

## Questerre Energy Corporation Consolidated Balance Sheets

	March 31, 2004	December 31, 2003
	<i>(unaudited)</i>	<i>(as restated – note 2)</i>
<b>Assets</b>		
Current assets		
Cash	\$ 1,709,213	\$ 1,678,611
Accounts receivable	158,445	623,544
Inventory	332,111	680,036
	<b>2,199,769</b>	2,982,191
Restricted cash (note 4)	100,000	100,000
Petroleum and natural gas properties - net of accumulated depletion and depreciation (note 3)	5,602,607	5,158,646
	<b>\$ 7,902,376</b>	<b>\$ 8,240,837</b>
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 9,394,869	\$ 7,225,137
Bank loan (note 4)	294,800	314,900
	<b>9,689,669</b>	7,540,037
Asset retirement obligation (note 2,5)	862,976	848,134
	<b>10,552,645</b>	8,388,171
<b>Shareholders' Equity</b>		
Common shares (note 6)	28,281,499	25,308,340
Contributed surplus (note 6)	117,726	–
Deficit	(31,049,494)	(25,455,674)
	<b>(2,650,269)</b>	<b>(147,334)</b>
<b>Going Concern Matters</b> (note 1)	<b>\$ 7,902,376</b>	<b>\$ 8,240,837</b>

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors



Director



Director

## Questerre Energy Corporation

### Consolidated Statements of Loss and Deficit

<i>For the Three Months Ended March 31 (unaudited)</i>	<b>2004</b>	<b>2003</b>
		<i>(as restated – note 2)</i>
<b>Revenue</b>		
Petroleum and natural gas, net of royalties	\$ 64,555	\$ 491,366
Interest income	3,504	5,236
	<b>68,059</b>	496,602
<b>Expenses</b>		
Operating	166,630	361,831
General and administrative	119,582	187,109
Stock-based compensation (note 2)	47,199	–
Interest on bank debt	7,785	17,612
Depletion and depreciation	5,235,314	170,690
Accretion on asset retirement obligation (note 2,5)	14,842	13,872
	<b>5,591,352</b>	751,114
<b>Net loss</b>	<b>(5,523,293)</b>	(254,512)
Deficit, beginning of period	(25,455,674)	(8,322,347)
Restatement for changes in accounting policies		
Stock-based compensation (note 2)	(70,527)	–
Asset retirement obligation (note 2)	–	(408,202)
	<b>\$ (31,049,494)</b>	\$ (8,985,061)
<b>Net loss per share</b>		
Basic and diluted	\$ (0.13)	\$ (0.01)

*See accompanying notes to consolidated financial statements.*

## Questerre Energy Corporation Consolidated Statements of Cash Flows

<i>For the Three Months Ended March 31 (unaudited)</i>	<b>2004</b>	2003
		<i>(as restated – note 2)</i>
<b>Cash provided by (used in):</b>		
<b>Operating Activities</b>		
Net loss	\$ (5,523,293)	\$ (254,512)
Items not affecting cash		
Depletion and depreciation	5,235,314	170,690
Accretion on asset retirement obligation	14,842	13,872
Stock based compensation expense	47,199	–
	<b>(225,938)</b>	(69,950)
Deferral of crown royalties	–	75,346
Net change in non-cash working capital	<b>91,086</b>	223,354
	<b>(134,852)</b>	228,750
<b>Financing Activities</b>		
Issue of common shares	745,570	–
Issue of flow-through shares	2,442,428	–
Share issue costs	(214,839)	–
Repayment of bank loan	(20,100)	(20,100)
	<b>2,953,059</b>	(20,100)
<b>Investing Activities</b>		
Expenditures on petroleum and natural gas properties	(5,679,275)	(158,468)
Disposal of petroleum and natural gas properties	–	259,100
Net change in non-cash working capital	<b>2,891,670</b>	(302,332)
	<b>(2,787,605)</b>	(201,700)
Increase in cash	<b>30,602</b>	6,950
Cash, beginning of period	<b>1,678,611</b>	555,004
<b>Cash, end of period</b>	<b>\$ 1,709,213</b>	\$ 561,954

*See accompanying notes to consolidated financial statements.*

During the three months ended March 31, 2004, the Company paid \$7,785 (2003 – \$17,612) of interest on bank indebtedness and \$Nil in cash taxes (2003 – \$Nil).

# Questerre Energy Corporation

## Selected Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2004 (unaudited)

The interim consolidated financial statements include the accounts of Questerre Energy Corporation and its subsidiaries ("Questerre" or "the Company") and have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles. The interim consolidated financial statements are unaudited and have not been subject to review. The interim financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2003, except as noted below. The disclosure, which follows, is incremental to the disclosure included with the annual consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual report for the year ended December 31, 2003.

### 1. CREDITOR PROTECTION – QUESTERRE BEAVER RIVER INC.

On April 1, 2004, Questerre Beaver River Inc. ("QBR"), a wholly owned subsidiary of Questerre was granted an Initial Order by the Court of Queen's Bench of Alberta providing for creditor protection under the *Companies' Creditors Arrangement Act* ("CCAA"). The Initial Order was amended by the Court on April 30, 2004 to provide for a general stay period that expires on June 30, 2004. The order may be further amended by the Court throughout the CCAA proceedings based on motions from QBR, its creditors and other interested parties.

QBR's current financial difficulty is the result of significant problems and cost overruns associated with a re-entry operation undertaken at the Beaver River field. QBR holds a 60% working interest and a 100% priority right to cash flow (subject to payouts) in the Beaver River natural gas field ("the Beaver River field") which is located approximately 100 miles northwest of Fort Nelson, British Columbia. QBR held a 100% working interest in the operation as a result of joint venture partners choosing to forego participation under penalty. The well was completed, tied-in and commenced production in April 2004.

The filing under CCAA is intended to allow QBR to restructure its affairs while continuing operations on a normalized basis. The court order prohibits creditors from taking action against QBR and prevents QBR from paying most claims which arose before April 1, 2004. QBR is working to put together a plan of arrangement between QBR and its creditors and other stakeholders. If the restructuring can not be completed, QBR may not be able to realize its assets and discharge its liabilities in the normal course of business.

These financial statements have been prepared using Canadian generally accepted accounting principles ("GAAP") and, accordingly, have been prepared using the same principles as those for a going concern. There is no assurance that the Company will be able to obtain creditor acceptance on the restructuring of its subsidiary under CCAA. If the going concern basis is not appropriate for the Company's subsidiary, adjustments may be necessary in the carrying amounts and/or classification of assets, liabilities, revenues and expenses in these financial statements.

### 2. CHANGE IN ACCOUNTING POLICIES

#### a) Full cost accounting guideline

In January 2004, the Company prospectively adopted the new Accounting Guideline 16 "Oil and Gas Accounting – Full Cost" issued by the Canadian Institute of Chartered Accountants ("CICA").

Consistent with the former guideline, the net carrying cost of the Company's petroleum and natural gas properties is limited to an estimated net recoverable amount ("ceiling test"). Under the new guideline, the ceiling test calculation is a two step process. First, the Company determines whether a write-down is required by comparing the carrying value of the properties to the undiscounted cash flow of its proved reserves (based on management's

## Questerre Energy Corporation Selected Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2004 (unaudited)

best estimate of future prices) plus the lower of cost and market value for unproved properties. If there is an impairment calculated under the first step, the carrying value of properties is written down to the discounted value of the proved plus probable reserves (based on management's best estimate of future prices) plus the lower of cost and market of unproved properties.

The Company recorded a \$5.2 million ceiling test writedown for the three months ended March 31, 2004 related to the Beaver River Project (see note 1). This amount was calculated in accordance with the new accounting guideline utilizing an internal estimate of reserves and cash flows. The writedown is included in the depletion and depreciation provision on the income statement.

### *b) Asset retirement obligation*

In January 2004, the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". This change in accounting policy has been applied retroactively with restatement of prior periods presented.

Utilizing the new accounting policy, the Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. The liability is recorded at fair value and is adjusted to its present value in subsequent periods as accretion expense is recorded. The associated asset retirement costs are capitalized as part of the carrying amount of the related asset. The capitalized amount is depleted on a unit of production basis in accordance with the Company's depletion policies. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the asset retirement obligation. Actual costs incurred upon settlement of the obligation are charged against the liability to the extent the liability is recorded. Any difference between actual costs incurred upon settlement of the asset retirement obligation and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which settlement occurs.

The previously reported amounts for 2003 have been restated due to the retroactive application of this new standard. Net loss for the three months ended March 31, 2003 decreased by \$8,474. The asset retirement obligation at December 31, 2003 decreased by \$30,699 to \$848,134, property, plant and equipment increased by \$20,599, net of accumulated depletion. Opening 2003 accumulated deficit increased by \$408,202 to reflect the cumulative impact of accretion and depletion expense, less the previously recorded cumulative site restoration provision. There was no impact on the Company's cash flow as a result of adopting this new policy.

### *c) Stock based compensation plan*

In January 2004, the Company adopted the amended CICA Handbook Section 3870 "Stock-based Compensation and Other Stock-based Payments". This change in accounting policy has been applied retroactively without restatement of prior periods presented.

Under this amended standard, the Company must account for compensation expense based on the fair value of rights granted under its stock-based compensation plan (see note 6(e)). Compensation cost attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the expected exercise time frame with a corresponding increase to contributed surplus. Upon exercise of the stock options, consideration paid by the unit holder together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

As a result of adopting this change in accounting policy, the consolidated financial statements at January 1, 2004 were changed as follows: contributed surplus increased by \$117,726 and the opening deficit was increased by \$70,527.

# Questerre Energy Corporation

## Selected Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2004 (unaudited)

### 3. CAPITAL ASSETS

	March 31, 2004	December 31, 2003
		<i>(as restated – note 2)</i>
Petroleum and natural gas properties	\$ 38,331,358	\$ 32,652,083
Less: Accumulated depletion and depreciation	(32,728,751)	(27,493,437)
	<b>\$ 5,602,607</b>	<b>\$ 5,158,646</b>

During the three months ended March 31, 2004, the company capitalized administrative overhead charges of \$290,135 (year ended December 31, 2003 – \$594,911) relating to exploration and development activities.

The company incurred a ceiling test writedown of \$5.2 million for the three months ended March 31, 2004 (December 31, 2003 – \$16.7 million) related to the Beaver River Project (see note 1). This amount is included in the depletion, depreciation and amortization provision on the income statement.

At March 31, 2004, petroleum and natural gas properties included \$4.5 million (December 31, 2003 – \$4.3 million) relating to unproved properties which have been excluded from the depletion and depreciation calculation. All costs associated with the Beaver River property, excluding geological and geophysical costs of \$2.7 million were written down and included in depletion for the year. Questerre does not include costs of \$1.8 million associated with its St. Lawrence Lowlands, Quebec prospect in the calculation of depletion or in costs subject to the ceiling test calculation. The Quebec property remains undeveloped at March 31, 2004.

### 4. BANK INDEBTEDNESS

In July 2002, the Company obtained a five year, \$400,000 term loan with a Canadian bank. Under the terms of the loan, the Company must make monthly payments of \$6,700 principal plus interest until the loan is paid out. The interest rate under the loan is the bank's floating base rate plus 2.0% and the company may lock in the rate at any time. The loan is secured by the first assignment to the bank of a \$100,000 Guaranteed Investment Certificate and by a General Security Agreement over the assets of the Company and its subsidiary, Questerre Beaver River Inc. Financial covenants include maintaining a minimum long term debt to tangible equity ratio of 0.8 to 1.0 and maintaining a working capital ratio of at least 1.0 to 1.0. The Company is not in compliance with the financial covenants and, therefore, the bank loan has been classified as a current liability.

### 5. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation was estimated by management based on Questerre's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company estimates the net present value of its total asset retirement obligations to be \$862,976 at March 31, 2004 based on a total future liability of \$907,500. Based on the current financial position of its subsidiary, QBR (note 1), the liability related to the Beaver River Project has been included as a current year liability. Questerre used a credit adjusted risk free rate of seven per cent and an inflation rate of 2 per cent to calculate the present value of the asset retirement obligation.

## Questerre Energy Corporation Selected Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2004 (unaudited)

The following table provides a reconciliation of the Company's total asset retirement obligation:

	March 31, 2004	December 31, 2003
		<i>(as restated – note 2)</i>
Balance, beginning of period	\$ 848,134	\$ 353,548
Adoption of asset retirement obligation	–	439,098
Accretion expense	14,842	55,488
<b>Balance, end of period</b>	<b>\$ 862,976</b>	<b>\$ 848,134</b>

### 6. SHARE CAPITAL

#### a) Authorized

The Company is authorized to issue an unlimited number of Class A common voting shares. The Company is also authorized to issue an unlimited number of Class B common voting shares and an unlimited number of preferred shares, issuable in one or more series. At March 31, 2004, there were no Class B common voting shares or preferred shares outstanding.

#### b) Issued and outstanding

Class A common shares and common share warrants

	Number	Amount
<b>Common Shares</b>		
Balance, December 31, 2003	42,112,246	\$ 25,279,580
Issued for cash	642,860	713,575
Flow through shares issued for cash	1,878,791	2,442,428
Issued for cash on exercise of warrants	31,995	32,155
Share issue costs	–	(214,839)
<b>Balance, March 31, 2004</b>	<b>44,665,892</b>	<b>\$ 28,252,899</b>
<b>Warrants</b>		
Balance, December 31, 2003	8,232,256	\$ 28,760
Exercised for common shares	(31,995)	(160)
<b>Balance, March 31, 2004</b>	<b>8,200,261</b>	<b>\$ 28,600</b>
<b>Total Common Share Capital</b>		<b>\$ 28,281,499</b>

The future tax liability associated with the renunciation of tax expenditures under the flow through shares was offset by existing losses and tax deductions not previously recognized.

#### c) Per share Amounts

The following table summarizes the weighted average common shares used in calculating net loss per common share:

	Three Months Ended March 31, 2004	2003
Basic	43,433,975	26,835,000
Diluted	43,436,987	26,835,000

The reconciling item between the basic and diluted average common shares is stock options.

## Questerre Energy Corporation Selected Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2004 (unaudited)

### d) Stock options

The Company has a stock option plan that provides for the issuance of options to its directors, officers and employees at or above market prices. The stock options granted under the plan vest evenly over a three year period and expire five years from the date of grant.

The following table sets forth a reconciliation of the stock option plan activity for the three months ended March 31, 2004:

	Number of Options	Weighted Avg Exercise Price
Outstanding, December 31, 2003	3,643,500	\$ 1.28
Granted	313,000	1.41
<b>Outstanding, March 31, 2004</b>	<b>3,956,500</b>	<b>\$ 1.29</b>
<b>Exercisable, March 31, 2004</b>	<b>2,546,167</b>	<b>\$ 1.28</b>

The outstanding options have a range of exercise prices between \$0.38 per share and \$1.50 per share, and a weighted average number of years to expiry of 3.0. The exercisable options have a range of exercise prices between \$1.00 and \$1.50 per share and have a weighted average number of years to expiry of 2.2.

### e) Stock-based compensation costs

The Company accounts for its stock based compensation plan using the fair value method. Under this method, compensation cost attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the expected exercise time frame with a corresponding increase to contributed surplus.

The fair value of each option granted is estimated in the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

Risk free interest rate (%)	3.0
Expected life (years)	3.0
Expected volatility (%)	60.0

### f) Contributed surplus

The following table sets forth a reconciliation of contributed surplus for the three months ended March 31, 2004:

Balance, December 31, 2003	\$ -
Adoption of stock based compensation (note 2)	117,726
<b>Balance, March 31, 2004</b>	<b>\$ 117,726</b>

## 7. FUTURE INCOME TAXES

The provision for income taxes in the financial statements differs from the result, which would have been obtained in applying the combined federal and provincial tax rate to the Company's earnings before income taxes.

## Questerre Energy Corporation Selected Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2004 (unaudited)

The difference results from the following items:

	Three Months Ended March 31,	
	2004	2003
Loss before income taxes	\$ (5,523,293)	\$ (254,512)
Combined federal and provincial tax rate	35.13%	42.24%
Computed "expected" income tax expense	(1,940,333)	(107,506)
Increase (decrease) in income taxes resulting from:		
Non-deductible crown charges and recoveries	6,688	45,411
Unrecognized tax benefit of accounting losses	1,933,645	62,095
	\$ -	\$ -

The components of the Company's future income tax liability are as follows:

	March 31, 2004	December 31, 2003
Future income tax assets:		
Property, plant and equipment	\$ 5,623,003	\$ 5,325,981
Asset retirement obligation	230,063	234,489
Share issue expenses	293,051	293,051
Non-capital loss carryforwards (expire 2007 – 2011)	1,598,441	1,199,865
Valuation adjustment	(7,744,558)	(6,707,186)
	-	346,200
Future income tax liabilities:		
Flow through share renunciations to be incurred	-	(346,200)
	-	(346,200)
Net future income tax liability	\$ -	\$ -

### 8. RELATED PARTY TRANSACTIONS

At March 31, 2004, Questerre had amounts owing to Terrenex Acquisition Corporation ("Terrenex") totalling \$1,836 (December 31, 2003 – \$1,237). Three directors of Questerre are also directors of Terrenex. Questerre incurred fees of \$31,500 for the three months ended March 31, 2004 (2003 – \$31,500) to a company with common directors and officers. The transactions were in the normal course of business paid pursuant to an Office Rental Agreement for the provision of office space, office equipment and support personnel. The agreement may be terminated by either party with six months written notice.

### 9. SUBSEQUENT EVENTS

On April 1, 2004, Questerre Beaver River Inc., a wholly owned subsidiary of Questerre Energy Corporation, was granted an order by the Court of Queen's Bench of Alberta providing for creditor protection under the *Companies' Creditors Arrangement Act* ("CCAA"). The initial order was amended by the Court on April 30, 2004 to provide for a general stay period that expires on June 30, 2004. The order may be further amended by the Court throughout the CCAA proceedings based on motions from the Company, its creditors and other interested parties. Statements of claim have been filed by various parties against the Company and its subsidiary, QBR. All of the claims relate to the provision of services and materials for the drilling of the Beaver River well. The amounts claimed have been fully provided for as part of accounts payable at March 31, 2004. The outcome of the lawsuits is dependent, in part, on the CCAA process (note 1) and is unknown at this time.