2012 ANNUAL REPORT

QUESTERRE ENERGY CORPORATION

2012

QUESTERRE ENERGY CORPORATION IS LEVERAGING ITS EXPERTISE GAINED THROUGH EARLY EXPOSURE TO SHALE AND OTHER NON-CONVENTIONAL RESERVOIRS.

THE COMPANY HAS BASE PRODUCTION AND RESERVES IN THE TIGHT OIL BAKKEN/TORQUAY OF SOUTHEAST SASKATCHEWAN.

IT IS BRINGING ON PRODUCTION FROM ITS LANDS IN THE HEART OF THE HIGH-LIQUIDS MONTNEY SHALE FAIRWAY.

IT IS A LEADER ON SOCIAL LICENSE TO OPERATE ISSUES FOR ITS GIANT UTICA SHALE GAS DISCOVERY IN QUEBEC.

IN CONJUNCTION WITH A SUPERMAJOR, IT IS AT THE LEADING EDGE OF COMMERCIALIZING A PROVEN PROCESS TO UNLOCK THE MASSIVE RESOURCE POTENTIAL OF OIL SHALE.

QUESTERRE IS A BELIEVER THAT THE FUTURE SUCCESS OF THE OIL AND GAS INDUSTRY DEPENDS ON A BALANCE OF ECONOMICS, ENVIRONMENT AND SOCIETY. WE ARE COMMITTED TO BEING TRANSPARENT AND ARE RESPECTFUL THAT THE PUBLIC MUST BE PART OF MAKING THE IMPORTANT CHOICES FOR OUR ENERGY FUTURE.

QUESTERRE'S COMMON SHARES TRADE ON THE TORONTO STOCK EXCHANGE AND OSLO STOCK EXCHANGE UNDER THE SYMBOL QEC.

PRESIDENT'S MESSAGE

In 2012, we transitioned our business plan to a balanced portfolio of several high-impact projects coupled with conventional producing assets. We began this transition in early 2011, when the Government of Quebec announced an environmental study for our Utica shale gas discovery.

Using the strategy that led us to our discovery in Quebec, we continue to focus on early-stage high-impact projects. We also are using what we have learned as an early participant in shale or tight rock plays. Our experience is that understanding the rocks is essential to developing these plays. Today that means using detailed rock evaluation to find the '4%' in successful tight rock reservoirs. This is based on our belief that only 20% of tight rock resources end up being developed and, of that, only 20% will make superior economics. We believe all of Questerre's projects have successfully targeted the sweet spots that represent the 4% of rock that is most profitable.

Highlights

- Wells testing at approximately 2,000 boe/d created new core area at Kakwa-Resthaven, Alberta for Montney liquids-rich natural gas
- Invested $40.73 million in oil shale to acquire an equity interest in Red Leaf, licensing rights to the EcoShale In-Capsule process and a 20% working interest in oil shale acreage in Wyoming
- Commenced pilot waterflood at Antler, Saskatchewan to increase recovery of light oil reserves
- Tripled proved and probable reserves to 6.72 MMboe from 2.59 MMboe with oil and natural gas liquids accounting for 71% of volumes with an NPV-10 of $126.59 million
- Increased oil weighting generated cash flow from operations of $10.24 million with average daily production of 678 boe/d for the year

Western Canada

After reviewing numerous opportunities, both domestically and internationally, we made a discovery in the high-liquids sweet spot of the prolific Montney natural gas play in Alberta. Based on our initial test results and industry activity in the area, we believe this acreage is in the 4% of the play.

We reinforced this success with an aggressive land acquisition program in early 2013. We now have 45 net sections representing a very dense resource of gas, liquids and condensate. We are working on an independent assessment of our resource and expect this will be completed in the second quarter of this year.

This acreage has the potential to match the magnitude of the resource in Quebec while creating scalable growth in production and cash flow in the near-term. Our first well is on early production and we have been assigned proved and probable reserves for this area of 4.34 MMboe with an NPV-10 of $45 million.

Our main focus for 2013 is developing an infrastructure strategy for this area, both in the short-term and the long-term. Related to this is a development drilling program to meet the expected infrastructure capacity commitments. We expect further delineation drilling with our partners this year and extended production testing will provide the information needed for a larger program next year.

The future development at Kakwa-Resthaven will be funded in part by our light oil assets at Antler. Realizing the full potential of this asset will depend on the success of our waterflood. We started a pilot project in

2012 and based on the encouraging initial results we are expanding it in 2013. With up to 11 gross sections available for waterflood and an estimated 500,000 barrels of incremental reserves per section, we anticipate the waterflood has the potential to materially increase our existing 2 million barrels of reserves at Antler.

Oil Shale Mining

We are on the cusp of commercializing one of the world's largest untapped oil resources with our investment in Red Leaf. The US Geological Survey estimates there are more than ten times the resource in oil shales than in oil sands. Oil shale resources are measured in trillions of barrels rather than billions of barrels.

The French supermajor, Total S.A., has also seen this potential and is the joint venture partner in developing Red Leaf's EcoShale process to extract oil from surface minable oil shales. In full development, this process creates resource projects with the scale of the oil sands but with what we anticipate will be much better environmental outcomes and economics. Just as steam assigned gravity drainage had a significant impact on the oil sands, we are convinced the EcoShale process can have a similar impact on oil shales.

Through our joint venture with Red Leaf in Wyoming and our own acreage in Pasquia Hills, we have been able to acquire significant acreage prospective for oil shale. We are targeting areas with low overburden ratios and high gallon per ton yields. We are again seeking to be in the 4% sweet spots of oil shale plays. While we monitor the development of the EcoShale process, our plans are to validate the scale of the resources with an independent assessment at Pasquia Hills and a core-hole program at Wyoming.

St. Lawrence Lowlands, Quebec

We have retained our long term upside in one of North America's most exciting natural gas discoveries in the Utica shale in Quebec. We continue to invest management time in communicating the advantages of local natural gas development to Quebecers. We remain confident that in the long run this project will be developed because it is so evidently in the best interests of Quebecers both environmentally and economically. Based on 31 well results to date, the only wells that have tested at high rates are on our lands. We believe our lands control the sweet spot in the Utica in Quebec for this reason.

Outlook

With our new high-impact projects, we are very pleased to have built a portfolio of near term, medium term and long term upsides with a balanced mix of large scale natural gas, oil and liquids.

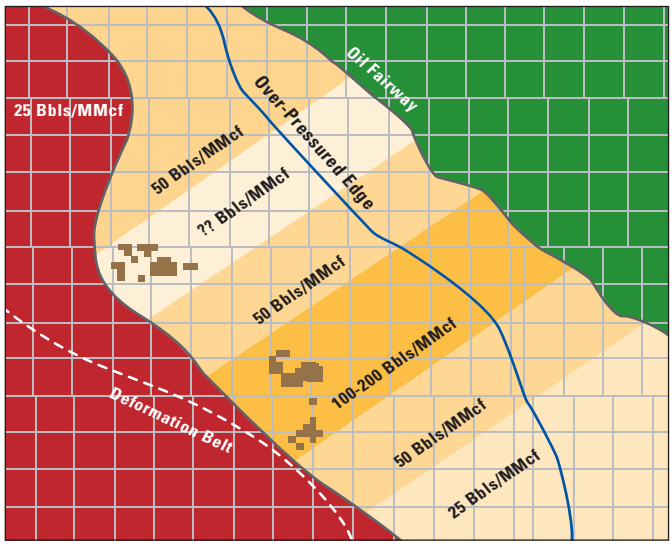
Our light oil assets provide near term production and cash flow with the waterflood as an upside. Our new asset at Kakwa is positioned to create value in the medium term as we accelerate development over the next two to three years. In the interim, it adds incremental production and reserves. In 2014 we are expecting to see the first large scale EcoShale capsule, which with success, will have a material impact on the value of our oil shale resources.

Michael Binnion
President and Chief Executive Officer

Kakwa-Resthaven, Alberta

The Kakwa-Resthaven area is situated approximately 75 kilometres south of Grand Prairie in west central Alberta. Among other zones of interest, the area is prospective for liquids-rich natural gas in the deep, over-pressured fairway of the Montney shale at a depth of approximately 3,100m to 3,600m. Questerre's wells are targeting one of three prospective intervals in the upper Montney formation. Economics for the Montney are enhanced by relatively high liquids content, particularly condensate, and Crown royalty incentives for new deep horizontal gas wells with initial royalty rates of 5%. The Company holds an average 76% working interest in 37,600 acres in this area.

Development of the Montney has historically focused on areas of dry gas or relatively low liquids of approximately 25 bbls/MMcf in British Columbia. Recent activity has targeted a sweet spot where natural gas liquids range between 50 bbls/MMcf to 100 bbls/MMcf. With test rates from its wells as high as 200 bbls/MMcf, the Company's acreage appears to be located in the sweet spot of this liquids-rich fairway. More importantly, liquids from these wells are mainly condensate which retains a premium to light oil and liquids prices as a diluent for heavy oil production in Alberta.



Questerre's acreage in liquids-rich fairway for Montney shale in Alberta

In addition to acquiring land through farm-ins and participation in Crown landsales, the Company spud four (1.55 net) wells in this area during 2012. Two (0.50 net) wells were drilled, completed and tested by year-end, one (0.25 net) that was drilled and completed during the first quarter of 2013 and one (0.8 net) completed with testing planned for April 2013.

The discovery well (the "13-17 Well") flowed 8.3 MMcf/d of natural gas and 1,150 bbl/d of condensate on the last 24 hours of a 96-hour test. Questerre holds a 37.5% interest in this well before payout and a 25% interest in this well after payout. The well was tied into the local gathering system and a third party processing plant and commenced production in early 2013.

The second well (the "14-30 Well") situated one mile to the north of the 13-17 Well flowed 4.97 MMcf/d of natural gas and 974 bbl/d of condensate over the last 24 hours of its 96-hour test. Questerre has a 25% interest in this well.

In 2012, Questerre operated the drilling and completion of its third well in the area (the "15-01 Well"), located approximately six miles south from

Pipeline tie-in of 14-30 Well

its other three wells. The well was successfully completed with a 15-stage fracture stimulation in the 1200m horizontal leg. During initial clean up and testing in early January 2013, equipment failure resulted in an uncontrolled release of completion fluids and gas for approximately 48 hours. During the well control operations, the well flowed at rates of approximately 9 MMcf/d. Liquids rates were not measured due to the well control conditions. The well was subsequently brought under control and is being prepared for additional testing in April 2013. Questerre has a 100% interest in this well before payout and an 80% interest in this well after payout.

The fourth well (the "03-19 Well"), where the Company holds a 25% working interest, was spud in December 2012 and completed and tested in March 2013. Over the last 24 hours of a 161-hour production test, the well flowed 5.83 MMcf/d and 826 bbl/d of condensate.

03-19 Well test completed in March 2013

The joint venture plans to equip the 14-30 Well, the 03-19 Well and future wells with central facilities to allow for condensate separation in the field. It is expected that these facilities will allow the flow of natural gas and liquids to a third party processing plant that is able to handle the remaining liquid volumes associated with these wells.

With production tests supporting significant resource potential in the area, access to infrastructure is essential to development. Questerre is assessing options including commitments to firm service at a third party processing plant upgrade that is scheduled for completion in 2015 and tie-ins to other pipelines. In conjunction, Questerre is also assessing commitments for pipeline, fractionating capacity and long-term marketing arrangements for its production. In the interim, Questerre and its partners have begun engineering work on constructing their own facilities to process natural gas and liquids production.

Subject to equipment availability, extended production tests and available third-party processing capacity, the Company plans to participate in the drilling of approximately three (1.3 net) wells in 2013. The Company is also assessing expanded production facilities to mitigate the impacts of short-term processing capacity constraints.

Antler, Saskatchewan

The Antler area is approximately 200 kilometres from Regina in southeast Saskatchewan. The primary target is high quality light oil from the Bakken/Torquay formation, a dolomitic siltstone shale sequence at a depth of between 1,050 metres and 1,150 metres. Secondary targets include the Souris Valley, a carbonate sequence at a depth of approximately 900 metres to 1,000 metres.

During 2012, Questerre continued development of its light oil pool at Antler through infill drilling and the implementation of a waterflood pilot to increase recovery of the oil in place. Production during the year was impacted by weather and related municipal road bans that effectively shut-in single well batteries and the main battery for a significant portion of the second quarter of 2012.

The Company drilled six (3.75 net) horizontal wells targeting the Torquay/Bakken formation and completed nine (6.25 net) wells including those drilled in the prior year. The Company also drilled two (1.50 net) wells targeting other formations, including the shallower Souris Valley formation and completed another one (0.50 net) Souris Valley well drilled in the prior year. While all the horizontal wells drilled in 2012 have been pipeline connected to the main battery, the Company is evaluating options for production facilities for its Souris Valley wells prior to placing them on stream.

The reservoir at Antler has little water or gas drive, making it an ideal candidate for a waterflood to increase recovery of the oil in place. A waterflood has been successfully implemented at a similar reservoir at the Sinclair field in Manitoba, approximately five miles away from the main pool at Antler. The operator at Sinclair is projecting an increase in recovery from about 9% to between 16% and 24% of the oil in place. Using more conservative increases in projected recovery at Antler of approximately 5% to 10% of the oil in place, Questerre estimates this could add an incremental 500,000 barrels of oil per section gross for very little additional capital.

In the third quarter of 2012, work began on a secondary recovery scheme with the conversion of an existing producing horizontal well to a water injection well. Based on the initial pressure and production responses in adjacent wells, Questerre plans to convert three more wells to injectors in the first half of 2013 to waterflood one and a half sections. It expects additional wells will be converted to injectors later this year with the potential for up to 11 sections in total available for waterflood in the future.

The Company's preliminary plans for the first half of 2013 include the drilling of one horizontal well, the recompletion of another and the expansion of the waterflood. With capital being reallocated to the Kakwa-Resthaven area in 2013, Questerre expects to defer further light oil drilling in Antler pending the results of the waterflood.

Targeting analogs for the producing oil pool at Antler, the Company continued its exploration activities on its adjacent Wawota acreage during the year. One well encountered permeable oil-stained rock in the main Torquay/Bakken formation. It was successfully stimulated but did not produce significant oil on test. Two additional vertical wells were also stimulated and tested for oil in the Souris Valley but were unsuccessful in identifying commercial reservoir. The Company has no immediate plans for further exploration work in the this area.

Oil Shale Mining

The announcement of a strategic environmental assessment in Quebec led Questerre to pursue unconventional oil opportunities. In the fall of 2011, the Company assembled a portfolio of oil shale mining opportunities including prospective acreage and licensing rights to a proprietary technology to produce oil from shale.

Through its equity investment in Red Leaf Resources Inc. ("Red Leaf"), Questerre has acquired an interest in two oil shale projects in Utah and Wyoming. Red Leaf is a private Utah-based oil shale and technology company. Red Leaf's assets are its proprietary EcoShale In-Capsule Technology to recover oil from shale in addition to its oil shale leases in the states of Utah and Wyoming.

Red Leaf's principal oil shale project covers approximately 17,000 acres in the Uintah Basin in southeastern Utah. To demonstrate the commercial scalability of the EcoShale process on this acreage, Red Leaf has joint ventured with a US affiliate of the French-based super major, Total S.A. The joint venture will launch an Early Production

System ("EPS") to prove the technical and environmental attributes of the process at large scale. It follows a successful field pilot that was completed in 2009. Total will fund an 80% share of the EPS expenses estimated at US$200 million. Red Leaf and Total subsequently plan to launch an advanced commercial pilot on their jointly held acreage for oil shale in Utah. Total will also fund an 80% share of the first US$200 million of the commercial production phase of operations. Red Leaf will hold a 50% interest in the project with Total holding the remaining 50% interest.

EcoShale pilot project in Utah

The EcoShale process is designed to extract high quality light oil from mined oil shale in an environmentally sustainable manner. The process involves the mining of shale that is placed in a large clay lined and covered capsule. Expendable heat pipe loops are strategically placed in the capsule with the oil shale. External blowers are used to force the hot flue gas from natural gas burners through the pipe loops to heat the oil shale. Collection pipes are located at the top and bottom of the capsule to recover the natural gas and oil respectively. Produced natural gas from heating the oil shale fuels the burners used to heat other capsules. Upon completion, the pipes in the capsule are sealed and the surface of the capsule is covered with top soil and seeded with native vegetation.

During the year, Red Leaf established the senior joint venture team with Total assigning several key employees including the deputy project manager to the project. Red Leaf also recently appointed a new Chief Executive Officer. Work has been progressing on the front end engineering and design in four key areas: mining and materials handling, capsule construction, processing facilities and site infrastructure. In addition, work is underway on several key risk mitigation tests to de-risk the project. The early tests have been successfully completed. This work is being done in advance of the first commercial-scale capsule in 2014.

Outcrop of the oil shale in Wyoming

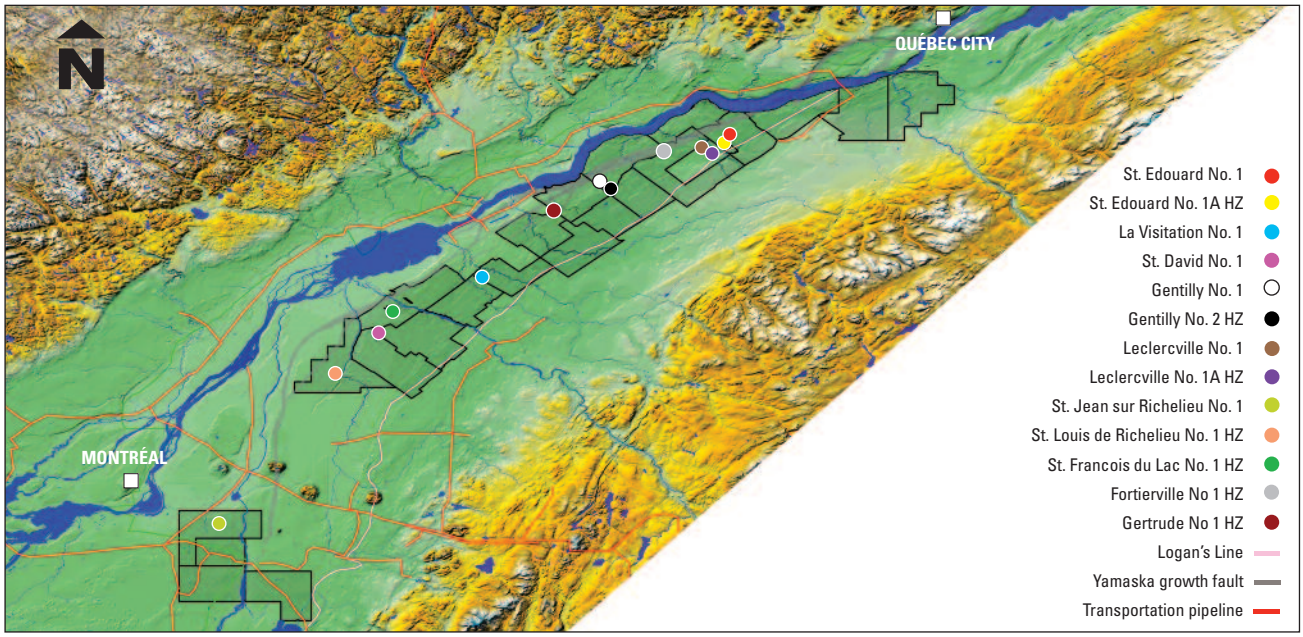
The Company has also entered into a farm-in and participation agreement with Red Leaf to develop 5,120 acres licensed by Red Leaf in the Washakie Basin in southwestern Wyoming. Questerre will participate for a 20% working interest with Red Leaf holding the remaining 80% interest. A work program has been developed to validate an existing resource assessment of the oil shale potential of the lands. Subject to regulatory approval and equipment availability, the joint venture plans a core-hole program for the summer of 2013-2014.

To capture additional resources, Questerre also executed a ten year non-exclusive option agreement to license Red Leaf's EcoShale processes and technology for any project identified by Questerre. Subject to the project meeting the criteria for commerciality, Questerre will pay Red Leaf a fee of US$2 million for each licence issued. Red Leaf will receive a gross overriding royalty on the project on mutually acceptable terms.

To assess its own acreage prospective for oil shale in the Pasquia Hills area of east central Saskatchewan, Questerre conducted a 16 well core-hole program during the year. Approximately 30m to 45m of good quality shale was encountered in all the wells drilled with grades of 10 g/t to 20 g/t and select intervals of up to 16 g/t to 20 g/t within a 20m to 30m section. Based on the core data, the original 100,000 acres has been high-graded to approximately 39,000 net acres. For 2013, Questerre plans to complete analysis of the core data in advance of developing an independent resource assessment.

Acquisition of core-hole data at Pasquia Hills, Saskatchewan

St. Lawrence Lowlands, Quebec



The Lowlands are situated in Quebec, south of the St. Lawrence River between Montreal and Quebec City. The exploration potential of the Lowlands is complemented by proximity to one of the largest natural gas markets in North America and a well-established distribution network.

The area is prospective for natural gas in several horizons with the primary target being the Utica shale. Secondary targets include the shallower Lorraine shale and the deeper Trenton Black-River carbonate. The majority of Questerre's one million gross acres lies in the heart of the fairway between two major geological features — Logan's Line, a subsurface thrust fault to the east and the Yamaska growth fault to the west.

Following a successful vertical test well program in 2008 and 2009, Questerre and its partner, Talisman Energy Inc., began a pilot horizontal well program to assess commerciality of the Utica shale in 2010. The initial results from the first two wells, St. Edouard and Gentilly, drilled in different parts of the fairway met or exceeded

Management's expectations. Two additional horizontal wells, Fortierville and St. Gertrude were also drilled and are awaiting completion.

Based on the preliminary results of the pilot program, Questerre commissioned an independent resource assessment of the Utica shale. Using a range of recovery factors based on more established shale plays, as at December 31, 2010, the prospective resources recoverable for Questerre's net interest is expected to range between 1.46 Tcf and 15.45 Tcf with a best estimate of 4.43 Tcf.

In 2011, the pilot program to assess the commerciality of the Utica shale was suspended while the government initiated a strategic environmental assessment to assess the impacts of shale gas development in the province. The assessment is scheduled to be completed in late 2013.

Questerre's efforts since the announcement of the assessment have focused on securing its social license to operate and develop its discovery in Quebec. This has included supporting the Oil and Gas Services Association of Quebec ("OGSAQ") which promotes the local benefits of developing an oil and gas service sector in the province. During the summer of 2012, with OGSAQ, Questerre helped sponsor a delegation of Quebec farmers to Alberta to learn how resource development can benefit all stakeholders.

Quebec farmers touring Alberta farms with existing oil and gas operations

Questerre expects that any further operations, including the completion of the Fortierville and St. Gertrude horizontal wells, may only be conducted after the oversight committee for the assessment has published its final report in November 2013.

Environmental Stewardship

Questerre is committed to the economic development of our resources in an environmentally conscious and socially responsible manner. We acknowledge that, like all industries, we impact the environment. Although this impact cannot be completely eliminated, we can ensure that our footprint is minimized. Questerre believes in a prudent approach to the sourcing, use and disposal of water for drilling and completion operations in compliance with strict environmental regulations. Wherever possible, we recycle and reuse water. Where produced water cannot be recycled, we dispose of it responsibly at controlled sites in accordance with government regulations.

Our surface rights are shared with stakeholders including the landowners and the government. Horizontal drilling and multi-well pads keep disturbance to a minimum by reducing the number of drilling pads required. Commercial development will use central facilities for drilling, completion and production operations to further reduce surface disturbance. We constantly invest in new technologies and adopt best practices that help us keep our surface footprint to a minimum. Our focus in Quebec is on natural gas, the cleanest fossil fuel. Production close to markets saves on transportation and reduces overall emissions. We support the use of technology to improve efficiencies and reduce emissions from our operations.

Management's Discussion and Analysis ("MD&A") was prepared as of March 27, 2013. This MD&A should be read in conjunction with the audited consolidated financial statements of Questerre Energy Corporation ("Questerre" or the "Company") as at and for the years ended December 31, 2012 and 2011. Additional information relating to Questerre, including Questerre's Annual Information Form for the year ended December 31, 2012 is avcailable on SEDAR at www.sedar.com.

Questerre is an independent energy company focused on non-conventional oil and gas resources. The Company is currently developing a portfolio of oil shale assets in North America. It is securing a social license to commercialize its Utica natural gas discovery in Quebec. The Company is underpinned by light oil and other conventional assets. Questerre is committed to the economic development of its resources in an environmentally conscious and socially responsible manner.

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

Basis of Presentation

Questerre presents figures in the MD&A using accounting policies within the framework of International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. All financial information is reported in Canadian dollars, unless otherwise noted. Certain amounts in prior years have been reclassified to conform to the current year's presentation.

Forward Looking Statements

Certain statements contained within this MD&A, and in certain documents incorporated by reference into this document, constitute forward-looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. We believe the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this MD&A, as the case may be.

This MD&A, and the documents incorporated by reference, contain forward-looking statements pertaining to the following:

- the performance of our oil and natural gas properties;
- the size of our oil, natural gas liquids and natural gas reserves and production levels;
- estimates of future cash flow;
- projections of prices and costs;
- drilling plans and timing of drilling, completion and tie-in of wells by Questerre and its partners;

- weighting of production between different commodities;
- commodity prices, exchange rates and interest rates;
- expected levels of royalty rates, operating costs, general and administrative costs, costs of services and other costs and expenses;
- capital expenditure programs and other expenditures and the timing and method of financing thereof;
- supply of and demand for oil, natural gas liquids and natural gas;
- expectations regarding our ability to raise capital and to continually add to reserves through acquisitions and development;
- our ability to grow or sustain production and reserves through prudent management;
- the emergence of accretive growth opportunities and continued access to capital markets;
- our future operating and financial results;
- schedules and timing of certain projects and our strategy for future growth; and
- treatment under governmental and other regulatory regimes and tax, environmental and other laws.

In particular, this MD&A contains the following forward-looking statements pertaining to the following:

- production volumes;
- timing of drilling programs and resulting cash flows;
- future oil, natural gas liquids and natural gas prices;
- operating costs;
- royalty rates;
- future development, exploration and acquisition activities and related expenditures;
- the amount of future asset retirement obligations; and
- future liquidity and future financial capacity.

With respect to forward-looking statements contained in this MD&A and the documents incorporated by reference herein, we have made assumptions regarding, among other things:

- future oil, natural gas liquids and natural gas prices;
- the continued availability of capital, undeveloped lands and skilled personnel;
- the costs of expanding our property holdings;
- the ability to obtain equipment in a timely manner to carry out exploration, development and exploitation activities;
- the ability to obtain financing on acceptable terms;
- the ability to add production and reserves through exploration, development and exploitation activities; and
- the continuation of the current tax and regulatory regime.

The actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A and the documents incorporated by reference into this document:

- volatility in market prices for oil, natural gas liquids and natural gas;
- counterparty credit risk;
- access to capital;
- changes or fluctuations in oil, natural gas liquids and natural gas production levels;
- liabilities inherent in oil and natural gas operations;
- adverse regulatory rulings, orders and decisions;
- attracting, retaining and motivating skilled personnel;
- uncertainties associated with estimating oil and natural gas reserves;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands, and services;
- incorrect assessments of the value of acquisitions and targeted exploration and development assets;
- fluctuations in foreign exchange or interest rates;
- stock market volatility, market valuations and the market value of the securities of Questerre;
- failure to realize the anticipated benefits of acquisitions;
- actions by governmental or regulatory authorities including changes in royalty structures and programs and income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry;
- limitations on insurance;
- changes in environmental or other legislation applicable to our operations, and our ability to comply with current and future environmental and other laws; and
- geological, technical, drilling and processing problems and other difficulties in producing oil, natural gas liquids and natural gas reserves.

Statements relating to "reserves" or "resources" are by their nature deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future.

Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. We do not undertake any obligation to publicly update or revise any forward-looking statements except as required by applicable securities law. The information set out herein with respect to forecasted 2013 results is "financial outlook" within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding the Company's reasonable expectations as to the anticipated results of its proposed business activities for 2013. Readers are cautioned that this financial outlook may not be appropriate for other purposes.

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. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalent of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

Additional IFRS and Non-IFRS Measures

This document contains the term "cash flow from operations", which is an additional IFRS measure. The Company uses this measure to help evaluate its performance.

As an indicator of Questerre's performance, cash flow from operations should not be considered as an alternative to, or more meaningful than, net cash flow from operating activities as determined in accordance with IFRS. Questerre's determination of cash flow from operations may not be comparable to that reported by other companies. Questerre considers cash flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund operations and support activities related to its major assets.

Cash Flow from Operations Reconciliation

		2012		2011
Net cash from operating activities	$	10,116,671	$	10,595,507
Change in non-cash operating working capital		127,772		(532,570)
Cash flow from operations	$	10,244,443	$	10,062,937

This document also contains the terms "netbacks" and "working capital surplus", which are non-IFRS measures.

The Company considers netbacks a key measure as it demonstrates its profitability relative to current commodity prices. Operating netbacks per boe equals total petroleum and natural gas sales per boe adjusted for royalties per boe and operating expenses per boe.

The Company also uses the term "working capital surplus". Working capital surplus, as presented, does not have any standardized meaning prescribed by IFRS and may not be comparable with the calculation of similar measures for other entities. Working capital surplus, as used by the Company, is calculated as current assets less current liabilities excluding the current portion of the share based compensation liability and risk management contracts.

Select Annual Information

As at/for the years ended December 31	**2012**	2011	2010
Financial ($, except common shares outstanding)			
Petroleum and Natural Gas Sales	**18,842,403**	18,273,083	11,989,713
Cash Flow from Operations	**10,244,443**	10,062,937	4,744,560
Per share - Basic	**0.04**	0.04	0.02
Per share - Diluted	**0.04**	0.04	0.02
Net profit (loss)	**(19,472,060)**	3,901,396	(10,933,885)
Per share - Basic	**(0.08)**	0.02	(0.05)
Per share - Diluted	**(0.08)**	0.02	(0.05)
Capital Expenditures, net of acquisitions and Dispositions	**42,350,395**	40,765,871	38,406,524
Working Capital Surplus	**33,215,954**	104,480,657	136,076,978
Total Assets	**243,365,009**	258,409,889	260,548,991
Shareholders' Equity	**217,456,454**	232,877,970	238,686,128
Common Shares Outstanding	**230,804,204**	231,300,028	234,131,728
Weighted average - basic	**230,913,671**	233,025,712	227,181,288
Weighted average - diluted	**232,774,483**	235,975,196	234,326,194
Operations (units as noted)			
Average Production			
Crude Oil and Natural Gas Liquids (bbl/d)	**580**	491	329
Natural Gas (Mcf/d)	**590**	930	1,738
Total (boe/d)	**678**	646	619
Average Sales Price			
Crude Oil and Natural Gas Liquids ($/bbl)	**86.14**	94.57	77.46
Natural Gas ($/Mcf)	**2.65**	3.91	4.24
Total ($/boe)	**75.95**	77.50	53.07
Netback ($/boe)			
Petroleum and Natural Gas Revenue	**75.95**	77.50	53.07
Royalties Expense	**(5.14)**	(6.60)	(6.89)
Percentage	**7%**	9%	13%
Operating Expense	**(18.05)**	(11.93)	(14.44)
Operating Netback	**52.77**	58.97	31.74
General and Administrative Expense	**(20.82)**	(18.24)	(5.43)
Cash Netback	**38.15**	13.50	18.31
Wells Drilled			
Gross	**15.00**	21.00	15.00
Net	**8.50**	14.77	6.96

Highlights

- Wells testing at approximately 2,000 boe/d created new core area at Kakwa-Resthaven, Alberta for Montney liquids-rich natural gas
- Invested $40.73 million in oil shale to acquire an equity interest in Red Leaf, licensing rights to the EcoShale In-Capsule process and a 20% working interest in oil shale acreage in Wyoming
- Commenced pilot waterflood at Antler, Saskatchewan to increase recovery of light oil reserves
- Tripled proved and probable reserves to 6.72 MMboe from 2.59 MMboe with oil and natural gas liquids accounting for 71% of volumes with an NPV-10 of $126.59 million
- Increased oil weighting generated cash flow from operations of $10.24 million with average daily production of 678 boe/d for the year

2012 Activities

Western Canada

Kakwa-Resthaven, Alberta

The Company began developing a new core area in Kakwa-Resthaven, west central Alberta, targeting liquids-rich natural gas from the Montney formation. In addition to acquiring land through farm-ins and participation in Crown landsales, the Company spud four (1.55 net) wells in this area during the year. A total of two (0.5 net) wells were drilled, completed and tested by year-end, one (0.25 net) that was drilled and completed during the first quarter of 2013 and one (0.8 net) completed with testing planned for April 2013.

The discovery well (the "13-17 Well") was drilled to a measured depth of 5,071m and completed with a 15-stage fracture stimulation in the 1,430m horizontal leg. Over the last 24 hours of a 96-hour test, the well flowed 8.3 MMcf/d of natural gas and 1,150 bbl/d of condensate. Questerre holds a 37.5% interest in this well before payout and a 25% interest in this well after payout. The well was tied into the local gathering system and a third party processing plant and commenced production in early 2013.

The second well (the "14-30 Well") situated one mile to the north of the 13-17 Well was drilled to a measured depth of 4,678m and completed with a 14-stage fracture stimulation in the 1,230m horizontal leg. Over the last 24 hours of a 96-hour production test, the well flowed 4.97 MMcf/d of natural gas and 974 bbl/d of condensate. Questerre has a 25% interest in this well.

Questerre operated the drilling and completion of its third well in the area (the "15-01 Well"), located approximately six miles from its other three wells. The well was successfully completed with a 15-stage fracture stimulation in the 1,200m horizontal leg. During initial clean up and testing in early January 2013, equipment failure resulted in an uncontrolled release of completion fluids and gas for approximately 48 hours. During the well control operations, the well flowed at rates of approximately 9 MMcf/d. Liquids rates were not measured due to the well control conditions. The well was subsequently brought under control and is being prepared for additional testing in April 2013. Questerre has a 100% interest in this well before payout and an 80% interest in this well after payout.

The fourth well (the "03-19 Well"), where the Company holds a 25% working interest, was spud in December 2012 and completed and tested in March 2013. The well was drilled to a measured depth of 4,970m and completed with a 14-stage fracture stimulation in the 1,321m horizontal section. Over the last 24 hours of a 161-hour production test, the well flowed 5.83 MMcf/d of natural gas and 826 bbl/d of condensate.

The well test results disclosed herein are not necessarily indicative of long-term performance or ultimate recovery.

The operator is planning to equip the 14-30 Well and the 03-19 Well with central facilities to allow for condensate separation in the field. It is expected that these facilities will allow the flow of natural gas and liquids to a third party processing plant that is able to handle the remaining liquid volumes associated with these wells.

In the first quarter of 2013, the Company materially expanded its acreage in the Kakwa-Resthaven area and currently holds over 37,600 (29,000 net) acres. In conjunction with its partners and subject to equipment availability, extended production tests and available third-party processing capacity, the Company plans to participate in the drilling of approximately three (1.3 net) wells in 2013. The Company is also assessing expanded production facilities to mitigate the impacts of short-term processing capacity constraints.

Antler, Saskatchewan

During 2012, Questerre continued development of its light oil pool in Antler, Saskatchewan through infill drilling and the implementation of a waterflood pilot to increase recovery of the oil in place.

The Company drilled six (3.75 net) horizontal wells targeting the Torquay/Bakken formation and completed nine (6.25 net) wells, including those drilled in the prior year. The Company also drilled two (1.5 net) wells targeting other formations including the shallower Souris Valley formation and completed another one (0.5 net) Souris Valley well drilled in 2011. While all the horizontal wells drilled in 2012 have been pipeline connected to the main battery, the Company is evaluating options for production facilities for its Souris Valley wells prior to placing them on-stream. Production during the year was impacted by weather and related municipal road bans that effectively shut-in single well batteries and the main battery for a significant portion of the second quarter of 2012.

In the third quarter of 2012, work began on a secondary recovery scheme with the conversion of an existing producing horizontal well to a water injection well. Based on the initial pressure and production responses in adjacent wells, Questerre plans to convert three additional wells to injectors in the first half of 2013 to waterflood one and a half sections. It expects additional wells will be converted to injectors later this year with the potential for up to 11 gross sections in total available for waterflood in the future.

The Company's preliminary plans for the first half of 2013 include the drilling of one horizontal well, the recompletion of another and the expansion of the waterflood. With capital being reallocated to the Kakwa-Resthaven area in 2013, Questerre expects to defer further light oil drilling in Antler pending the results of the waterflood.

Targeting analogs for the producing oil pool at Antler, the Company continued its exploration activities on its adjacent Wawota acreage during the year. One well encountered permeable oil-stained rock in the main Torquay/Bakken formation. It was successfully stimulated but did not produce significant oil on test. Two additional vertical wells were also stimulated and tested for oil in the Souris Valley but were unsuccessful in identifying commercial reservoir. The Company has no immediate plans for further exploration work in the Wawota area.

Other

The Company drilled and completed one oil well in Manyberries, southern Alberta during the second half of 2012. The well was placed on an extended production test late in the fourth quarter of 2012 and is currently producing approximately 30 bbl/d.

Through a farm-out agreement with an industry partner, the Company retained an interest in two (0.7 net) horizontal oil wells in the Pierson area of Manitoba. The wells are currently producing at approximately 70 bbl/d net to Questerre. Questerre plans to participate in the drilling of approximately four (1.4 net) wells on this acreage in 2013.

Oil Shale Mining

As part of its strategy to create shareholder value through new unconventional oil opportunities, the Company developed a portfolio of oil shale assets including prospective acreage and the licensing rights to a proprietary technology to produce oil from shale.

Questerre concluded its letter of intent with Red Leaf Resources Inc. ("Red Leaf"), a private Utah-based oil shale and technology company in the first quarter of 2012. Red Leaf's principal assets are its proprietary EcoShale In-Capsule Technology to recover oil from shale, in addition to its oil shale leases in the states of Wyoming and Utah.

Through participation in a US$100 million equity issue and subsequent transactions, Questerre acquired approximately 6% of the equity capital of Red Leaf for approximately $41 million. It has also partnered with Red Leaf to develop its oil shale acreage in the state of Wyoming and has an option to obtain licenses to utilize the EcoShale In-Capsule process.

To demonstrate the commercial scalability of the EcoShale In-Capsule process on their oil shale acreage in the Uintah Basin in Utah, Red Leaf has joint ventured with a US affiliate of the French-based super-major Total S.A. The joint venture will launch an Early Production System ("EPS") to prove the technical and environmental attributes of the process at large scale. It follows a successful field pilot that was completed in 2009. Total will fund an 80% share of the EPS expenses estimated at US$200 million. Red Leaf and Total subsequently plan to launch an advanced commercial pilot on their jointly held acreage for oil shale in Utah. Total will also fund an 80% share of the first US$200 million of the commercial production phase of operations.

During the year, Red Leaf established the senior joint venture team with Total assigning several key employees to the project including the deputy project manager. Red Leaf also recently appointed a new Chief Executive Officer. Work has been progressing on the front end engineering and design in four key areas: mining and materials handling, capsule construction, processing facilities and site infrastructure. In addition, work is underway on several key risk mitigation tests to de-risk the project. The early tests have been successfully completed. This work is being done in advance of constructing the first commercial-scale capsule in 2014.

In conjunction with the development of its oil shale acreage in Utah, Red Leaf concluded a farm-in and participation agreement with Questerre to develop 5,120 acres licensed by Red Leaf in the Washakie Basin in Wyoming. Questerre will participate for a 20% working interest with Red Leaf holding the remaining 80% interest. A work program has been developed to validate an existing resource assessment of the oil shale potential of the lands. Subject to regulatory approval and equipment availability, the joint venture plans a core-hole program for the summer of 2013-2014.

To assess its own acreage prospective for oil shale in the Pasquia Hills area of east central Saskatchewan, Questerre conducted a 16 well core-hole program during the year. Approximately 30m to 45m of good quality shale was encountered in all the wells drilled with grades of 10 g/t to 20 g/t and select intervals of up to 16 g/t to 20 g/t within a 20m to 35m section. Based on the core data, the acreage has been high-graded to approximately 39,000 net acres. For 2013, Questerre plans to complete analysis of the core data in advance of developing an independent resource assessment.

St. Lawrence Lowlands, Quebec

The pilot program to assess the commerciality of the Utica shale remained suspended in 2012 while the government conducted its strategic environmental assessment ("SEA") on shale gas development in Quebec.

Following the public consultation process, the oversight committee for the SEA recommended that no modern completion operations, in specific hydraulic fracturing, be conducted during the SEA. The committee commissioned several studies on the impacts of shale gas development including the effects on the agriculture, forestry and tourism industries. The committee also visited several Canadian provinces and US states where shale gas is being developed to further their understanding of the industry and its impacts on all stakeholders. In addition, the committee announced the formation of mirror committees to further promote public participation in the process. The mirror committees will focus on four issues: development scenarios, health and the environment, governance and land use, and lastly, social and economic benefits. Consistent with its original timeline, the committee announced that it plans to table its final report no later than November 2013.

In the first quarter of 2013, the Minister of Sustainable Development, Environment and Parks in Quebec ("MDDEP") announced that it plans to refer the study of shale gas development to the province's environmental assessment agency, the Bureau d'audiences publiques sur l'environment. The Minister also announced plans to table legislation that would introduce a moratorium on modern hydraulic fracturing operations and shale gas development in the province.

Questerre expects that any further operations, including the completion of the Fortierville and St. Gertrude horizontal wells will be deferred pending the release of the final report from the SEA and the proposed legislation by MDDEP.

Normal Course Issuer Bid

In December 2011, the Company announced its intention to conduct a Normal Course Issuer Bid ("NCIB") through the facilities of the Toronto Stock Exchange ("TSX") and the Oslo Stock Exchange ("OSE"). Under the terms of the NCIB, Questerre was authorized to acquire up to an aggregate of 11,605,776 of its common shares over the next 12-month period representing approximately 5% of its issued and outstanding common shares as at December 19, 2011. The NCIB commenced on December 22, 2011 and terminated on December 21, 2012.

For the year ended December 31, 2012, a total of 755,824 common shares were purchased at a weighted average price of $0.69 per common share during the year. A total of 78,000 common shares were purchased through the facilities of the TSX at a weighted average price of $0.70 per share and 677,824 common shares were purchased through the facilities of the OSE at a weighted average price of $0.68 per share.

Drilling Activities

In 2012, Questerre participated in the drilling of 15.0 (8.5 net) wells, comprising eight (5.25 net) oil wells in Antler, Saskatchewan, four (1.55 net) liquids-rich natural gas wells in Kakwa-Resthaven, Alberta, two (0.7) oil wells in Pierson, Manitoba and one oil well in Manyberries, Alberta. In 2011, Questerre participated in the drilling of 21.0 (14.77 net) wells, comprising of 20.0 (14.27 net) oil wells in Antler and Wawota in Saskatchewan and one (0.5 net) oil well in Vulcan, Alberta.

Production

	2012			2011		
	Oil and Liquids (bbl/d)	Natural Gas (Mcf/d)	Equivalent (boe/d)	Oil and Liquids (bbl/d)	Natural Gas (Mcf/d)	Equivalent (boe/d)
Saskatchewan	530	-	530	434	-	434
Alberta	36	525	124	57	636	163
Manitoba	13	-	13	-	-	-
British Columbia	-	65	11	-	294	49
	579	590	678	491	930	646

In 2012, increases in oil production in Saskatchewan were offset by natural declines in conventional gas production in Alberta and British Columbia.

Infill drilling at Antler contributed to the increasing oil production in Saskatchewan. The growth in volumes from the province was hampered by weather and related municipal road bans that shut-in production for the majority of the second quarter of the year. Furthermore, the Company's planned drilling program of up to 20.0 (12.0 net) horizontal wells at Antler was reduced to six (3.75 net) wells due to widening differentials from the benchmark West Texas Intermediate ("WTI") price which lowered netbacks and higher capital costs than forecasted.

In addition to the light oil drilling in Saskatchewan, the Company participated in the drilling of one oil well in southern Alberta which was brought on production in December at an average rate of approximately 30 bbl/d. Questerre also retained an interest in two (0.7 net) oil wells in Manitoba that were brought on production in November at a rate of approximately 100 bbl/d net. These wells contributed to crude and natural gas liquids accounting for 86% of corporate volumes in the current year as compared to 76% in the prior year.

The lower natural gas volumes for 2012 relative to 2011 are due to natural declines, reduced volumes from a property divestiture in 2011 and the Company's decision to shut-in production due to low natural gas prices.

Questerre's production in 2012 does not reflect the investment made in developing its liquids-rich natural gas assets in the Kakwa-Resthaven area of Alberta. Due to the high condensate and other natural gas liquids associated with these wells, additional production facilities were being installed at year-end to facilitate production of natural gas through third party processing plants.

For 2013, Questerre plans to further develop its Kakwa-Resthaven acreage through the drilling of approximately three (1.3 net) wells for liquids-rich natural gas. The Company also intends to invest in Antler with the expansion of the waterflood and the drilling of one horizontal well and the recompletion of another. Further drilling in Antler will depend on the results from the waterflood and the capital requirements for the Kakwa-Resthaven area.

2012 Financial Results

Petroleum and Natural Gas Sales

	2012			2011		
	Oil and Liquids	Natural Gas	Total	Oil and Liquids	Natural Gas	Total
Saskatchewan	$ 16,846,973	$ -	$ 16,846,973	$ 15,016,788	$ -	$ 15,016,788
Alberta	1,059,061	508,855	1,567,916	1,923,212	959,571	2,882,783
Manitoba	360,156	-	360,156	-	-	-
British Columbia	-	67,358	67,358	-	373,512	373,512
	$ 18,266,190	$ 576,213	$ 18,842,403	$ 16,940,000	$ 1,333,083	$ 18,273,083

In aggregate, petroleum and natural gas sales in 2012 remained relatively unchanged over the prior year. Higher oil revenue from the increased oil production was offset by lower realized prices. This was further impacted by lower natural gas revenue reflecting both lower realized prices and production volumes.

Pricing

	2012	2011
Benchmark prices:		
Natural Gas - AECO, daily spot ($/Mcf)	2.39	3.63
Crude Oil - Edmonton light ($/bbl)	86.12	95.03
Realized prices:		
Natural Gas ($/Mcf)	2.65	3.91
Crude Oil and Natural Gas Liquids ($/bbl)	86.14	94.57

Consistent with the prior year, crude oil prices remained relatively volatile with the benchmark WTI price trading between US$75/bbl and US$110/bbl. The volatility was driven in part by geopolitical tensions in the Middle East, concerns about the European sovereign debt crisis and the impact of slowing demand in China and North America. In North America, this was compounded by increased volatility in the differential between the benchmark WTI price and the Canadian Mixed Sweet Blend ("MSW") price which traded between a discount of $17.83/bbl to a premium of $5.86/bbl. Questerre expects this differential and its volatility to persist in 2013 while rail and other pipeline initiatives begin to relieve the robust inventories in the mid-continent.

Questerre's realized price for 2012 decreased to $86.14/bbl from $94.57/bbl in 2011, mirroring the decrease in the Edmonton Light price from $95.03/bbl to $86.12/bbl.

To partially mitigate the impact of further volatility in its realized prices, the Company entered into a $103/bbl WTI swap for 150 bbl/d from February to December 2012 and a $99.65/bbl WTI swap for 150 bbl/d for calendar 2013.

Natural gas prices continued to be challenged by persistent supply and limited demand growth. An unusually warm winter in 2012 led to record storage levels and the lowest natural gas prices in ten years. The low natural gas prices, relative to coal, partially tightened the supply demand imbalance with increased demand for power usage throughout the year. Further support came from the reduction in gas-directed drilling rigs over the prior year. Notwithstanding this reduction, further demand growth from the power sector will be necessary along with reductions in gas and associated gas directed drilling to improve prices in the longer term.

Higher heat content gas production from Questerre's assets in Vulcan, southern Alberta contributed to realized prices of $2.65/Mcf in 2012 (2011: $3.91/Mcf) as compared to the benchmark AECO average price of $2.39/Mcf (2011: $3.63/Mcf).

Royalties

		2012		2011
Saskatchewan	$	1,175,934	$	892,492
Alberta		55,664		650,332
Manitoba		42,187		0
British Columbia		119		14,514
	$	1,273,904	$	1,557,338
% of Revenue:				
Saskatchewan		7%		6%
Alberta		4%		23%
Manitoba		12%		0%
British Columbia		0%		4%
Total Company		7%		9%

In 2012, Questerre's effective royalty rate decreased to 7% from 9% in 2011. Excluding royalty credits recorded for Alberta, this decline was less pronounced from 9% in 2011 to 8% in 2012.

The Company's royalty rate on production from Saskatchewan increased to 7% as new wells were drilled on freehold lands with rates ranging from 15% to 18% of production revenue. The majority of Questerre's wells in Saskatchewan are located on Crown lands where it benefits from royalty incentive rates of up to 2.5% of revenue on the first 100,000 barrels of production from horizontal wells. Included in royalties payable in Saskatchewan is the Saskatchewan Resource Surcharge of 1.7% of gross revenue from the province.

Operating Costs

	2012	2011
Saskatchewan	$ 3,331,874	$ 1,493,475
Alberta	1,019,563	803,613
Manitoba	56,278	-
British Columbia	69,116	514,869
	$ 4,476,831	$ 2,811,957
$/boe:		
Saskatchewan	17.15	9.43
Alberta	22.63	13.51
Manitoba	11.90	-
British Columbia	17.23	28.79
Total Company	18.05	11.93

In 2012, operating costs increased from $11.93/boe to $18.05/boe driven largely by higher operating costs in Antler, Saskatchewan.

Higher operating costs at Antler relate to the increased proportion of production from single well batteries, including the Company's acquisition completed in the third quarter of 2011, which is south of the main producing pool. Operating costs associated with single well batteries reflect additional trucking fees, equipment rentals and fuel charges over wells that are generally electrified and tied-in to the main battery. Increased costs were also incurred for minor well servicing and workovers over the prior year. This was compounded by the shut-in of production during the second quarter due to weather and road bans where fixed costs continued to be incurred. In 2013, Questerre is targeting improving operating efficiencies through tie-ins to the main battery and connecting wells to the local electricity grid where possible.

In Alberta, the relatively fixed proportion of costs associated with operating the main battery at Vulcan and the lower production volumes over the prior year accounts for the increase in operating costs on a per unit basis. In British Columbia, the decline in operating costs relate primarily to the sale of the Company's interest in the Beaver River Field in British Columbia in the second quarter of 2011 and shut-in of its Midway production for five months of 2012.

General and Administrative Expenses

	2012	2011
General and administrative expenses, gross	$ 6,567,765	$ 7,396,467
Capitalized expenses and overhead recoveries	(2,349,960)	(2,488,126)
General and administrative expenses, net	$ 4,217,805	$ 4,908,341

Net general and administrative expenses ("G&A") decreased in 2012 to $4.22 million from $4.91 million in the prior year. The decrease in G&A was a result of lower staffing costs, a reduction in legal fees and lower stock exchange fees for 2012.

Other Income and Expenses

Marketable securities represent investments in shares of public companies which are designated as available for sale and are stated at fair value. The Company sold its marketable securities held in 2012 and recorded a realized gain of $0.29 million through net profit and loss. During the year, the Company also recorded an unrealized gain, net of deferred tax, of $1.90 million through other comprehensive income (loss) on this disposition. For 2011, the Company recorded an unrealized loss, net of deferred tax, of $1.61 million.

Changes to the fair value of the Company's risk management contracts are recorded through net profit and loss. For the Company's outstanding risk management contracts at December 31, 2012, the unrealized gain recorded in net profit (loss) for 2012 was $0.40 million (2011: $nil). For the Company's settled risk management contracts at December 31, 2012, the realized gain recorded in net profit (loss) for 2012 was $0.48 million (December 31, 2011: $nil).

Questerre holds investments in private companies which are designated as available for sale and are stated at fair value. For 2012, the Company recorded an unrealized gain, net of deferred tax, of $1.96 million in other comprehensive income (loss) related to these investments.

In 2011, the Company recorded a gain on sale of $4.68 million relating to the sale of its wholly-owned subsidiary, Questerre Beaver River Inc.

In 2012, Questerre's interest income was $1.09 million compared with $1.74 million in 2011. The decrease in interest income is attributable to a lower average cash and cash equivalent balance in 2012 than in the prior year. Interest was earned principally on the net proceeds of the equity issuance completed by Questerre in the first quarter of 2010. The cash is invested in Guaranteed Investment Certificates issued by Canadian chartered banks and credit unions.

Share Based Compensation

Pursuant to the Company's stock option plan, an optionee may request the Company to purchase all or any part of the then vested options of the optionee for an amount equal to the market price of the common shares less the exercise price of the option shares. Notwithstanding the foregoing, the Company may, at its sole discretion, decline to accept and, accordingly, has no obligations with respect to the exercise of a put right at any time. Once the put options are cash settled, the options are cancelled.

Under the plan, fair values are determined at each reporting date using the Black-Scholes option pricing model. Periodic changes in fair value are recognized in profit or loss as share based compensation expense (recovery) with a corresponding change to the liability. Obligations for cash payments are recorded as a share based compensation liability based on the fair value of the liability at the reporting date.

The Company uses the Black-Scholes model to calculate a theoretical value of the options based on the price of its shares, its volatility, risk-free rate and expected life. The expense recorded in 2012 relates to the "floor expense" required in relation to the modification of the Company's stock option plan in January 2011 for the put right. The recovery in 2011 mainly resulted from the decrease in the Company's share price in the year.

Depletion, Depreciation, Impairment and Accretion

Questerre recorded $9.82 million of depletion and depreciation expense for the year ended December 31, 2012 compared to $7.27 million for the same period in 2011. On a per unit basis, the Company's depletion and depreciation expense increased from $30.83/boe in 2011 to $39.57/boe in 2012. This is attributable to higher capital costs relative to reserves additions. The increase in depletion and depreciation is also due to slightly higher production volumes in 2012 of 678 boe/d compared to 646 boe/d in 2011.

The Company recorded $26.33 million for asset impairments in 2012 comprising $21.01 million relating to its exploration and evaluation assets and $5.32 million relating to property, plant and equipment assets.

In 2012, the Company recorded an impairment charge of $19.39 million relating to its Wawota, Saskatchewan exploration and evaluation assets. Based on the results, the Company does not plan to pursue further exploration work in the Wawota area. During 2012, the Company also recorded an impairment charge of $1.61 million for lease expiries of its undeveloped land.

At December 31, 2012, the Company reviewed the carrying amounts of its property, plant and equipment assets for indicators of impairment such as changes in future prices, future costs and reserves. Based on this review, certain of the Company's cash generating units ("CGU's") were tested for impairment in accordance with the Company's accounting policy. The recoverable amount of the CGUs was estimated based on the fair value less costs to sell ("FVLCTS") using a discounted cash flow model. The estimate of FVLCTS was determined using discount rates from 9% to 10% and forecasted cash flows based on proved plus probable reserves, with escalating prices and future development costs obtained from the reserve report after tax. Based on the assessment, for the year ended December 31, 2012, the Company recorded an impairment loss of $5.32 million relating to its Antler, Midway, Vulcan, and Other Alberta CGUs. The factors that led to the impairment were a reduction in forecasted near-term commodity prices and increased capital cost assumptions due to drilling performance.

In 2011, Questerre recorded $6.99 million for asset impairments primarily relating to its Midway CGU exploration and evaluation assets. The Company determined that it has no future plans relating to its Midway CGU due to declining gas prices and as a result recorded an asset impairment charge of $6.38 million.

Deferred Taxes

The recovery of deferred taxes for 2012 was $6.71 million compared to a recovery of $1.03 million in 2011. The higher recovery in 2012 corresponds with the higher impairment expense in the year. Consistent with prior periods, Questerre had sufficient tax pool deductions to offset taxable income in 2012.

Total Comprehensive Income (Loss)

Questerre's total comprehensive loss for 2012 was $16.19 million compared to the Company's total comprehensive income of $2.29 million in 2011. The Company's change in total comprehensive income (loss) is mainly attributable to higher asset impairment charges recorded in 2012 as compared with 2011 and the gain on the sale of the Company's subsidiary recorded in 2011. These changes were partially offset by the unrealized gain recorded in 2012 in respect of the Company's marketable securities and investments.

Capital Expenditures

		2012		2011
Saskatchewan	$	20,843,015	$	34,599,678
Alberta		20,211,022		2,689,156
Quebec		1,118,055		3,055,528
Manitoba		141,310		150,599
British Columbia		59,911		89,671
Corporate		152,082		181,239
		42,525,395		40,765,871
Dispositions		(175,000)		-
Total	$	42,350,395	$	40,765,871

Questerre incurred net capital expenditures of $42.35 million in 2012 as follows:

- $17.61 million in Saskatchewan mainly on drilling and completing wells in Antler. During the year, the Company drilled eight (5.25 net) wells and completed 11.0 (7.5 net) wells. The Company also spent $3.23 million on exploratory work assessing its oil shale acreage at Pasquia Hills, Saskatchewan.
- $17.41 million in its Kakwa-Resthaven lands in Alberta relating to drilling and completion activities. The Company drilled 3.0 (1.63 net) wells and completed two (0.5 net) wells. The Company also invested $2.57 million in Manyberries, Alberta to drill, complete, test and equip one oil well for production.
- In the St. Lawrence Lowlands, Quebec, $1.12 million primarily to secure the Company's social license to operate and develop its Utica shale discovery.

In 2011, the Company incurred capital expenditures of $40.77 million as follows:

- In Saskatchewan, the Company spent $12.89 million on a property acquisition, net of adjustments, and $21.71 million on development activities. In 2011, the Company spud a total of 20.0 (14.27 net) wells in the province.
- $3.06 million was invested in the St. Lawrence Lowlands, Quebec primarily working to securing the Company's social license to operate and to commercialize its Utica shale discovery.
- The $2.69 million spent in Alberta is comprised of the drilling, completing and tie-in of one (0.5 net) oil wells and a farm-in on the Kakwa-Resthaven area.

Liquidity and Capital Resources

Questerre had a working capital surplus of $33.22 million at December 31, 2012 as compared to a surplus of $104.48 million at December 31, 2011. The Company's capital investment program for 2013 is focused on further acquisition and development of its Kakwa-Resthaven, Antler, and Pierson assets. The Company believes it is sufficiently capitalized to fund this program from its working capital surplus, cash flow from operations and available conventional debt facilities.

Cash Flow from Operations

Cash flow from operations was $10.24 million in 2012 compared to $10.06 million in 2011. The Company realized higher net petroleum and natural gas revenue, which were mostly offset by increased operating expenditures.

Cash Flow used in Investing Activities

Cash flow used in investing activities increased from $42.23 million in 2011 to $74.74 million in 2012. The increase from the prior year is mainly due to higher capital expenditures of $14.65 million and Questerre's net investment in Red Leaf of $40.70 million in 2012. This was partially offset by lower property acquisitions than 2011 of $12.89 million and the proceeds received on sale of marketable securities of $5.41 million in 2012.

Cash Flow used in Financing Activities

Cash flow used in financing activities was $0.40 million in 2012 compared to $2.78 million in 2011. The decrease from the prior year is mainly due to lower purchases under the NCIB in 2012 as compared to 2011.

Share Capital

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, 2012, there were no Class B common voting shares or preferred shares outstanding.

The following table provides a summary of the outstanding common shares and options as at the date of the MD&A and the current and preceding year-ends.

	March 27, 2013	December 31, 2012	December 31, 2011
Common shares	234,947,538	230,804,204	231,300,028
Stock options	16,963,335	21,349,169	22,674,169
Weighted average common shares			
Basic		230,913,671	233,025,712
Diluted		232,774,483	235,975,196

Pursuant to the Company's NCIB, 755,824 common shares were purchased for the year ended December 31, 2012 for consideration of $0.52 million. The Company recorded $1.01 million as a reduction to share capital, representing the average cost basis of the acquired shares and $0.49 million to contributed surplus. All transactions have been settled and the common shares have been cancelled and returned to treasury as of December 31, 2012.

A summary of the Company's stock option activity during the years ended December 31, 2012 and 2011 follows:

	December 31, 2012		December 31, 2011	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	22,674,169	$2.27	20,035,835	$2.47
Forfeited	(1,950,000)	2.09	(1,006,666)	1.71
Expired	(255,000)	0.90	(1,105,000)	1.27
Exercised	(260,000)	0.45	(1,470,000)	0.72
Granted	1,140,000	0.68	6,220,000	0.99
Outstanding, end of year	21,349,169	$2.24	22,674,169	$2.27
Exercisable, end of year	12,972,560	$2.48	10,196,237	$2.12

Off-Balance Sheet Arrangements

Questerre has no off-balance sheet arrangements.

Related Party Transactions

Questerre had no related party transactions in 2012.

Commitments and Contingencies

The Company has commitments under a lease for office space of $0.32 million per year for 2013 to 2014 and $0.27 million in 2015. In 2011, Questerre entered into a data licensing agreement. The Company has commitments under the agreement of $0.10 million per year for 2013 to 2015.

The Company is a defendant and plaintiff in a number of legal actions arising in the normal course of business. The Company believes that any liabilities that might arise pertaining to any such matters would not have a material effect on its consolidated financial position.

In 2011, a joint venture partner filed a statement of claim with respect to amounts formally disputed by Questerre. Questerre has filed its statement of defense and counterclaim with respect to this issue. The claim is for $3.91 million and the entire amount is accounted for in the consolidated financial statements.

Risk Management

Companies engaged in the petroleum and natural gas industry face a variety of risks. For Questerre, these include risks associated with exploration and development drilling as well as production operations, commodity prices, exchange and interest rate fluctuations. Unforeseen significant changes in such areas as markets, prices, royalties, interest rates and government regulations could have an impact on the Company's future operating results and/or financial condition. While management realizes that all the risks may not be controllable, they can be monitored and managed.

A significant risk for Questerre as a junior exploration company is access to capital. The Company attempts to secure both equity and debt financing on terms it believes are attractive in current markets. Management also endeavors to seek participants to farm-in on the development of its projects on favorable terms. However, there can be no assurance that the Company will be able to secure sufficient capital if required or that such capital will be available on terms satisfactory to the Company.

As future capital expenditures will be financed out of cash flow from operations, current cash balances, borrowings and possible future equity sales, the Company's ability to do so is dependent on, among other factors, the overall state of capital markets and investor appetite for investments in the energy industry and the Company's securities in particular. To the extent that external sources of capital become limited or unavailable or available on onerous terms, the Company's ability to make capital investments and maintain existing assets may be impaired, and its assets, liabilities, business, financial condition and results of operations may be materially and adversely affected as a result. Based on current funds available, expected cash flow from operations, the Company believes it has sufficient funds available to fund its projected capital expenditures. However, if cash flow from operations are lower than expected or capital costs for these projects exceed current estimates, or if the Company incurs major unanticipated expense related to development or maintenance of its existing properties, it may be required to seek additional capital to maintain its capital expenditures at planned levels. Failure to obtain any financing necessary for the Company's capital expenditure plans may result in a delay in development or production on the Company's properties.

Questerre faces a number of financial risks over which it has no control, such as commodity prices, exchange rates, interest rates, access to credit and capital markets, as well as changes to government regulations and tax and royalty policies.

The Company uses the following guidelines to address financial exposure:

- Internally generated cash flow provides the initial source of funding on which the Company's annual capital expenditure program is based.
- Equity, including flow-through shares, if available on acceptable terms, may be raised to fund acquisitions and capital expenditures.
- Debt may be utilized to expand capital programs, including acquisitions, when it is deemed appropriate and where debt retirement can be controlled.
- Farm-outs of projects may be arranged if management considers that a project requires too much capital or where the project affects the Company's risk profile.

Credit risk represents the potential financial loss to the Company if a customer or counterparty to a financial instrument fails to meet or discharge their obligation to the Company. Credit risk arises from the Company's receivables from joint venture partners and oil and gas marketers. In the event such entities fail to meet their contractual obligations to the Company, such failures may have a material adverse effect on the Company's business, financial condition, results of operations and prospects. Credit risk also arises from the Company's cash and cash equivalents. The Company manages the credit risk exposure by investing in Canadian banks and credit unions. Management does not expect any counterparty to fail to meet its obligations.

Poor credit conditions in the industry may impact a joint venture partner's willingness to participate in the Company's ongoing capital program, potentially delaying the program and the results of such program until the Company finds a suitable alternative partner.

Substantially all of the accounts receivable are with oil and natural gas marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable counterparties and partners.

Accounts receivable related to the sale of the Company's petroleum and natural gas production is paid in the following month from major oil and natural gas marketing companies and the Company has not experienced any credit loss relating to these sales.

Receivables from joint venture partners are typically collected within one to three months after the joint venture bill is issued. The Company mitigates this risk by obtaining pre-approval of significant capital expenditures.

The Company has issued and may continue in the future to issue flow through shares to investors. The Company uses its best efforts to ensure that qualifying expenditures of Canadian Exploration Expense ("CEE") are incurred in order to meet its flow through obligations. However, in the event that the Company incurs qualifying expenditures of Canadian Development Expense ("CDE") or has CEE expenditures reclassified under audit by the Canada Revenue Agency, the Company may be required to liquidate certain of its assets in order to meet the indemnity obligations under the flow through share subscription agreements.

Exploration and development drilling risks are managed through the use of geological and geophysical interpretation technology, employing technical professionals and working in areas where those individuals have experience. For its non-operated properties, the Company strives to develop a good working relationship with the operator and monitors the operational activity on the property. The Company also carries appropriate insurance coverage for risks associated with its operations.

The Company may use financial instruments to reduce corporate risk in certain situations. Questerre's hedging policy is up to a maximum of 40% of total production at management's discretion.

Environmental Regulation and Risk

The oil and natural gas industry is currently subject to environmental regulations pursuant to provincial and federal legislation. Environmental legislation provides for restrictions and prohibitions on releases of emissions and regulation on the storage and transportation of various substances produced or utilized in

association with certain oil and gas industry operations, which can affect the location and operation of wells and facilities and the extent to which exploration and development is permitted. In addition, legislation requires that well and facility sites are abandoned and reclaimed to the satisfaction of provincial authorities. As well, applicable environmental laws may impose remediation obligations with respect to property designated as a contaminated site upon certain responsible persons, which include persons responsible for the substance causing the contamination, persons who caused the release of the substance and any past or present owner, tenant or other person in possession of the site. Compliance with such legislation can require significant expenditures and a breach of such legislation may result in the suspension or revocation of necessary licenses and authorizations, civil liability for pollution damage, the imposition of fines and penalties or the issuance of clean-up orders. The Company mitigates the potential financial exposure of environmental risks by maintaining adequate insurance.

Applicable provincial environmental laws in British Columbia, Alberta, Saskatchewan and Quebec are primarily found in the *Environmental Management Act*, *Environmental Protection and Enhancement Act*, *Environmental Management and Protection Act* 2002, and *Environmental Quality Act*, respectively. Environmental standards and compliance for releases, clean-up and reporting in each province are strict, and there is a range of enforcement actions available, with often severe penalties. All of these provinces review energy projects through environmental assessment processes, which may be held in conjunction with a federal assessment. These review processes involve public participation. Federal environmental laws such as the *Canadian Environmental Protection Act*, 1999 and the *Fisheries Act* also apply in a variety of circumstances. Potential risks to the environment are inherent in some of the business activities of the Company. Questerre endeavors to conduct its operations in a manner consistent with environmental regulations as stipulated in provincial and federal legislation.

Climate change is an issue that is increasingly subject to government regulation. In 2012 Canada announced that it would withdraw from the Kyoto Protocol, established under the United Nations Framework Convention on Climate Change, which set legally binding targets to reduce nationwide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases". Under the Copenhagen Accord, the intended successor to the Kyoto Protocol, which represents a broad political consensus rather than a binding international treaty like the Kyoto Protocol, Canada has committed to reducing its greenhouse gases emissions by 17% from 2005 levels by 2020. British Columbia, Alberta, Saskatchewan, Quebec and the federal Government have all introduced climate change action plans that include various means of achieving emissions or emissions intensity reductions, which may include direct reductions, emissions trading, carbon capture and storage, technology fund contributions, taxes on greenhouse gas emissions and credit for early action. Coordination between these plans has not yet been developed and remains a source of uncertainty. Given the evolving regulatory schemes related to climate change and the control of greenhouse gases and resulting requirements, it is not currently possible to predict the final form these requirements will take or the impact on Questerre and its operations and financial condition at this time.

Critical Accounting Estimates

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. These estimates and judgments have risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Petroleum and Natural Gas Reserves

All of Questerre's petroleum and natural gas reserves are evaluated and reported on by independent petroleum engineering consultants in accordance with Canadian Securities Administrators' National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities* ("NI 51-101"). The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, commodity prices and the timing of future expenditures, all of which are subject to numerous uncertainties and various interpretations. The Company expects that its estimates of reserves will change to reflect updated information. Reserve estimates can be revised upward or downward based on the results of future drilling, testing, production levels and changes in costs and commodity prices. These estimates are evaluated by independent reserve engineers at least annually.

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable and a 50 percent statistical probability that it will be less. The equivalent statistical probabilities for the proven component of proven and probable reserves are 90 percent and 10 percent, respectively.

Reserve estimates impact a number of the areas, in particular, the valuation of property, plant and equipment and the calculation of depletion.

Cash Generating Units

A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretations with respect to the way in which management monitors the operations.

Impairment of Property, Plant and Equipment, Exploration and Evaluation and Goodwill

The Company assesses its oil and gas properties, including exploration and evaluation assets, for possible impairment if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable. Determining if there are facts and circumstances present that indicate that carrying values of the assets may not be recoverable requires management's judgment and analysis of the facts and circumstances.

The recoverable amounts of CGUs have been determined based on the higher of value in use ("VIU") and the FVLCTS. The key assumptions the Company uses in estimating future cash flows for recoverable amounts are anticipated future commodity prices, expected production volumes, the discount rate and future operating and development costs. Changes to these assumptions will affect the recoverable amounts of the CGUs and may require a material adjustment to their related carrying value.

Goodwill is the excess of the purchase price paid over the fair value of the net assets acquired. Since goodwill results from purchase accounting, it is imprecise and requires judgment in the determination of the fair value of assets and liabilities. Goodwill is assessed for impairment on an operating segment level based on the recoverable amount for each CGU of the Company. Therefore, impairment of goodwill uses the same key judgment and assumptions noted above for impairment of assets.

Asset Retirement Obligation

Determination of the asset retirement obligation is based on internal estimates using current costs and technology in accordance with existing legislation and industry practice and must also estimate timing, a risk-free rate and inflation rate in the calculation. These estimates are subject to change over time and, as such, may impact the charge against profit or loss. The liability is recorded at fair value and is adjusted to its present value in subsequent periods and the amount of the accretion is charged to profit or loss in the period. The associated abandonment and retirement costs are capitalized as part of the carrying amount of the related asset. The capitalized amount is depleted on a unit of production basis in accordance with the Company's depletion policy. Changes to assumptions related to future expected costs, risk-free rates and timing may have a material impact on the amounts presented.

Share Based Compensation

The Company has a stock option plan enabling employees, officers and directors to receive common shares or cash at exercise prices equal to the market price or above on the date the option is granted. At each reporting date, the Company uses the Black-Scholes option pricing model as the fair value method for valuing stock options. The assumptions used in the calculation are: the volatility of the stock price, risk-free rates of return and the expected lives of the options. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Changes to assumptions may have a material impact on the amounts presented.

Income Tax Accounting

Deferred tax assets are recognized when it is considered probable that deductible temporary differences will be recovered in the foreseeable future. To the extent that future taxable income and the application of existing tax laws in each jurisdiction differ significantly from the Company's estimate, the ability of the Company to realize the deferred tax assets could be impacted.

The determination of the Company's income and other tax assets and liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax asset and liability may differ significantly from that estimated and recorded by management.

Investment in Red Leaf

Questerre has investments in certain private companies, including its investment in Red Leaf, which it classifies as an available for sale financial instrument and carries at fair value. The Company measures the fair market value of Red Leaf by reference to recent corporate transactions of Red Leaf, or in the absence of such transactions, other valuation techniques such as discounted cash flow analysis. The Company also assesses factors that might indicate that the corporate transaction price might not be representative of fair value at the measurement date. These factors include significant changes in the performance of the investee compared with budgets, plans or milestones, changes in management or strategy and significant changes in the price of oil. Considerable judgment is required in measuring the fair value of the Company's investment in Red Leaf, which may result in material adjustments to its related carrying value.

The Company also exercises judgment in its accounting for Red Leaf and the determination that the Company does not have significant influence over Red Leaf. Significant influence under IFRS represents the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. Although the Company holds less than 20% of the equity of Red Leaf, the threshold for presumption of significant influence under IFRS, the Company's President and Chief Executive Officer is a board member of Red Leaf, which is considered a potential indicator of significant influence. The Company's accounting determination considered certain factors including the fact that the Company holds only one out of nine board seats, other board member composition and representation and Red Leaf's joint venture relationship with another company. Consequently, it was determined that the Company did not have significant influence and this investment has been accounted for as an available for sale financial instrument.

Investment in Convertible Bonds

Questerre has an investment in convertible bonds, which is classified as fair value through profit and loss and carried at fair value. The Company uses its judgment to select the method of valuation and make assumptions that are primarily based on market conditions existing at the end of each reporting period. The Company uses directly and indirectly observable inputs in measuring the fair value of the convertible debt, including quoted commodity prices, volatility, credit spreads and foreign exchange rates.

Accounting Standards Changes

Changes in Accounting Policies for 2012

IFRS 7 Financial Instruments: Disclosures

Effective January 1, 2012, the Company adopted amendments to IFRS 7 that included additional disclosure requirements in the reporting of transfer transactions and risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving the securitization of financial assets. Adopting this accounting change had no impact on the Company's financial statements.

Future Accounting Pronouncements

The following standards and interpretations have not been illustrated as they will only be applied for the first time in future periods. They may result in consequential changes to the accounting policies and other note disclosures. The Company is currently evaluating the impact of adopting these standards on its consolidated financial statements.

IFRS 9 *Financial Instruments*

As at January 1, 2015, the Company will be required to adopt IFRS 9 *Financial Instruments*. IFRS 9 was issued in November 2009 and replaces the current multiple classification and measurement models for debt instruments with a new mixed measurement model having only two classification categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring investments in equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income or loss. Where such equity instruments are measured at fair value through other comprehensive income or loss, dividends are recognized in profit or loss to the extent they do not clearly represent a return of investment, however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive income or loss indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39 *Financial Instruments: Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit or loss would generally be recorded in other comprehensive income or loss.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 revises the definition of control and requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. It also includes guidance related to an investor with decision making rights to determine if it is acting as a principal or agent. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation—Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IAS 27 has been amended to conform to the changes made in IFRS 10 but retains the current guidance for separate financial statements.

IFRS 11 *Joint Arrangements*

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures that are jointly controlled entities. IFRS 11 supersedes IAS 31 Interests in Joint Ventures, and SIC-13 *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

IFRS 12 *Disclosure of Interest in Other Entities*

IFRS 12 establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities. IFRS 12 replaces disclosure requirements previously included in IAS 27, IAS 31 and IAS 28 *Investments in Associates*.

IAS 28 has been amended to conform to the changes made in IFRS 10 and IFRS 11.

IFRS 13 *Fair Value Measurement*

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

The above four standards are effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted, providing the standards are adopted concurrently.

IAS 1 *Presentation of Financial Statements*

In June 2011, the IASB issued an amendment to IAS 1 *Presentation of Financial Statements* requiring companies to group items presented within other comprehensive income or loss based on whether they may be subsequently reclassified to profit or loss. Entities that choose to present other comprehensive income or loss items before tax will be required to show the amount of tax related to the two groups separately. This amendment to IAS 1 is effective for annual periods beginning on or after July 1, 2012 with full retrospective application. Early adoption is permitted.

Design and Evaluation of Internal Controls over Financial Reporting and Disclosure Controls and Procedures

Questerre is required to comply with National Instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Filings" and is required to make specific disclosures with respect to NI 52-109 as follows:

- The Company has designed and evaluated the effectiveness of Disclosure Controls and Procedures ("DC&P"). The President and Chief Executive Officer and the Chief Financial Officer have concluded that DC&P are designed appropriately and are operating effectively as at December 31, 2012.

- The Company has designed and evaluated the effectiveness of Internal Controls over Financial Reporting ("ICFR"). The President and Chief Executive Officer and the Chief Financial Officer completed an assessment of the ICFR and during the process of the assessment, it was determined that certain weaknesses existed in ICFR. The weaknesses are the result of the Company's size and limited number of staff and include: (i) the inability to achieve complete segregation of duties; and (ii) having insufficient staff with the required technical tax knowledge to deal with complex and non-routine matters. The Company believes that these weaknesses are mitigated by: (i) the President and Chief Executive Officer and the Chief Financial Officer overseeing all material transactions; (ii) the audit committee, comprised of independent members of the Board of Directors, reviewing the quarterly interim and annual audited financial statements with management; (iii) the Board of Directors' approval of the financial statements based on the audit committee's recommendation after its review; and (iv) the Company consulting with its third party expert advisors as needed in connection with the recording and reporting of complex and non-routine transactions.
- The Company reports that no changes were made to ICFR during 2012 that have materially affected, or are reasonably likely to materially affect the Company's ICFR.

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.

Fourth Quarter 2012 Results

Questerre's cash flow from operations decreased from $3.15 million for the quarter ended December 31, 2011 to $2.89 million for the same period in 2012. The decrease in cash flow from operations is mainly due to lower oil and natural gas liquids sales prices and higher operating costs, which were partially offset by lower G&A expenses in the quarter.

Oil and natural gas liquids revenue decreased to $5.03 million for the three months ended December 31, 2012 compared to $5.60 million for the same period in 2011. The Company's realized price for oil and natural gas liquids was $83.26/bbl for the fourth quarter of 2012 compared with $97.47/bbl for the fourth quarter of 2011. Oil and natural gas liquids production increased from 625 bbls/d in the fourth quarter of 2011 to 658 bbls/d in the fourth quarter of 2012. The increased production was mainly from the Pierson, Manitoba and southern Alberta wells that were brought on stream in the fourth quarter of 2012. The increased production was partially offset by natural declines from existing assets.

Operating costs increased from $0.79 million or $11.61/boe to $1.40 million or $19.87/boe for the three months ended December 31, 2011 and 2012, respectively. The increase in operating costs is mainly due to minor well servicing and workover expenses recorded in the fourth quarter of 2012 over the prior year.

The Company's G&A was $1.24 million for the fourth quarter of 2011 compared to $0.95 million for the fourth quarter of 2012 mainly due to lower employment costs.

Total comprehensive loss for the 3 months ended December 31, 2012 was $17.16 million compared to $3.90 million for the same period in 2011. The comprehensive loss increase from 2011 is due to higher impairment charges.

Net capital expenditures were $12.98 million and $12.49 million for the three months ended December 31, 2012 and 2011, respectively. In 2012, the Company spent $10.63 million relating to its Kakwa-Resthaven assets and $1.37 million relating to its Manyberries assets. In 2011, the capital expenditures related to the Company's Antler assets and a farm-in on Kakwa-Resthaven.

Quarterly Financial Information

	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
Production (boe/d)	**766**	696	525	725
Average Realized Price ($/boe)	**74.22**	75.64	72.10	80.68
Petroleum and Natural Gas Sales	**5,231,973**	4,842,799	3,444,473	5,323,158
Cash Flow from Operations	**2,898,223**	2,834,293	1,220,773	3,291,154
Per share - Basic	**0.01**	0.01	0.01	0.01
Per share - Diluted	**0.01**	0.01	0.01	0.01
Net Profit (Loss)	**(17,658,572)**	(110,757)	130,555	(1,833,286)
Per share - Basic	**(0.08)**	-	-	(0.01)
Per share - Diluted	**(0.08)**	-	-	-
Capital Expenditures, net of acquisitions and dispositions	**12,981,123**	9,389,246	5,188,353	14,791,673
Working Capital Surplus	**33,215,954**	40,597,138	47,350,400	55,051,962
Total Assets	**243,365,009**	257,813,560	256,759,200	267,006,166
Shareholders' Equity	**217,456,454**	234,846,041	233,859,513	233,136,765
Common Shares Outstanding				
Weighted average - basic	**230,804,204**	230,793,334	230,945,633	231,114,039
Weighted average - diluted	**232,665,015**	232,420,240	232,955,303	232,694,570

	December 31, 2011	September 30, 2011	June 30, 2011	March 31, 2011
Production (boe/d)	743	604	586	650
Average Realized Price ($/boe)	85.42	77.93	77.60	67.78
Petroleum and Natural Gas Sales	5,839,520	4,330,124	4,138,050	3,965,389
Cash Flow from Operations	3,149,746	3,008,565	2,267,676	1,636,950
Per share - Basic	0.01	0.01	0.01	0.01
Per share - Diluted	0.01	0.01	0.01	0.01
Net Profit (Loss)	(4,030,018)	1,758,768	4,938,387	1,234,259
Per share - Basic	(0.02)	0.01	0.02	0.01
Per share - Diluted	(0.02)	0.01	0.02	0.01
Capital Expenditures, net of acquisitions and dispositions	12,490,404	19,726,206	1,305,781	7,243,480
Working Capital Surplus	104,480,657	114,194,728	131,312,369	130,616,809
Total Assets	258,409,889	258,890,553	250,973,021	261,365,161
Shareholders' Equity	232,877,970	236,592,124	234,312,816	232,275,278
Common Shares Outstanding				
Weighted average - basic	232,055,963	232,115,528	233,610,707	234,434,615
Weighted average - diluted	233,991,289	234,382,606	236,472,552	238,509,767

The general trends over the last eight quarters are as follows:

- Production has increased from 646 boe/d for the year ended December 31, 2011 to 678 boe/d for the same period in 2012. Liquids production has increased as a percentage of total production from 76% in 2011 to 86% in 2012.
- The Company's total comprehensive loss for the fourth quarter of 2012 increased due to higher impairment charges.
- The working capital surplus has decreased as the capital expenditures and investment in Red Leaf has been higher than the cash flow from operations.

Management's report

The consolidated financial statements of Questerre Energy Corporation were prepared by management in accordance with International Financial Reporting Standards. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

Management has designed and maintains a system of internal accounting controls that provide reasonable assurance that all transactions are accurately recorded, that the financial statements reliably report the Company's operations and that the Company's assets are safeguarded. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. Such estimates are based on careful judgments made by management.

PricewaterhouseCoopers LLP, an independent chartered accountant firm, was appointed by a resolution of the shareholders to audit the consolidated financial statements of the Company and provide an independent opinion. They have conducted an independent examination of the Company's accounting records in order to express their opinion on the consolidated financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through its Audit Committee. The Audit Committee, which consists of non-management directors, has met with PricewaterhouseCoopers LLP and management in order to determine that management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The Audit Committee has reported its findings to the Board of Directors, who have approved the consolidated financial statements.

Michael Binnion

President and Chief Executive Officer

Jason D'Silva

Chief Financial Officer

Calgary, Alberta, Canada

March 27, 2013

To the Shareholders of Questerre Energy Corporation

We have audited the accompanying consolidated financial statements of Questerre Energy Corporation (the "Company"), which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011 and the consolidated statements of net profit (loss) and comprehensive income (loss), changes in equity and cash flows for the years ended December 31, 2012 and December 31, 2011, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years ended December 31, 2012 and December 31, 2011 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants

Calgary, Alberta

March 27, 2013

Consolidated Balance Sheets

(Canadian dollars)	Note	December 31, 2012	December 31, 2011
Assets			
Current Assets			
Cash and cash equivalents	5	$ 42,540,650	$ 107,566,398
Marketable securities	6	-	3,274,768
Investment in convertible bonds	7	2,064,170	-
Accounts receivable	8	4,944,911	10,431,385
Current portion of risk management contracts	8	399,157	-
Deposits and prepaid expenses		546,288	349,375
		50,495,176	121,621,926
Investments	9	43,101,219	494,506
Property, plant and equipment	10,11	88,817,951	75,462,470
Exploration and evaluation assets	12	45,476,529	51,582,526
Goodwill	13	2,345,944	2,345,944
Deferred tax assets	14	13,128,190	6,902,517
		$ 243,365,009	$ 258,409,889
Liabilities			
Current Liabilities			
Accounts payable and accrued liabilities		$ 16,880,065	$ 17,141,269
Current portion of share based compensation liability	15	1,945,274	2,097,637
		18,825,339	19,238,906
Asset retirement obligation	16	6,644,004	5,805,972
Share based compensation liability	15	439,212	487,041
		25,908,555	25,531,919
Shareholders' Equity			
Share capital	17	307,034,623	307,856,902
Contributed surplus		16,179,385	14,588,016
Accumulated other comprehensive income (loss)		1,668,487	(1,612,967)
Deficit		(107,426,041)	(87,953,981)
		217,456,454	232,877,970
		$ 243,365,009	$ 258,409,889

Commitments and contingencies (note 18)

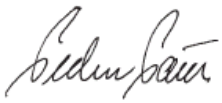
Subsequent events (note 23)

The notes are an integral part of these consolidated financial statements.

Signed on behalf of the Board of Directors

Russ Hammond

Director



Peder Paus

Director

Consolidated Statements of net profit (loss) and comprehensive income (loss)

(Canadian dollars)	Note	For the years ended December 31, 2012	2011
Revenue			
Petroleum and natural gas sales	19	$ 18,842,403	$ 18,273,083
Royalties		(1,273,904)	(1,557,338)
Petroleum and natural gas revenue, net of royalties		17,568,499	16,715,745
Expenses			
Direct operating		4,476,831	2,811,957
General and administrative	20,21	4,217,805	4,908,341
Pre-exploration		99,817	90,151
Gain on risk management contracts	8	(881,942)	-
Gain on divestiture		(220,214)	-
Gain on sale of subsidiary		-	(4,682,182)
Loss on investment in convertible bonds	7	240,248	-
Gain on foreign exchange	7	(80,642)	-
Reclass from OCI relating to marketable securities and investments	6,9	(247,635)	-
Bad debt expense		-	347,834
Depletion and depreciation	10	9,817,624	7,268,902
Impairment of assets	10,12	26,332,916	6,991,632
Accretion of asset retirement obligation	16	130,333	155,667
Share based compensation (recovery)	15	952,978	(2,259,924)
Interest income		1,091,574	1,741,758
Other income (expense)		(1,650)	49,940
Profit (loss) before taxes		(26,179,696)	2,875,065
Deferred taxes (recovery)	14	(6,707,636)	(1,026,331)
Net profit (loss)		(19,472,060)	3,901,396
Other comprehensive income (loss), net of tax			
Gain (loss) on marketable securities and investments	6,9	3,856,545	(1,612,967)
Loss on foreign exchange	9	(327,456)	-
Reclass to profit (loss) relating to marketable securities and investments	6,9	(247,635)	-
		3,281,454	(1,612,967)
Total comprehensive income (loss)		$ (16,190,606)	$ 2,288,429
Net profit (loss) per share			
Basic and diluted	17	$ (0.08)	$ 0.02

The notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Equity

(Canadian dollars)	Note	For the years ended December 31, 2012	2011
Share Capital			
Balance, beginning of year		$ 307,856,902	$ 311,652,770
Options exercised	17	183,700	995,480
Repurchase of shares under normal course issuer bid	17	(1,005,979)	(4,791,348)
Balance, end of year		307,034,623	307,856,902
Contributed Surplus			
Balance, beginning of year		14,588,016	18,888,735
Reclassification of share based compensation	15	1,105,874	(5,779,663)
Repurchase of shares under normal course issuer bid	17	485,495	1,478,944
Balance, end of year		16,179,385	14,588,016
Accumulated Other Comprehensive Income (Loss)			
Balance, beginning of year		(1,612,967)	-
Other comprehensive income (loss)		3,281,454	(1,612,967)
Balance, end of year		1,668,487	(1,612,967)
Deficit			
Balance, beginning of year		(87,953,981)	(91,855,377)
Net profit (loss)		(19,472,060)	3,901,396
Balance, end of year		(107,426,041)	(87,953,981)
Total Shareholders' Equity		$ 217,456,454	$ 232,877,970

The notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

(Canadian dollars)	Note	For the years ended December 31, 2012	2011
Operating Activities			
Net profit (loss)		$ (19,472,060)	$ 3,901,396
Adjustments for:			
Depletion and depreciation	10	9,817,624	7,268,902
Impairment of assets	10,12	26,332,916	6,991,632
Accretion of asset retirement obligation	16	130,333	155,667
Share based compensation (recovery)	15	952,978	(2,259,924)
Unrealized gain on risk management contracts	8	(399,157)	-
Gain on divestiture		(220,214)	-
Gain on sale of subsidiary		-	(4,682,182)
Loss on investment in convertible bonds	7	240,248	-
Gain on foreign exchange	7	(80,642)	-
Reclass from OCI relating to marketable securities and investments	6,9	(247,635)	-
Bad debt expense		-	347,834
Deferred taxes (recovery)	14	(6,707,636)	(1,026,331)
Cash paid on exercise of stock options	15	-	(597,070)
Abandonment expenditures	16	(102,312)	(36,987)
Cash flow from operations		10,244,443	10,062,937
Change in non-cash working capital	22	(127,772)	532,570
Net cash from operating activities		10,116,671	10,595,507
Investing Activities			
Property, plant and equipment expenditures		(17,162,209)	(21,422,475)
Exploration and evaluation expenditures		(25,363,186)	(6,449,488)
Expenditures on acquisitions	11	-	(12,893,908)
Sale of property, plant and equipment		175,000	-
Disposition of subsidiary		-	(705,986)
Proceeds from sale of marketable securities and investments	6,9	7,849,957	-
Purchase of marketable securities	6	-	(2,326,944)
Purchase of investments	9	(43,170,850)	(494,506)
Purchase of convertible bonds	7	(2,223,776)	-
Change in non-cash working capital	22	5,156,129	2,064,696
Net cash used in investing activities		(74,738,935)	(42,228,611)
Financing Activities			
Proceeds from issue of share capital	15	117,000	537,050
Shares repurchased	17	(520,484)	(3,312,404)
Net cash used in financing activities		(403,484)	(2,775,354)
Change in cash and cash equivalents		(65,025,748)	(34,408,458)
Cash and cash equivalents, beginning of year		107,566,398	141,974,856
Cash and cash equivalents, end of year		$ 42,540,650	$ 107,566,398
Cash interest received		$ 1,150,838	$ 1,599,923

The notes are an integral part of these consolidated financial statements.

1. Reporting Entity

Questerre Energy Corporation ("Questerre" or the "Company") is a full cycle exploration and production company. The Company targets scalable high-impact projects and has developed a portfolio of exploration and production assets. The consolidated financial statements of the Company as at and for the years ended December 31, 2012 and 2011 comprise the Company and its wholly-owned subsidiary in those years owned.

Questerre is incorporated under the laws of the Province of Alberta and is domiciled in Canada. The address of its registered office is 1650, 801 – 6th Avenue SW, Calgary, Alberta.

2. Basis of Preparation

a) Statement of compliance

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Boards ("IASB"). The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as at March 27, 2013, the date the Board of Directors approved the statements.

b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for available for sale financial assets, financial assets classified as fair value through profit and loss and share based payment transactions which are measured at fair value with changes in fair value recorded in other comprehensive income or loss or profit or loss.

c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

d) Jointly controlled assets

Many of the Company's oil and natural gas activities involve jointly controlled assets. The consolidated financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

d) Use of estimates and judgments

The preparation of consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. These estimates and judgments have risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Petroleum and natural gas reserves

All of Questerre's petroleum and natural gas reserves are evaluated and reported on by independent petroleum engineering consultants in accordance with Canadian Securities Administrators' National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities* ("NI 51-101"). The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, commodity prices and the timing of future expenditures, all of which are subject to numerous uncertainties and various interpretations. The Company expects that its estimates of reserves will change to reflect updated information. Reserve estimates can be revised upward or downward based on the results of future drilling, testing, production levels and changes in costs and commodity prices. These estimates are evaluated by independent reserve engineers at least annually.

Proven and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 percent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as proven and probable and a 50 percent statistical probability that it will be less. The equivalent statistical probabilities for the proven component of proven and probable reserves are 90 percent and 10 percent, respectively.

Reserve estimates impact a number of the areas, in particular, the valuation of property, plant and equipment and the calculation of depletion.

Refer to Note 10 for carrying amounts of property, plant and equipment.

Cash generating units ("CGU")

A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretations with respect to the way in which management monitors the operations.

Refer to Note 10 for carrying amounts of property, plant and equipment.

Impairment of property, plant and equipment, exploration and evaluation and goodwill

The Company assesses its oil and gas properties, including exploration and evaluation assets, for possible impairment if there are events or changes in circumstances that indicate carrying values of the assets may not be recoverable. Determining if there are facts and circumstances present that indicate that carrying values of the assets may not be recoverable requires management's judgment and analysis of the facts and circumstances.

The recoverable amounts of CGUs have been determined based on the higher of value in use ("VIU") and the fair value less costs to sell ("FVLCTS"). The key assumptions the Company uses in estimating future cash flows for recoverable amounts are anticipated future commodity prices, expected production volumes, the discount rate and future operating and development costs. Changes to these assumptions will affect the recoverable amounts of CGUs and may require a material adjustment to their related carrying value.

Goodwill is the excess of the purchase price paid over the fair value of the net assets acquired. Since goodwill results from purchase accounting, it is imprecise and requires judgment in the determination of the fair value of assets and liabilities. Goodwill is assessed for impairment on an operating segment level based on the recoverable amount for each CGU of the Company. Therefore, impairment of goodwill uses the same key judgment and assumptions noted above for impairment of assets.

Refer to Note 13 for the carrying amounts related to goodwill and Note 10 for the sensitivity analysis related to impairments.

Asset retirement obligation

Determination of the Company's asset retirement obligation is based on internal estimates using current costs and technology in accordance with existing legislation and industry practice and must also estimate timing, a risk-free rate and inflation rate in the calculation. These estimates are subject to change over time and, as such, may impact the charge against profit or loss. The amount recognized is the present value of estimated future expenditures required to settle the obligation using a credit-adjusted risk-free rate. The associated abandonment and retirement costs are capitalized as part of the carrying amount of the related asset. The capitalized amount is depleted on a unit of production basis in accordance with the Company's depletion policy. Changes to assumptions related to future expected costs, risk-free rates and timing may have a material impact on the amounts presented.

Refer to Note 16 for the carrying amounts related to the asset retirement obligation.

Share based compensation

The Company has a stock option plan enabling employees, officers and directors to receive common shares or cash at exercise prices equal to the market price or above on the date the option is granted. At each reporting date, the Company uses the Black-Scholes option pricing model as the fair value method for valuing stock options. The assumptions used in the calculation are: the volatility of the stock price, risk-free rates of return and the expected lives of the options. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Changes to assumptions may have a material impact on the amounts presented.

For further detail on carrying amounts and assumptions refer to Note 15.

Income tax accounting

Deferred tax assets are recognized when it is considered probable that deductible temporary differences will be recovered in the foreseeable future. To the extent that future taxable income and the application of existing tax laws in each jurisdiction differ significantly from the Company's estimate, the ability of the Company to realize the deferred tax assets could be impacted.

The determination of the Company's income and other tax assets or liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax asset or liability may differ significantly from that estimated and recorded by management.

Refer to Note 14 for the carrying amounts related to deferred taxes.

Investment in Red Leaf Resources

Questerre has investments in certain private companies, including the Company's investment in Red Leaf Resources Inc. ("Red Leaf"), which it classifies as an available for sale financial instrument and carries at fair value. The Company measures the fair market value of Red Leaf by reference to recent corporate transactions of Red Leaf, or in the absence of such transactions, other valuation techniques such as discounted cash flow analysis. The Company also assesses factors that might indicate that the corporate transaction price might not be representative of fair value at the measurement date. These factors include significant changes in the performance of the investee compared with budgets, plans or milestones, changes in management or strategy and significant changes in the price of oil. Considerable judgment is required in measuring the fair value of the Company's investment in Red Leaf, which may result in material adjustments to its related carrying value.

The Company also exercises judgment in its accounting for Red Leaf and the determination that the Company does not have significant influence over Red Leaf. Significant influence under IFRS represents the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. Although the Company holds less than 20% of the equity of Red Leaf, the threshold for presumption of significant influence under IFRS, the Company's President and Chief Executive Officer is a board member of Red Leaf, which is considered a potential indicator of significant influence. The Company's accounting determination considered certain factors including the fact that the Company holds only one out of nine board seats, other board member composition and representation and Red Leaf's joint venture relationship with another company. Consequently, it was determined that the Company did not have significant influence and this investment has been accounted for as an available for sale financial instrument.

Refer to Note 9 for the carrying amounts related to the Company's investment in Red Leaf.

Investment in convertible bonds

Questerre has an investment in convertible bonds, which is classified as fair value through profit and loss and carried at fair value. The Company uses its judgment to select the method of valuation and make assumptions that are primarily based on market conditions existing at the end of each reporting period. The Company uses directly and indirectly observable inputs in measuring the fair value of the convertible debt, including quoted commodity prices, volatility, credit spreads and foreign exchange rates.

Refer to Note 7 for the carrying amounts related to the Company's investment in convertible bonds.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

(a) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account.

The acquisition method of accounting is used to account for business combinations that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. Contingent consideration is included in the cost of acquisitions at fair value. Directly attributable transaction costs are expensed in the current period and reported within general and administrative expenses. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of the acquisition is less than the fair value of the net assets acquired, the difference is recognized immediately in profit or loss.

Transactions eliminated on consolidation

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(b) Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

The Company classifies its financial instruments in the following categories, at initial recognition, depending on the purpose for which the instruments were acquired.

Financial assets and liabilities at fair value through profit or loss

A financial asset or liability is classified in this category if it is held for trading. Derivatives are also included in this category unless they are designated as hedges. The Company has designated its convertible bonds and risk management contracts in this category.

Available for sale

Available for sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company has designated its investments in this category.

Available for sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Any unrealized gains or losses from remeasurement are recognized in other comprehensive income or loss. When an available for sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income or loss to profit or loss. Available for sale investments are classified as non-current, unless an investment matures within twelve months, or management expects to dispose of it within twelve months.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise receivables and cash and cash equivalents, and are included in current assets due to their short-term nature. Loans and receivables are recognized initially at the amount expected to be received, less, when material, a discount to reduce loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

Cash and cash equivalents include deposits held with banks, less outstanding cheques and short-term deposits with original maturities of three months or less.

Financial liabilities at amortized cost

Financial liabilities at amortized cost comprise accounts payable and accrued liabilities. Accounts payable and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within twelve months.

(c) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any tax effects.

(d) Property, plant and equipment and exploration and evaluation assets

Recognition and measurement

Exploration and evaluation expenditures

Costs incurred prior to acquiring the legal rights to explore an area are recognized as exploration and evaluation expense in profit or loss.

Exploration and evaluation costs, including the costs of acquiring licenses, exploratory well expenditures, costs to evaluate the commercial potential of underlying resources and directly attributable general and administrative costs, are capitalized as exploration and evaluation assets. The costs are accumulated in cost centres by exploration area pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable based on several factors including the assignment of reserves. A review of each exploration license or field is carried out, at each reporting date, to ascertain whether technical feasibility and commercial viability has been achieved. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to property, plant and equipment.

Development and production costs

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Cost includes all costs required to acquire developed or producing oil and gas properties and to develop oil and gas properties. Development and production assets are grouped into CGUs for impairment testing.

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the property, plant and equipment and are recognized net within (gain) loss on divestures in profit or loss.

Exchanges of properties are measured at fair value, unless the transaction lacks commercial substance or fair value cannot be reliably measured. When the exchange is at fair value, a gain or loss is recognized in profit or loss.

Other property, plant and equipment

Expenditures related to work-overs or betterments that improve the productive capacity or extend the life of an asset are capitalized. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

Depletion and depreciation

The net carrying value of development and production assets is depleted using the unit of production method based on estimated proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. These estimates are evaluated by independent reserve engineers at least annually.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the respective useful lives.

Depreciation methods and useful lives are reviewed at each reporting date.

(e) Goodwill

Goodwill arises on the acquisition of businesses, subsidiaries, associates and joint ventures. Goodwill is measured at cost less accumulated impairment losses. Goodwill is not amortized.

(f) Impairment

Non-financial assets

The carrying amounts of the Company's non-financial assets, other than exploration and evaluation assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated and compared to the carrying amount. For goodwill an impairment test is completed each year or when any indication of impairment exists.

For the purpose of impairment testing, assets are grouped together into CGUs. Goodwill, for the purpose of impairment testing, is assessed for impairment on an operating segment basis. The Company has one operating segment, which is Canada. Exploration and evaluation assets are allocated to related CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their reclassification to producing assets.

The recoverable amount of an asset or a CGU is the greater of its VIU and FVLCTS. FVLCTS is determined using discounted future cash flows of proved and probable reserves using an after tax discount rate for FVLCTS. In determining FVLCTS, recent market transactions are taken into account, if available. In the absence of such transactions, the discounted cash flow model is used. In assessing VIU, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized. Impairment reversals are recognized in profit or loss.

Financial assets

At each reporting date, the company assesses whether there is objective evidence that a financial asset (other than a financial asset classified as fair value through profit or loss) is impaired. The criteria used to determine if objective evidence of an impairment loss include:

(i) significant financial difficulty of the obligor;

(ii) delinquencies in interest or principal payments; and

(iii) it becomes probable that the borrower will enter bankruptcy or other financial reorganization.

For equity securities, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired. If such evidence exists, the company recognizes an impairment loss, as follows:

(i) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

(ii) Available for sale financial assets: The impairment loss is the difference between the original cost of the

asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of income. This amount represents the loss in accumulated other comprehensive income or loss that is reclassified to net income. Available for sale financial assets are tested for impairment on an equity by equity basis.

Impairment losses on financial assets carried at amortized cost and available for sale debt instruments are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available for sale equity instruments are not reversed.

(g) Share based compensation

The Company has issued options to directors, officers and employees. As at January 24, 2011, the Company modified its stock option plan.

Prior to the modification, the Company accounted for its stock option plan using the fair value method. Under this method, compensation costs attributable to stock options granted to employees, officers or directors was measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. The exercise of stock options was recorded as an increase in common shares with a corresponding reduction in contributed surplus.

Under the revised option plan, obligations for payments of cash or common shares under the Company's stock option plan are accrued over the vesting period using fair values. Fair values are determined at each reporting date using the Black-Scholes option pricing model. Periodic changes in fair value are recognized in profit or loss as share based compensation expense (recovery) with a corresponding change to the liability. Obligations for cash payments are recorded as a share based compensation liability based on the fair value of the liability at the reporting date. When options are surrendered for cash, the cash settlement paid reduces the outstanding liability. When options are exercised for common shares, consideration paid by the holder is recorded to share capital in shareholders' equity.

Under both plans, a forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

(h) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Asset retirement obligation

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Asset retirement obligations are measured at the present value of management's best estimate of

expenditure required to settle the present obligation at the balance sheet date. The best estimate of the provision is recorded on a discounted basis using a risk-free interest rate. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as accretion of the asset retirement obligation whereas increases or decreases due to changes in the estimated future cash flows and risk-free rates are adjusted through property, plant and equipment or exploration and evaluation assets. Actual costs incurred upon settlement of the asset retirement obligations are charged against the provision.

(i) Marketable securities

Marketable securities are carried at fair value and unrealized gains or losses are recognized in other comprehensive income or loss in the period incurred.

(j) Inventory

Inventory is recorded at the lower of cost or net realizable value. Cost is determined on a weighted average basis.

(k) Revenue

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is when legal title passes to the external party. Revenue is measured net of royalties. Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(l) Income tax

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax asset will be realized.

The effect of a change in enacted or substantively enacted income tax rates on future income tax assets and liabilities is recognized in profit or loss in the period that the change occurs unless the original entry was recorded to equity.

(m) Net profit or loss per share

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are calculated using the weighted average number of shares outstanding, adjusted for the potential number of shares which may have a dilutive impact on net profit. Potentially dilutive shares include stock options. The weighted average number of diluted shares is calculated in accordance with the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase common shares at the average market price.

Since the options may be settled in cash or shares at the Company's discretion and therefore there is no obligation to settle in cash, the share units are accounted for as equity-settled share based payment transactions and included in diluted profit per share if the effect is dilutive.

4. Changes in Accounting Policies and Disclosures

Changes in accounting policies for 2012

IFRS 7 Financial Instruments: Disclosures

Effective January 1, 2012, the Company adopted amendments to IFRS 7 that included additional disclosure requirements in the reporting of transfer transactions and risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving the securitization of financial assets. Adopting this accounting change had no impact on the Company's financial statements.

Future accounting changes

The following standards and interpretations have not been illustrated as they will only be applied for the first time in future periods. They may result in consequential changes to the accounting policies and other note disclosures. The Company is currently evaluating the impact of adopting these standards on its consolidated financial statements.

IFRS 9 *Financial Instruments*

As at January 1, 2015, the Company will be required to adopt IFRS 9 *Financial Instruments.* IFRS 9 was issued in November 2009 and replaces the current multiple classification and measurement models for debt instruments with a new mixed measurement model having only two classification categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring investments in equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income or loss. Where such equity instruments are measured at fair value through other comprehensive income or loss, dividends are recognized in profit or loss to the extent they do not clearly represent a return of investment, however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive income or loss indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39 *Financial Instruments: Recognition and Measurement,* except that fair value changes due to credit risk for liabilities designated at fair value through profit or loss would generally be recorded in

other comprehensive income or loss.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 revises the definition of control and requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. It also includes guidance related to an investor with decision making rights to determine if it is acting as a principal or agent. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation—Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IAS 27 has been amended to conform to the changes made in IFRS 10 but retains the current guidance for separate financial statements.

IFRS 11 *Joint Arrangements*

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures that are jointly controlled entities. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures*, and SIC-13 *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

IFRS 12 *Disclosure of Interest in Other Entities*

IFRS 12 establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities. IFRS 12 replaces disclosure requirements previously included in IAS 27, IAS 31 and IAS 28 *Investments in Associates*.

IAS 28 has been amended to conform to the changes made in IFRS 10 and IFRS 11.

IFRS 13 *Fair Value Measurement*

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

The above four standards are effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted, providing the standards are adopted concurrently.

IAS 1 *Presentation of Financial Statements*

In June 2011, the IASB issued an amendment to IAS 1 *Presentation of Financial Statements* requiring

companies to group items presented within other comprehensive income or loss based on whether they may be subsequently reclassified to profit or loss. Entities that choose to present other comprehensive income or loss items before tax will be required to show the amount of tax related to the two groups separately. This amendment to IAS 1 is effective for annual periods beginning on or after July 1, 2012 with full retrospective application. Early adoption is permitted.

5. Cash and Cash Equivalents

	December 31, 2012	December 31, 2011
Bank balances	$ 3,422,543	$ 3,120,606
Short-term bank deposits	39,118,107	104,445,792
	$ 42,540,650	$ 107,566,398

6. Marketable Securities

Marketable securities represent investments in shares of public companies. The following table sets out the changes in marketable securities:

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 3,274,768	$ -
Proceeds on sale of subsidiary	-	2,800,000
Purchase of marketable securities	-	2,326,944
Sale of marketable securities	(5,412,122)	-
Gain (loss) on marketable securities	2,137,354	(1,852,176)
Balance, end of year	$ -	$ 3,274,768

For the year ended December 31, 2012, the gain (loss) on marketable securities of $2.14 million (December 31, 2011: $(1.85) million) was recorded in other comprehensive income (loss) net of deferred tax expense (recovery) of $0.24 million (December 31, 2011: $(0.24) million).

7. Investment in Convertible Bonds

In May 2012, Questerre invested in Transeuro Energy Corp. senior secured convertible bonds. They mature May 22, 2015 and have a coupon rate of 12%.

The following table sets out the changes in the investment in convertible bonds:

	December 31, 2012
Balance, beginning of year	$ -
Purchase of convertible bonds	2,223,776
Loss on investment in convertible bonds	(240,248)
Gain on foreign exchange	80,642
Balance, end of year	$ 2,064,170

8. Financial Risk Management and Determination of Fair Values

a) Overview

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as credit risk, liquidity risk and market risk. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure.

b) Fair value of financial instruments

The Company's financial instruments as at December 31, 2012 included cash and cash equivalents, investment in convertible bonds, accounts receivable, risk management contracts, deposits, investments and accounts payable and accrued liabilities. As at December 31, 2012, the fair values of the Company's financial assets and liabilities equaled their carrying values due to the short-term maturity, except for the investment in convertible bonds, investments and the risk management contracts which are recorded at fair value.

Disclosures about the inputs to fair value measurements are required, including their classification within a hierarchy that prioritizes the inputs to fair value measurement.

Level 1 Fair Value Measurements

Level 1 fair value measurements are based on unadjusted quoted market prices.

The Company's marketable securities are considered a level 1 instrument. The fair value of marketable securities are determined by the closing bid price per share as at the balance sheet date multiplied by the number of shares.

Level 2 Fair Value Measurements

Level 2 fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices.

The Company's risk management contracts are considered a level 2 instrument. The Company's financial derivative instruments are carried at fair value as determined by reference to independent monthly forward settlement prices and currency rates.

Level 3 Fair Value Measurements

Level 3 fair value measurements are based on unobservable information.

The Company's investment in convertible bonds is considered a level 3 instrument. The fair values are determined using valuation models where significant inputs are not derived from observable market data.

The Company's investments are considered a level 3 instrument. The fair values are determined by reference to recent corporate transactions of the investee.

The following table sets forth a reconciliation of changes in the fair value of the assets classified as level 3 in the fair value hierarchy during 2012:

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 494,506	$ -
Purchases	45,394,626	494,506
Subscription refund	(2,437,835)	-
Gain recognized through other comprehensive income	1,836,155	-
Loss recognized through net profit (loss)	(122,063)	-
Balance, end of year	$ 45,165,389	$ 494,506

For the year ended December 31, 2012, the Company recorded a net gain relating to level 3 financial instruments of $1.84 million through other comprehensive income (loss) comprising $2.25 million recognized in gain (loss) on marketable securities and investments, $(0.38) million recognized in loss on foreign exchange and $(0.04) million recognized in reclass to profit (loss) relating to marketable securities and investments. For the year ended December 31, 2012, the Company recorded a net loss relating to level 3 financial instruments of $(0.12) million through net profit (loss) comprising $(0.24) million recognized in loss on investment in convertible bonds, $0.08 million recognized in gain on foreign exchange and $0.04 million recognized in reclass from other comprehensive income (loss) relating to marketable securities and investments.

c) Credit risk

Credit risk represents the potential financial loss to the Company if a customer or counterparty to a financial instrument fails to meet or discharge their obligation to the Company. Credit risk arises principally from the Company's receivables from joint venture partners and oil and gas marketers. The carrying amounts of accounts receivable and cash and cash equivalents represent the maximum credit exposure.

Substantially all of the accounts receivable are with oil and natural gas marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable counterparties and partners.

Accounts receivable related to the sale of the Company's petroleum and natural gas production is paid in the following month from major oil and natural gas marketing companies and the Company has not experienced any credit loss relating to these sales.

Receivables from joint venture partners are typically collected within one to three months of the joint venture bill being issued. The Company mitigates this risk by obtaining pre-approval of significant capital expenditures.

The Company's accounts receivables are aged as follows:

	December 31, 2012	December 31, 2011
Current	$ 2,297,324	$ 4,242,644
31 - 60 days	500,961	1,974,946
61 - 90 days	204,240	1,757,635
>90 days	2,036,100	2,549,874
Allowance for doubtful accounts	(93,714)	(93,714)
	$ 4,944,911	$ 10,431,385

The following table provides a reconciliation of the Company's allowance for doubtful accounts:

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 93,714	$ 5,240,034
Joint venture partner allowance	-	761,201
Sale of subsidary	-	(5,907,521)
Balance, end of year	$ 93,714	$ 93,714

The Company does not anticipate any default as it transacts with creditworthy customers and management does not expect any losses from non-performance by these customers. There are no material financial assets that the Company considers past due that are considered impaired.

Cash and cash equivalents include cash bank balances and short-term deposits. The Company manages the credit risk exposure by investing in Canadian banks and credit unions. Management does not expect any counterparty to fail to meet its obligations.

d) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's processes for managing liquidity risk include ensuring, to the extent possible, that it will have sufficient liquidity to meet its liabilities when they become due. The Company prepares annual capital expenditure budgets which are monitored and are updated as required. In addition, the Company requires authorizations for expenditures on projects to assist with the management of capital.

Since the Company operates in the upstream oil and gas industry, it requires sufficient cash to fund capital programs necessary to maintain or increase production, develop reserves and to potentially acquire strategic assets. The Company's capital programs are funded principally by cash obtained through equity issuances and from operating activities. During times of low oil and natural gas prices, a portion of capital programs can generally be deferred, however, due to the long cycle times and the importance to future cash flow in maintaining the Company's production, it may be necessary to utilize alternative sources of capital to continue the Company's strategic investment plan during periods of low commodity prices. As a result, the Company frequently evaluates the options available with respect to sources of long and short term capital resources. Occasionally, to the extent possible, the Company will use derivative instruments to manage cash flow in the event of commodity price declines.

The Company's financial obligations relate to trade and other payables, which consist of invoices payable to trade suppliers relating to the office and field operating activities and its capital spending program. The Company processes invoices within a normal payment period and all amounts are due within the next 12 months.

e) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's profit or loss or the value of the financial instruments. The objective of the Company is to mitigate exposure to these risks while maximizing returns to the Company.

Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted not only by the relationship between the Canadian and United States dollar, but also world economic events that dictate the levels of supply and demand. The Company may enter into oil and natural gas contracts to protect, to the extent possible, its cash flow on future sales. The contracts reduce the volatility in sales revenue by locking in prices with respect to future deliveries of oil and natural gas.

As at December 31, 2012, the Company had the following outstanding commodity risk management contracts in place:

	Volumes	Average Price	Term	Fair Value Asset
WTI NYMEX oil swap	150 bbl/d	$99.65/bbl	Jan. 1, 2013 - Dec. 31, 2013	$ 399,157

The net risk management position is as follows:

	December 31, 2012
Risk Management Assets:	
Current portion	$ 399,157

The unrealized gain recorded in net profit (loss) for the year ended December 31, 2012 was $0.40 million (December 31, 2011: $nil). The realized gain recorded in net profit (loss) for the year ended December 31, 2012 was $0.48 million (December 31, 2011: $nil).

The value of Questerre's commodity price risk management contracts fluctuate with changes in the underlying market price of crude oil. An increase or decrease of $5 to the Canadian dollar West Texas Intermediate ("WTI") price, with all other variables being held constant, would result in a $0.27 million increase or decrease to net profit (loss), respectively.

Currency risk

All of Questerre's petroleum and natural gas sales are denominated in Canadian dollars, however; the underlying market prices for these commodities are impacted by the exchange rate between Canada and the United States. As at December 31, 2012, the Company had no forward foreign exchange contracts in place.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company has had no debt outstanding, interest rate swaps or financial contracts in place at or during the period ended December 31, 2012.

f) Capital management

The Company believes it is well capitalized with positive cash flow from operations (a non-IFRS measure defined as cash flows from operating activities before changes in non-cash operating working capital), no debt and a working capital surplus (defined as current assets less current liabilities excluding the current portion of the share based compensation liability and risk management contracts) of $33.22 million consisting mainly of cash and cash equivalents.

The volatility of commodity prices has a material impact on Questerre's cash flow from operations. Questerre attempts to mitigate the effect of lower prices by shutting in production in unusually low pricing environments, reallocating capital to more profitable areas and reducing capital spending based on results and other market considerations.

The Company considers its capital structure to include shareholders' equity and any outstanding debt. The Company will adjust its capital structure to minimize its cost of capital through the issuance of shares, securing credit facilities and adjusting its capital spending. Questerre monitors its capital structure based on the current and projected cash flow from operations.

	December 31, 2012	December 31, 2011
Shareholders' equity	$ 217,456,454	$ 232,877,970

9. Investments

In March 2012, pursuant to an equity offering, Questerre acquired US$40 million of common shares of Red Leaf. Red Leaf is a private Utah based oil shale and technology based company whose principal assets are its proprietary EcoShale In-Capsule Technology to recover oil from shale in addition to its oil shale leases in the states of Wyoming and Utah. In June 2012, the Company purchased an additional US$3 million of common shares of Red Leaf from a private investor.

In October 2012, pursuant to a backstop agreement between the Company and Red Leaf, Red Leaf refunded US$2.44 million of Questerre's US$40 million subscription in its equity offering completed in March 2012. This was based on the gross proceeds of the equity offering completed by Red Leaf exceeding the minimum offering size.

The Company measured the fair market value of Red Leaf by reference to recent corporate transactions and assessed other factors that might indicate that the transaction price might not be representative of fair value at the measurement date. These factors included significant changes in the performance of Red Leaf compared with budgets, plans or milestones, changes in management or strategy and significant changes in the price of oil. No indicators of impairment were identified.

The investments balance comprises the following private company investments:

	December 31, 2012	December 31, 2011
Red Leaf	$ 42,593,313	$ -
Investment in other private company	507,906	494,506
	$ 43,101,219	$ 494,506

The following table sets out the changes in investments:

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 494,506	$ -
Purchase of investments	43,170,850	494,506
Subscription refund	(2,437,835)	-
Gain on investments	2,250,000	-
Loss on foreign exchange	(376,302)	-
Balance, end of year	$ 43,101,219	$ 494,506

For the year ended December 31, 2012, the loss on foreign exchange relating to investments was $0.38 million (December 31, 2011: $nil), which was recorded in other comprehensive income (loss) net of deferred tax of $0.05 million (December 31, 2011: $nil). For the year ended December 31, 2012, the gain on investments of $2.25 million (December 31, 2011: $nil) was recorded in other comprehensive income (loss) net of deferred tax of $0.29 million (December 31, 2011: $nil).

10. Property, Plant and Equipment

	Oil and Natural Gas Assets	Other Assets	Total
Cost or deemed cost:			
Balance, December 31, 2010	$ 72,543,248	$ 1,579,105	$ 74,122,353
Additions	23,240,878	181,239	23,422,117
Acquisitions	11,338,805	-	11,338,805
Transfer from exploration and evaluation assets	241,741	-	241,741
Disposals	(3,780,304)	(631,464)	(4,411,768)
Balance, December 31, 2011	103,584,368	1,128,880	104,713,248
Additions	17,761,156	152,082	17,913,238
Transfer from exploration and evaluation assets	10,583,398	-	10,583,398
Balance, December 31, 2012	**$ 131,928,922**	**$ 1,280,962**	**$ 133,209,884**
Accumulated depletion, depreciation and impairment losses:			
Balance, December 31, 2010	$ 24,488,470	$ 1,384,476	$ 25,872,946
Depletion and depreciation	7,048,579	126,353	7,174,932
Impairment	614,668	-	614,668
Disposals	(3,780,304)	(631,464)	(4,411,768)
Balance, December 31, 2011	28,371,413	879,365	29,250,778
Depletion and depreciation	9,712,581	105,043	9,817,624
Impairment	5,323,531	-	5,323,531
Balance, December 31, 2012	**$ 43,407,525**	**$ 984,408**	**$ 44,391,933**

	Oil and Natural Gas Assets	Other Assets	Total
Net book value:			
At December 31, 2011	$ 75,212,955	$ 249,515	$ 75,462,470
At December 31, 2012	**$ 88,521,397**	**$ 296,554**	**$ 88,817,951**

During the year ended December 31, 2012, the Company capitalized administrative overhead charges of $0.56 million (December 31, 2011: $0.66 million) including $0.06 million in capitalized stock based compensation expense directly related to development activities (December 31, 2011: $0.04 million). Included in the December 31, 2012 depletion calculation are future development costs of $56.44 million (December 31, 2011: $18.90 million).

At December 31, 2012, the Company reviewed the carrying amounts of its oil and gas assets for indicators of impairment such as changes in future prices, future costs and reserves. Based on this review certain of the Company's CGUs were tested for impairment in accordance with the Company's accounting policy. The recoverable amount of the CGUs was estimated based on the FVLCTS using a discounted cash flow model. The estimate of FVLCTS was determined using discount rates from 9% to 10% and forecasted after-tax cash flows based on proved plus probable reserves, with escalating prices and future development costs obtained from the external engineer.

The future prices used to determine cash flows from crude oil and natural gas reserves are as follows:

	2013	2014	2015	2016	2017	Average Annual % Change Thereafter
WTI (US$/barrel)	92.50	92.50	93.60	95.50	97.40	2%
AECO ($/mmbtu)	3.35	3.85	4.35	4.70	5.10	2%

Based on the assessment, for the year ended December 31, 2012, the Company recorded an impairment loss of $5.32 million relating to its Antler, Midway, Vulcan, and Other Alberta CGUs. The factors that led to the impairment were a reduction in forecasted near-term commodity prices and increased capital cost assumptions due to drilling performance.

For the purpose of impairment testing, the Company assesses goodwill for impairment at the Canada level, which represents the Company's only operating segment. Changes to the assumed discount rate or forward price estimates independently would have the following impact on impairment at the Canada operating segment level:

	One Percent Decrease in the Discount Rate	One Percent Increase in the Discount Rate	Five Percent Increase in the Forward Price Estimates	Five Percent Decrease in the Forward Price Estimates
Impairment of goodwill	$ -	$ -	$ -	$ -
Impairment charge (recovery) of property, plant and equipment	$ (2,948,287)	$ 5,187,884	$ (3,396,202)	$ 7,326,710

11. Property Acquisition

On July 7, 2011, Questerre acquired certain interests in oil properties located in southeast Saskatchewan for total cash consideration of $12.89 million. The consolidated financial statements include the results of operations for the period following the close of the transaction on July 7, 2011. If the properties had been acquired as of January 1, 2011, an additional $1.58 million in petroleum and natural gas revenue, net of

royalties and $0.21 million in operating expenses would have been recognized for the year ended December 31, 2011. Following the close of the transaction, $1.54 million in petroleum and natural gas revenue, net of royalties, and $0.19 million in operating expenses have been recognized in 2011. The impact on net profit (loss) is not readily determinable.

The transaction was accounted for as a business combination using the acquisition method of accounting under IFRS 3, whereby the net assets acquired are recorded at fair value.

The following table summarizes the net assets acquired pursuant to the acquisition:

		December 31, 2011
Fair value of net assets acquired:		
Property, plant and equipment	$	11,590,123
Exploration and evaluation assets		1,555,103
Asset retirement obligation		(251,318)
Net assets acquired	$	12,893,908

12. Exploration and Evaluation Assets

Exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of technical feasibility and commercial viability. Additions represent the Company's share of costs incurred on exploration and evaluation assets during the period.

Reconciliation of the movements in exploration and evaluation assets:

		December 31, 2012		December 31, 2011
Balance, beginning of year	$	51,582,526	$	49,762,437
Additions		25,486,786		6,977,661
Acquisitions		-		1,555,103
Transfers to property, plant and equipment		(10,583,398)		(241,741)
Impairment		(21,009,385)		(6,470,934)
Balance, end of year	$	45,476,529	$	51,582,526

During the year ended December 31, 2012, the Company capitalized administrative overhead charges of $1.52 million (December 31, 2011: $1.62 million), including $(0.04) million of capitalized stock based compensation expense (December 31, 2011: $0.08 million), directly related to exploration and evaluation activities.

In 2012, the Company performed an assessment of the indicators of impairment for its exploration and evaluation properties. Based on the assessment, the Company recorded an impairment charge of $19.39 million relating to its Wawota, Saskatchewan exploration and evaluation assets. As a result of exploratory work performed, the Company does not plan to pursue further activities in the Wawota area. During 2012, the Company also recorded an impairment charge of $1.61 million for lease expiries of its undeveloped land.

13. Goodwill

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 2,345,944	$ 2,467,816
Derecognition of goodwill	-	(121,872)
Balance, end of year	$ 2,345,944	$ 2,345,944

In 2011, the sale of QBR resulted in a derecognition of goodwill of $121,872.

14. Deferred Income Taxes

The tax on the Company's profit (loss) before taxes differs from the amount that would arise using the weighted average tax rate applicable to profits (losses) of the consolidated entities as follows:

	December 31, 2012	December 31, 2011
Profit (loss) before taxes	$ (26,179,696)	$ 2,875,065
Combined federal and provincial tax rate	25.91%	27.32%
Computed "expected" deferred taxes (recovery)	(6,783,159)	785,468
Increase (decrease) in deferred taxes resulting from:		
Non-deductible differences	209,998	(5,128,457)
Rate adjustments	20,678	182,104
Unrecognized deferred tax asset	-	3,009,043
Recognition of previously unrecognized deferred tax asset	(172,563)	-
Other	17,410	125,511
Deferred taxes (recovery)	$ (6,707,636)	$ (1,026,331)

The statutory tax rate decreased to 25.91% in 2012 from 27.32% in 2011 as a result of changes to the weighting of profit (loss) to provinces with different tax rates.

The movement of the deferred tax asset is as follows:

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 6,902,517	$ 9,348,832
Credit to statement of net profit (loss)	6,707,636	1,026,331
Tax credit relating to components of other comprehensive income (loss)	(481,963)	239,209
Sale of subsidiary	-	(3,711,855)
Balance, end of year	$ 13,128,190	$ 6,902,517

The movement in deferred tax assets during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

	Asset retirement obligation	Share issue costs	Non-capital losses	Marketable securities	Other
Deferred tax asset:					
Balance, December 31, 2010	$ 1,827,027	$ 2,180,938	$ 7,715,514	$ -	$ -
Credited (charged) to net profit (loss)	657,985	(875,557)	3,576,699	-	-
Credited to comprehensive income (loss)	-	-	-	239,209	-
Sale of subsidiary	(985,239)	(152)	(1,053,058)	-	-
Balance, December 31, 2011	1,499,773	1,305,229	10,239,155	239,209	-
Credited (charged) to net profit (loss)	221,902	(602,920)	3,744,419	-	276,144
Charged to comprehensive income (loss)	-	-	-	(239,209)	-
Balance, December 31, 2012	**$ 1,721,675**	**$ 702,309**	**$ 13,983,574**	**$ -**	**$ 276,144**

The amount and timing of reversals of temporary differences will be dependent upon, among other things, the Company's future operating results, and acquisitions and dispositions of assets and liabilities.

Deferred income tax assets are recognized for tax loss carry-forwards to the extent that the realization of the related tax benefit through future taxable profits is probable. It is expected that future cash flows, generated from its existing proved and probable reserves, will be sufficient to provide future taxable profits to utilize the deferred tax assets.

Non-capital loss carry-forwards at December 31, 2012 expire from 2014 to 2032.

The movement in deferred tax liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

	Petroleum and natural gas properties	Investments
Deferred tax liability:		
Balance, December 31, 2010	$ 746,547	$ 1,628,100
Charged to statement of net profit (loss)	2,332,796	-
Sale of subsidiary	1,673,406	-
Balance, December 31, 2011	4,752,749	1,628,100
Charged (credited) to statement of net profit (loss)	(3,171,526)	103,434
Charged to comprehensive income (loss)	-	242,755
Balance, December 31, 2012	**$ 1,581,223**	**$ 1,974,289**

Deferred tax assets have not been recognized in respect of the following items:

	December 31, 2012	December 31, 2011
Petroleum and natural gas properites	**$ 56,668**	$ 56,668
Capital losses	**4,239,534**	4,525,613
	$ 4,296,202	$ 4,582,281

The Company does not expect to recover or settle its deferred tax assets and liabilities within the next twelve month period.

15. Share Based Compensation

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

Under the Company's option plan, a put right is included that allows the optionee to settle options with cash or equity. The Company has the option to decline a put right exercise at any time. Under the put right, the optionee will receive the net cash proceeds that is the excess of the closing price at the day of the put notice over the exercise price. Once the options are cash settled, the options are cancelled.

The number and weighted average exercise prices of stock options are as follows:

	December 31, 2012		December 31, 2011	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	22,674,169	$2.27	20,035,835	$2.47
Forfeited	(1,950,000)	2.09	(1,006,666)	1.71
Expired	(255,000)	0.90	(1,105,000)	1.27
Exercised	(260,000)	0.45	(1,470,000)	0.72
Granted	1,140,000	0.68	6,220,000	0.99
Outstanding, end of year	21,349,169	$2.24	22,674,169	$2.27
Exercisable, end of year	12,972,560	$2.48	10,196,237	$2.12

The following table summarizes information about stock options outstanding and exercisable at December 31, 2012:

	Options Outstanding			Options Exercisable		
	Number of Options	Weighted Average Years to Expiry	Weighted Average Exercise Price	Number of Options	Weighted Average Years to Expiry	Weighted Average Exercise Price
$0.45 - $0.53	4,493,334	0.15	$0.45	4,493,334	0.15	$0.45
$0.54 - $1.39	4,330,000	4.09	0.70	106,457	3.69	0.84
$1.40 - $2.79	4,607,500	2.80	2.02	2,741,242	2.65	2.08
$2.80 - $4.22	5,488,335	2.23	4.03	3,201,527	2.23	4.03
$4.23 - $4.70	2,430,000	0.45	4.70	2,430,000	0.45	4.70
	21,349,169	2.09	$2.24	12,972,560	1.28	$2.48

The fair value of the liability was calculated using the Black-Scholes valuation model. The following weighted average assumptions were used in the model for options granted in 2012:

	December 31, 2012	December 31, 2011
Weighted average fair value per award ($)	0.49	0.22
Volatility (%)	93	83
Forfeiture rate (%)	5.35	2.31
Expected life (years)	4.83	2.62
Risk free interest rate (%)	1.36	1.25

This forfeiture rate estimate is adjusted to the actual forfeiture rate. Expected volatility and expected life is based on historical information.

The following table provides a reconciliation of the Company's share based compensation liability:

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 2,584,678	$ -
Amount transferred to contributed surplus modification	-	9,231,368
Amount transferred to contributed surplus	(1,105,874)	(3,451,705)
Share based compensation expense (recovery)	952,978	(2,259,924)
Capitalized share based compensation	19,404	120,439
Reclassification to share capital on exercise of stock options	(66,700)	(458,430)
Cash payment for options surrendered	-	(597,070)
Balance, end of year	$ 2,384,486	$ 2,584,678
Current portion	$ 1,945,274	$ 2,097,637
Non-current portion	439,212	487,041
	$ 2,384,486	$ 2,584,678

The current portion represents the maximum amount of the liability payable within the next 12-month period if all vested options are surrendered for cash settlement.

16. Asset Retirement Obligation

The Company's asset retirement and abandonment obligations result from its ownership interest in oil and natural gas assets. The total asset retirement obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of the asset retirement obligation to be $6.64 million as at December 31, 2012 (December 31, 2011: $5.81 million) based on an undiscounted total future liability of $9.21 million (December 31, 2011: $8.18 million). These payments are expected to be made over the next 38 years. The discount factor, being the risk-free rate related to the liabilities, is between 1.14% and 2.36% (December 31, 2011: 0.95% and 2.49%). An inflation rate of 3% over the varying lives of the assets is used 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, 2012	December 31, 2011
Balance, beginning of year	$ 5,805,972	$ 7,219,342
Revisions due to change in discount rate	120,349	1,029,172
Revisions due to change in estimates	80,355	201,290
Liabilities incurred	654,521	925,596
Liabilities disposed	(45,214)	-
Liabilities acquired	-	251,318
Liabilities settled	(102,312)	(36,987)
Sale of subsidiary	-	(3,939,426)
Accretion	130,333	155,667
Balance, end of year	$ 6,644,004	$ 5,805,972

17. Share Capital

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, 2012, there were no Class B common voting shares or preferred shares outstanding.

a) Issued and outstanding – Class A Common Shares

	Number	Amount
Balance, December 31, 2010	234,131,728	$ 311,652,770
Issued on exercise of options	767,000	995,480
Repurchased under normal course issuer bid	(3,598,700)	(4,791,348)
Balance, December 31, 2011	231,300,028	307,856,902
Issued on exercise of options	260,000	183,700
Repurchased under normal course issuer bid	(755,824)	(1,005,979)
Balance, December 31, 2012	230,804,204	$ 307,034,623

b) Normal course issuer bid

Pursuant to the Company's Normal Course Issuer Bid, 755,824 common shares were purchased for the year ended December 31, 2012 for consideration of $0.52 million. The Company reduced share capital by $1.01 million, representing the average cost basis of the acquired shares and recorded $0.49 million to contributed surplus. All transactions have been settled and the common shares have been cancelled and returned to treasury as of December 31, 2012.

c) Per share amounts

Basic net profit (loss) per share is calculated as follows:

	December 31, 2012	December 31, 2011
Net profit (loss)	$ (19,472,060)	$ 3,901,396
Issued common shares at beginning of year	231,300,028	234,131,728
Options exercised	129,645	572,131
Treasury stock reacquired	(516,002)	(1,678,147)
Weighted average number of common shares outstanding (basic)	230,913,671	233,025,712
Basic net profit (loss) per share	$ (0.08)	$ 0.02

Diluted net profit (loss) per share is calculated as follows:

	December 31, 2012	December 31, 2011
Net profit (loss)	$ (19,472,060)	$ 3,901,396
Weighted average number of common shares outstanding (basic)	230,913,671	233,025,712
Effect of outstanding options	-	2,949,484
Weighted average number of common shares outstanding (diluted)	230,913,671	235,975,196
Diluted profit per share	$ (0.08)	$ 0.02

Under the current stock option plan, options can be exchanged for common shares of the Company or for cash at the Company's discretion. As a result, they are considered potentially dilutive and are included in the calculation of diluted profit per share for the period. The average market value of the Company's shares for purposes of calculating the dilutive effect of options was based on quoted market prices for the period that the options were outstanding. At December 31, 2012, 1,860,812 options (2011: nil) were excluded from diluted weighted average number of common shares outstanding calculation as their effect would have been anti-dilutive.

18. Commitments and Contingencies

The Company has commitments under a lease for office space of $0.32 million per year for 2013 to 2014 and $0.27 million in 2015. In 2011, Questerre entered into a data licensing agreement. The Company has commitments under the agreement of $0.10 million per year for 2013 to 2015.

The Company is a defendant in a number of legal actions arising in the normal course of business. The Company considers the likelihood of such actions to be remote and believes that any liabilities that might arise pertaining to any such matters would not have a material effect on its consolidated financial position.

In 2011, a joint venture partner filed a statement of claim with respect to amounts formally disputed by Questerre. Questerre has filed its statement of defense and counterclaim with respect to this issue. The claim is for $3.91 million and the entire amount is accounted for in the consolidated financial statements.

19. Petroleum and Natural Gas Sales

	December 31, 2012	December 31, 2011
Oil and liquids	$ 18,266,190	$ 16,940,000
Natural gas	576,213	1,333,083
	$ 18,842,403	$ 18,273,083

20. Employee Salaries and Benefits

	December 31, 2012	December 31, 2011
Salaries, bonuses and other short-term benefits	$ 3,352,251	$ 3,525,131
Share based compensation (recovery)	972,382	(2,139,485)
	$ 4,324,633	$ 1,385,646

21. Key Management Compensation

Key management includes directors and officers. The compensation paid or payable to key management is as follows:

	December 31, 2012	December 31, 2011
Salaries, bonuses, director fees and other short-term benefits	$ 2,498,996	$ 2,409,844
Share based compensation	2,070,561	1,759,430
	$ 4,569,557	$ 4,169,274

The Company has entered into written executive employment agreements with each of the officers of the Company. Each of these written agreements provides that in the event of a change of control of the Company, each of the officers is entitled to: (i) the amount, ranging from one to six months of the then applicable base salary, less required withholdings; and (ii) the vesting of all options to purchase common shares.

22. Supplemental Cash Flow Information

Changes in non-cash working capital:

	December 31, 2012	December 31, 2011
Accounts receivable	$ 5,486,474	$ (2,537,004)
Deposits and prepaid expenses	(196,913)	157,749
Inventory	-	344,138
Accounts payable and accrued liabilities	(261,204)	2,497,747
Amounts removed related to sale of subsidiary	-	2,134,636
Change in non-cash working capital	$ 5,028,357	$ 2,597,266
Related to:		
Operating activities	$ (127,772)	$ 532,570
Investing activities	5,156,129	2,064,696
	$ 5,028,357	$ 2,597,266

23. Subsequent Events

In January 2013, Questerre entered into a $98.20/bbl WTI swap for 150 bbl/d from March 1, 2013 to December 31, 2013 and a $94.70/bbl WTI swap for 150 bbl/d for 2014.

CORPORATE INFORMATION

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Peder Paus

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Bjorn Inge Tonnessen

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VP Exploration

Peter Coldham
VP Engineering and
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