



Annual Consolidated Financial  
Statements for the years ended  
December 31, 2017 and 2016



April 26, 2018

## **Independent Auditor's Report**

### **To the Shareholders of PetroFrontier Corp.**

We have audited the accompanying consolidated financial statements of PetroFrontier Corp. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016 and the consolidated statements of loss and comprehensive loss, consolidated statement of changes in equity and consolidated statement 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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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of PetroFrontier Corp. and its subsidiaries as at December 31, 2017 and December 31, 2016 and their financial performance and their 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 2 in the consolidated financial statements, which describes the matters, and conditions that indicate the existence of a material uncertainty that may cast significant doubt on PetroFrontier Corporation and its subsidiaries' ability to continue as a going concern.

*PricewaterhouseCoopers LLP*

**Chartered Professional Accountants**

## MANAGEMENT'S REPORT

To the Shareholders of PetroFrontier Corp.:

Management is responsible for the preparation of the accompanying consolidated financial statements. Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial information.

PetroFrontier's external auditors, PricewaterhouseCoopers LLP, Chartered Professional Accountants, who are appointed by the shareholders, have audited the consolidated financial statements. The Audit Committee has reviewed the consolidated financial statements with management and the auditors and has recommended their approval to the Board of Directors. The Board of Directors has subsequently approved the consolidated financial statements.

"signed"

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Robert Iverach  
Chief Executive Officer

"signed"

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Robert Gillies, CPA, CA  
Vice President Finance and Chief Financial

Calgary, Canada  
April 26, 2018



# ***PetroFrontier Corp.***

## **CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

(Canadian Dollars)

<i>As at</i>	<b>December 31, 2017</b>	<b>December 31, 2016</b>
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 221,461	\$ 3,226,614
Trade and other receivables	748,163	851,970
Prepaid expenses and deposits	140,816	90,142
	1,110,440	4,168,726
<b>Property and equipment (note 6)</b>	20,582,194	18,526,706
	<b>\$ 21,692,634</b>	<b>\$ 22,695,432</b>
<b>LIABILITIES</b>		
<b>Current</b>		
Trade and other payables	\$ 1,924,506	\$ 1,126,187
Purchase price consideration payable (note 5)	-	616,181
Decommissioning liabilities (note 8)	-	294,675
Debenture (note 7)	3,000,000	-
	4,924,506	2,037,043
<b>Debenture (note 7)</b>	-	2,663,207
<b>Decommissioning liabilities (note 8)</b>	3,549,422	3,168,823
	8,473,928	7,869,073
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 9)	131,202,046	131,202,046
Contributed surplus (Note 9)	11,870,862	11,717,009
Accumulated other comprehensive loss	(5,269,883)	(5,269,883)
Deficit	(124,584,319)	(122,822,813)
	13,218,706	14,826,359
	<b>\$ 21,692,634</b>	<b>\$ 22,695,432</b>

See accompanying notes to the consolidated financial statements

Corporate information and going concern (note 2)

Commitments and contingencies (Note 13)

Subsequent events (Note 17)

Approved on behalf of the Board

“signed”

Robert Iverach  
Director

“signed”

Michael Hibberd  
Director

# ***PetroFrontier Corp.***

## **CONSOLIDATED STATEMENT OF LOSS AND COMPREHENSIVE LOSS**

*(Canadian Dollars)*

	<b>Years ended December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>PETROLEUM SALES</b>		
	\$ 5,368,064	\$ 1,261,385
<b>Less: royalties</b>	(431,649)	(111,209)
<b>Net revenue</b>	<b>4,936,415</b>	<b>1,150,176</b>
<b>EXPENSES</b>		
Production operating costs	3,254,505	1,116,575
General and administrative (note 15)	1,716,164	2,228,684
Depletion and depreciation (note 6)	912,991	220,574
Accretion (note 8)	239,953	120,781
Share-based compensation (note 9)	153,853	278,120
	<b>6,277,466</b>	<b>3,964,734</b>
Finance income	(6,338)	(45,760)
Finance expense (note 15)	426,793	93,399
	<b>420,455</b>	<b>47,639</b>
Gain on acquisition of petroleum and natural gas properties (note 5)	-	<b>2,154,428</b>
<b>NET LOSS</b>	<b>(1,761,506)</b>	<b>(707,769)</b>
<b>OTHER COMPREHENSIVE LOSS</b>		
<i>Items that may be reclassified subsequently to net loss:</i>		
Foreign exchange loss on foreign operations	-	(1,916)
<b>COMPREHENSIVE LOSS</b>	<b>\$ (1,761,506)</b>	<b>\$ (709,685)</b>
<b>Net loss per share</b>		
<b>Basic and diluted (note 9)</b>	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>

See accompanying notes to the consolidated financial statements

***PetroFrontier Corp.***

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

(Canadian Dollars)

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total Equity
<b>Balance at January 1, 2017</b>	<b>\$ 131,202,046</b>	<b>11,717,009</b>	<b>(5,269,883)</b>	<b>(122,822,813)</b>	<b>\$ 14,826,359</b>
Net loss	-	-	-	(1,761,506)	(1,761,506)
Share-based compensation	-	153,853	-	-	153,853
<b>Balance at December 31, 2017</b>	<b>\$ 131,202,046</b>	<b>11,870,862</b>	<b>(5,269,883)</b>	<b>(124,584,319)</b>	<b>\$ 13,218,706</b>
<b>Balance at January 1, 2016</b>	<b>\$ 125,952,046</b>	<b>11,048,889</b>	<b>(5,267,967)</b>	<b>(122,115,044)</b>	<b>\$ 9,617,924</b>
Net loss	-	-	-	(707,769)	(707,769)
Foreign exchange gain on translation of foreign operations	-	-	(1,916)	-	(1,916)
Issuance of share capital	5,250,000	-	-	-	5,250,000
Equity component of debenture	-	390,000	-	-	390,000
Share-based compensation	-	278,120	-	-	278,120
<b>Balance at December 31, 2016</b>	<b>\$ 131,202,046</b>	<b>11,717,009</b>	<b>(5,269,883)</b>	<b>(122,822,813)</b>	<b>\$ 14,826,359</b>

See accompanying notes to the consolidated financial statements



# ***PetroFrontier Corp.***

## **CONSOLIDATED STATEMENT OF CASH FLOWS**

(Canadian dollars)

	<b>For the year ended December 31</b>	
	<b>2017</b>	<b>2016</b>
<b>Cash provided by (used in)</b>		
<b>OPERATING</b>		
Net loss	\$ (1,761,506)	\$ (707,769)
Items not affecting cash:		
Depletion and depreciation	912,991	220,574
Accretion	239,953	120,781
Share-based compensation (Note 9)	153,853	278,120
Convertible debt accretion (Note 7)	336,793	53,207
Payment of decommissioning liabilities (Note 8)	-	(65,690)
Gain on acquisition of resource properties (Note 5)	-	(2,154,428)
Change in non-cash working capital (Note 10)	723,102	(237,938)
<b>Cash flow provided by (used in) operating activities</b>	<b>605,186</b>	<b>(2,493,143)</b>
<b>INVESTING</b>		
Expenditures on property and equipment	(2,994,158)	(373,334)
Payment of purchase price consideration	(616,181)	
Acquisition of resource properties (Note 5)	-	(3,500,000)
<b>Cash flow used in investing activities</b>	<b>(3,610,339)</b>	<b>(3,873,334)</b>
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	-	(1,915)
Decrease in cash and cash equivalents	(3,005,153)	(6,368,392)
Cash and cash equivalents and term deposits, beginning of year	3,226,614	9,595,006
<b>Cash and cash equivalents, end of year</b>	<b>\$ 221,461</b>	<b>\$ 3,226,614</b>
<b>Interest paid in the year</b>	<b>\$ 22,500</b>	<b>\$ 40,192</b>

*See accompanying notes to the consolidated financial statements*

# ***PetroFrontier Corp.***

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **1. REPORTING ENTITY**

PetroFrontier Corp. (the "Corporation") was incorporated in Alberta, Canada on February 6, 2009 under the name Australia Energy Corp. The Corporation's registered office is 900, 903 – 8<sup>th</sup> Ave. S.W. Calgary, Alberta, Canada T2P 0P7. The Corporation is engaged in exploring for and the production of petroleum and natural gas in western Canada (note 5). The Corporation had previously been engaged in the business of petroleum exploration in the Northern Territory, Australia, through its two wholly-owned subsidiaries, PetroFrontier (Australia) Pty Ltd ("PetroFrontier Australia") and Texalta (Australia) Pty Ltd ("Texalta Australia").

The consolidated financial statements of the Corporation as at and for the year ended December 31, 2017 comprises the Corporation, PetroFrontier Australia and Texalta Australia and unless otherwise indicated the term "Corporation" refers to both the Corporation and its wholly-owned subsidiaries.

### **2. CORPORATE INFORMATION AND GOING CONCERN**

The Corporation had been an oil and gas exploration corporation engaged in the acquisition, exploration, and development of both conventional and unconventional petroleum assets in Australia's Southern Georgina Basin. On July 21, 2016, the Corporation acquired certain resource assets in the Cold Lake area of northeastern Alberta from Kasten Energy Inc. ("Kasten"). The acquisition is further described in note 5.

The Corporation is no longer actively involved in Australia due to the lack of exploratory potential of its exploration and evaluation assets. As such the carrying value of its exploration and evaluation assets in Australia were written off in 2014.

#### **Discussion of current activity**

These financial statements have been prepared using International Financial Reporting Standards ("IFRS") as they apply to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they become due. The Corporation continues to incur losses from operations as evidenced by the 2017 net loss of \$1,761,506, was unable to pay debenture interest payments of \$67,500 as described in note 7 and has a working capital deficiency of \$3,814,066 (2016 - working capital surplus of \$2,131,683). These circumstances cause material uncertainties that may cast significant doubt upon the Corporation's ability to continue as a going concern, and accordingly, the appropriateness of the use of accounting principles applicable to a going concern.

In recognition of these conditions, the Corporation has negotiated a credit facility not exceeding \$1,500,000 which is further described in note 17, Subsequent Event, and have taken steps to reduce operational costs and will seek the continued support of the debenture holder.

These undertakings, while significant, may not be sufficient in and of themselves to enable the Corporation to fund all aspects of future operations, and accordingly, management will need to pursue other financing alternatives to fund the Corporation so that it may continue as a going concern. The necessary financing may require the issuance of equity and/or debt instruments. There is no assurance that such initiatives may be successful.

## **NOTES** *(continued)*

There can be no assurance that the Corporation will become profitable or be able repay the trade and other payables, and the debenture. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported amounts of revenues and expenses and the classification of the statement of financial position items if the going concern assumption is inappropriate and these adjustments could be material.

### **3. BASIS OF PRESENTATION**

#### **A) Statement of compliance**

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of December 31, 2017. On April 26, 2018, the Board of Directors approved the consolidated financial statements.

#### **B) Basis of measurement**

The consolidated financial statements have been prepared on the historical cost basis except as disclosed in note 4 to the consolidated financial statements.

#### **C) Functional and presentation currency**

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

#### **D) Use of estimates and judgments**

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. 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.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following notes:

#### **Reserve estimates**

Petroleum and natural gas assets are depleted on a unit-of-production basis at a rate calculated by reference to proved and probable reserves determined in accordance with National Instrument 51-101, Standards of disclosure for Oil and Gas Activities ("NI 51-101") and incorporating the estimated future cost of developing and extracting those reserves. Proved and probable reserves are estimated using independent reservoir engineering reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty

## NOTES (continued)

to be recoverable in future years from known reservoirs and which are considered commercially producible. Reserves estimates, although not reported as part of the Corporation's financial statements, can have a significant effect on net income (loss), assets and liabilities as a result of their impact on depreciation and depletion, decommissioning liabilities, deferred taxes and asset impairments. Independent reservoir engineers perform evaluations of the Corporation's oil and gas reserves on an annual basis. The estimation of reserves is an inherently complex process requiring significant judgment. Estimates of economically recoverable oil and natural gas reserves are based upon a number of variables and assumptions such as geoscientific interpretation, production forecast, commodity prices and costs and related future cash flows, all of which may vary considerably from actual results. These estimates are expected to be revised upward or downward over time, as additional information such as reservoir performance becomes available or as economic conditions change.

### **Impairment indicators and discount rate**

For purposes of impairment testing, petroleum and natural gas assets are grouped into cash generating units ("CGUs"), based on separately identifiable and largely independent cash flows. The determination of the Corporation's CGU is subject to judgment. Factors considered in the classification include the integration between assets, shared infrastructures, the existence of common sales points, geography, geologic structure, and the manner in which management monitors and makes decisions about its operations.

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

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

### **Acquisitions**

The acquired assets, assumed liabilities (other than deferred taxes) are recognized at fair value on the date the Corporation effectively obtains control. The measurement of each business combination is based on the information available on the acquisition date. The determination of fair value of the acquired intangible assets (including goodwill), property and equipment and other assets and the liabilities assumed at the date of acquisition as well as the useful lives of the acquired intangible assets and property and equipment are based on assumptions. The measurement is largely based on projected cash flows, discount rates and market conditions at the date of acquisition. Contingent consideration is based on the likelihood of various outcomes of specified future events.

## NOTES (continued)

### Decommissioning costs

At the end of the operating life of the Corporation's facilities and properties and upon retirement of its oil and natural gas assets, decommissioning costs will be incurred by the Corporation. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities. The liability, the related assets and the expenses are impacted by estimates with respect to the costs and timing of decommissioning.

### Convertible debt

The Corporation issues convertible debt that can be converted into common shares of the Corporation. The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. As such, the Corporation must consider what the fair value of a similar liability that does not have an equity conversion option.

### Measurement of share-based payments

The Corporation issues stock options to certain directors, employees and third parties. In accordance with *IFRS 2 Share-based payments*, in determining the fair value of options granted, the Corporation applies the Black-Scholes model and as a result makes assumptions for the expected volatility, expected life, risk free rate, behavioral considerations and expected dividend yield. The fair value of options granted at December 31, 2016 are shown in note 9.

### Income taxes

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

## 4. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

### A) Basis of consolidation

#### (i) Subsidiaries

Subsidiaries are entities controlled by the Corporation. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Control exists when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently

## **NOTES** *(continued)*

are exercisable are taken into account.

### **(ii) Transactions eliminated on consolidation**

All intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

## **B) Business combinations**

The acquisition method of accounting is used to account for acquisitions of subsidiaries or purchased assets which constitute a business. The cost of an acquisition is measured as the fair value of the assets acquired, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of comprehensive income (loss).

Transaction costs incurred in a business combination, other than those associated with the issuance of debt or equity securities, are expensed as incurred.

## **C) Foreign currency**

### **(i) Foreign currency transactions**

Transactions in foreign currencies are translated to the respective functional currencies of the Corporation's entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognized in other comprehensive loss.

### **(ii) Foreign operations**

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to Canadian dollars at exchange rates at the reporting date. The income and expenses of foreign operations are translated to Canadian dollars at exchange rates at the dates of the transactions.

Foreign currency differences are recognized in other comprehensive income in the cumulative translation account.

## **D) Cash and cash equivalents**

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

## **NOTES** *(continued)*

### **E) Jointly controlled operations and jointly controlled assets**

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

### **F) Property and equipment**

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

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

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

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

The recoverable amount is the greater of the value in use or fair value less costs to sell. Fair value is the amount the asset could be sold for in an arm's length transaction. The value in use is the present value of the estimated future cash flows of the asset from its continued use. The fair value less costs to sell considers the continued development of a property and market transactions in a valuation model. The Corporation 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.

Office equipment is recorded at cost and are depreciated on the straight-line basis over three years.

### **G) Convertible debentures**

Compound financial instruments issued by the Corporation comprise convertible debentures that can be converted into common shares of the Corporation. The liability component of a compound financial

## **NOTES** *(continued)*

instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry, where this is transferred to common shares or contributed surplus.

### **H) Decommissioning liabilities**

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

### **I) Income taxes**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in earnings 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 year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The Corporation uses the balance sheet method for calculating deferred income taxes. Temporary differences arising from the differences between the tax basis of an asset or liability and the carrying amount on the balance sheet are used to calculate deferred income tax assets or liabilities. Deferred income tax assets or liabilities are calculated using the currently enacted, or substantively enacted, tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A deferred income tax asset is recognized if it is probable that future taxable profit will be available which the Corporation can utilize the benefit. The effect of a change in income tax rates on deferred income tax assets and liabilities is recognized in the period that the change occurs. Interpretation of tax regulations and legislations in the jurisdictions in which the Corporation operates are subject to change, as such income taxes are subject to measurement uncertainty.



## **NOTES** *(continued)*

### **J) Revenue recognition**

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

### **K) Per share amounts**

The Corporation presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Corporation by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for own shares held, for the effects of all potentially dilutive common shares, which comprise warrants and share options granted to employees.

### **L) Share-based compensation plan**

The Corporation has a share-based compensation plan enabling officers and directors to purchase common shares at exercise prices equal to the price determined by the directors on the date the option is granted. Stock option awards are accounted for based on the fair value method of accounting. Under this method, share-based compensation is recorded as an expense over the vesting period of the option, with a corresponding increase in contributed surplus. Share-based compensation is based on the estimated fair value of the related stock option at the time of the grant using the Black-Scholes option model. The Black-Scholes option model is based on significant assumptions such as volatility, dividend yield and expected term. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. When stock options are exercised, the consideration paid to the Corporation, along with amounts previously credited to contributed surplus, is credited to share capital.

### **M) Financial instruments**

Financial instruments are comprised of cash, trade and other receivables, trade and other payables and a debenture. Financial assets and liabilities are recognized when the Corporation becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or when the Corporation has transferred all risks and rewards of ownership.

#### **(i) Financial assets**

Financial assets are measured at fair value on initial recognition of the instrument. Financial assets are classified as "available-for-sale-investments", "held-for-trading" or "loans and receivables".

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

Held-for-trading is financial assets and liabilities which are acquired for resale prior to maturity or are designated as such by the Corporation. The Corporation has no assets in this category.

## **NOTES** *(continued)*

Loan and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in the active market. The Corporation's loan and receivables are comprised of cash and trade and other receivables.

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

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

### **(ii) Financial liabilities**

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

### **N) Changes in accounting policies**

The Corporation adopted the accounting policies in 2016 as described in note 4 (G) – Convertible debentures, (H) – Decommissioning liabilities and (J) – Revenue recognition.

The Corporation has adopted the following accounting policy effective January 1, 2017:

#### **Amendments to IAS 7 Statement of Cash Flows**

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

### **O) Future accounting pronouncements**

A number of new accounting standards, amendments to accounting standards and interpretations are effective for annual periods beginning on or after January 1, 2018 and have not been applied in preparing the Consolidated Financial Statements for the year ended December 31, 2017. The standards applicable to the Corporation are as follows and will be adopted on their respective effective dates:

#### **IFRS 9 Financial Instruments**

This standard introduces new classification and measurement models for financial assets, using a single approach to determine whether a financial asset is measured at amortized cost or fair value. To be classified and measured at amortized cost, assets must satisfy the business model test for managing the financial assets and have certain contractual cash flow characteristics. All other financial instrument assets are to be classified and measured at fair value. This standard allows an irrevocable election on initial recognition to present gains and losses on equity instruments (that are not held-for-trading) in other comprehensive income, with dividends as a return on these investments being recognized in profit or loss. In addition, those

## NOTES (continued)

equity instruments measured at fair value through other comprehensive income would no longer have to apply any impairment requirements nor would there be any ‘recycling’ of gains or losses through profit or loss on disposal. The accounting for financial liabilities continues to be classified and measured in accordance with IAS 39, with one exception, being that the portion of a change of fair value relating to the entity’s own credit risk is to be presented in other comprehensive income unless it would create an accounting mismatch. This standard is effective for reporting periods beginning on or after January 1, 2018. The Corporation expects no material changes in the measurement and carrying values of the Company’s financial instruments as a result of adoption of IFRS 9. The Corporation anticipates there will be additional enhanced disclosures upon the adoption.

### **IFRS 15 Revenue from Contracts with Customers**

The IASB issued IFRS 15, Revenue from Contracts with Customers, which provides a single principle-based framework to be applied to all contracts with customers. IFRS 15 replaces the previous revenue standard IAS 18, Revenue, and the related Interpretations on revenue recognition. The standard scopes out contracts that are considered to be lease contracts, insurance contracts and financial instruments. The new standard is a control-based model as compared to the existing revenue standard which is primarily focused on risks and rewards. Under the new standard, revenue is recognized when a customer obtains control of a good or service. Transfer of control occurs when the customer has the ability to direct the use of and obtain the benefits of the good or service. This standard is effective for reporting periods beginning on or after January 1, 2018. The Corporation anticipates there will be additional enhanced disclosures upon the adoption.

### **IFRS 16 Leases**

IFRS 16 was issued in January 2016 and specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16’s approach to lessor accounting substantially unchanged from its predecessor, IAS 17. This standard is effective for reporting periods beginning on or after January 1, 2019. The Corporation is still assessing this standard.

## **5. BUSINESS COMBINATION**

On July 21, 2016, the Corporation, acquired certain petroleum and natural gas assets of Kasten (“Kasten Assets”) in western Canada for a total fair value consideration for accounting purposes of \$12,366,181.

The acquisition price for the Kasten Assets was payable as follows:

- a) by the issuance of 70,000,000 common shares of PetroFrontier at a value of \$0.075 per share;
- b) by the payment of \$3,500,000 in cash at closing, net of the secured loan in the amount of \$525,000 which was advanced to Kasten on June 28, 2016; and
- c) by the issuance by PetroFrontier of a secured convertible debenture in the face amount of \$3,000,000 in favor of Kasten; and
- d) by an adjustment of \$616,181 for certain working capital items and operations for period from the effective date of June 1, 2016 to the closing date of July 21, 2016.

The acquisition was accounted for using the acquisition method whereby the assets acquired and liabilities assumed were recorded at fair value. Subsequent to the date of acquisition, the operating results of the Kasten Assets have been included in the Corporation’s consolidated operating results.

**NOTES** *(continued)*

<b>Consideration</b>		<b>Fair value</b>
Cash	\$	3,500,000
Purchase price consideration payable		616,181
Issuance of debenture		3,000,000
Issuance of 70,000,000 common shares		5,250,000
	\$	12,366,181

<b>Consideration</b>		<b>Fair value</b>
Purchase price allocation:		
Prepaid expenses and other supplies	\$	181,998
Petroleum and natural gas assets		17,828,395
Decommissioning liabilities		(3,489,784)
		14,520,609
Gain on acquisition of resource properties		(2,154,428)
	\$	12,366,181

At the time of acquisition, it was determined that the fair value of the properties was greater than the consideration paid when compared to similar transactions and as result a gain on acquisition of \$2,154,428 was recorded.

From the date of acquisition to December 31, 2016, the Kasten Assets contributed \$1,261,385 in revenue and incurred a loss before income taxes of \$307,755 before transactional costs of \$512,000. If the acquisition had been completed on January 1, 2016, the estimated revenue and earnings before tax for the 2016 year would have been \$2,540,002 and \$454,085, respectively.

The Corporation has incurred costs of approximately \$512,000 related to this acquisition which have been included in the consolidated statements of net and comprehensive loss.

NOTES (continued)

## 6. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	Oil & Gas Properties	Office Equipment	Total
<b>Cost</b>			
Balance, December 31, 2015	\$ -	3,233	\$ 3,233
Acquired by acquisition (Note 5)	17,828,395	-	17,828,395
Additions	912,508	6,377	918,885
Balance, December 31, 2016	\$ 18,740,903	9,610	\$ 18,750,513
Revisions – decommissioning liabilities	(195,157)	-	(195,157)
Additions	3,163,636	-	3,163,636
Disposals		(3,233)	(3,233)
Balance, December 31, 2017	21,709,382	6,377	21,715,759
<b>Accumulated Depreciation</b>			
Balance, December 31, 2015	\$ -	(3,233)	\$ (3,233)
Depletion and depreciation	(218,448)	(2,126)	(220,574)
Balance, December 31, 2016	(218,448)	(5,359)	(223,807)
Disposals	-	3,233	3,233
Depletion and depreciation	(910,865)	(2,126)	(912,991)
Balance, December 31, 2017	(1,129,313)	(4,252)	(1,133,565)
<b>Net book value, December 31, 2016</b>	<b>\$ 18,522,455</b>	<b>4,251</b>	<b>\$ 18,526,706</b>
<b>Net book value, December 31, 2017</b>	<b>\$ 20,580,067</b>	<b>2,125</b>	<b>\$ 20,582,194</b>

At December 31, 2017, future development costs of \$42,496,000 (2016 - \$37,787,000) associated with proved and probable reserves are included in costs subject to depletion.

The Corporation has reviewed for impairment indicators at December 31, 2017 and 2016 and determined there were no indicators of impairment.

## 7. DEBENTURE PAYABLE

	December 31, 2017 (\$)	December 31, 2016 (\$)
Balance, beginning of year	2,663,207	-
Issued in the year - face value	-	3,000,000
Less: equity component	-	(390,000)
Accretion in the year	336,793	53,207
	<b>3,000,000</b>	<b>2,663,207</b>
Less: current portion	<b>(3,000,000)</b>	-
Balance, end of year	-	<b>2,663,207</b>

## NOTES (continued)

On July 21, 2016, the Corporation issued a 3% secured convertible debenture in the principal amount of \$3,000,000 to Kasten (note 5). The debenture matures no later than June 30, 2019, is secured against the property of the Corporation with interest payable monthly.

The Corporation may redeem the debenture prior to maturity as follows:

- By a cash payment of the principal and interest outstanding at the time or;
- By the issuance of common shares at a conversion price of \$0.157 if the Corporation has completed a minimum \$2,000,000 flow-through private placement ("FT Placement") of common shares ("FT Shares") on or before June 30, 2018 at a price of not less than \$0.157 per FT Share and the average price of WTI crude as quoted on NMYEX is the USD\$50 (for the 20-day period ending five days before the repayment date).

The holder of the debenture may convert the debenture at any time prior to maturity if the FT Placement has been completed. The conversion price into common shares shall not be less than the Market Price, as defined by regulatory authorities, on the day of conversion.

For accounting purposes, the debenture was separated into their liability and equity component using the effective interest rate method. The effective interest rate method was based on the estimated rate for a debenture without a conversion feature. The fair value of the convertible debenture was allocated to the liability, \$2,610,000 based on the fair value of the liability component, which was determined using future cash flows discounted at a rate of 8%.

As at December 31, 2017 interest of \$67,500 had not been paid as required under the terms of the debenture. On April 25, 2018, the debenture holder waived the requirement to pay interest until maturity including the arrears interest. As a result of the non-payment of the interest, the principal amount of the debenture becomes a current liability.

## 8. DECOMMISSIONING LIABILITY

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

By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements could be significant. The total undiscounted amount of the estimated cash flows required to settle its decommissioning liabilities are approximately \$5,017,254 (2016 -\$4,820,589) which will be settled over the operating lives of the underlying assets, estimated to occur primarily over the next ten years. A credit adjusted interest rate of 7% (2016 – 7%) and an inflation rate of 2% (2016 – 2%) were used to calculate the decommissioning liability. Settlement of the liability will be funded from general corporate funds at the time of retirement or removal.

## NOTES (continued)

Changes to the liabilities were as follows:

<b>Decommissioning Liabilities</b>	<b>2017 (\$)</b>	<b>2016 (\$)</b>
<b>Balance, beginning of year</b>	<b>3,463,498</b>	-
Liabilities acquired (note 5)	-	3,489,784
Liabilities incurred	<b>41,128</b>	-
Revisions to previously recorded liabilities	<b>(195,157)</b>	(81,377)
Settlement of decommissioning liabilities	-	(65,690)
Accretion	<b>239,953</b>	120,781
	<b>3,549,422</b>	3,463,498
Less: current portion	-	(294,675)
<b>Balance, end of year</b>	<b>3,549,422</b>	<b>3,168,823</b>

## 9. SHARE CAPITAL

### A) Authorized

Unlimited number of common voting shares, no par value.

Unlimited number of preferred shares, no par value, issuable in series.

### B) Issued – common shares of PetroFrontier

	<b>Year Ended December 31, 2017</b>		<b>Year Ended December 31, 2016</b>	
	<b>Number of shares</b>	<b>Amount (\$)</b>	<b>Number of shares</b>	<b>Amount (\$)</b>
<b>Common Shares</b>				
Balance, beginning of year	149,600,768	131,202,046	79,600,768	125,952,046
Issuance on acquisition of business (note 5)	-	-	70,000,000	5,250,000
<b>Balance, end of year</b>	<b>149,600,768</b>	<b>131,202,046</b>	<b>149,600,768</b>	<b>131,202,046</b>

### C) Stock options

Officers and directors of the Corporation have been granted options to purchase common shares. Options granted have a term of five years to expiry and typically vest equally over a two-year period on the basis of 40% on the date of grant, 30% on the first anniversary date of the grant, and 30% on the second anniversary date of the grant. The exercise price of each option equals the market price or greater of the Corporation's common shares on the date of grant.

## NOTES (continued)

The following table summarizes the changes to the Corporation's option plan:

	<b>December 31, 2017</b>		<b>December 31, 2016</b>	
	#	Weighted average exercise price	#	Weighted average exercise price
<b>Outstanding, beginning of year</b>	<b>13,900,000</b>	<b>\$ 0.16</b>	3,310,000	\$ 0.72
Expired	-	-	(2,210,000)	3.05
Issued	-	<b>0.16</b>	12,800,000	0.16
<b>Outstanding, end of year</b>	<b>13,900,000</b>	<b>\$ 0.16</b>	13,900,000	\$ 0.16
<b>Exercisable, end of year</b>	<b>10,060,000</b>	<b>\$ 0.16</b>	<b>6,220,000</b>	<b>\$ 0.16</b>

The following table summarizes stock options outstanding and exercisable under the plan at December 31, 2017.

<b>Options outstanding</b>				<b>Options exercisable</b>	
<b>Exercise price (\$)</b>	<b>Number outstanding at period end</b>	<b>Weighted average remaining contractual life</b>	<b>Weighted average exercise price</b>	<b>Number exercisable at period end</b>	<b>Weighted average exercise price</b>
\$0.18	1,100,000	0.83	\$0.18	1,100,000	\$0.18
\$0.16	12,800,000	3.58	\$0.16	8,960,000	\$0.16

The Corporation accounts for its share-based compensation using the fair value method for all stock options. On July 21, 2016, the Corporation issued 12,800,000 stock options to officers and directors with a fair value of \$473,397. The fair value of the stock options issued in the year has been estimated at the date of grant using the Black-Scholes option pricing model based on the following assumptions:

Dividend yield	-
Expected volatility	<b>80%</b>
Risk-free interest rate	<b>1.2%</b>
Expected life	<b>5 years</b>
Forfeiture	<b>nil</b>

No options were granted during 2017.



## NOTES (continued)

### D) Contributed surplus

The following table summarizes the changes in contributed surplus:

	<b>December 31, 2017 (\$)</b>	<b>December 31, 2016 (\$)</b>
Balance, beginning of year	11,717,009	11,048,889
Equity component of debenture	-	390,000
Share-based compensation expense	153,853	278,120
<b>Balance, end of year</b>	<b>11,870,862</b>	<b>11,717,009</b>

### E) Per common share amounts

	<b>Year ended December 31, 2017</b>	<b>2016</b>
<b>Issued common shares, beginning of year</b>	<b>149,600,768</b>	79,600,768
Weighted average number of shares issued	-	31,260,274
<b>Weighted average number of common shares, end of year – basic &amp; diluted</b>	<b>149,600,768</b>	110,861,042

As the Corporation has recorded a loss for the years ended December 31, 2017 and 2016, no addition is made to the basic weighted average number of common shares when calculating diluted weighted average number of common shares as the diluted per common share amounts are anti-dilutive. For the years ended December 31, 2017 and 2016 no options were in-the-money.

### F) Management of capital structure

The Corporation's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Corporation manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Corporation considers its capital structure to include shareholders' equity.

The Corporation expects to have adequate funding to provide for general operations for a period of at least 12 months with current working capital on hand and the finalization of the credit facility as described in Note 17, Subsequent Event. Refer also to note 2, Corporate Information and Going Concern. The Corporation's future commitments are disclosed in note 13.

**NOTES** (continued)

**10. SUPPLEMENTAL CASH FLOW INFORMATION**

The changes in non-cash working capital for the years ending December 31 is as follows:

	<b>2017</b>	<b>2016</b>
	<b>(\$)</b>	<b>(\$)</b>
Accounts receivable	103,807	(803,343)
Prepaid expenses and deposits	(50,674)	129,656
Accounts payables and accrued liabilities	669,969	435,749
Other	-	-
<b>Change in non-cash working capital</b>	<b>723,102</b>	<b>(237,938)</b>

During the years ended December 31, 2017 and 2016, the cash interest received by the Corporation totaled \$6,338 and \$45,760, respectively.

**11. DEFERRED TAX**

The recovery of income taxes differs from the amount computed by applying the combined statutory Canadian federal and provincial tax rates to losses before income taxes as follows:

	<b>Year ended December 31, 2017</b>	<b>Year ended December 31, 2016</b>
	<b>(\$)</b>	<b>(\$)</b>
Net loss before taxes	(1,761,506)	(707,769)
Statutory income tax rate	27.0%	27.0%
Expected recovery	(475,600)	(191,100)
Add (deduct):		
Non-deductible share-based compensation	41,500	75,100
Non-deductible accretion and finance costs	90,900	14,400
Gain on acquisition of properties	-	(581,800)
Petroleum and natural gas properties	-	(942,200)
Other	17,600	(14,200)
Change in deferred tax benefits deemed not probable to be recovered	325,600	1,639,800
<b>Deferred income tax recovery</b>	<b>-</b>	<b>-</b>

The following is a summary of the Corporation's deferred tax asset as at December 31, 2017 and 2016:

	<b>2017</b>		<b>2016</b>	
	<b>Australia</b>	<b>Canada</b>	<b>Australia</b>	<b>Canada</b>
	<b>(\$)</b>	<b>(\$)</b>	<b>(\$)</b>	<b>(\$)</b>
Deferred income tax assets / (liabilities)				
Non-capital loss	14,349,100	3,370,900	14,349,100	3,340,600
Share issue costs	-	-	-	-
Property and equipment	-	(89,900)	-	(362,000)
Decommissioning liabilities	-	958,400	-	935,200
Unrecognized deferred tax assets	(14,349,100)	(4,239,400)	(14,349,100)	(3,913,800)
<b>Total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

## NOTES (continued)

The Corporation has non-capital losses as at December 31, 2017 and 2016 of approximately AUD\$49.3 million in Australia which have no expiry and \$12.5 million (2015 - \$12.3 million) in Canada which expire between 2030 and 2037. Deferred tax assets have not been recognized in respect of all or a portion of these items because it is not probable that future taxable profit will be available against which the Corporation can utilize the benefits.

The following table summarizes the movement in the recognized and unrecognized deferred tax assets and liabilities during the year:

	<b>January 1, 2017</b>	<b>Change in temporary difference</b>	<b>December 31, 2017</b>
	<b>(\$)</b>	<b>(\$)</b>	<b>(\$)</b>
Non-capital loss	17,689,700	30,300	17,720,000
Property and equipment	(362,000)	272,100	(89,900)
Decommissioning liabilities	935,200	23,200	958,400
Unrecognized deferred tax assets	(18,262,900)	(325,600)	(18,588,500)
	-	-	-

	<b>January 1, 2016</b>	<b>Change in temporary difference</b>	<b>December 31, 2016</b>
	<b>(\$)</b>	<b>(\$)</b>	<b>(\$)</b>
Non-capital loss	17,174,395	515,035	17,689,700
Share issue costs	4,336	(4,336)	-
Property and equipment	-	(362,000)	(362,000)
Decommissioning liabilities	-	935,200	935,200
Unrecognized deferred tax assets	(17,178,731)	(1,084,169)	(18,262,900)
	-	-	-

## 12. FINANCIAL INSTRUMENTS

### Fair value of financial instruments

The Corporation's financial instruments recognized in the statement of financial position consist of cash, trade and other receivables, deposits, trade and other payables and debenture. The fair value of these financial instruments approximates their carrying amounts due to their short terms to maturity.

The Corporation classifies the fair value of the financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- 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.

## NOTES (continued)

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

Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

### **Credit risk**

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

### **Currency risks**

The Corporation may be exposed to exchange rate fluctuations in relation to amounts due to services it must purchase in foreign currencies including the Australian and United States dollars. As at December 31, 2017 and 2016, the Corporation did not retain cash and cash equivalents in Australian dollars.

### **Interest rate risk**

At December 31, 2017 and 2016, the Corporation had no outstanding floating interest rate debt and is not exposed to interest rate risk at this time.

### **Liquidity risk**

Liquidity risk relates to the risk the Corporation will encounter difficulty in meeting obligations associated with financial liabilities. The financial liabilities on its statement of financial position are limited to trade and other payables and the debenture, all of which are current in nature.

With a working capital deficiency of \$3,814,066 at December 31, 2017 (2016 – working capital of \$2,131,683), the Corporation expects it will have adequate liquidity to fund its existing financial liabilities and ongoing operating and general administrative expenses through its existing operations, upon finalization of the negotiated credit facility (note 17 Subsequent Event) and the continued support of its debenture holder. Refer also to note 2, Corporate Information and Going Concern.

The pace of future capital investment and the related financial liabilities incurred from the capital investment program will be dependent upon the Corporation's capacity to secure additional equity/debt financing on favorable terms. The Corporation had no defaults or breaches on any of its financial liabilities except as explained in note 7. The Corporation expects to satisfy obligations under trade and other payable in less than one year.

The Corporation has a commitment to drill one well by December 31, 2018. The Corporation may be required to secure debt and/or equity financing in order to meet their 2018 capital commitment otherwise the petroleum and natural gas lease may not be renewed.

## NOTES (continued)

The following are the contractual maturities of financial liabilities including expected interest payments at December 31, 2017 and 2016:

<b>2017</b>	<b>Contractual cash flows</b>	<b>Less than one year</b>	<b>1-3 years</b>	<b>Greater than 3 years</b>
Accounts payable and accrued liabilities	\$ 1,924,506	1,924,506	-	\$ -
Debenture payable	3,140,300	3,140,300	-	-
	\$ 5,064,806	5,064,806	-	\$ -

  

<b>2016</b>	<b>Contractual cash flows</b>	<b>Less than one year</b>	<b>1-3 years</b>	<b>Greater than 3 years</b>
Accounts payable and accrued liabilities	\$ 1,126,187	1,126,187	-	\$ -
Purchase price payable	616,181	616,181	-	-
Debenture payable	3,230,300	90,000	3,140,300	-
	\$ 4,972,668	1,832,368	3,140,300	\$ -

### Market risk

Market risk is comprised of currency risk, interest rate risk and other price risks which consist primarily of fluctuations in petroleum and natural gas prices. With no bank debt as at December 31, 2017 and 2016 there is no current direct exposure to fluctuations in interest rates. The Corporation is exposed to fluctuations in commodity prices which affects the Corporation's revenue and any adverse fluctuations in interest rates, and commodity prices may indirectly affect the Corporation's ability to obtain equity financing and future bank debt, if required, and on favorable terms.

## 13. COMMITMENTS AND CONTINGENCIES

### Office lease

The Corporation has an office lease that requires monthly payments of \$8,288 and expires March 29, 2019.

During the year ended December 31, 2017, the Corporation expensed \$110,807 relating to operating leases (December 31, 2016 - \$117,800).

### Drilling commitments

The Corporation has a commitment to drill one well by December 31, 2018. The Corporation may be required to secure debt and/or equity financing in order to meet their 2018 capital commitment otherwise the petroleum and natural gas lease may not be renewed.

### Litigation

During the year ended December 31, 2014, Macquarie Capital Markets Canada Ltd. filed a Statement of Defense and Counterclaim against the Corporation in response to a Statement of Claim filed by the Corporation against Macquarie in the Court of Queen's Bench of Alberta on July 7, 2014. The Corporation has not recorded a contingent liability associated with the Counterclaim as the Corporation is of the opinion

## NOTES (continued)

the Counterclaim is without merit. The Corporation is continuing with its lawsuit against Macquarie and its defense of the Counterclaim.

### 14. COMPENSATION OF KEY MANAGEMENT PERSONNEL

Key management personnel compensation, including directors, is as follows:

	Year ended December 31	
	2017	2016
	(\$)	(\$)
Salaries, directors' fees and other benefits	782,094	956,962
Share-based compensation	128,612	232,491
	<b>910,706</b>	<b>1,189,453</b>

Key management personnel are comprised of the Corporation's directors and executive officers.

### 15. EXPENSES BY NATURE

The main components of the Corporation's general and administrative expenditures are as follows:

	Year ended December 31	
	2017	2016
	(\$)	(\$)
Salaries and benefits	1,045,538	676,044
Severance costs	-	465,000
Office costs	397,589	340,862
Professional fees	258,943	686,198
Corporate and regulatory	14,094	60,580
	<b>1,716,164</b>	<b>2,228,684</b>

The main components of the Corporation's finance expense are as follows:

	Year ended December 31	
	2017	2016
	(\$)	(\$)
Interest on debentures	90,000	40,192
Accretion of debentures	336,793	53,207
	<b>426,793</b>	<b>93,399</b>

### 16. RELATED PARTIES

The Corporation is related to Kasten as a director of the Corporation is also an officer of Kasten. Pursuant to the Agreement of Purchase & Sale regarding the Kasten assets, Kasten agreed to act as a bare trustee which primarily included receiving the monthly cash receipts from petroleum and natural gas sales and

## NOTES (continued)

forwarding the monies to the Corporation. During 2017 and 2016, the following additional transactions occurred with Kasten:

### 2017

- During 2017, the Corporation acquired \$404,644 (\$190,421) of drilling inventory at fair value from a supplier in which a director holds an interest. At December 31, 2017, \$294,265 (December 31, 2016 - \$190,421) is included in trade and other payables
- A final adjusting payment of \$616,181 was paid in 2017 in respect of the 2016 purchase of the Kasten Assets
- Interest expense of \$90,000 was recorded in the Statement of Loss and Comprehensive Loss related to the debenture (note 7)

### 2016

- In 2016, the Corporation advanced \$525,000 prior to the acquisition of the Kasten Assets which was repaid at closing of the acquisition in 2016.
- In 2016, a \$3,000,000 debenture was issued to Kasten as part of the purchase consideration as described in note 5.
- Interest expense of \$40,192 was recorded in the Statement of Loss and Comprehensive Loss related to the debenture. At December 31, 2016, interest of \$25,192 was included in Trade and other payables on the Statement of Financial Position
- In 2016, an officer received \$16,000 for services rendered and the amount is included in general and administrative expenses in the Statement of Loss and Comprehensive Loss.

## 17. SUBSEQUENT EVENTS

### Credit facility

On April 11, 2018, the Corporation signed a term sheet (the “Term Sheet”) with a corporation controlled by a director (the “Lender”), which will provide for a credit facility not exceeding \$1,500,000. The advances under the credit facility will bear interest at 8% per annum payable monthly and are secured by a General Security Agreement with the minimum advance being \$500,000. The Lender will also be paid a structuring fee equal to 2% of the amount of any advance under the credit facility, with a minimum structuring fee of \$10,000 payable.

The Lender will have the option to convert the advances under the credit facility into common shares of the Corporation (“Common Shares”). The conversion price per Common Share shall be: (i) the greater of the closing price of the Common Shares on the TSX Venture Exchange on the day prior to the issuance of this press release (the “Market Price”) and \$0.05 for the first year of the term of the loan; and (ii) the greater of the Market Price and \$0.10 for the second year of the term of the loan.

Finalization of the credit facility agreement (which is subject to due diligence and regulatory approval) is expected to close on April 30, 2018. The credit facility will mature two years from the date of the Term Sheet.

## **NOTES** *(continued)*

### **Interest waiver**

On April 25, 2018, the holder of the debenture agreed to waive the requirement to pay the interest on the debenture including the arrears interest (note 7) until maturity.



## NOTES (continued)

### ***Directors***

Robert J. Iverach  
Chairman of the Board of Directors  
and Chief Executive Officer  
Calgary, Alberta

Kelly Kimbley  
President, PetroFrontier Corp.  
Calgary, Alberta

Al Kroontje  
Businessman  
Calgary, Alberta

Michael Hibberd  
Businessman  
Calgary, Alberta

Paul Cheung  
Businessman  
Calgary, Alberta

### ***Officers***

Robert J. Iverach  
Chief Executive Officer

Kelly Kimbley  
President

Robert Gillies  
Vice President Finance and  
Chief Financial Officer

### ***Corporate Head Office***

900, 903 – 8th Avenue S.W.  
Calgary, Alberta T2P 0P7

### ***Trustee and Transfer Agent***

Computershare Trust Corporation

### ***Solicitors***

Burstall Winger Zammit LLP

### ***Auditors***

PricewaterhouseCoopers LLP