

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, May 9, 2008. This MD&A is provided by Management of Questerre Energy Corporation ("Questerre" or the "Company") to review first quarter 2008 activities and results as compared to the same period in the prior year. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the three months ended March 31, 2008 and the audited consolidated financial statements for the year ended December 31, 2007.

Questerre is a junior oil and gas company involved in the exploration and development of scalable high-impact projects. To mitigate the risks associated with these projects, the Company has secured partners to assist in their development. To further diversify risk, the Company continues to develop a portfolio of conventional exploration and production assets.

The Company's common shares are listed on the Toronto Stock Exchange and Oslo Stock Exchange under the symbol QEC.

### Forward Looking Statements

This MD&A contains forward-looking statements. Management's assessment of future plans and operations, production estimates, drilling inventory and wells to be drilled, timing of drilling and tie in of wells, productive capacity of new wells, capital expenditures and the timing thereof, may constitute forward-looking statements under applicable securities laws and necessarily involve risks including, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, the timing and length of plant turnarounds and the impact of such turnarounds and the timing thereof, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources. As a consequence, the Company's actual results could differ materially from those expressed in, or implied by, the forward-looking statements. Readers are cautioned that the foregoing list of factors is not exhaustive. The forward-looking statements contained in this MD&A are made as at the date of this MD&A and the Company does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

### Non-GAAP Terms

This document contains the terms "funds generated from operations", "netbacks", "working capital" and "average sales price" which are non-GAAP terms. The Company uses these measures to help evaluate its performance. The Company considers netbacks a key measure as it demonstrates its profitability relative to current commodity prices and the Company's ability to generate funds necessary to repay debt and to fund future growth through capital investment. As an indicator of Questerre's performance, funds generated from operations should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian GAAP. Questerre's determination of funds generated from operations may not be comparable to that reported by other companies. The reconciliation between net income and funds generated from operations can be found in the consolidated statements of cash flows in the consolidated financial statements.

### BOE Conversions

Barrel of oil equivalent ("boe") amounts may be misleading, particularly if used in isolation. A boe conversion ratio has been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil and is based on an energy equivalent conversion method application at the burner tip and does not necessarily represent an economic value equivalency at the wellhead.

## SELECT INFORMATION

| Item  | Three Months Ended March 31, |             |
|---|------------------------------|-------------|
|   | 2008                         | 2007        |
| <b>Financial (\$)</b>                       |                              |             |
| Petroleum and natural gas sales             | <b>7,231,829</b>             | 7,502,436   |
| Funds generated from operations             | <b>3,939,125</b>             | 3,046,729   |
| Per share – Basic                           | <b>0.02</b>                  | 0.02        |
| Per share – Fully diluted                   | <b>0.02</b>                  | 0.02        |
| Net earnings (loss)                         | <b>1,472,201</b>             | 480,366     |
| Per share – Basic                           | <b>0.01</b>                  | 0.00        |
| Per share – Fully diluted                   | <b>0.01</b>                  | 0.00        |
| Capital expenditures                        | <b>17,694,854</b>            | 7,163,179   |
| Working capital surplus (deficiency)        | <b>(4,506,140)</b>           | 20,427,261  |
| Total assets                                | <b>103,426,756</b>           | 77,279,174  |
| Shareholders' equity                        | <b>73,603,296</b>            | 60,688,283  |
| Common shares outstanding                   |                              |             |
| Basic                                       | <b>170,890,470</b>           | 155,191,750 |
| Fully diluted                               | <b>187,659,640</b>           | 168,143,836 |
| <b>Operations (units as noted)</b>          |                              |             |
| Average production                          |                              |             |
| Crude oil and natural gas liquids (bbls/d)  | <b>304</b>                   | 210         |
| Natural gas (mcf/d)                         | <b>5,820</b>                 | 8,951       |
| Total (boe/d)                               | <b>1,274</b>                 | 1,702       |
| Average sales price                         |                              |             |
| Crude oil and Natural Gas Liquids (C\$/bbl) | <b>95.50</b>                 | 64.42       |
| Natural gas (C\$/mcf)                       | <b>8.64</b>                  | 7.77        |
| Total (\$/boe)                              | <b>62.36</b>                 | 48.98       |
| Netback (\$/boe)                            |                              |             |
| Total revenue                               | <b>62.36</b>                 | 48.98       |
| Royalties                                   | <b>10.99</b>                 | 13.40       |
| Percent                                     | <b>17.62</b>                 | 27.36       |
| Field operating expense                     | <b>12.33</b>                 | 11.01       |
| Operating netback                           | <b>37.08</b>                 | 24.57       |
| Net cash G&A                                | <b>4.62</b>                  | 5.36        |
| Cash netback                                | <b>32.46</b>                 | 19.21       |
| Wells drilled                               |                              |             |
| Gross                                       | <b>5.0</b>                   | 8.0         |
| Net   | <b>3.0</b>                   | 5.5         |

## HIGHLIGHTS

- Significant Utica shale gas discovery in the St. Lawrence Lowlands, Quebec
- Excellent results from horizontal wells in Antler, Saskatchewan
- Successfully drilled two Jean Marie wells and acquired a 46 sq mile 3-D seismic survey in Greater Sierra, northeast British Columbia
- Tested non-commercial well at Beaver River Field
- Cash flow from operations increased to \$3.94 million from \$3.05 million in 2007

## FIRST QUARTER 2008 ACTIVITIES

### St. Lawrence Lowlands, Quebec

Questerre's partner, Forest Oil Corporation ("Forest"), a major US independent, announced a significant Utica shale gas discovery on the Company's Yamaska licenses in the St. Lawrence Lowlands, Quebec. Questerre holds a 7.5% gross overriding royalty convertible into a 20% working interest on the Yamaska licenses.

The announcement follows the completion and stimulation of the St. Francois du Lac well early in the quarter. The well was one of two wells operated by Gastem Inc. ("Gastem") targeting the Utica shale in mid-2007. Based on the results of its technical work and the stimulation, Forest has elected to proceed with the drilling of two additional horizontal wells each with a four-stage fracture stimulation in 2008.

### Northeast British Columbia

#### Greater Sierra

During the quarter, Questerre fulfilled its obligations under the seismic and farm-in agreement with EnCana Corporation ("EnCana") covering 54 square miles in the Greater Sierra region of northeast British Columbia.

These commitments included the drilling and completion of two wells for the Jean Marie formation and acquiring a 46 square mile 3-D seismic survey. Questerre successfully drilled and completed the two wells in early February 2008 at a cost of approximately \$5.50 million. EnCana subsequently tied-in these wells to the local gathering system and production commenced in mid-March 2008 at an initial rate of 4.0 mmcf/d. Current production from these well is approximately 2.0 mmcf/d. Questerre holds a 50% interest in these wells.

The 3-D seismic survey was operated by EnCana and acquisition completed in early March 2008, ahead of schedule. Based on preliminary estimates, the project was completed under a budgeted cost of \$6.15 million. Processing and interpretation of the survey is underway. Subject to the final results, Questerre expects to participate with EnCana in the drilling of 6-8 wells next winter.

#### Beaver River Field

The completion and testing of the A-8 well was the focus of activity at the Beaver River Field in the first quarter of the year.

The primary target for this well was a potentially undrained Nahanni fault block identified on a reprocessed 3-D seismic survey. Additional targets included the Mattson, Mississippian fractured carbonate and Devonian shale.

The well was tested in early January 2008 and the results from the Nahanni were substantially less than expected. On initial cleanup the well flowed at rates in excess of 5 mmcf/d with final test rates of 400 mcf/d of gas and 900 bbls/d of formation water. Though the pressure data suggests the well is not in communication with the adjacent A-5 well and in a partially sealed block, the presence of formation water suggests a different sealing mechanism than originally expected.

Further testing for the Nahanni and the other prospective zones will be contingent upon capital, equipment availability and weather.

### **Antler, Saskatchewan**

During the quarter, Questerre participated in the drilling and completion of three (2.0 net) horizontal wells in the Antler area of southeast Saskatchewan.

To maximize recovery of the oil in place, Questerre and its partners evaluated the effectiveness of selective fracture stimulation on two horizontal wells. The initial results are consistent with the experience of other operators in the area. Results indicate initial stabilized production of 2 to 4 times the unstimulated rates. Plans are underway to stimulate additional wells and further validate the benefits of this stimulation technique within the Company's acreage.

Based on these preliminary results, Questerre plans to drill and fracture stimulate four new wells and further stimulate four existing wells this summer.

### **Southern and Central Alberta**

Questerre drilled its first horizontal well into the Mannville I Pool in Vulcan, southern Alberta this winter.

The initial completion operation was suspended due to poor hole conditions and a six week delay in securing a suitable rig. In late February, the well was re-entered and a 500m horizontal section drilled and production liner set. Questerre and its partner plan to selectively fracture stimulate the well this spring after breakup.

Questerre also completed the tie-in of two (0.66 net) wells drilled last year in the Vulcan area. The wells commenced production in mid-March at an average rate of 300 boe/d. In the middle of the second quarter, production from one of these wells unexpectedly declined with an increase in formation water. Questerre is evaluating remediation options for this well.

### **Drilling Activities**

In the first quarter of 2008, Questerre participated in the drilling of five (3.0 net) wells resulting in three (2.0 net) oil wells and two (1.0 net) gas wells for a 100% success rate.

### **Corporate**

On February 22, 2008, Questerre entered into an agreement to acquire Terrenex Ltd. ("Terrenex") a related party with common directors and officers. Terrenex's principal assets were a working interest in sixteen exploration licenses covering 719,000 acres in the Lowlands, a seismic database of over 5,300 km of 2-D data in the Lowlands and 10,698,785 Questerre Common Shares. Total consideration for the transaction was 15,892,785 Questerre Common Shares and the assumption of \$0.5 million in debt. The net debt component was paid through a non-refundable deposit on the transaction.

On April 27, 2008, Questerre and Terrenex amended their agreement to increase the share consideration to 18,910,403 Questerre Common Shares. The amendment reflects the announcement of the significant discovery in the Lowlands in April and the related concerns expressed by minority shareholders of Terrenex. The transaction received Terrenex shareholder and regulatory approval on April 28, 2008. On closing, Terrenex became a wholly owned subsidiary of Questerre.

## PRODUCTION

Average daily production for the first quarter of 2008 was 1,274 boe/d. By comparison, production in the preceding quarter was 1,216 boe/d and 1,702 boe/d in the first quarter of 2007.

With increased light oil production from the newly acquired Antler area, natural gas represented only 76% of Questerre's production during the quarter, down from 88% in 2007. Over 90% of Questerre's oil production is light oil and natural gas liquids from Antler and Vulcan. For the remainder of this year, the Company anticipates that oil will account for approximately 30% of Questerre's product mix with increased production from both these areas.

Production from the Company's 50% interest in the Mannville G Pool in Vulcan remained the largest single contributor and accounted for 593 boe/d or 46% of daily production during the reporting period. Ancillary assets in Alberta added an additional 218 boe/d to bring total production from Alberta to 811 boe/d or just under 2/3 of daily production. Subject to the test results from its first horizontal well into the Mannville I Pool at Vulcan, Questerre expects production from this well to mitigate the natural declines in its Alberta production in 2008.

Approximately 22% of Questerre production, or 287 boe/d was attributable to assets in British Columbia. Two Jean Marie wells were brought on-stream in mid-March with production averaging 65 boe/d in the quarter and current production of close to 150 boe/d. The two producing wells at the Beaver River Field, A-2 and A-7, averaged daily production of 222 boe/d during the quarter. Boost compression at the Field in early March had a marked improvement with production increasing by over 50%. Questerre plans to install wellhead compression on the A-2 well to further enhance productivity.

The remainder of Questerre's production of 176 boe/d per day was from its newly acquired assets in the Antler area of southeast Saskatchewan. An active drilling program in the last two quarters resulted in seven (4.5 net) horizontal oil wells on production in addition to the one horizontal well and 18 vertical wells acquired. Two horizontal wells were successfully fracture stimulated in the quarter with initial stabilized rates 2-4 times the unstimulated rate. Based on these results, Questerre plans to drill and stimulate four additional horizontal wells while also fracture stimulating four existing horizontals.

## FIRST QUARTER 2008 FINANCIAL RESULTS

### Revenue

Petroleum and natural gas revenue for the first quarter of 2008 was \$7.23 million, decreased marginally from \$7.50 million for the same period in 2007. Strong commodity prices compensated for the 25% decline in average daily production to 1,274 boe/d.

Questerre's higher quality gas production from Vulcan was responsible for realized natural gas prices that were above the Canadian industry average. During the quarter, Questerre sold its natural gas at an average price of \$8.64/mcf (2007: \$7.77/mcf) in comparison to an AECO daily index price of \$7.97/mcf (2007: \$7.41/mcf).

Higher oil and natural gas liquids also benefited from substantially improved prices. With less than 10% of oil production consisting of 25 API oil, Questerre's realized prices increased to \$95.50/bbl (2007:\$64.42/bbl). This parallels the Edmonton Light reference price of \$97.50/bbl during the quarter in 2008 and \$67.09/bbl in 2007.

To capitalize on the higher pricing environment and mitigate the historically lower gas prices during the summer, Questerre entered into a hedge for 2,000 GJ of production at \$8.49/GJ from April to October 2008.

## Royalties

Questerre recorded royalty expense of \$1.27 million for the first three months of 2008 (2007: \$2.05 million). This translates into an effective royalty rate of 17.62% (2007: 27.36%) with Crown royalties accounting for 12.63% (2007: 20.73%) and freehold and overriding royalties 4.99% (2007: 6.63%).

Higher than expected deductions for gas cost allowance in Vulcan coupled with an overall rate of just under 10% on other Alberta production continued to reduce royalties as a percentage of revenue. Over the quarter, royalties on Alberta production decreased by over 27% to 21.16% from 29.01% in 2007.

In British Columbia, Crown and overriding royalties increased from a combined rate of 17.66% in 2007 to 20.35% in 2008. The rate increase primarily reflects the higher prices realized in the quarter and base royalty rate of 27% on the A-7 well at the Beaver River Field that was placed on production in October 2007.

Questerre's production in Antler benefited from the significantly lower royalty rates in Saskatchewan. Royalties as a percentage of revenue were just under 6%. Questerre expects this rate to decrease marginally as additional horizontal wells will be drilled mainly on Crown land that attracts a royalty rate of 2.5% on the first 100,000 barrels of production.

## Operating Expenses

Total operating expenses, including gathering and processing charges, for the quarter decreased approximately 15% to \$1.43 million from \$1.69 million in 2007.

The decrease reflects a 25% decline in production offset by a 9% increase on a per boe basis from \$11.01 per boe in 2007 to \$12.33 in 2008. Questerre's Alberta production saw costs increase over one-third to \$13.50 per boe this year from \$9.88 boe the previous year. This reflects higher than expected production costs on ancillary assets in Alberta, particularly Grand Forks and Westlock. By comparison, costs at Vulcan remained relatively stable at \$8.06 per boe as compared to \$8.66 for the same period in 2007.

Operating expenses in British Columbia of \$0.58 million were primarily for the Beaver River Field. Beaver River operating expenses were \$0.52 million (2007: \$0.44 million) include gathering and processing charges of \$0.17 million (2007: \$0.19 million). The higher costs incurred reflect the increase activity supporting the A-8 operation. In Antler, Saskatchewan, production expenses totaled \$0.12 million.

## General and Administrative Expenses

Gross general and administrative expenses ("G&A") for the first quarter of 2008 increased 21.07% to \$1.15 million from \$0.95 million in the preceding year. The increase over the prior year is due to higher expenses in three main categories – salaries and consulting, legal fees and rent. On a net basis, this was offset by higher capitalized expenses and overhead recoveries of \$0.61 million (2007:\$0.33 million).

Based on its capital expenditures for the quarter, Questerre capitalized G&A expenses of \$0.53 million (2007: \$0.03 million) and recorded overhead recoveries of \$0.08 million (2007: nil) for capital projects where it was operator.

The higher capitalized expenses and overhead recoveries translated into a 13.8% decrease on a boe basis to \$4.62 from \$5.36 in the prior year. For the remainder of this year, Questerre expects this to remain relatively constant.

| (\$ thousands)                               | 2008  | 2007  |
|--|-------|-------|
| General and administrative expenses          | 1,149 | 949   |
| Bad debt expense                             | –     | 200   |
| Capitalized expenses and overhead recoveries | (613) | (328) |
| General and administrative expenses, net     | 536   | 821   |

## **Stock-Based Compensation**

Questerre recorded stock-based compensation expense of \$0.33 million for the quarter ended March 31, 2008, unchanged from the same period in 2007. Approximately 51% of this amount is attributable to 5.745 million options granted in the quarter with an exercise price of \$0.45 and a weighted average fair value of \$0.24 per option. The remainder relates to options granted in prior years. For this same period in 2007, a total of 0.17 million options were granted in the first quarter of 2007 with an average exercise price of \$1.26 and a weighted average fair value of \$0.64 per option.

## **Other Income and Expense**

During the first three months of 2008, Questerre realized a loss of \$0.70 million on the disposition of its marketable securities. For the same period in 2007, Questerre recorded a realized gain of \$0.34 million and an unrealized gain of \$0.79 million. The securities represent investments in two junior exploration and production companies.

Questerre's draw downs under its credit facility were largely responsible for interest expense of \$0.04 million during the quarter (2007: \$0.003 million). For the same period in 2007, the higher cash balances held by the Company generated interest income of \$0.11 million (2008: \$0.08 million). Interest expense is expected to increase further as Questerre draws on its facility to fund its capital program for the remainder of the year.

## **Depletion, Depreciation and Accretion Expense**

Depletion, depreciation and accretion expense for the first quarter of 2008 was \$3.55 million, relatively unchanged from the same period in 2007.

On a per boe basis, this equates to \$30.63 in 2008 and \$22.00 in 2007. The higher amount in 2008 reflects the significant increase to the depletion base in 2007 for the unsuccessful wells drilled at the Beaver River Field. This was substantially offset by the reserve additions in the Antler area through the acquisition of Magnus Energy Inc. and the successful drilling program in the first quarter of this year.

## **Taxes**

Consistent with the prior year, Questerre had sufficient tax pool deductions to offset taxable income in the first quarter of 2008 resulting in no income taxes payable for the quarter. During this period, Questerre recorded a future tax recovery of \$2.25 million, resulting in a future tax asset of \$3.38 million at March 31, 2008.

## **Net Earnings and Cash Flow**

Questerre reported a net earnings of \$1.47 million for the quarter ended March 31, 2008 as compared to net earnings of \$0.48 million in the first quarter of 2007. The net earnings in the current year is primarily due to the future tax recovery of \$2.25 million.

Funds generated from operations for the period increased to \$3.94 million up from \$3.05 million in the prior year. Despite a 25.1 decrease in production volumes, higher commodity prices and materially higher netbacks, particularly from Antler, were responsible for the improvement. A 27.54% increase in realized prices contributed to netbacks increasing from \$24.57 to \$37.08.

## Capital Expenditures

Capital expenditures incurred by Questerre in the first quarter of 2008 were \$17.69 million, an increase of \$10.53 million from \$7.16 million in 2007.

The front-end loaded capital program focused on the winter only access areas of Greater Sierra and the Beaver River Field in northeast British Columbia. The program consisted of the following:

- \$9.79 million spent in Greater Sierra includes \$5.8 million on the acquisition of the 3-D seismic survey with the balance spent finishing the drilling and completion of two horizontal Jean Marie wells;
- \$3.18 million primarily represent the costs at the Beaver River Field to finalize the drilling and completion of the unsuccessful A-8 well;
- \$3.28 million was spent in Antler to drill three (2.0 net) wells and successfully fracture stimulated two wells. The remainder was spent in Alberta mainly in Vulcan to drill one horizontal well and to tie-in two other wells.

In 2007, Questerre incurred \$3.68 million in British Columbia, primarily drilling the B-3 well, and \$3.28 million spent in Alberta with the remainder in Quebec.

| (\$ thousands)       | 2008      | 2007     |
|----------------------|-----------|----------|
| Capital Expenditures |           |          |
| Alberta              | \$ 1,760  | \$ 3,279 |
| British Columbia     | 13,325    | 3,683    |
| Saskatchewan         | 2,604     | –        |
| Quebec               | 6         | 201      |
| Total                | \$ 17,695 | \$ 7,163 |

## Capitalization and Financial Resources

Questerre reported a working capital deficiency of \$4.5 million at March 31, 2008 as compared to a surplus of \$10.01 million at December 31, 2007.

The Company's current assets consist of cash of \$3.76 million, \$5.55 million in deposits and accounts receivable of \$10.82 million. Current liabilities include \$3.69 million in bank debt and \$21.19 million in accounts payable and accrued liabilities. The Company funded its capital expenditures of \$17.69 million for the quarter through its cash flow, credit facility and working capital.

As at March 31, 2008, the Company had a credit facility of \$7.5 million with \$3.6 million drawn against this facility. Based on a review of its reserves subsequent to quarter-end, the facility was increased to \$11.25 million.

Questerre's capital budget for the remainder of this year is expected to be approximately \$14 million with one-half spent in Antler, one quarter spent in Quebec and the remainder in Alberta. This budget will be funded through cash flow, dispositions of non-core assets and additional draw downs on the credit facility.

## Share Capital

The following table provides a summary of the outstanding common shares and options as at the date of the MD&A, the end of the first quarter and the preceding year-end:

|                               | May 9<br>2008 | March 31<br>2008 | December 31<br>2007 |
|-------------------------------|---------------|------------------|---------------------|
| Common Shares                 | 179,127,088   | 170,890,470      | 168,930,470         |
| Stock Options                 | 16,744,170    | 16,769,170       | 13,064,170          |
| Fully Diluted Shares          | 195,871,258   | 187,659,640      | 181,994,640         |
| Weighed average common shares |               |                  |                     |
| Basic                         |               | 169,733,932      | 157,078,211         |
| Fully Diluted                 |               | 172,902,492      | 163,260,612         |

The increase in common shares outstanding from March 31, 2008 to May 2008 was the 8,211,618 net common shares issued on the acquisition of Terrenex Ltd. and the exercise of 25,000 stock options.

## Contractual Obligations

Pursuant to a flow-through share private placement entered into on December 13, 2007, the Company was obligated to incur \$1.0 million in qualifying Canadian Exploration Expenses by December 31, 2008. As at March 31, 2008, the Company has a remaining commitment of \$0.5 million.

The Company is obligated to make total payments under an operating lease of \$86,859 in 2008, \$115,812 in 2009 and 2010. Questerre has commitments under a lease for office space of \$241,889 in 2009 and \$322,519 in 2009 and 2010.

## Off-Balance Sheet Arrangements

There were no off-balance sheet transactions entered into during the period, nor were there any outstanding as of the date of this MD&A.

## Business Environment and Risk

Except as detailed below, there were no changes to Questerre's risk management policies during the three months ended March 31, 2008 from those detailed in the audited financial statements for the year ended December 31, 2007.

### Environmental Regulation and Risk

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. In 2002, the Government of Canada ratified the Kyoto Protocol (the "Protocol"), which calls for Canada to reduce its greenhouse gas emissions to specified levels. There has been much public debate with respect to Canada's ability to meet these targets and the Government's strategy or alternative strategies with respect to climate change and the control of greenhouse gases. Implementation of strategies for reducing greenhouse gases whether to meet the limits required by the Protocol or as otherwise determined could have a material impact on the nature of oil and natural gas operations, including those of the Company.

The Federal Government released on April 26, 2007, its Action Plan to Reduce Greenhouse Gases and Air Pollution (the "Action Plan"), also known as ecoACTION and which includes the Regulatory Framework for Air Emissions. This Action Plan covers not only large industry, but regulates the fuel efficiency of vehicles and the strengthening of energy standards for a number of energy-using products. Regarding large industry and industry related projects the Government's Action Plan intends to achieve the following: (i) an absolute reduction of 150 megatonnes in greenhouse

gas emissions by 2020 by imposing mandatory targets; and (ii) air pollution from industry is to be cut in half by 2015 by setting certain targets. New facilities using cleaner fuels and technologies will have a grace period of three years. In order to facilitate the companies' compliance of the Action Plan's requirements, while at the same time allowing them to be cost-effective, innovative and adopt cleaner technologies, certain options are provided. These are: (i) in-house reductions; (ii) contributions to technology funds; (iii) trading of emissions with below-target emission companies; (iv) offsets; and (v) access to Kyoto's Clean Development Mechanism.

On March 8, 2007, the Alberta Government introduced Bill 3, the Climate Change and Emissions Management Amendment Act, which intends to reduce greenhouse gas emission intensity from large industries. Bill 3 states that facilities emitting more than 100,000 tonnes of greenhouse gases a year must reduce their emissions intensity by 12% starting July 1, 2008; if such reduction is not initially possible the companies owning the large emitting facilities will be required to pay \$15 per tonne for every tonne above the 12% target. These payments will be deposited into an Alberta-based technology fund that will be used to develop infrastructure to reduce emissions or to support research into innovative climate change solutions. As an alternate option, large emitters can invest in projects outside of their operations that reduce or offset emissions on their behalf, provided that these projects are based in Alberta. Prior to investing, the offset reductions, offered by a prospective operation, must be verified by a third party to ensure that the emission reductions are real.

Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict the impact of those requirements on the Company and its operations and financial condition.

### Review of Alberta Royalty and Tax Regime

The government has previously stated its intention to consult with industry and potentially revise the New Royalty Framework ("NRF") for unintended consequences. This consultation has now been concluded and on April 10, 2008 the government released its clarifications as well as a new "deep resource program". Highlights of this release are as follows:

#### *Deep oil wells*

- A five-year oil program for exploration wells over 2,000 meters will provide royalty adjustments to offset higher drilling costs and provide a greater incentive for producers to continue to pursue new, deeper oil plays.
- Wells deeper than 2,000 meters represented 20 per cent of oil wells drilled and 26 per cent of new conventional oil production between 2002 and 2007.
- Wells will qualify for up to \$1 million or 12 months of royalty offsets, whichever comes first.

#### *Deep natural gas*

- To encourage continued deep gas exploration, the government will replace the existing Royalty Adjustment Program with the Natural Gas Deep Drilling Program for wells deeper than 2,500 meters.
- Wells over 2,500 meters represented five per cent of natural gas wells drilled and 27 per cent of natural gas production between 2002 and 2007.
- The Natural Gas Deep Drilling Program will provide greater benefits to deeper wells, creating a sliding scale of royalty credit according to depth, up to \$3,750 per meter.

#### *Other clarifications as a result of the unintended consequences analysis*

- Under the New Royalty Framework, four par prices instead of two will be used to calculate royalties on oil, allowing royalties to be charged at a price closer to that received by the producer.
- Natural gas royalty will be calculated based on the sum of vertical drill depth and all laterals, encouraging greater development of coalbed methane. Greater use of laterals may significantly lessen land use and the environmental footprint of CBM development.

Questerre has reviewed the new program as well as the "clarifications" and it has determined that they do not materially alter the impact of the NRF as disclosed in the Company's 2007 annual report.

## **Critical Accounting Estimates**

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. There were no changes to Questerre's critical accounting estimates in the period from those used in the audited financial statements from 2007.

## **Changes in Accounting Policies**

### **Accounting Standard Changes**

As of January 1, 2008 Questerre adopted the new CICA standards, Section 3862 "Financial Instruments – Disclosures", Section 3031 "Inventories" and Section 3863 "Financial Instruments – Presentation", which will replace Section 3861 "Financial Instruments – Disclosure and Presentation". The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

Also effective January 1, 2008, the Company adopted CICA 1535 "Capital Disclosures", which will require additional disclosures of objectives, policies and processes for managing capital. In addition, disclosures will include whether companies have complied with externally imposed capital requirements.

### **Future Accounting Pronouncements**

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

In February 2008, the AcSB issued Handbook Section 3064, Goodwill and Intangible Assets and amended Section 1000, Financial Statement Concepts clarifying the criteria for the recognition of assets, intangible assets and internally developed intangible assets. Items that no longer meet the definition of an asset are no longer recognized with assets. The standard is effective for fiscal years beginning on or after October 1, 2008 and early adoption is permitted. Questerre is currently evaluating the impact this section will have on its results of operations and financial position.

## **Disclosure Controls and Procedures**

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to Questerre's management as appropriate to allow timely decisions regarding required disclosure. Questerre's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the interim filings are being prepared.

Internal controls have been designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements together with the other financial information for external purposes in accordance with Canadian GAAP. The Company's Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision internal controls over financial reporting related to the Company, including its consolidated subsidiaries.

The Company's Chief Executive Officer and Chief Financial Officer are required to cause the Company to disclose here-in any change in the Company's internal control over financial reporting that occurred during the Company's most recent interim period that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. There were no material changes in the Company's internal controls over financial reporting during the quarter ended March 31, 2008.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.