costs to sell. These calculations require the use of estimates and assumptions. Unless indicated otherwise, the recoverable amount used in assessing impairment charges is fair value less costs to sell. The Company generally estimates fair value less costs to sell using a discounted cash flow model, which has a significant number of assumptions. The model uses expected cash flows from proved plus probable reserves. These estimates are subject to measurement uncertainty as discussed above and subject to variability to changes in forecasted commodity prices. The discount rate applied to the cash flows is also subject to management's judgment and will affect the recoverable amount calculated.

It is reasonably possible that the commodity price assumptions may change which may then impact the estimated life of the field and may then require a material adjustment to the carrying value of its tangible and intangible assets. The Company monitors internal and external indicators of impairment relating to its tangible assets. These indicators include changes in (a) commodity prices, (b) reserve volumes and (c) discount rates.

The future cash flows are adjusted for risks specific to the asset and discounted using an after-tax discount rate of 10%. As a result, changes in commodity prices, a reduction to reserve volumes or an increase in the discount rate may potentially lead to impairments.

2. Basis of preparation, significant estimates and judgments (continued)

c. Decommissioning costs

At the end of the operating life of the Company's facilities and properties and upon retirement of its oil and natural gas assets, decommissioning costs will be incurred by the Company. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities. These assumptions can be impacted by changes outside of the Company's control, such as technological advancements, legal and regulatory requirements and environmental laws and regulations. The liability, the related assets and the expenses are impacted by estimates with respect to the costs and timing of decommissioning.

d. Measurement of share-based compensation

The estimation of the fair value of the stock options requires the use of assumptions, which include the estimated volatility of the issuer's stock price over the life of the options, future interest rates, dividend yield, forfeiture rates and the estimated life of the option. Changes in these estimates would alter the option's fair value and the related expense as determined by the valuation model.

e. Income taxes

Tax regulations and legislation and the interpretations thereof are subject to change. The Company recognized the net future tax benefit of deferred tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred tax assets requires the Company to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted. Additionally, future changes in tax laws in the jurisdictions in which the Company operates could limit the ability of the Company to obtain tax deductions in future periods.

3. Significant accounting policies

Jointly controlled operations and jointly controlled assets

Some of the Company's petroleum and natural gas properties are jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

Carried working interest arrangement

The Company has entered into a carried working interest arrangement on one of its properties whereby the Carried Working Interest Partner ("Partner") pays the cost of drilling, completing and equipping the well in return for a share of the net operating profits of that particular well. The Partner has no ownership interest in any of the petroleum and natural gas leases or the well and is only entitled to their predetermined share of the operating profits. As such, the Company records a liability for the decommissioning costs of the well and records as an operating expense, the share of net operating profits earned by the Partner.

Property and equipment

Property and equipment consist of oil and gas assets, computer equipment, office equipment, furniture and vehicle. Oil and gas properties are stated at cost, less any accumulated depletion, depreciation and accumulated impairment losses. These properties and equipment include oil and natural gas development and production assets, which represent costs incurred in developing oil and natural gas reserves and maintaining or enhancing production from such reserves. Future decommissioning liabilities related to producing assets are also capitalized to property and equipment.

Oil and gas properties are not depreciated until commercial production commences. The net carrying value of oil and gas assets is depleted using the unit-of-production method based on estimated proven and probable oil and gas reserves. The depletion calculation takes into account the estimated future development costs of the recognized proved plus probable reserves.

Proven and probable reserves are determined by independent engineers in accordance with Canadian National Instrument 51-101. Production and reserves of natural gas are converted to equivalent barrels of crude oil on the basis of six thousand cubic feet of gas to one barrel of oil. Changes in estimates of proved and probable reserves used in prior periods that affect the unit-of-production calculations do not give rise to prior year adjustments and are dealt with on a prospective basis.

Values of oil and gas properties are reviewed for impairment at the end of each reporting period for any indication that the carrying value of the asset may not be recoverable. If any such indication of impairment exists, an estimate of the recoverable amount is calculated. Individual assets are grouped, for the purposes of impairment testing, together into the smallest group of assets or group of assets that generates cash flows that are largely independent of the cash flows of other assets or group of assets (the cash generating unit or CGU). A CGU's recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of a CGU exceeds it recoverable amount, the CGU is considered impaired and is written-down to its recoverable amount.

3. Significant accounting policies (continued)

Property and equipment (continued)

The recoverable amount is the greater of the value in use or fair value less costs to sell. Fair value is the amount the asset could be sold for in an arm's length transaction. The value in use is the present value of the estimated future cash flows of the asset from its continued use. The fair value less costs to sell considers the continued development of a property and market transactions in a valuation model. The Company uses the present value of the cash generating unit's estimated future cash flows from both proved and probable reserves in its fair value model. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded entities or other available fair value indicators.

Computer equipment, office equipment, furniture and vehicles are recorded at cost. The declining balance method of depreciation is used to depreciate the cost of these assets over their estimated useful lives. Computer equipment is depreciated at 100% per annum, office equipment and furniture is depreciated at 20% per annum and vehicles are depreciated at 30% per annum.

Exploration and evaluation

Exploration and evaluation ("E&E") costs are capitalized for projects after the Company has acquired the legal right to explore but prior to their technical feasibility and commercial viability being confirmed, generally determined as the establishment of proved or probable reserves. These costs may include costs of license acquisition, technical services and studies, seismic acquisition, exploration drilling and testing, directly attributable overhead and administration expenses, including remuneration of production personnel and supervisory management, the projected costs of retiring the assets, and any activities in relation to evaluating the technical feasibility and commercial viability of extracting mineral resources.

Exploration and evaluation assets are subject to a separate impairment test at least annually or when facts and circumstances indicate that an impairment has occurred.

Once technical feasibility and commercial viability are confirmed, the E&E asset is then reclassified to property and equipment and tested for impairment.

Expired lease costs are expensed as part of impairment expense as they occur and costs incurred prior to the legal right to explore are charged to net income (loss).

Decommissioning liabilities

The Company provides for future decommissioning liabilities related to its oil and gas operating activities based on current legislation, constructive obligation and industry operating practices. Decommissioning liabilites are recognized as a liability in the period in which they are incurred. Decommissioning liabilities are measured as the present value of management's best estimate of the expenditure required to settle the asset retirement liability at the reporting date using a discount rate. When the liability is initially recognized, an amount equivalent to the provision is capitalized to the cost of the related oil and gas asset. This cost is amortized to expense through depletion and depreciation over the life of the related asset on a unit-of-production basis. Subsequent to initial measurement, the liability is adjusted at the end of each period to reflect the passage of time and changes in the estimated future costs underlying the liability. The increase in the balance due to the passage of time is charged to the statement of comprehensive loss whereas increases or decreases due to changes in the estimated future costs are capitalized. Actual costs incurred upon settlement of the decommissioning liability are charged against the liability or expense if greater than the liability.

3. Significant accounting policies (continued)

Cash and cash equivalents

Cash and cash equivalents include balances with banks and other short-term highly liquid investments with an original maturity date of less than three months.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Financial instruments

Financial instruments are comprised of cash and cash equivalents, trade and other receivables, accounts payable and accrued liabilities, debentures and note payable. Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or when the Company has transferred all risks and rewards of ownership**.**

a. Financial assets

Financial assets are measured at fair value on initial recognition of the instrument. Financial assets are classified as “available-for-sale-investments”, “fair value through profit or loss” or “loans and receivables”.

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company has no assets in this category.

Fair value through profit or loss are financial assets and liabilities which are acquired for resale prior to maturity or are designated as such by the Company. The Company has no assets in this category.

Loans and receivables are non-derivate financial assets with fixed or determinable payments that are not quoted in the active market. The Company’s loans and receivables comprise cash and cash equivalents and trade and other receivables.

Loans and receivables are recognized initially at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value.

Financial assets are assessed for indicators of impairment at each financial reporting date and are impaired when there is objective evidence that the estimated future cash flow has been impacted.

b. Financial liabilities

Financial liabilities include accounts payable and accrued liabilities, debentures payable and note payable. Financial liabilities are recognized on an accrual basis and are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

3. Significant accounting policies (continued)

Finance charges

Included in finance charges is interest on the debentures and note payable and costs incurred in sourcing additional capital.

Revenue recognition

Revenue associated with the sales of the Company's crude oil owned by the Company is recognized when title passes from the Company to its customer. This generally occurs when product is physically transferred into a vessel, pipe or other delivery mechanism.

Interest income is recognized when earned.

Share-based compensation plan

The Company has issued options to acquire common shares to directors, officers and employees of the Company. These options are accounted for using the fair-value method which estimates the value of the options at the date of the grant using the Black Scholes option pricing model. The fair value thus established is recognized as compensation expense over the vesting period of the options using the graded method of amortization, with an equivalent increase to contributed surplus. A forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest. At the time the stock options are exercised, the fair value of the associated share-based compensation is reclassified from contributed surplus to share capital.

At each reporting date, the Company revises its estimates of the number of options expected to vest. It recognized the impact of the revision of original estimates, if any, in the statement of comprehensive loss, with a corresponding adjustment to equity.

Convertible debentures

The proceeds received on the issuance of convertible debt are allocated into their liability and equity components. The amount initially attributed to the debt component equals the discounted cash flows using a market rate of interest that would be payable on a similar debt instrument that does not include an option to convert. The remainder of the proceeds is allocated to the conversion option and is recognized within a separate component of shareholders' equity, net of income tax effects. Subsequently, the debt component is accounted for as a financial liability measured at amortized cost until extinguished on conversion or maturity of the instrument.

Income taxes

Deferred income tax is determined on a non-discounted basis using the liability method and tax rates and laws that have been enacted or substantially enacted at the reporting date. Provision is made for temporary differences at the reporting date between the tax basis of the assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets are recognized to the extent that it is probable that the future taxable profit will be available against which the deductible 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.

3. Significant accounting policies (continued)

Earnings (loss) per share

Earnings (loss) per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments using the treasury stock method. The Company's potentially dilutive common shares include convertible debentures convertible into common shares and stock options granted to employees and directors. It is assumed that any proceeds obtained on the exercise of any options or warrants would be used to purchase common shares at the average price during the period.

4. Newly adopted accounting standards and pronouncements

The Company has adopted these accounting standards effective January 1, 2017. The adoption of the standards and amendments had no material impact on the financial statements:

Amendments to IAS 7 Statement of Cash Flows
These amendments (Disclosure Initiative) require that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes. One way to fulfil the new disclosure requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. Finally, the amendments state that changes in liabilities arising from financing activities must be disclosed separately from changes in other assets and liabilities.

Amendments to IAS 12 Income Taxes
These amendments, Recognition of Deferred Tax Assets for Unrealized Losses (Amendments to IAS 12), clarify how to account for deferred tax assets related to debt instruments measured at fair value.

Future accounting standards and pronouncements

The following accounting standards and amendments are effective for future periods.

IFRS 9 Financial Instruments
This standard introduces new classification and measurement models for financial assets, using a single approach to determine whether a financial asset is measured at amortized cost or fair value. To be classified and measured at amortized cost, assets must satisfy the business model test for managing the financial assets and have certain contractual cash flow characteristics. All other financial instrument assets are to be classified and measured at fair value. This standard allows an irrevocable election on initial recognition to present gains and losses on equity instruments (that are not held-for-trading) in other comprehensive income, with dividends as a return on these investments being recognized in profit or loss. In addition, those equity instruments measured at fair value through other comprehensive income would no longer have to apply any impairment requirements nor would there be any 'recycling' of gains or losses through profit or loss on disposal. The accounting for financial liabilities continues to be classified and measured in accordance with IAS 39, with one exception, being that the portion of a change of fair value relating to the entity's own credit risk is to be presented in other comprehensive income unless it would create an accounting mismatch. The Corporation does not believe this new standard will have a material impact when adopted.

This standard is effective for reporting periods beginning on or after January 1, 2018.

4. Newly adopted accounting standards and pronouncements (continued)

IFRS 15 Revenue from Contracts with Customers
The IASB issued IFRS 15, Revenue from Contracts with Customers, which provides a single principle-based framework to be applied to all contracts with customers. IFRS 15 replaces the previous revenue standard IAS 18, Revenue, and the related Interpretations on revenue recognition. The standard scopes out contracts that are considered to be lease contracts, insurance contracts and financial instruments. The new standard is a control-based model as compared to the existing revenue standard which is primarily focused on risks and rewards. Under the new standard, revenue is recognized when a customer obtains control of a good or service. Transfer of control occurs when the customer has the ability to direct the use of and obtain the benefits of the good or service. The Corporation does not believe this new standard will have a material impact when adopted other than enhanced disclosures.

This standard is effective for reporting periods beginning on or after January 1, 2018.

Amendments to IAS 28 Investments in Associates and Joint Ventures
These amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition. The Corporation does not believe this new standard will have a material impact when adopted.

These amendments are effective for reporting periods beginning on or after January 1, 2018.

Amendments to IFRS 2 Share-based Payment
These amendments added guidance that introduces accounting requirements for cash-settled share-based payments that follow the same approach as used for equity-settled share-based payments. They introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety, provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature. Finally, they clarify the accounting treatment in situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The Corporation does not believe this new standard will have a material impact when adopted.

These amendments are effective for reporting periods beginning on or after January 1, 2018.

IFRS 16 Leases
IFRS 16 was issued in January 2016 and specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. The Corporation is still assessing the impact of this new standard.

This standard is effective for reporting periods beginning on or after January 1, 2019.

(Expressed in Canadian Dollars)

5. Cash and cash equivalents

	2017	2016
Cash at bank and on hand	**$ 1,955,578**	$ 741,993
Cashable guaranteed investment certificate	**112,783**	112,271
Cash and cash equivalents	**$ 2,068,361**	$ 854,264

6. Trade and other receivables

	2017	2016
Trade receivables	**$ 449,255**	$ 277,359
GST receivable	**44,470**	-
Trade and other receivables	**$ 493,725**	$ 277,359

The trade receivables have been reviewed for collectability and no allowance for doubtful accounts is considered necessary.

7. Property and equipment

Petroleum and natural gas properties are as follows at December 31:

	2017	2016
Cost, beginning of year	**$ 24,613,193**	$ 24,455,915
Additions	**268,354**	227,459
Revisions to decommissioning liabilities	**-**	(70,181)
Cost, end of year	**24,881,547**	24,613,193
Accumulated depletion, beginning of year	**13,264,549**	11,805,868
Depreciation and depletion	**1,156,416**	1,458,681
Accumulated depletion, end of year	**14,420,965**	13,264,549
Carrying value, end of year	**$ 10,460,582**	$ 11,348,644

As at December 31, 2017 and 2016, the Company did not record an impairment charge related to any of their various properties and equipment. Recoverable amounts have been determined using the fair value less costs to sell method and based on internally generated cash flow projections. In determining fair value less costs to sell, the Company considered recent transactions within the industry, long-term views of oil prices, externally evaluated reserve volumes, and discount rates specific to the asset. The estimated future cash flows were estimated as the proved plus probable reserve value for the property in each CGU discounted at 10% per annum and were based on the Company's independent engineering report.

At December 31, 2017, future development costs of $7,537,000 (2016 - $6,978,000) associated with proved and probable reserves are included in costs subject to depletion.

(Expressed in Canadian Dollars)

7. Property and equipment (continued)

The benchmark prices used by the independent reserve evaluators in preparing the Company's reserve report are outlined below and were also used in determining whether impairment of the carrying value of the CGU's existed at December 31, 2017. The prices are referenced for medium crude oil based on Western Canadian Select ("WCS") Crude Oil at Hardisty:

	2018	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Cdn$/bbl	$48.89	$53.16	$56.25	$59.26	$62.20	$65.06	$68.67	$72.29	$75.10	$76.96	+2%/yr

8. Exploration and evaluation assets

Exploration and evaluation expenditures consist of the Company's exploration projects which are pending the determination of proven or probable reserves.

		2017		2016
Cost, beginning of year	**$**	**-**	$	421,125
Impairment		**-**		(421,125)
Cost, end of year	**$**	**-**	$	-

As at December 31, 2017, the Company reviewed the Exploration and Evaluation Expenditures for recoverability and impairment and determined that an impairment charge of $nil (2016 - $421,125) be recorded. The Company performed this review after considering capital market conditions for raising funds for exploration and production activities and near term drilling plans. The recoverable amount has been determined to be the assets' fair value less cost of disposals.

Impairments were in the following areas:

		2017		2016
Red Willow	**$**	**-**	$	106,125
Panny		**-**		315,000
	$	**-**	$	421,125

9. Debenture payable

In December 2017, the Company extended for one year $2,075,000 of the debentures originally issued on December 23, 2015 to December 23, 2018 and repaid one debenture in the amount of $50,000. The extended debentures have the same terms as the debentures originally issued in December 2015 being 8% per annum, interest payable quarterly, secured and convertible. The debentures are convertible at the holder's option into common shares of the Company at a conversion price of $0.10 per common share.

On December 28, 2017, the Company issued an 8% secured convertible debenture in the principal amount of $100,000 to a director. The debenture will mature one year from the date of issuance, is secured against the property of the Company and interest is paid quarterly. The debenture is convertible at the holder's option into common shares of the Company at a conversion price of $0.10 per common share.

(Expressed in Canadian Dollars)

9. Debenture payable (continued)

On December 23, 2015, the Company had issued 8% secured convertible debentures in the principal amount of $2,125,000 to directors. The debentures matured two years from the date of issuance, were secured against the property of the Company and interest was paid quarterly. The debentures were convertible at the holder's option into common shares of the Company at a conversion price of $0.10 per common share. None of the debentures were converted.

The fair value of the convertible debenture was allocated solely to the liability based on the fair value of the liability component, which was determined to be materially similar to using future cash flows discounted at an estimated interest rate for a comparable non-convertible financial instrument.

10. Note payable

On December 29, 2015, the Company issued an 8% unsecured promissory note in the principal amount of $25,000 to an officer. The promissory note matured two years from the date of issuance and was repaid at maturity.

11. Deferred income taxes

Deferred income taxes are based on the differences between the accounting amounts and the related tax bases of the Company's assets and liabilities. The income tax rate used to calculate deferred income taxes is 27% (2016 - 27%).

	2017	2016
Temporary differences related to:		
Property and equipment	**$ 6,954,000**	$ 6,611,000
Decommissioning liabilities	**(301,000)**	(284,000)
Tax loss carry forwards	**4,637,000**	4,730,000
Other	**141,000**	140,000
Deferred tax assets not recognized, net	**(11,431,000)**	(11,197,000)
Deferred income tax asset	**$ -**	$ -

At December 31, 2017, the Company has tax pools and non-capital losses as described below totaling approximately $52,363,000 (2016 - $52,470,000) that are available to shelter future taxable income. The Company's non-capital losses expire between the years 2026 and 2036.

Non-capital losses	$ 17,176,000
Undepreciated capital cost	4,581,000
Canadian exploration expenses	11,868,000
Canadian development expenses	7,589,000
Canadian oil and gas property expenses	11,017,000
Financing costs	132,000
	$ 52,363,000

(Expressed in Canadian Dollars)

11. Deferred income taxes (continued)

The income tax provision recorded differs from the income tax obtained by applying the statutory income tax rate to the income for the year and is reconciled as follows:

	2017	2016
Loss before income taxes	**$ (868,804)**	$ (2,341,837)
Statutory rate	**27.0%**	27.0%
Anticipated income tax recovery at the combined basic federal and provincial tax rate	**$ (235,000)**	$ (632,000)
Increase resulting from:		
Share-based compensation	**1,000**	5,000
Effect of change in tax rates	**-**	-
Change in deferred tax assets not recognized	**234,000**	627,000
Tax expense	**$ -**	$ -

12. Decommissioning liabilities

The Company's total decommissioning liability is estimated based on the Company's net ownership in wells and facilities and management's estimate of costs to abandon and reclaim those wells and facilities, as well as an estimate of the future timing of the costs to be incurred.

By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements could be significant. The total undiscounted amount of the estimated cash flows required to settle its decommissioning liabilities are approximately $1,259,600 (2016 - $1,200,700) which will be settled over the operating lives of the underlying assets, estimated to occur between 2018 and 2041. A credit adjusted interest rate of 7% and an inflation rate of 2% were used to calculate the decommissioning liability. Settlement of the liability will be funded from general corporate funds at the time of retirement or removal. As at December 31, 2017, $536,437 (2016- $531,607) has been paid as deposits to the applicable regulatory bodies for settlement of these obligation. Changes to the liabilities were as follows:

	2017	2016
Balance, beginning of year	**$ 1,051,507**	$ 1,078,107
Additions	**36,529**	-
Revisions	**-**	(70,181)
Accretion	**27,399**	43,581
Balance, end of year	**$ 1,115,435**	$ 1,051,507

(Expressed in Canadian Dollars)

13. Share capital

a. Authorized

Unlimited number of voting Class A, B and C common shares
Unlimited number of non-voting Class D, E and F common shares
Unlimited number of non-voting, non-cumulative, redeemable Class A preferred shares
Unlimited number of non-voting, cumulative, redeemable Class B preferred shares

b. Issued and outstanding – Class A common shares

	# of shares		Amount
Class A common shares – December 31, 2017, 2016, 2015	**60,499,971**	**$**	**29,565,885**

14. Share-based compensation

The Company has established a stock option plan (the "Plan") which is administered by the Board of Directors, allowing the Board of Directors to grant stock options. The Company adopted a 10% Rolling Stock Option Plan, which allows for the granting of stock options for the purchase of up to 10% of the outstanding shares of the Company.

Additionally, options may not be granted to any one person, any one consultant or any persons performing investor relations duties in any twelve month period which could, when exercised, result in the issuance of shares exceeding 5%, 2% or 2%, respectively, of the issued and outstanding shares of the Company. All options granted under the Plan shall expire no later than the tenth anniversary of the date the options were granted.

The exercise price of the options is to be determined by the Board of Directors, subject to any applicable Exchange approval, at the time any option is granted. In no event shall such exercise price be lower than the exercise price permitted by any applicable Exchange. Vesting of the options is at the discretion of the Board of Directors.

A summary of the status of the stock option plan and changes during the year is presented below:

			December 31, 2017			December 31, 2016
	#		**Weighted average exercise price**	#		Weighted Average exercise price
Outstanding, beginning of year	**4,650,000**	**$**	**0.25**	4,750,000	$	0.25
Forfeited	**(450,000)**		**0.25**	(100,000)		0.25
Outstanding, end of year	**4,200,000**	**$**	**0.25**	4,650,000	$	0.25
Exercisable, end of year	**4,200,000**	**$**	**0.25**	4,500,000	$	0.25

(Expressed in Canadian Dollars)

14. Share-based compensation (continued)

The details of the options outstanding at December 31, 2017 are as follows:

Options outstanding	Weighted average exercise price	Options exercisable	Weighted average years to expiry
4,200,000	0.25	4,200,000	6.5

In April 2015, the Company, issued 450,000 stock options to a director. These options vested equally as to one-third annually commencing from the date of grant. The total share-based compensation recognized in 2017 in respect of these stock options was $5,250 (2016 - $17,500).

15. Earnings (loss) per share

Basic earnings (loss) per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares issued during the year excluding ordinary shares purchased by the Company and held as treasury shares. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares.

	2017	2016
Loss attributable to equity holders of the Company	**$ (868,804)**	$ (2,341,837)
Weighted average number of common shares outstanding - basic and diluted	**60,499,971**	60,499,971

The Company has dilutive instruments outstanding, which consist of stock options and convertible debentures. The dilutive impact of these instruments using the treasury stock method results in anti-dilution as a result of the Company incurring losses during the years presented. As a resulted, diluted loss per share and the impact of these instruments on the weighted average number of shares outstanding is not presented in the financial statements.

16. Financial instruments

The Company's financial instruments recognized on the balance sheet includes cash and cash equivalents, trade and other receivables, accounts payable and accrued liabilities, debentures payable and note payable.

Fair value

The fair value of these financial instruments approximates their carrying value due to their short-term nature.

(Expressed in Canadian Dollars)

16. Financial instruments (continued)

Risks associated with financial assets and liabilities

The Company's activities are exposed to a variety of financial risks such as credit risk, market risk and liquidity risk that arise as a result of its exploration, development and production activities. Management has primary responsibility for monitoring and managing financial instrument risks under the direction of the Board of Directors, which has overall responsibility for establishing the Company's risk management framework.

a. Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company limits its exposure to credit risk related to cash and cash equivalents by only investing in liquid securities and only with counterparties that have an acceptable credit rating. Given these factors, management does not expect any counterparty to fail to meet its obligations.

Credit risk is primarily related to the Company's trade receivables from petroleum and natural gas marketers and the risk of financial loss if a marketer fails to meet its contractual obligation. The Company's policy to mitigate credit risk associated with these receivables is to establish marketing relationships with large, credit worthy purchasers. The Company has not experienced any collection issues with its petroleum and natural gas marketers. As at December 31, 2017 and 2016, the majority of the Company's trade accounts receivable are all current. No default on outstanding receivables is anticipated and, as such, no provision for doubtful accounts has been recorded. The aging of the Company's trade and other receivables at December 31 is as follows:

	Total	0 - 30 days	31 - 60 days	61 - 90 days	Over 90 days
2017	**$ 493,725**	$ 426,578	$ 65,969	$ 1,178	$ -
2016	**$ 277,359**	$ 239,919	$ 37,440	$ -	$ -

b. Liquidity risk

Liquidity risk relates to the risk the Company will encounter should it have difficulty in meeting obligations associated with the financial liabilities which are due within one year. The financial liabilities on its balance sheet consist of accounts payable and accrued liabilities, note payable and debentures payable, which are due within one year. The Company manages its liquidity through continuously monitoring its cash flows from operating activities and review of its actual capital expenditure program against budget. Liquidity difficulties would emerge if the Company was unable to establish a profitable production base to generate sufficient cash flow to cover both operating and capital requirements and service debt financing arrangements. The Company anticipates it will continue to have adequate liquidity to fund its financial liabilities through its future funds from operations and issuance of debt or equity instruments except as discussed in note 1 concerning the repayment of the debentures. The Company has no bank debt as at December 31, 2017.

16. Financial instruments (continued)

b. Liquidity risk (continued)

The following are the contractual maturities of financial liabilities including expected interest payments at December 31:

2017	**Contractual cash flows**	**Less than one year**	**1 - 3 years**
Accounts payable, accrued liabilities and goods and services tax payable	$ 1,700,105	$ 1,700,105	$ -
Debenture payable	2,349,000	2,349,000	-
	$ 4,049,105	**$ 4,049,105**	**$ -**

2016	Contractual cash flows	Less than one year	1 - 3 years
Accounts payable, accrued liabilities and goods and services tax payable	$ 367,057	$ 367,057	$ -
Debenture payable	2,295,000	2,295,000	-
Note payable	27,000	27,000	-
	$ 2,689,057	$ 2,689,057	$ -

c. Market risk

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

d. Commodity price risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world and continental/regional economic and other events that dictate the level of supply and demand. The Company has no commodity hedges in place as at December 31, 2017 and 2016.

e. Foreign currency risk

Foreign currency risk is the risk that future cash flow will fluctuate as a result of changes in foreign exchange rates. Although all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market price in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian dollar and the United States dollar. The Company has no forward exchange rate contracts in place as at December 31, 2017 and 2016.

(Expressed in Canadian Dollars)

16. Financial instruments (continued)

f. Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent the changes in market interest rates will impact the Company's cash and cash equivalents that are at a floating or short-term rate of interest. The Company does not have any floating interest rate contracts in place as at December 31, 2017 and 2016. The debentures and note payable are at a fixed interest rate and therefore not exposed to interest rate risk.

17. Capital risk management

The Company's policy is to maintain a strong capital base for the objectives of maintaining financial flexibility in order to preserve its ability to meet financial obligations, to execute on strategic acquisitions, and to provide an appropriate return on investment to its shareholders.

The Company manages its capital structure and makes adjustments to respond to changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholders' equity and debentures. In order to maintain or adjust its capital structure, the Company may from time to time issue new shares or debentures and adjust its capital spending.

In order to facilitate the management of capital expenditures, the Company prepares annual budgets which are updated as necessary depending upon varying factors including current and forecast crude oil and natural gas prices, capital expenditure and general industry conditions.

The Company's share capital is not subject to external restrictions. The Company has not declared or paid any dividends since inception and does not contemplate doing so in the foreseeable future.
The Company has issued debentures and a note payable in order to balance its capital structure.

18. Expenses by nature

	2017	2016
Wages and employee benefits	$ **307,979**	$ 427,786
Professional fees	**124,485**	87,251
Consulting fees	**195,324**	438,926
User fees	**54,879**	66,840
Rental	**73,625**	89,487
Office	**67,255**	115,277
Travel and entertainment	**7,404**	15,654
Total general and administration costs	$ **830,951**	$ 1,241,221

Finance costs were $231,127 for the year ended December 31, 2017 (2016 - $310,707). The 2017 finance costs include $59,258 (2016 - $139,680) paid as a finder's fee for attempting to source new capital.

(Expressed in Canadian Dollars)

19. Key management compensation

Key management includes directors involved with the daily operations of the Company. The compensation paid or payable to key management for employee services is shown below:

		2017		2016
Salaries and other short-term employee benefits	**$**	**240,000**	$	288,000
Directors fees		**-**		108,000
Share-based compensation		**5,250**		17,500
Consulting fees		**145,000**		231,500
	$	**390,250**	$	645,000

20. Related party transactions

Transactions with related parties are incurred in the normal course of business and are measured at the exchange amount which is the amount of consideration established and approved by the related parties. Related party transactions are disclosed below, unless they have been disclosed elsewhere in the financial statements.

During the year ended December 31, 2017, the Company incurred $145,000 (2016 - $231,500) in consulting fees to officers or companies controlled by officers.

During the year, $nil (2016 - $108,000) was paid to directors as consulting fees.

The debentures payable (note 9) are to directors as was the note payable (note 10). Included in finance charges in the Statement of Comprehensive Loss is related interest expense of $171,868 (2016 - $171,027).

In April 2015, the Company issued 450,000 stock options to a director at an exercise price of $0.25 per common share. The stock options had a fair value of $54,000 at the date of grant and $5,250 was recorded in 2017 as share-based compensation (2016 - $15,000).

21. Commitments

The Company is committed under an office lease that commenced August 1, 2017 and expires on July 31, 2021. The minimum annual payments are $11,665 during the first two years of the lease and then increase to $14,245 per year for the remainder of the lease.

22. Carried working interest arrangement

On March 20, 2017, the Company entered into a Carried Working Interest Agreement regarding the development of lands in the Pennant area. Under the Agreement, the Carried Working Interest partner ("Partner") would advance by December 31, 2017 up to $10,500,000 for the drilling, completion, equipping and all testing facilities for seven (7) horizontal wellbores, construction of five (5) lease pads and associated road works. In addition, the Partner would advance up to $500,000 for the acquisition of petroleum and natural gas leases.

In exchange, the Company will pay 80% of the net profits from the seven (7) horizontal wells to the Partner until such time as the Partner has recovered 180% of their investment. At that time, the carried working interest will convert to a 5% gross overriding royalty.

On April 17, 2017, the Partner made its initial advance of $360,000 to fund the acquisition of petroleum and natural gas leases.

As at December 31, 2017, the Partner had advanced $1,565,840 for the drilling, completion and equipping of the first well which was drilled in December 2017. As at December 31, 2017, the Company has a net cash call liability position of $25,298 (2016 - $nil) and third-party invoices of $1,245,703 (2016 - $nil), which are included in accounts payable and accrued liabilities in these financial statements. As of the date of these financial statements, there have been no further wells drilled.

23. Comparative figures

Certain comparative figures were restated to conform to the financial statement presentation adopted in the current year. The adjustments were reflected within current liabilities on the statement of financial position. Accordingly, there was no impact on the prior year's net and comprehensive loss.