Hillcrest Petroleum

Consolidated Financial Statements

December 31, 2016 and 2015

(Expressed in Canadian Dollars)

May 1, 2017

To the Shareholders of Hillcrest Petroleum Ltd.

We have audited the accompanying consolidated financial statements of Hillcrest Petroleum Ltd., which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015 and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity (deficiency) and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Hillcrest Petroleum Ltd. as at December 31, 2016 and December 31, 2015 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter
Without qualifying our opinion, we draw attention to Note 1 to the consolidated financial statements, which discloses conditions and matters that indicate the existence of a material uncertainty that may cast significant doubt about the ability of Hillcrest Petroleum Ltd. to continue as a going concern.

(signed) "PricewaterhouseCoopers LLP"

Chartered Professional Accountants

HILLCREST PETROLEUM LTD.
Consolidated Statements of Financial Position
(Expressed in Canadian dollars)

	December 31, 2016	December 31, 2015
	($)	($)
ASSETS		
Current assets		
Cash	184,940	198,581
Accounts receivable	29,402	305,095
GST receivable	3,945	5,953
Short-term investments (Note 4)	-	34,659
Prepaid expenses	63,953	228,338
Total current assets	282,240	772,626
Non-current assets		
Restricted Cash (Note 11)	2,048,604	2,456,013
Exploration and evaluation assets (Note 6)	-	87,545
Property and equipment (Note 5)	272,530	11,892,067
TOTAL ASSETS	2,603,374	15,208,251
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (Note 7)	5,763,186	4,667,255
Secured loans (Note 8)	526,381	418,841
Current portion of decommissioning liability (Note 11)	27,019	2,061,484
Current portion of unsecured loans (Note 9)	245,000	227,583
Total current liabilities	6,561,586	7,375,163
Unsecured loans (Note 9)	84,761	212,176
Decommissioning liability (Note 11)	2,740,024	11,578,388
TOTAL LIABILITIES	9,386,371	19,165,727
SHAREHOLDERS' DEFICIENCY		
Share capital (Note 12)	6,178,384	5,708,384
Contributed surplus (Note 12)	980,454	949,834
Reserves	1,348,392	1,112,538
Deficit	(15,290,227)	(11,728,232)
	(6,782,997)	(3,957,476)
TOTAL LIABILITIES & SHAREHOLDERS' DEFICIENCY	2,603,374	15,208,251

Nature of operations and going concern (Note 1)
Commitments (Note 13)
Subsequent events (Note 20)

These consolidated financial statements were authorized for issue by the Board of Directors on May 1, 2017.
They were signed on the Board's behalf by:

"Don Currie"	*"Thomas Milne"*
Director	Director

HILLCREST PETROLEUM LTD.

Consolidated Statements of Loss and Comprehensive Loss

(Expressed in Canadian dollars)

	Year Ended December 31, 2016	Year Ended December 31, 2015
	($)	**($)**
Revenue, net of royalties	1,299,214	3,925,785
Expenses		
Operating costs	2,020,821	3,015,467
Consulting fees (Note 10)	632,511	737,939
Depletion and depreciation (Note 5)	806,918	2,791,793
Office and general (Note 18)	1,684,431	2,004,349
Share-based payments (Note 12)	76,000	-
	5,220,681	8,549,548
Loss from operations	(3,921,467)	(4,623,763)
Change in estimate of decommissioning liability (Note 11)	(321,168)	-
Financing expenses (Note 18)	(338,870)	(781,726)
Gain on disposal of oil and gas properties (Note 5)	961,134	-
Interest Income	-	29
Impairment of oil and gas properties (Note 5)	(332,865)	(7,790,717)
Impairment of exploration and evaluation assets (Note 6)	(410,955)	(826,501)
Impairment of short-term investments (Note 4)	(34,659)	(162,642)
Loss on disposal of exploration and evaluation assets	-	(421,083)
Proceeds from insurance settlement (Note 5)	832,018	-
Foreign exchange gain (loss)	4,837	(96,120)
Loss for the year	(3,561,995)	(14,702,523)
Item that may be subsequently reclassified to net loss		
Exchange differences on translating foreign operations	190,474	1,116,045
Comprehensive loss	(3,371,521)	(13,586,478)
Basic and diluted loss per share	(0.07)	(0.29)
Weighted average common shares outstanding:		
Basic	52,141,830	50,295,655
Diluted	52,141,830	50,295,655

HILLCREST PETROLEUM LTD.

Consolidated Statements of Changes in Shareholders' Equity (Deficiency)

(Expressed in Canadian dollars)

	Share Capital				Reserves			
	Number of Shares	**Amount**	**Share Subscriptions**	**Contributed Surplus**	**Warrants**	**Foreign Currency Translation**	**Deficit**	**Shareholders' Equity (Deficiency)**
		($)	**($)**	**($)**	**($)**	**($)**	**($)**	**($)**
Balance at December 31, 2014	50,295,655	5,707,184	(46,000)	949,834	30,620	(34,127)	2,974,291	9,581,802
Cash received from share subscription	-	-	46,000	-	-	-	-	46,000
Share issuance cost recovery	-	1,200	-	-		-	-	1,200
Loss and comprehensive loss for the year	-	-	-	-	-	1,116,045	(14,702,523)	(13,586,478)
Balance at December 31, 2015	50,295,655	5,708,384	-	949,834	30,620	1,081,918	(11,728,232)	(3,957,476)
Proceeds from private placement	7,300,000	365,000	-	-	-	-	-	365,000
Shares issued for unsecured loan	1,000,000	30,000	-	-	-	-	-	30,000
Shares issued for secured loan	1,500,000	75,000	-	-	-	-	-	75,000
Transfer expired warrants to contributed surplus	-	-	-	30,620	(30,620)	-	-	-
Warrant extension	-	-	-	-	76,000	-	-	76,000
Loss and comprehensive loss for the year	-	-	-	-	-	190,474	(3,561,995)	(3,371,521)
Balance at December 31, 2016	60,095,655	6,178,384	-	980,454	76,000	1,272,392	(15,290,227)	(6,782,997)

HILLCREST PETROLEUM LTD.
Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

	Year Ended December 31, 2016	Year Ended December 31, 2015
	($)	**($)**
Loss for the year	(3,561,995)	(14,702,523)
Adjusted for items not involving cash:		
Accretion	201,898	480,914
Accrued interest expense	14,825	597
Change in estimate of decommissioning liability	321,168	-
Financing fees	-	78,375
Depletion and depreciation	806,918	2,791,955
Impairment of exploration and evaluation assets	410,955	826,501
Impairment of oil and gas properties	332,865	7,790,717
Impairment of short-term investments	34,659	162,642
Gain on disposal of oil and gas properties	(961,134)	-
Loss on disposal of exploration and evaluation assets	-	421,083
Share-based payments	76,000	-
Unrealized foreign exchange gain	96,434	238,484
Changes in non-cash working capital:		
Accounts receivable	197,952	122,310
Prepaid expenses	51,925	6,114
GST receivable	2,008	6,051
Accounts payable and accrued liabilities	1,541,112	1,180,382
Cash flows used in operating activities	(434,410)	(596,398)
Release of restricted cash	334,074	282,209
Proceeds from disposal of exploration and evaluation assets	-	52,049
Purchase of equipment	-	(7,888)
Exploration and evaluation expenditures	(323,410)	(38,429)
Cash flows provided by investing activities	10,664	287,941
Proceeds from private placement	365,000	-
Proceeds from share subscriptions	-	46,000
Proceeds from secured loan	425,000	440,000
Repayment of unsecured loan	(216,765)	(47,000)
Repayment of secured loan	(159,341)	(581,159)
Cash flows provided by (used in) financing activities	413,894	(142,159)
Change in cash	(9,852)	(450,616)
Effect of exchange rate changes on cash denominated in a foreign currency	(3,789)	29,880
Cash, beginning of the year	198,581	619,317
Cash, end of the year	184,940	198,581

Supplemental cash flow information (Note 17)

1. Nature of Operations and Going Concern

Hillcrest Petroleum Ltd. (the "Company") was incorporated on May 2, 2006 under the Business Corporations Act of British Columbia, and is in the business of acquiring, exploring and developing exploration interests in oil and gas projects located in North America. Effective March 10, 2015, the Company changed its name from Hillcrest Resources Ltd. to Hillcrest Petroleum Ltd. The Company's registered office is suite 1410 – 1030 West Georgia Street, Vancouver, BC, V6E 2Y2. The Company's shares are listed for trading on the TSX Venture Exchange ("TSX-V") under the symbol "HRH" and on the OTCQB Exchange under the symbol "HLRTF".

The Company is subject to several categories of risk associated with the exploration and development of oil and gas resources. Oil and gas exploration and production is a speculative business, and involves a high degree of risk. Among the factors that have a direct bearing on the Company's prospects are uncertainties inherent in estimating oil and gas reserves, future hydrocarbon production, and cash flows, particularly with respect to wells that have not been fully tested and with wells having limited production histories; access to additional capital; changes in the price of oil and gas; availability and cost of services and equipment; and the presence of competitors with greater financial resources and capacity.

These consolidated financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. The Company incurred a loss for the year of $3,561,995 and had a working capital deficiency of $6,279,346 as at December 31, 2016. The Company's ability to meet its obligations as they fall due and to continue to operate as a going concern is dependent on the continued financial support of its creditors and its shareholders and ultimately, the attainment of profitable operations. There is no certainty that the Company will continue to produce revenue due to the inherent production risks associated with the oil and natural gas industry. In the past, the Company has relied on sales of equity securities, debt instruments and asset sales to meet its cash requirements. There can be no assurance that funding from this or other sources will be sufficient in the future to satisfy operational requirements and cash commitments. Even if the Company is able to obtain new financing, it may not be on commercially reasonable terms or terms that are acceptable to it. Failure to obtain such financing on a timely basis could cause the Company to reduce or terminate its operations. Subsequent to December 31, 2016, the Company placed its wholly-owned subsidiary, Hillcrest GOM Inc., into Chapter 7 liquidation in the U.S. Court for the Southern District of Texas in order to preserve the existing cash in the consolidated entity (Note 20).

Due to the conditions and events as noted above, there is material uncertainty casting significant doubt on the Company's ability to continue as a going concern. These consolidated financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. These adjustments could be material.

2. Basis of Preparation

(a) Statement of Compliance

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

These consolidated financial statements were authorized by the Audit Committee and Board of Directors of the Company on May 1, 2017.

2. Basis of Preparation (continued)

(a) Basis of Measurement

The consolidated financial statements have been prepared on a historical cost basis, using the accrual basis of accounting, except for cash flow information and certain financial assets that are measured at fair value as explained in the significant accounting policies set out in Note 3.

(b) Basis of Consolidation

These consolidated financial statements include the accounts of the parent company, Hillcrest Petroleum Ltd., and its wholly-owned subsidiaries. Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

Name of Subsidiary	Jurisdiction of Incorporation	Principal Activity
Hillcrest Exploration Ltd. (“HEL”)	USA	Oil and Gas exploration
1084580 BC Ltd.	Canada	Oil and Gas exploration
Hillcrest Resources (Arizona) Ltd. (“HARL”)	USA	Dormant
Hillcrest GOM Inc. (“HGOM”)	USA	Oil and gas production
Darcy Energy LLC (“Darcy”)	USA	Dormant

(c) Functional and Presentation Currency

These consolidated financial statements are presented in Canadian dollars. The functional currency of the parent, 1084580 BC Ltd. and HARL is the Canadian dollar. The functional currency of HEL, HGOM and Darcy is the United States dollar.

(d) Use of Estimates and Judgements

The preparation of these consolidated financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the period. Actual results could differ from these estimates.

These consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the reporting date that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

2. Basis of Preparation (continued)

(d) Use of Estimates and Judgements (continued)

Depletion and Depreciation
The amounts recorded for depletion and depreciation of oil and natural gas properties and the amounts used in impairment testing are based on independent estimates of proved and probable reserves, well production rates, realized and forecast oil and natural gas prices, future development costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty. Accordingly, the impact on the consolidated financial statements for future periods may be material.

Decommissioning provisions
Restoration costs will be incurred by the Company at the end of the operating life of the Company's oil properties. The Company estimates abandonment and reclamation costs based on a combination of publicly available industry benchmarks and internal site specific information. For producing wells and facilities, the expected timing of settlement is estimated based on the period to abandonment for each field, as per an independent report. The ultimate restoration liability is uncertain and can vary in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques, experience at other production sites, or changes in the risk-free discount rate. The expected timing and amount of expenditure can also change in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the provisions established which would affect future financial results (Note 11).

Income taxes
The calculation of income taxes requires judgment in applying tax laws and regulations, estimating the timing of the reversals of temporary differences, and estimating the reliability of deferred tax assets. These estimates impact current and deferred income tax assets and liabilities, and current and deferred income tax expense (recovery).

Significant judgements that management has made at the end of the reporting year are as follows:

Determination of functional currency
The functional currency of each entity is the currency of the primary economic environment in which that entity operates. The Company has determined the functional currency of the parent company, 1084580 BC Ltd. and Hillcrest Resources (Arizona) Ltd. to be the Canadian dollar, and that the remaining subsidiaries be the United States dollar. Determination of the functional currency may involve certain judgments to determine the primary economic environment. The functional currency may change if there is a change in events and conditions which determines the primary economic environment.

Carrying value and the recoverability of exploration and evaluation assets
Management has determined that exploration, evaluation and related costs incurred which were capitalized may have future economic benefits and may be economically recoverable. Management uses several criteria in its assessments of economic recoverability and probability of future economic benefits including geologic and other technical information, history of conversion of mineral deposits with similar characteristics to its own properties to proven and probable mineral reserves, scoping and feasibility studies, accessible facilities and existing permits.

2. Basis of Preparation (continued)

(e) Use of Estimates and Judgements (continued)

Carrying value and the recoverability of property and equipment
The Company reviews its equipment for indicators of impairment whenever there is a change in events or circumstances that indicate an asset may be impaired and at each reporting period. Reviews are undertaken to evaluate the carrying value of the property and equipment considering, among other factors: the carrying value of each type of asset and the changes in circumstances that affect the carrying value of the Company's property and equipment. If such indication exists, a formal estimate of recoverable amount is performed and an impairment loss is recognized to the extent that the carrying amount exceeds the recoverable amount. The determination of recoverable amount is based on fair value estimation.

Determination of cash generating units
Management must make judgements as to which oil and gas properties can be aggregated into a cash generating unit ("CGU"). The Company's oil and gas assets are aggregated into CGUs for the purpose of calculating impairment and depletion. Factors considered by management include, but are not limited to, the product produced (i.e. oil versus gas), the common infrastructure shared by individual properties, proximity of properties to each other, and planned development activities.

3. Significant Accounting Policies

(a) Foreign Currency Translation

Functional and presentation currency
The financial results of foreign operations that have a functional currency different from the presentation currency are translated into the presentation currency. Income and expenditure transactions of foreign operations are translated at the average rate of exchange for the quarter except for significant individual transactions which are translated at the rate of exchange in effect at the transaction date. All assets and liabilities, including fair value adjustments and goodwill arising on acquisition, are translated at the rate of exchange ruling at the reporting date. Differences arising on translation from the transaction date are recognized as other comprehensive income.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of the net investment in a foreign operation and are recognized in other comprehensive income. On disposal of part or all of the operations, the proportionate share of the related cumulative gains and losses previously recognized in the comprehensive income are included in determining the profit or loss on disposal of that operation. The consolidated financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency, while the United States dollar is the functional currency of several of the Company's subsidiaries.

Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognised in net loss, except for the Company's net investment in its foreign subsidiaries which are recognised in other comprehensive income.

3. Significant Accounting Policies (continued)

(b) 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.

Once technical feasibility and commercial viability are confirmed the E&E asset is then reclassified to property and equipment and tested for impairment. For purposes of impairment testing, E&E assets are allocated to the appropriate cash-generating units based on geographic proximity. Expired lease costs are expensed as part of depletion and depreciation expense as they occur and costs incurred prior to the legal right to explore are charged to net income (loss).

(c) Property and Equipment

<u>Cost and valuation</u>
All costs directly associated with the development of oil and gas interests are capitalized on a CGU basis as oil and gas interests and are measured at cost less accumulated depletion and net impairment losses. These costs include expenditures for areas where technical feasibility and commercial viability have been determined. These costs include property acquisitions with proved and/or probable reserves, development drilling, completion, gathering and infrastructure, decommissioning liabilities and transfers of exploration and evaluation assets.

Equipment includes computer equipment which is recorded at cost on initial acquisition. Cost includes the purchase price and the directly attributable costs of acquisition required to bring an asset to the location and condition necessary for the asset to be capable of operating in the manner intended by management. Subsequent expenditure relating to an item of equipment is capitalized when it is probable that future economic benefits from the use of the assets will be increased. All other subsequent expenditure is recognized as repairs and maintenance expenses during the period in which they are incurred.

<u>Depletion and depreciation</u>
The provision for depletion for oil and natural gas assets is calculated based on each asset’s production for the period divided by the Company’s estimated total proved and probable oil and natural gas reserve volumes before royalties for that asset, taking into account estimated future development costs. Production and reserves of natural gas and associated liquids are converted at the energy equivalent ratio of six thousand cubic feet of natural gas to one barrel of oil. Changes in estimates used in prior periods, such as proven and probable reserves, that affect the unit-of-production calculations do not give rise to prior period adjustments and are dealt with on a prospective basis.

Equipment is depreciated on a declining balance basis over the estimated useful life of the asset at the rate of 33% to 55% per annum. Where components of an asset have a different useful life and cost that is significant to the total cost of the asset, depreciation is calculated on each separate component. Depreciation methods, useful lives and residual values are reviewed at the end of each reporting date, and adjusted on a prospective basis if appropriate.

3. Significant Accounting Policies (continued)

(d) Impairment of Non-Financial Assets

At each reporting period the carrying amounts of the Company's non-financial assets, other than exploration and evaluation assets, are reviewed for indicators of impairment. If indicators exist, the recoverable amount of the asset is estimated. Exploration and evaluation assets are assessed for impairment when they are reclassified to property and equipment and if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For purposes of assessing impairment, exploration and evaluation assets and property and equipment are grouped into CGUs defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The Company has used geographical proximity, geological similarities, analysis of shared infrastructure, commodity type, assessment of exposure to market risks and materiality to define its CGUs.

If the carrying amount exceeds the recoverable amount, the asset or CGU is recorded at its recoverable amount with the reduction recognized in net income (loss) as an impairment expense. The recoverable amount is the greater of the value in use or fair value less costs of disposal ("FVLCD"). 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 of disposal 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.

Impairments are reversed in subsequent periods when there has been an increase in the recoverable amount of a previously impaired asset or CGU and these reversals are recognized in net income (loss). The recovery is limited to the original carrying amount less depletion and depreciation that would have been recorded had the asset not been impaired.

(e) Impairment of Financial Assets

At each reporting date, the Company assesses whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset or group of financial assets.

(f) Decommissioning and Restoration Costs

Decommissioning and restoration costs will be incurred by the Company at the end of the operating life of certain of the Company's assets. The ultimate decommissioning and restoration costs are uncertain and cost estimates can vary in response to many factors including changes to relevant legal and regulatory requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing and amount of expenditure can also change, for example in response to changes in reserves or changes in laws and regulations or their interpretation. In determining the amount of the provision, assumptions and estimates are required in relation to discount rates. As a result, there could be significant adjustments to the provisions established which would affect future financial results.

3. Significant Accounting Policies (continued)

(g) Provisions

A provision is recognised 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 "risk-free" rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognised for future operating losses.

(h) Financial Instruments

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities classified at fair value through profit or loss) are added to, or deducted from, the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities classified at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets and financial liabilities are measured subsequently as described below. The Company does not have any derivative financial instruments.

<u>Financial assets</u>
For the purpose of subsequent measurement, financial assets other than those designated and effective as hedging instruments are classified into the following categories upon initial recognition:

- Financial assets at fair value through profit or loss;
- Loans and receivables;
- Held-to-maturity investments; and
- Available-for-sale financial assets.

The category determines subsequent measurement and whether any resulting income and expense is recognized in profit or loss or in other comprehensive income.

All financial assets except for those at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, which are described below.

- *Financial assets at fair value through profit or loss* – Financial assets at fair value through profit or loss include financial assets that are either classified as held for trading or that meet certain conditions and are designated at fair value through profit or loss upon initial recognition. Assets in this category are measured at fair value with gains or losses recognized in profit or loss. The Company currently does not hold financial assets in this category.

- *Loans and receivables* – Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial recognition, these are measured at amortized cost using the effective interest method less any provision for impairment. Discounting is omitted where the effect of discounting is immaterial. The Company's cash, accounts receivable, GST receivable, other receivables and restricted cash fall into this category of financial instruments.

3. Significant Accounting Policies (continued)

(h) Financial Instruments (continued)

- *Held-to-maturity investments* – Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity, other than loans and receivables. Investments are classified as held-to-maturity if the Company has the intention and ability to hold them until maturity. The Company currently does not hold financial assets in this category.

- *Available-for-sale financial assets* – Available-for-sale financial assets are non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. The Company has classified short-term investments in this category.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, then the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire or when the financial asset and all substantial risks and rewards are transferred.

<u>Financial liabilities</u>
For the purpose of subsequent measurement, financial liabilities are classified as either financial liabilities at fair value through profit or loss or other financial liabilities upon initial recognition.

- *Financial liabilities at fair value through profit or loss* – Financial liabilities at fair value through profit or loss include financial liabilities that are either classified as held for trading or that meet certain conditions and are designated at fair value through profit or loss upon initial recognition. Liabilities in this category are measured at fair value with gains or losses recognized in profit or loss. The Company currently does not hold financial liabilities in this category.

- *Other financial liabilities* – Other financial liabilities are measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the liabilities are derecognized as well as through the effective interest rate method amortization process. The Company's accounts payable and secured and unsecured loans fall into this category of financial instruments.

A financial liability is derecognized when it is extinguished, discharged, cancelled, or expired.

(i) Basic and Diluted Earnings (Loss) Per Share

Earnings (loss) per share are calculated using the weighted-average number of common shares outstanding during the year. In calculating diluted earnings (loss) per share, the Company considers the potential exercise of outstanding share purchase options and warrants to the extent each option, warrant or contingent issuance was dilutive. Potentially dilutive securities were excluded in the computation of diluted loss per share as their inclusion would be anti-dilutive.

(j) Joint Operations

Oil and natural gas operations are conducted jointly with external parties and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

3. Significant Accounting Policies (continued)

(k) Revenue Recognition

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, and is based on volumes delivered to customers at contractual delivery points and rates. Delivery is generally at the time the petroleum enters the tank and when natural gas enters the pipeline. The costs associated with the delivery, including operating and maintenance costs, transportation and production-based royalty expenses, are recognized during the same period in which the related revenue is earned and recorded. Revenue is measured net of royalties, discounts and customs duties.

(l) Share-based Payments

The grant date fair value of share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

Where equity instruments are granted to parties other than employees, they are recorded by reference to the fair value of the services received. If the fair value of the services received cannot be reliably estimated, the Company measures the services received by reference to the fair value of the equity instruments granted, measured at the date the counterparty renders service.

All equity-settled share-based payments are reflected in contributed surplus, until exercised. Upon exercise, shares are issued from treasury and the amount reflected in contributed surplus is credited to share capital, adjusted for any consideration paid.

(m) Taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

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

<u>Deferred income tax</u>
Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

3. Significant Accounting Policies (continued)

(m) Taxes (continued)

Deferred tax is not recognized for the following temporary differences:

- liabilities arising from initial recognition of goodwill for which amortization is not deductible for tax purposes;

- liabilities arising from the initial recognition of an asset/liability other than in a business combination which, at the time of the transaction, does not affect either the accounting or the taxable profit; and

- liabilities arising from undistributed profits from investments where the entity is able to control the timing of the reversal of the difference and it is probable that the reversal will not occur in the foreseeable future.

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

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they 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.

Sales tax

Revenues, expenses and assets are recognized net of the amount of sales tax except:

- Where the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case, the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable;

- Receivables and payables that are stated with the amount of sales tax included. The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position.

(o) New Standards, Amendments and Interpretations to Existing Standards Not Yet Effective

Standards issued but not yet effective up to the date of issuance of the Company's consolidated financial statements are listed below. This listing is of standards and interpretations issued, which the Company reasonably expects to be applicable at a future date. The Company intends to adopt these standards when they become effective. The pronouncements are being assessed to determine their impact on the Company's results and financial position.

The following standards, amendments to standards and interpretations have been issued for annual periods beginning on or after January 1, 2018 but are not yet effective:

IFRS 9, Financial instruments

IFRS 9 is effective for annual periods beginning on or after January 1, 2018. This new standard replaces International Accounting Standards ("IAS") 39, Financial Instruments: Recognition and Measurement. IFRS 9 addresses the classification, measurement and de-recognition of financial assets and financial liabilities, introduces a new impairment model for financial assets and new rules for hedge accounting.

3. Significant Accounting Policies (continued)

(o) New Standards, Amendments and Interpretations to Existing Standards Not Yet Effective (continued)

IFRS 9 requires financial assets to be classified into one of three measurement categories on initial recognition: FVTPL, fair value through OCI and amortized cost. Measurement and classification of financial assets is dependent on the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial asset. The new standard retains most of the existing requirements for financial liabilities.

IFRS 9 introduces a new impairment model for financial assets. This new model may result in the earlier recognition of credit losses as it requires the Company to account for expected credit losses from the time the financial instruments are first recognized.

IFRS 15, Revenue from Contracts with Customers

IFRS 15 is effective for annual periods beginning on or after January 1, 2018. This new standard is based on the principle that revenue should be recognized to depict the transfer of goods or services to customers at an amount that the entity expects it will be entitled to in exchange for those goods.

IFRS 15 introduces a new five step model for the recognition of revenue based on when control of a good or service transfers to a customer. The notion of control replaces the existing notion of risks and rewards and could result in changes in the timing of revenue recognition for certain contracts.

The following standards, amendments to standards and interpretations have been issued for annual periods beginning on or after January 1, 2019 but are not yet effective:

IFRS 16, Leases

IFRS 16 is effective for annual periods beginning on or after January 1, 2019. This new standard replaces the existing leasing guidance in IAS 17, Leases.

IFRS 16 distinguishes between leases and service contracts on the basis of whether the customer controls the asset being leased. For those contracts determined to meet the definition of a lease, IFRS 16 requires a lessee to recognize on the balance sheet a lease asset along with the associated lease liability which reflects future lease payments, similar to current finance lease accounting. There are limited exceptions for leases with a term of less than 12 months or leases of assets which have a very low value. As a result of the adoption of IFRS 16, operating leases which were previously only recognized on the statement of earnings will be recognized on the balance sheet.

The purpose of the standard is to provide users of the financial statements with a more accurate picture of a company's leased assets and associated liabilities, while also improving the comparability of companies that lease assets to those that purchase them.

4. Short-term Investments

Short-term investments consist of common shares of Black Stallion Oil and Gas, Inc. ("Black Stallion"), a publicly traded American energy corporation, with an original acquisition cost of $197,301.

During the year ended December 31, 2016, the Company recorded an impairment loss of $34,659 (2015 - $162,642). As at December 31, 2016, the Company held 250,000 common shares of Black Stallion with a fair value of $Nil (2015 - $34,659).

(Expressed in Canadian dollars)

5. Property and Equipment

	Computers	Oil and Gas Interests	Total
	($)	($)	($)
Cost			
At January 1, 2015	18,341	24,038,117	24,056,458
Additions	7,888	-	7,888
Change in decommissioning estimate	-	(4,060,913)	(4,060,913)
Foreign exchange movement	1,395	4,029,315	4,030,710
At December 31, 2015	27,624	24,006,519	24,034,143
Disposals	-	(19,889,477)	(19,889,477)
Change in decommissioning estimate	-	(80,205)	(80,205)
Foreign exchange movement	(331)	(767,502)	(767,833)
At December 31, 2016	**27,293**	**3,269,335**	**3,296,628**
Accumulated depletion and depreciation			
At January 1, 2015	13,343	1,246,229	1,259,572
Depletion and depreciation for the year	5,262	2,786,531	2,791,793
Foreign exchange movement	284	300,297	300,581
At December 31, 2015	18,889	4,333,057	4,351,946
Depletion and depreciation for the year	4,967	801,951	806,918
Disposals	-	(2,586,082)	(2,586,082)
Foreign exchange movement	(56)	(202,921)	(202,977)
At December 31, 2016	**23,800**	**2,346,005**	**2,369,805**
Impairment			
At January 1, 2015	-	-	-
Impairment for the year	-	7,790,130	7,790,130
At December 31, 2015	-	7,790,130	7,790,130
Impairment for the year	-	332,865	332,865
Disposals	-	(7,192,475)	(7,192,475)
Foreign exchange movement	-	(276,227)	(276,227)
At December 31, 2016	**-**	**654,293**	**654,293**
Carrying amounts:			
At December 31, 2015	8,735	11,883,332	11,892,067
At December 31, 2016	**3,493**	**269,037**	**272,530**

(Expressed in Canadian dollars)

5. Property and Equipment (continued)

Hartburg Project, Texas

A total 4 wells have been completed with the following working interests to the Company:

Well	Working Interest
Donner #1	30.0%
Donner #2	48.0%
Donner #4	48.0%
Brown #1	90.0%

As at December 31, 2016, the Donner #1 well was the only active producing well. All of the remaining wells are shut-in and under re-evaluation.

Gulf of Mexico Properties

During the year ended December 31, 2016, the Company received $832,018 from its insurance carrier for costs related to a rig incident at the Ship Shoal 271 Platform in 2013. The proceeds from the insurance claim have been recorded as a recovery of costs on the consolidated statement of loss.

The Company included future development costs of $3,182,062 (2015 - $3,336,944) in property, plant and equipment costs in the calculation of depletion.

During the year ended December 31, 2016, the Company disposed of the Eugene Island offshore oil field. This portfolio of non-operated oil and gas properties located shallow offshore waters of the Gulf of Mexico were comprised of 6 leases containing 4 producing fields. It was sold to the operator of the property in exchange for the settlement of $2,218,932 (US$1,662,121) in existing payables owing to the purchaser, and the release of liability for any future asset retirement obligations currently estimated at US$7,083,105 on an undiscounted basis. Accordingly, the Company recorded a gain on disposal of $961,134.

Subsequent to the end of the year, the Company placed its wholly-owned subsidiary HGOM into a Chapter 7 liquidation in the U.S. Court for the Southern District of Texas. This has resulted in the disposal of the remaining non-operated assets located shallow offshore waters of the Gulf of Mexico.

Impairment

During the year ended December 31, 2016, the Company reviewed the carrying value of its oil and gas interests for impairment indicators. It was determined that the carrying values of the Brown 1 and Donner 2 onshore oil wells and the Eugene Island offshore oil field exceeded their recoverable amounts. Accordingly, the Company recorded an impairment of $332,865 (2015 - $386,126) and $Nil (2015 - $7,468,704), respectively, for each CGU.

The recoverable amount for the CGUs were based on their fair value less costs of disposal ("FVLCD"). To determine the FVCLD, the Company considered the current operational status and asset sales which occurred subsequent to year end.

(Expressed in Canadian dollars)

6. Exploration and Evaluation Assets

	Muddy Creek	Woodrow	Carrera Prospect	Pettit	Total
	($)	($)	($)	($)	($)
Balance at January 1, 2015	345,706	670,434	401,120	-	1,417,260
Additions	-	-	38,429	-	38,429
Disposals	-	(670,434)	-	-	(670,434)
Impairment	(345,706)	-	(480,795)	-	(826,501)
Foreign exchange movement	-	-	128,791	-	128,791
Balance at December 31, 2015	-	-	87,545	-	87,545
Additions	-	-	4,197	319,213	323,410
Impairment	-	-	(91,742)	(319,213)	(410,955)
Balance at December 31, 2016	-	-	-	-	-

Muddy Creek Project – Montana

On September 26, 2011, the Company entered into a purchase and sale agreement with Longshot Oil, LLC for the acquisition of certain oil and gas properties in Teton County, Montana. The Company issued 1,000,000 common shares of the Company at a fair value of $0.25 per share and paid $400,000.

On September 2, 2013, the Company entered into a Letter of Intent with Nelan Advisors Corporation ("Nelan") pursuant to which Nelan has the right to farm in to a 50% working interest in the Company's oil and gas interests and related rights to the oil and gas leases in Montana. Pursuant to the Letter of Intent, the Company received an aggregate of US$400,000 as consideration for the farm-in. During the year ended December 31, 2014, the Company recognized a gain on sale of working interest of $84,546.

During the year ended December 31, 2015, the Company decided that it would discontinue exploration on the Muddy Creek Project and, accordingly, recorded an impairment of $345,706.

Woodrow Project – Montana

On November 30, 2011 and amended in August 2012, the Company entered into a purchase and sale agreement with Bakken Oil Holdings, LLC ("Bakken") to acquire certain oil and gas properties in Teton and Pondera Counties, Montana. As consideration, the Company paid $365,000 and gave Bakken the Company's interest in a property known as the Tulla property.

On August 14, 2013, the Company signed a definitive agreement with West Bakken Holdings Ltd ("WBHL") giving them the right to farm in to the working interest of the Company. The agreement, when completed, includes 50% in the oil and gas interests, and properties and related rights and interests to the oil and gas leases in Teton and Pondera counties, Montana.

6. Exploration and Evaluation Assets (continued)

Pursuant to the agreement, the Company received a total of US$550,000 as consideration from WBHL for the farm-in. During the year ended December 31, 2014, the Company recognized a loss on sale of working interest of $87,897.

On October 2, 2015, the Company sold its remaining 50% interest to Black Stallion Oil and Gas, Inc. ("Black Stallion") in exchange for $65,062 (US$50,000) cash and 500,000 common shares of Black Stallion, 250,000 common shares payable upon closing and 250,000 common shares upon Black Stallion spudding a well on the property. As at December 31, 2016, a total of 250,000 common shares of Black Stallion have been received. No new wells have been drilled on the property (Note 4).

Carrera Prospect – Texas
On August 1, 2013, Bazmo Exploration Inc., ("Bazmo") and the Company entered into an exploration agreement (the "Exploration Agreement"). Pursuant to the terms of the Exploration Agreement, Bazmo agreed to identify and secure leases which would subsequently be assigned to the Company and pursuant to the terms of such agreement, the Company agreed to pay 100% of the lease acquisition costs and operating costs of all wells drilled. In exchange for Bazmo's performance under the Exploration Agreement, Bazmo obtained a 10% carried interest in all target wells, until payout in each of the wells. Upon payout, Bazmo's carried interest will convert to a 50% working interest in all target wells. As a result, the Company had mineral interests of up to 80% within certain parts of the Carrera Prospect area.

During the year ended December 31, 2015, the Company reviewed the carrying value of the Carerra Prospect for impairment indicators. It was determined that the carrying value of the Carrera Prospect exceeded its recoverable amount and the Company recorded an impairment of $480,795. The recoverable amount of the Carrera Prospect was based on the fair value less costs of disposal as "value in use" was not determinable for a project that is not currently generating any cash flows. The fair value was determined in conjunction with a proposed offer of US$885,000 for all of the Hartburg assets, inclusive of the Carrera Prospect, that was received in 2015. The fair value of the asset was therefore determined to be $87,545.

Effective September 30, 2016, the Company terminated the Exploration Agreement with Bazmo in exchange for a cash payment of US$15,000 and the assignment of a 15% working interest in certain currently held leases in the Carrera Prospect.

As at December 31, 2016, the Company decided to discontinue exploration on the Carrera Prospect, and as a result recorded an impairment of $91,742.

Pettit Project - Louisiana
On July 29, 2016, the Company entered into a definitive agreement ("Pettit Agreement") for the right to acquire up to a 75% working interest in 6,200 acres in the state of Louisiana. The terms of the Pettit Agreement require the Company to undertake an initial six well development drilling program with a maximum commitment of US$3,000,000.

The Company paid a US$240,000 acreage fee to the vendor for the initial six wells. The Company will pay an acreage fee of US$40,000 for each additional well drilled after the initial six well program and will implement a bonus program payable in common shares of the Company, subject to TSX-V approval, for each barrel of oil reserves incrementally added to the proved, developed producing category.

As at December 31, 2016, the Company decided to discontinue exploration on the Pettit Project, and as a result recorded an impairment of $319,213.

(Expressed in Canadian dollars)

7. Accounts Payable and Accrued Liabilities

	2016	2015
	($)	($)
Trade payables	3,196,190	2,296,961
Related party payables	386,428	123,504
Accrued liabilities	2,180,568	2,246,790
	5,763,186	4,667,255

Included in accrued liabilities at December 31, 2016 is a provision for repair of a drilling rig and offshore platform totaling $1,683,388 (December 31, 2015 - $1,732,938). The provision has been accrued for costs and expenses related to the operation of a certain property in the Gulf of Mexico for which the operator has billed but are disputed by the Company as the expenditures were incurred without the consent of the working interest partners.

8. Secured Loans

ASI Loan

On July 19, 2013, the Company closed its initial draw of $1,000,000 (the "Initial Draw") pursuant to a senior secured loan facility of up to $2,000,000 arranged with Ascendant Securities Inc.("ASI") on behalf of a group of clients of ASI (the "Lenders"). An additional $1,000,000 may be drawn at the option of the Company subject to the terms and conditions of a trust indenture between the Company and ASI. In connection with the Initial Draw, the Company has issued senior secured debentures of the Company (the "Debentures") in an aggregate principal amount of $1,000,000. The Debentures have a two year term and bear interest at a rate of 15% per annum, compounded monthly. The principal amount of the Debentures matured on July 18, 2015 without being fully repaid, but with the lender verbally agreeing to extend the loan under the existing repayment terms.

As part of the consideration for the Loan Facility, the Lenders received an aggregate 8% overriding royalty interest in the Company's proceeds from all oil, gas and other hydrocarbons produced from any new wells developed on the Company's Hartburg Properties using any portion of the proceeds from the Initial Draw. The Company has paid ASI a cash agent's fee of $60,000, the first two installments of an annual monitoring fee of $25,000 and a 2% overriding royalty interest on the Company's proceeds from all oil, gas and other hydrocarbons produced from any well, for acting as collateral agent.

The Company also issued an aggregate of 1,200,000 Agent Warrants. The Agent Warrants entitled the holder thereof to purchase up to 1,200,000 common shares of the Company at a price of $0.10 per share until July 18, 2015. The Agents Warrants all expired without being exercised.

On September 9, 2014, the Company amended the senior secured loan terms such that if the principal payments were not paid, then the Company would pay $4,000 plus 15% interest on the outstanding principal, and the overriding royalty interest will be increased to 10% of the net revenue interest received by the Company on its Brown #1 and Donner #4 wells. Furthermore, the Parties have agreed that as a minimum monthly principal payment the revenue received from all producing wells in Newton County, less any joint interest billings and any other costs associated with the operation of these wells each month, will be paid to the Lenders until the Company has paid all past outstanding principal payments. Commencing on January 1, 2016, the Company amended the senior secured loan terms such that the $4,000 interest payment was eliminated and the stated interest rate was increased to 20%.

8. Secured Loans (continued)

During the year ended December 31, 2016, the Company incurred $80,210 (2015 - $170,091) and $13,954 (2015 - $35,912) in interest expense and overriding royalty payments, respectively. At December 31, 2016, a total of $259,500 (December 31, 2015 - $409,500) in loan principal remained outstanding.

Bridge Loan

On August 10, 2016, the Company borrowed $300,000 under a secured loan agreement (the "Bridge Loan") bearing interest at 1% per month, compounded monthly, and maturing on August 9, 2017. The Bridge Loan is secured by the Company's interest in the Pettit Project leases. The Company also issued 1,500,000 common shares with a value of $75,000 as payment of arrangement fees and syndication fees incurred in connection with the Bridge Loan. The cash received under the Bridge Loan has been allocated between the fair value of the loan liability and the value of the 1,500,000 common shares. The value ascribed to the common shares as at the loan date was $75,000, and the residual amount has been allocated to the loan liability.

During the year ended December 31, 2016, the Company incurred $41,881 (2015 - $Nil) in interest expense, including $27,056 (2015 - $Nil) in accretion of the loan liability. At December 31, 2016, a total of $314,825 (2015 - $Nil) in loan principal and accrued interest remained outstanding.

9. Unsecured Loans

On July 29, 2016, the Company received a cash subscription of $65,000 for a proposed equity financing. As at December 31, 2016, the financing had not closed so the subscription receipt was treated as an unsecured, interest free loan that was repayable upon demand. The equity financing subsequently closed in January 2017, and the subscription receipt liability was recognized as paid in full.

On November 17, 2015, the Company obtained an unsecured loan of $50,000. The loan carried an interest rate of 10% per annum and was payable on maturity. The Company agreed to a monthly payment of $3,000 commencing on December 8, 2015 and increasing to $5,500 after six months until the loan matured on December 8, 2016. As at December 31, 2016, the loan had been repaid in full.

On December 10, 2015, the Company obtained access to an unsecured line of credit bearing interest at an annual rate calculated semi-annually which is equal to the lending rate of the Canadian Imperial Bank of Commerce ("CIBC"). The credit line has a term of 30 months, and it is a non-revolving facility of up to $400,000 that requires monthly repayments equal to the lesser of i) $15,000 and ii) the aggregate principal and interest outstanding. In addition, the Company issued 1,000,000 common shares as consideration to the lender. The Company borrowed $390,000 under the credit line, and the cash received has been allocated between the fair value of the loan liability and the fair value of the 1,000,000 common shares. The fair value of the common shares as at the loan date was $30,000, and the residual amount has been allocated to the loan liability.

During the year ended December 31, 2016, the Company borrowed an additional $70,000 and incurred $26,612 (2015 - $4,675) in interest expense, including $11,767 (2015 - $664) in accretion of the loan liability. At December 31, 2016, a total of $282,330 (2015 - $439,759) in loan principal and accrued interest remained outstanding.

(Expressed in Canadian dollars)

10. Related Party Transactions

The following summarizes the Company's related party transactions during the years ended December 31, 2016 and 2015:

Key management compensation

	2016 ($)	2015 ($)
Consulting fees paid or accrued to the Executive Chairman of the Company	244,181	193,794
Consulting fees paid or accrued to the Chief Executive Officer ("CEO") of the Company	240,610	306,447
Consulting fees paid or accrued to a corporation controlled by the Chief Financial Officer ("CFO") of the Company	103,854	98,075
Professional and consulting fees paid to two corporations controlled by the former CFO of the Company	-	17,500
Salary and consulting fees paid to the Chief Operating Officer ("COO") of the Company	258,662	310,187
Share-based payments paid to certain directors and officers of the Company in connection with the extension of the expiry date of share purchase warrants	24,856	-
	872,163	926,003

a) As at December 31, 2016, a total of $158,767 (2015 - $66,302) was included in accounts payable and accrued liabilities owing to the CEO of the Company for consulting fees and reimbursable expenses.

b) As at December 31, 2016, a total of $135,209 (2015 - $50,602) was included in accounts payable and accrued liabilities owing to the Executive Chairman of the Company for consulting fees and reimbursable expenses.

c) As at December 31, 2016, a total of $25,117 (2015 - $6,600) was included in accounts payable and accrued liabilities owing to a corporation controlled the CFO of the Company for consulting fees.

d) As at December 31, 2016, a total of $67,335 (2015 - $Nil) was included in accounts payable and accrued liabilities owing to the COO of the Company for wages.

(Expressed in Canadian dollars)

11. Decommissioning Liability

The decommissioning liability relates to the expected present value of costs of plugging and abandoning the oil and gas held by Hillcrest. The provision for decommissioning is estimated after taking account of inflation, years to abandonment and an appropriate discount rate. As at December 31, 2016, the oil and gas properties had estimated abandonment dates between 2017 and 2034.

Actual decommissioning costs will ultimately depend upon future market prices for the decommissioning work required, which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain.

The movement in the provision for the decommissioning liability was as follows:

	Hartburg Project, Texas	Gulf of Mexico Properties	Total
	($)	($)	($)
Balance, January 1, 2015	104,266	14,212,362	14,316,628
Accretion	10,916	469,334	480,250
Change in estimate	41,202	(4,102,115)	(4,060,913)
Expenditures during the year	-	(85,247)	(85,247)
Foreign exchange movement	-	2,989,154	2,989,154
Balance, December 31, 2015	156,384	13,483,488	13,639,872
Accretion	2,346	160,730	163,076
Change in estimate	(90,612)	331,575	240,963
Disposal	-	(8,854,449)	(8,854,449)
Expenditures during the year	-	(1,968,586)	(1,968,586)
Foreign exchange movement	-	(453,833)	(453,833)
Balance, December 31, 2016	68,118	2,698,925	2,767,043
Current portion	27,019	-	27,019
Non-current portion	41,099	2,698,925	2,740,024
	68,118	2,698,925	2,767,043

The total undiscounted amount of estimated cash flows required to settle the provision for decommissioning liability for the Hartburg Project and the Gulf of Mexico Properties is $75,694 (2015 - $159,708) and $2,806,630 (2015 - $14,260,558), respectively, as at December 31, 2016. The provision has been estimated using a risk-free discount rate of 1.93% (2015 -1.50%) and an inflation rate of 2.00% (2015 – 1.00%).

As a result of certain oil properties having been disposed of or written down to a $Nil carrying value, the Company recorded $321,168 (2015 - $Nil) as a change in estimate of decommissioning liability in the consolidated statement of loss for the year ended December 31, 2016.

In addition, the Company had $2,048,604 (US$1,521,192) in escrow as security for reclamation bonds held with CHUBB Limited as at December 31, 2016. These funds will be released to the Company upon completion of decommissioning activities on certain properties held by the Company.

(Expressed in Canadian dollars)

12. Share Capital

Authorized

Unlimited number of common shares without par value

Issued and outstanding

Year Ended December 31, 2016

a) The Company issued 1,000,000 common shares with a fair value of $30,000 to a lender as partial consideration for an unsecured loan.

b) The Company issued 1,200,000 common shares with a fair value of $60,000 to a lender as partial consideration for a secured loan. Furthermore, the Company issued 300,000 common shares with a fair value of $15,000 as a syndication fee in connection with the secured loan.

c) The Company completed the first tranche of a non-brokered private placement wherein it issued 7,300,000 units at $0.05 per unit for gross proceeds of $365,000. Each unit is comprised of a common share and one half of a common share purchase warrant. Each whole warrant entitles the holder to acquire an additional common share at $0.08 until December 8, 2018. No finder's fees were paid in connection with this placement.

Year Ended December 31, 2015

The Company did not issue any common shares.

Share Purchase Warrants

Year Ended December 31, 2016

a) The Company extended the expiry date of 5,312,500 share purchase warrants to December 30, 2017. Accordingly, the Company recorded $76,000 as a share-based payment.

b) The Company issued 3,650,000 share purchase warrants in connection with a non-brokered private placement. Each warrant entitles the holder to acquire a common share of the Company at $0.08 until December 8, 2018.

Year Ended December 31, 2015

The Company extended the expiry date of 853,111 share purchase warrants to February 28, 2016. These warrants expired during the year ended December 31, 2016.

The continuity of the Company's share purchase warrants is as follows:

	Number of Warrants	Weighted Average Exercise Price
		($)
Balance, December 31, 2014 and 2015	6,165,611	0.09
Expired	(853,111)	0.12
Issued	3,650,000	0.08
Balance, December 31, 2016	8,962,500	0.08

(Expressed in Canadian dollars)

12. Share Capital (continued)

The following table summarizes the share purchase warrants outstanding as at December 31, 2016:

Number of Warrants	Weighted Average Exercise Price	Expiry Date	Weighted Average Remaining Contractual Life
	($)		(yrs)
3,650,000	0.08	December 8, 2018	1.94
5,312,500	0.08	December 30, 2017	1.00
8,962,500	0.08		1.38

Agent's Warrants

The Company did not issue any Agent's warrants during the years ended December 31, 2016 or 2015. A total of 1,360,000 Agent's warrants exercisable at $0.10 per share expired during the year ended December 31, 2015.

Stock Options

Effective November 4, 2010, the Company adopted a stock option plan to grant stock options to its directors, officers, employees and consultants. In accordance with the policies of the TSX Venture Exchange (the "Exchange"), the aggregate number of securities reserved for issuance under the plan, at any point in time, will be 10% of the number of common shares of the Company issued and outstanding at the time the option is granted (on a diluted basis), less any common share reserved for issuance under share options granted under share compensation arrangements other than the plan. The exercise price of option grants will be determined by the Board of Directors, but will not be less than the closing market price of the common shares on the Exchange at the time of grant. All options granted under the plan will expire no later than five years from the date of grant.

The continuity of the Company's stock options is as follows:

	Number of Stock Options	Weighted Average Exercise Price
		($)
Balance, December 31, 2014 and 2015	2,700,000	0.11
Expired	(800,000)	0.23
Balance, December 31, 2016	1,900,000	0.06

The following table summarizes the stock options outstanding and exercisable as at December 31, 2016:

Number of Options Outstanding	Number of Options Exercisable	Weighted Average Exercise Price	Expiry Date	Weighted Average Remaining Contractual Life
		($)		(yrs)
1,400,000	1,400,000	0.06	September 9, 2018	1.69
500,000	500,000	0.06	November 26, 2018	1.90
1,900,000	1,900,000	0.06		1.75

13. Commitments

a) The Company entered into an office rental agreement in Vancouver, British Columbia on October 8, 2015, with a term of 24 months, terminating on November 30, 2017. The remaining base rent payable under the lease is $16,729 up until the lease expires. In addition to the base rent, the Company's share of operating costs is estimated at approximately $1,217 per month.

b) On February 12, 2015, HGOM entered into an Installment Agreement with the United States Department of the Interior and through the Office of Natural Resources Revenue ("ONRR") in connection with civil penalties that had been levied against HGOM. HGOM agreed to pay the balance of the civil penalties of US$313,176 in 60 monthly installments of US$5,220 beginning on March 12, 2015. A total of $260,017 remains unpaid at December 31, 2016 (2015 – $361,741) and is included within accounts payable and accrued liabilities. This debt has been subsequently extinguished through the Chapter 7 liquidation of HGOM (Note 20).

c) On June 3, 2013, HGOM entered into an office rental agreement in Houston, Texas, with a term of 50 months, terminating on July 31, 2017. The remaining base rent payable under the lease is US$53,577. In addition to the above base rent, the Company's share of the operating costs for calendar year 2016 is estimated at US$5,306 per month. This lease was terminated subsequent to year end and HEL entered into a new office rental agreement with a term of 72 months, terminating on February 28, 2023. The remaining base rent payable under the lease is $166,776 up until the lease expires. In addition to the base rent, the Company's share of operating costs is estimated at approximately $1,547 per month.

14. Capital Management

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of oil and gas properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The Company is primarily dependent on external financing to fund its activities. In order to carry out the planned exploration and development and pay for administrative costs, the Company will spend its existing working capital and raise additional funds as needed using best efforts. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient economic potential and if it has adequate available or committed financial resources to complete such acquisitions.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the year ended December 31, 2016. The Company is not subject to externally imposed capital requirements.

15. Geographical Segmented Information

The Company is engaged in one business activity, being the acquisition, exploration, development and production of oil and gas reserves.

16. Financial Instruments and Risk Management

Financial Risk Management
The Company's financial instruments that are measured at fair value on a recurring basis in periods subsequent to initial recognition and the fair value hierarchy used to measure them are presented in the table below. The Company classifies its other financial assets and other financial liabilities measured at fair value using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

The fair value hierarchy has the following levels:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3: Inputs for the asset or liability that is not based on observable market data (unobservable inputs).

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's financial instruments consist of cash, restricted cash, accounts receivable, short-term investments, accounts payable, secured loans, and unsecured loans.

The Company has classified its cash, accounts receivable, other receivables and restricted cash as loans and receivables; short-term investments as available-for sale; and accounts payable, secured loan and unsecured loans as other financial liabilities. The fair value of cash, accounts receivable and accounts payable approximate their book values because of the short-term nature of these instruments. The fair value of the short-term investments is based on quoted market prices for publicly traded shares. The carrying amounts of the secured and unsecured loans approximate fair value as the applicable interest rates, which were negotiated between the Company and arm's length third parties, are similar to market interest rates which would be available to the Company at the balance sheet date.

Financial Instrument Risk Exposure
The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board approves and monitors the risk management processes.

Credit risk
The Company's credit risk is primarily attributable to cash and accounts receivable. The Company's maximum exposure to credit risk at the end of the reporting period is the carrying value of these assets. Substantially all of the Company's customers are in the oil and natural gas industry and are subject to normal industry credit risks. The Company has minimal collection risk related to these receivables and expects to collect the outstanding receivables in the normal course of operations. At December 31, 2016, the maximum credit exposure is the carrying amount of the accounts receivable of $29,402 (2015 - $305,095). Furthermore, there were no receivables overdue, and thus no allowance for doubtful debt recorded.

The Company has no significant concentration of credit risk arising from operations. Cash is held with reputable financial institutions, from which management believes the risk of loss to be remote.

Market risk
Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

Interest rate risk
The Company is exposed to interest rate risk. The Company's bank account earns interest income at variable rates, and the Company has an unsecured loan associated with a CIBC line of credit which has a variable interest rate, recalculated semi-annually. Interest rate risk, however, is minimal as the Company does not have significant variable interest bearing assets or liabilities that are tied into market rates.

16. Financial Instruments and Risk Management (continued)

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquid capital to meet its current liabilities as they come due. At December 31, 2016, the Company had a working capital deficiency of $6,279,346 (2015 - $6,602,537), refer to note 1 for further discussion.

As at December 31, 2016 and 2015, the Company's financial liabilities had contractual maturities as follows:

	2016	2015
	($)	($)
Less than 1 year	6,358,902	5,002,173
Between 1 – 2 years	169,113	266,834
Between 2 – 5 years	91,314	220,248
	6,619,328	5,489,255

Foreign currency risk

Foreign currency exchange rate risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in foreign exchange rates. The Company operates in Canada and the United States. All of the Company's oil and natural gas sales are denominated in United States dollars.

The Company was exposed to the following foreign currency risk as at December 31, 2016 and 2015:

	2016	2015
	(US$)	(US$)
Cash	102,180	249,259
Accounts receivable	49,187	188,269
Restricted cash	1,521,192	1,771,568
Accounts payable and accrued liabilities	(4,136,877)	(3,254,122)
	(2,464,318)	(1,045,026)

The following foreign exchange rates applied for the years ended December 31, 2016 and 2015:

	2016	2015
Average USD to CAD	1.3251	1.2783
As at	1.3467	1.3864

(Expressed in Canadian dollars)

17. Supplemental Cash Flow Information,

	2016	2015
	($)	($)
Non-cash investing and financing activities:		
Common shares issued as a bonus in connection with an unsecured loan	30,000	-
Common shares issued as a bonus and a syndication fee in connection with a secured loan	75,000	-
Warrants extended for one year	76,000	-
Increase (reduction) in oil and gas interest through change in estimate of decommissioning liabilities	(140,950)	(4,060,914)
Interest paid during the year	106,283	179,013
Income taxes paid during the year	-	-

18. Expenses By Nature

Office and general expenses for the years ended December 31, 2016 and 2015 are comprised of the following:

	2016	2015
	($)	($)
Administration	145,539	189,376
Bad debt allowance	114,811	-
Investor relations and business development	106,093	196,788
Professional fees	209,908	281,741
Rent	251,897	244,631
Transfer and filing fees	32,585	45,425
Travel	57,590	85,966
Wages and benefits	766,008	960,422
	1,684,431	2,004,349

Financing expenses for the years ended December 31, 2016 and 2015 are comprised of the following:

	2016	2015
	($)	($)
Accretion	163,075	480,914
Bank charges and interest	13,138	12,424
Debt issue costs	-	78,375
Interest expense on secured loan	122,091	170,091
Interest expense on unsecured loans	26,612	4,010
Over-riding royalty interest	13,954	35,912
	338,870	781,726

(Expressed in Canadian dollars)

19. Income Taxes

a) Provision for Income Taxes

A reconciliation of the combined income taxes at statutory rates and the Company's effective income tax expense is as follows:

	2016	2015
	($)	($)
Income (Loss) for the year	(3,561,995)	(14,702,523)
Expected income tax expense (recovery) at 26%	(926,000)	(3,822,656)
Non-deductible items	20,000	216,652
Difference due to overseas tax rates and foreign exchange	(81,000)	(966,747)
Change in unrecognized deductible temporary differences	987,000	4,572,751
Income tax expense	-	-

b) Deferred Income Taxes

The Company's unrecognized deductible temporary differences and unused tax losses for which no deferred tax asset is recognized consists of the following amounts:

	2016	2015
	($)	($)
Non-capital losses carry-forward	20,393,000	21,707,000
Property and equipment	796,000	1,935,000
Share issuance costs	29,000	46,000
Other	86,000	-
	21,304,000	23,711,000

Tax attributes are subject to review, and potential adjustment, by tax authorities.

(Expressed in Canadian dollars)

20. Subsequent Events

Subsequent to December 31, 2016, the Company:

a) granted an aggregate of 4,500,000 incentive stock options to certain directors, officers, employees and consultants for the purchase of common shares exercisable at a price of $0.07 per share until Feb. 21, 2022.

b) signed a letter agreement with a Canadian oil and gas company, whereby it will become the operator of record in two petroleum assets located in Western Canada. The Company will earn up to a 75% working interest in exchange for posting the requisite $1,300,000 Operator and Licence Liability Rating (LLR) Bonds, providing technical expertise and funding the restoration of existing shut-in wells.

c) completed the second and final tranche of a non-brokered private placement wherein it issued 8,900,000 units at a price of $0.05 per unit. Each unit consisted of one common share in the capital of the Company plus one half of one common share purchase warrant. Each whole warrant of this second tranche offering will entitle the holder to purchase one additional share at a price of $0.08 until January 18, 2019. The Company paid cash commissions of $5,200 in connection with the closing of the second tranche.

d) sold 100% of its interest in the Donner 1 well to non-related party in exchange for a cash payment of US$232,742.

e) placed its wholly-owned subsidiary HGOM into a Chapter 7 liquidation in the U.S. Court for the Southern District of Texas. Consequently, the Company has lost control over all of the assets and liabilities of HGOM.

A summary of the assets and liabilities of HGOM as at December 31, 2016 and 2015 is as follows:

	2016	**2015**
	($)	**($)**
Cash	136,627	191,710
Restricted cash	2,048,604	2,456,013
Accounts receivable	-	238,577
Prepaid expenses	-	198,039
Oil and gas properties	-	9,499,340
Equipment	3,493	7,608
Total Assets	2,188,724	12,591,287
Accounts payable and accrued liabilities	5,167,444	4,400,685
Asset retirement obligation	2,698,925	13,483,489
Total Liabilities	7,866,369	17,884,174
Net Assets (Liabilities)	(5,677,645)	(5,292,887)

(Expressed in Canadian dollars)

20. Subsequent Events (continued)

The net loss of HGOM for the years ended December 31, 2016 and 2015 is as follows:

	2016	**2015**
	($)	**($)**
Revenue, net of royalties	1,056,444	3,057,238
Expenses		
Operating costs	1,829,379	2,680,324
Consulting fees	10,183	81,979
Depletion and depreciation	466,362	1,914,375
Office and general	1,106,001	1,423,107
	(3,411,925)	(6,099,785)
Other Items		
Financing expenses	(169,497)	(477,374)
Change in estimate of decommissioning liability	(331,575)	-
Gain on disposal of oil and gas properties	961,134	-
Impairment of oil and gas properties	-	(7,469,130)
Proceeds from insurance settlement	832,018	-
	1,292,080	(7,946,504)
Net loss	(1,063,401)	(10,989,051)

The cash flows of HGOM for the years ended December 31, 2016 and 2015 are as follows:

	2016	**2015**
	($)	**($)**
Cash flows provided by operations	511,137	313,262
Cash flows used in investing activities	(565,437)	(686,451)
Change in cash	(54,300)	(373,189)
Cash, beginning of the year	183,013	556,202
Cash, end of the year	128,713	183,013