Questfire Energy Corp.

Condensed Interim Financial Statements

For the three and nine months ended September 30, 2012

(amounts in Canadian dollars)

(unaudited)

Questfire Energy Corp.
Condensed Interim Balance Sheets
(amounts in Canadian dollars)

(unaudited)

	Notes	September 30, 2012	December 31, 2011
Assets			
Current assets			
Cash and cash equivalents	17	$ 954,613	$ 4,473,765
Accounts receivable	4(c)	145,845	141,875
Deposits and prepaid expenses		36,102	30,000
Total current assets		1,136,560	4,645,640
Non-current assets			
Property and equipment	6	3,374,781	607,648
Exploration and evaluation assets	7	1,879,167	3,390,131
Total non-current assets		5,253,948	3,997,779
Total assets		$ 6,390,508	$ 8,643,419
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	4(d)	$ 439,010	$ 1,920,082
Flow-through share premium	13(e)	668,208	966,970
Total current liabilities		1,107,218	2,887,052
Non-current liabilities			
Decommissioning provisions	9	215,656	128,297
Convertible Class B Shares liability	10	3,881,800	3,638,810
Convertible debentures	11	1,326,613	-
Deferred tax liabilities		570,162	756,069
Total liabilities		7,101,449	7,410,228
Shareholders' Equity			
Share capital	13(b)	4,193,633	4,193,633
Equity component of convertible Class B Shares	10	(2,081,352)	(2,081,352)
Equity component of convertible debentures	11	79,767	-
Warrants	11	28,295	-
Contributed surplus		107,409	25,327
Deficit		(3,038,693)	(904,417)
Total equity attributable to equity holders of the Corporation		(710,941)	1,233,191
Total liabilities and shareholders' equity		$ 6,390,508	$ 8,643,419

Going Concern (note 3)
Commitments (note 19)

See accompanying notes to the condensed interim financial statements.

(Signed) "Richard Dahl", Director

(Signed) "Roger MacLeod", Director

Questfire Energy Corp.

Condensed Interim Statements of Loss and Comprehensive Loss

(amounts in Canadian dollars)

(unaudited)

		Three months ended		Nine months ended	
	Notes	**September 30, 2012**	**September 30, 2011**	**September 30, 2012**	**September 30, 2011**
Revenue					
Oil and natural gas sales		$ 138,123	$ -	$ 296,167	$ -
Royalties		(7,399)	-	(29,291)	-
		130,724	-	266,876	-
Expenses					
Production and operating		49,791	-	123,344	-
Transportation		6,359	-	15,167	-
Write-down of property and equipment	6(d)	124,000	-	124,000	-
Exploration and evaluation		64,624	72,527	1,189,233	97,215
General and administrative		292,592	218,249	853,603	355,482
Stock-based compensation	14(b)	27,360	-	82,082	-
Depletion and depreciation	6	94,468	1,900	198,388	5,800
		659,194	292,676	2,585,817	458,497
		(528,470)	(292,676)	(2,318,941)	(458,497)
Finance income	15	3,604	2,522	10,895	10,407
Finance expense	15	(166,405)	(5,818)	(346,919)	(12,401)
Net finance expense		(162,801)	(3,296)	(336,024)	(1,994)
Loss before income taxes		(691,271)	(295,972)	(2,654,965)	(460,491)
Deferred income tax recovery	12	(123,726)	(31,414)	(520,689)	(31,414)
Loss and comprehensive loss for the period		$ (567,545)	$ (264,558)	$ (2,134,276)	$ (429,077)
Loss per share					
Basic and diluted	13(f)	$ (0.04)	$ (0.03)	$ (0.17)	$ (0.05)

See accompanying notes to the condensed interim financial statements.

Questfire Energy Corp.

Condensed Interim Statements of Changes in Equity

(amounts in Canadian dollars)

(unaudited)

	Notes	Share capital	Equity component of convertible Class B Shares	Equity component of convertible debentures	Warrants	Contributed surplus	Deficit	Total equity
Balance at December 31, 2010		$ 1,573,679	$ -	$ -	$ -	$ -	$ (56,693)	$ 1,516,986
Issuance of Common Shares	13(d)	50,000	-	-	-	-	-	50,000
Loss for the period		-	-	-	-	-	(429,077)	(429,077)
Balance at September 30, 2011		1,623,679	-	-	-	-	(485,770)	1,137,909
Issuance of flow-through Class A Shares	13(e)	3,088,000	-	-	-	-	-	3,088,000
Issuance of flow-through Class B Shares	10	-	(2,081,352)	-	-	-	-	(2,081,352)
Share issuance costs, net of tax	13(b)	(518,046)	-	-	-	-	-	(518,046)
Stock-based compensation related to stock options		-	-	-	-	25,327	-	25,327
Loss for the period		-	-	-	-	-	(418,647)	(418,647)
Balance at December 31, 2011		4,193,633	(2,081,352)	-	-	25,327	(904,417)	1,233,191
Issuance of convertible debenture units, net of issuance costs and income taxes	11	-	-	79,767	28,295	-	-	108,062
Stock-based compensation related to stock options	14(b)	-	-	-	-	82,082	-	82,082
Loss for the period		-	-	-	-	-	(2,134,276)	(2,134,276)
Balance at September 30, 2012		$ 4,193,633	$ (2,081,352)	$ 79,767	$ 28,295	$ 107,409	$ (3,038,693)	$ (710,941)

See accompanying notes to the condensed interim financial statements.

Questfire Energy Corp.

Condensed Interim Statements of Cash Flows

(amounts in Canadian dollars)

(unaudited)

	Notes	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Cash and cash equivalents provided by (used in):					
Cash flows from (used in) operating activities					
Loss for the period		$ (567,545)	$ (264,558)	$ (2,134,276)	$ (429,077)
Adjustments for:					
Depletion and depreciation	6	94,468	1,900	198,388	5,800
Deferred income tax recovery	12	(123,726)	(31,414)	(520,689)	(31,414)
Exploration and evaluation impairment	7	-	-	999,309	-
Write-down of property and equipment	6(d)	124,000	-	124,000	-
Net finance expense	15	162,801	3,296	336,024	1,994
Stock-based compensation	14(b)	27,360	-	82,082	-
Change in non-cash working capital	5	(76,354)	36,821	(59,338)	582
Net cash used in operating activities		(358,996)	(253,955)	(974,500)	(452,115)
Cash flows from (used in) investing activities					
Additions to exploration and evaluation assets	7	(761,232)	(258,669)	(2,314,673)	(534,363)
Additions to property and equipment	6	(15,871)	-	(178,391)	-
Interest received	15	3,604	2,522	10,895	10,407
Change in non-cash working capital	5	75,344	104,175	(1,437,626)	92,325
Net cash used in investing activities		(698,155)	(151,972)	(3,919,795)	(431,631)
Cash flows from (used in) financing activities					
Proceeds from issuance of common shares	13(d)	-	50,000	-	50,000
Proceeds from issuance of convertible debenture units	11	-	-	1,510,000	-
Issuance costs	11	-	-	(65,503)	-
Deferred financing charges		-	(243,268)	-	(243,268)
Interest paid	15	(56,413)	(5,818)	(75,174)	(12,401)
Change in non-cash working capital	5	(54,491)	215,473	5,820	221,056
Net cash from (used in) financing activities		(110,904)	16,387	1,375,143	15,387
Change in cash and cash equivalents		(1,168,055)	(389,540)	(3,519,152)	(868,359)
Cash and cash equivalents, beginning of period		2,122,668	1,022,743	4,473,765	1,501,562
Cash and cash equivalents, end of period		$ 954,613	$ 633,203	$ 954,613	$ 633,203

See accompanying notes to the condensed interim financial statements.

1. General business description

Questfire Energy Corp. ("Questfire" or the "Corporation") was incorporated under the laws of Alberta on January 15, 2010. The Corporation is engaged in the exploration for and development and production of oil and natural gas and may conduct its activities jointly with others; these financial statements reflect only the Corporation's proportionate interest in such activities. The Class A Shares and Class B Shares of the Corporation are listed on the TSX Venture Exchange (TSX-V). The address and principal place of business of the Corporation is Suite 400, 703 – 6th Ave S.W., Calgary, Alberta, T2P 0T9.

The condensed interim financial statements were authorized for issuance by the Board of Directors on November 27, 2012.

2. Basis of preparation

Statement of compliance

These condensed interim financial statements were prepared following the same accounting policies and methods of computation as the audited financial statements for the year ended December 31, 2011. They were prepared in accordance with International Accounting Standard (IAS) 34, "Interim Financial Reporting" as issued by the International Accounting Standards Board (IASB). Accordingly, certain financial information and disclosure normally included in annual financial statements prepared in accordance with International Financial Reporting Standards (IFRS) has been omitted or condensed. The disclosure provided herein is incremental to the disclosure included in the annual financial statements. The condensed interim financial statements should be read in conjunction with Questfire's annual audited financial statements for the year ended December 31, 2011.

3. Going concern

These financial statements were prepared on the going-concern assumption that the Corporation will be able to realize its assets and discharge its liabilities in the normal course of operations. At September 30, 2012, the Corporation has working capital of $697,550 (excluding the flow-through share premium), but has $3,761,761 (note 19(c)) of flow-through share expenditures to incur by no later than December 31, 2012. The Corporation has indemnified flow-through subscribers for their income taxes payable as a result of any deficiency in flow-through share renouncements ultimately made by the Corporation. These factors cast significant doubt on the Corporation's ability to continue as a going concern. The Corporation's ability to continue as a going concern and to meet its flow-through share obligations depends upon its ability to attain profitable operations and to generate funds there from and/or financing from third parties sufficient to meet future obligations. There is no guarantee that management will be able to raise funds sufficient to meet its flow-through share obligations. These financial statements do not reflect the adjustments that would be necessary to the presentation and carrying amounts of the assets and liabilities if the Corporation were not able to continue operations and such adjustments and reclassifications could be material.

4. Financial instruments and risk management

(a) Risk management overview

The Corporation's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk. This note presents information about the Corporation's exposure to each of the above risks, the Corporation's objectives, policies and processes for measuring and managing risk, and the Corporation's management of capital. Further quantitative disclosure is included throughout this document. The Corporation employs risk management strategies and polices to ensure that risk exposure complies with the Corporation's business objectives and risk tolerance. While the Board of Directors has overall responsibility for the Corporation's risk management framework, Questfire's management administers and monitors these risks.

(b) Fair value of financial instruments

The fair values of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their carrying value due to the short-term maturity of those instruments. The fair value of the convertible debentures is approximated by their carrying value given interest rates the Corporation believes it would currently have to pay on an instrument with similar terms.

The fair value of convertible Class B Shares at September 30, 2012 was determined to be $1,222,848 based on the market price of $2.20 per Class B Share on that date.

The fair value of financial derivatives, including commodity contracts, if any, is determined by discounting the difference between the contracted prices and published forward price curves as at the balance sheet date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate adjusted for the Corporation's non-performance risk and the non-performance risk of the counterparty.

The significance of inputs used in making fair-value measurements is examined and classified according to a fair-value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly, and are based on valuation models and techniques where the inputs are derived from quoted indices. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

Cash and cash equivalents are measured at fair value based on their Level 1 designation. Derivative financial instruments, including commodity contracts, if any, are measured at fair value based on a Level 2 designation.

(amounts in Canadian dollars)

(c) Credit risk

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Corporation is exposed to credit risk with respect to accounts receivable and cash and cash equivalents.

Substantially all of the Corporation's accounts receivable are due from purchasers of Questfire's oil and natural gas production, joint venture partners and government agencies and are subject to normal industry credit risk. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Corporation mitigates the credit risk associated with the marketing of its petroleum and natural gas production by establishing the marketing relationships with large, credit-worthy purchasers.

Significant changes in industry conditions and risks that weaken partners' ability to generate cash flow will increase collection risk. Management of Questfire believes the risk is mitigated by the size and reputation of the companies to which the Corporation extends credit. Questfire's management believes all receivables will be collected.

As at September 30, 2012 and December 31, 2011, the Corporation's accounts receivable were comprised of the following:

	Carrying amount	
	September 30, 2012	**December 31, 2011**
Oil and natural gas sales	$ 91,126	$ -
GST	54,719	129,901
Other	-	11,974
	$ 145,845	$ 141,875

The Corporation manages the credit exposure related to cash and cash equivalents by selecting financial institutions with high credit ratings and monitors all short-term deposits to ensure an adequate rate of return. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

(amounts in Canadian dollars)

(d) Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation's approach to managing liquidity is to ensure it will have sufficient liquidity to meet its liabilities when due. The Corporation's liquidity is affected by various external events and conditions, including commodity price fluctuations and global economic instability.

The Corporation expects to repay its financial liabilities in the normal course of operations and to fund future operational, capital and other obligations through future operating cash flow, as well as future equity and debt financings (see note 3).

The Corporation's accounts payable and accrued liabilities as at September 30, 2012 and December 31, 2011 are aged as follows:

	September 30, 2012	December 31, 2011
0 to 30 days	$ 439,010	$ 1,920,082
31 to 60 days	-	-
61 to 90 days	-	-
Greater than 90 days	-	-
Total accounts payable and accrued liabilities	$ 439,010	$ 1,920,082

The Corporation expects to satisfy its obligations under accounts payable and accrued liabilities within the next year.

The Corporation is also subject to future commitments as disclosed in note 19.

(e) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates, will reduce the Corporation's net earnings or the value of financial instruments. These risks are largely outside the Corporation's control. The Corporation's objective is to manage and mitigate market risk exposure within acceptable limits, while maximizing returns. Market risks are as follows:

Foreign currency risk

Crude oil prices are determined in global markets and generally denominated in United States dollars. Natural gas prices obtained by the Corporation are influenced by U.S. and Canadian supply and demand and, to a much lesser degree, by imports of liquefied natural gas. An increase in the value of the Canadian dollar relative to the U.S. dollar will decrease the revenues received from the sale of oil and natural gas. The impact of such exchange rate fluctuations cannot be predicted. As at September 30, 2012 and December 31, 2011, the Corporation had no forward exchange rate contracts nor any working capital denominated in foreign currencies.

Interest rate risk

Interest rate risk is the risk that future cash flows will fall as a result of changes in market interest rates. The Corporation is currently not exposed to interest rate cashflow risk as its borrowing bears interest at fixed rates. The Corporation had no interest rate swaps or financial contracts in place as at or during the nine months ended September 30, 2012 or the year ended December 31, 2011.

Commodity price risk

The Corporation's operations expose it to fluctuations in commodity prices. Commodity prices for oil and natural gas are affected by global economic events that influence supply and demand. Questfire's management continuously monitors commodity prices and may consider risk-management instruments when it deems appropriate.

The Corporation's production is usually sold using "spot" or near-term contracts, with prices fixed at the time of transfer of custody or on the basis of a monthly average market price. The Corporation, however, may consider the appropriateness of entering into long-term, fixed-price marketing contracts. Its policy is to enter into commodity price contracts when considered appropriate to a maximum of 50 percent of forecast production volume. The Corporation may enter into derivative financial instruments, being collars, to meet this objective. Collars ensure that the commodity prices realized will fall into a contracted range for a contracted sale volume based on the monthly index price. Monthly gains and losses are determined based on the differential between the daily settlement price and the monthly index price when the monthly index price falls between the floor and the ceiling.

(f) Capital management

The Corporation’s capital management policy is to maintain a strong capital base that optimizes the Corporation’s ability to grow and to maintain investor and creditor confidence, and provides a platform to create value for its shareholders. The Corporation maintains a flexible capital structure to maximize its ability to pursue oil and natural gas exploration opportunities and to sustain future development of the business. The Corporation monitors risks for each capital project to balance the proportion of debt and equity in its capital structure. The Corporation’s officers are responsible for managing its capital and do so through quarterly meetings and regular reviews of financial information including budgets and forecasts. The Corporation’s Board of Directors is responsible for overseeing this process. The Corporation considers its capital structure to include shareholders’ equity, convertible Class B Shares liability, convertible debentures and bank debt, if any.

The Corporation monitors capital based on its current working capital, projected cash flow from operations and anticipated capital expenditures. In order to manage its capital structure, the Corporation prepares annual capital expenditure and operating budgets, which are updated as necessary. The annual and updated budgets are prepared by management and approved by the Board of Directors. The budget results are regularly reviewed and updated as required.

In order to maintain or adjust the capital structure, the Corporation may issue shares, seek debt financing and adjust its capital spending to manage its current and projected capital structure. The Corporation’s ability to raise additional debt or equity financing is affected by external conditions, including future commodity prices, particularly of natural gas, and by global economic conditions (see note 3). The Corporation continually monitors business conditions including: changes in economic conditions; the risk encountered in its drilling programs; forecast commodity prices; and potential corporate or asset acquisitions.

The Corporation has no externally imposed capital requirements and has not paid or declared any dividends since the date of incorporation. Other than issuing convertible debentures (see note 11), there were no changes to the Corporation’s approach to capital management during the nine months ended September 30, 2012.

(amounts in Canadian dollars)

5. Supplemental cash flow information

Changes in non-cash working capital are comprised of:

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Source (use) of cash:				
Accounts receivable	$ (101,164)	$ 6,592	$ (3,970)	$ 774
Deposits and prepaid expenses	9,583	7,109	(6,102)	(20,625)
Accounts payable and accrued liabilities	36,080	342,768	(1,481,072)	333,814
	$ (55,501)	$ 356,469	$ (1,491,144)	$ 313,963
Related to operating activities	$ (76,354)	$ 36,821	$ (59,338)	$ 582
Related to investing activities	75,344	104,175	(1,437,626)	92,325
Related to financing activities	(54,491)	215,473	5,820	221,056
Changes in non-cash working capital	$ (55,501)	$ 356,469	$ (1,491,144)	$ 313,963

(amounts in Canadian dollars)

6. Property and equipment (P&E)

	Oil and natural gas interests	Corporate and other	Processing and other equipment	Total
Cost				
Balance at December 31, 2010	$ -	$ 30,856	$ -	$ 30,856
Transfer from exploration and evaluation (E&E) assets (note 7)	548,619	-	-	548,619
Additions	-	6,026	-	6,026
Decommissioning provision	35,247	-	-	35,247
Balance at December 31, 2011	583,866	36,882	-	620,748
Transfer from E&E assets (note 7)	2,868,981	-	-	2,868,981
Additions	178,391	-	-	178,391
Decommissioning provision	42,149	-	-	42,149
Balance at September 30, 2012	$ 3,673,387	$ 36,882	$ -	$ 3,710,269
Depletion, depreciation and impairment losses				
Balance at December 31, 2010	$ -	$ 4,400	$ -	$ 4,400
Depletion and depreciation for the period	-	8,700	-	8,700
Balance at December 31, 2011	-	13,100	-	13,100
Impairment loss	124,000	-	-	124,000
Depletion and depreciation for the period	193,088	5,300	-	198,388
Balance at September 30, 2012	$ 317,088	$ 18,400	$ -	$ 335,488

	Oil and natural gas interests	Corporate and other	Processing and other equipment	Total
Net book value:				
At December 31, 2010	$ -	$ 26,456	$ -	$ 26,456
At December 31, 2011	$ 583,866	$ 23,782	$ -	$ 607,648
At September 30, 2012	$ 3,356,299	$ 18,482	$ -	$ 3,374,781

(a) Depletion and depreciation charge

The depletion, depreciation and impairment of P&E, and any eventual reversal thereof, are recognized in depletion and depreciation in the income statement.

(b) Contingencies

Although the Corporation believes that it has title to its oil and natural gas interests, it cannot control or completely protect itself against the risk of title disputes or challenges.

(c) Capitalized general and administrative and financing costs

To September 30, 2012, the Corporation has not capitalized any general and administrative expenses to P&E. No interest has been capitalized.

(d) Impairment

During the three-month and nine-month periods ended September 30, 2012, the Corporation recorded an impairment of its P&E assets of $124,000 and $124,000 respectively, which was recorded as a write-down of property and equipment on the statement of loss and comprehensive loss. The impairment related to the Corporation's Richdale cash generating unit (CGU) and was a result of management's assessment of expected future recoverable proved and probable reserves of the related asset being reduced from previous estimates. The impairment loss was based on the fair value less cost to sell of the CGU, estimated based on a 15% discounted cash flow model.

(amounts in Canadian dollars)

7. Exploration and evaluation (E&E) assets

	E&E assets
Balance at December 31, 2010	$ 331,339
Additions	3,514,361
Transfers to P&E (note 6)	(548,619)
Decommissioning provision	93,050
Balance at December 31, 2011	3,390,131
Additions	2,314,673
Impairment	(999,309)
Transfers to P&E (note 6)	(2,868,981)
Decommissioning provision	42,653
Balance at September 30, 2012	$ 1,879,167

E&E assets consist of the Corporation's exploration projects which are pending the determination of proved and/or probable reserves. Additions represent the Corporation's share of costs incurred on E&E assets during the period.

During the three-month and nine-month periods ended September 30, 2012, the Corporation recorded an impairment of its E&E assets of $Nil and $999,309 respectively, upon the transfer of assets in the Niton CGU to P&E, which was recorded as exploration and evaluation expense on the statement of loss and comprehensive loss. The impairment was a result of management's assessment of expected future recoverable proved and probable reserves of the related asset. The impairment loss was based on the fair value less cost to sell of the transferred assets based on a 10% discounted cash flow model.

(amounts in Canadian dollars)

8. Impairment

Oil and natural gas CGUs

At September 30, 2012, the Corporation tested its CGUs for impairment.

The recoverable amount of the CGU was estimated based on the higher of the value in use and the fair value less costs to sell. The estimate of fair value less costs to sell was determined using a discount rate of 10% for properties with oil as their principal reserves and a discount rate of 15% for properties with natural gas as their principal reserves, and forecast cash flows, with escalating prices and future development costs, as obtained from both externally and internally prepared reserve estimates. The forecast prices used to estimate the fair value less costs to sell are those used by independent industry reserve engineers. One oil and one natural gas CGU was considered impaired as at or during the nine months ended September 30, 2012 (note 6(d) and note 7).

9. Decommissioning provisions

The Corporation's decommissioning provisions result from its ownership interest in oil and natural gas assets, including well sites and gathering systems. The total decommissioning provision is estimated based on the Corporation'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 years. The total estimated, inflated undiscounted risked cash flows required to settle the provisions, before considering salvage, are approximately $245,620 at September 30, 2012, which was discounted using a risk-free rate of 1.6 percent at September 30, 2012. These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 18 years into the future and will be funded from general corporate resources at the time of abandonment.

The following table summarizes changes in the decommissioning provisions for the nine months ended September 30, 2012:

		Nine months ended September 30, 2012		**Year ended December 31, 2011**
Decommissioning provisions, beginning of period	$	128,297	$	-
Accretion		2,557		-
Liabilities incurred		29,114		128,297
Change in estimates		55,688		-
Decommissioning provisions, end of period	$	215,656	$	128,297

(amounts in Canadian dollars)

10. Class B Shares

On October 18, 2011, the Corporation completed its initial public offering (note 13(e)) which included the issuance of 555,840 Class B Shares with a face value of $5,558,400 ($10.00 per Class B Share).

The Class B Shares are convertible (at the Corporation's option) into Class A Shares at any time after September 30, 2014 and on or before November 30, 2016. The number of Class A Shares to be issued upon conversion of one Class B Share is calculated by dividing $10 by the greater of $1 and the then-current market price of the Class A Shares. If conversion has not occurred by the close of business on November 30, 2016, the Class B Shares become convertible (at the option of the shareholder) into Class A Shares on the same basis. Effective at the close of business on December 31, 2016, all remaining Class B Shares will be automatically converted into Class A Shares. The Class B Shares are listed and posted for trading on the TSX-V under the symbol "Q.B".

The Class B Shares were determined to be compound instruments. As the Class B Shares are convertible into Class A Shares, based on the conversion formula above, the number of Class A Shares is unknown, and therefore presented as a liability. The Class B Share liability, estimated at $3,576,932 based on the present value of discounted cash flows using a discount rate of 9 percent, is accreted using the effective interest rate method over the term of the Class B Shares, such that the carrying amount of the financial liability will be equal to the principal of $5,558,400 at maturity.

The following table is a continuity of the convertible Class B Shares liability:

	Nine months ended September 30, 2012
Balance, beginning of period	$ 3,638,810
Accretion of convertible Class B Shares liability (note 15)	242,990
Balance, end of period	$ 3,881,800

Upon issuance of the Class B Shares, the Corporation recognized the equity component of the convertible Class B Shares as a conversion option of $1,585,985 and $495,367 related to the deferred income tax effect of the Class B Shares, for a total of $2,081,352.

(amounts in Canadian dollars)

11. Convertible debentures

On June 28, 2012, the Corporation completed the issuance of unsecured senior convertible debentures for gross proceeds of $1,510,000 (net proceeds of $1,444,497). Of the $1,510,000 raised, $750,000 was raised from officers and directors of the Corporation. The Corporation issued 302 units at a price of $5,000 per unit, with each unit being comprised of one $5,000 debenture and 5,000 Class A Share purchase warrants. The debentures bear interest at a rate of 12 percent per annum, which is payable quarterly in arrears commencing on September 30, 2012, mature on June 30, 2014 and can be converted into common shares of Questfire at any time at the option of the holders at a conversion price of $0.50 per Class A Share. In aggregate the Corporation issued 1,510,000 share purchase warrants and each warrant entitles the holder to acquire one Class A Share at a price of $0.75 until June 30, 2014.

The debentures have been classified as debt, net of issuance costs and net of the fair value of the conversion feature and the warrants (the “Conversion Features”) at the date of issuance, which have been classified in shareholders’ equity. The issuance costs will be amortized over the term of the debentures and the debt portion will accrete up to the original face value of the debentures at maturity. The accretion, amortization of issuance costs and the interest paid are expensed on the statement of loss and comprehensive loss. The fair value of the Conversion Features was determined at the time of issuance as the difference between the face value of the debentures and the discounted cash flows assuming an 18 percent effective interest rate, which was the estimated rate for debt with similar terms but without any Conversion Features. If the debentures or the warrants are converted to Class A Shares, a portion of the value of the Conversion Features under shareholders’ equity will be reclassified to share capital along with the conversion price paid.

The following table sets forth a reconciliation of the convertible debentures for the period ended September 30, 2012:

	Liability component	Warrants	Equity conversion feature	Total
Balance, January 1, 2012	$ -	$ -	$ -	$ -
Gross cash proceeds	1,360,946	39,028	110,026	1,510,000
Accretion on discount	26,198	-	-	26,198
Issuance costs	(60,531)	(1,302)	(3,670)	(65,503)
Deferred tax liability	-	(9,431)	(26,589)	(36,020)
Balance, September 30, 2012	$ 1,326,613	$ 28,295	$ 79,767	$ 1,434,675

(amounts in Canadian dollars)

12. Income tax expense

Reconciliation of effective tax rate:

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Loss before income tax	$ (691,271)	$ (295,972)	$ (2,654,965)	$ (460,491)
Statutory tax rate	25.0%	26.5%	25.0%	26.5%
Expected income tax recovery	(172,817)	(78,432)	(663,741)	(122,030)
Non-deductible expenses	187	270	813	401
Statutory rate changes and other	-	4,001	-	6,461
Non-deductible stock-based compensation	6,841	-	20,521	-
Reversal of flow-through share premium	(103,244)	(31,414)	(298,762)	(31,414)
Flow-through expenditures incurred	145,307	46,719	420,480	46,719
Unrecognized tax asset	-	27,442	-	68,449
Total income tax recovery	$ (123,726)	$ (31,414)	$ (520,689)	$ (31,414)

13. Share capital

(a) Authorization

At September 30, 2012, the Corporation was authorized to issue the following:

Unlimited number of voting Class A Shares

Unlimited number of voting Class B Shares (note 10)

Unlimited number of preferred shares, issuable in series

(amounts in Canadian dollars)

(b) Issued

Class A Shares	Number of shares	Amount
Balance, December 31, 2010	9,475,001	$ 1,573,679
Issued for cash pursuant to private placement (note 13(d))	250,000	50,000
Issued as flow-through shares for cash pursuant to initial public offering (note 13(e))	3,088,000	3,088,000
Share issuance costs (net of $172,682 tax effect)	-	(518,046)
Balance, December 31, 2011 and September 30, 2012	12,813,001	$ 4,193,633

(c) During 2010, the Corporation issued 9,475,000 Class A Shares, on a flow-through basis, at $0.20 per share for total proceeds of $1,895,000. The Corporation estimates that the Class A Shares issued without a flow-through provision would have been issued at a 16.8 percent discount to the flow-through price and, therefore, the flow-through premium of $318,461 was recorded as a liability with the remainder of $1,576,539 recorded as share capital. As at December 31, 2011, the Corporation had incurred $1,895,000 (December 31, 2010 - $nil) of qualifying flow-through expenditures thereby reducing the related flow-through share premium to $nil (December 31, 2010 - $318,461).

(d) On August 18, 2011, the Corporation issued 250,000 Class A Shares at $0.20 per share for total proceeds of $50,000.

(e) On October 18, 2011, the Corporation completed its initial public offering for gross proceeds of $6,176,000. A total of 6,176 units at a price of $1,000 per unit were sold, each consisting of 500 Class A Shares at a price of $0.20 per share and 90 Class B Shares (note 10) at a price of $10.00 per share, all of which were issued on a flow-through basis under the Income Tax Act (Canada). The Corporation estimates that had these shares been issued without a flow-through provision they would have been issued at a 17.8 percent discount to the flow-through price and, therefore, the flow-through share premium of $1,097,053 was recorded as a liability at the time of issuance.

The value of the Class A Shares on issuance, reduced by the flow-through share premium, was determined to be $3,088,000 ($1.00 per Class A Share).

As at September 30, 2012, the Corporation had incurred $2,414,239 of qualifying flow-through expenditures, thereby reducing the related flow-through share premium to $668,208.

(amounts in Canadian dollars)

(f) Basic and diluted loss per share was calculated based on the weighted average common shares outstanding of 12,813,001 for the three-month and nine-month periods ending September 30, 2012, and of 9,593,133 and 9,514,378 for the three-month and nine-month periods ending September 30, 2011 respectively. The potential dilutive effect of stock options, warrants, Class B Shares and convertible debentures was not included in the calculation as the effect would be anti-dilutive.

(g) Shares in escrow

At December 31, 2011, 7,375,500 Class A Shares were held in escrow pursuant to TSX-V requirements. On April 25, 2012, 1,229,250 Class A Shares were released from escrow and a total of 6,146,250 Class A Shares remained in escrow at September 30, 2012. The remaining shares will be released from escrow in equal installments at six-month intervals, commencing October 25, 2012 with the last release on October 25, 2014. The above escrow release schedule is subject to acceleration in accordance with National Policy 46-201 - *Escrow for Initial Public Offerings* and the policies of the TSX-V in the event that the Corporation subsequently meets certain listing requirements.

14. Stock-based compensation

(a) Stock options

On August 30, 2011, the Corporation adopted a stock option plan under which it is authorized to issue stock options to employees, officers, directors and consultants for up to 10 percent of the total issued and outstanding number of Class A and Class B Shares. Options under the stock option plan cannot have an exercise price less than the closing market price on the day immediately preceding the date of grant and will expire a maximum of ten years from the date of grant. It is the Corporation's intention that options granted will generally vest as to one-third on each of the first, second and third anniversaries of the date of grant and expire ten years from the date of grant.

The following options have been awarded under the stock option plan:

	Nine months ended September 30, 2012	
	Number	**Exercise price**
Outstanding, beginning of period	1,281,000	$ 0.20
Granted	-	-
Forfeited	-	-
Outstanding at September 30	1,281,000	$ 0.20

(amounts in Canadian dollars)

Exercisable at September 30	-	$ -

The following table summarizes the expiry terms and exercise prices of the Corporation's outstanding stock options as at September 30, 2012:

Date of grant	Exercise price	Outstanding options	Weighted average remaining contractual life (years)	Number of stock options exercisable
October 18, 2011	$ 0.20	1,281,000	9.0	-
	$ 0.20	1,281,000	9.0	-

(b) Stock-based compensation expense

Compensation costs of $27,360 and $82,082 for the three and nine months ended September 30, 2012 respectively (three and nine months ended September 30, 2011 - $nil) have been expensed, with a corresponding increase in contributed surplus.

The fair value of stock options granted during the year ended December 31, 2011 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	December 31, 2011
Risk-free interest rate	2.0%
Expected volatility	75%
Expected life	10 years
Expected dividend yield	0%
Estimated forfeiture rate	0%
Fair value per option	$ 0.1574

A forfeiture rate of nil was used when recording stock-based compensation as it is expected that all officers, directors, employees and consultants will continue with the Corporation over the vesting period. This estimate is adjusted to the actual forfeiture rate.

(amounts in Canadian dollars)

15. Finance income and expense

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Finance income				
Interest income on cash and cash equivalents	$ 3,604	$ 2,522	$ 10,895	$ 10,407
Finance expense				
Part XII.6 tax on flow-through share expenditures	(9,438)	(5,818)	(28,199)	(12,401)
Interest on convertible debenture	(46,975)	-	(46,975)	-
Accretion on decommissioning provision (note 9)	(1,046)	-	(2,557)	-
Accretion on Class B Shares liability (note 10)	(82,748)	-	(242,990)	-
Accretion on convertible debenture (note 11)	(26,198)	-	(26,198)	-
	(166,405)	(5,818)	(346,919)	(12,401)
Net finance expense recognized in profit or loss	$ (162,801)	$ (3,296)	$ (336,024)	$ (1,994)

16. Personnel expenses

The aggregate payroll expense of employees, officers and directors was $187,500 and $562,500 for the three and nine months ended September 30, 2012 respectively (three and nine months ended September 30, 2011 - $187,500 and $187,500).

(amounts in Canadian dollars)

Key management personnel include executive officers and non-executive directors. Executive officers were paid a salary commencing in July 2011 and participate in the Corporation's stock option program. The executive officers are the Chief Executive Officer, Chief Financial Officer, Vice President, Land, Vice President, Engineering & Operations, Vice President, Exploration and the Vice President, Exploitation. Non-executive directors also participate in the Corporation's stock option program. The Corporation currently has no employees not considered key management personnel. Compensation of key management personnel is as follows:

	Three months ended		**Nine months ended**	
	September 30, 2012	**September 30, 2011**	**September 30, 2012**	**September 30, 2011**
Salaries and short-term benefits (*of which $375,000 is included in general and administrative expense and $187,500 is included in E&E expenditures for the nine months ended September 30, 2012*)	$ 187,500	$ 187,500	$ 562,500	$ 187,500
Amortization of share-based payments	27,360	-	82,082	-
	$ 214,860	$ 187,500	$ 644,582	$ 187,500

17. Cash and cash equivalents

	September 30, 2012	**December 31, 2011**
Bank balances	$ 954,613	$ 4,473,765
Term deposits	-	-
Cash and cash equivalents in the statements of cash flows	$ 954,613	$ 4,473,765

(amounts in Canadian dollars)

18. Related-party transactions

A director of Questfire is a partner of a law firm that provided legal services to Questfire in 2012. For the three and nine months ended September 30, 2012, Questfire incurred a total of $7,756 and $58,527 respectively (three and nine months ended September 30, 2011 – $96,081 and $96,081 respectively) to this firm for legal fees and disbursements, of which $nil and $34,000 respectively (2011 – $nil and nil) was charged to debenture issuance costs, $7,756 and $24,527 respectively (2011 - $nil and $nil) was charged to general and administrative expenses and $nil and $nil (2011 - $96,081 and $96,081) was charged to deferred financing charges. Of the $34,000 related to debenture issuance costs, $31,419 was charged to the convertible debenture liability, while $1,904 and $677 were charged to the equity component of convertible debentures and warrants, respectively. As at September 30, 2012, $5,000 (September 30, 2011 - $96,081) of the amount above was included in accounts payable.

19. Commitments

(a) Office lease

The Corporation is committed under a lease on its office premises expiring August 31, 2013 for future minimum rental payments, excluding estimated operating costs, of $17,055 for 2012 and $45,480 for 2013.

(b) Software licence

The Corporation is committed under a software licence agreement expiring January 1, 2014 for future minimum payments estimated as follows:

2012	$ 14,669
2013	58,677
	$ 73,346

(c) Flow-through share commitments

On October 18, 2011, the Corporation issued a total of 3,088,000 flow-through Class A Shares and 555,840 flow-through Class B Shares for gross proceeds of $6,176,000 (note 13(e)). In accordance with the offering, the Corporation is required to expend $6,176,000 on qualifying exploration activities no later than December 31, 2012. The Corporation renounced the tax benefit to subscribers effective December 31, 2011. The Corporation has incurred $2,414,239 of related exploratory expenditures as at September 30, 2012.