

Management's Report

TO THE SHAREHOLDERS OF QUESTERRE ENERGY CORPORATION

The accompanying consolidated financial statements of Questerre Energy Corporation and all the information in this Annual Report are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the consolidated financial statements are presented fairly, in all material respects. The financial information contained elsewhere in this report has been reviewed to ensure consistency with the consolidated financial statements.

Management has established systems of internal controls, which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. It exercises its responsibilities primarily through the Audit Committee, which is comprised of non-management directors. The Audit Committee has reviewed the consolidated financial statements with management and the auditors and has reported to the Board of Directors which have approved the consolidated financial statements.

The consolidated financial statements have been audited by Pricewaterhouse Coopers LLP, the external auditors, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.



Michael Binnion
President and Chief Executive Officer



Jackie Cugnet, CA
*Vice-President, Finance and
Chief Financial Officer*

Calgary, Canada
April 30, 2004

Auditors' Report

TO THE SHAREHOLDERS OF QUESTERRE ENERGY CORPORATION

We have audited the consolidated balance sheets of Questerre Energy Corporation as at December 31, 2003 and 2002 and the consolidated statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Calgary, Canada
April 30, 2004

Questerre Energy Corporation Consolidated Balance Sheets

<i>As at December 31</i>	2003	2002
Assets		
Current assets		
Cash	\$ 1,678,611	\$ 555,004
Accounts receivable	623,544	752,013
Inventory	680,036	135,742
	2,982,191	1,442,759
Restricted cash (note 6)	100,000	100,000
Petroleum and natural gas properties – net of accumulated depletion and depreciation (note 4)	5,138,047	8,392,789
	\$ 8,220,238	\$ 9,935,548
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 7,225,137	\$ 840,409
Bank loan (note 6)	314,900	366,500
	7,540,037	1,206,909
Deferred crown royalties (note 7)	–	1,439,409
Future site restoration and abandonment	878,833	353,548
	8,418,870	2,999,866
Shareholders' Equity		
Common shares (note 8)	25,308,340	10,758,029
6% Cumulative redeemable convertible preferred shares (note 8)	–	4,500,000
Deficit	(25,506,972)	(8,322,347)
	(198,632)	6,935,682
Going Concern Matters (note 1 and 2)	\$ 8,220,238	\$ 9,935,548

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 years ended December 31</i>	2003	2002
Revenue		
Petroleum and natural gas, net of royalties	\$ 1,349,292	\$ 1,801,252
Recovery of deferred crown royalties (note 7)	1,439,409	–
Interest income	53,022	22,061
Other income	–	20,000
	2,841,723	1,843,313
Expenses		
Operating	1,141,527	1,460,810
General and administrative	1,001,874	486,571
Interest on bank debt	64,754	23,031
Depletion, depreciation and site restoration	17,818,193	5,418,117
	20,026,348	7,388,529
Loss before income taxes	(17,184,625)	(5,545,216)
Current and capital taxes (note 9)	–	11,399
Net loss	(17,184,625)	(5,556,615)
Deficit, beginning of period	(8,322,347)	(2,765,732)
Deficit, end of period	\$ (25,506,972)	\$ (8,322,347)
Net loss per share		
Basic and diluted (note 8d)	\$ (0.56)	\$ (0.21)

See accompanying notes to consolidated financial statements.

Questerre Energy Corporation Consolidated Statements of Cash Flows

<i>For the years ended December 31</i>	2003	2002
Cash provided by (used in):		
Operating Activities		
Net loss	\$ (17,184,625)	\$ (5,556,615)
Items not affecting cash		
Depletion, depreciation and amortization	17,818,193	5,418,117
	633,568	(138,498)
Deferral of crown royalties	(1,439,409)	405,598
Net change in non-cash working capital	(18,382)	(238,230)
	(824,223)	28,870
Financing Activities		
Issue of common shares and warrants	5,228,237	–
Issue of flow-through shares	5,127,356	–
Share issue costs	(1,056,032)	–
Proceeds (repayment) of bank loan	(51,600)	366,500
Restricted cash	–	(100,000)
	9,247,961	266,500
Investing Activities		
Expenditures on petroleum and natural gas properties	(13,287,416)	(4,494,630)
Net change in non-cash working capital	5,987,285	(1,293,908)
	(7,300,131)	(5,788,538)
Increase (decrease) in cash	1,123,607	(5,493,168)
Cash, beginning of period	555,004	6,048,172
Cash, end of period	\$ 1,678,611	\$ 555,004

See accompanying notes to consolidated financial statements.

During the year ended December 31, 2003, the Company paid \$64,754 (2002 – \$23,031) of interest on bank indebtedness and \$Nil in cash taxes (2002 – \$11,399).

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

1. CREDITOR PROTECTION – QUESTERRE BEAVER RIVER INC.

On April 1, 2004, Questerre Beaver River Inc. (“QBR”), a wholly owned subsidiary of Questerre Energy Corporation (“Questerre” or the “Company”), 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 (note 5). 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. In August 2003 QBR began a re-entry operation on a wellbore in the Beaver River Field. 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, the Company may not be able to realize its assets and discharge its liabilities in the normal course of business.

2. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Questerre Energy Corporation and its subsidiary, QBR, are primarily involved in the exploration and development of two large scale natural gas projects. One project, the Beaver River Field, is a discovered hydrothermal dolomite natural gas reservoir in northeast British Columbia (note 5). The second project is the exploration for hydrothermal dolomite reservoirs in the St. Lawrence Lowlands in Quebec. The Quebec project remains undeveloped at December 31, 2003. In addition to the Company’s two major projects, Questerre also holds minority interests in producing, non-operated properties in Alberta.

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.

3. SIGNIFICANT ACCOUNTING POLICIES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from estimated amounts.

a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Questerre Beaver River Inc. and 6058931 Canada Inc.

Questerre Energy Corporation Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

b) Cash and cash equivalents

Cash consists of cash in the bank, less outstanding cheques and short term deposits with a maturity of less than three months.

c) Inventory

Inventory is recorded at the lower of weighted average cost and market, measured by replacement cost.

d) Revenue recognition

Revenue from the sale of petroleum and natural gas are recorded when the title passes to a third party.

e) Oil and natural gas operations

The Company follows the full cost method of accounting whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges of non-producing property, costs of drilling both productive and non-productive wells, petroleum and natural gas production equipment and overhead charges related to exploration and development activities. Proceeds received from the disposition of oil and gas properties and equipment are credited against the capitalized costs unless the disposition would significantly alter the rate of depletion and depreciation, in which case a gain or loss on disposal would be recorded.

All costs of acquisition, exploration and development of oil and gas reserves, associated tangible plant and equipment costs, and estimated costs of future development of proven undeveloped reserves are depleted and depreciated using the unit of production method based on estimated proven reserves before royalties as determined by independent engineers. For purposes of this calculation, reserves and production are converted to equivalent units of oil based on relative energy content.

Depreciation of capital assets not related to oil and gas properties is provided using the straight line method over periods ranging from five to ten years.

Costs of unproved properties are initially excluded from oil and gas properties for the purpose of calculating depletion. These properties are assessed periodically to determine whether impairment has occurred. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

The net carrying cost of the Company's petroleum and natural gas properties is limited to an estimated net recoverable amount. The net carrying cost is the capitalized costs less accumulated depletion and depreciation, future income taxes and the accumulated provision for future site restoration. The net recoverable amount is the estimated future net revenues from proven reserves using prices and costs in effect at year end, plus the cost of unproved properties, less estimated future capital costs and estimated costs for future general and administrative expenses, financing and income taxes. Any costs carried on the balance sheet in excess of the net recoverable amount are charged to current operations as additional depletion.

f) Future site restoration

Estimated future site restoration costs for petroleum and natural gas properties are provided for over the life of the proven reserves on a unit of production basis. Costs are estimated each year by management based upon current regulations and industry practices. The annual charge is recorded as part of depletion expense. Actual costs incurred are charged against the accumulated liability.

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

g) Joint operations

Significant portions of the Company's exploration and production activities are conducted jointly with others and accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

h) Foreign currency translation

Monetary assets and liabilities, denominated in foreign currencies, are translated into Canadian dollars at rates of exchange in effect at the balance sheet date. Other assets and revenue and expense items are translated at rates prevailing when they were acquired or incurred. Foreign exchange gains and losses are included in income.

i) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions when the expenses are renounced.

j) Stock based compensation plan

The company has a stock option plan for directors and employees. The stock option plan is described in note 8. Any consideration paid by holders of the stock options is credited to share capital. No compensation expense is recorded either on the granting or exercise of options under the plan.

k) Per share information

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are calculated based on the treasury-stock method, which assumes that any proceeds obtained on exercise of options would be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

4. CAPITAL ASSETS

	2003	2002
Petroleum and natural gas properties	\$ 31,959,756	\$ 17,921,591
Less: Accumulated depletion and depreciation	(26,821,709)	(9,528,802)
	\$ 5,138,047	\$ 8,392,789

During the year ended December 31, 2003, the company capitalized administrative overhead charges of \$594,911 (2002 – \$512,554) relating to exploration and development activities.

The Company incurred a ceiling test writedown of \$16.7 million for the year ended December 31, 2003 (2002 – \$3.7 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 December 31, 2003, petroleum and natural gas properties included \$4.3 million (2002 - \$3.5 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 \$2.6 million were written down and included in depletion for the year. Questerre does not include costs of \$1.7 million associated with its St. Lawrence Lowlands acreage in Quebec in the calculation of depletion or in costs subject to the ceiling test calculation. The Quebec property remains undeveloped at December 31, 2003.

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

5. BEAVER RIVER PROJECT

On January 12, 2001, the company executed the Beaver River Farmout and Operating Agreement (the "Beaver River Agreement") whereby the company earned a 60% interest in the Beaver River natural gas field and project (collectively, the "project") subject to a lien until the company has completed a specified work program and spent a minimum \$5,000,000 on the project (increased to \$9,000,000 effective June 2001). Any amounts spent by the company under the Beaver River Agreement for the specified work program are accumulated in an account (the "Payout Amount") and cash flow is shared by the company and the Farmers as follows:

- a) 4% override payable to the Farmers until the company receives 6 times the Payout Amount
- b) then, the company receives cash flow as follows:
 - 100% until 1 times Payout Amount received;
 - 80% until 2 times Payout Amount received and an Environmental Reserve has been fully funded, such Environmental Reserve to be determined by the company and set aside to cover future abandonment and reclamation expenses;
 - 70% until 6 times Payout Amount received;
 - 60% thereafter
- c) Effective April 1, 2002 the specified work program was completed. At December 31, 2003, the Payout Amount balance was \$10,923,075. For the year ended December 31, 2003, the company received \$221,932 (2002 – \$119,146) of cash flow applicable to the Payout Amount.
- d) In August 2003 QBR began a re-entry operation on the A-5 wellbore in the Beaver River Field. QBR held a 100% working interest in the operation as a result of joint venture partners choosing to forego participation under a 600% penalty. Operating cash flows from the well must be applied against the 600% penalty payout prior to being applied against the Payout Amount noted in c) above.

6. 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.

7. DEFERRED CROWN ROYALTIES

Royalties payable to the Province of British Columbia on production from the Beaver River Project are governed by a Royalty Agreement between the Province and the Joint Venture partners dated April 1, 1999 and amended October 1, 2001. Until the earlier of June 30, 2004 and cumulative production of 13 bcf from the Project, royalties payable to the Crown are deferred. Repayment of deferred royalties is contingent on the success of the experimental project for which the deferral was granted and on monthly production exceeding volumes established by the Crown. At December 31, 2003, the Company has adjusted the liability to Nil (2002 - \$1,439,409) on the basis that the conditions for repayment do not exist.

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

8. 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 December 31, 2003, 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
Common Shares		
Balance, December 31, 2001 and 2002	26,835,000	\$ 10,758,029
Issued on termination of Terrenex farmout agreement	750,000	750,750
Issued for cash	3,478,980	3,528,333
Flow through shares issued for cash	5,038,600	5,127,356
Issued on conversion of preferred shares	4,500,000	4,500,000
Issued for cash on exercise of warrants	1,509,666	1,673,212
Share issue costs	–	(1,058,100)
Balance, December 31, 2003	42,112,246	\$ 25,279,580
Warrants		
Balance, December 31, 2001	3,690,000	\$ –
Issued to Terrenex on extension of farmout agreement	150,000	–
Balance, December 31, 2002	3,840,000	\$ –
Issued for cash	5,338,330	26,692
Issued for broker commission	413,592	2,068
Issued to Terrenex on extension of farmout agreement	150,000	750
Exercised for common shares	(1,509,666)	(750)
Balance, December 31, 2003	8,232,256	\$ 28,760
Total Common Share Capital		\$ 25,308,340

On June 18, 2003, the shareholders of the company, at the annual and special meeting of the shareholders, approved a subdivision of the company's common shares on a three-for-one basis. The effect on the company's common shares at December 31, 2002 was an increase from 8,945,000 common shares to 26,835,000 common shares. All common share and per share information in these financial statements has been restated to give effect to the subdivision.

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.

The Company has a commitment to spend \$1.0 million in 2004 on qualifying expenditures pursuant to the December 31, 2003 flow through private placement. All of the expenditures were renounced effective December 31, 2003 but were incurred in 2004.

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

c) Issued and outstanding

6% cumulative redeemable convertible preferred shares Series I issued January 19, 2001

	Number	Amount
Balance, December 31, 2001 and 2002	4,500,000	\$ 4,500,000
Converted into Class A common shares	(4,500,000)	(4,500,000)
Balance, December 31, 2003	-	\$ -

On December 22, 2003, Terrenex Acquisition Corporation and its wholly owned subsidiary Cabernet Holdings Ltd. redeemed their preferred shares for Class A common shares at a deemed price of \$1.00 per share.

d) Per share amounts

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

	2003	2002
Basic and Diluted	30,816,683	26,835,000

There are no reconciling items between the basic and diluted average common shares.

e) Warrants

On August 23, 2002, the company signed an agreement with Terrenex to extend the deadline for drilling a test well under the St. Lawrence Lowlands Farmout agreement to February 28, 2003 in exchange for 150,000 common share warrants in the company. Such warrants are exercisable for a period of 2 years from September 1, 2002, at a price of US\$0.83 for each common share.

On February 28, 2003, the Company issued 150,000 common share warrants to Terrenex Acquisition Corporation in exchange for an extension under the St. Lawrence Lowlands Farmout agreement. The warrants are exercisable for a period of two years from February 28, 2003, at a price of US\$0.83 per common share.

On July 18, 2003 pursuant to a prospectus offering, the Company issued 5,338,330 common share warrants. The Company also issued 413,592 common share warrants to brokers as commission on the financing. Each warrant entitles the holder to acquire one common share at a price of \$1.50 per common share until December 31, 2003 and thereafter at \$2.00 per common share until December 31, 2004. All of the warrants issued remain outstanding at December 31, 2003.

f) 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.

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

The following table sets forth a reconciliation of the stock option plan activity for the years ended December 31, 2002 and December 31, 2003:

	2003		2002	
	Number of Options	Weighted Avg Exercise Price	Number of Options	Weighted Avg Exercise Price
Outstanding, beginning of year	2,788,500	\$ 1.30	2,659,500	\$ 1.29
Granted	1,020,000	1.23	633,000	1.50
Expired / Forfeited	(165,000)	1.35	(504,000)	1.50
Outstanding, end of year	3,643,500	\$ 1.28	2,788,500	\$ 1.30
Exercisable, end of year	2,242,542	\$ 1.28	1,491,363	\$ 1.29

The outstanding options have a range of exercise prices between \$1.00 per share and \$1.50 per share, and a weighted average number of years to expiry of 3.0 (2002 – 1.4). 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 2.4 (2002 – 1.28).

g) Stock-based compensation costs

The Company accounts for its stock based compensation plan using the settlement value method. Under this method, no costs are recognized in the financial statements for share options granted to employees or directors when the options are issued at market value. If the fair value method had been used, the Company's net loss would have approximated the following pro forma amounts:

	2003	2002
Stock based compensation costs	\$ 70,527	\$ –
Net loss		
As reported	\$ (17,184,625)	\$ (5,556,615)
Pro forma	\$ (17,255,152)	\$ (5,556,615)
Net loss per share		
As reported	\$ (0.56)	\$ (0.21)
Pro forma	\$ (0.56)	\$ (0.21)

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

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

9. 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. The difference results from the following items:

	2003	2002
Loss before income taxes	\$ (17,184,625)	\$ (5,545,216)
Combined federal and provincial tax rate	35.22%	42.24%
Computed "expected" income tax expense	(6,052,425)	(2,342,299)
Increase (decrease) in income taxes resulting from:		
Non-deductible crown charges and recoveries	(481,285)	171,325
Resource allowance	-	(38,906)
Tax rate reduction	(495,148)	-
Unrecognized tax benefit of accounting losses	7,028,858	2,209,880
Future income taxes	-	-
Capital taxes	-	11,399
	\$ -	\$ 11,399

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

	2003	2002
Future income tax assets:		
Property, plant and equipment	\$ 5,325,981	\$ 2,730,808
Future site restoration	234,489	102,916
Share issue expenses	293,051	-
Non-capital loss carryforwards (expire 2007-2011)	1,199,865	232,053
Valuation adjustment	(6,707,186)	(3,065,777)
	346,200	-
Future income tax liabilities:		
Flow through share renunciations to be incurred	(346,200)	-
	(346,200)	-
Net future income tax liability	\$ -	\$ -

10. FINANCIAL INSTRUMENTS

The company's financial instruments included in the balance sheet are comprised of accounts receivable, accounts payable and accrued liabilities and bank debt. The fair value of financial instruments classified as current assets approximate their carrying amounts due to the short-term maturity of these instruments. The fair value of bank debt approximates its carrying amount as the interest rate approximates market.

The fair value of current liabilities is indeterminable at this time and is subject to proceedings under CCAA as disclosed in note 1.

Virtually all of the company's accounts receivable are for refundable taxes. The Company is not exposed to significant credit risks. At December 31, 2003, the Company recorded an allowance for doubtful accounts in the amount of \$650,000 (2002 - Nil) related to outstanding accounts receivable from industry partners.

Questerre Energy Corporation

Notes to Consolidated Financial Statements

For the Years ended December 31, 2003 and 2002

11. RELATED PARTY TRANSACTIONS

In July 2002, the company exchanged an asset valued at \$20,000 for a fixed asset valued at the same amount from a company with two directors who are also directors of the company. The transactions were recorded at the exchange amount and were in the normal course of business.

On August 23, 2002, the company signed an agreement with Terrenex Acquisition Corporation to extend the deadline for drilling a test well under the St. Lawrence Lowlands Farmout agreement to February 28, 2003 in exchange for 150,000 common share warrants in the company. Three directors of Questerre are also directors of Terrenex.

On February 28, 2003, the Company issued 150,000 common share warrants to Terrenex in exchange for an extension under the St. Lawrence Lowlands Farmout agreement. On May 12, 2003, the Company issued 750,000 common shares to Terrenex as consideration for the termination of the St. Lawrence Lowlands Farmout agreement. Subsequent to the termination of the agreement, Questerre successfully obtained the gas exploration licenses previously held by Terrenex which had been covered by the Farmout agreement.

At December 31, 2003, Questerre had amounts owing to Terrenex totalling \$1,237 (2002 – \$2,333).

Questerre incurred fees of \$126,000 in the year ended December 31, 2003 (2002 – \$126,000) with a company with common directors and officers. The transactions were in the normal course of business as the fees were 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.

12. SUBSEQUENT EVENTS

On February 13, 2004, the Company completed a private placement for 642,860 common shares and 1,878,791 flow-through common shares for gross proceeds of \$3,156,003. Proceeds from the offering will be used to finance the completion and tie-in of the exploration well at the Beaver River Field.

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.

Subsequent to year end, 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 December 31, 2003. The outcome of the lawsuits is dependent, in part, on the CCAA process (note 1) and is unknown at this time.