# Management's Report

**To the Shareholders of Traverse Energy Ltd.**

The preparation of the accompanying financial statements is the responsibility of management. The financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

Management is responsible for the integrity of the financial information. Internal controls are designed and maintained to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

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

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board exercises this responsibility through the Audit Committee, with assistance from the Reserves Committee regarding the annual evaluation of the Company's petroleum and natural gas reserves. The Audit Committee meets regularly with management and the independent auditors to ensure that management's responsibilities are properly discharged, to review the financial statements and recommend that the financial statements be presented to the Board of Directors for approval. On the recommendation of the Audit Committee, the accompanying financial statements have been approved by the Board of Directors.

(signed) "*Laurie J. Smith*"
Laurie J. Smith
President & Chief Executive Officer

(signed) "*Sharon A. Supple*"
Sharon A. Supple
Chief Financial Officer

## Independent Auditors' Report

**To the Shareholders of Traverse Energy Ltd.**

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

**Management's Responsibility for the 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.

**Auditors' 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 audit 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 our 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, we consider 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 Traverse Energy Ltd. as at December 31, 2015 and December 31, 2014, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) "*KPMG LLP"*
Chartered Professional Accountants
April 14, 2016
Calgary, Canada

**TRAVERSE ENERGY LTD.**
**STATEMENTS OF FINANCIAL POSITION**

| | Notes | December 31, 2015 | December 31, 2014 |
|---|---|---|---|
| **Assets** | | | |
| Current assets | | | |
| Cash and cash equivalents | | $ 1,050,938 | $ - |
| Accounts receivable | | 991,845 | 1,989,437 |
| Income tax receivable | | 678,904 | 415,000 |
| Prepaid expenses and deposits | | 186,972 | 147,123 |
| | | 2,908,659 | 2,551,560 |
| Exploration and evaluation assets | 6 | 4,781,709 | 5,082,893 |
| Property and equipment | 7 | 31,095,748 | 36,403,918 |
| | | $ 38,786,116 | $ 44,038,371 |
| **Liabilities** | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | | $ 2,141,215 | $ 5,752,857 |
| Bank debt | 8 | - | 1,439,819 |
| | | 2,141,215 | 7,192,676 |
| Deferred flow-through share premium | | - | 325,000 |
| Decommissioning obligations | 9 | 4,326,000 | 3,600,000 |
| Deferred income taxes | 10 | 2,215,900 | 1,410,600 |
| | | 8,683,115 | 12,528,276 |
| **Shareholders' Equity** | | | |
| Share capital | 11 | 39,374,829 | 38,577,928 |
| Contributed surplus | | 2,262,634 | 1,705,122 |
| Deficit | | (11,534,462) | (8,772,955) |
| | | 30,103,001 | 31,510,095 |
| Commitment | 15 | | |
| | | $ 38,786,116 | $ 44,038,371 |

*See accompanying notes to the financial statements*

Approved on behalf of the Board:

(signed) "*A. David van der Lee"*
A. David van der Lee
Director

(signed) "*Laurie J. Smith"*
Laurie J. Smith
Director

**TRAVERSE ENERGY LTD.**
**STATEMENTS OF LOSS AND COMPREHENSIVE LOSS**
*For the years ended December 31,*

| | Notes | 2015 | 2014 |
|---|---|---|---|
| **Revenue** | | | |
| Petroleum and natural gas | 13 (a) | $ 12,882,314 | $ 19,716,684 |
| Royalties | | (416,334) | (2,794,621) |
| | | 12,465,980 | 16,922,063 |
| Realized gain (loss) on financial derivatives | | - | (219,749) |
| Unrealized gain (loss) on financial derivatives | | - | 15,664 |
| | | 12,465,980 | 16,717,978 |
| **Expenses** | | | |
| Operating | | 4,046,235 | 3,730,408 |
| Transportation | | 638,225 | 444,241 |
| General and administrative | | 1,074,154 | 972,474 |
| Share based compensation | | 644,702 | 783,182 |
| Net finance expense | 12 | 206,263 | 95,383 |
| Exploration and evaluation expense | 6 | 4,289,050 | 1,323,312 |
| Depletion and depreciation | 7 | 7,273,039 | 6,708,724 |
| Impairment of property and equipment | 7 | 6,150,000 | 7,900,000 |
| Gain on sale of property and equipment | 7 | (8,787,761) | - |
| | | 15,533,907 | 21,957,724 |
| Loss before income taxes | | (3,067,927) | (5,239,746) |
| **Income taxes** | 10(a) | | |
| Current income tax (recovery) | | (678,904) | (15,096) |
| Deferred income tax (recovery) | | 372,484 | (654,585) |
| | | (306,420) | (669,681) |
| **Net loss and comprehensive loss** | | $ (2,761,507) | $ (4,570,065) |
| **Net loss per share - basic and diluted** | 11(d) | $ (0.04) | $ (0.07) |

*See accompanying notes to the financial statements*

**TRAVERSE ENERGY LTD.**
**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

| | Share capital | Contributed surplus | Deficit | Total Shareholders' Equity |
|---|---|---|---|---|
| Balance January 1, 2014 | $ 25,798,292 | $ 1,398,190 | $ (4,202,890) | $ 22,993,592 |
| Net loss | - | - | (4,570,065) | (4,570,065) |
| Issued on exercise of common share options | 355,250 | - | - | 355,250 |
| Transfer of share based compensation on exercise | 476,250 | (476,250) | - | - |
| Share based compensation | - | 783,182 | - | 783,182 |
| Issued for cash | 11,500,000 | - | - | 11,500,000 |
| Issued for cash - flow-through | 1,495,000 | - | - | 1,495,000 |
| Deferred flow-through share premium | (325,000) | - | - | (325,000) |
| Share issue costs, net of tax of $240,625 | (721,864) | - | - | (721,864) |
| Balance December 31, 2014 | $ 38,577,928 | $ 1,705,122 | $ (8,772,955) | $ 31,510,095 |
| Net loss | - | - | (2,761,507) | (2,761,507) |
| Issued on exercise of common share options | 150,000 | - | - | 150,000 |
| Transfer of share based compensation on exercise | 87,190 | (87,190) | - | - |
| Share based compensation | - | 644,702 | - | 644,702 |
| Issued for cash - flow-through | 700,800 | - | - | 700,800 |
| Deferred flow-through share premium | (116,800) | - | - | (116,800) |
| Share issue costs, net of tax of $8,984 | (24,289) | - | - | (24,289) |
| Balance December 31, 2015 | $ 39,374,829 | $ 2,262,634 | $ (11,534,462) | $ 30,103,001 |

*See accompanying notes to the financial statements*

**TRAVERSE ENERGY LTD.**
**STATEMENTS OF CASH FLOWS**
*For the years ended December 31,*

| | Notes | 2015 | 2014 |
|---|---|---|---|
| **Cash provided by (used in):** | | | |
| **Operating activities:** | | | |
| Net loss | | $ (2,761,507) | $ (4,570,065) |
| Adjustments for: | | | |
| Depletion and depreciation | | 7,273,039 | 6,708,724 |
| Exploration and evaluation expense | | 4,289,050 | 1,323,312 |
| Impairment of property and equipment | | 6,150,000 | 7,900,000 |
| Share based compensation | | 644,702 | 783,182 |
| Accretion on decommissioning obligations | 9, 12 | 82,000 | 81,000 |
| Deferred income tax (recovery) | | 372,484 | (654,585) |
| Unrealized gain (loss) on financial derivatives | | - | (15,664) |
| Gain on sale of property and equipment | 7 | (8,787,761) | - |
| Decommissioning expenditures | 9 | (142,719) | (193,955) |
| Changes in non-cash working capital | 13(b) | 478,900 | (1,179,792) |
| | | 7,598,188 | 10,182,157 |
| **Financing activities:** | | | |
| Proceeds from (repayment of) bank debt | | (1,439,819) | 1,439,819 |
| Proceeds on issue of common shares | | 700,800 | 12,995,000 |
| Share issue costs | | (33,273) | (962,489) |
| Proceeds on exercise of common share options | | 150,000 | 355,250 |
| Changes in non-cash working capital | 13(b) | (4,048) | (4,811) |
| | | (626,340) | 13,822,769 |
| **Investing activities:** | | | |
| Exploration and evaluation asset additions | | (8,226,167) | (23,594,852) |
| Property and equipment asset additions | | (3,217,957) | (7,226,394) |
| Property and equipment assets dispositions | | 8,915,869 | - |
| Changes in non-cash working capital | 13(b) | (3,392,655) | 1,821,998 |
| | | (5,920,910) | (28,999,248) |
| Change in cash and cash equivalents | | 1,050,938 | (4,994,322) |
| Cash and cash equivalents, beginning of year | | - | 4,994,322 |
| **Cash and cash equivalents, end of year** | | $ 1,050,938 | $ - |

*See accompanying notes to the financial statements*

## 1. Reporting entity

Traverse Energy Ltd. (the "Company" or "Traverse") is an oil and gas exploration, development and production company based in Calgary, Alberta, Canada. Traverse conducts its operations in the province of Alberta. The common shares of Traverse trade on the TSX Venture Exchange under the symbol "TVL". The Company's head and principal office is located at 780, 839 - 5 Avenue S.W., Calgary, Alberta, T2P 3C8 and its registered office is located at 2500, 450 - 1 Street SW Calgary, Alberta T2P 5H1.

These financial statements were approved and authorized for issuance by the Board of Directors of the Company on April 14, 2016.

## 2. Basis of presentation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These financial statements have been prepared in accordance with the significant accounting policies and methods of computation as set forth in Note 3.

Operating expenses in the statement of loss are presented as a combination of function and nature in conformity with industry practice. Depletion and depreciation are presented on a separate line by their nature, while operating expenses and net general and administrative expenses are presented on a functional basis. Significant expenses such as compensation are presented by their nature in the notes to the financial statements.

These financial statements have been prepared on a historical cost basis. The methods used to measure fair values are discussed in Note 4. These financial statements are presented in Canadian dollars, which is the functional currency of the Company.

## 3. Significant accounting policies

### (a) Jointly controlled operations and jointly controlled assets

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

### (b) Financial instruments

*(i) Non-derivative financial instruments*

Non-derivative financial instruments are comprised of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and bank debt. Cash and cash equivalents comprise cash on hand, term deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured at amortized cost using the effective interest method.

*(ii) Derivative financial instruments*

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

Contracts that are entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the Company's expected purchase, sale or usage requirements (such as physical delivery commodity contracts) are accounted for as executory contracts. These contracts are not fair valued on the statement of financial position. Settlements are recognized in the statement of income as they occur.

*(iii) Share capital*

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

**(c) Exploration and evaluation assets and property and equipment**

*(i) Pre-license expenditures*

Costs incurred prior to obtaining the legal rights to explore a specific area have been obtained are recognized in profit or loss as incurred.

*(ii) Exploration and evaluation assets*

The costs of acquiring undeveloped land, technical services and studies, seismic acquisition and exploration drilling and completion are initially capitalized as exploration and evaluation assets. These costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment, on a license or field basis, if: (i) sufficient data exists to determine technical feasibility and commercial viability; or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. The recoverable amount of an asset is defined as the higher of fair value less costs to sell and value in use. The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proved and/or probable reserves are determined to exist. Upon determination of proved and/or probable reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified to development and production assets included in property and equipment.

Exploration and evaluation assets are measured at cost less accumulated impairment losses and are not subject to depletion expense until after the assets are reclassified to property and equipment. Gains or losses are not recognized on the disposition of exploration and evaluation assets. Any impairment loss on exploration and evaluation assets, unsuccessful costs and the cost of undeveloped land that has expired are charged to profit and loss as exploration and evaluation expense.

*(iii) Development and production assets*

Items of property and equipment, which include oil and natural gas properties, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into cash-generating units ("CGUs").

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

The costs of development and production assets are depleted on an area level using the unit-of-production method by reference to the ratio of production in the period to the related proved and probable reserves of the area, taking into account estimated future development costs necessary to bring those reserves into production and the estimated salvage value of the assets at the end of their useful lives. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers annually.

Gains and losses on disposal of development and production assets are determined by comparing the proceeds from disposal with the carrying amount of the asset and are recognized in profit or loss.

*(iv) Corporate assets*

Corporate assets are stated at cost less accumulated depreciation and include office equipment and leasehold improvements.

Office equipment is depreciated on a declining balance basis at a rate of 30 percent per annum and leasehold improvements are amortized on a straight line basis over the term of the related lease.

**(d) Impairment**

*(i) Financial assets*

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

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. All impairment losses are recognized in profit or loss.

*(ii) Non-financial assets*

The carrying amounts of the Company's non-financial assets, other than exploration and evaluation assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Exploration and evaluation assets are assessed for impairment when they are transferred to development and production assets, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets ("cash-generating unit" or "CGU"). The recoverable amount of an asset or 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 future cash flows expected to be derived from production of proved and probable reserves. Fair value less costs to sell is the amount for which the asset could be sold in an arm's length transaction and may be determined using discounted future net cash flows of proved and probable reserves. Consideration is given to acquisition metrics of recent transactions completed on similar assets to those contained within the relevant CGU.

An impairment loss is recognized if the carrying amount of a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in prior years are assessed at each reporting date if facts and circumstances indicate 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.

**(e) Share based compensation**

The Company has a share based compensation plan comprised of a stock option plan (Note 11(e)). The Company uses the fair value method for valuing stock option grants using the Black Scholes option pricing model. Under this method, the compensation cost attributable to stock options granted is measured at the fair value at the date of the grant and expensed over the vesting period with a corresponding increase to contributed surplus. A forfeiture rate is estimated on the grant date and is subsequently adjusted each period to reflect the actual number of options that are expected to vest. Upon exercise of stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

**(f) Provisions**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits 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.

*(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 abandonment and site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the reporting 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 accretion (within finance expense) whereas increases/decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

**(g) Revenue**

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. Oil and natural gas royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

**(h) Net finance expense**

Finance expense is comprised of interest expense on bank debt, credit facility fees and the accretion of the discount on provisions. Finance income is comprised of interest income and is recognized as it accrues in profit or loss.

**(i) Income tax**

Income tax expense is comprised of current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

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

Deferred tax is recognized on the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity.

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.

**(j) Flow-through shares**

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. On issuance, the premium received on the flow-through shares, being the difference in price over a common share with no tax attributes, is recognized as a liability on the statement of financial position. As qualifying expenditures are incurred, the liability is reversed and a corresponding deferred tax liability is recognized based on the Company's effective tax rate and the amount of expenditure. Any difference between the flow-through premium and the amount recognized by the Company as a deferred tax liability is recognized as deferred tax expense in profit or loss.

**(k) Per share amounts**

Basic income (loss) per share is calculated by dividing the income or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted income per share is determined by adjusting the net income per share attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted. If the Company is in a net loss position, there is no dilutive impact for outstanding stock options.

**(l) Critical accounting judgments and key sources of estimation uncertainty**

The timely preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities and income and expenses. Accordingly, actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Significant estimates and judgments made by management in the preparation of these financial statements are outlined below.

*Critical judgments in applying accounting policies:*

The following are the critical judgments that management has made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in these consolidated financial statements:

*(i) Identification of cash-generating units*

Traverse's assets are aggregated into CGUs, for the purpose of calculating impairment, based on their ability to generate largely independent cash inflows. The determination of these CGUs was based on management's judgment in regards to geographical proximity, geology, production profile, production type and similar exposure to market risk and materiality.

(ii) *Impairment of petroleum and natural gas assets*

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

(iii) *Exploration and evaluation assets*

The application of the Company's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves have been found in assessing technical feasibility and commercial viability.

(iv) *Deferred income taxes*

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

*Key sources of estimation uncertainty:*

The following are the key assumptions concerning the sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing adjustments to the carrying amounts of assets and liabilities.

(i) *Reserve estimates*

The assessment of reported recoverable quantities of proved and probable reserves include estimates regarding production profile, commodity prices, exchange rates, remediation costs, timing and amount of future development costs, and production, transportation and marketing costs for future cash flows. It also requires interpretation of geological and geophysical models in anticipated recoveries.

The economical, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact the carrying value of the Company's petroleum and natural gas properties and equipment, the calculation of depletion, the provision for decommissioning obligations, and the recognition of deferred tax assets due to changes in expected future cash flows. The recoverable quantities of reserves and estimated cash flows from the Company's petroleum and natural gas interests are independently evaluated by reserve engineers at least annually. Traverse's petroleum and natural gas reserves are determined pursuant to National Instrument 51-101, Standards of Disclosures for Oil and Gas Activities.

(ii) *Decommissioning obligations*

The Company estimates future decommissioning obligations of production facilities, wells and pipelines based on current legal and constructive requirements, technology, price levels and expected plans for remediation. In most instances, removal of assets occurs many years into the future. This requires assumptions regarding abandonment date, future environmental and regulatory legislation, the extent of reclamation activities, the engineering methodology for estimating cost, future removal technologies in determining the removal cost and liability specific discount rates to determine the present value of these cash flows.

(iii) *Share based compensation*

Compensation costs recognized for share based compensation plans are subject to the estimation of what the ultimate payout will be using pricing models such as the Black Scholes model which is based on significant assumptions such as share price, volatility, forfeiture rate, dividend yield and expected term.

(iv) *Income taxes*

Tax interpretations, regulations and legislation in the jurisdictions in which the Company operates are subject to change. As such, income taxes are subject to measurement uncertainty. Deferred income tax assets are assessed by management at the end of each reporting period to determine the likelihood that they will be realized from future taxable earnings.

*(v) Derivative financial instruments*

The Company's estimate of the fair value of derivative financial instruments is dependent on estimated forward prices and volatility in those prices.

**(m) Accounting policy changes**

The following accounting standards and amendments, issued by the International Accounting Standards Board ("IASB"), become effective between January 1, 2016 and January 1, 2019: IFRS 11 (amendments to *Joint Arrangements)* , IAS 16 and IAS 38 (amendments to *Clarification of Acceptable Methods of Depreciation and Amortization* ), IFRS 15 *Revenue from Contracts with Customers* , IFRS 16 *Leases* and IFRS 9 *Financial Instruments* . The impact of these accounting standards and amendments are not expected to have a material impact on the Company's financial statements, although the Company is still finalizing its assessment.

## 4. Determination of fair values

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

The Company classifies the fair value of financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instruments:

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

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

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

**(a) Cash and cash equivalents, accounts receivable, bank debt and accounts payable and accrued liabilities**

The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2015 and 2014, the fair value of these balances approximated their carrying value due to their short term to maturity. The fair value of bank debt approximates its carrying value as it bears a floating rate of interest and the margin charged by the lenders are indicative of current credit spreads.

**(b) Financial derivatives**

The Company's derivative commodity contracts are classified as level 2 measurements. The fair value of commodity contracts is determined by discounting the difference between the contracted price and published forward prices curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes. The Company had no outstanding derivative contracts at December 31, 2015.

**(c) Stock options**

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

## 5. Financial risk management

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production and financing activities such as credit risk, market risk and liquidity risk. This note presents information about the Company's exposure to each of these risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital.

### (a) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint operations and oil and natural gas marketers.

Substantially all of the Company's petroleum and natural gas production is marketed under standard industry terms. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large credit worthy purchasers. During 2015, two third party purchasers marketed 78% of the Company's petroleum and natural gas revenue. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers.

Substantially all of the Company's royalty income production is marketed by the operator of the property. Royalty income receivables are normally paid within the second month following the month of production. During 2015, one industry partner accounted for 78% of the Company's royalty income. Joint interest receivables are typically collected within one to three months of the joint interest bill being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures prior to the expenditure.

However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances can be impacted by industry factors such as commodity price fluctuations, limited capital availability and unsuccessful drilling programs. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however the Company can elect or take overriding production royalties in kind, cash call for major projects and does have the ability, in some cases, to withhold production from joint interest partners in the event of non-payment.

The Company does not anticipate any default as it transacts with credit-worthy customers and management does not expect any losses from non-performance by these customers. As such, a provision for doubtful accounts has not been recorded at December 31, 2015 or 2014.

The maximum exposure to credit risk for trade and other receivables at the reporting date by type of customer was:

| | 2015 | 2014 |
|---|---|---|
| Petroleum and natural gas marketing companies | $ 972,829 | $ 1,336,939 |
| Government agencies | 685,142 | 768,150 |
| Joint interest receivables | 12,778 | 299,348 |
| | $ 1,670,749 | $ 2,404,437 |

The Company's accounts receivable are aged as follows:

| | 2015 | 2014 |
|---|---|---|
| Current (less than 90 days) | $ 1,668,280 | $ 2,370,189 |
| Past due (greater than 90 days) | 2,469 | 34,248 |
| | $ 1,670,749 | $ 2,404,437 |

**(b) Market risk**

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

*(i) Foreign currency exchange risk*

Foreign currency exchange risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. Substantially all of the Company's petroleum and natural gas sales are conducted in Canada and are denominated in Canadian dollars. Canadian commodity prices are influenced by fluctuations in the Canadian to U.S. dollar exchange rate.

*(ii) Interest rate risk*

Interest rate risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its banking facility, when drawn, as it bears a floating rate of interest.

*(iii) 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 not only by the relationship between the Canadian and United States dollar but also North American and global economic events that dictate the levels of supply and demand. Management continuously monitors commodity prices and initiates instruments to manage exposure to these risks when it deems appropriate. As a means of managing commodity price volatility, the Company enters into various derivative financial instruments and physical commodity contracts.

**(c) Liquidity risk**

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company's financial liabilities consist of accounts payable which are invoices payable to trade suppliers for office expenses, field operating activities and capital expenditures. The Company processes invoices within a normal payment period and all accounts payable have contractual maturities of less than one year. The Company manages liquidity by monitoring cash flows and maintaining a banking facility, as outlined in Note 8.

**(d) Capital management**

The Company’s objective in managing its capital structure is to maintain financial flexibility through periods of market fluctuations and to sustain the future development of the business. The Company considers its capital structure to include shareholders' equity, debt and working capital. The Company manages its capital structure and makes adjustments relative to changes in economic conditions and the Company's risk profile. In order to maintain the capital structure, the Company may from time to time issue shares, adjust its capital spending or consider utilizing debt. The Company monitors its working capital in order to assess capital and operating efficiency.

The capital structure of the Company is as follows:

| As at December 31 | **2015** | **2014** | **Change %** |
|---|---|---|---|
| Shareholders' equity [(1)] | $ 30,103,001 | $ 31,510,095 | (4) |
| Working capital (deficit) [(2)] | 767,444 | (4,641,116) | 117 |
| Capital | $ 30,870,445 | $ 26,868,979 | 15 |

*(1) Shareholders' equity is defined as share capital plus contributed surplus plus retained earnings, less any deficit.*

*(2) Working capital is defined as current assets less current liabilities.*

The Company's current borrowing capacity is based on the lenders' annual review of the borrowing base which is directly impacted by the value of the oil and natural gas reserves. The Company is also subject to various covenants including reporting requirements; permitted levels of indebtedness, dispositions, hedging, and encumbrances; other standard business operating covenants and a financial covenant as described in Note 8. At December 31, 2015 the Company was in compliance with the financial covenant.

## 6. Exploration and evaluation assets

| | Total |
|---|---|
| Balance, January 1, 2014 | $ 5,056,426 |
| Additions | 23,594,852 |
| Transfers to property and equipment | (22,253,073) |
| Changes in decommissioning liabilities | 8,000 |
| Exploration and evaluation expense - land expiries | (674,654) |
| Exploration and evaluation expense - unsuccessful exploration | (648,658) |
| Balance, December 31, 2014 | $ 5,082,893 |
| Additions | 8,226,167 |
| Transfers to property and equipment | (4,697,020) |
| Changes in decommissioning liabilities | 458,719 |
| Exploration and evaluation expense - land expiries | (917,796) |
| Exploration and evaluation expense - unsuccessful exploration | (3,371,254) |
| Balance, December 31, 2015 | $ 4,781,709 |

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proved and/or probable reserves. Costs consist mainly of undeveloped land, geological and geophysical, and drilling costs until the drilling of the well is complete and the results have been evaluated. Additions represent the Company's share of costs incurred on E&E assets during the year.

At December 31, 2015 and 2014 the Company performed an impairment assessment of the E&E assets and determined there were no impairment triggers identified at the end of the reporting period.

## 7. Property and equipment

| Cost: | Oil and natural gas properties | Corporate | Total |
|---|---|---|---|
| Balance, January 1, 2014 | $ 33,597,117 | $ 119,964 | $ 33,717,081 |
| Additions | 7,055,771 | 170,623 | 7,226,394 |
| Transfers from exploration and evaluation | 22,253,073 | - | 22,253,073 |
| Changes in decommissioning liabilities | 1,229,955 | - | 1,229,955 |
| Balance, December 31, 2014 | $ 64,135,916 | $ 290,587 | $ 64,426,503 |
| Additions | 3,213,866 | 4,091 | 3,217,957 |
| Transfers from exploration and evaluation | 4,697,020 | - | 4,697,020 |
| Dispositions | (247,005) | - | (247,005) |
| Changes in decommissioning liabilities | 328,000 | - | 328,000 |
| Balance, December 31, 2015 | $ 72,127,797 | $ 294,678 | $ 72,422,475 |

| **Accumulated depletion and depreciation:** | **Oil and natural gas properties** | **Corporate** | **Total** |
|---|---|---|---|
| Balance, January 1, 2014 | $ (13,354,943) | $ (58,918) | $ (13,413,861) |
| Depletion and depreciation | (6,669,754) | (38,970) | (6,708,724) |
| Impairment | (7,900,000) | - | (7,900,000) |
| Balance, December 31, 2014 | $ (27,924,697) | $ (97,888) | $ (28,022,585) |
| Dispositions | 118,897 | - | 118,897 |
| Depletion and depreciation | (7,232,099) | (40,940) | (7,273,039) |
| Impairment | (6,150,000) | - | (6,150,000) |
| Balance, December 31, 2015 | $ (41,187,899) | $ (138,828) | $ (41,326,727) |

| **Net book value:** | **Oil and natural gas properties** | **Corporate** | **Total** |
|---|---|---|---|
| As at December 31, 2014 | $ 36,211,219 | $ 192,699 | $ 36,403,918 |
| As at December 31, 2015 | $ 30,939,898 | $ 155,850 | $ 31,095,748 |

The calculation of depletion at December 31, 2015 included estimated future development costs of $7.9 million (2014 - $4.8 million) associated with the development of the Company's proved and proved plus probable reserves and excluded salvage value of $1.4 million (2014 - $1.3 million).

In June 2015 the Company disposed certain assets for gross proceeds of approximately $8.9 million. As the property sold was entirely composed of royalty interests, there were no associated asset retirement obligations. This resulted in a gain on sale of $8,787,761. There were no dispositions of property and equipment in the prior year.

Impairment

As a result of a significant decline in the price of oil and gas commodities during 2015, the Company determined that indicators of impairment were present and tested all of its CGUs for impairment at both September 30 and December 31, 2015. The recoverable amounts of the Company's CGUs were based on the higher of fair value less costs to sell ("FVLCS") and value in use ("VIU"). The impairment tests were completed using estimates of VIU consistent with the net present value of the before income tax cash flows from proved plus probable reserves discounted at 10%. For the December 31, 2015 test, the cash flow information was derived from the independent external reserve evaluators report. For the year ended December 31, 2015 total impairment charges of $6.15 million were recognized in the Oil CGU. The recoverable amount of the Oil CGU at December 31, 2015 was $31 million.

The independent external reserves evaluator's commodity price estimates used at December 31, 2015 were:

| Year | WTI Oil ($US/barrel) | Canadian Light Sweet Crude ($Cdn/barrel) | AECO-C Spot ($Cdn/MMbtu) | Exchange Rate ($Cdn/$US) |
|---|---|---|---|---|
| 2016 | 45.00 | 55.20 | 2.25 | 0.75 |
| 2017 | 60.00 | 69.00 | 2.95 | 0.80 |
| 2018 | 70.00 | 78.43 | 3.42 | 0.83 |
| 2019 | 80.00 | 89.41 | 3.91 | 0.85 |
| 2020 | 81.20 | 91.71 | 4.20 | 0.85 |
| 2021 | 82.42 | 93.08 | 4.28 | 0.85 |
| 2022 | 83.65 | 94.48 | 4.35 | 0.85 |
| 2023 | 84.91 | 95.90 | 4.43 | 0.85 |
| 2024 | 86.18 | 97.34 | 4.51 | 0.85 |
| 2025 | 87.48 | 98.80 | 4.59 | 0.85 |
| 2026 | 88.79 | 100.28 | 4.67 | 0.85 |
| Thereafter | 1.5%/year | 1.5%/year | 1.5%/year | |

At December 31, 2014 due to declining commodity prices and reserve revisions, the Company tested all of its CGUs for impairment resulting in an impairment of $7.9 million in the Oil CGU. The recoverable amounts of the Company's CGUs were estimated as FVLCS, calculated using the present value of the CGUs' expected future cash flows before tax discounted at a rate of 10%.

The independent external reserves evaluator's commodity price estimates used at December 31, 2014 were:

| Year | WTI Oil ($US/barrel) | Canadian Light Sweet Crude ($Cdn/barrel) | AECO-C Spot ($Cdn/MMbtu) | Exchange Rate ($Cdn/$US) |
|---|---|---|---|---|
| 2015 | 65.00 | 70.35 | 3.32 | 0.85 |
| 2016 | 80.00 | 87.36 | 3.71 | 0.87 |
| 2017 | 90.00 | 98.28 | 3.90 | 0.87 |
| 2018 | 91.35 | 99.75 | 4.47 | 0.87 |
| 2019 | 92.72 | 101.25 | 5.05 | 0.87 |
| 2020 | 94.11 | 103.85 | 5.13 | 0.87 |
| 2021 | 95.52 | 105.40 | 5.22 | 0.87 |
| 2022 | 96.96 | 106.99 | 5.31 | 0.87 |
| 2023 | 98.41 | 108.59 | 5.40 | 0.87 |
| 2024 | 99.89 | 110.22 | 5.49 | 0.87 |
| 2025 | 101.38 | 111.87 | 5.58 | 0.87 |
| Thereafter | 1.5%/year | 1.5%/year | 1.5%/year | |

## 8. Banking facility

The Company's bank facility consists of a revolving operating loan facility (the “facility”) with a Canadian bank. The facility is provided on a demand basis in the amount of $10.0 million subject to an annual review of the borrowing base. The borrowing base is determined by the lender based on the lender's interpretation of the Company’s reserves, future commodity prices and other factors. There can be no assurance that the amount of the available facility will not be adjusted at the next scheduled borrowing base review on or before May 31, 2016.

The facility bears interest at the Lender’s prime lending rate plus 1.25% and standby fees are charged on the undrawn facility at a rate of 0.30%. Under the terms of the facility, a financial covenant must be maintained. The Company must not permit the working capital ratio, as defined by the bank, to fall below 1.00:1. The bank defines the working capital ratio as the ratio of (i) current assets plus any undrawn availability under the facility, to (ii) current liabilities less (to the extent included therein) any amount drawn under the facilities. At December 31, 2015 the Company was in compliance with the financial covenant. As security for the facility, the Company has provided a general security agreement providing a security interest over all present and after acquired personal property and a floating charge on all lands.

## 9. Decommissioning obligations

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and facilities. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning obligations to be $4.3 million as at December 31, 2015 (2014 - $3.6 million) based on an undiscounted inflation adjusted total future liability of $6.0 million (2014 - $4.6 million). These payments are expected to be made over the next 30 years with the majority of the costs to be incurred between 2026 and 2046. The inflation rate applied to the liability is 2% (2014 - 2%). The discount factor, being the risk-free interest rate related to the liability, is 2.2% (2014 - 2.3%).

A reconciliation of the decommissioning obligations is provided below:

| | | **Total** |
|---|---|---|
| Balance, January 1, 2014 | $ | 2,475,000 |
| Obligations incurred and acquired | | 892,000 |
| Change in estimates | | 81,955 |
| Change in risk free rate | | 264,000 |
| Settled during the year | | (193,955) |
| Accretion expense | | 81,000 |
| Balance, December 31, 2014 | $ | 3,600,000 |
| Obligations incurred | | 480,000 |
| Change in estimates | | 248,719 |
| Change in risk free rate | | 58,000 |
| Settled during the year | | (142,719) |
| Accretion expense | | 82,000 |
| Balance, December 31, 2015 | $ | 4,326,000 |

## 10. Deferred income tax

### (a) Income tax

The provision for income tax in the financial statements differs from the result which would have been obtained by applying the combined federal and provincial income tax rate to the Company's loss before income taxes. This difference results from the following items:

| | **Year ended December 31,** | | | |
|---|---|---|---|---|
| | | **2015** | | **2014** |
| Loss before income taxes | $ | (3,067,927) | $ | (5,239,746) |
| Combined federal and provincial income tax rate | | 26.0% | | 25.0% |
| Computed "expected" income tax (recovery) | $ | (797,661) | $ | (1,309,937) |
| Increase (decrease) in income taxes resulting from: | | | | |
| Non-deductible share based compensation expense | | 167,623 | | 195,796 |
| Change in income tax rates | | 199,550 | | - |
| Flow-through shares | | 121,160 | | 454,900 |
| Other | | 2,908 | | (10,440) |
| Income tax (recovery) | $ | (306,420) | $ | (669,681) |
| Current income tax expense (recovery) | | (678,904) | | (15,096) |
| Deferred income tax expense (recovery) | $ | 372,484 | $ | (654,585) |

The combined income tax rate change is due to an increase in the Alberta corporate income tax rate from 10% to 12%.

### (b) Deferred income tax liability

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

| | **As at December 31,** | | | |
|---|---|---|---|---|
| | | **2015** | | **2014** |
| Deferred tax liabilities: | | | | |
| E&E assets & property & equipment | $ | 3,770,800 | $ | 2,564,600 |
| Deferred tax assets: | | | | |
| Decommissioning liabilities | | (1,168,000) | | (900,000) |
| Loss carry forwards | | (203,600) | | - |
| Share issue costs | | (183,300) | | (254,000) |
| Deferred income tax liability | $ | 2,215,900 | $ | 1,410,600 |

The Company's assets have an approximate tax basis of $23.3 million at December 31, 2015 (2014 - $32 million) available for deduction against future taxable income. A deferred tax asset has not been recognized in respect of approximately $175,000 (2014 -$175,000) of successored Canadian Exploration expenses at December 31, 2015 because it is not probable that the Company will be able to utilize the benefit.

A continuity of the net deferred income tax liability (asset) is provided below:

| | Balance December 31, 2013 | Recognized in income or loss | Recognized in equity | Flow-through shares | Balance December 31, 2014 |
|---|---|---|---|---|---|
| E&E assets & property & equipment | $ 2,836,830 | $ (613,330) | $ - | $ 341,100 | $ 2,564,600 |
| Decommissioning liabilities | (618,750) | (281,250) | - | - | (900,000) |
| Non-capital losses | (136,220) | 136,220 | - | - | - |
| Financial derivatives | (3,920) | 3,920 | - | - | - |
| Share issue costs | (113,230) | 99,855 | (240,625) | - | (254,000) |
| | $ 1,964,710 | $ (654,585) | $ (240,625) | $ 341,100 | $ 1,410,600 |

| | Balance December 31, 2014 | Recognized in income or loss | Recognized in equity | Flow-through shares | Balance December 31, 2015 |
|---|---|---|---|---|---|
| E&E assets & property & equipment | $ 2,564,600 | $ 764,400 | $ - | $ 441,800 | $ 3,770,800 |
| Decommissioning liabilities | (900,000) | (268,000) | - | - | (1,168,000) |
| Non-capital losses | - | (203,600) | - | - | (203,600) |
| Share issue costs | (254,000) | 79,684 | (8,984) | - | (183,300) |
| | $ 1,410,600 | $ 372,484 | $ (8,984) | $ 441,800 | $ 2,215,900 |

## 11. Share capital

### (a) Authorized

The Company is authorized to issue an unlimited number of common shares without nominal or par value and an unlimited number of preferred shares. No preferred shares have been issued. The holders of common shares are entitled to receive dividends as declared by the Company and are entitled to one vote per share.

### (b) Issued and outstanding

| Common shares | Number | Amount |
|---|---|---|
| Balance January 1, 2014 | 53,507,911 | $ 25,798,292 |
| Issued for cash | 14,375,000 | 11,500,000 |
| Issued for cash on exercise of stock options | 875,000 | 355,250 |
| Issued on surrender of stock options | 472,358 | - |
| Transferred from contributed surplus on exercise of stock options | - | 236,250 |
| Transferred from contributed surplus on surrender of stock options | - | 240,000 |
| Issued for cash - flow-through | 1,300,000 | 1,495,000 |
| Deferred flow-through share premium | - | (325,000) |
| Share issue costs, net of tax of $240,625 | - | (721,864) |
| Balance December 31, 2014 | 70,530,269 | $ 38,577,928 |
| Issued for cash on exercise of stock options | 250,000 | 150,000 |
| Transferred from contributed surplus on exercise of stock options | - | 87,190 |
| Issued for cash - flow-through | 1,168,000 | 700,800 |
| Deferred flow-through share premium | - | (116,800) |
| Share issue costs, net of tax of $8,984 | - | (24,289) |
| Balance December 31, 2015 | 71,948,269 | $ 39,374,829 |

**(c) Private placements**

On March 12, 2014 the Company completed a bought deal financing by issuing 14,375,000 common shares at $0.80 per common share for gross proceeds of $11.5 million, before share issue costs.

In November 2014 the Company completed a private placement of 1,300,000 flow-through common shares at a price of $1.15 per common share for gross proceeds of $1,495,000. The Company has incurred the qualifying expenditures.

In October 2015 the Company completed a private placement of 1,168,000 flow-through common shares at a price of $0.60 per common share for gross proceeds of $700,800. Directors and officers of the Company subscribed for 454,667 common shares for consideration of $272,800. The Company has incurred the qualifying expenditures.

**(d) Per share amounts**

Basic and diluted net loss were calculated as follows:

| | Year ended December 31, 2015 | 2014 |
|---|---|---|
| Net loss for the year | $ (2,761,507) | $ (4,570,065) |
| Weighted average number of common shares - basic | 70,881,869 | 65,844,173 |
| Effect of dilutive stock options | - | - |
| Weighted average number of common shares - diluted | 70,881,869 | 65,844,173 |
| Net loss per share - basic and diluted | $ (0.04) | $ (0.07) |

The Company experienced a net loss in the 2015 and 2014 years and therefore the effect of outstanding options were excluded as they were anti-dilutive.

**(e) Stock option plan**

The Company has established a stock option plan for the benefit of its directors, officers, employees and consultants. The Board of Directors establishes at the time of grant, subject to regulatory approval, the option exercise price, the expiry date and vesting provisions. The options granted to directors and officers vest immediately and the options granted to consultants vest over a one year time period. Options granted expire five years from the date of grant.

The following table sets forth a reconciliation of the stock option plan activity:

| | Number of options | Weighted average exercise price |
|---|---|---|
| Balance January 1, 2014 | 4,430,000 | $ 0.59 |
| Exercised for cash | (875,000) | 0.40 |
| Surrendered for shares | (700,000) | 0.40 |
| Granted | 1,735,000 | 0.96 |
| Balance December 31, 2014 | 4,590,000 | $ 0.79 |
| Granted | 2,290,000 | 0.62 |
| Exercised for cash | (250,000) | 0.60 |
| Forfeited | (385,000) | 0.81 |
| Expired | (700,000) | 0.60 |
| Balance, December 31, 2015 | 5,545,000 | $ 0.75 |

The weighted average share price at the date stock options were exercised in 2015 was $0.61 (2014 - $1.07).

In September 2014, as permitted under the stock option plan, certain officers, employees and consultants surrendered unexercised options to the Company in consideration for payment of an amount equal to the excess of the aggregate fair market value of the common shares on that date over the aggregate exercise price for those common shares pursuant to the options, payable in common shares. The fair market value of the common shares was determined as the weighted average trading price of the common shares during the five trading days preceding the surrender date.

The fair value of options granted in 2015 and 2014 was estimated using a Black Scholes model with the following weighted average assumptions:

| Assumptions | 2015 | 2014 |
|---|---|---|
| Risk free interest rate (%) | 0.9 | 1.6 |
| Expected life (years) | 4.9 | 4.8 |
| Expected volatility (%) | 49.9 | 57.4 |
| Forfeiture rate (%) | 1.2 | 2.2 |
| Weighted average fair value of options | $ 0.28 | $ 0.46 |

The following table summarizes stock options outstanding and exercisable under the plan at December 31, 2015:

| Exercise price | Number outstanding | Weighted average remaining contractual life (years) | Weighted average exercise price | Number exercisable | Weighted average exercise price |
|---|---|---|---|---|---|
| $0.60 - $0.70 | 2,865,000 | 3.8 | $ 0.62 | 2,695,001 | $ 0.60 |
| $0.71 - $0.80 | 1,000,000 | 0.7 | 0.80 | 1,000,000 | 0.80 |
| $0.91 - $1.00 | 1,530,000 | 3.3 | 0.95 | 1,530,000 | 0.95 |
| $1.01 - $1.10 | 150,000 | 3.4 | 1.07 | 150,000 | 1.07 |
| $0.60 - $1.10 | 5,545,000 | 3.1 | $ 0.75 | 5,375,001 | $ 0.76 |

## 12. Net finance expense

| | Year ended December 31, 2015 | 2014 |
|---|---|---|
| Interest income | $ (8,849) | $ (44,294) |
| Interest expense and financing charges | 133,112 | 58,677 |
| Accretion of decommissioning obligations | 82,000 | 81,000 |
| | $ 206,263 | $ 95,383 |

## 13. Supplemental information

### (a) Revenue

The components of the Company's revenue are as follows:

| | Year ended December 31, 2015 | 2014 |
|---|---|---|
| Petroleum and natural gas sales | $ 12,526,125 | $ 17,474,217 |
| Royalty income | 356,189 | 2,242,467 |
| Petroleum and natural gas | $ 12,882,314 | $ 19,716,684 |

**(b) Cash Flow Statement Presentation**

**Changes in non-cash working capital is comprised of:**

| | Year ended December 31, 2015 | 2014 |
|---|---|---|
| Provided by (used in): | | |
| Accounts receivable | $ 997,592 | $ (692,231) |
| Prepaid expenses and deposits | (39,849) | (87,721) |
| Accounts payable and accrued liabilities | (3,611,642) | 2,111,347 |
| Income taxes | (263,904) | (694,000) |
| | $ (2,917,803) | $ 637,395 |
| Provided by (used in): | | |
| Operating | $ 478,900 | $ (1,179,792) |
| Financing | (4,048) | (4,811) |
| Investing | (3,392,655) | 1,821,998 |
| | $ (2,917,803) | $ 637,395 |

**(c) Interest and taxes paid:**

| | Year ended December 31, 2015 | 2014 |
|---|---|---|
| Interest paid | $ 89,714 | $ 12,442 |
| Interest received | (8,849) | (44,294) |
| Taxes paid | - | 678,904 |
| | $ 80,865 | $ 647,052 |

**14. Key management compensation**

Key management personnel includes both officers and directors of the Company. The compensation paid or payable to key management is shown below:

| | Year ended December 31, 2015 | 2014 |
|---|---|---|
| Salary, wages and fees | $ 192,023 | $ 188,810 |
| Share based compensation | 487,505 | 478,292 |
| Key management compensation | $ 679,528 | $ 667,102 |

**15. Commitment**

The Company has entered into a lease commitment for office space. The term of the lease is 10 years commencing November 1, 2011. The annual payments under this commitment are approximately as follows:

| Year | Annual amount ($) |
|---|---|
| 2016 | 212,600 |
| 2017 | 223,900 |
| 2018 | 226,100 |
| 2019 and 2020 | 237,400 |
| 2021 | 197,800 |