# Petro Viking Energy Inc.
## Consolidated Financial Statements
*December 31, 2012 and 2011*

## MANAGEMENT'S RESPONSIBILITY

To the Shareholders of PetroViking Energy Inc.

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the consolidated financial statements.

The Board of Directors exercises its responsibilities for financial controls through an Audit Committee (the “Committee”). The Committee is responsible for overseeing management in the performance of its financial reporting responsibilities and for approving the financial information included in the annual report. The Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

MNP LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

| | |
|---|---|
| *“Irvin Eisler”* | *“Lars Glimhagen”* |
| President & Chief Executive Officer | Director & Chief Financial Officer |

Calgary, Canada

## INDEPENDENT AUDITORS' REPORT

**To the Shareholders of PetroViking Energy Inc.:**

We have audited the consolidated financial statements of Petro Viking Energy Inc. and its subsidiary, which comprise the consolidated statement of financial position as at December 31, 2012, and the consolidated statements of operations, loss and comprehensive loss, changes in shareholders' equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

*Management's Responsibility for 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 audit. We conducted our audit 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 of 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 controls 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 the audit evidence obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*
In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Petro Viking Energy Inc. and its subsidiary as at December 31, 2012, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Emphasis of Matter – Going Concern*
Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt on Petro Viking Energy Inc.'s ability to continue as a going concern.

*Other Matter*
The consolidated financial statements of Petro Viking Energy Inc. the year ended December 31, 2011, were audited by another auditor who expressed an unmodified opinion on those statements on April 27, 2012.

MNP LLP

Calgary, Alberta
April 26, 2013

Chartered Accountants

| | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| | $ | $ |
| **Assets** | | |
| **Current** | | |
| Cash and cash equivalents | 368,468 | 2,140,122 |
| Short-term investments | - | 650,242 |
| Accounts receivable (note 5) | 494,924 | 565,352 |
| Prepaid expenses and deposits | 19,538 | 22,480 |
| Total current assets | 882,930 | 3,378,196 |
| Property and equipment (note 7) | 1,731,686 | 2,598,174 |
| **Total assets** | **2,614,616** | **5,976,370** |
| **Liabilities** | | |
| **Current** | | |
| Accounts payable and accrued liabilities (note 8) | 584,836 | 1,431,068 |
| Debenture (note 9) | 640,000 | - |
| Total current liabilities | 1,224,836 | 1,431,068 |
| Debenture (note 9) | - | 640,000 |
| Decommissioning liabilities (note 10) | 3,778,928 | 3,798,277 |
| **Total liabilities** | 5,003,764 | 5,869,345 |
| **Shareholders' Equity (Deficiency)** | | |
| Share capital (note 11) | 4,525,521 | 4,367,233 |
| Warrants (note 13) | 870,773 | 870,773 |
| Contributed surplus | 746,987 | 630,100 |
| Deficit | (8,532,429) | (5,761,081) |
| **Total shareholders' equity (deficiency)** | (2,389,148) | 107,025 |
| **Total liabilities and shareholders' equity** | **2,614,616** | **5,976,370** |

Going concern *(note 1)*
Basis of preparation *(note 2)*
Contingency *(note 27)*

**Approved on behalf of the Board of Directors**

*"Irvin Eisler" (signed)*
**Irvin Eisler**

*"Keith Watts" (signed)*
**Keith Watts**

| | **Year ended December 31, 2012** | Year ended December 31, 2011 |
|---|---|---|
| | $ | $ |
| **Revenue** | | |
| Petroleum and natural gas sales, net (note 14 ) | 1,160,548 | 824,090 |
| Other income (note 15) | 95,070 | 158,830 |
| **Total Revenue** | 1,255,618 | 982,920 |
| **Expenses** | | |
| Operating and production | 1,198,527 | 675,468 |
| General and administrative (note 17) | 1,495,725 | 833,176 |
| Share-based compensation (note 12) | 163,175 | 399,385 |
| Depletion, depreciation and impairment (note 18) | 1,067,720 | 4,528,276 |
| Financing costs (note 16) | 101,819 | 88,156 |
| **Total Expenses** | 4,026,966 | 6,524,461 |
| **Net loss and comprehensive loss before income taxes** | **(2,771,348)** | **(5,541,541)** |
| Deferred tax recovery (note 24) | - | 48,500 |
| **Net loss and comprehensive loss** | **(2,771,348)** | **(5,493,041)** |
| **Net loss per share (note 19)** | | |
| Basic | (0.09) | (0.22) |
| Diluted | (0.09) | (0.22) |
| **Weighted average number of shares (note 19)** | | |
| Basic | 30,099,756 | 24,989,359 |
| Diluted | 30,099,756 | 24,989,359 |

*The accompanying notes are an integral part of these consolidated financial statements*

| | Year ended December 31, 2012 | Year ended December 31, 2011 |
|---|---|---|
| | $ | $ |
| **Share capital (note 11)** | | |
| Balance, beginning of year | 4,367,233 | 1,198,963 |
| Issued | 112,000 | 3,887,423 |
| Flow-through share premium | - | (48,500) |
| Option value transferred to share capital from contributed surplus | 46,288 | 9,216 |
| Share issue costs | - | (679,869) |
| Balance end of year | 4,525,521 | 4,367,233 |
| **Warrants (note 13)** | | |
| Balance, beginning of year | 870,773 | - |
| Issued: | | |
| Share purchase warrants | - | 790,314 |
| Agent warrants | - | 80,459 |
| Balance end of year | 870,773 | 870,773 |
| **Contributed surplus** | | |
| Balance, beginning of year | 630,100 | 169,000 |
| Share-based compensation related to: | | |
| Options granted to directors, officers and consultants | 163,175 | 339,385 |
| Options granted to agent | - | 130,931 |
| Option value transferred from contributed surplus to share capital | (46,288) | (9,216) |
| Balance end of year | 746,987 | 630,100 |
| **Deficit** | | |
| Balance, beginning of year | (5,761,081) | (268,040) |
| Net loss and comprehensive loss | (2,771,348) | (5,493,041) |
| Balance, end of year | (8,532,429) | (5,761,081) |
| **Shareholders' Equity** | **(2,389,148)** | **107,025** |

| | Year ended December 31, 2012 $ | Year ended December 31, 2011 $ |
|---|---|---|
| **Operating** | | |
| Net loss and comprehensive loss for the year | (2,771,348) | (5,493,041) |
| Add back (deduct) non-cash items: | | |
| Share-based compensation (note 12) | 163,175 | 399,385 |
| Depletion, depreciation and impairment (note 18) | 1,067,720 | 4,528,276 |
| Accretion on decommissioning liabilities (note 10) | 45,490 | 42,911 |
| Gain on sale of asset (note 7) | (83,000) | (126,247) |
| Deferred income tax recovery | - | (48,500) |
| Cash settlement of decommissioning liability (note 10) | (43,245) | - |
| Changes in non-cash working capital (note 20) | 224,690 | (64,691) |
| **Cash flows used in operating activities** | (1,396,518) | (761,907) |
| **Financing** | | |
| Issue of equity instruments (note 11) | 112,000 | 4,393,400 |
| Share issue costs | - | (465,199) |
| Repayment of debenture | - | (200,000) |
| **Cash flows provided by financing activities** | 112,000 | 3,728,201 |
| **Investing** | | |
| Expenditures on property and equipment | (129,077) | (2,113,859) |
| Expenditures on exploration and evaluation (note 6) | (93,750) | - |
| Sale of property and equipment (note 7) | 83,000 | 125,000 |
| Sale of short-term investments | 650,242 | 1,904,337 |
| Purchase of short-term investments | - | (2,498,528) |
| Working capital deficiencies acquired (note 4) | - | (194,921) |
| Changes in non-cash working capital (note 20) | (997,551) | 952,551 |
| **Cash flows used in investing activities** | (487,136) | (1,825,420) |
| **Change in cash** | (1,771,654) | 1,140,874 |
| **Cash, beginning of the year** | 2,140,122 | 999,248 |
| **Cash, end of the year** | **368,468** | **2,140,122** |
| **Supplemental cash flow information** | | |
| Interest received | 12,070 | 32,583 |
| Interest paid | 56,329 | 45,245 |
| **Non-cash transactions** | | |
| Shares issued for property and equipment acquisition | - | 157,500 |
| Agent options, warrants and units issued for share issue costs | - | 214,670 |
| Option value transferred from contributed surplus to share capital | 46,288 | 9,216 |
| Shares issued to officer and consultant | - | 60,000 |

*The accompanying notes are an integral part of these consolidated financial statements*

## 1. Corporate information and going concern

Petro Viking Energy Inc. ("Petro Viking" or the "Company") is incorporated under the laws of the province of Alberta with shares listed on the TSX Venture Exchange, and is engaged in petroleum and natural gas exploration and development activities in western Canada. The records office and principal address is located at 200 – 744 4th Ave SW, Calgary, AB T2P 3T4.

On February 28, 2011, the Company completed its "Qualifying Transaction" pursuant to which Deep Creek Oil & Gas Inc. ("Deep Creek") and 1560368 Alberta Ltd., a wholly owned subsidiary of the Company, amalgamated pursuant to the provisions of the Business Corporations Act (Alberta) ("the Transaction"). On March 21, 2011, Deep Creek changed its name to Petro Viking Management Corp.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Petro Viking Management Corp. ("PVMC"), after the elimination of intercompany transactions and balances.

The business of exploring for oil and gas involves a high degree of risk and there can be no assurance that planned exploration and development programs will result in profitable reserves that are economically recoverable. The recovery of amounts capitalized for mineral properties and related costs in the consolidated statement of financial position is dependent upon the existence of economically recoverable reserves, the ability of the Company to arrange appropriate financing to complete development of its properties and upon future profitable production or proceeds from their disposition. Changes in future conditions could require material write-downs of the carrying values of its properties.

The consolidated financial statements have been prepared using International Financial Reporting Standards applicable to a going concern, which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business. In assessing whether or not there are material uncertainties that may lend doubt as to the ability of the Company to continue as a going concern, management takes into account all available information about the future, which is at least but is not limited to twelve months from the end of the reporting period. Management is aware of the material uncertainties that could cast doubt upon the Company's ability to continue as a going concern. As at December 31, 2012, the Company reported a net loss of $2,771,348 and a negative working capital of $341,906. Included in working capital at December 31, 2012 is debentures payable of $640,000. Subsequent to year end the terms of these debentures were extended to an initial two year term. In subsequent reporting periods the debentures will be classified as a non-current liability and will improve the negative working capital position. Included in the current year's loss is an impairment loss of $870,750 as a reflection of a decrease in the carrying values of its oil and gas assets. As a result the Company will need to raise additional financing within the next twelve months in order to meet its liabilities as they come due and to continue with its business activities.

## 2. Basis of presentation

These consolidated financial statements, including the relevant comparative periods, have been prepared on a going concern basis in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") effective as of December 31, 2012.

The consolidated financial statements were authorized by the Board of Directors for issue on April 25, 2013.

## 3. Summary of significant accounting policies

### a) Basis of measurement

The consolidated financial statements have been prepared under the historical cost method, except for the revaluation of certain financial assets and financial liabilities to fair value.

These consolidated financial statements are presented in Canadian Dollars, which is also the Company's functional currency.

### b) Basis of consolidation

#### i. Subsidiaries

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

#### ii. Joint venture operations

A portion of the Company's petroleum and natural gas exploration and production activities are conducted jointly with others, and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

#### iii. Transactions eliminated on consolidation

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

### c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash in banks and all short-term investments that are highly liquid in nature, cashable, and have an original maturity date of three months or less.

### d) Short-term investments

Short-term investments include highly liquid investments with an original term of one year or less, but greater than three months.

## 3. Summary of significant accounting policies (continued)

### e) Exploration and Evaluation Expenditures

Pre-license costs are expensed as incurred. Exploration and evaluation expenditures directly attributable to the exploration for petroleum and natural gas reserves are capitalized as exploration and evaluation assets on an area basis. These costs include, but are not limited to: lease acquisition either directly or by business combination, lease rentals on undeveloped properties, acquisition of rights to explore, geological, and geophysical costs, exploratory drilling of both productive and unproductive wells and overhead charges. No depletion or amortization is charged during the exploration and evaluation phase.

Exploration and evaluation expenditures are capitalized until reserves are evaluated and determined to be commercially viable and technically feasible. If reserves are not identified, these costs are expensed. The balance of exploration and evaluation expenditures is carried forward as an exploration and evaluation asset in the consolidated statement of financial position where the mineral rights are current and it is considered probable that costs will be recovered through the future development or sale of the property.

If it is determined that a commercial discovery of reserves will not be achieved, the capitalized exploration and evaluation assets are written down to their recoverable amounts. Where commercial discovery of reserves has been made, the exploration and evaluation assets are tested for impairment and transferred to property and equipment as petroleum and natural gas properties. The methodology for measuring impairments and reversals of impairments is described under note 3(f)(ii).

### f) Property and equipment

#### i. Property and equipment

Property and equipment (P&E) are carried at cost, less accumulated depletion, depreciation and accumulated impairment losses. The cost of an item of P&E consists of the purchase price, any costs directly attributable to bringing the asset into the location and condition necessary for its intended use, a discounted current estimate of the decommissioning costs and borrowing costs for qualifying assets. All costs incurred to identify and evaluate assets are expensed as incurred.

Petroleum and natural gas capitalized costs are depleted using the unit-of-production method. Depletion is calculated using the ratio of production in the year to the remaining total proved and probable reserves before royalties, taking into account future development costs prior to inflation necessary to bring those reserves into production. These estimates are evaluated and reported on by independent reserve engineers annually. Proven and probable reserves are estimated using independent reserve engineer reports. There is a 50 percent estimated statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable. The statistical probability for proven reserves is 90 percent.

**3. Summary of significant accounting policies (continued)**

Where an item of P&E comprises major components with different useful lives, the components are accounted for as separate items of P&E. The expected useful lives of P&E, residual values and methods of depreciation are reviewed at each reporting period and, if necessary, changes are accounted for prospectively.

Changes in estimates such as quantities of proved and probable reserves that affect unit-of-production calculations are applied on a prospective basis.

An item of P&E is derecognized upon disposal or is impaired when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss on disposal of the asset, determined as the difference between the net proceeds and the carrying amount of the asset, is recognized in the consolidated statement of operations, loss and comprehensive loss in the period incurred.

The carrying amounts of property and equipment are reviewed for impairment when indicators of such impairment exist. If indicators exist, the assets are tested for impairment under IAS 36.

**ii. Impairment of non-financial assets under IAS 36**

At each financial reporting date, the carrying amounts of property and equipment are reviewed to determine whether there is any indication that those assets are impaired. If such indication exists, an estimate of the recoverable amount of the asset is calculated.

Individual assets are grouped together for impairment assessment purposes into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash generating unit or CGU). The carrying amount of P&E assets within a CGU are compared to the recoverable amount of the CGU.

A CGU's recoverable amount is the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money to the Company and the risks specific to the asset. In determining fair value less cost to sell, recent market transactions are taken into account, if available. If no transactions can be identified, an appropriate valuation model is used.

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 impairment loss is charged to the consolidated statement of operations, loss and comprehensive loss. A previously recognized impairment loss is reversed or partially reversed only if there has been a change in the assumptions used to determine the assets recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The new carrying amount cannot exceed the carrying amount that would have been determined, net of depletion and depreciation, had no impairment loss been recognized for the asset in prior periods.

## 3. Summary of significant accounting policies (continued)

### iii. Decommissioning liabilities

The Company recognizes a decommissioning liability in the period it arose with a corresponding increase to the carrying amount of the related asset. Measurement occurs when a legal or constructive obligation arises. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation discounted using the pre-tax risk-free rate, updated at each reporting date. The increase in the provision due to the passage of time (accretion) is recognized as a financing cost whereas increases or decreases due to changes in the estimated cost to decommission the asset are capitalized as P&E. Actual costs incurred upon settlement of the decommissioning liability reduce the liability to the extent the provision was established. The related decommissioning asset is depreciated or depleted on the same basis as the P&E to which it relates.

### iv. Maintenance and turnarounds

Expenditures associated with maintenance activities or major turnarounds that improve the productive capacity or extend the life of an asset are capitalized. These costs are included in P&E when incurred and charged to depletion and depreciation over the estimated useful life. Any remaining carrying amounts of any replaced or sold components are derecognized. Maintenance and repairs, other than major turnaround costs, are expensed as incurred.

### g) Provisions

Provisions are recognized when the Company has a present obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The provisions are measured at Management's best estimate of the expenditure required to settle the obligation at the statement of financial position date, and are discounted to present value where the effect of time is material.

### h) Share capital

Common shares issued for non-monetary consideration are recorded at their fair market value based upon the trading price of the Company's shares on the TSX Venture Exchange. Share issue costs incurred on the issue of the Company's shares are charged directly to share capital.

### i) Flow-through shares

Expenditure deductions for income tax purposes related to exploratory activities funded by flow-through equity instruments are renounced to investors in accordance with income tax legislation. The difference between the value ascribed to flow-through shares issued and the value that would have been received for common shares at the date of issuance of the flow-through shares is initially recognized as a liability on the consolidated statement of financial position. The liability is reversed when tax benefits are renounced and a deferred tax liability is recognized at that time. Income tax expense is the difference between the amount of the deferred tax liability and the liability recognized on issuance.

### j) Revenue recognition

Revenue is recognized from oil sales when the oil is delivered to the buyer and from gas sales when the gas passes through the pipeline at the delivery point. Interest income is recorded as earned.

## 3. Summary of significant accounting policies (continued)

### k) Transportation

The Company is contractually obligated to pay to transport on the Company's share of oil and gas products sold to the nearest market terminal. These costs are presented in the consolidated statement of operations, loss and comprehensive loss as transportation expense.

### l) Income taxes

Income tax expense represents the sum of current tax expense and deferred tax expense. Current tax expense is based on the taxable profits for the year. Income tax is recognized in the consolidated statement of operations, loss and comprehensive loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax expense 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.

Deferred tax assets and liabilities are recognized based on differences in the financial statement carrying amount for assets and liabilities and the associated tax balance. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences, unused tax credits carried forward and unused tax losses to the extent that it is probable that there will be taxable profits against which deductible temporary differences can be utilized.

Deferred taxes are measured based on enacted or substantively enacted tax rates for the period in which the temporary differences are expected to be realized or settled, and are presented as non-current.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities, when they relate to income taxes levied by the same taxation authority and when the Company intends to settle its current tax assets and liabilities on a net basis.

### m) Share-based compensation plans

When options to purchase shares are granted to employees, directors, officers and consultants, the fair value of the options on the date of the grant, using the Black-Scholes option pricing model, is recognized as a compensation expense, with a corresponding increase in contributed surplus, over the period during which the related options vest. An estimated forfeiture rate is applied to the options granted before applying the Black-Scholes pricing model except for options which vest immediately on issuance for which no forfeiture is required. When options to purchase shares are granted to non-employees in return for goods or services, the fair value of the options granted is recognized as an expense, with a corresponding increase in contributed surplus, in the period in which the goods or services are received or are expected to be received. The consideration received on the exercise of share options is credited to share capital. When options are exercised, previously recorded compensation is transferred from contributed surplus to share capital to fully reflect the consideration for the shares issued.

### n) Share purchase warrants

The Company's share purchase warrants ("warrants") are classified as equity. The warrants are initially measure using the Black-Scholes model, which is based on significant assumptions such as volatility, dividend yield and expected term.

## 3. Summary of significant accounting policies (continued)

### o) Loss per share

Basic earnings per share ("EPS") is calculated by dividing the net loss for the period attributable to equity owners of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is calculated by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for dilutive instruments. The Company's potentially dilutive instruments are comprised of stock options granted and warrants issued.

### p) Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instrument were acquired.

<u>Financial assets</u>

**i. Fair value through profit or loss**

A financial asset can be classified as fair value through profit or loss only if it is designated at fair value through profit or loss or held-for-trading. The Company's financial assets at fair value through profit or loss are held for trading financial assets. They include cash and cash equivalents and short-term investments. Transaction costs related to the acquisition of financial assets that are classified as held for trading are expensed in net profit or loss as incurred.

**ii. Held-to-maturity**

These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company has the positive intention and ability to hold until maturity. Subsequent to initial recognition, these assets are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, impairment losses are included in profit or loss. The Company does not have any financial assets in this category.

**iii. Loans and receivables**

These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, these assets are measured at amortized cost using the effective interest method. Any gains or losses on the realization of receivables are included in profit or loss. The Company's accounts receivable are classified as loans and receivables

**3. Summary of significant accounting policies (continued)**

**Impairment of financial assets**

All financial assets except for those at fair value through profit or loss are subject to review for impairment at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets are impaired. Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Financial liabilities

**i. Fair value through profit or loss**

These liabilities are comprised of derivatives or liabilities acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are measured at fair value with changes in fair value included in profit or loss. The Company does not have any financial liabilities in this category.

**ii. Other financial liabilities**

Subsequent to initial recognition, these liabilities are measured at amortized cost using the effective interest method. Any gains or losses in the realization of other financial liabilities are included in profit or loss. The Company's accounts payable and accrued liabilities and debentures are classified as other financial liabilities.

The Company provides information for users of the Company's consolidated financial statements to understand the significance of financial instruments to the Company's financial position, performance and cash flows.

The Company provides disclosure of its objectives, policies and processes for managing capital. Disclosures include what is defined as capital, how it is managed, and what externally imposed restrictions on capital are present.

In addition, the Company provides disclosures relating to the fair value of financial instruments and the liquidity risk associated with financial instruments which now require that all financial instruments measured at fair value be categorized into one of three hierarchy levels.

**q) Borrowing costs and discounts on issuance of new debt**

Borrowing costs that are directly related to the issuance of new debt are recorded net of the associated debt and recognized into income using the effective interest rate method over the life of the debt. Discounts, where proceeds received are less than the par value of the debt, are recorded as a reduction to long-term debt. These discounts are being amortized using the effective interest method and included in borrowing costs.

**r) Business combinations**

Business combinations are accounted for using the acquisition method of accounting. The acquired net identifiable assets are measured at their fair value at the date of acquisition. Any excess of the purchase price over the fair value of the identifiable net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the fair value of the identifiable net assets acquired is recognized as a gain in the consolidated statement of operations, loss and comprehensive loss. Associated transactions costs and costs incurred to identify and evaluate business acquisitions are expensed when incurred.

**3. Summary of significant accounting policies (continued)**

**s) Business combinations under common control**

Business combinations under common control are accounted for prospectively from the date the Company obtains the ownership interest using the predecessor values method, whereby, assets and liabilities are recognized upon consolidation at their carrying amount recorded in the books of the acquired company.

**t) Related party transactions**

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the two parties and management believes to approximate fair value.

**u) Goodwill**

Upon recognition, goodwill is measured at cost less accumulated impairment losses and attributed to the applicable cash-generating unit (CGU) that is expected to benefit from the business combination's synergies. Goodwill is reviewed annually for impairment. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of a CGU include the carrying amount of goodwill relating to the CGU sold.

Goodwill is tested for impairment at the CGU level by combining the property and equipment, exploration and evaluation assets and goodwill and comparing this to the recoverable amount. If the goodwill carrying amount exceeds the recoverable amount, that associated goodwill is written down with an impairment recognized in the consolidated statement of operations, loss and comprehensive loss. The methodology for measuring impairments is described under note 3(f)(ii).

**v) Significant accounting judgments and estimates**

The preparation of the consolidated financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect reported amounts and presentation of assets, liabilities, revenues, expenses and disclosures of contingencies and commitments. Such estimates primarily relate to unsettled transactions and events at the statement of financial position date which are based on information available to management at each financial statement date. Actual results could differ from those estimated.

Judgments, estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

**Judgments**

CGU Determination

Management uses judgment when determining the Company's cash-generating units ("CGUs"). The Company's assets are aggregated into CGUs based on their ability to generate largely independent cash flows and are used for impairment testing. CGUs are determined by similar geological structure, shared infrastructure and geographical proximity.

**3. Summary of significant accounting policies (continued)**

**Judgments (continued)**

Contingencies

By their nature, contingencies will only be resolved when one or more of the future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

**Estimates**

Reserves

Reserves and resources are used in the unit of production calculation for depletion and depreciation as well as impairment analysis. The quantity of reserves is subject to a number of estimates and projections including assessment of engineering data, projected future rates of production, commodity prices, regulatory changes, foreign exchange rates, operating costs and sustaining capital expenditures. These estimates and projections are uncertain as the Company does not have a long commercial production history to assist in the development of these forward-looking estimates. However, all reserve and associated financial information is evaluated and reported on by a firm of qualified independent reserve evaluators in accordance with the standards prescribed by applicable securities regulators.

The calculation of future cash flows based on these reserves is dependent on a number of estimates including: production volumes, facility performance, commodity prices, and royalties, operating costs, sustaining capital, foreign exchange and tax rates. The price used in our assessment of future cash flows is based on the Company's independent evaluator's estimate of future prices and evaluated for reasonability by the Company against other available information. The Company believes these prices are reasonable estimates for a long-term outlook.

Impairment

The Company assesses its P&E for possible impairment if there are events or changes in circumstances that indicate the carrying values of the assets may not be recoverable. Such indicators include changes in the Company's business plans, changes in commodity prices, evidence of physical damage and significant downward revisions to estimated recoverable volumes or increases in estimated future development expenditures.

The assessment for impairment for P&E assets involves comparing the carrying value of the CGU with the higher of value in use calculations and fair value less costs to sell. Determination as to whether and how much an asset is impaired involves management estimates on highly uncertain matters such as future commodity prices, the effects of inflation on operating expenses, discount rates, production profiles and the outlook for regional supply-and-demand conditions for crude oil. Impairment is recognized in earnings in the period in which carrying amount exceeded the recoverable amount.

Depletion and depreciation

Depletion of resource assets is measured over the life of proved and probable reserves on a unit-of-production basis and commences when the facilities are substantially complete and after commercial production has begun. Reserve estimates and the associated future capital can have a significant impact on earnings, as these are key components to the calculation of depletion. A downward revision in the reserve estimate or an upward revision to future capital would result in increased depletion, reduced earnings and reduced carrying value of petroleum and natural gas property assets.

## 3. Summary of significant accounting policies (continued)

**Estimates (continued)**

Decommissioning liabilities

The Company measures decommissioning liabilities at each financial statement date. The estimate is based on the Company's share of costs to reclaim the resource assets and certain facilities related to the Project as well as other resource assets associated with future expansions. To determine the future value of the liability, estimates of the amount, timing and inflation of the associated abandonment costs are made. The present value of the cost is recorded as decommissioning liability using a risk-free discount rate. Due to the long-term nature of current and future project developments, abandonment costs will be incurred many years in the future. As a result of these factors, different estimates could be used for such abandonment costs and the associated timing. Assumptions of higher future abandonment costs, regulatory changes, higher inflation, lower risk-free rates or an assumption of earlier or specified timing of abandonment would cause the decommissioning liability and corresponding asset to increase. These changes would also cause future accretion expenses to increase and future earnings to decrease.

Deferred taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax bases of assets and liabilities. An estimate is required for both the timing and corresponding tax rate for this reversal. Should these estimates change, it may impact the measurement of asset or liability as well as deferred tax recovery or expense recognized to earnings. The Company only recognizes deferred tax assets arising from unused tax losses to the extent that the Company has sufficient taxable temporary differences or it is probable that sufficient taxable profit will be available against which the unused tax losses can be utilized.

Other areas of estimates

The recognition of amounts in relation to share-based compensation requires estimates related to valuation of stock options at the time of issuance. By their nature, estimates are subject to measurement uncertainty and the effect of changes in such estimates on the consolidated financial statements for current and future periods could be significant.

## 3. Summary of significant accounting policies (continued)

### w) Accounting standards issued but not yet applied

#### i. IFRS 9 - Financial Instruments

IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Two measurement categories continue to exist to account for financial liabilities in IFRS 9, fair value through profit or loss (FVTPL) and amortized cost. Financial liabilities held for trading are measured at FVTPL, and all other financial liabilities are measured at amortized cost unless the fair value option is applied. The treatment of embedded derivatives under the new standard is consistent with IAS 39 and is applied to financial liabilities and non-derivative hosts not within the scope of the standard.

#### ii. IFRS 10 - Consolidated Financial Statements

IFRS 10 replaces IAS 27, “Consolidated and Separate Financial Statements” and Standing Interpretations Committee (“SIC”) 12, “Consolidation – Special Purpose Entities”. IFRS 10 revises the definition of control to include three elements: (1) power over an investee; (2) exposure to variable returns from its involvement with the investee and (3) the ability to use its power to affect returns from the investee. IFRS 10 provides guidance on participating and protective rights and also addresses the notion of “de facto” control. It also includes guidance related to an investor with decision making rights to determine if it is acting as a principal or agent.

#### iii. IFRS 11 - Joint Arrangements

IFRS 11 replaces IAS 31, “Interest in Joint Ventures” and SIC 13, “Jointly Controlled Entities – Non-Monetary Contributions by Venturers”. Under IFRS 11, a joint arrangement is classified as either a “joint operation” or a “joint venture” depending on the rights and obligations of the parties to the arrangement. Under a joint operation, parties have rights to the assets and obligations for the liabilities of the arrangement and account for their share of assets, liabilities, revenues and expenses. Under a joint venture, parties have the rights to the net assets of the arrangement and account for the arrangement as an investment using the equity method.

#### iv. IFRS 12 - Disclosure of Interest in Other Entities

IFRS 12 replaces the disclosure requirements previously included in IAS 27, IAS 31, and IAS 28, “Investments in Associates”. It sets out the extensive disclosure requirements relating to an entity’s interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.

#### v. IFRS 13 - Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

## 3. Summary of significant accounting policies (continued)

### vi. IAS 1 - Presentation of Financial Statements

IAS 1 has been amended. The amendment within IAS 1 addresses the presentation of items of other comprehensive income that requires the grouping of items within other comprehensive income.

### vii. IAS 27 - Separate Financial Statements

IAS 27 has been amended to conform to the changes made in IFRS 10, but retains the current guidance for separate financial statements.

### viii. IAS 28 - Investments in Associates and Joint Ventures

IAS 28 has been amended to conform to the changes made in IFRS 10 and IFRS 11.

### ix. IAS 32 Financial Instruments Presentation

In December 2011, the IASB issued amendments to IAS 32 to address inconsistencies when applying the offsetting criteria. These amendments clarify some of the criteria required to be met in order to permit the offsetting of financial assets and financial liabilities

The above standards are effective for annual periods beginning on or after January 1, 2013 except IFRS 9 which is effective on or after January 1, 2015, and amendments to IAS 32, which is effective on or after January 1, 2014. Management is currently assessing the impact of the standards on the Company's consolidated financial statements.

## 4. Business acquisitions

### Deep Creek acquisition

On February 28, 2011, the Company entered into a transaction pursuant to which Deep Creek Oil & Gas Inc. (Deep Creek) and 1560368 Alberta Ltd., a wholly owned subsidiary of the Company, amalgamated pursuant to the provisions of the Business Corporations Act (Alberta).

This acquisition is considered a business combination under common control, as the two entities, Petro Viking and Deep Creek, had common directors, as at February 28, 2011. The acquisition has been accounted for by the Company prospectively from the date of obtaining the ownership interest. Assets and liabilities have been recognized upon consolidation at their carrying amounts in the IFRS financial statements of Deep Creek.

The information in the following table summarizes the consideration paid for Deep Creek and the amounts of the assets acquired and the liabilities that were recognized at the acquisition date.

| | **$** |
|---|---|
| **Consideration (i)** | |
| 5,313,136 common shares | 63,557 |
| **Total Consideration paid** | **63,557** |
| **Recognized amounts (predecessor values)** | |
| ***Assets Acquired*** | |
| Property and equipment | 2,115,065 |
| Cash and cash equivalents | - |
| Accounts receivable | 106,224 |
| Prepaid expenditures | 151,691 |
| Total | 2,372,980 |
| ***Liabilities taken over*** | |
| Accounts payable and accrued liabilities | 452,836 |
| Debenture | 840,000 |
| Decommissioning liabilities | 1,016,587 |
| Total | 2,309,423 |
| **Total recognized net assets (ii)** | **63,557** |

i. The Company issued 4,760,000 common shares on February 28, 2011 as purchase consideration. On June 27, 2011, Petro Viking's Board resolved that an additional 553,136 common shares will be issued to the shareholders of Deep Creek, as a result of Deep Creek satisfying post-closing adjustments relating to working capital and production at February 28, 2011. These shares were issued on October 11, 2011. This acquisition constituted the Company's Qualifying Transaction.

ii. Total recognized net assets of $63,557 above include working capital deficiencies of $194,921.

## 4. Business acquisition (continued)

### Alberta acquisition

On June 30, 2011 the Company purchased a portfolio of petroleum and natural gas assets located in Alberta. The assets were acquired for their current production and future development potential. The following summarizes the consideration transferred, and the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

| | $ |
|---|---|
| **Identifiable assets acquired and liabilities assumed** | |
| Property and equipment | 2,749,967 |
| Decommissioning liabilities | (2,278,447) |
| **Total net identifiable assets** | **471,520** |
| **Consideration transferred** | |
| **Cash** | **471,520** |

### Plato acquisition

On November 11, 2011 the Company purchased additional working interest in an existing property at Plato, Saskatchewan. The additional working interests were acquired for their current production and future development potential. The following summarizes the consideration transferred, and the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

| | $ |
|---|---|
| **Identifiable assets acquired and liabilities assumed** | |
| Property and equipment | 435,750 |
| Decommissioning liabilities | (42,000) |
| **Total net identifiable assets** | **393,750** |
| **Consideration transferred** | |
| Cash | 236,250 |
| 630,000 common shares | 157,500 |
| **Total** | **393,750** |

Of the above consideration, $225,000 relates to purchase of working interest from a company which is a related party. This includes $135,000 in cash and $90,000 in 360,000 common shares. The market price of the common shares at the issue date was $0.25 per common share.

## 5. Accounts receivable

| | **2012** | 2011 |
|---|---|---|
| | **$** | $ |
| **Significant components of Accounts Receivable** | | |
| Accounts receivable - trade and joint venture | 483,927 | 479,185 |
| GST and HST Receivable | 10,997 | 86,167 |
| | **494,924** | **565,352** |
| **Accounts Receivable for:** | | |
| Capital | 45,000 | 45,000 |
| Operating | 449,924 | 520,352 |
| | **494,924** | **565,352** |

The Company did not provide for any doubtful accounts at December 31, 2012. During the year, $7,041 (2011: $2,420) of receivables was written off to general and administrative expenses in the Company's consolidated statements of operations, loss and comprehensive loss.

As at December 31, 2012, the Company had two individual receivables that individually accounted for more than 10% of the outstanding accounts receivable balance. The individual balances are $273,402 and $52,961 respectively, totaling $326,363 or 76% of the total receivables.

As at December 31, 2012, the amounts due from related parties are $Nil (2011: $25,894) (see note 21).

As at December 31, 2012, the Company considers its receivables to be aged as follows:

| | $ |
|---|---|
| Not past due | 334,435 |
| Past due by less than 90 days | 81,282 |
| Past due by more than 90 days | 79,207 |
| **Total** | **494,924** |

## 6. Exploration and evaluation assets

| | **2012** | 2011 |
|---|---|---|
| | **$** | $ |
| Balance, beginning of year | - | - |
| Additions | 93,750 | - |
| Impairments | (93,750) | - |
| **Balance, end of year** | **-** | - |

Additions during the year comprised lease acquisitions for exploration, evaluation and development, pending determination of proved or probable reserves.

At December 31, 2012, the Company has determined that it will not develop the exploration and evaluation assets and has recorded impairment (note 18) of the entire amount of $93,750 (2011:$Nil)

## 7. Property and equipment

### Oil and Natural Gas Interests

| | **2012** $ | 2011 $ |
|---|---|---|
| **Cost or deemed cost** | | |
| Balance, beginning of year | 7,126,450 | - |
| Acquisitions (i) | - | 5,300,782 |
| Additions | 107,482 | 1,825,668 |
| Balance, end of year | 7,233,932 | 7,126,450 |
| **Depletion, depreciation and impairment losses** | | |
| Balance, beginning of year | (4,528,276) | - |
| For the year (note 18) | (973,970) | (4,528,276) |
| Balance, end of year | (5,502,246) | (4,528,276) |
| **Net book amount** | **1,731,686** | 2,598,174 |

(i) Acquisitions of property and equipment during the year ended December 31, 2011, include:

a. $2,115,065 relates to assets acquired in business combination with Deep Creek. There was no cash consideration for this acquisition. (note 4)

b. $2,749,967 relates to assets acquired in Alberta purchase. Cash consideration for this acquisition was $471,520. (note 4)

c. $393,750 relates to acquisition of additional working interests in an existing property. Cash consideration for this acquisition was $236,250. (note 4)

(ii) The Company disposed of its assets in the Brazeau area during the year ended December 31, 2011. The carrying value of the assets was $Nil and the assets were sold for a cash consideration of $125,000. The Company had recorded a decommissioning liability of $1,247 on the Brazeau assets. The Company has recorded $126,247 as a gain on sale and disclosed in the Company's consolidated statements of operations, loss and comprehensive loss for the year ended December 31, 2011 (note 15).

(iii) The Company disposed an asset in the Kaybob area during the year ended December 31, 2012. The carrying value of the assets was $Nil and the assets were sold for a cash consideration of $83,000. The Company has recorded a gain on sale of asset of $83,000, which has been disclosed in the Company's consolidated statements of operations, loss and comprehensive loss for the year ended December 31, 2012 (note 15).

## 8. Accounts payable and accrued liabilities

| **Significant components of Accounts Payable and Accrued Liabilities** | **2012** **$** | 2011 $ |
|---|---|---|
| Accounts payable - trade and joint venture | 527,269 | 1,261,444 |
| GST Payable | - | 866 |
| Interest Payable (note 9) | 4,067 | 4,349 |
| Accrued liabilities | 53,500 | 164,409 |
| | 584,836 | 1,431,068 |
| **Accounts Payable and Accrued Liabilities for:** | | |
| Capital | - | 997,551 |
| Operating | 548,836 | 433,517 |
| | 548,836 | 1,431,068 |

As at December 31, 2012, the amounts due to related parties are $62,169 (2011: $35,233) (see note 21).

## 9. Debenture

| | **2012** **$** | 2011 $ |
|---|---|---|
| Balance, beginning of year (ii) | 640,000 | - |
| Debenture taken over, pursuant to Deep Creek acquisition (note 4) | - | 840,000 |
| Repayment (iv) | - | (200,000) |
| Balance, end of year (i), (ii), (v) | 640,000 | 640,000 |
| Accrued debenture interest, end of year (note 8) | 4,067 | 4,349 |

(i) Subsequent to December 31, 2012, the Company has renewed the debentures for a two year term. The revised maturity date after renewal is February 28, 2015.

(ii) Prior to renewal of the debentures described in 9 (i) above, the debentures had a maturity date of February 28, 2013. Therefore, the debenture is classified as a current liability at December 31, 2012 and as a non-current liability at December 31, 2011

(iii) The debentures bear interest at a rate of 8% per annum For the year ended December 31, 2012, interest expense on the debentures of $56,329 (2011- $45,245) was recorded (note 16).

(iv) During March, 2011, the Company repaid $200,000 of the $840,000 debentures outstanding, of which $100,000 was repaid to a director of the Company (note 21).

(v) At December 31, 2012, $370,000 of the debenture balance payable is due to related parties (note 21).

## 10. Decommissioning liabilities

The following table presents the reconciliation of the carrying amount of the obligation associated with the decommissioning of the Company's property and equipment:

| *(for the year ended December 31)* | **2012** $ | **2011** $ |
|---|---|---|
| | $ | $ |
| Decommissioning liabilities, beginning of year | 3,798,277 | - |
| Liabilities acquired | | |
| Deep Creek business combination | - | 1,016,587 |
| Alberta acquisition | - | 2,278,447 |
| Plato acquisition | - | 42,000 |
| | - | 3,337,034 |
| Liabilities incurred | - | 96,905 |
| Liabilities settled | (43,245) | (1,247) |
| Effect of change in estimates | (21,594) | 322,674 |
| Accretion (i) | 45,490 | 42,911 |
| Decommissioning liabilities, end of year | **3,778,928** | **3,798,277** |

The following significant assumptions were used to estimate the decommissioning liabilities:

| | | **2012** | 2011 |
|---|---|---|---|
| Undiscounted cash flows | $ | 4,055,860 | 4,046,100 |
| Discount rate | | 1.30% | 1.36% |
| Inflation rate | | 2.50% | 2.50% |
| Weighted average expected timing of cash flows | | 4.65 years | 5.3 years |

(i) Accretion expense included under financing costs in the consolidated statements of operations, loss and comprehensive loss.

(ii) Discount rate based on Government of Canada marketable bond yields for 3-5 year term.

(iii) Inflation rate based on Bank of Canada consumer price index.

## 11. Share capital

### a. Authorized

Unlimited number of common shares, without nominal or par value

### b. Issued and outstanding common shares

| | **2012** | | 2011 | | *Sub-Note Reference* |
|---|---|---|---|---|---|
| | **Number** | **Amount** | Number | Amount | |
| | | **$** | | $ | |
| Balance, beginning of year | 29,753,707 | 4,367,233 | 9,490,000 | 1,198,963 | |
| Issued to director and officers | - | - | 200,000 | 60,000 | *v* |
| Issued on private placement | - | - | 13,998,571 | 3,582,686 | *i, iii* |
| Less: Flow-through share premium | - | - | - | (48,500) | *iii* |
| Issued on acquisition of Deep Creek (note 4) | - | - | 5,313,136 | 63,557 | |
| Issued to agent | - | - | 20,000 | 3,280 | *iv* |
| Issued on acquisition of Plato (note 4) | - | - | 630,000 | 157,500 | *vi* |
| Agent options exercised (note 12) | 506,000 | 112,000 | 102,000 | 20,400 | |
| Option value transferred to share capital from contributed surplus | - | 46,288 | - | 9,216 | |
| Share issue costs | - | - | - | (679,869) | *ii, iv* |
| Balance, end of period | 30,259,707 | 4,525,521 | 29,753,707 | 4,367,233 | |

(i) On February 28, 2011, the Company completed a brokered private placement for aggregate gross proceeds of $3,450,000, through the issuance of 11,500,000 Units at a purchase price of $0.30 per unit.

Each Unit is comprised of one Common Share of the Company and one Common Share Purchase Warrant. Each Warrant entitles the holder to purchase one additional share at a purchase price of $0.50 per share for a period of 24 months following the closing, subject to an accelerated expiry date. If, on any 20 consecutive trading days occurring after four months and one day has elapsed following the closing date, the closing sales price of the Common Shares (or the closing bid, if no sales were reported on a trading day) as quoted on the Exchange is greater than $0.60 per Common Share, the Company may provide notice in writing to the holders of the Warrants by issuance of a press release that the expiry date of the Warrants will be accelerated to the 30th day after the date on which the Company issues such press release.

The fair value of the warrants issued was $506,000 (note 13).

## 11. Share capital (continued)

### b. Issued and outstanding common shares (continued…)

(ii) In connection with the brokered private placement described in (i) above, the Company paid Wolverton Securities Ltd. (the "Agent") a cash commission equal to 8% of the gross proceeds, amounting to $276,000, and 8% in Agent's options entitling the Agent to acquire 920,000 Units at a price of $0.30 per Unit until February 28, 2013.

Each Unit is comprised of one common share and one warrant. Each Warrant entitles the Agent to purchase one additional Share at a purchase price of $0.50 per share for a period of 24 months following the closing.

The estimated fair value of $80,960 for the options (note 12) and $39,560 for the warrants (note 13) as calculated using the Black-Scholes pricing model has been charged to share issuance costs with a related credit to contributed surplus. In addition, the Company has paid the Agent a corporate finance fee and related costs amounting to $66,363. The Company incurred legal fees of $22,000. This amount has been has been charged to share issuance costs with a related credit to Share Capital.

(iii) On May 24, 2011, the Company completed the sale of 1,528,571 Units at $0.35 per unit and 970,000 flow-through ("FT") Shares at $0.40 per FT Share for aggregate gross proceeds of $923,000. The associated premium on the FT shares totaled $48,500.

Each unit consists of one common share in the capital of the Company and one common share purchase warrant. Each warrant is exercisable for 2 years from the closing of the offering to acquire one common share at a price of $0.55 per common share, subject to an accelerated expiry date in certain circumstances. If, on any 20 consecutive trading days occurring after four months and one day has elapsed following the closing date, the closing sales price of the Common Shares (or the closing bid, if no sales were reported on a trading day) as quoted on the Exchange is greater than $0.60 per Common Share, the Company may provide notice in writing to the holders of the Warrants by issuance of a press release that the expiry date of the Warrants will be accelerated to the 30th day after the date on which the Company issues such press release.

The fair value of the warrants issued was $ 284,314 (note 13).

In connection with the FT share offering, the Company has satisfied all its obligations relating to incurring of eligible exploration expenditures during the year ended December 31, 2011 and does not have any liabilities associated with its FT share offering of May 24, 2011.

## 11. Share capital (continued)

### b. Issued and outstanding common shares (continued)

(iv) In connection with the brokered private placement described in (iii) above, the Company paid Wolverton Securities Ltd. (the "Agent") a cash commission equal to 8% of the gross proceeds, amounting to $73,840, and 8% in Agent's options entitling the Agent to acquire 199,885 Units at a price of $0.35 per Unit until May 24, 2013.

Each Unit is comprised of one Share and one Warrant. Each Warrant entitles the Agent to purchase one additional Share at a purchase price of $0.55 per share for a period of 24 months following the closing.

The estimated fair value of $49,971 for the options (note 12) and $37,179 for the warrants (note 13) as calculated using the Black-Scholes pricing model, has been charged to share issuance costs with a related credit to contributed surplus.

In addition, the Company has paid the Agent a corporate finance fee and related costs amounting to $10,647 and issued 20,000 Units (each unit is comprised of one share and one warrant), valued at $7,000 ($3,280 for the shares and $3,720 for the warrants (note 13). This amount has been has been charged to share issuance costs.

The Company also incurred legal fees of $16,349.

(v) The Company issued 200,000 common shares as bonus, of which 100,000 shares was issued to a key management personnel and 100,000 shares to a consultant. The market price of the common shares at the issue date was $0.30 per common share for a value of $60,000.

### c. Escrow

At December 31, 2012, the Company has 2,782,426 (2011- 4,631,728) common shares subject to an escrow agreement. 924,650 shares will be released from escrow during March and September of each year until 2014.

## 12. Share-based compensation

The Company has a stock option plan under which the Board of Directors may grant options to directors, officers, other employees and key consultants. The Company may also grant options to agents.

Under the plan, the number of shares reserved for issuance pursuant to the exercise of all options under the plan may not exceed 10% of the issued and outstanding common shares at any time. The options expire not more than five years from the date of grant (except for 949,000 options issued during 2010, which expire after ten years from the date of grant), or earlier if the individual ceases to be associated with the Company, and vest over terms determined at the time of grant. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model.

During the year ended December 31, 2012, the Company granted 1,400,000 options, exercisable at $0.10 per option, to its directors, officers and consultants. The options vest immediately upon grant and expire 5 years after grant date.

The share based compensation expense at for the year ended December 31, 2012 is $163,175 (2011: $399,385). The share based compensation expense for 2011 includes the fair value of $60,000 relating to 200,000 common shares issued as bonus (note 11(b) (v)).

The following tables summarize information about directors, officers and consultants stock options outstanding as at, and for the year ended December 31:

| | **2012** | | 2011 | |
|---|---|---|---|---|
| | **Options** | **Weighted – average exercise price $** | Options | Weighted – average exercise price $ |
| Opening | 2,819,000 | 0.27 | 949,000 | 0.20 |
| Granted | 1,400,000 | 0.10 | 1,870,000 | 0.31 |
| Forfeited | (1,594,499) | 0.27 | - | - |
| Closing | 2,624,501 | 0.18 | 2,819,000 | 0.27 |

| Range of exercise price $ | Number outstanding | Weighted-average remaining contractual life (years) | Weighted-average exercise price $ | Number exercisable |
|---|---|---|---|---|
| 0.10 | 1,400,000 | 4.79 | 0.10 | 1,400,000 |
| 0.20 | 474,501 | 7.43 | 0.20 | 474,501 |
| 0.30 | 650,000 | 3.17 | 0.30 | 650,000 |
| 0.35 | 100,000 | 3.46 | 0.35 | 100,000 |
| | 2,624,501 | 4.82 | 0.18 | 2,624,501 |

## 12. Share-based compensation (continued)

The following tables summarize information about agent stock options outstanding as at, and for the year ended December 31:

| | **2012** | | 2011 | |
|---|---|---|---|---|
| | **Options** | **Weighted – average exercise price** | Options | Weighted – average exercise price |
| | | $ | | $ |
| Opening | 1,517,885 | 0.28 | 500,000 | 0.20 |
| Granted | - | - | 1,119,885 | 0.31 |
| Exercised | (506,000) | 0.22 | (102,000) | 0.20 |
| Closing | 1,011,885 | 0.31 | 1,517,885 | 0.28 |

| Range of exercise price | Number outstanding | Weighted-average remaining contractual life (years) | Weighted-average exercise price | Number exercisable |
|---|---|---|---|---|
| $ | | | $ | |
| 0.30 | 812,000 | 0.17 | 0.30 | 812,000 |
| 0.35 | 199,885 | 0.39 | 0.35 | 199,885 |
| | 1,011,885 | 0.21 | 0.31 | 1,011,885 |

The Black-Scholes pricing model was used to estimate the fair value of options granted issued based on the following significant assumptions:

| | **2012** | | 2011 |
|---|---|---|---|
| | Stock Options | Stock Options | Agent |
| Weighted average fair value per option | $ 0.08 | $ 0.21 | $ 0.12 |
| Risk-free interest rate | 1.19% | 2.17%-2.5% | 1.59%-1.88% |
| Expected volatility | 132% | 90%-138% | 55%-149% |
| Dividend yield | 0% | 0% | 0% |
| Estimated forfeiture rate | 0% | 0% | 0% |
| Expected life of each option granted | 5 years | 5 years | 2 years |

## 13. Warrants

The following table summarizes information about warrants outstanding as at, and for the year ended December 31:

| | **2012** | | | 2011 | | |
|---|---|---|---|---|---|---|
| | **Number of warrants** | **Weighted –average Exercise price $** | **Fair value ascribed $** | Number of warrants | Weighted –average Exercise price $ | Fair value ascribed $ |
| Opening | 14,168,456 | 0.51 | 870,773 | - | - | - |
| Issued (i) | | | | | | |
| Share purchase warrants | - | - | - | 13,028,571 | 0.51 | 790,314 |
| Agent warrants | - | - | - | 1,139,885 | 0.51 | 80,459 |
| Exercised | - | - | - | - | - | - |
| Closing (ii) | 14,168,456 | 0.51 | 870,773 | 14,168,456 | 0.51 | 870,773 |

The Black-Scholes pricing model was used to estimate the fair value of warrants issued based on the following significant assumptions:

| **Year ended December 31, 2011** | **Share Purchase warrants** | **Agent** |
|---|---|---|
| Weighted average fair value per warrant | $0.11 | $0.07 |
| Risk-free interest rate | 1.59%-2.5% | 1.59% -1.88% |
| Expected volatility | 90%-123% | 55%-123% |
| Dividend yield | 0% | 0% |
| Expected life of each warrant granted | 2 years | 2 years |

(i) See note 11(b)(ii), 11(b)(iii) and 11(b)(iv)
(ii) As at December 31, 2012, warrants had a weighted average remaining life of 0.2 years.

## 14. Petroleum and natural gas sales

| | **2012** | 2011 |
|---|---|---|
| | **$** | $ |
| Petroleum and natural gas sales (gross) | 1,364,886 | 999,186 |
| Less: Royalty expense | (204,338) | (175,096) |
| Petroleum and natural gas sales (net) | 1,160,548 | 824,090 |

## 14. Petroleum and natural gas sales (continued)

| | 2012 Gross Sales $ | 2012 Royalties $ | 2012 Net Sales $ | 2011 Gross Sales $ | 2011 Royalties $ | 2011 Net Sales $ |
|---|---|---|---|---|---|---|
| Oil | 1,063,480 | (132,220) | 931,260 | 666,013 | (103,292) | 562,721 |
| Natural Gas | 178,902 | (22,066) | 156,836 | 237,471 | (20,308) | 217,163 |
| Liquids | 62,832 | (50,052) | 12,780 | 86,904 | (51,496) | 35,408 |
| Other | 59,672 | - | 59,672 | 8,798 | - | 8,798 |
| Total | 1,364,886 | (204,338) | 1,160,548 | 999,186 | (175,096) | 824,090 |

The Company derived approximately 36% of its revenue from its Ronalane property. The property is operated by the Company and the product is sold exclusively to one marketer.

## 15. Other Income

| | **2012** $ | 2011 $ |
|---|---|---|
| Gain on sale of asset (notes 7(ii) and 7(iii)) | 83,000 | 126,247 |
| Interest income | 12,070 | 32,583 |
| Total | **95,070** | **158,830** |

## 16. Financing costs

| | **2012** $ | 2011 $ |
|---|---|---|
| Interest expense on debenture | 56,329 | 45,245 |
| Accretion on decommissioning liabilities (note 10) | 45,490 | 42,911 |
| Total | **101,819** | **88,156** |

## 17. General and administrative expenses

Included in general and administrative expenses in the consolidated statements of operations, loss and comprehensive loss are business investigation costs as follows:

| | **2012** $ | 2011 $ |
|---|---|---|
| *To related parties (note 21)* | | |
| Consulting fee, to related parties | 141,000 | - |
| Legal and administrative fees paid to a law firm in which one director of the Company is council | 85,925 | 54,270 |
| *To others:* | | |
| Consulting fee, others | 79,863 | - |
| Legal fees paid to unrelated law firms | 65,543 | - |
| Non-refundable deposit to Grisham Assets Corp. | 100,440 | - |
| Travel and other expenses | 204,540 | - |
| Total Business investigation costs | 677,311 | 54,270 |

Business investigation costs were incurred during the year ended December 31, 2012 on activities relating to the acquisition of leases for offshore drilling in Namibia. The Company has determined to no longer proceed with the acquisition of offshore leases 1710, 1810 and 2913B in Namibia.

## 18. Depreciation, depletion and impairment

| | **2012** **$** | 2011 $ |
|---|---|---|
| Depletion for the year on developed and producing properties (i) | 196,970 | 335,276 |
| Impairment for the year on developed and producing properties (ii) | 777,000 | 4,193,000 |
| Impairment on exploration and evaluation expenditures (note 6) | 93,750 | - |
| Total | 1,067,720 | 4,528,276 |

(i) The depletion, depreciation and impairment of property and equipment, are recognized in the Company's consolidated statements of operations, loss and comprehensive loss. There were no costs that were excluded from the depletion calculation for the year. Future development costs at December 31, 2012 and December 31, 2011 was $Nil.

(ii) The Company recorded an impairment expense of $777,000 (2011: $4,193,000) for the year on its developed and producing CGU's. The impairment was calculated based on the difference between the carrying value and the net recoverable value of the assets. The net recoverable value is based on the fair value less costs to sell ("FVLCTS") of the reserves, which was determined using the proved plus probable reserve value discounted at 10%. The impairment has occurred due to a combination of lower estimated economic recoverable reserves and a lower product price forecast used by the independent reserve evaluator, when compared to 2011. The CGU's that were impaired are as follow:

| **CGU** | **Impairment $** | **Primary Product** |
|---|---|---|
| Kaybob | 190,000 | Gas |
| Kinsella | 155,000 | Oil |
| Olds | 122,000 | Gas |
| Plato | 71,000 | Oil |
| Farrow | 67,000 | Oil |
| Coutts | 62,000 | Oil |
| Gosfield | 44,000 | Oil |
| Brownsfield | 43,000 | Oil |
| Carson Creek | 13,000 | Gas |
| Brock | 5,000 | Gas |
| Dankin | 5,000 | Oil |
| **Total** | **777,000** | |

(iii) The prices used in the impairment test evaluation were as follows:

| **Year -->** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2027** | **Thereafter** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Gas** - US Henry Hub - USD/MMBtu | 3.75 | 4.30 | 4.85 | 5.25 | 5.70 | 6.10 | 6.20 | 6.35 | 6.45 | 6.60 | 6.70 | 6.85 | 7.00 | 7.10 | 7.25 | +2%/yr |
| **Gas** - AECO Spot - CAD/MMBtu | 3.35 | 3.85 | 4.35 | 4.70 | 5.10 | 5.45 | 5.55 | 5.70 | 5.80 | 5.90 | 6.00 | 6.15 | 6.25 | 6.35 | 6.50 | +2%/yr |
| **Oil** - WTI (USD/bbl) | 92.50 | 92.50 | 93.60 | 95.50 | 97.40 | 99.40 | 101.40 | 103.40 | 105.40 | 107.60 | 109.70 | 111.90 | 114.10 | 116.40 | 118.80 | +2%/yr |

## 19. Net loss per share

Basic and diluted earnings per common share are calculated as follows:

| | **2012** **$** | 2011 $ |
|---|---|---|
| Net loss and comprehensive loss | (2,771,348) | (5,493,041) |
| Weighted average number of shares (basic) | 30,099,756 | 24,989,359 |
| Weighted average number of shares (diluted) (i) | 30,099,756 | 24,989,359 |
| Loss per share: | | |
| Basic | (0.09) | (0.22) |
| Diluted | (0.09) | (0.22) |

(i) Options to purchase securities in the number of Nil (2011 – nil) were 'in-the-money' at year end. These options to purchases securities were excluded from the weighted average number of shares calculation for the year ended December 31, 2012 and 2011 as the Company is in a loss position.

## 20. Change in non-cash working capital

| | **2012** **$** | 2011 $ |
|---|---|---|
| Accounts receivable | 70,428 | (553,976) |
| Prepaid expenses and deposits | 2,943 | 126,090 |
| Accounts payable and accrued liabilities | (846,232) | 1,315,746 |
| Total | (772,861) | 887,860 |
| Operating | 224,690 | (64,691) |
| Financing | - | - |
| Investing | (997,551) | 952,551 |
| Total | (772,861) | 887,860 |

## 21. Related party disclosures

Balances between Petro Viking Energy Inc. and its subsidiary, Petro Viking Management Corp., which is a related party, have been eliminated on consolidation and are not disclosed in this note.

See note 4 which explains the terms of acquisition of Deep Creek, a related party, by the Company.

| | **2012** | 2011 |
|---|---|---|
| **Key management personnel compensation:** | | |
| Administration and consulting fees | 278,695 | 171,000 |
| Stock options | 124,551 | 196,841 |
| Bonus shares issued | - | 30,000 |
| *(Key management personnel are comprised of the Company's directors and officers.)* | | |
| **Other related party transactions:** | | |
| Legal and administrative fees charged by a law firm of which one director of the Company is council. | 115,845 | 116,560 |
| Debenture – repayment of principal to a director of the Company. | - | 100,000 |
| Interest expense on the Company's debentures, held by a director of the Company, and companies controlled by a director of the Company. | 29,622 | 25,168 |
| Consideration transferred for acquisition of additional working interest in an existing property (note 4) | - | 225,000 |

| **Amount owing to / from related parties** | **2012** **$** | 2011 $ |
|---|---|---|
| Accounts payable and accrued liabilities for administration and consulting fees, legal fees, and debenture interest. | 62,169 | 35,233 |
| Accounts receivable from a company, controlled by an officer of the Company, with a working interest in one of the Company's wells. | - | 25,894 |
| Debenture – Principal outstanding. | 370,000 | 370,000 |

## 22. Financial instruments and financial risk management

The Company's risk management policies are established by the Board of Directors to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's policy.

The Company's financial instruments include cash and cash equivalents, short–term investments, accounts receivable, accounts payable and accrued liabilities, and debentures. The carrying values of cash and cash equivalents accounts receivable, accounts payable and accrued liabilities, approximate their fair values due to their relatively short periods to maturity. The short-term interest bearing securities are recorded at cost plus accrued interest earned which approximates current market value. These financial instruments are classified as follows:

- Cash and cash equivalents - Fair value through profit or loss – held-for-trading
- Short-term investments - Fair value through profit or loss – held-for-trading
- Accounts Receivable - Loans and receivables
- Accounts payable and accrued liabilities - Other financial liabilities
- Debentures - Other financial liabilities

The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these consolidated financial statements.

### a. Fair values

The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 – quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

The fair value of cash and cash equivalents and short-term investments is determined using level 1 inputs as it is determined by amounts held at/lent by financial institutions.

The fair value of debentures approximates their carrying value as they bear interest at a rate that is comparable to current market rates. The Company has classified these as Level 2 financial instruments.

The fair value of the amounts due to related parties (note 8) is less than carrying value, as the amounts are non-interest bearing. As the amounts have no terms of repayment, the fair value cannot be calculated with any degree of certainty, therefore the Company has classified these as Level 3 financial instruments.

## 22. Financial instruments and financial risk management (continued)

### b. Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its commercial obligations.

The Company's cash and cash equivalents consist of cash in bank accounts at major financial institutions which are highly liquid bank deposits with original maturities of less than three months. Accordingly, the Company views credit risk as minimal.

Credit risk to the Company arises principally from joint venture partners and natural gas marketers.

Virtually all of the Company's accounts receivable are with companies in the petroleum and natural gas industry within Canada and are subject to normal industry credit risks. The Company generally extends unsecured credit to these companies and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company's maximum credit risk exposure is limited to the carrying value of its accounts receivable. However, the receivables are from participants in the oil and gas sector and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalation costs and the risk of unsuccessful drilling.

The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Company does have the ability to withhold production from joint venture partners in the event of non-payment.

### c. Liquidity risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

The Company anticipates it will continue operations in the foreseeable future and it will have adequate liquidity to fund its financial liabilities through its future cash flows.

At December 31, 2012, the Company's financial liabilities are comprised of accounts payable, and accrued liabilities and debentures, which have expected maturities of less than one year resulting in their current classification on the consolidated statement of financial position.

At December 31, 2012, the Company had a net working capital position of $(341,906) (unfavourable). This includes debentures payable of $640,000, which has been classified as a current liability at December 31, 2012, as they mature on February 28, 2013. Subsequent to December 31, 2012, the Company has renewed its debentures (note 9). The renewed debentures have a maturity of February 28, 2015. When debentures are excluded from the calculation, the company has a net working capital position of $298,094 (favourable).

## 22. Financial instruments and financial risk management (continued)

### d. Market risk

Market risk is the risk that changes in market factors, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's cash flows, net income, liquidity or the value of financial instruments. The objective of market risk management is to mitigate market risk exposures where considered appropriate and maximize returns.

**i.** Interest rate risk
Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk on its cash and cash equivalents and short-term investments. The Company had no interest rate swap or financial contracts in place at December 31, 2012 or 2011. For the year ended December 31, 2012 or 2011, an increase or decrease of interest rates by one percent would not have materially affected the financial results of the Company.

**ii.** Currency risk
Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum and natural gas sales are denominated in Canadian dollars; however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at December 31, 2012 or 2011.

**iii.** Commodity price risk
Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand. Significant changes in commodity prices may materially impact the Company's financial results. If the price of oil decreased by $10/bbl, the net loss and comprehensive loss for the year would have increased by $152,600. A decrease in the price of gas by$0.50/mcf would have increased the net loss and comprehensive loss by $40,540. An equal and opposite effect would have occurred if the price of oil and gas had increased.

## 23. Capital Management

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include shareholders equity and debentures.

The Company monitors capital based on annual funds from operations and capital expenditure budgets, which are updated as necessary and are reviewed and periodically approved by the Company's Board of Directors. In order to maintain or adjust the capital structure, from time to time the Company may issue common shares, debt or other securities, sell assets or adjust capital spending to manage current and projected debt levels.

At December 31, 2012, the Company's capital structure was not subject to external restrictions.

The Company anticipates it will continue operations in the foreseeable future and it will have adequate liquidity to fund its financial liabilities through its future cash flows. Subsequent to December 31, 2012, the Company has renewed its debentures (note 9). The renewed debentures have a maturity of February 28, 2015.

## 24. Income Taxes

### i. Deferred tax recovery

The provision for income tax reflects an effective income tax rate which differs from federal and provincial statutory income tax rates. The main differences are as follows:

| | **2012** $ | 2011 $ |
|---|---|---|
| Loss before income taxes | (2,771,348) | (5,541,541) |
| Enacted income tax rate | 25.0% | 26.5% |
| Expected income tax (recovery) | (692,837) | (1,468,508) |
| Increase (decrease) in taxes resulting from: | | |
| Share-based compensation | 40,794 | 105,837 |
| Change in tax pool estimates | 396,038 | - |
| Impact of change in effective tax rate | - | 143,549 |
| Change in tax benefits not recognized | 256,005 | 1,170,622 |
| **Deferred tax (recovery)** | - | (48,500) |

### ii. Components of the net deferred tax asset

Temporary differences and carry forwards that give rise to deferred tax assets as of December 31, 2012 and 2011 are as follows:

| | **2012** $ | 2011 $ |
|---|---|---|
| Non-capital losses | 1,537,576 | 962,471 |
| Decommissioning liability | 944,732 | 949,569 |
| Property and equipment | 14,777 | 298,230 |
| Share issue costs and other | 93,219 | 124,029 |
| Total gross deferred tax assets | 2,590,304 | 2,334,299 |
| Tax benefits not recognized | (2,590,304) | (2,334,299) |
| **Net deferred tax assets** | - | - |

The tax benefits not recognized offsets the net deferred tax assets for which there is no assurance of recovery. The tax benefits not recognized is evaluated considering positive and negative evidence about whether the deferred tax assets will be realized. At the time of evaluation, the tax benefits not recognized is either increased or reduced. Reduction could result in the complete elimination of the tax benefits not recognized, if positive evidence indicated that the value of the deferred tax assets is no longer impaired and the tax benefits not recognized is no longer required.

## 24 Income Taxes (continued)

### iii. Tax pools

As at December 31, 2012, the Company has available for deduction against future taxable income, the following approximate amounts:

| | Rate | **2012** **$** |
|---|---|---|
| Non-capital losses carry forwards | 100% | 6,150,000 |
| Share issue costs | 20% | 361,000 |
| Canadian exploration expenditures | 100% | 820,000 |
| Canadian development expenditures | 30% | 57,000 |
| Canadian oil and gas property expenditures - regular | 10% | 532,000 |
| Capital cost allowances | 20-25% | 401,000 |

The availability of deduction of the operating loss carry forwards against future taxable income expires as follows:

| Year expire: | **$** |
|---|---|
| | ***Nearest '000*** |
| 2026 | 173,000 |
| 2027 | 1,019,000 |
| 2028 | 802,000 |
| 2029 | 794,000 |
| 2030 | 377,000 |
| 2031 | 1,018,000 |
| 2032 | 1,967,000 |
| Total | 6,150,000 |

## 25. Operating Leases

Non-cancellable operating lease rentals for a compressor are payable as follows:

| | **2012** **$** | 2011 $ |
|---|---|---|
| Less than one year | - | 36,850 |
| Between one and five years | - | - |
| More than five years | - | - |

The table below shows the expense recorded for the year ended December 31, 2012 and 2011:

| | **2012** **$** | 2011 $ |
|---|---|---|
| Equipment lease rentals for a compressor. | 36,850 | 6,847 |

## 26. Letters of Credit

| | **2012** | 2011 |
|---|---|---|
| | **$** | $ |
| Letter of Credit issued to Saskatchewan Ministry of Energy and Resources under the Saskatchewan License Liability Rating (LLR) Program | 74,045 | 74,045 |

## 27. Contingency

A former director of the Company has made a claim for payment of amounts alleged to be owed to him (or a company controlled by him) under a consulting agreement. The claimants commenced an action in the Alberta Court of Queen's Bench on September 27, 2012, seeking judgment against the Company for the principal amount of $54,000, plus unspecified amounts for interest, taxes and costs. The Company denies that there is any amount owing to the claimants, and believes that the claimants were overpaid for services provided under the consulting agreement by an amount of $12,600, improperly invoiced by the claimants. The Company has filed a Statement of Defence and Counterclaim in the action, and intends to vigorously defend the claim.