Annual Financial Statements

For the years ended
December 31, 2015 and 2014

MANAGEMENT'S RESPONSIBILITY

To the Shareholders of Virginia Hills Oil Corp.

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

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

The Board of Directors is responsible for overseeing Management in the performance of its financial reporting responsibilities and for approving the consolidated financial statements. The Audit Committee has the responsibility of meeting with Management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee is also responsible for recommending the appointment of the Company's external auditors.

PricewaterhouseCoopers LLP, an independent firm of Chartered Professional Accountants, was appointed by the shareholders to audit the consolidated financial statements and report directly to them for the years ended December 31, 2015 and 2014, and to provide an independent professional opinion. The external auditors have full and free access to, and may meet periodically and separately with, the Audit Committee, and Management to discuss their audit findings.

Signed *"Colin Witwer"*

Colin Witwer
President & Chief Executive Officer

Signed *"Tracie Noble"*

Tracie Noble
Vice President Finance & Chief Financial Officer

March 30, 2016

March 30, 2016

Independent Auditor's Report

To the Shareholders of
Virginia Hills Oil Corp.

We have audited the accompanying consolidated financial statements of Virginia Hills Oil Corp. (a successor to Pinecrest Energy Inc.), which comprise the consolidated balance sheet as at December 31, 2015 and December 31, 2014 and the consolidated statements of net loss and comprehensive loss, changes in equity and cash flow for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Virginia Hills Oil Corp. as at December 31, 2015 and December 31, 2014 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 1 in the consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about Virginia Hills Oil Corp.'s ability to continue as a going concern.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

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Virginia Hills Oil Corp.

Consolidated Balance Sheets

As at December 31
(Canadian $000's)

	Note	2015	2014
ASSETS			
Current assets			
Restricted cash	2	$ 1,000	$ -
Trade and other receivables		4,906	4,805
Prepaids and deposits		374	553
Assets held for sale	7	467	-
		6,747	5,358
Non-current assets			
Exploration and evaluation assets	8	3,010	3,633
Property, plant and equipment	9	90,573	112,110
Total Assets		**$ 100,330**	**$ 121,101**
LIABILITIES			
Current liabilities			
Bank overdraft		$ 228	$ 259
Trade and other payables		10,527	10,031
Flow through share premium		250	-
Bank debt	10	104,262	110,570
		115,267	120,860
Non-current liabilities			
Decommissioning provision	11	9,365	11,245
Total Liabilities		124,632	132,105
Shareholders' Deficit			
Share capital	13	284,183	281,308
Warrants	14	1,455	5,283
Contributed surplus	15	18,658	13,089
Deficit		(328,598)	(310,684)
Total Shareholders' Deficit		(24,302)	(11,004)
Total Liabilities and Shareholders' Deficit		**$ 100,330**	**$ 121,101**

	Note
Going Concern	1(b)
Commitments	20
Subsequent Event	21

The notes are an integral part of these consolidated financial statements

On behalf of the Board of Directors:

Signed *"John Brussa"*

John Brussa, Director

Signed *"Rob Zakresky"*

Rob Zakresky, Director & Audit Committee Chair

Virginia Hills Oil Corp.

Consolidated Statements of Net Loss and Comprehensive Loss
For the years ended December 31
(Canadian $000's, except per share amounts)

	Note	2015	2014
Revenue			
Petroleum and natural gas sales		$ 32,839	$ 63,683
Royalties		(3,157)	(11,830)
Petroleum and natural gas revenue		29,682	51,853
Other operating income		657	642
Loss on derivative financial instruments		-	(231)
Total revenue and other operating income		**30,339**	**52,264**
Expenses			
Production		13,100	18,610
Transportation		1,864	2,070
Exploration expense and impairment	8	899	79,165
Depletion, depreciation and impairment	9	31,215	115,978
General and administrative		3,591	4,681
Transaction costs		4,142	569
		54,811	221,073
Operating loss		**(24,472)**	**(168,809)**
Finance expense			
Interest expense	10	7,450	6,281
Fair value on convertible debt derivative	10	(260)	-
Accretion on decommissioning provision	11	632	635
		7,822	**6,916**
Gain on asset disposition	2	(13,882)	-
Loss before income tax		**(18,412)**	**(175,725)**
Deferred income tax recovery	12	**(498)**	**-**
Net Loss and Comprehensive Loss		**$ (17,914)**	**$ (175,725)**
Net Loss per share	16		
Basic		**$ (1.28)**	**$ (80.90)**
Diluted		**$ (1.28)**	**$ (80.90)**

The notes are an integral part of these consolidated financial statements

Virginia Hills Oil Corp.

Consolidated Statements of Changes in Deficit

(Canadian $000's)

	Note	2015	2014
Share Capital	13		
Balance, January 1		$ 281,308	$ 281,308
Common shares issued:			-
Capital reorganization	2	853	-
Private placement		2,994	-
Flow through share premium		(748)	-
Fair value, warrants		(729)	-
Business acquisition		544	-
Share issue costs, net of tax		(39)	-
Balance, December 31		284,183	281,308
Warrants	14		
Balance, January 1		5,283	5,283
Cancelled pursuant to capital reorganization	2	(5,283)	-
Issued:			-
Capital reorganization	2	98	-
Business acquisition		637	-
Fair value, warrants		729	-
Warrant issue costs, net of tax		(9)	-
Balance, December 31		1,455	5,283
Contributed Surplus	14		
Balance, January 1		13,089	13,114
Capital reorganization	2	5,283	-
Share-based payments	15	286	760
Forfeited incentive awards		-	(645)
Cash-settled equity instruments		-	(140)
Balance, December 31		18,658	13,089
Deficit			
Balance, January 1		(310,684)	(134,959)
Total comprehensive loss		(17,914)	(175,725)
Balance, December 31		(328,598)	(310,684)
Total Shareholders' Deficit		**$ (24,302)**	**$ (11,004)**

The notes are an integral part of these consolidated financial statements

Virginia Hills Oil Corp.

Consolidated Statements of Cash Flows
For the years ended December 31
(Canadian $000)

	Note	2015	2014
Operating activities			
Net loss		$ (17,914)	$ (175,725)
Items not affecting cash:			
Deferred income tax recovery		(498)	-
Accretion on decommissioning provision		632	635
Fair value of convertible debt derivative		(260)	-
Amortized deferred finance costs		1,475	72
Depletion, depreciation and impairment		31,215	115,978
Exploration, evaluation and impairment expense		899	79,165
Share-based payments		266	(11)
Unrealized gain on derivative financial instruments		-	(615)
Gain on sale of asset disposition		(13,882)	(7)
Decommissioning expenditures		(37)	(55)
Change in non-cash working capital	19	1,186	3,099
Net cash flow from operating activities		**3,082**	**22,536**
Investing activities			
Expenditure on exploration and evaluation assets		(523)	(217)
Expenditure on property, plant and equipment		(9,807)	(8,538)
Net working capital deficit acquired in business combination		609	-
Proceeds on capital reorganization	2	23,500	10
Increase in restricted cash	2	(1,000)	-
Change in non-cash working capital	19	(1,651)	(2,727)
Net cash flows from (used in) investing activities		**11,128**	**(11,472)**
Financing activities			
Repayment of bank debt		(16,100)	(11,030)
Debt issue and cancellation costs		(2,171)	-
Issue of shares, net of costs		3,800	-
Change in non-cash working capital	19	292	131
Net cash flows from financing activities		**(14,179)**	**(10,899)**
Net change in bank overdraft		**31**	**165**
Bank overdraft, beginning of year		(259)	(424)
Bank overdraft, end of year		**$ (228)**	**$ (259)**

The notes are an integral part of these consolidated financial statements

1. REPORTING ENTITY AND GOING CONCERN

a) Reporting Entity: Virginia Hills Oil Corp. ("Virginia Hills" or the "Company") is engaged in the acquisition, exploration, and development of oil and gas properties in western Canada. Virginia Hills was incorporated under the Business Corporations Act (*Alberta*) on November 5, 2014. The Company was incorporated for the purposes of participating in the capital reorganization of Pinecrest Energy Inc. ("Pinecrest") (Note 2). The Company's head office and principal place of business is located at 1500, 202-6th Avenue S.W., Calgary, Alberta T2P 2R9. The common shares of the Company are listed on the TSX Venture Exchange under the symbol "VHO".

These consolidated financial statements include the accounts of Virginia Hills Inc. and its wholly owned subsidiary 1834163 Alberta Ltd. Virginia Hills subscribed for shares on February 6, 2015 for the sole purpose of completing the acquisition of Dolomite Energy Inc. ("Dolomite") (Note 6). Upon completion of the acquisition, the Company's subsidiary amalgamated with Dolomite and continued as Dolomite Energy Inc. All intercompany balances and transactions have been eliminated.

b) Going Concern: These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") on a going concern basis which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due. At December 31, 2015, Virginia Hills had a working capital deficiency of $108.5 million (December 31, 2014: $115.5 million) and an accumulated deficit of $24.3 million (December 31, 2014: $11.0 million). During the year ended December 31, 2015, the Company reported net loss of $17.9 million (December 31, 2014: $175.7 million) and generated cash from operating activities of $3.1 million (December 31, 2014: $22.5 million), which included a non-recurring gain of $13.9 million and transaction costs of $4.1 million related to the capital reorganization and a corporate acquisition. Starting April 1, 2016, principal repayments are due on the syndicated facility based on the prior month's available cash flow (as defined by the credit agreement). In addition to its working capital requirements, the Company must secure sufficient funds to meet its on-going operations and commitments (Note 20).

During the year ended December 31, 2015, the Company completed the capital reorganization ("Arrangement" – see Note 2); entered into new and amended credit facilities in the amount of $108.0 million; closed a $3.0 million private placement equity offering; met its obligations under a farm-in arrangement and completed a corporate acquisition of a private oil and gas company. While these developments are positive, there can be no assurance that these initiatives are sufficient to meet the Company's commitments. Management is limiting expenditures to its bank-approved budget, which outlines permitted capital and operating expenditures, and is currently monitoring business alternatives, including potential asset sales and joint venture opportunities, which could result in additional available funds for the Company.

The Company's cash flows and compliance with debt covenants are dependent upon realized current period net revenues. Operating cash flows were lower than the prior year due to depressed commodity prices and lower production volumes. The recent decrease in revenues, operating cash flow and recent history of losses indicates the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern and accordingly, the appropriateness of the use of accounting principles applicable to a going concern. In addition, the lending value of the credit facility is dependent upon the Company's reserves which are directly linked to oil and natural gas forecasted benchmark prices that are expected to remain low for the immediate future. The credit facilities are due on September 30, 2016, and there is no assurance the credit facilities will be renewed upon the current terms or levels once the bank review is completed. At December 31, 2015, the Company was in breach of its production covenant and cumulative development capital expenditure covenant, which limits total cumulative development capital expenditures from April 1, 2015 to March 31, 2016 to $6.4 million (See Note10). Subsequent to December 31, 2015, the Company and its lenders entered into an amending agreement and waiver, which redefined the Company's limits on capital spending to be an aggregate of $9.3 million from April 15, 2015 to March 31, 2016 and waived the production default.

Should the lenders not renew the credit facilities, the Company would need to seek alternate forms of debt or equity financing, which would be difficult in the current business environment, or seek strategic alternatives, which could include disposal of certain assets. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial position and results of operations. Virginia Hills' ability to continue as a going concern is dependent upon its ability to fund the repayment of existing borrowings, secure additional financing and generate positive cash flows from operations. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and reported revenues, expenses and balance sheet classifications that would be necessary if the Company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

2. CAPITAL REORGANIZATION

On April 15, 2015 (the "Effective Date") the Company completed a corporate reorganization as part of a plan of arrangement (the "Arrangement") pursuant to section 193 of the Business Corporations Act (*Alberta*).
Pursuant to the Arrangement, the common shareholders of Pinecrest became the common shareholders of the Company and approximately 90% of Pinecrest's Alberta oil and gas assets, and substantially all of the other assets and liabilities were transferred to the Company. The common shares of Pinecrest were then sold to Cardinal Energy Ltd. ("Cardinal") for cash proceeds of $23.5 million, of which $1.0 million was placed into escrow, to satisfy certain closing adjustments. The escrow period expires August 15, 2016. The $1.0 million of proceeds in escrow is presented as Restricted Cash on the Balance Sheets at December 31, 2015. In addition to the upfront proceeds, the Company is entitled to receive an additional payment of $5.0 million if, during the period from April 16, 2015 and ending on April 26, 2016, a front-month hedge is made available to Cardinal by one or more financial institutions, financial intermediaries or credit branches at a price of $US 65 WTI per barrel of oil for a minimum of twelve months. This contingent consideration has not been recorded in these financial statements, as the amount is contingent upon the reference price of crude oil (WTI). Should Cardinal establish a front-month hedge, the value of the proceeds will be known and the full amount will be recorded at such time.

As part of the Arrangement, Pinecrest's shareholders (the "Shareholders") exchanged their shares on a basis of 100 Pinecrest shares for one (1) common share of the Company, and received eight (8) arrangement rights. Each arrangement right entitled the Shareholders to acquire one (1) common share of the Company at $0.25 per share and expired on May 15, 2015. A total of 3,412,175 arrangement rights were exercised for gross proceeds of $0.9 million. All outstanding common share purchase warrants, performance warrants and share incentive plan awards of Pinecrest were cancelled at April 15, 2015 for a nominal amount, pursuant to the Arrangement. On April 15, 2015, a total of $22.6 million from the gross proceeds and exercise of the arrangement rights were used to repay outstanding bank debt. In addition, any contingent consideration received will be used to pay down outstanding debt. In conjunction with closing of the Arrangement, the Company arranged a new bank facility with the senior lenders.

On the Effective Date, Virginia Hills and Pinecrest were considered to be under common control as the Virginia Hills shareholders are the former Pinecrest shareholders, and therefore, the business of Virginia Hills is controlled by the same shareholders immediately before and after the Arrangement. The accounting for common control entities is not addressed under *IFRS Standards 3 – Business Combinations*, therefore an entity is required to develop an accounting policy. Management has determined that the predecessor values method of accounting is the most appropriate, whereby the predecessor carrying values of Pinecrest are reported, without any step-up in fair value, if any.

The transaction was accounted for as a capital reorganization of Pinecrest, and comparative financial information of Virginia Hills is reported as a continuation of Pinecrest's historical accounting records. Virginia Hills, reports its full interest in the properties until disposed, and recorded a gain on the disposition of the Pinecrest shares during the second quarter of 2015 of $13.9 million. Transaction costs associated with the capital reorganization totalling $2.4 million dollars have been expensed.

3. BASIS OF PREPARATION

a) Statement of Compliance: These financial statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB"). These financial statements were approved and authorized for issuance by Virginia Hills' Board of Directors on March 30, 2016.

b) Basis of Measurement, Functional & Presentation Currency: These financial statements are presented in Canadian dollars and have been prepared on the historical cost basis, except for derivative financial instruments and share-based payments, which are measured at fair value. The methods used to measure fair values are discussed in Note 5 (e). Certain prior period amounts have been reclassified for presentation purposes. The policies applied in these financial statements are based on IFRS issued, effective and outstanding as of December 31, 2015.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires Management to make certain judgements, accounting estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual outcomes could differ from those estimates. Estimates and assumptions are reviewed on a continual basis. Changes to such estimates are based on historical experience, and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The impact of these estimate, assumption and judgement revisions are recognized in the year in which they occur. The effect on the financial statements in future periods could be material. Significant judgements, estimates and assumptions made by Management in the preparation of these financial statements are described below:

a) Key sources of estimation uncertainty: The following are key assumptions about the sources of estimation uncertainty at the end of the reporting period that have significant risk of causing adjustments to the carrying values of assets and liabilities and revenues and expenses:

(i) **Fair values:** The estimate of fair value of the Company's financial assets and liabilities, the determination of the fair value of net identifiable assets acquired under a business combination, and impairment calculations by their nature are subject to measurement uncertainty. Fair values are dependent on estimated forward crude oil and natural gas prices, expected discount rates used to estimate reserves, expected interest rates, expected future foreign currency exchange rates and expected volatility in these variables. The fair value is estimated, whenever possible, based on published market prices and if not available, on estimates from third-party brokers as at the reporting date and may differ from what will eventually be realized.

(ii) **Estimation of Petroleum and Natural Gas Reserves:** The assessment of reported recoverable quantities of proved and probable reserves ("Reserves") include estimates regarding production volumes, commodity prices, exchange rates, remediation costs, timing and amount of future development costs, and production, transportation and marketing costs for future cash flows. The economical, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact the carrying value of the Company's oil and natural gas properties and equipment, the calculation of depletion and depreciation, the provision for decommissioning liabilities, and the recognition of deferred tax assets due to changes in expected future cash flows. The Company's petroleum and natural reserves are independently evaluated by reserve engineers at least annually and are determined pursuant to National Instrument 51-101, Standard of Disclosures for Oil and Gas Activities.

In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed, which includes assessing the value of petroleum and natural gas properties based upon the estimates of recoverable quantities Reserves.

(iii) **Decommissioning Provisions:** The calculation of decommissioning liabilities and related accretion expense includes estimates of current credit-adjusted risk-free interest rates, future inflation rates, future restoration and reclamation expenditures and the timing of those expenditures. Provisions for environmental clean-up and remediation costs are based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates due to changes in laws and regulations, public expectations, prices, discovery and analysis of site conditions and changes in clean-up technology.

(iv) **Share-based payments:** All share-based equity-settled and cash-settled awards issued by Virginia Hills are recorded at fair value using the Black-Scholes option pricing model. The calculation of share-based payment expense requires estimates which involve considerable assumptions about the share price volatility, forfeiture rates, option life, dividend yield, risk-free rate and forfeiture rate at the initial grant date. These estimates are subject to measurement uncertainty and impact the share-based payment expense and contributed surplus or liability, if cash-settled.

b) Critical judgements in applying accounting policies: The following are critical judgements, apart from those involving estimates, which Management has made in the process of applying the Company's accounting policies that have the most significant effect on the amounts recognized in the financial statements:

(i) **Joint Control:** Judgement is required to determine when Virginia Hills has joint control over an arrangement. This requires assessment of the capital and operating activities and whether those activities require unanimous consent of the projects it undertakes with partners.

(ii) **Identification of Cash Generating Units**: Virginia Hills' assets are aggregated into cash generating units ("CGU's") for impairment testing. The determination of a CGU requires judgement in defining a group of assets that generate independent cash inflows. CGU's are determined by Management's judgement about the assets: similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality.

(iii) **Depletion of Oil and Gas Assets:** The Company allocates its oil and gas assets to components with similar lives and depletion methods. The grouping of assets is subject to Management's judgement and is performed on the basis of geographical proximity and similar reserve life. Depletion of oil and gas assets is determined based on total proved and probable reserve values as well as future development costs as estimated by the Company's external reserve evaluator. Changes to these estimates, will result in changes to the depletion provision.

(iv) **Capitalized Exploration and Evaluation Expenditures:** In making decisions regarding whether to continue to capitalize exploration and evaluation expenditures, Management makes judgements about the commercial Reserves and the level of activities that constitute on-going evaluation. If there is a change in judgement in a subsequent period, the related capitalized exploration and evaluation expenditures would be charged as an expense in that period. The decision to transfer exploration and evaluation assets ("E&E") to property, plant and equipment ("PP&E") is based on Management's determination of an area's technical feasibility and commercial viability based on estimates of Reserves.

(v) **Recoverability of Asset Carrying Values:** At each reporting date, the Company assesses its property, plant and equipment, including intangible exploration and evaluation assets, for possible impairment if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable. Exploration and evaluation assets are also tested for impairment when transferred to property, plant and equipment. Impairment indicators include changes in the Company's business plans and market capitalization, changes in commodity prices, evidence of physical damage and, for petroleum and natural gas properties, significant downward revisions of estimated recoverable volumes, price forecasts or increases in estimated future development expenditure. If there are low oil or natural gas prices during an extended period the Company may need to recognize significant impairment charges. Determination as to whether and how much an asset is impaired involves estimates and assumptions on uncertain matters such as future commodity prices, the effects of inflation on production expenses, discount rates, production profiles and the outlook for regional market supply-and-demand conditions for crude oil, natural gas and refined products.

(vi) **Deferred Taxes**: Tax regulations and legislation are subject to change and differing interpretations require significant Management judgement in determining the provision for income taxes. Deferred tax liabilities are recognized when it is considered probable that temporary differences will be payable to tax authorities in future periods. Recognition of deferred tax assets is based on estimates made in determining whether sufficient future taxable profit will be available to utilize the deferred tax assets. Income tax filings are subject to audits and re-assessments and changes in facts, circumstances and interpretations of the tax standards may result in a material increase or decrease in the Company's provision for income taxes.

5. SIGNIFICANT ACCOUNTING POLICIES

a) Revenue Recognition: Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities. Revenue is recognized when the amount can be reliably measured; it is probable that future economic benefits will flow to the Company, and when the following recognition criteria have been met for each of the Company's activities:

(i) Revenue from the sale of petroleum and natural gas is recognized when the significant risks and rewards of ownership of the products is transferred to the buyer, which is usually when legal title passes and the volumes have been delivered to the third-party purchaser and when collectability is reasonably assured. The Company uses the entitlement method to account for its revenue from sales of petroleum and natural gas production, whereby the Company recognizes revenue based on its direct ownership interest in its underlying petroleum and natural gas properties. Revenue is measured net of discounts, customs duties and royalties.

(ii) Royalty income and other income is recognized as it accrues in accordance with the terms of the governing agreements. Interest income is recognized as it is earned on a time proportion basis using the effective interest method.

b) Joint Arrangements: Where the Company's exploration and production activities are conducted jointly with others and are considered joint operations, the accounts reflect only the Company's proportionate interest in such activities. Joint control exists for contractual arrangements governing Virginia Hill's assets, whereby Virginia Hills has less than 100 per cent working interest, all of the partners have control of the arrangement collectively and spending on the project requires unanimous consent of all parties that, together, control the arrangement and share the associated risks. Virginia Hills does not have any joint arrangements that are individually material or that are structured through joint venture arrangements.

c) Business Combinations: Business combinations are accounted for using the acquisition method, where the acquisition of companies and assets meet the definition of a business under IFRS. The cost of an acquisition is measured initially at the fair value of the assets transferred, equity instruments issued and liabilities incurred or assumed at the date of exchange. The acquired identifiable assets and liabilities are measured initially at their fair value at the date of acquisition. The fair value of E&E assets and PP&E is the estimated amount for which these assets could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgably, prudently and without compulsion. The market value of oil and natural gas interests is estimated with reference to discounted cash flows expected to be derived from oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions. Any excess of the purchase price over the fair value of the identifiable assets and liabilities acquired is recognized as goodwill. If the cost of acquisition is less than fair value of the identifiable assets and liabilities, the difference is recorded as a gain in the Statements of Loss and Comprehensive Loss. Associated transaction costs are expensed when incurred.

d) Financial Instruments: Financial assets, financial liabilities and derivatives are measured at fair value on initial recognition on the Balance Sheets when Virginia Hills becomes party to the contractual provisions of the instrument. Measurement in subsequent period depends on the financial instrument's classification, as described below:

(i) Fair value through profit or loss: Financial assets and liabilities classified as fair value through profit or loss are initially recognized and subsequently measured at fair value with changes in those fair values charged immediately to earnings.

(ii) Held-to-maturity investments, loans, receivables and other financial liabilities*:* these financial instruments are initially recognized at fair value, net of directly attributable transaction costs and are subsequently measured at amortized cost using the effective interest method. Virginia Hills classifies trade and other receivables as loans and receivables, and classifies trade and other payables as other financial liabilities.

(iii) Available for sale financial assets: Non-derivative financial assets may be disengaged as available for sale as they are not classified in another category. Available-for-sale financial assets 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 ("OCI"), net of tax. Transaction costs related to the purchase of available-for-sale assets are recognized in the statement of income. Amounts recognized in OCI are charged to earnings when the asset is derecognized or when there is significant or prolonged decrease in the value of the asset.

Classification of financial assets at initial recognition is dependent on the purpose for which they were acquired. Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. Financial assets are derecognized when the contractual rights to the cash flow from the financial asset expire or when the contractual rights to those assets are transferred. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expired. Financial assets and liabilities are offset and the net amount presented on the Balance Sheets when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. The Company does not employ hedge accounting for its risk management contracts.

e) Fair value measurement: A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants in its principal or most advantageous market at the reporting date.

All financial assets and liabilities for which fair value is measured or disclosed are categorized using a three-level hierarchy, based on the amount of observable inputs used to value the instrument:

Level 1:	Observable inputs, such as quoted market prices in an active market for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis;
Level 2:	Inputs, other than quoted market prices in an active market, which are observable, either directly and/or indirectly. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the market place; and
Level 3:	Unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

At each reporting date, Virginia Hills determines whether transfers have occurred between levels in the hierarchy by reassessing the level of classification for each financial asset and financial liability measured or disclosed at fair value. Assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the placement within the fair value hierarchy. Fair values have been determined for measurement and disclosure purposes based on the following methods:

(i) ***Trade and other receivables, trade and other payables and bank overdraft****:* The fair value of trade and other receivables, trade and other payables and bank overdraft is estimated as the present value of future cash flows, discounted at the market rate of interest at each reporting date. The fair value of these balances approximate their carrying value at the reporting period due to their short term to maturity.

(ii) ***Derivative financial instruments*****:** The fair value of derivative contracts is determined by the difference between the contracted prices and published forward commodity price curves at each reporting date, using the remaining contracted commodity volumes.

(iii) ***Bank debt***: The fair value of bank debt outstanding on the revolving credit facility approximates is fair value due to the use of short-term borrowing instruments at market rates of interest.

(iv) ***Property, Plant and Equipment ("PP&E") and Exploration and Evaluation ("E&E") Assets*****:** The fair value of PP&E recognized in a business combination and/or an impairment provision is based on market values. The market value of PP&E is the estimated amount for which PP&E could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing, wherein the parties had each acted knowledgably, prudently and without compulsion. The market value of petroleum and natural gas properties included in PP&E and E&E assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions. The market value of other items of property and equipment is based on the quoted market prices for similar items.

(v) ***Stock options and share awards:*** The fair value of stock options and share awards is measured using a Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for expected changes due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected forfeiture rates and the risk-free interest rate (based on government bonds).

f) Property, Plant and Equipment ("PP&E") and Exploration and Evaluation ("E&E") Assets

***(i)* Exploration and evaluation expenditures:** Expenditures incurred before acquiring the legal right to explore in a specific area (pre-license costs) are recognized in the Statements of Net Loss and Comprehensive Loss as incurred. E&E expenditures incurred, after the legal right to explore has been acquired, that are directly attributable to the exploration for petroleum and natural gas reserves are capitalized as E&E assets on a field-by-field basis. These costs include, but are not limited to: lease acquisition either directly or by business combination, lease rentals on undeveloped properties, acquisition of rights to explore, geological and geophysical costs, exploratory drilling of both productive and unproductive wells and overhead charges. E&E expenditures are capitalized until reserves are evaluated and determined to be commercially viable and technically feasible. If reserves are not identified, these costs are expensed in the Statements of Net Loss and Comprehensive Loss. The balance of E&E expenditures is carried forward as an E&E asset on the Balance Sheets where the mineral rights are current and it is considered probable that costs will be recovered through the future development or sale of the property. If it is determined that a commercial discovery of reserves will not be achieved, capitalized E&E assets are written down to their recoverable amounts. Where commercial discovery of reserves has been made, the E&E assets are tested for impairment and transferred to PP&E as petroleum and natural gas properties.

***(ii)* Property, plant and equipment:** Items of PP&E, which include petroleum and natural gas development and production assets, are measured at historical cost, less any accumulated depletion and, depreciation and accumulated impairment losses. The initial cost of an asset comprises its purchase price (the acquisition of petroleum and natural gas assets directly, or by means of a business combination) or construction cost which includes costs directly attributable to bringing the asset into operation including initial estimates of the decommissioning obligation. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of PP&E are recognized as assets only when they increase the future economic benefits of the related asset. All other expenditures are recognized in the Statements of Net Loss and Comprehensive Loss as incurred. These costs generally represent expenditures incurred in developing proved and probable reserves and establishing or enhancing production from existing reserves, and are accumulated on a well, field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. Gains and losses on the disposal, or derecognition of a component of PP&E are recognized by comparing the proceeds from disposal with the carrying amount of the asset and any difference is recognized directly in the Statements of Net Loss and Comprehensive Loss.

***(iii)* Depletion and depreciation:** Where commercial production in an area has commenced, petroleum and natural gas properties are depleted on a unit-of-production basis, by field, over the proved and probable reserves, before royalties. If the asset's useful life is shorter than the lifetime of the field, depreciation is recorded on a straight-line method, over the estimated useful life of the asset. The unit-of-production rate for the depletion of developed and producing petroleum and natural gas properties takes into account expenditures incurred to date, plus future development expenditures to develop the proved and probable reserves. Changes in factors such as estimates of proved and probable reserves that affect unit-of-production calculations are accounted for on a prospective basis. For other assets, depreciation is recognized in earnings on a declining balance method, with rates ranging from 20% to 100% based on their estimated useful lives. No depletion or amortization is charged on E&E assets.

g) Assets Held for Sale: Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition. For the sale to be highly probable Management must be committed to a plan to sell the asset and an active program to locate a buyer and complete the plan must have been initiated. The asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value and the sale should be expected to be completed within one year from the date of classification. Non-current assets classified as held for sale are measured at the lower of carrying amount and their fair value less costs of disposal, with impairment recognized in the Statements of Loss and Comprehensive Loss in the period measured. Non-current assets held for sale are classified and presented in current assets and liabilities within the Balance Sheets. Assets held for sale are not depleted, depreciated or amortized.

h) Impairment

(i) **Financial assets:** Financial assets are assessed for impairment at each reporting date to determine whether there is any objective evidence that they are impaired, which would indicate one or more events have had a negative effect on the estimated future cash flows of the asset and will not be realized. For loans and receivables, the amount of impairment is the difference between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

If there is impairment, the carrying amount of the financial asset is reduced by the impairment loss, except for trade receivables where the carrying amount is reduced through the use of an allowance account, and the loss is recognized in the Statements of Net Loss and Comprehensive Loss. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the Statements of Net Loss and Comprehensive Loss.

(ii) **Non-financial assets:** The Company reviews the carrying amounts of its non-financial assets at each reporting date to determine whether there is any indication of impairment. If such indication exists, then the asset's recoverable amount is estimated. E&E assets are tested for impairment when reclassified to PP&E, and also if facts and circumstances suggest that the carrying value exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the lowest level at which there is identifiable cash flows that are largely independent of the cash flows of other groups of assets, known as a CGU. E&E assets and PP&E costs are grouped into CGU's based on their ability to generate independent cash flows. The goodwill acquired in a business combination, for the purposes of impairment testing, is allocated to the CGU's that are expected to benefit from the synergies of the combination.

An impairment loss is recognized if the CGU's carrying amount exceeds its recoverable amount determined as the higher of its fair value less costs of disposal ("FVLCD") and its value in use ("VIU"). In assessing VIU, the estimated future pre-tax cash flows are adjusted for the risks specific to the asset group and are discounted to present value using a discount rate that reflects current market assessments of the time value of money. FVLCD is the amount for which the CGU could be sold in an arm's length transaction, less the costs of disposal, and is based on discounted cash flow forecasts using market assumptions, including market assessment of reserves, future prices and a risk-adjusted discount rate appropriate to the asset by reference to general market conditions, market expectations of current and future development, and the costs of future development. Impairment losses are recognized in the Statements of Net Loss and Comprehensive Loss.

Impairment losses recognized in prior years are assessed at each reporting date for indications that previously recognized impairment losses may no longer exist or may have decreased. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. The impairment loss is reversed only to the extent that the CGU's carrying amount does not exceed the carrying amount that would have been determined, net of depletion, had no impairment loss been recognized in prior years.

i) Provisions: Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. For obligations relating to the abandonment (dismantling and site reclamation and remediation activities) of oil and gas wells and related facilities, the fair value is measured at the present value of the estimated future cost of decommissioning using a credit-adjusted risk-free rate. Cost is estimated based upon current regulation, technology and the latest assumptions as to scope and method of the abandonment. Costs and the discount rate are updated at each reporting date to reflect current market assessments of the time value of money, current regulations, technologies and industry standards.

The corresponding amount is capitalized to petroleum and natural gas assets and is amortized on a unit-of-production basis as part of depletion and depreciation. The increase in the provision due to the passage of time is recognized as a finance expense on the Statements of Net Loss and Comprehensive Loss. Any adjustments arising from the reassessment of estimated costs or the current estimate of the discount rate used are reflected as an adjustment to the provision and the relevant assets. Actual restoration expenditures are charged as reductions to the accumulated provision when incurred.

j) Income Taxation: Deferred income tax is recognized, using the liability method, which determines the amount payable or recoverable on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that is probable that sufficient future taxable profit will be available against which the temporary differences can be utilized and the carry forward of unused tax credits and unused tax losses can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax is measured at the tax rates and tax laws that have been enacted or substantively enacted at each reporting date and are expected to be applied when the deferred tax asset is realized or the deferred tax liability is settled. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity.

k) Share-Based Payments: The Company's compensation structure consists of three primary components: i) annual base salary ii) discretionary short-term incentive cash bonus and iii) periodic grants of long-term incentives in the form of stock options, performance warrants and/or share awards (collectively "Stock Awards"), which are granted from time to time to participants at varying levels consistent with the individual's position and level of responsibility. Virginia Hills accounts for Stock Awards using the Black-Scholes option-pricing model which includes assumptions regarding interest rates, underlying volatility of the shares, forfeiture rates, and expected life of the Stock Awards. Stock Awards granted are measured at fair value at the grant date; determined using the Company's share price on the grant date and the share-based payment expense is recognized, on a graded-vesting basis, over the related vesting period with a corresponding increase to contributed surplus. When Stock Awards vest in installments each installment is accounted for as a separate arrangement. The Company capitalizes the qualifying portion of share-based payments directly attributable to the development activities of PP&E, with a corresponding decrease to share-based compensation expense.

(i) Equity-Settled Share-Based Payments*:* At each reporting date, Virginia Hills revises its estimates of the number of Stock Awards that are expected to vest and recognizes the impact of the revision, if any, in the Statements of Net Loss and Comprehensive Loss, with a corresponding adjustment to contributed surplus. In the event that the vested Stock Awards expire without being exercised, previously recognized compensation costs associated with such Stock Awards are not reversed. When Stock Awards are exercised, the proceeds received, net of any directly attributable transaction costs, together with the amount previously recognized in contributed surplus is credited to share capital.

(ii) Cash-Settled Share-Based Payments**:** Share based compensation awards that settle in cash or have the option to settle in cash or shares are accounted for as cash-settled plans. The expense is recognized over the vesting period, with a corresponding adjustment to liabilities. When awards are surrendered for cash, the cash settlement paid reduces the outstanding liability. When awards are exercised for common shares, consideration paid by the holder and the previously recognized liability associated with the Stock Awards are recorded to share capital. The related liabilities are revalued at each reporting period.

l) Finance Expense: Finance expense includes interest expense on borrowings, which is expensed as incurred, amortization of deferred financing fees and accretion of the discount on decommissioning provisions. Finance expense also includes any realized or unrealized changes in the fair value of embedded derivatives associated with bank debt.

m) Leases: The Company enters into operating leases in the normal course of business, which are not recognized on the Balance Sheets. Operating lease payments are recognized in the Statements of Net Loss and Comprehensive Loss in the period in which they are incurred, which is generally on a straight-line basis over the term of the lease.

n) Per Share Calculations: Basic income (loss) per share is calculated by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted income (loss) per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive potential common shares which comprise warrants, share options and incentive awards granted. The calculation assumes that the proceeds on exercise of the warrants or options are used to repurchase shares at the average market price during the period. Should the Company have a loss in a period, stock options and share warrants would be anti-dilutive and are excluded from the determination of fully diluted loss per share.

o) Flow-Through Shares: The Company, from time to time, finances a portion of its exploration activities through the issuance of flow-through shares. The related resource expenditure deductions normally available for income tax purposes are renounced to investors in accordance with income tax legislation. Proceeds from a flow-through share offering are allocated between the sale of the shares and the sale of the tax benefit. The allocation is made based on the difference between the quoted market price of the existing shares and the amount the investor pays for the flow through shares. A liability is established for the difference that is reversed upon renunciation of the tax benefit. The difference between the liability and the deferred tax liability is recorded as an income tax expense or recovery, if applicable.

p) New Accounting Pronouncements: During the year ended December 31, 2015, Virginia Hills adopted *IFRS 11 Joint Arrangements ("IFRS 11")* as amended, which requires that interests in joint operations be accounted for using the principles related to business combinations accounting as outlined in *IFRS 3, Business Combinations.* The amendments are to be applied prospectively and are effective for annual periods beginning on or after January 1, 2016, with early adoption permitted. Adoption of this amended IFRS did not have any impact on the consolidated financial statements.

q) Future Accounting Policy Changes: The following accounting standards are currently being evaluated by Management to determine their impact on the financial statements and have not yet been implemented:

- ***IFRS 9 Financial Instruments ("IFRS 9"):*** IFRS 9 was amended to introduce a single, forward-looking "expected loss" impairment model for financial assets which will require more timely recognition of expected credit losses, and a fair value through other comprehensive income category for financial assets that are debt instruments and supplements the new hedge accounting principles published in 2013 These amendments are effective for annual periods beginning on or after January 1, 2018 and are available for early adoption.

- ***IFRS 15 Revenue From Contracts With Customers ("IFRS 15"):*** IFRS15 provides clarification for recognizing revenue from contracts with customers and establishes a single revenue recognition and measurement framework and replaces *IAS 18 Revenue, IAS 11 Construction Contracts* and related interpretations The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. The new standard will be effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The standard may be applied retrospectively, or using a modified retrospective approach.

- ***IFRS 16 Leases ("IFRS 16"):*** IFRS 16 replaces IAS 17 Leases with a single recognition and measurement model which will be applied to leases for lessees, with required recognition of assets and liabilities being required for most leases. The standard is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted if the entity is also applying IFRS 15.

6. BUSINESS COMBINATION

On April 27, 2015, the Company acquired all the issued and outstanding common shares of Dolomite, a private oil and gas producer by way of an amalgamation with its wholly owned subsidiary (the "Acquisition"). The Acquisition complements the Company's existing operations in the Red Earth area and land base, and included approximately $51 million of tax pools. The purchase price was settled by issuance of 10,600 common shares at a fair value of $0.48 per common share based on the market value of the shares on the date of acquisition and 4.0 million common share purchase warrants with a fair value of $0.1592 per warrant (Note 15 "Series C Warrants") for total consideration of $0.6 million and assumed $11.5 million of net debt, defined as bank debt, net of working capital. Each warrant entitles the holder to purchase one Virginia Hill's share at a price of $0.50 for a period of three years.

The purchase price allocation was based on the best estimates of Management, giving consideration to the discounted cash flows expected to be derived from the oil and natural gas properties, based on an internally generated reserve report, which applied forward looking commodity prices as well as internal estimates as at the date of acquisition. The fair value of exploration and evaluation assets is based on average crown land purchases in the specific fields. The fair value of the net assets acquired and aggregate consideration paid were as follows:

Fair value of net assets acquired	**$**
Exploration and evaluation assets	125
Property, plant and equipment	12,994
Decommissioning liability	(939)
Working capital deficit	(760)
Bank debt	(10,778)
Fair value of net assets	**642**
Consideration paid	
Common shares	5
Common share purchase warrants	637
	642

Deferred tax assets of $9.8 million were not recognized in these financial statements given the uncertainty as to whether sufficient income will be generated in the future to recover these deferred tax assets. The Company incurred transaction costs of $1.6 million in conjunction with the acquisition, all of which have been expensed. A total of 983,624 common shares were issued at a price of $0.25 per common share to former executive officers of Dolomite in satisfaction of a portion of their severance. The balance of executive severance is due on April 27, 2016, and may be settled by the issuance of a maximum of an additional 1,229,530 common shares, issued at a deemed price of the greater of $0.30 per share or the market price of Virginia Hills shares at the time of issuance.

Should the executives elect to be paid in cash, the payment is subject to approval from the Company's senior lenders. In addition certain third party service providers of Dolomite were issued 1,171,332 shares at a price of $0.25 per share as payment for services previously provided (Note 13). Had the transaction closed on January 1, 2015, the estimated revenue and net loss that would have been reported by the Company for the period ending December 31, 2015 would have been $1.9 million and $5.5 million, respectively.

7. ASSETS HELD FOR SALE

At December 31, 2015, the Company reclassified certain capital spare parts assets from its Red Earth CGU to assets held for sale, due to a sales agreement, which closed in January, 2016. The assets were valued at the lower of carrying amount and fair value less costs of disposal, which resulted in an impairment loss of $0.5 million which is included in the impairment loss on the Statements of Net Loss and Comprehensive Loss.

	Cost
At December 31, 2014	$ -
Transfer from property, plant and equipment	952
Impairment	(485)
At December 31, 2015	**$ 467**

8. EXPLORATION AND EVALUATION ASSETS

	Cost
At December 31, 2013	$ 82,582
Additions	218
Disposals	(2)
Expensed	(17,738)
Impairment	(61,427)
At December 31, 2014	3,633
Capital reorganization (Note 2)	(372)
Acquired in a business combination (Note 6)	125
Additions	523
Expensed	(813)
Impairment	(86)
At December 31, 2015	**$ 3,010**

E&E assets are tested for impairment when reclassified to PP&E and when facts and circumstances suggest that the carrying value exceeds the recoverable amount. For the year ended December 31, 2015, costs related to expired lands of $0.8 million and $0.1 million of impairment loss (December 31, 2014; $17.7 million and $61.4 million respectively) were charged directly to the Statements of Net Loss and Comprehensive Loss. The impairment losses were determined by assessing land sale activity, as published by the Government of Alberta for crown land acquisitions in Virginia Hills' core Red Earth land base.

9. PROPERTY, PLANT AND EQUIPMENT

Cost	Petroleum and natural gas properties	Office furniture and equipment	Total
December 31, 2013	$ 481,235	$ 573	$ 481,808
Additions	8,714	39	8,753
At December 31, 2014	489,949	612	490,561
Capital reorganization (Note 2)	(48,740)	-	(48,740)
Acquired in a business combination (Note 6)	12,994	-	12,994
Dispositions	-	(26)	(26)
Assets held for sale	(952)	-	(952)
Additions	7,574	14	7,588
At December 31, 2015	460,825	600	461,425
Accumulated Depletion, Depreciation and Impairment			
December 31, 2013	262,226	247	262,473
Depletion, depreciation and impairment	115,877	101	115,978
At December 31, 2014	378,103	348	378,451
Capital reorganization (Note 2)	(38,307)	-	(38,307)
Dispositions	-	(22)	(22)
Depletion, depreciation and impairment	30,651	79	30,730
At December 31, 2015	$ 370,447	$ 405	$370,852
Carrying Value			
At December 31, 2014	$ 111,846	$ 264	$ 112,110
At December 31, 2015	$ 90,378	$ 195	**$ 90,573**

Summary of Depletion, Depreciation and Impairment expense		2015	2014
Impairment on assets held for sale	Note 7	$ 485	$ -
Depletion, depreciation and impairment		30,730	115,978
Total depletion, depreciation and impairment		**$ 31,215**	$ 115,978

(i) **Capitalized general and administrative expense:** During the year ended December 31, 2015, Virginia Hills capitalized directly attributable administrative costs of $0.2 million (December 31, 2014: $0.5 million of administrative expenses).

(ii) **Depletion and depreciation:** At December 31, 2015, future development costs of $78.4 million (December 31, 2014: $45.0 million) were included in the depletion calculation and costs of $1.7 million (December 31, 2014: $3.1 million) relating to capital spare inventory were excluded from the depletion calculation.

(iii) **Impairment**: Virginia Hills assessed the recoverable amount of its CGU's based on the estimated FVLCD as at the reporting date. FVLCD is determined by calculating the net present value of future after-tax net cash flows from the petroleum and natural gas Reserves. The FVLCD was based on estimates of future commodity prices, royalty rates and cost assumptions used by the Company's independent qualified reserves evaluator and Management's expectation of tax rates in determining the estimated after-tax net cash flows. The determination of the FVLCD is a Level 3 measurement within the fair value hierarchy (Note 5 (e)).

The Company recorded an impairment loss on its Alberta oil CGU of $16.3 million for the year ended December 31, 2015 (December 31, 2014: $93.0 million). The recoverable amount of the CGU was estimated to be $90.0 million (December 31, 2014: $112.1 million) using a discount rate of 11% (December 31, 2014: 10%). The 2015 impairment loss was attributable to lower future prices, whereas the 2014 impairment loss was the result of revisions to reserves and to future prices and operating costs. A one percent increase in the assumed discount rate would result in an additional impairment of $5.6 million. A 10 percent decrease in the operating cash flows would result in in additional impairment of approximately $9.1 million

Benchmark prices used in the December 31, 2015 and December 31, 2014 calculations of recoverable amounts were determined by multiplying the Reserves quantities by the price forecasts for each year. The commodity prices, inflation rate and exchange rate forecasts used to determine FVLCD were:

	2015				**2014**			
Year	**Canadian Light Sweet Crude 40^0 API- Oil ($/bbl)**	**AECO Gas ($/MMBtu)**	**Inflation rate (%/Yr)**	**Exchange Rate ($US/$Cdn)**	**Canadian Light Sweet Crude 40^0 API- Oil ($/bbl)**	**AECO Gas ($/MMBtu)**	**Inflation rate (%/Yr)**	**Exchange Rate ($US/$Cdn)**
2015	-	-	-	0.75	70.35	3.32	1.5	0.85
2016	55.20	2.25	1.5	0.75	87.36	3.71	1.5	0.87
2017	69.00	2.95	1.5	0.80	98.28	3.90	1.5	0.87
2018	78.43	3.42	1.5	0.83	99.75	4.47	1.5	0.87
2019	89.41	3.91	1.5	0.85	101.25	5.05	1.5	0.87
2020	91.71	4.20	1.5	0.85	103.85	5.13	1.5	0.87
2021	93.08	4.28	1.5	0.85	105.40	5.22	1.5	0.87
2022	94.48	4.35	1.5	0.85	106.99	5.31	1.5	0.87
2023	95.90	4.48	1.5	0.85	108.59	5.40	1.5	0.87
2024	97.34	4.51	1.5	0.85	110.22	5.49	1.5	0.87
2025	98.80	4.59	1.5	0.85	111.87	5.58	1.5	0.87
2026	100.28	4.67	1.5	0.85	Thereafter escalated at 1.5%			
2027	Thereafter escalated at 1.5%							

10. BANK DEBT

As at December 31,		2015	2014
Senior bank debt			
Facility A - syndicated revolving loan	a)	$ 90,000	$ 95,000
Facility B - revolving operating loan		4,500	15,570
Subtotal		94,500	110,570
Less: unamortized deferred financing charges		(915)	-
		93,585	110,570
Subsidiary bank debt			
Credit facility – non-revolving operating loan	b)	5,000	-
Credit facility – revolving term loan		5,818	
Fair value allocated to embedded derivative		(260)	-
Accretion on credit facility		194	-
		10,752	-
Less: unamortized deferred financing charges		(75)	-
		10,677	-
Outstanding bank debt		**$ 104,262**	**$ 110,570**

At December 31, 2015 the Company had a total of $105.3 million (December 31, 2014: $110.6 million) outstanding on its credit facilities. At December 31, 2015, the interest rate on the Company's credit facilities was 5.7%. The Company incurred interest expense of $6.0 million (December 31, 2014: $4.5 million) during the year ended December 31, 2015. All bank facilities have a term to September 30, 2016, with no bank review scheduled between December 31, 2015 and September 30, 2016.

a) Senior Bank Debt: Facilities A and B

The Company's $97.0 million credit facility is comprised of a $90.0 million syndicated revolving facility ("Facility A") and a $7.0 million non-syndicated operating facility ("Facility B"), together the "Facilities", both of which have a term to September 30, 2016. The Facilities are secured by a general security agreement and a first floating charge debenture of $300.0 million covering all of the Company's assets. Starting April 1, 2016, principal repayments are due on the syndicated facility based on the prior month's available cash flow.

Advances under the Facilities may be made by way of Canadian prime rate loans, US base rate loans and letters of credit. Amounts borrowed under the Facilities bear interest on a floating rate based on the applicable Canadian prime rate plus a sliding scale pricing grid tied to the Company's trailing debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio. The interest pricing margin ranges from 1% to 3% and is dependent upon the form of borrowing. If at any time, the Company is in default under the Facilities, the interest margin will be increased by 2%, at the discretion of the lenders. At December 31, 2015 the Facilities interest rate was 5.7%.

The Company incurred $1.6 million ($1.5 million in cash fees and $0.1 million in non-cash fees paid in the form of warrants) to establish the Facilities which were deferred and amortized over the term of the Facilities. The Company issued a total of 1,972,416 common share purchase warrants to the lenders ("Series D Warrants") representing 10% of the issued and outstanding shares of the Company as at May 15, 2015. The warrants are exercisable at a price of $0.30 per common share for a period ending on the earlier of five years from the date of issue or 30 days following the date on which the facilities mature (Note 14). A total of $1.0 million remains payable at December 31, 2015 which is included in trade and other payables.

The Facilities contain the following non–financial covenants: monthly reporting requirements which include reporting actual monthly results against the bank approved business plan, permitted indebtedness, permitted hedging, permitted encumbrances and a requirement that daily production volumes may not vary below the bank approved business plan by more than 10% in any month.

The Company is subject to financial covenants, based on cash flow and EBITDA which restricts the variance from the bank-approved business plan over the periods from:

- April 1, 2015 to September 30, 2015 to a maximum of $0.7 million;
- October 1, 2015 to March 31, 2016 to the lesser of 25% and $1.5 million and
- April 1, 2016 to September 30, 2016 to the lesser of 25% and $2.0 million;

Other financial covenants include: a restriction on the Company's cumulative capital expenditures to a maximum of $9.3 million from April 1, 2015 to March 31, 2016, with maintenance capital limited to $2.9 million and development capital limited to $6.4 million, of which a maximum of $4.8 million may be spent on the commitment farm-in wells; limitation on the monthly amount of capital spent from April 1, 2016 to September 30, 2016 and a requirement that net debt not exceed $100.2 million.

During the year and as a result of the cross default provision in the credit agreement, the Company was in default due to Dolomite's breach of its financial covenant at each month end from April to October 2015. The Company received waivers from its lenders relating to this default. At December 31, 2015, the Company was in compliance with its covenants, except the allocation of capital expenditures between development and maintenance capital, and its minimum required production covenant. Subsequent to December 31, 2015, the Company and its lenders entered into an amending agreement and waiver, which redefined the Company's limits on capital spending to be an aggregate of $9.3 million from April 15, 2015 to March 31, 2016, limited capital spending from April 1, 2016 to September 30, 2016 to a maximum of $85,000, on a cash basis and waived the production default.

b) Subsidiary Bank Debt

Virginia Hills' subsidiary entered into an agreement to amend and restate its $11.0 million credit facility on April 27, 2015. The facility provides for a $6.0 million revolving operating loan and a $5.0 million non-revolving reducing term loan. Interest is payable on the loans based on Canadian prime plus 3%, at December 31, 2015 the interest rate was 5.7%. Total fees of $0.1 million were paid for amending the credit agreement. Both facilities are due on September 30, 2016.

From April 1, 2016 through to and including April 15, 2016, the lender, at their option, may convert up to $4.0 million of the non-revolving reducing term loan into common shares of Virginia Hills at a deemed price of the greater of $0.30 per share or the market price based on a 20-day volume weighted average price. This conversion feature is an embedded derivative and is reported separately as a current derivative financial liability on the Balance Sheets. The embedded derivative will be revalued and marked to market on each reporting date, with the resulting difference being recorded as a financing gain or loss in the Statements of Net Loss and Comprehensive Loss. At December 31, 2015, the derivative had a fair value of $nil. The bank debt is carried at amortized cost, using the effective interest method, which will accrete the liability up to full value of the outstanding bank debt at the expiry of the conversion feature; this amount is recorded as a non-cash finance expense.

The subsidiary is subject to customary monthly reporting covenants, and a financial covenant that restricts the subsidiary's monthly working capital deficit to a maximum of $1.3 million from November 30, 2015 to March 31, 2016, and $1.2 million from April 2016 to September 30, 2016. The Company was in compliance with its subsidiary bank debt financial covenant at December 31, 2015.

The senior debt and subsidiary debt agreements contain customary events of default, including: events based on bankruptcy and insolvency, non-payment of principal, interest or fees when due, change in control, material inaccuracy of representations and warranties, and a cross-default provision for breach of covenants. In the event of default, the total outstanding principal amounts of the credit facilities plus all accrued interest and costs become immediately due and payable by the Company, at the discretion and upon request from the lenders. During 2015, the Company was in default of its financial covenant, which was based on a three-month rolling average available cash flow (as defined in the agreement), under the subsidiary credit agreement at each month end from April to October 2015. The Company received waivers from its lenders relating to this default, and during the fourth quarter of 2015 the lender and Dolomite amended the subsidiary bank debt agreement financial covenant to be based on a monthly minimum working capital deficit amount.

11. PROVISION FOR DECOMMISSIONING OBLIGATIONS

Year ended December 31,	**2015**	**2014**
Balance, beginning of period	$ 11,245	$ 10,450
Capital Reorganization (Note 2)	(1,184)	-
Assumed in a business combination (Note 6)	939	-
Obligations incurred	145	298
Revision of discount and inflation rates	146	(83)
Changes in estimated future cash flows	(2,521)	-
Accretion expense	632	635
Expenditures incurred	(37)	(55)
Balance, end of period	**$ 9,365**	**$ 11,245**

The Company's decommissioning liability results from net ownership interests in petroleum and natural gas properties and equipment including well sites, gathering systems and facilities. Virginia Hills estimated the total undiscounted cash flows required to settle its asset obligations is approximately $16.4 million at December 31, 2015 (December 31, 2014: $22.8 million). Settlement of the obligation is expected to be funded from general corporate funds at the time of retirement which is expected to occur between 2017 and 2040. A credit adjusted risk-free rate of 7.6% and an inflation rate of 2.0% (December 31, 2014: 7.8% and 2.0%, respectively) were used to calculate the fair value of the decommissioning obligation at December 31, 2015.

12. TAXATION

a) **Deferred income tax expense:** The provision for income tax expense reflects an effective income tax rate which differs from federal and provincial statutory tax rates as follows:

	2015	**2014**
Loss before income taxes	$ (18,412)	$ (175,725)
Corporate income tax rate [(1)]	26%	25%
Expected income tax recovery	(4,787)	(43,931)
Increase (decrease) resulting from:		
Non-taxable gain from capital reorganization[(2)]	(2,162)	-
Unrecognized tax assets from capital reorganization & acquisition	(17,509)	-
Non-deductible share-based payments	15	3
Other non-deductible expenses	60	132
Impact of flow through share renouncement	40	-
Change in tax rates	(265)	-
Unrecognized deferred tax asset	24,110	43,796
Total income tax recovery	**$ (498)**	$ -

(1) The corporate tax rate consists of the combined federal and provincial statutory tax rates for the Company and its subsidiary. The combined federal and provincial tax rate increased to 26% in 2015 from 25% in 2014 due to the Alberta corporate tax rate increasing from 10% to 12% effective July 1, 2015.

(2) The gain recognized from the capital reorganization (Note 2), represents the difference between the carrying amount of the Pinecrest assets exchanged and their tax basis for the period from January 1, 2015 to the closing date of April 15, 2015.

b) Deferred tax assets and liabilities:

Sources of temporary differences	**2015**	**2014**
Deferred income tax asset:		
Tax value in excess of capital assets	$ 14,485	$ 34,021
Decommissioning liability	2,529	2,812
Share issue and debit issue costs	407	785
Cumulative eligible capital	427	221
Non-capital loss carry forward	6,262	38,411
Deferred tax asset - unrecognized	**$ 24,110**	**$ 76,250**

The decrease in the unrecognized deferred tax asset is attributable to the capital reorganization (Note 2), that closed on April 15, 2015, where by the shares of Pinecrest were sold to Cardinal which resulted in a decrease in the deferred income tax assets.

c) Available tax pools: The following tax pools are available for deduction against future taxable income:

	2015	**2014**
Canadian oil and gas property expense	$ 97,306	$ 82,161
Canadian development expense	2,051	113,325
Canadian exploration expense	20,212	728
Undepreciated capital cost	27,782	52,708
Share and debt issue costs	1,507	3,140
Cumulative eligible capital	1,581	883
Non-capital loss carry forward	23,194	153,645
Total	**$ 173,633**	**$ 406,590**

d) Non-capital losses: The Company has non-capital losses for income tax purposes of approximately $23.2 million for the year ended December 31, 2015 (December 31, 2014: $57.9 million).

Year of Expiry	**$**
2025	842
2026	974
2027	1,062
2028	1,757
2029	-
2030	2,262
2031 and beyond	16,297
As At December 31, 2015	**23,194**

13. SHARE CAPITAL

a) Authorized:

At December 31, 2015, the Company was authorized to issue an unlimited number of common shares without nominal or par value and an unlimited number of preferred shares, issuable in series, with rights and privileges to be determined at time of issue. The holders of common shares are entitled to receive dividends as declared by the Board of Directors and to one vote per share.

b) Issued:

Share Capital Issued:	**Number (000's)**	**Stated Value ($)**
Balance December 31, 2013	217,212	281,308
Balance, December 31, 2014	217,212	281,308
Cancelled pursuant to the Arrangement (Note 2) (i)	(217,212)	-
Issued pursuant to the Arrangement (Note 2) (i)	2,172	-
Common shares issued:		
Arrangement Rights exercised (Note 2) (ii)	3,412	853
Private Placement (iii)	11,974	2,994
Less: Premium on flow-through shares	-	(748)
Fair value of Warrants Series A & Series B	-	(729)
Dolomite acquisition (Note 8) (iv)	11	5
Dolomite acquisition, debt settlement (Note 8) (v)	2,155	539
Share issue costs, net of tax	-	(39)
Balance, December 31, 2015	**19,724**	**284,183**

(i) Effective April 15, 2015, under the terms of the Arrangement, each holder of Pinecrest common shares received one (1) Virginia Hills' common share for each 100 Pinecrest common shares held (Note 2). All share information relating to basic and diluted income (loss) per share, issued and outstanding common shares and common shares issued, warrants, stock options and the weighted average number of common shares outstanding is presented on a retroactive basis as if the consolidation took place at the beginning of all years presented, unless otherwise noted.

(ii) On April 15, 2015, under the terms of the Arrangement, each holder of one (1) Virginia Hills' common share received eight (8) Arrangement Rights, resulting in a total of 17,376,989 Arrangement Rights being issued. They were exercisable for $0.25 per share up to May 15, 2015. A total of 3,412,175 Arrangement Rights were exercised on May 15, 2015 for gross proceeds of $0.9 million (Note 2).

(iii) On April 27, 2015, a total of 11,974,300 flow-through units ("Units") were issued for gross proceeds of $3.0 million. Each Unit comprises one common share, issued on a flow-through basis, under the Income Tax Act (*Canada*), and two (2) common share purchase warrants ("Series A Warrants" and "Series B Warrants"). The Company is committed to incur the full amount on qualifying Canadian Exploration Expenditures prior to December 31, 2016. Insiders subscribed for a total of 5,266,000 common shares issued.

(iv) On April 27, 2015 the Company completed an acquisition of a private company by way of an amalgamation with its wholly owned subsidiary. Virginia Hills issued a total of 10,600 common shares at a price of $0.48 per share (Note 6).

(v) As part of the Acquisition (Note 6), certain payable obligations were settled by the issuance of 983,624 common shares at a price of $0.25 per common share for a total of $0.2 million, to the former executive officers of Dolomite as satisfaction of a portion of the change in control payments. The balance of the change in control payments of $0.6 million is due on April 27, 2016, and may be settled by the issuance of a maximum of an additional 1,229,530 common shares issued at a deemed price of the greater of $0.30 per share or the market price, at the time of issuance. Should the executives elect to be paid in cash, the payment is subject to approval by the Company's senior lenders. In addition, a total of 1,171,332 common shares were issued at a price of $0.25 for a total of $0.3 million to certain third-party service providers as payment for services previously provided.

14. WARRANTS

	Number (000's)	Stated Value ($)
Balance, December 31, 2013	23,270	5,283
Balance, December 31, 2014	23,270	5,283
Cancelled pursuant to the Arrangement (Note 2) (i)	(23,270)	(5,283)
Warrants issued:		
Series A – Private Placement (Note 13) (ii)	11,974	418
Series B – Private Placement (Note 13) (ii)	11,974	311
Series C – Dolomite acquisition (Note 6) (iii)	4,000	637
Series D – New bank facilities (Note 10) (iv)	1,972	98
Warrant issue costs, net of tax	-	(9)
Balance, December 31, 2015	**29,920**	**1,455**

(i) On April 15, 2015, and as part of the closing consideration under the Arrangement, all Pinecrest outstanding common share purchase warrants and performance warrants were cancelled for total consideration of $10 per warrant holder (Note 2).

(ii) On April 27, 2015, a total of 11,974,300 Units were issued for gross proceeds of $3.0 million. Each Unit comprises one common share, issued on a flow-through basis (Note 13), and two common share purchase warrants ("Series A Warrants" and "Series B Warrants"). The Series A Warrants are exercisable at a price of $0.30 and the Series B Warrants are exercisable at $0.35. The warrants vest in tranches of 1/3 upon the 20-day weighted average trading price of the Company's share equaling or exceeding $0.35, $0.40 and $0.45 respectively and will be outstanding for five years.

(iii) On April 27, 2015 the Company completed an Acquisition (Note 6) and issued a total of 10,600 common shares and 4.0 million common share purchase warrants ("Series C Warrants") to the common shareholders of Dolomite. The warrants entitle the holders to acquire on common share of the Company at a price of $0.50 per share for a period of three years.

(iv) As part of the consideration for providing the senior debt to the Company, the Company issued a total of 1,972,416 common share purchase warrants ("Series D Warrants") representing 10% of the issued and outstanding shares of the Company as at May 15, 2015, to the senior lender group. The Series D Warrants are exercisable at a price of $0.30 per common share for a period ending on the earlier of five years from the date of issue or 30 days following the date on which the bank facilities mature.

The following option pricing models were used to determine the fair values of the warrants issued during 2015:

Assumptions	**Series A**	**Series B**	**Series C**	**Series D**
Option Pricing Model	Monte Carlo	Monte Carlo	Black Scholes	Black Scholes
Grant date share price ($)	0.48	0.48	0.48	0.25
Fair value ($)	0.035	0.026	0.16	0.05
Expected volatility (%)	50.59	50.59	50.59	50.79
Risk free rate (%)	0.88	0.88	0.64	0.64
Forfeiture rate & dividend yield (%)	-	-	-	-
Expected life (years)	5	5	3	1.5
At December 31, 2015				
Quantity outstanding (000's)	11,974	11,974	4,000	1,972
Quantity exercisable (000's)	-	-	-	-
Remaining life (years) [1]	4.3	4.3	1.8	1.8
Exercise price ($ per share) [1]	0.30	0.35	0.50	0.30

[1] *Weighted average*

15. SHARE-BASED PAYMENTS

a) Stock-Option Plan:

The Company has a stock option plan whereby options may be granted from time to time to directors, officers, employees and consultants of the Company, with shares to be reserved for issuance as options not to exceed 10% of the issued and outstanding common shares. Options vest as to one-third on each of the first, second and third anniversary from the date of grant. The maximum term of an option grant is five years. At December 31, 2015 the following share options were issued and outstanding:

	Number (000's)	Exercise Price ($) [1]	Remaining Expected life (years)
Outstanding, December 31, 2014	-	-	
Issued	1,844	0.26	4.4
Forfeited	(71)	(0.26)	4.4
Outstanding, December 31, 2015	**1,773**	**0.26**	**4.4**

[1] *Weighted average*

The fair value of the options issued was estimated using the Black-Scholes option pricing model and the following weighted average assumptions: fair value at grant date of $0.11, exercise price of $0.26, risk-free interest rate of 1.0%, forecast volatility of 50.4%, forfeiture rate of 14.1% expected average life of 5 years, and dividend yield of 0%. During the year ended December 31, 2015, the Company recorded share-based payment compensation of $0.3 million which has been expensed (December 31, 2014: $0.8 million).

b) Performance Warrants:

On April 15, 2015, all issued and outstanding performance warrants were cancelled pursuant to the Arrangement (Note 2).

	Number (000's)	Exercise Price ($) [1]
Outstanding, December 31, 2014	3,920	0.50
Cancelled	(3,920)	(0.50)
Outstanding, December 31, 2015	**-**	**-**

[1] *Weighted average*

c) Share Incentive Plan:

On April 15, 2015, all issued and outstanding Share Incentive Awards were cancelled pursuant to the Arrangement (Note 2). All performance incentive awards were settled with a payment based on the five-day weighted average trading price time the number of outstanding incentive awards times a performance factor of 0. All restricted incentive awards were settled with a payment based on the five-day weighted average trading price of Pinecrest common shares times the number of outstanding restricted incentive awards which resulted in a nominal payment to the security holders. At December 31, 2015 no Share Incentive Awards were outstanding:

	Restricted awards (000's)	Performance awards (000's)	Remaining Life (years)
Outstanding, December 31, 2014	1,577	2,148	1.7
Cancelled	(1,552)	(2,135)	1.7
Forfeited	(25)	(13)	1.7
Outstanding, December 31, 2015	**-**	**-**	**-**

16. PER SHARE AMOUNTS

The average market value of the Company's shares for the purposes of calculating the dilutive effect of share options and warrants was based on quoted market prices for the period that the options, incentive awards and warrants were outstanding. The effect of 31.7 million stock options and warrants are excluded from the calculation in periods where the company reported a loss, as they are anti-dilutive. The following table summarizes the weighted average shares used in calculating the net income per share:

	2015	2014 [1]
Issued common shares, beginning of year	2,172	2,172
Common shares issued	11,812	-
Weighted average number of common shares - basic	**13,984**	2,172
Effect of incentive awards outstanding	-	16
Weighted average number of common shares – diluted	**13,984**	2,188

[1] *The weighted average number of basic and diluted common shares have been restated to reflect the 100:1 share consolidation*

17. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The following table summarizes the carrying amount of Virginia Hills' financial instruments as at December 31, 2015 and 2014:

	Hierarchy Level	Classification[1]	2015		2014	
			Carrying Amt	Fair Value	Carrying Amt	Fair Value
Financial Assets						
Trade and other receivables[2]	1	LAR[1]	5,906	5,906	4,805	4,805
Financial Liabilities						
Bank overdraft	1	OFL	228	228	259	259
Trade and other payables[2]	1	OFL	10,527	10,527	10,031	10,031
Bank debt[3]	2	OFL	104,262	104,262	110,570	110,570

[1] *LAR = Loans and receivables; OFR = Other Financial Liabilities; FVTPL = Fair value through profit and loss*

[2] *Carried at cost which approximates the fair value due to the short-term nature of the accounts.*

[3] *The bank debt carries interest based on specified benchmark interest rates plus a margin for the Company's own credit risk. The fair values of the bank debt approximate its carrying amount due to the fact that interest is adjusted periodically based on changes in the relevant benchmark interest rates and Company credit risk and is based on Level 2 in the fair value measurement hierarchy.*

Risk Management:

The Company is exposed to credit, market and liquidity risks from its use of financial instruments. The risk management policy is established by the Board of Directors and is implemented and monitored by senior management.

a) Credit risk: Credit risk results from the possibility that parties may default on their financial obligations. As at December 31, 2015, Virginia Hill's maximum exposure to credit risk was $4.9 million (December 31, 2014 - $4.8 million) which is the aggregate of trade and other receivables. Virginia Hills manages its credit risk and exposure by entering into sales contracts with only established, creditworthy counterparties. In addition, cash equivalent investments and risk management transactions with counterparties are, at the time of transaction, not less than investment grade.

(i) ***Trade and other receivables:*** The Company's accounts receivable are subject to concentration of credit risk as all of the Company's customers are in the oil and gas sector. The majority of the Company's trade and other receivables are from joint interest partners and crude oil and natural gas marketers. Receivables from oil and gas marketers are typically collected on the 25th day of the month following production. Receivables from joint interest partners are typically collected within one to three months from the joint venture billing date. The Company attempts to mitigate collection risk from joint interest partners by obtaining partner pre-approval of significant capital expenditures prior to initiation of the capital project. However, joint interest partners are exposed to various oil and gas industry risks that could impact the Company's ability to collect these amounts.

(ii) ***Derivative financial instruments:*** Collectability of derivative financial instruments depends on the creditworthiness of the counterparty. Virginia Hills mitigates this risk by entering into contracts with established Canadian banks. There are none outstanding at December 31, 2015. The following table illustrates the Company's maximum credit exposure for receivables:

As at December 31,	**2015**	**2014**
Petroleum and natural gas sales	$ 2,979	$ 3,129
Joint venture receivables	1,593	1,184
Other receivables [1]	347	499
Provision for bad debt	(13)	(7)
	$ 4,906	**$ 4,805**
Accounts Receivable Aging		
Current to 90 days	4,632	4,743
Greater than 90 days	274	62
	$ 4,906	**$ 4,805**

At December 31, 2015, the Company's trade and other receivables include $3.0 million from crude oil and natural gas marketers which has substantially been collected subsequent to December 31, 2015. Collectability of the accounts receivable balances are assessed at each period end by Management by reviewing the counterparty's creditworthiness and assessing the frequency of payments collected. The majority of the balances over 90 days are from an industry partner that has a history of consistent monthly payments.

b) Liquidity risk: Liquidity risk is the risk that the Company will not be able to meet a demand for cash, fund its financial liabilities as they come due, or not being able to liquidate assets in a timely manner at a reasonable price. The Company monitors its liquidity requirements by preparing an annual budget, which anticipates operating, investing and financing activities. The Company generates a certain level of cash flows which is used to partially fund operating, investing and financing activities. In addition, the Company has a revolving reserves-based credit facility which is disclosed in Note 10. Virginia Hill's liquidity could be significantly impacted, should the bank determine that the credit facility will not be renewed (See Going Concern Note 1 b)). The following table shows the nature of Virginia Hill's payment obligations in the next year and beyond, in addition see Commitments (Note 20):

As at December 31,	**2015**	**2014**
Trade payables - production	$ 6,495	$ 7,084
Trade payables - capital	1,252	2,690
Other payables	2,007	-
Joint venture payables	773	257
Total trade and other payables	10,527	10,031
Flow-through share premium	250	-
Bank overdraft	228	259
Bank debt, before deduction of debt issue costs	105,318	110,570
Total current liabilities, due within 1 year	**$ 116,323**	$ 120,860

c) Market risk: Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will impact the Company's net earnings, future cash flows or the value of the Company's financial assets and financial liabilities. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing return. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted within the risk management tolerances as established by the Board of Directors.

(i) Interest Rate Risk: Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The interest charged on Virginia Hills' credit facility fluctuates with the interest rates posted by lenders, plus a margin. The Company has not entered into any mitigating interest rate swaps or hedges as at December 31, 2015 or 2014. Assuming all other variables remain constant, had the borrowing rate been 1 percent (100 basis points) higher (lower) for the year ended December 31, 2015, net income would have decreased or increased by approximately $0.8 million based on the average outstanding bank debt balance for the year.

(ii) Commodity Price Risk: Commodity prices for petroleum and natural gas are impacted by global economic events that dictate the levels of supply and demand, as well as the relationship between the Canadian dollar and the United States dollar ("USD"). Significant changes in commodity prices may materially impact the Company's ability to raise capital. The fair value of outstanding commodity price contracts as at December 31, 2015 was nil (December 31, 2014: $nil).

For the years ended December 31,	**2015**	**2014**
Realized loss	$ -	$ 846
Unrealized gain	-	(615)
Loss on derivative financial instruments	$ -	$ 231

The Company had the following physical delivery contracts, which committed the delivery of fixed volumes per month, at a fixed price. These contracts are not considered financial instruments, and are not fair valued each period end. There were no contracts outstanding at December 31, 2015. The following table summarizes the fixed, physical oil contracts that were in place during the year ended December 31, 2015:

Type of Contract	**Term**	**Volume (bbl/d)**	**Price (USD$/bbl)**
Oil	May 1, 2015 – Jun 30, 2015	1,135	$55.10
Oil	Jul 1, 2015 - Sep 30, 2015	1,128	$53.47
Oil	Oct 1, 2015 – Dec 31, 2015	1,128	$53.22

Physical commodity contracts are not financial instruments and are not marked-to-market at the reporting period. The contracts have a fixed price, payable in USD, adjusted for quality and transportation and are settled each month with the Company's regular monthly revenue payments. Virginia Hills received $3.2 million in additional revenues during the year ended December 31, 2015 on these physical commodity contracts.

(iii) Foreign Exchange Risk: The Company's functional and reporting currency is Canadian dollars. The Company does not sell or transact in any foreign currency, however commodity prices are largely denominated in USD, and as a result the prices that the Company receives are affected by fluctuations in the exchange rates between the USD 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 USD will reduce the prices received by the Company for its crude oil and natural gas sales. The Company did not have any foreign exchange rate swaps or related financial contracts in place as at December 31, 2015 or 2014.

d) Capital Management: Virginia Hill's capital structure includes working capital, bank debt and shareholders' equity, which is not subject to external restrictions. The Company's objectives for managing its capital structure are to: meet its financial obligations; internally finance future capital projects, including property and corporate acquisitions, and preserve its ability to access capital markets. The Company's overall objective in managing its capital structure has not changed during year ended December 31, 2015.

Virginia Hills monitors its capital structure using a non-GAAP financial measure, which is the ratio of net debt to funds flow from operations. Net debt is defined as total bank debt plus working capital. Funds flow from operations is defined as cash flow from operating activities adjusted for changes in non-cash working capital, decommissioning expenditures and transaction costs. This ratio is calculated by dividing the net debt at the end of the period by the annualized current monthly funds flow from operations. This ratio may increase at certain times due to the timing of capital expenditures, acquisitions and changes in market conditions.

Management prepares production and capital expenditures budgets and forecasts, which are updated on a regular basis depending on factors such as current and forecast crude oil and natural gas prices, capital deployment and general industry conditions. The budget is approved by the Board of Directors and monitored by Management throughout the year. In addition, the Company regularly reports to its lender group compared to budgets. In order to maintain or adjust its capital structure, the Company may issue common shares if available upon acceptable terms, repay existing debt, seek additional debt financing, adjust its capital spending and/or seek strategic alternatives.

18. RELATED PARTY BALANCES AND TRANSACTIONS

a) Related Parties

The Company has retained the law firm of Burnet, Duckworth and Palmer LLP to provide legal services. The current Chairman of the Board is a partner and the Corporate Secretary is an associate at the law firm. During the year ended December 31, 2015, the Company incurred legal fees and disbursements of $1.0 million (December 31, 2014: $0.5 million) related to general corporate matters, of which $0.2 million was outstanding at December 31, 2015 (December 31, 2014: $0.3 million). These transactions were in the normal course of business and have been measured at fair value.

b) Key Management Compensation

Virginia Hills' considers its Board of Directors and officers as key management. At December 31, 2015, the Company did not have employment agreements with its officers. The Company had employment agreements with its previous officers ("Pinecrest officers") which required payment of termination benefits, in the event of a change in control or termination of employment without cause, an amount equal to 18 months of the executive's annual base salary plus an amount equal to the average cash bonus paid (or declared but not yet paid) to the officer in the two full calendar months preceding termination of the officer's employment. Pursuant to the Arrangement (Note 2), termination benefits of $2.0 million were paid during the year ended December 31, 2015 to Pinecrest officers (December 31, 2014: $nil). At December 31, 2015 a total of $0.4 million remained payable, and is included in trade and other payables. The fair value of compensation and other fees paid to members of the Board of Directors and officers of the Company for the years ended December 31, 2015 and 2014 is as follows:

	2015 *(1)*	**2014**
Salaries, bonus and short-term benefits	$ 948	$ 1,820
Termination benefits	1,953	-
Share-based compensation	182	-
Director fees	-	36
	$ 3,083	$ 1,856
Number of key management	8	9

(1) 2015 includes compensation and termination benefits paid to five Pinecrest executives covering the period from January 1, 2015 to the termination date of April 15, 2015. Virginia Hills has four officers, three which were employed effective April 15, 2015 and one employed since June of 2015. There were four independent Directors on the Board of Directors for 2014 and 2015.

19. SUPPLEMENTARY CASH FLOW INFORMATION

As at December 31	2015 ($)	2014 ($)
Provided by (used in):		
Trade and other receivables	61	3,528
Prepaids and deposits	230	763
Trade and other payables	(464)	(3,788)
	(173)	503
Provided by (used in)		
Operating activities	1,186	3,099
Investing activities	(1,651)	(2,727)
Financing activities	292	131
	(173)	503
Interest received	-	3
Interest paid	5,975	5,979
Non-cash investing and financing activities		
Issue of shares on Acquisition	5	-
Issue of warrants	735	-

20. COMMITMENTS

The Company had the following commitments at December 31, 2015.

($000's)	2016	2017	2018	2019	Thereafter
Office lease	145	145	193	16	-
Field office lease	39	16	-	-	-
Equipment rentals	11	12	10	-	-
Electrification agreements	288	288	-	-	-
Flow-through share expenditures	1,000	-	-	-	-
Commitments	**1,483**	**461**	**203**	**16**	**-**

The Company has $0.6 million in commitments to install electrical service to a number of its well sites over the next 24 months. The agreements may be cancelled by the Company upon providing written notice at any time, but will be responsible for costs incurred by the vendor from date of contract up to date of cancellation.

During 2015, the Company issued flow through units, at a price of $0.25 per Unit for gross proceeds of $3.0 million. As at December 31, 2015, the Company had incurred qualifying expenditures of $2.0 million, and is committed to spend $1.0 million on qualifying expenditures by December 31, 2016.

21. SUBSEQUENT EVENTS

Subsequent to December 31, 2015, the Company and its lenders entered into an amending agreement and waiver, which redefined the Company's limits on capital spending to be an aggregate of $9.3 million from April 15, 2015 to March 31, 2016 and waived the production default.

Subsequent to December 31, 2015, the Company sold certain capital spare parts to a third party for proceeds of $0.3 million.