

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



Jason D'Silva
Vice President, Finance

Calgary, Alberta, Canada
March 27, 2006

auditors' report

TO THE SHAREHOLDERS OF QUESTERRE ENERGY CORPORATION

We have audited the consolidated balance sheets of Questerre Energy Corporation as at December 31, 2005 and 2004 and the consolidated statements of income 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, 2005 and 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Calgary, Alberta, Canada

March 24, 2006

consolidated balance sheets

	December 31 2005	December 31 2004
Assets		
Current assets		
Cash	\$ 9,296,160	\$ 2,701,477
Marketable securities (market value: \$546,120)	499,311	-
Accounts receivable	1,533,354	218,249
Inventory	92,925	141,373
Deposits and cash calls paid	32,064	502,522
	11,453,814	3,563,621
Restricted Cash (note 5)	100,000	100,000
Petroleum and natural gas properties (note 4)	50,383,321	40,075,517
Less: accumulated depletion and depreciation	(35,744,372)	(33,935,459)
	14,638,949	6,140,058
	\$ 26,192,763	\$ 9,803,679
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,597,584	\$ 572,033
Bank loan (note 5)	154,100	234,500
	1,751,684	806,533
Promissory note payable (note 6)	-	600,000
Asset retirement obligation (note 7)	2,271,192	1,848,503
	4,022,876	3,255,036
Shareholders' Equity		
Common shares (note 8)	49,268,507	31,339,389
Contributed surplus (note 8)	739,640	41,952
Deficit	(27,838,260)	(24,832,698)
	22,169,887	6,548,643
	\$ 26,192,763	\$ 9,803,679

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors



Director



Director

consolidated statements of income (loss) and deficit

	For the years ended December 31	
	2005	2004
Revenue		
Petroleum and natural gas revenue	\$ 2,097,422	\$ 1,942,523
Royalties	(362,945)	(306,427)
	1,734,477	1,636,096
Expenses		
Operating	714,783	1,718,803
General and administrative	1,034,429	737,600
Restructuring costs	80,500	430,219
Stock-based compensation (note 8 (e))	697,688	(28,575)
Interest expense	67,832	69,984
Interest income	(40,194)	(25,033)
Gain on settlement of obligations (note 3)	–	(7,630,778)
Foreign exchange gain (loss)	(46,603)	1,803
Depletion and depreciation	2,074,544	7,402,949
Accretion on asset retirement obligation (note 7)	157,060	91,190
	4,740,039	2,768,162
Net (loss) before income taxes	(3,005,562)	(1,132,066)
Taxes		
Future tax recovery	–	1,825,569
	–	1,825,569
Net (Loss) income	(3,005,562)	693,503
Deficit, beginning of period	(24,832,698)	(25,526,201)
Deficit, end of period	\$ (27,838,260)	\$ (24,832,698)
Net (loss) income per share		
Basic and diluted (note 8 (c))	\$ (0.03)	\$ 0.02

See accompanying notes to consolidated financial statements.

consolidated statements of cash flows

For the years ended December 31
2005 2004

Cash provided by (used in):

Operating Activities

Net loss (income)	\$ (3,005,562)	\$ 693,503
Items not affecting cash		
Depletion and depreciation	2,074,544	7,402,949
Accretion on asset retirement obligation	157,060	91,190
Non cash corporate restructuring costs	80,500	–
Gain on settlement of obligations	–	(7,630,778)
Stock-based compensation expense	697,688	(28,575)
Future tax recovery	–	(1,825,569)
	4,230	(1,297,280)
Net change in non-cash working capital	(779,302)	377,459
	(775,072)	(919,821)

Financing Activities

Issue of common shares	19,189,908	8,238,452
Share issue and listing costs	(1,941,290)	(353,234)
Promissory note	–	600,000
Repayment of bank loan	(80,400)	(80,400)
Net change in non-cash working capital	–	7,602,180
	17,168,218	16,006,998

Investing Activities

Expenditures on petroleum and natural gas properties	(10,307,805)	(7,475,182)
Net change in non-cash working capital	1,008,653	(6,589,129)
	(9,299,152)	(14,064,311)

Increase in cash	7,093,994	1,022,866
Cash, beginning of period	2,701,477	1,678,611
Cash, end of period	\$ 9,795,471	\$ 2,701,477

See accompanying notes to consolidated financial statements.

During the year ended December 31, 2005, the Company paid \$67,832 (2004 – \$69,984) of cash interests and \$Nil in cash taxes (2004 – \$Nil).

notes to the consolidated financial statements

For the years ended December 31, 2005 and 2004

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Questerre Energy Corporation (“Questerre” or the “Company”) is primarily involved in the exploration and development of naturally fractured and hydrothermally dolomitized reservoirs. The Company has two primary projects – the Beaver River Field in British Columbia (the “Field”) and the St. Lawrence Lowlands in Quebec (note 4). To mitigate the risks associated with these primary projects, the Company has secured partners to assist in the development of these projects.

The Company has also developed a portfolio of conventional exploration and production assets in five areas in Central and Southern Alberta – Westlock, Hector, Vulcan, Parkland and Drumheller.

2. SIGNIFICANT ACCOUNTING POLICIES

The preparation of financial statements in conformity with GAAP 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. (“QBR”) and 6058931 Canada Inc.

b) Cash

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

c) Marketable securities

Marketable securities are carried at the lower of weighted average cost and market value.

d) Measurement uncertainty

Depletion and depreciation, amounts used for ceiling test calculations and asset retirement obligations are estimates. The ceiling test is based on estimates of oil and natural gas reserves and commodity prices, production expenses and capital costs required to develop and produce those reserves. By their nature, these estimates are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

e) Inventory

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

f) Revenue recognition

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

g) Oil and natural gas properties

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 Company reviews the carrying amount of its oil and natural gas properties (“the properties”) relative to their recoverable amount (“the ceiling test”) at each annual balance sheet date, or earlier if circumstances or events indicate impairment may have occurred. The recoverable amount is calculated as the undiscounted cash flow from the properties using proved reserves and expected future prices and costs. If the carrying amount of the properties exceeds their recoverable amount, then an impairment loss, equal to the amount by which the carrying amount of the properties exceeds the discounted cash flow from those properties using proved and probable reserves and expected future prices and costs, is recognized in depletion.

h) Asset retirement obligation

The fair value of asset retirement obligations related to long-term assets are recognized as a liability in the period in which they are incurred. The fair value of the asset retirement obligation is estimated by discounting the expected future cash flows to settle the asset retirement obligation at the Company’s credit adjusted risk free rate. Asset retirement costs equal to the discounted asset retirement obligation are capitalized as part of the cost of the associated capital asset and amortized to expense through depletion over the life of the asset. In subsequent periods, the asset retirement obligation is adjusted for the passage of time and for any changes in the amount or timing of the underlying future cash flows.

i) 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.

j) 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.

k) 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 at the date of renouncement.

l) Stock based compensation plan

The company has a stock option plan for directors and employees. The stock option plan is described in note 8(d). The compensation cost attributable to share options granted is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase in contributed surplus.

m) 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.

3. CORPORATE RESTRUCTURING

On April 1, 2004, QBR was granted an Order by the Court of Queen's Bench of Alberta providing for creditor protection under the *Companies' Creditors Arrangement Act ("CCAA")*. On June 22, 2004, Questerre also applied for and was granted an Order by the Court of Queen's Bench of Alberta providing for creditor protection under CCAA.

QBR's financial difficulty was the result of significant problems and cost overruns associated with a re-entry operation undertaken at the Field. QBR held a 100% working interest in the operation as a result of joint venture partners choosing to forego participation under penalty. The CCAA filing by Questerre was necessary due to claims advanced or threatened by certain parties that provided goods and services in connection with the re-entry operation and was intended to allow the Company to restructure its affairs while continuing operations on a normalized basis.

On August 9, 2004, the Company filed Plans of Compromise or Arrangement (the "Plans") under the CCAA for the settlement of all outstanding claims. The Plans were approved by the requisite majority of unsecured creditors at meetings of creditors held on August 31, 2004 and sanctioned by the Court of Queen's Bench of Alberta on September 9, 2004. Questerre and QBR subsequently emerged from Court protection under the CCAA on October 8, 2004.

Pursuant to the Plans proposed by Questerre and QBR, unsecured creditors received either the lesser of the amount of their claim or \$2,000. Alternatively, unsecured creditors elected to receive a cash dividend of \$0.05 plus one Common Share of Questerre for each dollar of their claims. The Common Shares of Questerre issued under the Plans were subject to a contractual escrow and released in two equal instalments on the fourth and eighth month anniversary of the date the Plans received final Court approval.

In addition to the proposed settlement, Questerre arranged for a liquidity option. Under this liquidity option, unsecured creditors received \$0.05 for each dollar of their claims, and also received an additional \$0.07 for each dollar of their claim in exchange for foregoing each Common Share they would have otherwise received. This resulted in a cash settlement of \$0.12 per dollar of claim outstanding.

The Common Shares that would otherwise have been issued to these unsecured creditors were issued to Terrenex Acquisition Corporation ("Terrenex"), a related party, pursuant to the terms of the Liquidity Option Agreement. In consideration, Terrenex established a fund to finance the liquidity option up to a maximum of \$668,500 and was issued 300,000 Common Shares.

A total of \$0.56 million in cash and 9,623,012 Common Shares were issued on the implementation of these Plans. 6,756,102 Common Shares were issued to Terrenex pursuant to the Liquidity Option Agreement.

4. PETROLEUM AND NATURAL GAS PROPERTIES

	December 31 2005	December 31 2004
Petroleum and natural gas properties (net of accumulated depletion and depreciation)		
Alberta	\$ 9,374,442	\$ 1,024,584
British Columbia	3,458,224	3,346,186
Quebec	1,806,283	1,769,288
	\$ 14,638,949	\$ 6,140,058

During the year ended December 31, 2005, the Company capitalized administrative overhead charges of \$415,957 (2004 – \$326,619) relating to exploration and development activities.

The Company incurred a writedown of \$1.31 million for the year ended December 31, 2005. This amount relates to the Company's share of costs of an unsuccessful well in the Simonette area of Alberta during the first quarter of the year. This amount is included in the depletion and depreciation provision on the income statement.

At December 31, 2005, the Company used the following prices in its ceiling test calculation (C\$/GJ):

2006	2007	2008	2009	2010
10.05	9.05	8.05	7.00	6.55

(a) Alberta

The Company does not include costs of \$1.37 million related to its exploration project in the Parkland area in Alberta in its calculation of depletion or in costs subject to the ceiling test calculation. This project remains unproved at December 31, 2005.

(b) British Columbia

In May 2005, QBR entered into a Royalty and Quitclaim agreement with its partners at the Field (the "Farmors") and Ampac Petroleum Inc. ("Ampac") ("Quitclaim Agreement"). Ampac is a private exploration and production company controlled by a Director of Questerre. Pursuant to the Quitclaim Agreement, the Farmors quitclaimed their interest in the Field to Ampac and QBR in consideration of a royalty and a release by QBR of any amounts owed under the original farmout agreement dated January 12, 2001 (the "Beaver River Agreement"). QBR and Ampac would assume all liabilities associated with the Farmors' interest in the Field. The respective interests of QBR and Ampac in the Field post the quitclaim are 66.67% and 33.33%. Upon the execution of this Quitclaim Agreement, QBR and the Farmors agreed to terminate their existing farm-in agreement.

In May 2005, QBR and Ampac entered into a Farmout and Operating Agreement ("Farmout Agreement") for the Field. Pursuant to the Farmout Agreement, Ampac would conduct an initial work program ("Initial Work Program") involving the re-entry of four wells to earn a 50% interest in the drilling spacing units of the wells for a shallow horizon only. The second phase will involve two optional wells. Upon the completion of the Initial Work Program and the two optional wells, Ampac will hold a 50% interest in the Field, including all horizons, infrastructure and equipment. Should Ampac not complete the two optional wells, it will transfer its interest in the Field, excluding the interest earned under the Initial Work Program to QBR.

In prior years, all costs associated with the Field, net of estimated salvage values, were written down except \$2.95 million of seismic costs. These costs primarily relate to the 3-D seismic survey acquired over the Field in 2002 and have continuing value to QBR.

(c) Quebec

Questaerre does not include costs of \$1.81 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 Company's assets in Quebec remain unproved at December 31, 2005.

5. BANK LOAN

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 fix 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, QBR. 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.

While Questaerre currently meets this financial covenant, the Company has not been in compliance with this covenant in the past and, therefore, the bank loan has been classified as a current liability.

6. PROMISSORY NOTE PAYABLE

The Company issued a promissory note for \$0.6 million to Rupert's Crossing, an Investment Corporation ("Rupert's"). Rupert's is a private investment holding company controlled by the President and Chief Executive Officer of Questaerre. The promissory note was issued in 2004 on the receipt of \$0.6 million in cash from Rupert's.

The promissory note was due November 14, 2006 and bore interest at 8% per annum, payable monthly. It was secured by a General Security Agreement over the assets of the Company and the hypothecation of the Company's exploration licenses in the St. Lawrence Lowlands in Quebec.

Pursuant to the terms of the note, the Company had the right to prepay the entire amount or any portion thereof with 30 days' notice in writing to Rupert's. Rupert's was granted an option to convert the entire amount into Common Shares of the Company at a conversion rate of \$0.30 per Common Share.

In November 2005, Rupert's elected to convert its \$0.6 million promissory note. A total of 2,000,000 Common Shares were issued at a conversion price of \$0.30 per Common Share.

7. 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 its total undiscounted asset retirement obligations to be \$2,382,942 at December 31, 2005. Questerre used a credit adjusted risk free rate of seven per cent and an inflation rate of three per cent over the varying lives of the assets to calculate the present value of the asset retirement obligation.

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

	December 31 2005	December 31 2004
Balance, beginning of period	\$ 1,848,503	\$ 848,134
Increase in estimate of obligation	265,629	909,179
Accretion expense	157,060	91,190
Balance, end of period	\$ 2,271,192	\$ 1,848,503

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, 2005, 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, 2003	42,112,246	\$ 25,279,580
Issued for cash	3,280,860	1,373,075
Flow through shares issued for cash	11,703,791	5,389,928
Issued for cash on exercise of warrants	31,995	32,155
Issued under Plans	9,623,012	1,443,454
Tax effect of flow-through share issue		(1,825,569)
Share issue costs	-	(353,234)
Balance, December 31, 2004	66,751,904	\$ 31,339,389
Issued for cash	43,112,690	19,189,908
Issued on conversion of promissory note	2,000,000	600,000
Issued for corporate restructuring (note 3)	1,150,000	80,500
Share issue costs	-	(1,941,290)
Balance, December 31, 2005	113,014,594	49,268,507
Total Common Share Capital		\$ 49,268,507

Common Shares

In April 2005, the Company completed a private placement of 3,125,000 Common Shares at \$0.32 per Common Share for gross proceeds of \$1.0 million.

In June 2005, the Company completed an offering of 30,000,000 Common Shares at \$0.33 per Common Share for gross proceeds of \$10 million. Concurrent with this offering, the Company listed its Common Shares for trading on the Oslo Stock Exchange.

In September 2005, the Company completed a private placement of 9,987,690 Common Shares at \$0.82 per Common Shares for gross proceeds of \$8.19 million.

c) Per share amounts

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

	2005	2004
Basic	91,308,441	48,273,347
Diluted	93,742,194	48,817,849

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

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 year ended December 31, 2005:

	Number of Options	Weighted Avg Exercise Price
Outstanding, December 31, 2003	3,643,500	\$ 1.28
Granted		
January 2004	313,000	1.41
September 2004	2,315,000	0.10
November 2004	50,000	0.25
December 2004	1,000,000	0.30
Cancelled	(3,956,000)	1.29
Outstanding, December 31, 2004	3,365,000	\$ 0.16
Granted		
March 2005	250,000	\$ 0.72
June 2005	3,000,000	0.40
September 2005	2,220,000	0.82
November 2005	550,000	0.53
Cancelled	(180,000)	(0.14)
Outstanding, December 31, 2005	9,205,000	0.44
Exercisable, December 31, 2005	2,062,083	\$ 0.29

The outstanding options have a range of exercise prices from \$0.10 to \$1.00, and a weighted average number of years to expiry of 4.2 (2004 – 5.0 years). The exercisable options have a range of exercise prices from \$0.10 to \$1.00 and 4.0 years to expiry (2004 – 5.0 years).

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 vesting period with a corresponding increase to contributed surplus. The fair value of each option granted is estimated at the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

	2005	2004
Weighted average fair value per option	\$ 0.26	\$ 0.13
Risk free interest rate (%)	3.0	3.0
Expected life (years)	3.0	3.0
Expected volatility (%)	105	173

f) Contributed surplus

The following table sets forth a reconciliation of contributed surplus for the year ended December 31, 2005:

Balance, December 31, 2003	-
Adoption of Stock based compensation	\$ 70,527
Stock based compensation expense	136,350
Forfeit of options	(164,925)
Balance, December 31, 2004	\$ 41,952
Stock based compensation expense	717,641
Forfeit of options	(19,953)
Balance, December 31, 2005	\$ 739,640

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:

	Year ended December 31	
	2005	2004
Net loss before income taxes	\$ (3,005,562)	\$ (1,132,066)
Combined federal and provincial tax rate	33.69%	38.66%
Computed "expected" income tax recovery	(1,009,869)	(437,657)
Increase in income taxes resulting from:		
Non-deductible crown charges and recoveries	404,371	73,541
Tax rate reduction	-	45,208
Unrecognized tax benefit of accounting losses	605,498	318,908
Recognition of future income tax in recognition of tax on flow-through shares	-	(1,825,569)
Future income tax recovery	\$ -	\$ (1,825,569)

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

	December 31 2005	December 31 2004
Future income tax assets:		
Property, plant and equipment	\$ 3,061,927	\$ 5,214,245
Asset retirement obligation	712,721	626,088
Share issue expenses	652,273	401,459
Non-capital loss carryforwards	771,526	276,024
Valuation adjustment	(5,198,447)	(4,692,247)
	-	-
Future income tax liabilities:		
Flow through share renouncements to be incurred	-	(1,825,569)
	-	(1,825,569)
Net future income tax liability	\$ -	\$ -

Non-capital loss carryforwards at December 31, 2005 represent non-capital losses and expire in 2011.

10. FINANCIAL INSTRUMENTS

The company's financial instruments included in the balance sheet are comprised of accounts receivable, accounts payable, accrued liabilities and bank loan. 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 the bank loan approximates its carrying amount as the interest rate approximates market.

Virtually all of the Company's accounts receivable are for revenue on its non-operated properties in Alberta. The Company is exposed to credit risks normal for the oil and gas industry.

11. RELATED PARTY TRANSACTIONS

At December 31, 2005, Questerre had amounts owing to Terrenex totaling \$754 (December 31, 2004 – \$5,040). All of the directors of Terrenex serve as directors or officers of Questerre.

Questerre incurred fees of \$126,000 for the year ended December 31, 2005 (2004 – \$126,000) 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.

In April 2005, the Company completed a private placement of 3,000,000 Common Shares at \$0.32 per Common Share. Terrenex subscribed for 2,812,500 Common Shares and Rupert's subscribed for 312,500 Common Shares.

In April 2005, the Company executed a purchase and sale agreement with Rupert's to acquire its interest in producing properties and exploration acreage in Central Alberta. The purchase price of \$2.1 million was based on an evaluation of the assets prepared by an independent reservoir engineering firm.

In May 2005, QBR entered into the Farmout Agreement with Ampac Petroleum ("Ampac"), a private exploration and production company. A director of the Company is the sole shareholder and director of Ampac. See Note 4 (b).

In November 2005, the Company issued a total of 3,150,000 Common Shares as follows:

- 2,000,000 Common Shares were issued on the conversion of the \$0.6 million promissory note due to Rupert's at a conversion rate of \$0.30 per Common Share. See Note 6.
- 300,000 Common Shares were issued to Terrenex pursuant to the Liquidity Option Agreement. See Note 3.
- 850,000 Common Shares were issued to employees of the Company and QBR pursuant to the Employee Retention Plan established in May 2004.

12. SUBSEQUENT EVENTS

In February 2006, the Company completed a private placement of 11,000,000 Common shares at \$0.65 per Common Share for gross proceeds of \$7.15 million.

In February 2006, QBR granted Ampac an extension from March 1, 2006 to June 15, 2006 to complete the Initial Work Program under the Farmout Agreement.