



## **Annual Financial Statements**

**For the three and twelve months ended December 31, 2018**

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**December 31, 2018**

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## **MANAGEMENT'S REPORT**

### **To the Shareholders of Kaisen Energy Corp.:**

#### Management's Responsibility on Financial Statements

Management is responsible for the preparation of the annual Kaisen Energy Corp. financial statements. The financial statements have been prepared in accordance with the accounting policies detailed in the notes thereto. In Management's opinion, the financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and include certain estimates that reflect Management's best judgments.

Management is responsible for the integrity of the financial statements. Management has developed and maintains an adequate system of internal control over financial reporting which provides reasonable assurance that all transactions are recorded, that the financial statements realistically report the Company's operating and financial results, and that the Company's assets are safeguarded from loss or unauthorized use. Management believes that this system of internal controls has operated effectively for the year ended December 31, 2018. The Company has effective disclosure controls and procedures to ensure timely and accurate disclosure of material information relating to the Company which complies with the requirements of Canadian securities legislation.

The Board of Directors has approved the information contained in the financial statements. Their financial statement related responsibilities are fulfilled mainly through the Audit Committee which is composed entirely of independent directors and includes at least one director with financial expertise. The Audit Committee meets regularly with management and the external auditors to discuss reporting issues and ensures each party is properly discharging its responsibilities. The Audit Committee also considers the independence of the external auditors and reviews their fees.

The financial statements have been audited by Ernst & Young LLP, Independent Registered Chartered Professional Accountants, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders.

(Signed)

John Zahary  
Managing Director

March 20, 2019

## INDEPENDENT AUDITOR'S REPORT

To the Directors of Kaisen Energy Corp.

### Opinion

We have audited the financial statements of Kaisen Energy Corp. ("the Company"), which comprise the statement of financial position as at December 31, 2018, and the statement of loss and comprehensive loss, statement of changes in shareholders equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

### Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Material Uncertainty Related to Going Concern

We draw attention to Note 2(d) in the financial statements, which indicates that the Company incurred a loss of \$32,699,279 during the year ended December 31, 2018, and as of that date, the Company's current liabilities exceeded its current assets by \$3,309,681. As stated in Note 2(d), these events or conditions, along with other matters as set forth in Note 2(d), indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

### Other Information

Management is responsible for the other information. The other information comprises Management's Discussion and Analysis.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion & Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.



## **Responsibilities of Management and Those Charged with Governance for the Financial Statements**

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

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

## **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure, and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.



We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Calgary, Canada  
March 20, 2019

*Ernst & Young LLP*

Chartered Professional Accountants  
Licensed Public Accountants



## Statements of Financial Position

(Canadian dollars)

	Note	December 31, 2018	December 31, 2017
<b>Assets</b>			
Current assets			
Cash		\$ 328	\$ 822,010
Accounts receivable		292,251	1,991,332
Prepaid expenses and deposits		134,933	132,923
Risk management contracts	9	484,417	-
		<b>911,929</b>	2,946,265
Due from shareholder	22	-	268,525
Property, plant and equipment	6,7	32,600,132	57,720,471
		<b>\$ 33,512,061</b>	<b>\$ 60,935,261</b>
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities		\$ 2,126,023	\$ 2,319,729
Risk management contracts	10	-	887,852
Bank loan	8	2,095,587	3,051,501
		<b>4,221,610</b>	6,259,082
Risk management contracts	10	702,439	634,994
Other long-term liabilities	14	11,822,343	11,506,151
		<b>16,746,392</b>	18,400,227
<b>Shareholders' equity</b>			
Shareholders' capital	15	53,189,854	53,189,854
Convertible debentures	9	5,317,100	-
Contributed surplus		7,766,507	6,153,693
Deficit		(49,507,792)	(16,808,513)
		<b>16,765,669</b>	42,535,034
		<b>\$ 33,512,061</b>	<b>\$ 60,935,261</b>

Going Concern (note 2(d))

Commitments (note 21)

Subsequent events (note 23)

See accompanying notes to the financial statements.

## Statements of Earnings (Loss) and Comprehensive Earnings (loss)

(Unaudited, Canadian dollars, except per share amounts)

	Note	Three months ended		Twelve months ended	
		2018	December 31, 2017	2018	December 31, 2017
<b>Revenues</b>					
Petroleum and natural gas sales		\$ 1,475,951	\$ 5,578,173	\$ 14,468,581	\$ 21,432,511
Royalties		(265,508)	(975,978)	(2,675,916)	(3,711,376)
Revenue, net of royalties		1,210,443	4,602,195	11,792,665	17,721,135
Saskatchewan resource tax		(124,406)	(9,622)	(196,496)	(300,472)
Realized gain (loss) on risk management contracts	10	(485,392)	(256,044)	(2,929,008)	124,018
Other income		8,149	-	18,212	-
		608,794	4,336,529	8,685,373	17,544,681
<b>Expenses</b>					
Operating expenses		1,794,796	2,150,478	8,660,105	10,767,470
Transportation expenses		188,183	244,039	835,766	1,054,299
General and administrative expenses		64,722	448,916	1,428,651	2,649,231
Net finance expenses	13	82,206	82,229	371,103	322,728
Share-based compensation	16	276,959	481,263	1,346,909	1,937,229
Restructuring expenses	12	-	-	1,167,028	-
Depletion and depreciation		767,951	1,441,199	4,076,914	5,632,069
Impairment loss on property plant and equipment	7	24,803,000	-	24,803,000	-
Unrealized (gain) loss on risk management contracts	10	(3,600,095)	1,312,370	(1,304,824)	(2,460,437)
		24,377,722	6,160,494	41,384,652	19,902,589
<b>Earnings (loss) before income taxes</b>		<b>(23,768,928)</b>	<b>(1,823,965)</b>	<b>(32,699,279)</b>	<b>(2,357,908)</b>
<b>Income taxes</b>	19				
Current tax expense		-	-	-	4,514
Deferred tax expense		-	-	-	-
		-	-	-	4,514
<b>Net loss and comprehensive loss</b>		<b>\$ (23,768,928)</b>	<b>\$ (1,823,965)</b>	<b>\$ (32,699,279)</b>	<b>\$ (2,362,422)</b>
<b>Net loss per share</b>					
Basic and diluted	17	\$ (0.52)	\$ (0.04)	\$ (0.72)	\$ (0.05)

See accompanying notes to the financial statements.

## Statements of Cash Flows

(Canadian dollars)

		Three months ended December 31,		Twelve months ended December 31,	
	Note	2018	2017	2018	2017
<b>Cash provided by (used in) the following activities:</b>					
<b>Operating activities</b>					
Net loss for the period		\$ (23,768,928)	\$ (1,823,965)	\$ (32,699,279)	\$ (2,362,422)
Add (deduct) items not affecting cash from operations:					
Depletion and depreciation expense		767,951	1,441,199	4,076,914	5,632,069
Impairment loss on property plant and equipment	7	24,803,000	-	24,803,000	-
Accretion of decommissioning obligations	14	65,279	57,428	258,882	224,786
Restructuring expenses	12	-	-	257,162	-
Share-based compensation	16	276,959	481,263	1,346,909	1,937,229
Unrealized (gain) loss on risk management contracts	10	(3,600,095)	1,312,370	(1,304,824)	(2,460,437)
Other		(13,460)	-	(40,559)	-
Well abandonment costs incurred		-	(7,960)	-	(63,873)
		(1,469,294)	1,460,335	(3,301,795)	2,907,352
Change in non-cash working capital	18	(250,171)	(1,570,828)	1,656,751	(1,912,426)
Cash flow from (used in) operating activities		(1,719,465)	(110,493)	(1,645,044)	994,926
<b>Financing activities</b>					
Net (payments) advances of bank loan		980,457	1,702,195	(955,914)	3,051,501
Proceeds from issuance of shares	15	-	-	-	2,500,000
Issuance of convertible debentures, net of issue costs	9	1,301,000	-	5,317,100	-
Cash flow from financing activities		2,281,457	1,702,195	4,361,186	5,551,501
<b>Investing activities</b>					
Development of oil and gas properties		(503,078)	(310,770)	(3,441,108)	(8,157,521)
Change in non-cash working capital	18	(58,961)	(592,102)	(96,716)	34,019
Cash used in investing activities		(562,039)	(902,872)	(3,537,824)	(8,123,502)
Change in cash		(47)	688,830	(821,682)	(1,577,075)
Cash, beginning of the period		375	133,180	822,010	2,399,085
<b>Cash, end of the period</b>		<b>\$ 328</b>	<b>\$ 822,010</b>	<b>\$ 328</b>	<b>\$ 822,010</b>
<b>Supplementary disclosure</b>					
Cash interest paid		\$ 85,553	\$ 24,801	\$ 112,221	\$ 97,942
Cash taxes paid		-	-	-	-

See accompanying notes to the financial statements.

## Statements of Changes in Shareholders' Equity

(Canadian dollars)

	Note	Share capital	Contributed surplus	Convertible debentures	Retained earnings (deficit)	Shareholders' equity
Balance as at January 1, 2017		\$ 50,689,854	\$ 3,851,531	\$ -	\$ (14,446,091)	\$ 40,095,294
Net loss		-	-	-	(2,362,422)	(2,362,422)
Common shares issued	15	2,500,000	-	-	-	2,500,000
Share-based compensation	16	-	2,302,162	-	-	2,302,162
Balance as at December 31, 2017		\$ 53,189,854	\$ 6,153,693	\$ -	\$ (16,808,513)	\$ 42,535,034
Net loss		-	-	-	(32,699,279)	(32,699,279)
Convertible debentures issued	9	-	-	5,317,100	-	5,317,100
Share-based compensation	16	-	1,612,814	-	-	1,612,814
<b>Balance as at December 31, 2018</b>		<b>\$ 53,189,854</b>	<b>\$ 7,766,507</b>	<b>\$ 5,317,100</b>	<b>\$ (49,507,792)</b>	<b>\$ 16,765,669</b>

See accompanying notes to the financial statements.

## Notes to the Financial Statements

As at December 31, 2018 and for the three and twelve months ended December 31, 2018 and 2017

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### 1. Reporting Entity

Kaisen Energy Corp. (the "Company" or "Kaisen") is a Calgary based energy company primarily focused on heavy oil development and production in Saskatchewan. The Company was incorporated in Canada on November 6, 2012. The Company's principal place of business is 400, 522 – 11th Avenue S.W. Calgary, Alberta, Canada, T2R 0C8.

### 2. Basis of Presentation and Going Concern

#### (a) Statement of compliance:

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. These financial statements were authorized for issue by the Board of Directors on March 20, 2019.

#### (b) Basis of measurement:

These financial statements have been prepared on a going concern basis under the historical cost basis, except as detailed in the accounting policies disclosed in Note 3 "Summary of Significant Accounting Policies".

#### (c) Functional and presentation currency:

The functional and presentation currency of the Company is the Canadian dollar. Unless otherwise stated, amounts presented in these financial statements, including tabular amounts, are stated Canadian dollars

#### (d) Going Concern:

These financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Company incurred a loss of \$32,699,279 during the year ended December 31, 2018, and as of that date, the Company's current liabilities exceeded its current assets by \$3,309,681. Sustained low commodity prices in recent months have put pressure on the Company's cash flows. As at December 31, 2018 the Company still had access to \$2,126,000 in available financing from unissued convertible debentures of which \$200,000 was drawn on in February of 2019. The management of the Company believes that the current level of financing may not be sufficient to pay for expected cash expenditures over the next 12 months. Although the Company has been successful in the past in obtaining financing, there is no assurance that it will be able to secure adequate financing in the future or that such financing will be on terms acceptable to the Company. The recoverability of the underlying value of the Company's assets is entirely dependent on the Company's ability to obtain the necessary financing to complete the development of its assets and achieve future profitable production. As a result, there is a material uncertainty that may cast substantial doubt on the Company's ability to continue as a going concern. These financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used. These adjustments could be material.

### 3. Summary of Significant Accounting Policies

#### (a) Financial instruments

Financial assets and financial liabilities are measured at fair value on initial recognition. Measurement in subsequent periods depends on the financial instrument's classification, as described below.

- *Fair value through profit or loss:* Financial instruments designated at fair value through profit or loss are initially recognized and subsequently measured at fair value with changes in those fair values charged immediately to net earnings. Financial instruments under this classification include derivative assets and liabilities.
- *Amortized cost:* Financial instruments designated as amortized cost are initially recognized at fair value, net of directly attributable transaction costs, and are subsequently measured at amortized cost using the effective interest method. Financial instruments under this classification include cash, restricted cash, accounts receivable, accounts payable and accrued liabilities, income taxes payable and term loan and associated liabilities.
- *Fair value through other comprehensive income:* Financial instruments designated as fair value through other comprehensive income are initially recognized at fair value, net of directly attributable transaction costs, and are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax.

Financial derivatives may be used by the Company to manage exposure to market risk relating to commodity prices, foreign exchange rates and interest rates. The Company does not designate its financial derivatives contracts as hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded and carried on the consolidated statement of financial position at fair value with actual amounts received or paid on the settlement of the financial derivative instrument recorded in net earnings. Forward crude oil derivative contracts are recorded at their estimated fair value based on the difference between the contracted price and the period end forward price, using quoted market.

## **(b) Fair value measurement**

The Company measures its cash at fair value at each reporting date. Fair value less costs of disposal is also calculated at each reporting date to determine the recoverable amount of non-financial assets that are tested for impairment

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 in its principal or most advantageous market at the measurement date. To estimate the fair value of its financial instruments, the Company uses quoted market prices when available or third-party models and valuation methodologies that use observable market data. Fair value is measured using the assumptions that market participants would use, including transaction-specific details and non-performance risk. All financial assets and liabilities for which fair value is measured or disclosed in the financial statements are further categorized using a three-level hierarchy that reflects the significance of the lowest level of inputs used in determining fair value:

- i. Level 1 - inputs represent quoted prices in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- ii. Level 2 – inputs other than quoted prices used in Level 1 that are observable, either directly or indirectly, as of the reporting date. Level 2 valuations are based on inputs which can be observed or corroborated in the market place.
- iii. Level 3 – inputs that are less observable, unavailable or where observable data does not support the majority of the instrument's fair value.

At each reporting date, the Company determines whether transfers have occurred between levels in the fair value hierarchy by reassessing the level of classification for each financial asset and financial liability measured or disclosed at fair value in the consolidated financial statements. Assessments of the significance of a particular input to the fair value measurement requires judgement and may affect the placement within the fair value hierarchy.

## **(c) Impairment of financial assets**

The Company recognizes loss allowances for expected credit losses on its financial assets measured at amortized cost. Expected credit losses exist if one or more loss events occur after initial recognition of the financial asset which has an impact on the estimated future cash flows of the financial asset and that impact can be reliably measured. The Company uses a combination of historical and forward-looking information to determine the appropriate expected credit loss. The carrying amount of the asset is reduced through the use of an allowance account, and the loss is recognized in general and administrative expenses.

## **(d) Exploration assets**

Expenditures incurred before the Company has obtained legal rights to explore an area are recognized in the consolidated statements of comprehensive income as exploration expenses. Exploration assets reflect expenditures for an area where technical feasibility and commercial viability have not yet been determined. Expenditures, including land acquisition, geological and geophysical, drilling and completion costs and directly attributable employee salaries and benefits are capitalized and accumulated pending determination of technical feasibility and commercial viability. Exploration assets are not depleted. When assets are determined to be technically feasible and commercially viable, the accumulated costs are tested for impairment within the cash-generating unit ("CGU"), and the recoverable amount is transferred to property and equipment. Management considers technical feasibility and commercial viability to exist when a project is expected to be free cash flow positive for the remaining life of the project, as demonstrated by the assignment of proved reserves, combined with Management's judgement of other factors impacting current project status and forecasted operating and financial results.

Exploration assets are also assessed for impairment when facts and circumstances suggest that the carrying amount exceeds the recoverable amount. Indications of impairment are assessed by the Company on a quarterly basis.

## **(e) Property, plant and equipment**

All costs directly associated with the acquisition and development of petroleum and natural gas properties are capitalized and measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development costs include expenditures for areas where technical feasibility and commercial viability have been determined. The initial cost of an asset is comprised of the purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning obligation, and for qualifying assets, borrowing costs. The purchase price or constructed cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Expenditures on major turnarounds comprises the cost of replacement assets or parts of assets and inspection and overhaul costs. Where an asset or part of an asset is replaced and it is probable that future economic benefits will flow to the Company from the replacement, the expenditure is capitalized and the replaced part is derecognized. Inspection and overhaul costs relating to turnarounds and all other repairs and maintenance costs are expensed when incurred. Well workover costs incurred to stimulate depleted wells are charged as an expense when incurred. Certain stimulation costs which increase production and reserves, extending beyond one year, are capitalized in property, plant and equipment and depleted over the economic life of the asset.

Petroleum and natural gas assets are accumulated in cost centers based on CGUs. CGUs are depleted using the unit-of-production method based upon estimated gross proved plus probable reserves, determined annually by independent professional engineers. Estimated future

development costs necessary to bring the reserves into production are included in the depletion calculation. Other property and equipment assets are depreciated over the estimated useful lives of the assets at various rates per annum calculated on a declining balance basis. Depreciation methods, useful lives and residual values are reviewed at least annually.

A gain or loss arising on the disposal or retirement of fixed assets is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the Statement of Earnings (Loss) for the relevant period. Property and equipment balances are tested for impairment when indications of impairment exist. Indications of impairment are assessed by the Company on a quarterly basis.

**(f) Impairment of non-financial assets**

The carrying amounts of the Company's non-financial assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. These indicators include future prices, future cost and reserves value, but this list is not exhaustive. Exploration assets are assessed for impairment when they are reclassified to property, plant and equipment, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash flows that are largely independent of the cash flows of other assets or groups of assets (the CGU). The recoverable amount of an asset or a CGU is the greater of its value-in-use and its fair value less costs of disposal.

Fair value is determined as the amount that would be obtained from the sale of the assets in an arm's length transaction between knowledgeable and willing parties. Fair value for oil and gas assets is generally determined as the present value of estimated future cash flows arising from the continued use of assets, which includes estimates such as the cost of future expansion plans and eventual disposal, using assumptions that an independent market participant may take into account. Cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses are recognized in net earnings. An impairment loss recognized in prior periods for an asset other than goodwill is reversed if there has been a change in facts and circumstances used to determine the asset's recoverable amount since the last impairment was recognized, such that the impairment no longer exists or has decreased. An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment has been recognized.

**(g) Inventory**

Inventory is valued at the lower of cost and net realizable value. Cost comprises direct purchase costs (including transportation), production costs and taxes. Net realizable value is the estimated selling price in the ordinary course of business, less applicable expected variable selling expenses.

**(h) Leased assets**

When it is determined that an arrangement contains a lease, the Company classifies the lease as either a financing lease or operating lease. Financing leases are those which will transfer substantially all the benefits and risks of ownership to the lessee.

When the Company is a lessee, assets acquired under financing leases are depleted and depreciated with property, plant and equipment. Obligations recorded under financing leases are reduced by the principal as incurred, and the imputed interest portion of financing lease payments is charged to interest expense. Payments under operating leases are expensed as incurred.

**(i) Provisions**

A provision is recognized if, as a result of a past event, the Company has a present, legal or constructive obligation that can be estimated reliably and is probable that an outflow of economic benefit will be required to settle the obligation. Provisions are measured using the best estimate of the expenditure required to settle the obligation.

**(j) Onerous contracts**

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract.

**(k) Decommissioning liability**

Decommissioning liabilities are recognized when the Company has a statutory, contractual or legal obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. A corresponding amount equivalent to the liability is recognized as part of the cost of the related property, plant and equipment.

Estimated decommissioning liabilities are carried on the Statement of Financial Position at present value, calculated using a weighted average risk-free rate, accreted over time for the change in present value, with this accretion expense included in finance costs on the statement of earnings (loss). Actual expenditures incurred are charged against the accumulated obligation. Any difference between the recorded decommissioning liability and the actual retirement costs incurred is recorded as a gain or loss when the field is abandoned.

The resulting increase in capitalized costs due to the inclusion of the decommissioning liability is amortized to income on a basis consistent with depletion and depreciation of the underlying assets. Subsequent changes in the estimated decommissioning liabilities are capitalized and amortized over the remaining useful life of the underlying asset.

Liabilities for environmental costs are recognized when an obligation exists and the associated costs can be reliably estimated. Generally, the timing of recognition of these liabilities coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites. The amount recognized is the best estimate of the expenditure required. Where the liability will not be settled for a number of years, the amount recognized is the present value of the estimated future expenditure. These estimates are included in decommissioning liabilities.

**(l) Revenue Recognition**

Revenue associated with the sale of crude oil, natural gas, or natural gas liquids is measured based on the consideration specified in contracts with customers. Revenue from contracts with customers is recognized when or as the Company satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. The transfer of control of crude oil, natural gas, or natural gas liquids coincides with title passing to the customer and the customer taking physical possession.

**(m) Share-based compensation**

The Company accounts for share-based compensation using the fair-value method of accounting for executive incentive options, share options and performance warrants granted to directors, officers, employees and consultants using the Black-Scholes option-pricing model. The grand date fair values are recognized over the vesting periods of the awards with a corresponding increase in contributed surplus. When awards are exercised, the consideration received, and the associated amounts previously recorded as contributed surplus are reclassified to shareholders capital.

**(n) Income taxes**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in net earnings except to the extent that it relates to items recognized directly in equity, in which case the related income tax is also recognized in equity. Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the financial position date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the consolidated balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but the Company intends to settle current tax liabilities and assets on a net basis or the tax assets and liabilities will be realized simultaneously.

Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is neither a business combination nor an event resulting in income or expense. Deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized.

**(o) Per share information**

Basic net earnings per share amounts are calculated by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per share is determined by adjusting the net earnings and the weighted average number of common shares outstanding using the treasury stock method for the effects of dilutive instruments which include outstanding share options and incentive share options.

#### **4. Summary of Significant Accounting Policies**

##### **(a) Adoption of IFRS 9 Financial Instruments**

Effective January 1, 2018, the Company adopted IFRS 9 Financial Instruments (“IFRS 9”), which replaced IAS 39 Financial Instruments: Recognition and Measurement. The adoption of IFRS 9 did not result in any adjustments to the measurement of financial instruments, and no adjustment to retained earnings was required.

##### **(b) Adoption of IFRS 15 Revenue Recognition**

Effective January 1, 2018, the Company adopted IFRS 15 Revenue from Contracts with Customers (“IFRS 15”). The Company primarily enters into non-complex and routine revenue contracts with customers that require daily physical delivery of produced volumes priced at the current daily or monthly average spot price. Performance obligations are met upon delivery of the volumes at the processing facility and the transaction price is established based on the date of delivery.

The Company adopted IFRS 15 using the modified retrospective approach. Under this transitional provision, the cumulative effect of initially applying IFRS 15 was recognized on the date of initial application as an adjustment to retained earnings. The adoption of IFRS 15 did not impact the timing or measurement of revenue, and no adjustment to retained earnings was required.

##### **(c) Standards issued but not yet adopted**

IFRS 16 Leases (“IFRS 16”) replaces IAS 17 Leases and requires entities to recognize lease assets and lease obligations on the statement of financial position. For lessees, IFRS 16 removes the classification of leases as either operating leases or finance leases, effectively treating all leases as finance leases. Certain short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements and may continue to be treated as operating leases. Lessors will continue with a dual lease classification model. Classification will determine how and when a lessor will recognize lease revenue and what assets would be recorded. The standard will come into effect for annual periods beginning on or after January 1, 2019 and may be applied retrospectively or using a modified retrospective approach. The modified retrospective approach does not require restatement of prior period financial information as it recognizes the cumulative effect as an adjustment to opening retained earnings and applies the standard prospectively. The Company has elected to adopt IFRS 16 on January 1, 2019 using the modified retrospective approach.

As of December 31, 2018, the Company has performed an initial assessment of its lease contracts that will fall into scope of this standard. The Company is currently evaluating the financial impact of the standard on its financial statements in preparation for adoption. The Company anticipates that the standard will increase both assets and liabilities reported on the consolidated statement of financial position. Additionally, the Company expects impacts to the consolidated statement of comprehensive income (loss), likely with an increase in depreciation and net finance expenses and decreases in general and administrative expenses. As part of this review, the Company is also assessing potential changes to its financial reporting policies and internal controls.

#### **5. Use of Estimates, Judgements and Assumptions**

The preparation of financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ from estimates, and those differences may be material. The estimates and assumptions used are subject to updates based on experience and the application of new information. Estimates and underlying assumptions are reviewed on an ongoing basis, and any revisions to accounting estimates are recognized in the period in which the estimates are revised. Significant estimates and judgements made by Management in the preparation of these consolidated financial statements are outlined below.

##### **(a) Fair value of financial instruments**

The estimated fair value of financial instruments is reliant upon a number of estimated variables including forward commodity prices, foreign exchange rates and interest rates, volatility curves and risk of non-performance. Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair values.

The fair value of financial derivatives was based on fair values provided by counterparties with whom the transactions were completed. By their nature, these estimates and assumptions were subject to measurement uncertainty.

##### **(b) Oil and gas reserves, recoverability of asset carrying values and depletion**

The amounts recorded for exploration assets, property and equipment, depletion and depreciation and impairment testing are based on estimates of proven and probable reserves, production rates, future oil prices, future costs, future foreign exchange rates and other relevant assumptions. All the Company’s petroleum reserves are evaluated and reported by independent engineering consultants in accordance with Canadian Securities Administrators’ National Instrument 51-101.

There are a number of inherent uncertainties associated with estimating reserves and resources. Reserve and resource estimates are based on engineering data, estimated future prices, expected future rates of production and the timing and amount of future expenditures, all of which are subject to many uncertainties, interpretations and judgments. Estimates reflect market and regulatory conditions existing at December 31, 2018, which could differ significantly from other points in time throughout the year or in future periods. Assumptions that are valid at the time of reserves estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs or recovery rates may change the economic status of reserves. Changes in the economic environment could result in significant changes to the discount rate used to calculate net present values. Changes in reserves impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion and are also used in measuring fair value less costs of disposal of property and equipment for impairment calculations.

**(c) Determination of cash-generating units**

Determination of what constitutes a CGU is subject to the judgement of Management. The recoverability of development and production asset carrying values are assessed at the CGU level, and the asset composition of a CGU can directly impact the recoverability of the assets included therein. Furthermore, the transfer of exploration assets to property and equipment is based on Management's judgement of technical feasibility and commercial viability.

**(d) Share-based compensation**

The Company measures the cost of equity-settled transactions by reference to the estimated fair value of the equity instruments at the date at which they are granted. The fair value of share options is measured using a Black-Scholes option pricing model. Measurement inputs include weighted average share prices prior to the measurement date, exercise price of the instrument, expected volatility, weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on Government of Canada bonds).

**(e) Income taxes**

Accounting for income taxes is a complex process requiring Management to interpret frequently changing laws and regulations and make judgments relating to the application of tax law, the estimated timing of temporary difference reversals, and the estimated realization of tax assets. All tax filings are subject to subsequent government audits and potential reassessment. These interpretations, judgments and changes related to them impact current and deferred tax provisions, deferred income tax assets and liabilities and earnings.

**6. Property, Plant and Equipment**

	Oil and gas assets	Corporate assets	Total assets
<b>Cost:</b>			
<b>Balance, January 1, 2017</b>	<b>\$ 67,678,798</b>	<b>\$ 181,003</b>	<b>\$ 67,859,801</b>
Development expenditures	7,929,179	14,851	7,944,030
Additions to decommissioning obligations	1,306,427	-	1,306,427
Capitalized general and administrative costs	390,000	-	390,000
Capitalized share-based compensation	364,933	-	364,933
<b>Balance, December 31, 2017</b>	<b>\$ 77,669,337</b>	<b>\$ 195,854</b>	<b>\$ 77,865,191</b>
Development expenditures	3,062,518	1,926	3,064,444
Additions to decommissioning obligations	52,562	-	52,562
Capitalized general and administrative costs	376,664	-	376,664
Capitalized share-based compensation	265,905	-	265,905
<b>Balance, December 31, 2018</b>	<b>\$ 81,426,986</b>	<b>\$ 197,780</b>	<b>\$ 81,624,766</b>
<b>Accumulated depletion and depreciation:</b>			
<b>Balance, January 1, 2017</b>	<b>\$ 14,443,615</b>	<b>\$ 69,036</b>	<b>\$ 14,512,651</b>
Depletion and depreciation	5,595,061	37,008	5,632,069
<b>Balance, December 31, 2017</b>	<b>\$ 20,038,676</b>	<b>\$ 106,044</b>	<b>\$ 20,144,720</b>
Depletion and depreciation	4,050,416	26,498	4,076,914
Impairment	24,803,000	-	24,803,000
<b>Balance, December 31, 2018</b>	<b>\$ 48,892,092</b>	<b>\$ 132,542</b>	<b>\$ 49,024,634</b>
<b>Net book value:</b>			
Balance, December 31, 2017	\$ 57,630,661	\$ 89,810	\$ 57,720,471
<b>Balance, December 31, 2018</b>	<b>32,534,894</b>	<b>65,238</b>	<b>32,600,132</b>

During the three and twelve months ended December 31, 2018, the Company capitalized general and administrative expenses in the amount of \$92,499 and \$376,664, respectively (2017 - \$97,500 and \$390,000) and capitalized share-based compensation expense in the amount of \$56,054 and \$265,905, respectively (2017 - \$89,733 and \$390,000), relating to development activities.

Future development costs associated with proved plus probable undeveloped reserves of \$93,253,000 (2017 - \$98,869,400) are included in the depletion calculation net of salvage values of \$2,590,000 as at December 31, 2018 (2017 - \$2,580,000). No other costs have been included or excluded from property plant and equipment in the determination of depletion and depreciation expense.

## 7. Impairment loss on Property, Plant and Equipment

At December 31, 2018, the Company assessed whether there were indicators of impairment present. The assessment factored in reserves, change in commodity prices year over year, the health of the sector and the general economy, and near-term development plans. It was determined that all CGUs exceeded their recoverable amount. The recoverable amount was calculated as the fair value of assets less cost of disposal. The fair value was determined using an after-tax discount rate of 19.6% and forecasted cash flows. The forecasted cash flows are based on the year-end total proved reserves and pricing used by Sproule Associates Limited, the Company's independent reserve engineers. An impairment loss of \$24,803,000 was recorded for the year. Recoverable amounts of the Company's CGUs at December 31, 2018 were \$32.6 million (2017 - \$148.4 million).

In 2017, the Company performed an impairment test using forecasted cash flows based on proved plus probable reserves and a discount rate of 10%. Management changed its approach from the prior year due to uncertainties surrounding the Company's access to sufficient capital required to fund the development of proved plus probable reserves.

The following commodity price estimates were used to determine the recoverable amount:

Year	WTI Cushing Ok (US\$/bbl)	Western Canadian Select (C\$/bbl)	US\$ to C\$ Foreign exchange rate
2019	63.00	59.47	0.77
2020	67.00	62.31	0.80
2021	70.00	67.45	0.80
2022	71.40	69.53	0.80
2023	72.83	71.66	0.80
2024	74.28	73.10	0.80
2025	75.77	74.56	0.80
2026	77.29	76.05	0.80
2027	78.83	77.57	0.80
2028	80.41	79.12	0.80
2029	82.02	80.70	0.80
Thereafter	+2% per year	+2% per year	0.80

The results of the impairment test are sensitive to changes in any of the key judgements, such a revision in reserves, a change in forecast commodity prices, expected royalties, required future development capital expenditures or expected future production costs, which could decrease or increase the recoverable amounts of assets and result in additional impairment charges or recovery of impairment charges. The estimated recoverable amount of the impaired CGU's is classified as a Level 3 fair value measurement. Refer to Note 3(b) for information on hierarchy classifications.

## 8. Bank Loan

The Company's revolving operating facility limit of \$2.5 million (December 31, 2017 - \$5.5 million) is payable in full on demand by the lender, and the lender may terminate the availability thereof (including any undrawn portion) at any time without notice; therefore, the Bank loan is presented as a current liability on the Statement of Financial Position. Prime-based loans are available through the revolving operating facility at the Canadian prime rate plus 1.25% per annum. A demand debenture on all the assets of the Company has been provided as collateral for the facility.

The Bank loan is subject to a financial covenant wherein the working capital ratio shall not fall below 1.00:1.00 where working capital is defined under the lending agreement to include current assets plus any undrawn availability under the operating facility, less current liabilities, less any amount currently drawn under the facility (if applicable). As at December 31, 2018, the Company was in breach of its lenders covenant as its working capital was 0.39:1.00. As a result, the lender can demand repayment of the bank loan in full which had a balance of \$2,095,587 owing at December 31, 2018 and is classified as a current liability on the statement of financial position. Management plans to address any future working capital deficiencies by accessing the remaining \$2,126,000 in funding available through undrawn Obligation Debentures and by using future cash flows in excess of capital spending to improve its working capital position. Refer to Note 9 (b).

## 9. Convertible Debentures and Obligation Debentures

On May 28, 2018, the Company provided all shareholders and its Managing Director the opportunity to subscribe for an aggregate of \$7,503,000 in convertible debentures and the execution of an agreement for 5,426 committed convertible debentures ("Obligation Debentures"), as described in further detail in note 9b. During the fourth quarter of 2018, the Company issued an additional 1,301 convertible debentures for total gross and net proceeds of \$1,301,000. On a year to date basis, the Company has issued a total of 5,377 convertible debentures for total gross proceeds of \$5,377,000 (\$5,317,100 net of issue costs).

### (a) Convertible Debentures

The key terms of the convertible debentures are as follows:

- issuable only in denominations of \$1,000 or multiples thereof
- mature on the occurrence of a liquidity event, with a qualifying liquidity event including, but not limited to:
  - (i) an amalgamation, arrangement, merger, or other similar transaction wherein all issued and outstanding common shares are sold for cash and/or securities, or which results in all of the Company's common shares being listed on a stock exchange
  - (ii) a sale of all or substantially all of the property and assets of the Company for consideration consisting of cash and/or securities and the subsequent distribution of all of such consideration to all common shareholders, on a pro rata basis;
  - (iii) the liquidation, dissolution or winding up of the Company;
  - (iv) a public offering; and
  - (v) any combination of the events or circumstances described in subsections (i), (ii), (iii) or (iv) above.
- the debentures bear interest at a fixed rate of 8.00% per annum compounded quarterly and payable in arrears on the occurrence of a liquidity event,
- upon the occurrence of a liquidity event, the Company shall:
  - (i) satisfy its obligation to pay all accrued and unpaid Interest through a cash payment; and
  - (ii) at the election of the holder of each convertible debenture, repay all or any portion of the face value of the convertible debenture by cash payment and/or by issuing and delivering common shares at a deemed price of \$0.05 per common share;

The convertible debentures represent the Company's obligation to deliver a variable number of its own equity instruments upon a liquidity event. The Company has determined that the liquidity event is a contingent settlement provision for which the Company has control over. As such, the convertible debentures have been classified as equity net of issue costs. If a liquidity event occurred on December 31, 2018 and the convertible debentures were converted to common shares, 107,540,000 additional shares of the Company would have been issued. Furthermore, had the Company issued the entire subscription of convertible debentures (\$7,503,000 in aggregate) in the current quarter and converted then to common shares, a total of 150,060,000 additional shares of the Company would have been issued and Kaisen would have received an additional \$2,126,000 of cash. As at December 31, 2018, the total face value of the convertible debentures plus accrued undeclared interest was \$5,540,000.

### (b) Obligation Debentures

Concurrent with the initial convertible debenture issuance, on May 28, 2018 the Company entered into an agreement with the subscriber for 5,426 committed, but as yet uncalled Obligation Debentures, which require the subscriber to subscribe for and purchase, and for the Company to issue and sell, the remaining \$5,426,000 in convertible debentures, two years from the date of issuance or at the Company's discretion. In the fourth quarter of 2018, the Company called on the subscriber to purchase an additional 1,300 Obligation Debentures resulting in the issuance of \$1,300,000 in convertible debentures by the Company. At December 31, 2018, a total of 2,126 Obligation Debentures remain, which represent an additional \$2,126,000 in funding available to the Company.

## 10. Risk Management

### (a) Credit risk

Credit risk arises from the potential that the Company may incur a loss if a counterparty to a financial instrument fails to meet its obligation in accordance with agreed terms. All the Company's crude oil and natural gas production is sold, as determined by market-based prices adjusted for quality differentials to midstream companies and intermediate producers. Typically, the Company's maximum credit exposure is petroleum sales for 1 month, of which \$148,865 was included in accounts receivable as at December 31, 2018.

The Company's carrying values of accounts receivable represented the Company's maximum credit exposure. The aging of account receivable as at December 31, 2018 and 2017 were as follow:

	December 31, 2018	December 31, 2017
Not past due	\$ 188,597	\$ 1,763,558
Past due greater than 90 days	103,654	227,774
<b>Accounts receivable</b>	<b>\$ 292,251</b>	<b>\$ 1,991,332</b>

Receivables from customers are normally collected approximately 25 days following the month of production. As at December 31, 2018, 51% of the Company's accounts receivables were with three crude oil marketing counterparts to whom the Company sells its production. The Company has not experienced any collection issues with its crude oil sales and therefore has not recorded an allowance for doubtful accounts as at December 31, 2018.

**(b) Liquidity risk**

Liquidity risk is the risk that the Company will encounter difficulties in meeting its financial liability obligations. The Company manages its liquidity risk through funds flow and debt management. See Note 11 for a more detailed discussion. Kaisen's financial liabilities on the statement of financial position consist of accounts payable and accrued liabilities and its bank loan.

**(c) Commodity price risk**

The Company is exposed to commodity price movements as part of its operations. The Company maintains a risk management strategy to protect funds flow from operations from the volatility of commodity prices. The Company's strategy focuses on the use of puts, costless collars, swaps or fixed price contracts to limit exposure to fluctuations in commodity prices. The Company had the following risk management contracts in place as at December 31, 2018:

Type	Period	Volume	Price/unit <sup>(1)</sup>	Index
Basis Swap	January 1, 2019 – December 31, 2019	300 bbl/d	US\$20.80	WTI-NYMEX
Fixed Swap	January 1, 2019 – December 31, 2019	300 bbl/d	C\$71.00	WTI-NYMEX
Call option <sup>(2)</sup>	January 1, 2020 – December 31, 2020	500 bbl/d	US\$60.00	WTI-NYMEX

(1) Based on the weighted average price/bbl for the duration of the contract

(2) The Call Option contract provides ATB with an option (at only their election) to exercise the contract terms (on a month to month basis) throughout the term of the contract.

As at December 31, 2018, the fair value associated with these risk management contracts was a net liability of \$218,022 (2017 - \$1,522,846), of which \$484,417 is reported as a current asset reflecting contracts which will settle by December 31, 2019, and \$702,439 reported as a long-term liability for contracts that will settle after December 31, 2019.

**(d) Interest rate risk**

The only liability on the Company's balance sheet exposed to fluctuations in interest rates is the bank debt. Based upon the Company' bank debt at December 31, 2018, an increase or decrease in net earnings for the year for each 1% change in interest rates would amount to \$21,000 (2017 - \$30,000).

**(e) Foreign currency risk**

The Company does not sell or transact in any foreign currency except the Company's commodity prices are largely denominated in United States dollars. As a result, the prices that the Company receive are affected by fluctuations in the exchange rates between the US dollar and the Canadian dollar. The exchange rate effect cannot be quantified, but generally an increase in the value of the Canadian dollar compared to the US dollar will reduce the prices received by the Company for its crude oil and natural gas sales. The Company had no foreign exchange forward rate contracts in place as at or during the period ended December 31, 2018.

**11. Capital Management**

The Company's policy is to maintain a strong capital base to provide flexibility in the future development of the business and to maintain the confidence of investors and lenders. The Company periodically reviews certain quantitative measures of its capital structure to understand its position relative to industry peers but does not set certain limits or ranges with respect to these quantitative measures. The Company is not subject to any external restrictions on its capital structure, with the exception of the single covenant in place with the Company's lender. As discussed in note 8, the Company was in breach of its lenders working capital covenant at December 31, 2018. Management closely monitors debt leverage to ensure the Company maintains financial flexibility and balance sheet strength sufficient to manage unforeseen events and/or opportunities as they arise.

## 12. Restructuring Expenses

Kaisen underwent a restructuring in the second quarter of 2018 resulting in a reduction to the Company's employee base and office space requirements. During the twelve months ended December 31, 2018, the Company recorded \$1,167,028 in restructuring expenses (2017 - \$nil). Cash based restructuring expenses for the twelve months ended December 31, 2018 comprised of severance payments of \$720,000, legal fees of \$55,888 and other costs of \$133,978. Non-cash expenses contain onerous lease charges of \$102,470, and \$154,692 relating to the impairment of the due from shareholder loan (see note 22). The Company still intends on actively pursuing re-payment in full for this amount. Restructuring expenses for the three months ended December 31, 2018 and the prior year comparative quarter were \$nil.

## 13. Net Finance Expenses

The following table summarizes net finance expenses recorded during the three and twelve months ended December 31, 2018 and 2017:

	Three months ended		Twelve months ended	
	2018	December 31, 2017	2018	December 31, 2017
Interest expense on bank loan	\$ 16,927	\$ 24,801	\$ 112,221	\$ 97,942
Accretion of decommissioning obligations	65,279	57,428	258,882	224,786
<b>Net finance expenses</b>	<b>\$ 82,206</b>	<b>\$ 82,229</b>	<b>\$ 371,103</b>	<b>\$ 322,728</b>

## 14. Other Long-Term Liabilities

	December 31, 2018	December 31, 2017
Decommissioning obligations	\$ 11,817,595	\$ 11,506,151
Onerous lease	4,748	-
<b>Total other long-term liabilities</b>	<b>\$ 11,822,343</b>	<b>\$ 11,506,151</b>

### (a) Decommissioning Obligations

The total future asset retirement obligations were estimated by management based on the expected cost to reclaim and abandon its net ownership interest in well sites and facilities and the estimated timing of the costs to be incurred in future periods. Decommissioning obligations acquired as part of an acquisition are initially measured at fair value using a credit-adjusted risk-free rate. The Company has estimated that the total undiscounted amount of cash flows required to settle its asset retirement obligations at December 31, 2018 is \$13.8 million which will be incurred over the next 10-15 years with the majority of costs incurred between 2020 and 2025. The Bank of Canada's long-term risk-free rate of 2.2% (2017 – 2.3%) and an inflation rate of 2.0% (2017 – 2.0%) were used to calculate the present value of the decommissioning obligation at December 31, 2018. A reconciliation of the changes to the decommissioning obligations during the periods were as follows:

	December 31, 2018	December 31, 2017
<b>Balance, beginning of period</b>	<b>\$ 11,506,151</b>	<b>\$ 9,862,302</b>
Liabilities incurred	40,409	296,726
Accretion	258,882	224,786
Change in estimate	12,153	1,186,210
Decommissioning expenditures incurred	-	(63,873)
<b>Balance, end of period</b>	<b>\$ 11,817,595</b>	<b>\$ 11,501,151</b>

### (b) Onerous Leases

The Company records a provision related to the unused portion of its office lease which have been determined to be an onerous contract. The provision represents the present value of the unused portion relating to the minimum future lease payments that the Company is obligated to make under a non-cancellable operating lease contract. As at December 31, 2018, the undiscounted amount of estimated future cash flows to settle the obligations was \$63,389. These cash flows have been discounted using an interest rate of 1.8%. The onerous contract provision is estimated to be settled in the periods up to the year 2020.

As at December 31, 2018, the balance of the provision was \$61,911, of which \$57,163 is classified as accounts payable and accrued liabilities. Charges of \$102,470 related to the original recognition of the onerous lease were recorded as restructuring costs in the second quarter of 2018 (see note 12).

	December 31, 2018	December 31, 2017
<b>Balance, beginning of period</b>	\$ -	\$ -
Additions	102,470	-
Amortization of onerous lease	(40,559)	-
<b>Balance, end of period</b>	<b>\$ 61,911</b>	<b>\$ -</b>
Current	57,163	-
Non-current	4,748	-
<b>Total</b>	<b>\$ 61,911</b>	<b>\$ -</b>

#### 15. Shareholders Capital

The Company is authorized to issue an unlimited number of voting common shares and an unlimited amount of special voting shares. The following table is a continuity schedule of the Company's common shares outstanding and shareholders' capital:

	Number of Shares	Amount
Balance, January 1, 2017	43,420,029	\$ 50,689,854
Issued for cash	2,000,000	2,500,000
<b>Balance, December 31, 2017 and December 31, 2018</b>	<b>45,420,029</b>	<b>\$ 53,189,854</b>

On July 11, 2017, the Azimuth Capital Management converted 2,000,000 Special Voting Shares into Common Shares for net proceeds to the Company of \$2,500,000 (nil share issuance costs). Subsequent to the conversion, Azimuth held 6.0 million Special Voting Shares representing a remaining \$7.5 million of equity available to Kaisen to fund future growth opportunities. On November 12, 2017, the 6,000,000 special voting shares were cancelled and the attached put and call obligations expired.

#### 16. Share-based Compensation

The Company's current share-based compensation plans consist of stock options, performance warrants and executive incentive options ("incentive options"). The following table summarizes the Company's outstanding equity compensation units as at December 31, 2018 and December 31, 2017:

	December 31, 2018			December 31, 2017		
	Number of units outstanding	Weighted average exercise price (\$ per share)	Weighted average remaining life (years)	Number of units outstanding	Weighted average exercise price (\$ per share)	Weighted average remaining life (years)
Incentive options	4,500,000	0.05	2.5	-	-	-
Share options	10,931,000	0.11	4.5	1,448,000	1.46	0.9
Performance warrants	33,480,999	0.46	4.1	10,780,999	1.78	3.2
Units outstanding	48,911,999	0.34	4.0	12,228,999	1.74	2.9

#### (a) Stock Options

The Company's stock option plan allows for the granting of options to directors, officers, employees and contractors serving in capacity of employees of the Company. The exercise price of each option may shall be fixed by the Board of Directors when such option is granted, provided that from and after the date that the common shares are listed on a stock exchange (the "Exchange"), such price shall not be less than the price permitted by such Exchange. Unless otherwise determined by the Board of Directors, vesting typically occurs one third on each of the next three anniversaries of the date of the grant as recipients render continuous service to the Company, and the share options typically expire five years from the date of the grant. The maximum number of common shares issuable on the exercise of outstanding share options at any time is limited to 10% of the issued and outstanding common shares. The follow table summarizes information about the Company's share options under the stock option plan:

	For the year ended December 31,	
	2018	2017
Balance, beginning of year	1,448,000	1,448,000
Granted	10,650,000	-
Forfeited	(1,167,000)	-
Balance, end of year	<b>10,931,000</b>	1,448,000

The fair value of share options granted during the year was estimated using the Black-Sholes pricing model. The following weighted-average assumptions were used during the year ended December 31, 2018 and 2017:

	For the year ended December 31,	
	2018	2017
Fair value of option granted (\$)	0.03	-
Risk-free interest rate (%)	2.02	-
Expected life (years)	5.00	-
Expected forfeiture rate (%)	5.00	-
Expected volatility (%)	75.00	-
Expected dividend yield (%)	0.00	-

A summary of share options outstanding and exercisable into common shares at December 31, 2018 is as follows:

Exercise Price (\$)	Outstanding		Exercisable	
	Number of Options	Weighted average remaining life (years)	Number of Options	Weighted average remaining life (years)
0.05	10,650,000	4.5	-	-
2.25	281,000	0.7	281,000	0.7
0.11	10,931,000	4.5	281,000	0.7

**(b) Performance Warrants**

The Company's stock option plan allows for the granting of performance warrants to directors, officers, employees and contractors serving in capacity of employees of the Company. The performance warrants vest upon a qualifying liquidity event and expire in 5 years from the date of issuance.

The follow table summarizes information about the Company's performance warrants under the stock option plan:

	For the year ended December 31,	
	2018	2017
Balance, beginning of year	10,780,999	10,780,999
Granted	26,625,000	-
Forfeited	(3,925,000)	-
Balance, end of year	33,480,999	10,780,999

The fair value of performance warrants granted during the year was estimated using the Black-Sholes pricing model. The following weighted-average assumptions were used during the year ended December 31, 2018 and 2017:

	For the year ended December 31,	
	2018	2017
Fair value of performance warrants granted (\$)	0.02	-
Risk-free interest rate (%)	2.02	-
Expected life (years)	5.00	-
Expected forfeiture rate (%)	5.00	-
Expected volatility (%)	75.00	-
Expected dividend yield (%)	-	-

A summary of performance warrants outstanding and exercisable into common shares at December 31, 2018 is as follows:

Exercise Price (\$)	Outstanding		Exercisable	
	Number of Options	Weighted average remaining life (years)	Number of Options	Weighted average remaining life (years)
0.10	6,656,250	4.55	-	-
0.15	6,656,250	4.55	-	-
0.20	6,656,250	4.55	-	-
0.25	6,656,250	4.55	-	-
1.25	885,000	2.53	-	-
1.50	1,535,000	2.25	-	-
1.75	1,465,000	2.27	-	-
2.00	2,390,999	2.11	-	-
2.25	580,000	1.87	-	-
0.11	33,480,999	4.07	-	-

(c) Incentive options

During 2018 the Company granted 4,500,000 incentive options to directors of the Company which expire three years from the grant date and vest quarterly with the final vesting date of April 1, 2019. Each incentive option entitles the holder to receive one common share of the Company without the payment of an exercise price. The weighted average fair value of incentive options granted was \$0.05 per option. As at December 31, 2018 a total of 2,250,000 of the 4,500,000 incentive options outstanding were exercisable with a weighted average life of 2.55 years.

17. Net Loss per Common share

	Three months ended December 31,		Twelve months ended December 31,	
	2018	2017	2018	2017
Net loss	\$ (23,768,928)	\$ (1,823,965)	\$ (32,699,279)	\$ (2,362,422)
Weighted number of average common shares outstanding:				
Basic & Diluted	45,420,029	45,420,029	45,420,029	44,368,974
<b>Basic and diluted income (loss) per share</b>	<b>\$ (0.52)</b>	<b>\$ (0.04)</b>	<b>\$ (0.72)</b>	<b>\$ (0.05)</b>

For the purpose of calculating net loss per diluted share for three and twelve months ended December 31, 2018, none of the outstanding options, performance warrants, incentive options or convertible debentures are included as these instruments are anti-dilutive.

18. Supplemental Cash Flow Information

The net change in non-cash working capital is comprised of:

	Three months ended December 31,		Twelve months ended December 31,	
	2018	2017	2018	2017
Accounts receivable and due from shareholder	\$ 1,465,619	\$ 417,537	\$ 1,812,914	\$ (169,112)
Prepaid expenses and deposits	133,715	163,477	(2,010)	476,919
Accounts payable and accrued liabilities	(1,908,466)	(2,743,944)	(250,869)	(2,186,214)
Change in non-cash working capital	(309,132)	(2,162,930)	1,560,035	(1,878,407)
Related to operating activities	(250,171)	(1,570,828)	1,656,751	(1,912,426)
Related to investing activities	\$ (58,961)	\$ (592,102)	\$ (96,716)	\$ 34,019

19. Income Taxes

The following is a reconciliation of income taxes by applying the applicable statutory rates to net earnings (loss) before income taxes:

	December 31, 2018	December 31, 2017
Earnings (loss) before income taxes	\$ (32,699,279)	\$ (2,357,908)
Canadian statutory rate	27%	27%
Expected income tax (recovery)	\$ (8,828,805)	\$ (636,635)
Effect on income tax of:		
Share-based compensation	363,665	523,052
Other	49,631	6,105
Deferred tax assets not recognized	8,415,509	111,992
Total current and deferred income tax expense (recovery)	\$ -	\$ 4,514

As part of the Hawk acquisition (July 2016), the Company acquired tax pools that would have resulted in a deferred tax asset of which only the portion equally offsetting the Company's deferred tax liability as at December 31, 2018 has been recognized with the remaining deferred tax asset not recognized due to the uncertainty of future recoverability.

	December 31, 2018	December 31, 2017
Deferred tax assets:		
Non-capital losses	\$ 9,011,169	\$ 7,120,516
Decommissioning liability	3,190,751	3,106,661
Other	312,195	223,810
Share issuance costs	181,989	284,284
Deferred tax assets not recognized	(8,415,600)	(6,695,320)
Deferred tax liabilities:		
Capital assets in excess of tax value	\$ (4,280,504)	\$ (4,039,951)
Net deferred tax liability	-	-

The Company's estimated tax pools at December 31, 2018 are as follow:

	December 31, 2018	December 31, 2017
Canadian oil and gas property expense	\$ 9,957,723	\$ 10,021,741
Canadian exploration expense	5,888,912	5,888,912
Canadian development expense	16,110,207	16,417,432
Capital cost allowance	9,592,573	10,429,607
Non-capital losses	33,374,702	26,372,280
Other	673,980	1,053,654
	\$ 75,598,097	\$ 70,183,626

## 20. Major Customers

The majority of the Company's credit exposure on accounts receivable at December 31, 2018 pertains to accrued revenue for December 2018 production volumes in addition to amounts receivable from joint operating partners. Kaisen typically sells its heavy oil production to four separate oil and natural gas marketing companies. These marketing companies remit amounts to Kaisen typically on or about the 25th day of the month following the production month. All accrued revenues at December 31, 2018 were received in January 2018. For joint operating partners, Kaisen bills these partners typically 2 months after the month of activity with receipt 30 days thereafter. Kaisen did not have any other counterparties from which it had outstanding accounts receivable greater than 10 per of the total outstanding balance at December 31, 2018. The Company is confident in the collectability of its' receivables and therefore has not recorded an allowance for doubtful accounts.

## 21. Commitments and Contingencies

The following is a summary of the Company's contractual obligations and commitments as at December 31, 2018:

(\$ thousands)	Total	2019	2020	2021	2022	2023
Office leases	190	175	15	-	-	-

## 22. Related Party Transactions

On December 23, 2015, the Company provided a loan in the amount of \$250,000 to a shareholder on competitive commercial interest-bearing terms with a maturity period of 5 years. In the second quarter of 2018, a portion of the individual's severance was applied against the loan and the Company impaired \$154,692, the remaining balance owing at that time, to restructuring expenses. The individual is still personally liable to Kaisen for the remaining balance and the Company will continue to seek repayment in full.

The corporate secretary of the Company is a partner of the Company's legal counsel, Burnet, Duckworth & Palmer LLP ("BDP"). As at December 31, 2018, \$180,300 in related party amounts were included in accounts payable and accrued liabilities (2017 – \$68,213). The Managing Director of Kaisen is the President and Chief Executive Officer of a transloading company that Kaisen engages for emulsion treating of a portion of its production volumes. As at December 31, 2018, \$nil in related party amounts were included in accounts payable and accrued liabilities (2017 - \$nil).

The Company provides salaries and benefits to its officers as well as director fees to its directors. Directors and officers also participate in the Company's share-based payment compensation programs. Key management personnel compensation is comprised of the following:

	Twelve months ended December 31,	
	2018	2017
Salaries, incentives and short-term benefits <sup>1</sup>	\$ 1,498,564	\$ 1,368,799
Director fees	37,500	75,000
Share-based compensation	754,474	1,339,116
<b>Key management compensation</b>	<b>\$ 2,290,538</b>	<b>\$ 2,782,915</b>

(1) One-time severance costs of \$721,270 in 2018 (\$nil - 2017)

### 23. Subsequent Events

#### (a) Senior unsecured promissory note and issuance of convertible debentures

On January 15<sup>th</sup>, 2019 the Company entered into a \$200,000 senior unsecured promissory note ("Promissory Note") with Azimuth Capital Management for the purpose of funding current working capital requirements. The Promissory Note bears interest of 8.0% per annum and the principal sum and interest is payable in full on February 28, 2019. On February 28, 2019, the Company issued an additional 200 convertible debentures for total proceeds of \$200,000 to pay off the full principal balance of Promissory Note plus accrued interest of \$1,973, leaving the Company with \$1,926,000 of remaining funding available under the original convertible debenture subscription dated May 28, 2018.

#### (b) Risk management contracts

Subsequent to year end, the Company entered into a 200 barrel per day WCS basis swap from which fixes the WCS price received relative to the NYMEX WTI price at a differential of US\$17.55 per barrel. The contract period runs from February 1, 2019 to December 31, 2019.