



## Financial Statements

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December 31, 2019

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## MANAGEMENT'S REPORT

To the Shareholders of Kaisen Energy Corp.:

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, 2019. 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

April 17, 2020

## 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, 2019, 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, 2019, 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 \$7,607,830 during the year ended December 31, 2019, and as of that date, the Company's current liabilities exceeded its current assets by \$5,454,097. 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.

*Ernst + Young LLP*

Chartered Professional Accountants  
Calgary, Canada  
April 17, 2020

## Statements of Financial Position

(Canadian dollars)

	Note	December 31, 2019	December 31, 2018
<b>Assets</b>			
Current assets			
Cash		\$ 373,033	\$ 328
Accounts receivable	6	1,125,545	292,251
Prepaid expenses and deposits		136,593	134,933
Risk management contracts	12	-	484,417
		1,635,171	911,929
<b>Property, plant, and equipment</b>			
	7,8	28,404,521	32,600,132
		\$ 30,039,692	\$ 33,512,061
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities	9	\$ 4,514,745	\$ 2,126,023
Risk management contracts	12	724,523	-
Term loan	10	1,850,000	-
Bank loan	10	-	2,095,587
		7,089,268	4,221,610
Risk management contracts	12	-	702,439
Decommissioning and other	15	11,874,113	11,822,343
		18,963,381	16,746,392
<b>Shareholders' equity</b>			
Share capital	17	53,189,854	53,189,854
Convertible debentures	11	6,517,100	5,317,100
Contributed surplus		8,484,979	7,766,507
Deficit		(57,115,622)	(49,507,792)
		11,076,311	16,765,669
		\$ 30,039,692	\$ 33,512,061

Going concern (note 2)

Subsequent events (note 23)

See accompanying notes to the financial statements.

## Statements of Loss and Comprehensive Loss

(Canadian dollars)

		Twelve months ended	
	Note	2019	December 31, 2018
Revenue			
Petroleum and natural gas sales		\$ 14,630,549	\$ 14,468,581
Royalties		(2,440,059)	(2,675,916)
Revenue, net of royalties		12,190,490	11,792,665
Saskatchewan resource tax		(326,016)	(196,496)
Realized loss on risk management contracts	12	(2,144,282)	(2,929,008)
Unrealized gain (loss) on risk management contracts	12	(506,501)	1,304,824
Other income		30,446	18,212
		9,244,137	9,990,197
Expenses			
Operating		8,067,144	8,660,105
Transportation		743,310	835,766
General and administrative		1,091,525	1,428,651
Net finance	14	400,044	371,103
Share-based compensation	18	602,699	1,346,909
Restructuring	16	-	1,167,028
Depletion and depreciation	7	3,036,245	4,076,914
Impairment loss on property, plant, and equipment	8	2,911,000	24,803,000
		16,851,967	42,689,476
Net loss and comprehensive loss		\$ (7,607,830)	\$ (32,699,279)
Net loss per share			
Basic and diluted	19	\$ (0.17)	\$ (0.72)

See accompanying notes to the financial statements.

## Statements of Cash Flows

(Canadian dollars)

		Twelve months ended December 31,	
	Note	2019	2018
Cash provided by (used in) the following activities:			
Operating activities			
Net loss for the period		\$ (7,607,830)	\$ (32,699,279)
Items not affecting cash:			
Depletion and depreciation		3,036,245	4,076,914
Impairment loss on property plant and equipment		2,911,000	24,803,000
Accretion of decommissioning obligations	14	259,371	258,882
Share-based compensation	18	602,699	1,346,909
Restructuring	16	-	257,162
Unrealized (gain) loss on risk management contracts	12	506,501	(1,304,824)
Other		1	(40,559)
		(292,013)	(3,301,795)
Change in non-cash working capital	20	1,387,467	1,656,751
Cash from operating activities		1,095,454	(1,645,044)
Financing activities			
Net (payments) advances of bank loan		(2,095,587)	(955,914)
Advance of term loan	10	2,280,000	-
Term loan principal repayments	10	(430,000)	-
Lease payments	15	(95,037)	-
Issuance of convertible debentures, net of issue costs	11	1,200,000	5,317,100
Cash from financing activities		859,376	4,361,186
Investing activities			
Development of oil and gas properties		(1,792,130)	(3,441,108)
Change in non-cash working capital	20	210,005	(96,716)
Cash used in investing activities		(1,582,125)	(3,537,824)
Change in cash		372,705	(821,682)
Cash, beginning of the period		328	822,010
Cash, end of the period		\$ 373,033	\$ 328
Supplementary disclosure			
Cash interest paid		\$ 115,957	\$ 112,221
Cash taxes paid		-	-

See accompanying notes to the financial statements.

## Statements of Changes in Shareholders' Equity

(Canadian dollars)

	Note	Share capital	Convertible debentures	Contributed surplus	Deficit	Shareholders' equity
Balance as at January 1, 2018		\$ 53,189,854	\$ -	\$ 6,153,693	\$ (16,808,513)	\$ 42,535,034
Net loss		-	-	-	(32,699,279)	(32,699,279)
Convertible debentures issued	11	-	5,317,100	-	-	5,317,100
Share-based compensation	18	-	-	1,612,814	-	1,612,814
Balance as at December 31, 2018		\$ 53,189,854	\$ 5,317,100	\$ 7,766,507	\$ (49,507,792)	\$ 16,765,669
Net loss		-	-	-	(7,607,830)	(7,607,830)
Convertible debentures issued	11	-	1,200,000	-	-	1,200,000
Share-based compensation	18	-	-	718,472	-	718,472
Balance as at December 31, 2019		\$ 53,189,854	\$ 6,517,100	\$ 8,484,979	\$ (57,115,622)	\$ 11,076,311

See accompanying notes to the financial statements.

## Notes to the Financial Statements

As at December 31, 2019 and for the twelve months ended December 31, 2019 and 2018

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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, Statement of Compliance and Assumption of 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 April 17, 2020.

#### (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 dollar.

#### (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 \$7,607,830 during the year ended December 31, 2019, and as of that date, the Company's current liabilities exceeded its current assets by \$5,454,097. The impact of realized losses on risk management contracts throughout 2019, combined with the sudden collapse in global oil prices in 2020, have lowered the Company's current and projected cash flows. As at December 31, 2019 the Company still had access to \$926,000 in available financing from unissued convertible debentures. Management of the Company believes that the current level of financing is not 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 significant 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, accounts receivable, accounts payable and accrued liabilities, and term loan.
- 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.

The Company's financial derivatives are recorded and carried on the statements of financial position at a fair value with actual amounts received or paid on the settlement of the financial derivative instrument recorded in the statements of comprehensive income. Forward commodity 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 prices.

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 an 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 arrangements

Effective January 1, 2019, the Company adopted IFRS 16 Leases ("IFRS 16") as described further in Note 4 "Changes to Accounting Policies". The Company applied IFRS 16 using the modified retrospective approach; therefore, the comparative information provided continues to be accounted for in accordance with the Company's previous accounting policy found in the audited financial statement for the year ended December 31, 2018. The accounting policy set forth below is applicable from January 1, 2019.

The Company assess whether an arrangement is a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

As Lessee

When the Company is a party to a lease arrangement as the lessee, leases are recognized as a right-of-use ("ROU") asset and a corresponding lease liability on the statements of financial position on the date that the leased asset becomes available for use.

ROU assets and lease liabilities are initially measured on a present value basis. Lease liabilities include the net present value of fixed payments, variable lease payments that are based on an index or a rate, amounts expected to be paid by the lessee under residual value guarantees, the exercise price of purchase options if the lessee is reasonably certain to exercise that option, and payments of penalties for terminating the lease, less any incentives receivable. The future payments are discounted using the interest rate implicit in the lease or, when that rate cannot be readily determined, the Company's incremental borrowing rate. The Company uses a single discount rate for a portfolio of leases with reasonably similar characteristics. Lease payments are allocated between the lease liability and finance expenses. Finance expenses are charged to the statements of comprehensive income over the lease term.

Associated ROU assets are initially measured at cost, which comprises the initial amount of the lease liability, any initial direct costs incurred, and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset, less any lease payments made at or before the commencement date. ROU assets are depreciated on a straight-line basis over the shorter of the estimated useful life of the asset or the lease term. ROU assets may be adjusted for certain remeasurements of the lease liability and impairment losses.

#### As Lessor

Where the Company acts as the lessor in a lease arrangement, the Company assesses at inception whether the lease is a finance lease or an operating lease. Leases where the Company transfers substantially all the risk and rewards incidental to ownership of the underlying asset are classified as financing leases. Under a finance lease, the Company records the current portion of the finance lease in accounts receivable and the non-current portion in other assets. Finance income related to the lease is recognized using an approach that equals a constant rate of return on the net investment of the lease. The net investment of the lease is the aggregate of the net minimum lease payments and unearned finance income discounted at the interest rate implicit in the lease. Unearned finance income is deferred and recognized in the statements of comprehensive income over the lease term. The Company records lease payments received under operating leases as other income on a straight-line basis over the lease term.

#### (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.

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.

A contingent liability is disclosed when the Company has a possible obligation arising from a past event whose existence will be confirmed by future events not wholly under its control, or when the Company has a present obligation that arises from past events that is not recognized because it is not probable that an outflow of resources will be required to settle the obligation, or the amount the obligation cannot be measured with sufficient reliability.

#### (j) Decommissioning obligations

Decommissioning obligations 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 obligations 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 obligation 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 obligation is amortized to income on a basis consistent with depletion and depreciation of the underlying assets. Subsequent changes in the estimated decommissioning obligations 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 obligations.

#### (k) Revenue from petroleum sales

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.

(l) 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 grant 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.

(m) 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.

4. Changes to Accounting Policies

Adoption of IFRS 16 Leases

IFRS 16 replaced IAS 17 Leases ("IAS 17") and requires the recognition of right-of-use ("ROU") assets and lease obligations on the statement of financial position for most leases where the entity is acting as the lessee. For lessees, IFRS 16 removes the classification of leases as either operating leases or finance leases, effectively treating all leases as finance leases. IFRS 16 allows lessors to continue with the dual classification model for recognized leases, with the resultant accounting remaining unchanged from IAS 17.

The Company adopted IFRS 16 on January 1, 2019 using the modified retrospective approach. On adoption of IFRS 16, the Company recognized lease liabilities measured at the present value of remaining lease payments, discounted using the interest rate implicit in the lease or the Company's incremental borrowing rate as at January 1, 2019. The Company used a weighted average incremental borrowing rate of 5.5% to measure the present value of the future lease payments on January 1, 2019. The associated ROU assets were measured at the amount equal to the lease liabilities on January 1, 2019 less any amount previously recognized for onerous leases, with no impact on opening retained earnings.

On January 1, 2019, the provision for office lease inducements previously recognized was applied to the value of the associated ROU asset.

The Company identified ROU lease assets and liabilities related to head office space and office equipment. The impact on the consolidated statement of financial position as at January 1, 2019 was as follows:

	January 1, 2019
ROU asset (included in property, plant and equipment)	\$ 46,586
Increase in total assets	\$ 46,586
Short-term portion of lease liability (included in accounts payable and accrued liabilities)	\$ 95,038
Onerous leases	(61,911)
Long-term portion of lease liabilities (included in other long-term liabilities)	13,459
Increase in total liabilities and shareholder's equity	\$ 46,586

The following table provides a reconciliation of the contractual obligations and commitments as at December 31, 2018 to the Company's lease liabilities as at January 1, 2019:

	January 1, 2019
Commitments as at December 31, 2018	\$ 190,166
Less:	
Non-lease components	(77,610)
Impact of discounting	(4,059)
Lease liabilities as at January 1, 2019	\$ 108,497

Cash flows associated with lease repayments were allocated to operating activities and financing on the consolidated statement of cash flows based on their interest and principal repayments, respectively.

#### 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. 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.

##### (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, 2019, 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) Decommissioning liabilities

The provision for decommissioning liabilities is based on numerous assumptions and judgements, including ultimate remediate plans, settlement amounts, historical production volumes, inflation factors, risk-free discount rates, timing of settlement and changes in the applicable legal and regulatory environments. To the extent future revisions to these assumptions impact the measurement of the existing decommissioning liability, a corresponding adjustment is made to the associated property, plant and equipment balance.

(e) 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 behavior), expected dividends, and the risk-free interest rate (based on Government of Canada bonds).

(f) 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.

(g) Lease arrangements

Management applies judgement in reviewing each of its contractual arrangements to determine whether the arrangements contain a lease within the scope of IFRS 16. Leases that are recognized are subject to further Management judgement and estimation in various areas specific to the contractual arrangements, including lease terms and discount rates. In determining the lease term to be recognized, Management considers all facts and circumstances that create an economic incentive to exercise and extension option or not to exercise a termination option. Lease obligations are estimated using a discount rate equal to the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. The Company's incremental borrowing rate represents the rate that the Company would incur to obtain the funds necessary to purchase an asset of a similar value, with comparable payment terms and security in a similar economic environment.

6. Financial Assets and 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. The Company's credit exposure on accounts receivable at December 31, 2019 pertains to accrued revenue for December 2019 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. All revenues recorded at December 31, 2019 were received in January 2020. For joint operating partners, Kaisen bills these partners typically 2 months after the month of activity with receipt 30 days thereafter.

The Company's carrying values of accounts receivable represent the Company's maximum credit exposure. The aging of accounts receivable is as follows:

	December 31, 2019	December 31, 2018
Not past due	\$ 1,022,859	\$ 188,597
Past due greater than 90 days	102,686	103,654
Accounts receivable	\$ 1,125,545	\$ 292,251

Receivables from customers are normally collected approximately 25 days following the month of production and the Company has historically not experienced any collection issues with its oil and natural gas sales and therefore has not recorded an allowance for doubtful accounts as at December 31, 2019.

7. Property, Plant, and Equipment

	Oil and gas assets	Corporate assets	Total assets
Cost:			
Balance, January 1, 2018	\$ 77,669,337	\$ 195,854	\$ 77,865,191
Development additions	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
Balance, December 31, 2018	\$ 81,426,986	\$ 197,780	\$ 81,624,766
Development additions	1,541,480	1,050	1,542,530
Decommissioning obligations change in estimate	(202,855)	-	(202,855)
Right-of-use assets (note 3)	-	46,586	46,586
Capitalized general and administrative costs	249,600	-	249,600
Capitalized share-based compensation	115,773	-	115,773
Balance, December 31, 2019	\$ 83,130,984	\$ 245,416	\$ 83,376,400

	Oil and gas assets	Corporate assets	Total assets
Accumulated depletion and depreciation:			
Balance, January 1, 2018	\$ 20,038,676	\$ 106,044	\$ 20,144,720
Depletion and depreciation	4,050,416	26,498	4,076,914
Impairment	24,803,000	-	24,803,000
Balance, December 31, 2018	\$ 48,892,092	\$ 132,542	\$ 49,024,634
Depletion and depreciation	2,978,864	57,381	3,036,245
Impairment	2,911,000	-	2,911,000
Balance, December 31, 2019	\$ 54,781,956	\$ 189,923	\$ 54,971,879
Net book value:			
Balance, December 31, 2018	32,534,894	65,238	32,600,132
Balance, December 31, 2019	28,349,028	55,493	28,404,521

As at December 31, 2019, \$77,814,900 in future development costs associated with proved plus probable reserves and net salvage values of \$2,610,000 were included in the petroleum and natural gas asset cost bases for depletion calculation purposes (2018 - \$93,253,000 and \$2,590,000, respectively). No other costs have been included or excluded from property plant and equipment in the determination of depletion. During the year ended December 31, 2019, \$249,600 and \$115,773 in general and administrative expenses and share-based compensation expenses, respectively, were capitalized to property, plant and equipment (2018 - \$376,664 and \$265,905).

#### 8. Impairment loss on property, plant, and equipment

##### 2019 Impairments

At December 31, 2019, the Company evaluated its property, plant, and equipment for indicators of any potential impairment or related impairment reversals. 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. As a result of uncertainties regarding future strip pricing, impairment tests were conducted on all properties resulting in an impairment charge of \$2,911,000 recognized in the statement of income.

##### 2018 Impairments

Based on the results of the Company's December 31, 2018 evaluation of potential impairment or related reversals, indicators were identified on all the Company's CGU's. An impairment test was conducted resulting in an impairment charge of \$32.6 million.

##### Property, plant, and equipment impairment assumptions

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 19.2% (2018 – 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 (considered level 3 inputs within the fair value hierarchy). The Company used the same approach for its test as at December 31, 2018.

The following commodity price estimates were used to determine the recoverable amount as at December 31, 2019:

Year	WTI Cushing Ok (US\$/bbl)	Western Canadian Select (C\$/bbl)	US\$ to C\$ Foreign exchange rate
2020	61.00	59.81	0.76
2021	65.00	63.98	0.77
2022	67.00	63.77	0.80
2023	68.34	65.04	0.80
2024	69.10	66.34	0.80
2025	71.10	67.67	0.80
2026	72.52	69.02	0.80
2027	73.97	70.40	0.80
2028	75.45	71.81	0.80
2029	76.96	73.25	0.80
Thereafter	+2% per year	+2% per year	0.80

#### 9. Financial Liabilities and Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure it will have sufficient liquidity to meet liabilities when due, under both normal and unusual conditions without incurring unacceptable losses or jeopardizing the Company's business objectives. The Company's liquidity is dependent on the Company's expected business growth and changes in its business environment. The Company manages this risk by continuously monitoring forecast and

actual cash flows from operating, financing, and investing activities and opportunities to extend or modify its existing debt facility or to issue additional equity. The Company will continue to manage its capital expenditures to reflect current financial resources in the interest of sustaining long-term viability. Estimated undiscounted cash outflows relating to financial liabilities as at December 31, 2019 were as follows:

	Undiscounted amount	Less than 1 year	1 - 3 years	4 – 5 years
Accounts payable and accrued liabilities	\$ 4,514,745	\$ 4,514,745	\$ -	\$ -
Risk management contracts	724,523	724,523	-	-
Term loan	1,850,000	1,850,000	-	-
Financial liabilities	\$ 7,089,268	\$ 7,089,268	\$ -	\$ -

#### 10. Term Loan

On July 15, 2019, the Company completed an arrangement with its lender for a \$2,280,000 term loan, which discharged and replaced the \$2,500,000 revolving bank loan previously in place with the same lender. When entered, the term loan bore interest at a rate of prime plus 1.25% per annum, was payable in full on demand by the lender, and required the Company to make the monthly principal payments up until May 31, 2020, when the term loan was scheduled to be repaid in full. On December 11, 2019, the Company and its lender entered into an amending agreement whereby the scheduled borrowing base determination date was extended from November 30, 2019 to January 31, 2020, the interest rate was raised to prime plus 3.5% per annum, and it was agreed upon that the Company shall make principal payments of \$240,000 per month commencing February 29, 2020 until the term loan was repaid in full. Subsequent to year end the Company and its lender entered into second and third amending agreements, with the latter amendment deferring the borrowing base determination date to March 31, 2020 and deferring the requirement for monthly \$240,000 principal repayments to April 30, 2020 (refer to note 23).

The term loan is classified as current on the statement of financial position and is principally secured by fixed and floating security interest over all present and after acquired assets of the Company. The term loan arrangement contains industry standard representation and warranties, positive and negative covenants and events of default, and does not contain financial covenants. During the twelve months ended December 31, 2019, \$430,000 in principal payments were made on the new term loan.

#### 11. 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 executed an agreement for 5,426 committed convertible debentures ("Obligation Debentures"), as described in further detail in note 7(b).

During the year ended December 31, 2019, the Company issued 1,200 convertible debentures for total gross and net proceeds of \$1,200,000 (2018 – 5,377 convertible debentures issued for net proceeds of \$5,317,000). Since being introduced, the Company has issued a total of 6,577 convertible debentures representing \$6,517,100 in financing net of transaction 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. Management has determined that the liquidity event is a contingent settlement provision that 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, 2019 and the convertible debentures were converted to common shares, 131,540,000 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 since inception) in the current quarter and converted them 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 \$926,000 of cash. As at December 31, 2019, the total face value of the convertible debentures plus accrued undeclared interest was \$7,248,000.

(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 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. During the first nine months of the year, the Company called on the subscriber to purchase an additional 1,200 Obligation Debentures resulting in the issuance of \$1,200,000 in convertible debentures by the Company (refer to note 7(a) above). At December 31, 2019, a total of 926 Obligation Debentures remain uncalled, representing an additional \$926,000 in funding available to the Company.

12. Financial Derivatives and Market Risk Management

Management of cash flow variability is an integral component of the Company's business strategy. Changing business conditions are monitored regularly and, where material, reviewed with the Board of Directors to establish risk management guidelines to be used by Management. The risk exposure inherent in the movement of the price of crude oil and natural gas prices and fluctuations in foreign exchange rates are all proactively reviewed by the Company and may be managed through the use of derivative contracts as considered appropriate.

(a) 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 contract in place as at December 31, 2019:

Type	Period	Volume	Price/unit <sup>(1)</sup>
WTI - Call option <sup>(2)</sup>	January 1, 2020 – December 31, 2020	500 bbl/d	US\$60.00

(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, 2019, the fair value associated with these risk management contracts was a liability of \$724,523 (2018 – net liability of \$218,022), of which the total amount is reported as a current liability reflecting contracts which will settle by December 31, 2020.

(b) Interest rate risk

The only liability on the Company's balance sheet exposed to fluctuations in interest rates is the term loan. Based upon the Company' term debt at December 31, 2019, an increase or decrease in net earnings for the year for each 1% change in interest rates would amount to \$18,500 (2018 - \$21,000).

(c) 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, 2019.

13. 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. Management closely monitors debt leverage to ensure the Company maintains financial flexibility and balance sheet strength sufficient to manage unforeseen events and opportunities as they arise.

14. Net Finance Expenses

The following table summarizes net finance expenses recorded during the twelve months ended December 31, 2019 and 2018:

	Twelve months ended December 31,	
	2019	2018
Interest expense on term and bank loans	\$ 115,957	\$ 112,221
Interest on Saskatchewan resource taxes	21,002	-
Accretion of decommissioning obligations	259,371	258,882
Capital lease interest expense	3,714	-
Net finance expenses	\$ 400,044	\$ 371,103

15. Decommissioning and Other

	December 31, 2019	December 31, 2018
Decommissioning obligations	\$ 11,874,113	\$ 11,817,595
Onerous lease	-	4,748
Lease liabilities	-	-
<b>Decommissioning and Other</b>	<b>\$ 11,874,113</b>	<b>\$ 11,822,343</b>

(a) Decommissioning obligations

The total future decommissioning 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. Management estimates the total undiscounted amount of cash flows required to settle its decommissioning obligations at December 31, 2019 is \$13.5 million, which will be incurred over the next 10-15 years with the majority of costs incurred between 2021 and 2026. The Bank of Canada's long-term risk-free rate of 2.2% (2018 – 2.2%) and an inflation rate of 1.8% (2018 – 2.0%) were used to calculate the present value of the decommissioning obligation at December 31, 2019.

A reconciliation of the changes to the decommissioning obligations during the periods is as follows:

	December 31, 2019	December 31, 2018
Balance, beginning of period	\$ 11,817,595	\$ 11,506,151
Liabilities incurred	53,172	40,409
Accretion	259,371	258,882
Change in estimate	(256,025)	12,153
<b>Balance, end of period</b>	<b>\$ 11,874,113</b>	<b>\$ 11,817,595</b>

(b) Lease liabilities

The following table details the movements of the Company's lease liabilities for the period ended December 31, 2019:

	Total
Balance, January 1, 2019 (note 4a)	\$ 108,497
Interest expense	3,714
Payments	(98,751)
<b>Balance, December 31, 2019</b>	<b>\$ 13,460</b>
Current (included in accounts payable and accrued liabilities)	13,460
Non-current (included in other long-term liabilities)	-
<b>Total</b>	<b>\$ 13,460</b>

The Company has lease liabilities for head office space and office equipment. The lease contracts are effective from one to two years. Discount rates used in calculating the present value of lease payments were between 5 and 10 percent. Leases are negotiated on an individual basis and contain varying terms and conditions. Undiscounted cash flows of \$13,804 associated with these leases, which include both principal and interest components of the Company's lease liabilities as at December 31, 2019, will be settled in less than one year.

16. Restructuring Expenses

In the second quarter of 2018, the Company's employee base and office space requirements were significantly reduced resulting in the Company recording \$1,167,028 in restructuring expenses. Cash based restructuring expenses 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 (note 22). The Company still intends on actively pursuing re-payment in full for this amount. The Company incurred nil restructuring costs in 2019.

17. Share 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 share capital:

	Number of Shares	Amount
December 31, 2018 and December 31, 2019	45,420,029	\$ 53,189,854

18. 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:

	December 31, 2019			December 31, 2018		
	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	10,700,000	0.05	1.5	4,500,000	0.05	2.5
Share options	11,000,000	0.05	3.6	10,931,000	0.11	4.5
Performance warrants	34,250,999	0.49	3.1	33,480,999	0.46	4.1
Units outstanding	55,950,999	0.32	2.9	48,911,999	0.34	4.0

(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 following table summarizes information about the Company's share options under the stock option plan.

	For the year ended December 31,	
	2019	2018
Balance, beginning of year	10,931,000	1,448,000
Granted	800,000	10,650,000
Forfeited	(454,500)	(699,000)
Expired	(276,500)	(468,000)
Balance, end of year	11,000,000	10,931,000

The fair value of share options granted during the year was estimated using the Black-Scholes pricing model. The following table summarizes the weighted-average assumptions used in the Black-Scholes pricing model:

	For the year ended December 31,	
	2019	2018
Fair value of option granted (\$)	0.03	0.03
Risk-free interest rate (%)	1.30	2.02
Expected life (years)	5.00	5.00
Expected forfeiture rate (%)	5.00	5.00
Expected volatility (%)	75.00	75.00
Expected dividend yield (%)	0.00	0.00

A summary of share options outstanding and exercisable into common shares at December 31, 2019 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	11,000,000	3.6	3,400,000	3.6

(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,	
	2019	2018
Balance, beginning of year	33,480,999	10,780,999
Granted	2,000,000	26,625,000
Forfeited	(1,230,000)	(3,925,000)
Balance, end of year	34,250,999	33,480,999

The fair value of performance warrants granted during the year was estimated using the Black-Sholes pricing model. The following table summarizes the weighted-average assumptions used in the Black-Sholes pricing model:

	For the year ended December 31,	
	2019	2018
Fair value of performance warrants granted (\$)	0.02	0.02
Risk-free interest rate (%)	1.30	2.02
Expected life (years)	5.00	5.00
Expected forfeiture rate (%)	5.00	5.00
Expected volatility (%)	75.00	75.00
Expected dividend yield (%)	-	-

A summary of performance warrants outstanding and exercisable into common shares at December 31, 2019 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	6,875,000	3.6	-	-
0.15	6,875,000	3.6	-	-
0.20	6,875,000	3.6	-	-
0.25	6,875,000	3.6	-	-
1.25	872,500	1.5	-	-
1.50	1,512,500	1.3	-	-
1.75	1,442,500	1.3	-	-
2.00	2,353,499	1.1	-	-
2.25	570,000	0.9	-	-
0.11	34,250,999	3.1	-	-

(c) Incentive options

The Company's stock option plan allows for the granting of incentive options to directors, officers, employees and contractors serving in capacity of employees of the Company. The incentive options typically vest quarterly over one year and expire three years from the grant date. Each incentive option entitles the holder to receive one common share of the Company without the payment of an exercise price.

The follow table summarizes information about the Company's incentive options under the stock option plan:

	For the year ended December 31,	
	2019	2018
Balance, beginning of year	4,500,000	-
Granted	6,200,000	4,500,000
Balance, end of year	10,700,000	4,500,000

A summary of incentive options outstanding and exercisable into common shares at December 31, 2019 is as follows:

Exercise Price (\$)	Outstanding		Exercisable	
	Number of Options	Weighted average remaining life (years)	Number of Options	Weighted average remaining life (years)
nil	10,700,000	1.5	6,250,000	1.7

19. Net Loss per Common Share

	Twelve months ended December 31,	
	2019	2018
Net loss	\$ (7,607,830)	\$ (32,699,279)
Weighted number of average common shares outstanding:		
Basic and diluted	45,420,029	45,420,029
Basic and diluted net loss per share	\$ (0.17)	\$ (0.72)

For the purpose of calculating net loss per diluted share for the twelve months ended December 31, 2019 and 2018, none of the outstanding options, performance warrants, incentive options, or convertible debentures are included as these instruments are anti-dilutive.

20. Supplemental Cash Flow Information

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

	Twelve months ended December 31,	
	2019	2018
Accounts receivable	\$ (833,294)	\$ 1,812,914
Prepaid expenses and deposits	(1,660)	(2,010)
Accounts payable and accrued liabilities, and other	2,432,426	(250,869)
Change in non-cash working capital	\$ 1,597,472	\$ 1,560,035
Related to operating activities	1,387,467	1,656,751
Related to investing activities	\$ 210,005	\$ (96,716)

21. 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, 2019	December 31, 2018
Earnings (loss) before income taxes	\$ (7,607,830)	\$ (32,699,279)
Canadian statutory rate	26.77%	27.00%
Expected income tax (recovery)	\$ (2,036,616)	\$ (8,828,805)
Effect on income tax of:		
Share-based compensation	161,343	363,665
Changes in rate	1,134,905	-
Other	26,905	49,631
Deferred tax assets not recognized	713,463	8,415,509
Total current and deferred income tax expense (recovery)	\$ -	\$ -

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, 2019 has been recognized with the remaining deferred tax asset not recognized due to the uncertainty of future recoverability.

	December 31, 2019	December 31, 2018
Deferred tax assets:		
Non-capital losses	\$ 9,765,231	\$ 9,011,169
Capital assets	2,684,558	-
Decommissioning liability	2,985,152	3,190,751
Other	304,224	312,195
Share issuance costs	86,617	181,989
Deferred tax assets not recognized	(15,825,782)	(8,415,600)
Deferred tax liabilities:		
Capital assets in excess of tax value	\$ -	\$ (4,280,504)
Net deferred tax liability	-	-

The Company's estimated tax pools at December 31, 2019 are as follow:

	December 31, 2019	December 31, 2018
Canadian oil and gas property expense	\$ 9,892,424	\$ 9,957,723
Canadian exploration expense	5,888,912	5,888,912
Canadian development expense	15,902,260	16,110,207
Capital cost allowance	7,399,624	9,592,573
Non-capital losses	38,895,139	33,374,702
Other	344,538	673,980
	<u>\$ 78,322,897</u>	<u>\$ 75,598,097</u>

## 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, 2019, \$174,222 in related party amounts were included in accounts payable and accrued liabilities (2018 – \$180,300). The Managing Director of Kaisen is the President and Chief Executive Officer of a transloading company that the Company occasionally engages for emulsion treating of a portion of its production volumes. As at December 31, 2019, \$nil in related party amounts owing in respect of emulsion treating were included in accounts payable and accrued liabilities (2018 - \$nil).

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

	December 31, 2019	December 31, 2018
Salaries, incentives and short-term benefits	\$ 426,370	\$ 1,498,564
Director fees	-	37,500
Share-based compensation	440,762	754,474
Key management compensation	<u>\$ 867,132</u>	<u>\$ 2,290,538</u>

(1) One-time severance costs of \$721,270 in 2018 (2019- \$nil)

## 23. Subsequent Events

### (a) Term loan amendments

The Company and its lender entered into second and third amending agreements with respect to its term loan on January 30, 2020 and February 27, 2020, respectively. The second amendment deferred the borrowing base determination date from January 31, 2020 to February 28, 2020 and deferred the commencement of \$240,000 monthly principal repayments to March 31, 2020. The third amending agreement extended the deferral of the borrowing base determination date and the commencement of \$240,000 monthly principal repayments to March 31, 2020 and April 30, 2020, respectively.

### (b) Senior unsecured promissory note

On April 15, 2020 the Company issued a \$160,000 subordinated secured promissory note ("Promissory Note") to Azimuth Capital Management for the purpose of funding current working capital requirements. The Promissory Note is due on demand and bears interest at a rate of 8% per annum, accruing daily. The repayment of principal is due on demand and subrogated in right of payment in full of all senior indebtedness (see note 10). The Promissory Note is secured by the Company's present and after-acquired personal and real property, subordinate to any claims to such property by the holders of its Term loan.

### (c) Economic uncertainty and crude oil price volatility

Subsequent to year-end, significant declines and abnormal volatility in financial markets and world crude oil prices have occurred as a result of the coronavirus pandemic and concurrent oil market share war. The scale and duration of these developments remain uncertain but could impact the Company's operations, future net earnings, cash flows and financial condition.

The impairment tests for the Company's petroleum and natural gas assets are based on the fair value of assets less cost of disposal calculations. As required by IFRS, the Company has not reflected these subsequent conditions in its indicators of impairment analysis or recoverable amount estimates of its petroleum and natural gas assets as at December 31, 2019.