Questfire Energy Corp.

Audited Financial Statements

For the year ended December 31, 2013

(amounts in Canadian dollars)

Collins Barrow
Chartered Accountants & Consultants

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Independent Auditors' Report

To the Shareholders
Questfire Energy Corp.

We have audited the accompanying financial statements of Questfire Energy Corp., which comprise the balance sheets as at December 31, 2013 and December 31, 2012, and the statements of loss and comprehensive loss, statements of changes in equity and statements of cash flows for the years ended December 31, 2013 and December 31, 2012, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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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 financial statements present fairly, in all material respects, the financial position of Questfire Energy Corp. as at December 31, 2013 and December 31, 2012, and its financial performance and its cash flows for the years ended December 31, 2013 and December 31, 2012 in accordance with International Financial Reporting Standards.

Collins Barrow Calgary LLP

CHARTERED ACCOUNTANTS

Calgary, Canada
April 8, 2014

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

	Note	December 31, 2013	December 31, 2012 (Note 3(r))
		$	$
Assets			
Current assets			
Cash and cash equivalents		**-**	395,288
Accounts receivable	4(c)	**8,256,402**	200,482
Deposits and prepaid expenses		**592,870**	36,948
Total current assets		**8,849,272**	632,718
Non-current assets			
Property and equipment	6, 8	**122,140,086**	3,069,632
Exploration and evaluation assets	7, 8	**1,564,044**	1,910,773
Deferred tax asset	17(b)	**623,976**	-
Total assets		**133,177,378**	5,613,123
Liabilities			
Current liabilities			
Bank overdraft		**167,201**	-
Accounts payable and accrued liabilities	9	**12,247,693**	323,024
Bank debt	10	**41,000,000**	-
Risk management contracts	4(e)	**1,606,257**	-
Flow-through share commitments	11	**-**	1,840,817
Convertible debentures	14	**1,382,604**	-
Total current liabilities		**56,403,755**	2,163,841
Non-current liabilities			
Decommissioning provisions	12	**34,706,080**	156,198
Convertible Class B shares	13, 21	**15,088,437**	3,966,350
Convertible debentures	14, 21	**31,002,508**	1,352,811
Deferred tax liabilities	17(b)	**-**	47,849
Total liabilities		**137,200,780**	7,687,049
Shareholders' Equity (Deficiency)			
Share capital	15(b)	**4,272,595**	4,193,633
Equity component of convertible Class B shares	13	**(2,081,352)**	(2,081,352)
Equity component of convertible debentures	14	**75,805**	79,767
Warrants	14	**28,295**	28,295
Contributed surplus	15(f)	**288,768**	134,770
Deficit		**(6,607,513)**	(4,429,039)
Total deficiency attributable to equity holders of the Corporation		**(4,023,402)**	(2,073,926)
Total liabilities and shareholders' equity		**133,177,378**	5,613,123

Commitments (note 20)
Subsequent events (note 21)

(Signed) "Richard Dahl", Director

(Signed) "Roger MacLeod", Director

See accompanying notes to the financial statements.

Questfire Energy Corp.

Statements of Loss and Comprehensive Loss

(amounts in Canadian dollars)

	Note	Year ended December 31, 2013	2012
		$	$
Revenue			
Oil and natural gas sales		**40,537,638**	509,124
Royalties		**(5,304,284)**	(31,057)
		35,233,354	478,067
Realized gain on risk management		**311,372**	-
Unrealized gain on risk management	4(e)	**583,019**	-
		36,127,745	478,067
Expenses			
Production and operating		**16,768,668**	180,948
Transportation		**1,175,079**	24,321
General and administrative		**4,001,331**	1,192,008
Share-based compensation	15(f)	**153,998**	109,443
Exploration and evaluation		**590,825**	1,251,733
Depletion and depreciation	6	**8,439,015**	299,209
Impairment	8	**-**	313,500
Transaction costs	5	**1,280,632**	-
Flow-through share indemnity and penalties		**-**	1,840,817
		32,409,548	5,211,979
Operating Income (Loss)		**3,718,197**	(4,733,912)
Finance income	16	**-**	11,296
Finance expense	16	**(6,568,496)**	(513,216)
Net Finance Income (Expense)		**(6,568,496)**	(501,920)
Loss Before Income Taxes		**(2,850,299)**	(5,235,832)
Deferred income tax recovery	17(a)	**671,825**	1,711,210
Loss and Comprehensive Loss for the Year		**(2,178,474)**	(3,524,622)
Loss per Share			
Basic and diluted	15(c)	**(0.17)**	(0.28)

See accompanying notes to the financial statements.

Questfire Energy Corp.

Statements of Changes in Equity

(amounts in Canadian dollars)

	Note	Share capital	Equity component of convertible Class B shares	Equity component of convertible debentures	Warrants	Contributed surplus	Deficit	Total
		$	$	$	$	$	$	$
Balance, January 1, 2012		4,193,633	(2,081,352)	-	-	25,327	(904,417)	1,233,191
Equity component of convertible debenture units, net of issuance costs and income taxes	14	-	-	79,767	28,295	-	-	108,062
Share-based compensation	15(f)	-	-	-	-	109,443	-	109,443
Loss for the year		-	-	-	-	-	(3,524,622)	(3,524,622)
Balance, December 31, 2012		4,193,633	(2,081,352)	79,767	28,295	134,770	(4,429,039)	(2,073,926)
Issued on conversion of convertible debentures	14	78,962	-	(3,962)	-	-	-	75,000
Share-based compensation	15(f)	-	-	-	-	153,998	-	153,998
Loss for the year		-	-	-	-	-	(2,178,474)	(2,178,474)
Balance, December 31, 2013		**4,272,595**	**(2,081,352)**	**75,805**	**28,295**	**288,768**	**(6,607,513)**	**(4,023,402)**

See accompanying notes to the financial statements.

Questfire Energy Corp.

Statements of Cash Flows

(amounts in Canadian dollars)

	Note	Year ended December 31, 2013	2012
		$	$
Cash flows related to:			
Operating Activities			
Loss		**(2,178,474)**	(3,524,622)
Add (deduct) items not involving cash:			
Unrealized gain on risk management	4(e)	**(583,019)**	-
Share-based compensation	15(f)	**153,998**	109,443
Exploration and evaluation	7	**40,825**	999,309
Depletion and depreciation	6	**8,439,015**	299,209
Property and equipment impairment	8	**-**	313,500
Acquired office lease amortization	18	**150,677**	-
Net finance expense	16	**6,568,496**	501,920
Deferred income tax recovery	17(a)	**(671,825)**	(1,711,210)
Funds flow from (used in) operations		**11,919,693**	(3,012,451)
Decommissioning costs incurred	12	**(1,020,788)**	-
Change in non-cash working capital	18	**(1,121,125)**	1,835,842
Cash from (used in) operating activities		**9,777,780**	(1,176,609)
Investing Activities			
Exploration and evaluation expenditures	7	**(13,722)**	(2,373,779)
Property and equipment expenditures	6	**(8,180,311)**	(196,542)
Property acquisitions	5	**(42,115,140)**	-
Disposal of assets held for sale	5	**281,000**	-
Purchase of risk management contracts	4(e)	**(593,363)**	-
Interest received	16	**-**	11,296
Change in non-cash working capital	18	**2,789,417**	(1,672,679)
Cash used in investing activities		**(47,832,119)**	(4,231,704)
Financing Activities			
Bank debt draws		**43,000,000**	-
Bank debt repayments		**(2,000,000)**	
Convertible debenture issuance proceeds	14	**-**	1,510,000
Convertible debenture issuance costs	14	**(62,875)**	(65,503)
Interest and finance costs paid	16	**(3,211,260)**	(129,702)
Change in non-cash working capital	18	**(234,015)**	15,041
Cash from financing activities		**37,491,850**	1,329,836
Decrease in Cash and Cash Equivalents		**(562,489)**	(4,078,477)
Cash and Cash Equivalents, Beginning of Year		**395,288**	4,473,765
Cash and Cash Equivalents (Bank Overdraft), End of Year		**(167,201)**	395,288

See accompanying notes to the financial statements.

1. General business description

Questfire Energy Corp. ("Questfire" or the "Corporation") is engaged in the exploration for, and development and production of, oil and natural gas in Alberta and may conduct its activities jointly with others; these financial statements reflect only the Corporation's proportionate interest in such activities. The Corporation's Class A shares and Class B shares are listed on the TSX Venture Exchange (TSXV). The address and principal place of business of the Corporation is Suite 500, 400 – 3rd Avenue S.W., Calgary, Alberta, T2P 4H2.

2. Basis of preparation

Statement of compliance

These financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), interpretations of the International Financial Reporting Interpretations Committee (IFRIC), and Canadian generally accepted accounting principles (GAAP) as set out in Part 1 of the Chartered Professional Accountants Canada Handbook – Accounting.

The policies applied in these financial statements are based on IFRS issued and outstanding as of April 8, 2014, the date the Corporation's Board of Directors approved the statements.

Basis of measurement and going-concern

These financial statements were prepared on a historical costs basis, except for certain financial instruments and share-based payment transactions, which were measured at fair value.

These financial statements were prepared on a going-concern basis, which assumes that the Corporation will realize its assets and discharge its liabilities in the normal course of business.

These financial statements are presented in Canadian dollars, the Corporation's functional currency.

Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the period. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in the period in which they become known. By their nature, these estimates and related future cash flows are subject to measurement uncertainty, and the impact on the financial statements of future periods could be material. Significant estimates and judgments made by management in the preparation of the financial statements are outlined below:

a) Reserves

Reserve estimates, although not reported as part of the Corporation's financial statements, can have a significant effect on profit or loss, assets and liabilities as a result of their impact on depletion and depreciation, decommissioning provisions, deferred tax, asset impairments and business combinations. Independent petroleum reservoir engineers evaluate the Corporation's oil and natural gas reserves annually. The estimation of reserves is a complex and inherently uncertain process requiring significant judgment. Estimates of economically recoverable oil and natural gas reserves are based on a number of variables and assumptions, such as geo-scientific interpretation, production forecasts, current and estimated future commodity prices, costs and related future cash flows, all of which may vary considerably from actual results. These estimates are expected to be revised upward or downward over time, as additional information such as reservoir performance becomes available, or as economic conditions change.

b) Impairment

The valuation of the oil and natural gas properties is based on management's best estimate of the future recoverability of these assets. Various estimates are required in assessing the potential impairment of costs capitalized. Consideration of impairment includes estimates relating to reserve quantities, overall costs, future cash flows, regulatory approval, timing, commodity prices, the general economic environment and the ability to finance future activities.

Evaluations of discounted future cash flows are initiated using a discount rate of 10 percent, which is common industry practice and used by the Corporation's independent petroleum reservoir engineers in preparing their reserve reports. Based on an asset's individual characteristics of the asset, other economic and operating factors are also considered, which may increase or decrease the implied discount rate. Changes in the economic conditions could significantly change the estimated recoverable amount.

c) Exploration and evaluation (E&E) assets

The application of the Corporation's accounting policy for E&E expenditures requires judgment in determining whether future economic benefits are likely before activities have reached a stage at which technical feasibility and commercial viability can be reasonably determined. Factors such as drilling results, future capital programs, future commodity prices, future operating costs, as well as estimated economically recoverable reserves are considered.

d) Identification of cash-generating units (CGUs)

The Corporation's upstream assets are grouped into CGUs, defined as the lowest level of assets for which there is separately identifiable independent cash inflow. The classification and allocation of assets into CGUs requires significant judgment and interpretation. Factors considered in the classification include the integration among assets, shared infrastructure, the existence of common sales points, geography, geological structure and the manner in which management monitors and makes decisions about their operations. The recoverability of the Corporation's assets is assessed at the CGU level and therefore, the particular classification of the CGUs could have a significant impact on impairment losses and reversals.

e) Decommissioning provisions

The decommissioning provision utilizes assumptions to estimate the future liability based on past experience and current economic factors which management believes are reasonable. The actual cost of decommissioning, however, is uncertain and cost estimates may change in response to numerous factors including changes in legal requirements, technological advances, inflation and the timing of expected decommissioning and restoration. In addition, management determines the appropriate discount rate at the end of each reporting period. This discount rate, which is credit adjusted, determines the present value of the estimated future cash outflows required to settle the obligation and may change in response to numerous market and Questfire-specific factors.

f) Assets or liabilities held for sale

The decision to transfer property and equipment, E&E assets and the related decommissioning provision to assets or liabilities held for sale is based on management's determination that the assets and liabilities are available for immediate sale in their current condition and that the sale is highly probable.

g) Derivative commodity contracts

The amounts recorded for the fair value of risk management contracts are based on estimates of future commodity prices and the volatility in those prices.

h) Business combinations and asset acquisitions

The value assigned and the allocation of the purchase price to the net assets in an acquisition are based on numerous estimates that affect the valuation of certain assets and liabilities acquired, including the discount rates, estimates of proved and probable reserves, estimates of fair values of exploration and evaluation assets, future oil and natural gas prices and other factors.

i) Valuation of accounts receivable

The valuation of accounts receivable is based on management's best estimate of the provision for doubtful accounts.

j) Income tax

Tax interpretations, regulations and legislation in the jurisdiction in which the Corporation operates are subject to interpretations and changes. As such, income taxes are subject to measurement uncertainty. Assessing the recoverability of deferred tax assets requires the Corporation to make significant estimates relating to the expectations of future cash flows from operations, and the application of existing tax laws. To the extent that future cash flows and taxable income differ significantly from estimates, the Corporation's ability to realize the deferred tax assets and liabilities recorded at the balance sheet date could be affected. Additionally, changes in tax laws could limit the Corporation's ability to obtain future tax deductions.

k) Share-based compensation and financial instruments

The amounts disclosed relating to fair value of stock options and warrants issued are based on estimates of future volatility in the Corporation's share price, expected lives of options and warrants, the risk-free interest rate, and other relevant assumptions. Volatility is estimated to be a blend of the average price volatility of the Corporation's common shares subsequent to the April 30, 2013 asset acquisition (Note 5) and the average price volatility of common shares of a comparative group of companies over the preceding period equalling the expected lives of Questfire options.

l) Share capital, flow-through share premium, convertible Class B shares and convertible debentures

The amounts disclosed relating to share capital, flow-through share premium, convertible Class B shares and convertible debentures are based on factors including the estimated value of Class A shares on the issuance date excluding the flow-through provision, the Corporation's estimated borrowing rates if debt were incurred, estimated interest rates for similar non-convertible instruments and other relevant assumptions.

3. Significant accounting policies

The following significant accounting policies are presented to assist the reader in evaluating these financial statements:

a) New and amended standards adopted by the Corporation

Questfire adopted the following new and revised standards, along with any amendments, effective January 1, 2013:

(i) IFRS 10, *Consolidated Financial Statements*, replaces Standing Interpretations Committee (SIC) 12, *Consolidation – Special Purpose Entities*, and the consolidation requirements of International Accounting Standard (IAS) 27, *Consolidated and Separate Financial Statements*. IFRS 10 requires consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its involvement with the investee and can use its power over the investee to affect its returns. The accounting requirements for consolidation have remained largely consistent with IAS 27.

The adoption of IFRS 10 had no impact on the financial statements.

(ii) IFRS 11, *Joint Arrangements*, replaces IAS 31, *Interests in Joint Ventures*, and SIC 13, *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. IFRS 11 defines a joint arrangement as one in which two or more parties have joint control. A joint arrangement is classified as either a “joint operation” or a “joint venture” depending on the rights and obligations of the parties to the arrangement. A joint operation is one in which the parties that have joint control have rights to the assets and obligations for the liabilities related to the arrangement. A joint operator accounts for its share of the assets, liabilities, revenues and expenses of the joint arrangement. A joint venturer has rights to the net assets of the arrangement and accounts for the arrangement as an investment using the equity method, as set out in IAS 28, *Investments in Associates and Joint Ventures* (amended in 2011). The other amendments to IAS 28 did not affect the Corporation.

The Corporation assessed its joint arrangements and concluded that the adoption of IFRS 11 did not change the accounting for its joint arrangements.

(iii) IFRS 12, *Disclosure of Interests in Other Entities*, replaces the disclosure requirements previously included in IAS 27, IAS 31, and IAS 28. It outlines the required disclosure for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. An entity is required to disclose information that helps financial statement users evaluate the nature, risks and financial effects associated with interests in other entities.

The Corporation assessed its joint arrangements as part of IFRS 10 and 11 for which it has joint control, considering the structure, legal form, contractual terms and other facts and circumstances. The application of IFRS 10 and 11 requires judgment in determining the classification of the joint arrangement. It was determined that Questfire has the rights to the assets and obligations for the liabilities of its working interest ownership in oil and natural gas properties. As a result, these assets have been classified as a joint operation under IFRS 11, and the Corporation’s share of the assets, liabilities, revenues and expenses have been recognized in the financial statements.

(iv) IFRS 13, *Fair Value Measurement*, provides a single framework for measuring fair value. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. The Corporation adopted IFRS 13 on January 1, 2013 on a prospective basis.

The adoption of IFRS 13 did not require adjusting the valuation techniques used by the Corporation to measure fair value nor cause any measurement adjustments at January 1, 2013.

(v) IAS 1, *Presentation of Financial Statements*, requires companies to classify items presented within other comprehensive income according to those that will be reclassified subsequently to profit or loss and those that will not be reclassified.

The adoption of IAS 1, effective January 1, 2013, did not result in any adjustments to other comprehensive loss or comprehensive loss.

(vi) IFRS 7, *Financial Instruments: Disclosures*, was amended to provide more extensive quantitative disclosure for financial instruments that are offset in the balance sheet, or are subject to enforceable master netting or similar arrangements.

The adoption of IFRS 7 had no impact on the financial statements. The additional disclosure can be found in Note 4.

(vii) IAS 32, *Financial Instruments: Presentation*, was amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right to offset must be available on the current date and cannot be contingent on a future event.

The adoption of IAS 32 had no impact on the financial statements.

(viii) IAS 36, *Impairment of Assets*, was amended in May 2013, requiring certain disclosures of the recoverable amount of a CGU. The amendment is effective retrospectively for annual periods beginning on or after January 1, 2014. As allowed by the standard, the Corporation opted for early adoption of the amendment in the current period. Refer to Note 8 for the amended disclosure.

These changes were made in accordance with the applicable transitional provisions.

b) Cash and cash equivalents

Cash and cash equivalents consist of deposits held with banks, and term deposits and other similar short-term money market instruments with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Corporation's cash management are included as a component of cash and cash equivalents.

c) Assets held for sale

Non-current assets, or disposal groups consisting of assets and liabilities, are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition.

Non-current assets classified as held for sale are measured at the lower of the carrying amount and fair value less costs of disposal, with impairments recognized in profit or loss for the period measured. Non-current assets and disposal groups held for sale are presented in current assets and liabilities on the balance sheet and are not depleted or depreciated.

d) Jointly controlled entities

Many of the Corporation's oil and natural gas activities involve jointly controlled assets and are conducted under joint operating agreements. The financial statements include the Corporation's proportionate interest in such revenues, expenses, assets and liabilities.

e) E&E assets

All costs directly associated with the exploration and evaluation of oil and natural gas reserves are initially capitalized. E&E costs are those expenditures for an area where technical feasibility and commercial viability have not yet been determined. These costs include unproved property acquisition, exploration, geological and geophysical, E&E drilling, sampling, appraisals, and decommissioning provision. Costs incurred prior to acquiring the legal rights to explore an area are charged directly to profit or loss as E&E expense.

When an area is determined to be technically feasible and commercially viable the accumulated costs are transferred to property and equipment. When an area is determined not to be technically feasible and commercially viable or the Corporation decides not to continue with its activity, the unrecoverable costs are charged to profit or loss as an exploration expense. E&E assets are not amortized.

Exchanges or swaps that involve only E&E assets are accounted for at cost. Any gains or losses from the divestiture of E&E assets are recognized in profit or loss.

f) Property and equipment (P&E)

P&E are carried at cost less accumulated depreciation, depletion, amortization, and impairment.

Included in cost are the purchase price and the costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by the Corporation's management. For oil and natural gas properties, cost includes land acquisition costs, geological and geophysical expenditures, drilling costs, and the estimated costs of provisions for restoring and abandoning sites located on the asset in question. Costs incurred subsequent to the determination of technical feasibility and commercial viability are added to the cost base of the respective item of P&E when they increase the future economic benefits of that asset. The costs of regular service and maintenance are expensed in profit or loss in the period in which they occur.

Costs associated with office furniture and fixtures, office equipment, computer hardware and computer software are carried at cost and depreciated on a declining basis, at rates approximating the estimated service lives of the assets, between 20 percent and 50 percent per year.

Depletion, depreciation, and amortization

Depletion of oil and natural gas properties within each CGU is recognized using the unit-of-production method based on the Corporation's share of total proved plus probable oil and natural gas reserves before royalties as determined by independent reserve engineers. Future development costs are included in costs subject to depletion. For purposes of the depletion calculation, proved plus probable oil and natural gas reserves are converted to a common unit of measurement on the basis of the relative energy content of 6,000 standard cubic feet of natural gas per barrel of oil. Costs of major development projects are excluded from the costs subject to depletion until they are available for use.

Processing facilities and well equipment will be depleted using the unit of production method along with the related reserves when the assets are designed to have a life similar to the reserves of the related wells. Where processing facilities and well equipment, including major components, have differing useful lives from that of the related wells, they are depreciated separately, on a straight-line basis over their estimated respective useful lives.

g) Impairment of assets

Impairment of financial assets

Financial assets are assessed at the end of each reporting period for any indication that an asset may be impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the asset's estimated future cash flows. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that have similar credit risk characteristics.

Impairment losses are recognized in profit or loss in the period in which they occur. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. Impairment loss reversals are recognized in profit or loss.

Impairment of non-financial assets

Non-financial assets are reviewed at the end of each reporting period for any indication that an asset may be impaired and, if so, the Corporation compares the carrying amount to the estimated recoverable amount to determine if the asset is impaired. E&E assets are also assessed for impairment when they are reclassified to P&E.

For the purpose of the impairment test, non-financial assets are grouped into CGUs, which are the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of a CGU is the higher of its fair value less costs of disposal and its value in use. E&E assets are tested separately from the related CGU containing development and production assets for the purposes of testing for impairment.

The Corporation determines value in use by estimating the future cash flows expected from the CGU, discounted at a rate which reflects the current market assessment of the time value of money and the risks specific to the CGU. Fair value less costs of disposal is determined as the amount obtainable from the sale of the CGU in an arm's-length transaction between knowledgeable, willing parties, less the costs of disposal. The Corporation considers recent transactions for similar assets within the same industry as indicators of fair value.

An impairment loss is recognized when the carrying amount of the CGU exceeds its recoverable amount. Impairment losses for a CGU are allocated first to any goodwill allocated to the CGU and then to the other assets of the group pro rata on the basis of the carrying amount of each asset of the group. The reductions in carrying amounts are recognized in profit or loss in the period in which they occur.

At the end of each reporting period, the Corporation assesses whether there is indication that an impairment loss recognized in prior periods, for assets other than goodwill, may no longer exist. Impairment losses to goodwill cannot be reversed. If circumstances have changed since the recognition of an impairment loss such that the loss has been reduced, the carrying amount of the CGU is increased to the revised estimate of its recoverable amount to the extent that the CGU's carrying amount does not exceed the carrying value that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized for the asset in prior periods.

h) Decommissioning provisions

The Corporation recognizes provisions for legal, contractual or constructive liabilities relating to the dismantling and reclamation of E&E and P&E in the period in which the liability is incurred. The amount recognized is the best estimate of the decommissioning cost, discounted to its present value using a credit-adjusted risk-free discount rate, and is added to the carrying amount of the related asset and depreciated or depleted on a unit-of-production or straight line basis, depending on the asset. The decommissioning provision is increased over time, with the accretion recognized as a financing expense. The Corporation reviews the appropriateness of the provision at the end of each reporting period. Changes in the estimated timing, cost of decommissioning, or discount rate are recognized on a prospective basis with an adjustment to the provision and corresponding adjustment to the related asset. The actual costs of decommissioning are charged against the accumulated liability. See note 3(r) for a description, and impact, of a current year change in accounting policy for decommissioning provisions.

i) Flow-through shares

From time to time, the Corporation finances a portion of its exploration and development activities through the issuance of flow-through shares. Under the flow-through share agreements, the tax attributes of the related expenditures are renounced to subscribers. The stated capital recorded on flow-through share issuances is equal to the estimated fair value of the common shares, exclusive of the flow-through component, on the date of issuance. The difference between the gross proceeds received and the stated capital recorded is a liability ("flow-through share premium") until qualifying expenditures are incurred. When the expenditures are incurred the resulting deferred tax liability is recorded through income tax expense less the reversal of the flow-through share premium previously recorded.

j) Income taxes

Income tax expense consists of current and deferred taxes. The expense is recognized in the statement of loss and comprehensive loss, except for income tax related to the components of equity; which in such cases is recognized in equity.

Income taxes receivable and payable are obligations or claims for the current and prior periods to be paid to (or recovered from) taxation authorities that are outstanding at the end of the reporting period. Current tax is computed on the basis of tax profit, which differs from net profit. This calculation is made using tax rates and laws enacted or substantively enacted at the end of the reporting period.

The Corporation uses the liability method of accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on the difference between the carrying value and the tax basis of the assets and liabilities. Any changes in the net amount of deferred income tax assets and liabilities is determined based on enacted or substantively enacted tax rates and laws that will be in effect when differences are expected to reverse. Deferred income tax assets and unused tax losses are recognized to the extent that it is probable that the assets can be recovered.

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in profit or loss in the period in which the change is substantively enacted.

k) Revenue

Revenue from the sale of crude oil, natural gas and natural gas liquids is recognized based on volumes delivered to customers at contractual delivery points and prices when commodities are delivered and title passes to purchasers. Transportation costs are reported as a separate expense and are not netted against revenue. Revenues from crude oil natural gas, and natural gas liquids production represent the Corporation's gross revenue, before royalty payments to governments and other mineral interest owners.

l) Finance expense

Finance expense comprises interest expense on borrowings, including convertible debentures, demand loans, and flow-through expenditures made under the "look-back rule", financing costs, accretion of the discount on decommissioning provisions, accretion of the convertible Class B share liability, accretion on convertible debentures and impairment losses recognized on financial assets.

Borrowing costs incurred for the acquisition or construction of qualifying assets are capitalized during the period required to complete and prepare the assets for their intended use or sale. A qualifying asset is one that takes substantial time to get ready for use or sale.

When funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs. When the funds used to finance a project form part of general borrowing, the amount capitalized is calculated using the weighted average of rates applicable to the Corporation's relevant general borrowing during the period.

All other borrowing costs are recognized in the statement of loss and comprehensive loss in the period in which they are incurred, using the effective interest rate method.

m) Share-based payments

Equity-settled share-based awards granted by the Corporation include options to purchase common shares and warrants granted to employees, consultants, officers and directors. The fair value of equity-settled share-based payments is determined by the fair value of the equity instruments on the grant date using the Black-Scholes option pricing model. The Corporation measures share-based payments to consultants at the fair value of the goods or services received at the date of receipt of the goods or services. If the fair value of the goods or services cannot be measured reliably, the value of the options or warrants granted will be used, measured using the Black-Scholes option pricing model. Awards are recognized in profit or loss over the vesting period with a corresponding increase in contributed surplus. Awards issued in tranches that vest at different times are expensed on a graded basis over the vesting period of each respective tranche. On the grant date, and subsequently at the end of each reporting period, the Corporation estimates the number of awards expected to vest by applying an estimated forfeiture rate for each vesting tranche, with revisions recognized in profit or loss.

Upon the exercise of the stock options, consideration received, together with the amount previously recognized in contributed surplus, is recorded as an increase in share capital. In the event that vested options expire without being exercised, previously recognized compensation expense associated with such stock options is not reversed.

n) Earnings (loss) per share

Basic per share amounts are computed by dividing the loss by the weighted-average number of common shares outstanding during the period. The Corporation utilizes the treasury stock method in the determination of diluted per share amounts. Under this method, the diluted weighted-average number of shares is calculated assuming that proceeds arising from the exercise of options, convertible Class B shares and other dilutive instruments where the market price exceeds option and warrant price are used to purchase, for cancellation, common shares of the Corporation at their average market price for the period. The weighted-average number of shares is then adjusted by the net change.

The number of Class A shares assumed to be issued upon conversion of each Class B share is equal to $10.00 divided by the greater of $1.00 and the weighted average trading price of the Class A shares for the last 30 consecutive trading days as of the balance sheet date.

o) Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Upon initial recognition, all financial instruments, including derivatives, are recognized on the balance sheet at fair value.

Subsequent measurement of financial assets and liabilities, except those classified as fair value through profit and loss and available-for-sale, are measured at amortized cost, determined using the effective interest rate method. Financial assets classified as fair value through profit and loss are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial assets are measured at fair value with changes in fair value recognized in other comprehensive income and reclassified to earnings when derecognized or impaired. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted through active markets. The Corporation assesses whether its financial assets are impaired at each reporting period.

The Corporation accounts for cash and cash equivalents and derivative commodity contracts as fair value through profit or loss, accounts receivable as loans and receivables, and accounts payable and accrued liabilities, flow-through share commitments, convertible Class B shares and convertible debentures as financial liabilities measured at amortized cost.

Derivative financial instruments

Risk management assets and liabilities are derivative financial instruments classified as held-for-trading unless designated for hedge accounting. Derivative instruments that do not qualify as hedges, or are not designated as hedges, are recorded using mark-to-market accounting whereby instruments are recorded on the balance sheet as either an asset or liability with changes in fair value recognized in profit or loss as a gain or loss on risk management. The estimated fair value of all derivative instruments is based on quoted market prices or, in their absence, third-party market indications and forecasts.

Derivative financial instruments are used to manage economic exposure to market risks relating to commodity prices. Derivative financial instruments are not used for speculative purposes.

The Corporation does not have any derivative instruments that are designated as hedges.

Compound financial instruments

The components of compound instruments are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. At the issuance date, the fair value of the liability component is estimated using the prevailing market interest rate for a similar non-convertible instrument. This amount is recorded as a liability, based on amortized cost, until the instrument is converted or matures. The equity component is determined by deducting the liability component from the total fair value of the compound instrument and is recognized as equity, net of income tax effects, with no subsequent re-measurement.

Share capital

Class A shares are classified as equity. Convertible Class B shares and convertible debentures are classified as compound instruments. Incremental costs directly attributable to the issuance of Class A shares, stock options and warrants are recognized as a reduction to equity, net of any tax effects.

p) Leases

Leases in which substantially all of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

Leases where the Corporation assumes substantially all the risks and rewards of ownership are classified as finance leases within P&E.

q) Business combinations

Business combinations are accounted for using the acquisition method of accounting in which the identifiable assets acquired, liabilities assumed and any non-controlling interest are recognized and measured at their fair value at the date of acquisition. Any excess of the purchase price plus any non-controlling interest over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price over the fair value of the net assets acquired is credited to profit and loss.

r) Reclassification

Under the Corporation's previous accounting policy for decommissioning provisions, the estimate of the expenditure required to settle the present obligation at the balance sheet date was recorded on a discounted basis using the pre-tax risk-free interest rate and the future cash flow estimates were adjusted to reflect the risks specific to the liability. At January 1, 2013, the Corporation voluntarily changed its accounting policy to use a credit-adjusted risk-free discount rate and future cash flow estimates will not be adjusted to reflect the risks specific to the liability. The Corporation believes the change in discount rate provides reliable and relevant information to the users of the financial statements as the discount rate is consistent with the Corporation's cost of capital. The change in policy must be applied retrospectively and resulted in property and equipment at December 31, 2012 decreasing by $71,000 with a corresponding decrease to decommissioning provisions of $71,000. Deferred tax, depletion and accretion amounts related to prior periods were not adjusted as any changes were immaterial.

s) New and revised IFRS not yet adopted

A number of new and revised IFRS that are effective for annual periods beginning after January 1, 2013 were not applied in preparing these financial statements. The standards that may have a significant effect on the financial statements in the future are as follows and will be adopted by Questfire on their respective effective dates:

(i) IFRS 9, *Financial Instruments*, addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the parts of IAS 39, *Financial Instruments: Recognition and Measurement*, that relate to the classification and measurement of financial instruments. IFRS 9 will be published in three phases, of which two phases have been published.

Phases one and two address accounting for financial assets and financial liabilities, and hedge accounting, respectively. The third phase will address impairment of financial instruments.

For financial assets, IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. For financial liabilities, IFRS 9 retains most of the IAS 39 requirements; however, where the fair value option is applied to financial liabilities, the change in fair value resulting from an entity's own credit risk is recorded in other comprehensive income rather than profit and loss, unless this creates an accounting mismatch.

IFRS 9 introduces a simplified hedge accounting model, aligning hedge accounting more closely with risk management. In addition, improvements have been made to hedge accounting and risk management disclosure requirements. Questfire does not currently apply hedge accounting.

A mandatory effective date for IFRS 9 in its entirety will be announced when the project is closer to completion. Early adoption of the two completed phases is permitted only if adopted in their entirety at the beginning of a fiscal period. The Corporation is evaluating the impact of adopting IFRS 9 on the financial statements.

(ii) IAS 32, *Financial Instruments: Presentation*, clarifies the requirements for offsetting financial assets and liabilities. The amendments clarify that the right to offset must be available on the current date and cannot be contingent on a future event. The amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014, requiring retrospective application. IAS 32 will not have a significant impact on the financial statements.

(iii) In December 2013, the IASB issued narrow-scope amendments to a total of nine standards as part of its annual improvement process. The improvement process is designed to make non-urgent but necessary amendments to IFRS. Some of the amendments made to the existing standards included: clarifying the definition of vesting conditions in IFRS 2, *Share-based payment*; defining the classification and measurement of contingent consideration; scope exclusion for the formation of joint arrangements in IFRS 3, *Business Combinations*, and modifying the definition of a related party in IAS 24, *Related Party Disclosures*. The Corporation intends to adopt these amendments in its financial statements for the annual period beginning on January 1, 2014. The adoption of these standards is not expected to have a material impact on the financial statements.

There are no other IFRS or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Corporation.

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 these risks, its objectives, policies and processes for measuring and managing risk, and its management of capital. Further quantitative disclosure is included throughout this document. Questfire employs risk management strategies and polices to ensure its risk exposure is consistent with its business objectives and risk tolerance. While the Board of Directors has overall responsibility for Questfire's risk management framework, Questfire's management monitors the risks and administers the risk management measures.

b) Fair value of financial instruments

The fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, bank overdraft, bank debt and flow-through share commitments approximate their carrying value due to the short-term maturity of those instruments. The fair value of the bank debt is equal to its carrying value as the facility bears interest at floating rates, and credit spreads within the facility are indicative of market rates. The fair value of the convertible debentures is approximated by their carrying value given interest rates the Corporation believes it would have to pay on an instrument with similar terms.

The fair value of convertible Class B shares at December 31, 2013, based on a discounted cash flow model assuming a 10.44 percent effective interest rate, is approximately $14.8 million (December 31, 2012 - $972,720).

The fair value of financial derivatives, including risk management contracts, is determined by discounting the difference between the contracted prices and published forward price curves 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 (see also note 4(e)).

The significance of inputs used in making fair-value measurements is examined and the inputs are 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 in which the inputs are derived from quoted indices. Level 3 valuations are based on inputs that are unobservable, but are 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 risk management contracts, are measured at fair value based on a Level 2 designation.

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, cash and cash equivalents, and risk management contracts.

Substantially all of the Corporation's accounts receivable are due from purchasers of Questfire's oil and natural gas production, joint interest partners and government agencies and are subject to normal industry credit risk. Receivables from oil 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 oil and natural gas production by establishing marketing relationships with large, credit-worthy purchasers. The Corporation has not experienced any collection issues with its marketers.

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

At December 31, 2013 and 2012, the Corporation's accounts receivable were comprised of the following:

	December 31, 2013	December 31, 2012
	$	$
Oil and natural gas sales	**5,789,802**	53,264
Joint interest billings, GST and other	**2,466,600**	147,218
Accounts receivable	**8,256,402**	200,482

The Corporation considers all amounts greater than 90 days to be past due. At December 31, 2013, $542,509 is past due (December 31, 2012 - $Nil). The Corporation considers this amount fully collectible. It arose as a result of the acquisition of producing assets from Advantage Oil & Gas Ltd. (note 5(a)), and the subsequent delay in some parties recognizing Questfire's ownership of the assets.

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. The Corporation manages the credit exposure related to risk management contracts by ensuring the contracts are entered into with counterparties who are financial institutions with high credit ratings. Given these credit ratings, management does not expect any counterparty to fail to meet its obligations.

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.

The timing of undiscounted cash flows relating to the financial liabilities outstanding at December 31, 2013 is outlined below:

	1 year	2 years	3 years	>3 years	Total
	$	$	$	$	$
Accounts payable and accrued liabilities	12,247,693	-	-	-	12,247,693
Bank overdraft	167,201	-	-	-	167,201
Risk management contracts	1,606,257	-	-	-	1,606,257
Bank debt (1)	41,000,000	-	-	-	41,000,000
Convertible debentures (2)	34,020,000	-	-	-	34,020,000

(1) This amount excludes future interest payable on amounts drawn on the bank credit facility.

(2) The Corporation believes that the current portion of the convertible debentures will be converted and has adequate operating cash flow to repay this amount if required. See note 21 for a description of the circumstances subsequent to December 31, 2013 regarding an early redemption of the non-current convertible debentures.

The Corporation's credit facility is a demand loan, and as such the bank could demand repayment any time. Management is not aware of any indications that the bank would demand repayment within the next 12 months. Indications considered include the lack of any breach or default of credit facility covenants during the period by the Corporation, the initiation of the credit facility during the current year, and the renewal of the facility subsequent to year end. The Corporation further ensures it will have sufficient access to funds to meet short-term obligations by actively monitoring its credit facilities, and coordinating payment cycles with revenue cycles.

The Corporation is also subject to commitments as disclosed in note 20, 21(i) and 21(ii).

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 by exports 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. At December 31, 2013 and 2012, 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 has exposure to interest rate cash flow risk as its bank borrowing bears interest at variable rates. For the year ended December 31, 2013, a 1 percent increase in interest rates would increase the loss by approximately $307,500 (year ended December 31, 2012 - $Nil). The Corporation had no interest rate swaps or contracts in place at or during the years ended December 31, 2013 or 2012.

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 was historically 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's policy is to limit swap commodity price contracts to a maximum of 50 percent of forecast production volume. The Corporation may also enter into other derivative financial instruments, being collars and put options, to achieve 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, while puts ensure the realized price will not fall below a price floor. At December 31, 2013, the Corporation's forward commodity contracts consisted of a mix of fixed-price, fixed-volume oil and natural gas swaps and purchased put options.

I. Summary of risk management positions

At December 31, 2013, Questfire had the following crude oil and natural gas risk management contracts with a total mark-to-market liability of $1,606,257:

Period	Commodity	Type of contract	Notional quantity	Pricing point	Contract price
Jan. 1/14 - Dec. 31/14	Natural gas	Fixed price	8,000 GJ/d	AECO 7A	Cdn$3.3575/GJ
Jan. 1/14 - Dec. 31/14	Natural gas	Purchased put (1)	5,000 GJ/d	AECO 7A	Cdn$3.00/GJ
Jan. 1/14 - Dec. 31/14	Natural gas	Purchased put (2)	10,000 GJ/d	AECO 7A	Cdn$3.00/GJ
Jan. 1/14 - Dec. 31/14	Crude oil	Fixed price	200 bbls/d	WTI Nymex	Cdn$94.80/bbl

(1) The put contracts require the Corporation to pay a monthly premium of approximately $28,000 over the term for a total premium of $332,150.

(2) The put contracts required the Corporation to pay total premiums of $424,313 at inception.

Reconciliation of unrealized risk management contracts during the year ended December 31, 2013:

	Fair value	Total unrealized gain
	$	$
Fair value of contracts, beginning of year	-	-
Contracts entered into	593,363	-
Acquisition (note 5)	(2,782,639)	-
Change in fair value of contracts	583,019	583,019
Fair value of contracts, end of year	**(1,606,257)**	**583,019**

II. Commodity price sensitivities – risk management positions

The following table summarizes the sensitivity of the fair value of Questfire's risk management contracts to fluctuations in commodity prices, with all other variables held constant. Management believes the price fluctuations identified in the table below are a reasonable measure of volatility. The impact of fluctuating commodity prices on the Corporation's risk management contracts at December 31, 2013 could have resulted in unrealized gains or losses affecting profit or loss for the year ended December 31, 2013 as follows:

Commodity	Sensitivity range	Increase	Decrease
		$	$
Natural gas commodity price	± $0.10 per Mcf - AECO 7A contracts	(257,360)	265,938
Crude oil commodity price	± $1.00 per bbl - WTI Canadian contracts	(58,483)	58,483

f) Capital management

The Corporation maintains a flexible capital structure to maximize its ability to pursue oil and natural gas exploration and asset acquisition 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 or deficiency, the convertible Class B share liability, convertible debentures and bank debt.

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 throughout the year 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 its current and projected capital structure, the Corporation may issue shares, seek debt financing and adjust its capital spending. The Corporation's ability to raise additional debt or equity is affected by external conditions, including future commodity prices, particularly of natural gas, and by global economic conditions. The Corporation continually monitors business conditions, including: changes in economic conditions, the risks encountered in its drilling programs, forecast commodity prices, and potential corporate or asset acquisitions.

The Corporation has no externally imposed capital requirements other than its working capital covenants related to its bank debt (note 10) and any debt or equity raised must be used to repay the 2013 Debentures (note 14) and would be subject to approval by the Corporation's priority lender (note 10). The Corporation also cannot redeem or pay dividends on its Class A or Class B shares until the 2013 Debentures are repaid in full. The Corporation has not paid or declared any dividends since incorporation. There were no changes to the Corporation's approach to capital management during the year ended December 31, 2013.

5. Acquisitions

a) On April 30, 2013, the Corporation completed its acquisition of producing assets in Alberta from Advantage Oil & Gas Ltd. (Advantage). The producing assets are all located in Alberta.

The acquisition has been accounted for using the purchase method, with the results of the acquired assets included in the Corporation's financial statements commencing on the day of closing. The allocation of fair values to the net assets acquired is based on the best available information at this time and could be subject to further change.

The acquisition-date fair value of consideration transferred and net assets acquired was as follows:

	Amounts previously recognized as of acquisition date (provisional) [a]	Measurement period adjustments	Recognized as of acquisition date
	$	$	$
Fair value of net assets acquired			
Risk management contracts (note 4(e))	(2,782,639)	-	(2,782,639)
Office lease	312,944	-	312,944
Assets held for sale	281,000	-	281,000
Property and equipment	108,796,681	8,121,680	116,918,361
Decommissioning provisions (note 12)	(25,971,025)	(7,665,193)	(33,636,218)
Total net assets acquired	80,636,961	456,487	81,093,448
Consideration			
Cash	40,152,343	456,487	40,608,830
Accrued liabilities assumed	200,000	-	200,000
Convertible senior secured debentures (notes 14 and 21)	30,284,618	-	30,284,618
Class B shares (notes 13 and 21)	10,000,000	-	10,000,000
Total purchase price	80,636,961	456,487	81,093,448

[a] As previously reported in Questfire's 2013 condensed interim financial statements for the three and six months ended June 30, 2013 and three and nine months ended September 30, 2013.

During the fourth quarter of 2013, Questfire received new information related to facts in existence but unknown at the acquisition date, as a result of the final statement of adjustments, as well as revised reserve estimations as at April 30, 2013. This new information results in retrospective measurement period adjustments to the purchase price equation. The measurement period adjustments did not result from events subsequent to the acquisition date.

The adjustments were made largely to better reflect market participant assumptions about facts and circumstances as of the acquisition date, such as the following: for decommissioning provisions, long-term expectations of well lives, estimated costs to reclaim and abandon the wells and facilities, revised well status, type, and working interests; for property and equipment, revised reserve estimates. These items also resulted in retrospective adjustments to the statements of loss, cash flow, and changes in equity for the periods subsequent to the acquisition date. The Corporation recalculated depletion and depreciation, and finance expense as though these changes were made upon acquisition. The impacts for the three months ended June 30, 2013 were: depletion and depreciation increased by $101,412, finance expense increased by $76,272 and deferred income tax expense was reduced by $44,421. The impacts for the three months ended September 30, 2013 were: depletion and depreciation increased by $148,752, finance expense increased by $108,378 and deferred income tax recovery increased by $64,282.

The assets were acquired with full tax pools.

The Corporation funded the cash portion of the purchase price by entering into an agreement for a credit facility with National Bank of Canada and the Alberta Treasury Branches that provides a revolving operating demand loan of $60.0 million (note 10). Questfire paid National Bank Financial Inc. a success fee on closing of the asset purchase and credit facility.

The assets held for sale were disposed of prior to year end.

b) On July 31, 2013, the Corporation purchased a working interest in certain Alberta producing assets for $1,506,310, which was allocated to P&E. The acquisition has been accounted for using the purchase method, with the results of the operations of the acquired assets included in the Corporation's financial statements commencing on the date of the acquisition. The allocation of fair values to the net assets acquired is based on the best available information at this time and could be subject to further change.

During the year ended December 31, 2013, the Corporation incurred $1,280,632 (year ended December 31, 2012 - $Nil) of costs related to acquisitions that are recorded as transaction costs in the statement of loss.

The revenues and profit or loss since the closing date of the acquisitions and pro-forma revenues and profit or loss giving effect to the acquisitions as if they had occurred on January 1 are not practical to determine. The operations of the acquired assets are not managed as a separate business unit or division of the Corporation, and general business overhead and other costs of the Corporation are not allocated or identified on a specific property basis. Accordingly, any such allocation would be arbitrary and would require significant assumptions and estimates about what management's intent would have been during those periods.

6. Property and equipment (P&E)

	Oil and natural gas interests (restated – note 3(r)	Corporate and other	Total
Cost	$	$	$
Balance, January 1, 2012	583,866	36,882	620,748
Additions	196,542	-	196,542
Transfer from E&E (note 7)	2,907,002	-	2,907,002
Decommissioning provision	(28,851)	-	(28,851)
Balance, December 31, 2012	3,658,559	36,882	3,695,441
Additions	8,070,844	109,467	8,180,311
Acquisitions (note 5)	118,424,671	-	118,424,671
Transfers from E&E (note 7)	319,626	-	319,626
Decommissioning provision	584,861	-	584,861
Balance, December 31, 2013	**131,058,561**	**146,349**	**131,204,910**
Accumulated depletion, depreciation and impairment			
Balance, January 1, 2012	-	13,100	13,100
Impairment (note 8)	313,500	-	313,500
Depletion and depreciation	292,109	7,100	299,209
Balance, December 31, 2012	605,609	20,200	625,809
Depletion and depreciation	8,418,215	20,800	8,439,015
Balance, December 31, 2013	**9,023,824**	**41,000**	**9,064,824**
Balance, January 1, 2012	583,866	23,782	607,648
Balance, December 31, 2012	3,052,950	16,682	3,069,632
Balance, December 31, 2013	**122,034,737**	**105,349**	**122,140,086**

To December 31, 2013, the Corporation has not capitalized any general and administrative expenses to P&E. No interest has been capitalized.

7. Exploration and evaluation (E&E) assets

As at December 31,	**2013**	2012
	$	$
Balance, beginning of year	**1,910,773**	3,390,131
Additions	**13,722**	2,373,779
Decommissioning provision	**-**	53,174
Transfer to P&E (note 6)	**(319,626)**	(2,907,002)
Expense	**(40,825)**	-
Impairment (note 8)	**-**	(999,309)
Balance, end of year	**1,564,044**	1,910,773

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 year.

8. Impairment

At December 31, 2013, the Corporation assessed its P&E CGUs and E&E assets for indicators of impairment and noted none.

The following table outlines forecasted commodity prices used in the Corporation's CGU tests at December 31, 2013. The forecast commodity prices are consistent with those used by the Corporation's independent reservoir engineers, and are a key assumption in assessing the recoverable amount.

	Medium and Light Crude Oil		Natural Gas	Natural Gas Liquids				
Year	WTI Cushing 40˚ API ($US/bbl)	Edmonton par 40˚ API ($/bbl)	AECO-C Hub ($/MMBtu)	Ethane ($/bbl)	Propane ($/bbl)	Butane ($/bbl)	Pentane plus ($/bbl)	Exchange rate (US$/Cdn$)
2014	97.50	92.76	4.03	13.26	57.83	73.22	105.20	0.95
2015	97.50	97.37	4.26	14.08	58.42	75.95	107.11	0.95
2016	97.50	100.00	4.50	14.89	60.00	78.00	107.00	0.95
2017	97.50	100.00	4.74	15.71	60.00	78.00	107.00	0.95
2018	97.50	100.00	4.97	16.53	60.00	78.00	107.00	0.95
2019	97.50	100.00	5.21	17.34	60.00	78.00	107.00	0.95
2020	98.54	100.77	5.33	17.77	60.46	78.60	107.82	0.95
2021	100.51	102.78	5.44	18.13	61.67	80.17	109.97	0.95
2022	102.52	104.83	5.55	18.52	62.90	81.77	112.17	0.95
2023	104.57	106.93	5.66	18.88	64.16	83.40	114.41	0.95
Thereafter	2% annual price increase							0.95

(1) Source: GLJ Petroleum Consultants price forecast, effective January 1, 2014.

(2) The forecast benchmark commodity prices listed above are adjusted for quality differentials, heat content, distance to market and other factors in performing our impairment tests.

During the year ended December 31, 2012, the Corporation recognized an impairment of P&E of $313,500, which was recorded as a write-down of P&E on the statement of loss. The impairment related to the Corporation's Northwest ($28,500) and East Central ($285,000) CGUs and was a result of management's assessment of expected future recoverable proved and probable reserves of the related assets. The impairment loss was based on the fair value less costs of disposal of the CGU based on a 10 percent and 15 percent discounted cash flow model for Northwest and East Central, respectively.

During the year ended December 31, 2012, the Corporation recognized an impairment of E&E assets of $999,309, upon the transfer of assets in the Northwest CGU to P&E, which was recorded as E&E expense on the statement of 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 costs of disposal of the transferred assets based on a 10 percent discounted cash flow model.

The following table outlines forecasted commodity prices used in the Corporation's CGU tests at December 31, 2012. The forecast commodity prices are consistent with those used by the Corporation's independent reservoir engineers, and are a key assumption in assessing the recoverable amount.

	Medium and Light Crude Oil		Natural Gas	Natural Gas Liquids				
Year	WTI Cushing 40° API ($US/bbl)	Edmonton par 40° API ($/bbl)	AECO-C Hub ($/MMBtu)	Ethane ($/bbl)	Propane ($/bbl)	Butane ($/bbl)	Pentane plus ($/bbl)	Exchange rate (US$/Cdn$)
2013	90.00	85.00	3.38	11.09	34.06	64.45	96.63	1.00
2014	92.50	91.50	3.83	12.65	45.75	70.46	97.91	1.00
2015	95.00	94.00	4.28	14.20	56.40	72.38	97.76	1.00
2016	97.50	96.50	4.72	15.75	57.90	74.31	100.36	1.00
2017	97.50	96.50	4.95	16.53	57.90	74.31	100.36	1.00
2018	97.50	96.50	5.22	17.46	57.90	74.31	100.36	1.00
2019	98.54	97.54	5.32	17.81	58.52	75.11	101.44	1.00
2020	100.51	99.51	5.43	18.15	59.71	76.62	103.49	1.00
2021	102.52	101.52	5.54	18.55	60.91	78.17	105.58	1.00
2022	104.57	103.57	5.64	18.82	62.14	79.75	107.71	1.00
Thereafter	2% annual price increase							1.00

(1) Source: GLJ Petroleum Consultants price forecast, effective January 1, 2013.

(2) The forecast benchmark commodity prices listed above are adjusted for quality differentials, heat content, distance to market and other factors in performing our impairment tests.

There were no impairment reversals for either P&E or E&E in 2013.

9. Accounts payable and accrued liabilities

As at December 31,	**2013**	2012
	$	$
Accruals	**6,944,491**	108,706
Trade	**5,222,409**	214,318
Other	**80,793**	-
	12,247,693	323,024

10. Bank debt

On April 30, 2013, the Corporation entered into a $60.0 million demand revolving credit facility with a syndicate of Canadian banks (the "Credit Facility"). The Credit Facility provides that advances may be made by way of direct advances, bankers' acceptances or standby letters of credit. At December 31, 2013, $41.0 million of the Credit Facility was drawn. Amounts borrowed under the Credit Facility bear interest at a floating rate based on the applicable Canadian prime rate, plus between 1.00 percent and 3.00 percent depending on the Corporation's senior net debt to cash flow ratio. For the year ended December 31, 2013, the average effective interest rate on the amount drawn under the Credit Facility was 4.3 percent. The Credit Facility is secured by all assets of the Corporation.

The Corporation is subject to certain reporting and financial covenants in its Credit Facility. The financial covenant requires the Corporation to maintain an adjusted working capital ratio of at least 1:1 at all times (for purposes of the covenant, bank debt, the current portion of any subordinated convertible debentures, and the fair value of any risk management contracts are excluded and the undrawn portion of the bank debt is added to current assets). This covenant was met at December 31, 2013 at 2.24 to 1. The Corporation is limited to hedging no greater than 60 percent of its production (not including fully paid put options).

At December 31, 2013, the Corporation had negative working capital (excluding bank debt, the current portion of convertible debentures, and risk management contracts) of $3,565,622, and letters of credit of $350,000, totaling $3,915,622 (December 31, 2012 - $Nil), which reduces the borrowing capacity under the credit facility.

11. Flow-through share commitments

a) 2010 flow-through shares

During 2010 the Corporation completed an offering of flow-through shares for total proceeds of $1,895,000. Pursuant to the offering, the Corporation committed to renouncing the tax deductions and was required to incur $1,895,000 of qualifying expenditures no later than December 31, 2011. The tax filings to effect the renunciations were filed in early 2011 in accordance with the applicable legislation and were effective December 31, 2010.

At January 1, 2012, the Corporation had incurred $1,895,000 of qualifying flow-through expenditures related to this offering. At December 31, 2012, however, the Corporation amended its calculation to allocate additional expenditures to the 2011 flow-through shares (see 11(b) below) resulting in qualifying expenditures on the 2010 offering being incurred totalling $267,318, resulting in a shortfall on the 2010 offering of $1,627,682. Pursuant to the flow-through share agreements, the Corporation indemnified subscribers for the tax benefits lost in the event the qualifying expenditures renounced to subscribers were reduced. Accordingly, at December 31, 2012 the Corporation recorded a provision of $832,564 related to flow-through share indemnification amount and penalties.

In 2012, the Corporation recorded a commitment of $634,796 related to the flow-through shares, representing the estimated amount payable to indemnify the subscribers for the reduced renunciations. The Corporation also made a provision of $197,768 in additional penalties relating to the December 31, 2011 shortfall of $1,627,682. The liability for flow-through share commitments at December 31, 2012 included the $634,796 flow-through share indemnification plus penalties of $197,768.

b) 2011 flow-through shares

During 2011 the Corporation completed its initial public offering for total proceeds of $6,176,000 issued on a flow-through basis. Pursuant to the offering, the Corporation committed to renouncing the tax deductions and was required to incur $6,176,000 of qualifying expenditures no later than December 31, 2012. The tax filings to effect the renunciations were filed in early 2012 in accordance with the applicable legislation and were effective December 31, 2011.

At December 31, 2012 the Corporation had incurred $4,148,953 of qualifying flow-through expenditures related to this offering, resulting in a shortfall of $2,027,047. Pursuant to the flow-through share agreements, the Corporation indemnified subscribers for the tax benefits lost in the event the qualifying expenditures renounced to subscribers were reduced. Accordingly, at December 31, 2012 the Corporation recorded a provision of $1,008,253 related to flow-through share indemnification and penalties.

In 2012, the Corporation recorded a commitment of $790,548 related to the flow-through shares, representing the estimated amount payable to indemnify the subscribers for the reduced renunciations. The Corporation also made a provision of $217,705 for additional penalties relating to the December 31, 2012 shortfall of $2,027,047. The liability for flow-through share commitments at December 31, 2012 included the $790,548 flow-through share indemnification plus penalties of $217,705.

In aggregate, the liability for the flow-through share commitments at December 31, 2012 related to the unexpended portion of the 2010 flow-through shares and the 2011 flow-through shares amounted to $1,840,817. These amounts were paid in full before August 2013.

12. Decommissioning provisions

The Corporation's decommissioning provisions result from its ownership interest in oil and natural gas assets, including well sites, facilities and gathering systems. The total decommissioning provision is estimated based on the Corporation's net ownership interest, estimated costs to reclaim and abandon its wells, facilities and gathering systems and the estimated timing of the costs to be incurred in future years. The estimated cash flows required to settle the provisions, excluding salvage, are approximately $91.2 million at December 31, 2013 (December 31, 2012 - $219,632). This was inflated using a weighted-average rate of 2.0 percent (December 31, 2012 - 2.0 percent), to arrive at undiscounted future cash flows of approximately $173.1 million at December 31, 2013 (December 31, 2012 - $261,840), and then discounted using a weighted-average credit-adjusted risk-free rate of 6.48 percent at December 31, 2013 (December 31, 2012 (restated - note 3(r)) - 6.5 percent) to arrive at the present value of the decommissioning provision as disclosed in the table below. The weighted-average credit-adjusted risk-free rate is based on a combination of Government of Canada benchmark bond rates and an adjustment for Questfire's estimated credit risk. These obligations are to be settled based on the estimated economic lives of the underlying assets, which currently extend up to 50 years into the future, and will be funded from general corporate resources at the time of abandonment.

The following table reconciles the decommissioning provisions for the years ended December 31, 2013 and 2012:

As at December 31,	**2013**	2012 (restated note 3(r))
	$	$
Balance, beginning of year	**156,198**	96,297
Acquisitions (note 5)	**33,636,218**	-
Additions	**111,166**	29,114
Costs incurred	**(1,020,788)**	-
Accretion (note 16)	**1,349,591**	3,578
Change in estimated future cash flows	**136,435**	27,209
Change in discount rate	**337,260**	-
Balance, end of year	**34,706,080**	156,198

Sensitivities

Changes to the risk-free discount rate or the inflation rate would have the following impact on the decommissioning provisions:

As at December 31,	2013		2012	
	Credit-adjusted risk- free discount rate $	Inflation rate $	Credit-adjusted risk-free discount rate $	Inflation rate $
1 percent increase	(3,696,124)	5,283,231	(10,113)	13,372
1 percent decrease	4,967,450	(3,953,973)	11,318	(12,058)

13. Convertible Class B shares

Class B shares are convertible (at Questfire's option) into Class A shares 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 TSXV under the symbol "Q.B".

The Class B shares were determined to be compound financial 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, they are presented as a liability.

The Class B share liability related to the Class B shares issued in 2011 ("2011 Class B shares"), estimated at issuance to be $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 2011 Class B shares, such that the carrying amount of the financial liability will be equal to the principal of $5,558,400 at maturity. Upon issuance of the 2011 Class B shares, the Corporation recognized the equity component of the convertible 2011 Class B shares as a conversion option of $1,585,985, with a further $495,367 related to the deferred income tax effect of the 2011 Class B shares, for a total of $2,081,352.

The Class B share liability related to the shares issued in 2013 ("2013 Class B shares"), estimated at issuance to be $10.0 million, based on the present value of discounted cash flows using a discount rate of 11.69 percent, is accreted using the effective interest rate method over the term of the 2013 Class B shares, such that the carrying amount of the financial liability will be equal to the principal of $15.0 million at maturity. Upon issuance of the 2013 Class B shares, the Corporation estimated the equity component to be $Nil.

The Corporation has authorized an unlimited number of Class B shares. The following table is a continuity of the convertible Class B shares liability:

As at December 31,	2013		2012	
	Number of shares	Amount $	Number of shares	Amount $
Balance, beginning of year	**555,840**	**3,966,350**	555,840	3,638,810
Issuance of Class B shares in acquisition (note 5)	**1,500,000**	**10,000,000**	-	-
Accretion of convertible Class B shares liability (note 16)	**-**	**1,122,087**	-	327,540
Balance, end of year	**2,055,840**	**15,088,437**	555,840	3,966,350

14. Convertible debentures

On June 28, 2012, the Corporation completed the issuance of unsecured senior convertible debentures (the "2012 Debentures") for gross proceeds of $1,510,000 ($1,444,497 net), of which $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 2012 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 Class A shares of Questfire 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. These warrants are all outstanding at December 31, 2013. During the year ended December 31, 2013, $75,000 of the 2012 Debentures were converted into 150,000 Class A shares by officers and directors of the Corporation.

The 2012 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 at maturity. The accretion, amortization of issuance costs and interest paid are expensed to profit or 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 convertibility. 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.

On April 30, 2013, the Corporation issued convertible debentures in association with the acquisition discussed in note 5 (the "2013 Debentures"). The 2013 Debentures have a face value of $32,585,000, and the Corporation incurred $62,875 of issuance costs. The 2013 Debentures bear interest at a rate of 6 percent per annum until April 30, 2014, 7 percent per annum from May 1, 2014 to April 30, 2015, and 9 percent per annum from May 1, 2015 until maturity on April 30, 2016. Interest on the 2013 Debentures is payable quarterly in arrears, and commenced on June 30, 2013. They mature on April 30, 2016 and can be converted into Class A shares of Questfire at a conversion price equal to the trailing 20-day volume-weighted average trading price of Class A shares at the time of exercise for a 30-day period following certain events listed below:

- i) If the Corporation chooses to pay interest by delivering Class A shares to the debenture trustee;
- ii) Any event of default;
- iii) Any conversion by the Corporation of Class B shares into Class A shares;
- iv) The date 30 months from closing;
- v) The date one month before maturity;
- vi) Upon a change of control; or
- vii) Upon an equity financing by the Corporation whereby the holder of a Debenture has the option of conversion (at the financing price), up to a maximum of 50 percent of the total shares issued in the financing, unless mutually agreed to otherwise.

The 2013 Debentures have been classified as debt, net of issuance costs. The debt portion will accrete up to the original face value at maturity and the accretion and interest paid are expensed to profit or loss. The fair value of the debentures was determined at the time of issuance based on the discounted cash flows assuming a 10 percent effective interest rate, which was the estimated rate for debt with similar terms but without convertibility. The conversion feature of the debenture is recorded as a liability as it converts at market prices, and as such its fair value is nominal.

The 2013 Debentures were repurchased on March 26, 2014 as described in note 21.

The following table is a continuity of the convertible debentures for the years ended December 31, 2013 and 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
Issuance costs	(60,531)	(1,302)	(3,670)	(65,503)
Deferred tax liability	-	(9,431)	(26,589)	(36,020)
Accretion of discount (note 16)	52,396	-	-	52,396
Balance, December 31, 2012	1,352,811	28,295	79,767	1,460,873
Conversions	(75,000)	-	(3,962)	(78,962)
Issued on acquisition (note 5)	30,284,618	-	-	30,284,618
Issuance costs	(62,875)	-	-	(62,875)
Accretion of discount (note 16)	885,558	-	-	885,558
Balance, December 31, 2013	**32,385,112**	**28,295**	**75,805**	**32,489,212**

As the 2012 Debentures mature on June 30, 2014, the liability component, totalling $1,382,604, has been classified as a current liability. The remaining $31,002,508 has been classified as a non-current liability.

15. Share capital

a) **Authorized** - Unlimited number of common shares with no par value.

b) **Issued - Class A shares**

	Number of shares	Amount
		$
Balance, January 1, 2012 and December 31, 2012	12,813,001	4,193,633
Conversion of convertible debentures	150,000	78,962
Balance, December 31, 2013	**12,963,001**	**4,272,595**

c) **Loss per share**

The following table sets forth the computation of per share amounts:

Year ended December 31,	**2013**	2012
	$	$
Weighted average number of shares outstanding for basic and diluted per share amounts	**12,910,809**	12,813,001
Basic and diluted loss per share attributable to Class A shareholders	**(0.17)**	(0.28)

For the year ended December 31, 2013, the Corporation excluded the following securities from the calculation of diluted loss per share as they would be anti-dilutive:

i. Stock options - 1,971,000 (year ended December 31, 2012 - 1,281,000)
ii. Warrants - 1,510,000 (year ended December 31, 2012 - 1,510,000)
iii. Class B shares - 2,055,840 (year ended December 31, 2012 - 555,840)
iv. Face value of convertible debentures - $34,020,000 (year ended December 31, 2012 - $1,510,000)

d) Shares in escrow

At December 31, 2013 a total of 2,458,500 Class A shares (December 31, 2012 - 4,917,000) were held in escrow pursuant to TSXV requirements. The remaining shares will be released from escrow in equal installments on April 25 and 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 TSXV in the event that the Corporation meets certain listing requirements.

e) Share-based compensation

The Corporation has a stock option plan under which it is authorized to issue stock options to employees, officers, directors and consultants for up to 20 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 grant and expire a maximum of ten years from 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 grant and expire ten years from grant.

During the year ended December 31, 2013, the Corporation granted 690,000 options (year ended December 31, 2012 - nil) to acquire Class A shares. The options vest one-third on each of the first, second and third anniversaries of grant and expire ten years from grant. The fair value of the options granted during the year ended December 31, 2013 was estimated at $391,372, using the Black-Scholes option pricing model with the following weighted-average assumptions: an exercise price of $0.99, market price of Class A shares of $0.99, a risk-free interest rate of 2.15 percent, volatility of 70 percent, an expected life of six years, a forfeiture rate of 10 percent and no dividend yield.

The following table provides information with respect to stock option transactions:

	December 31, 2013		December 31, 2012	
	Number of options	Weighted-average exercise price $	Number of options	Weighted-average exercise price $
Outstanding, beginning of year	1,281,000	0.20	1,281,000	0.20
Granted	690,000	0.99	-	-
Outstanding, end of year	**1,971,000**	**0.48**	1,281,000	0.20

The following provides information about stock options outstanding at December 31, 2013:

Range of exercise prices ($)	Number outstanding	Weighted-average remaining contractual life (years)	Options outstanding – weighted-average exercise price ($)	Number exercisable	Options exercisable – weighted-average exercise price ($)
0.20 - 0.65	1,401,000	7.96	0.24	854,000	0.20
0.95 - 1.25	570,000	9.57	1.07	-	-
	1,971,000	**8.43**	**0.48**	**854,000**	**0.20**

f) Contributed surplus

Year ended December 31,	**2013**	2012
	$	$
Balance, beginning of year [1]	**134,770**	25,327
Share-based compensation expensed for options	**153,998**	109,443
Balance, end of year	**288,768**	134,770

1) All of the contributed surplus at January 1, 2012 pertained to stock options.

16. Finance income and expense

	Year ended December 31,	
	2013	2012
	$	$
Finance income		
Interest on cash and cash equivalents	**-**	11,296
Finance expense		
Part XII.6 tax on flow-through share expenditures	**-**	(37,420)
Interest on convertible debentures	**(1,486,777)**	(92,282)
Interest on demand loan	**(1,235,996)**	-
Financing costs	**(488,487)**	-
Accretion on decommissioning provisions (note 12)	**(1,349,591)**	(3,578)
Accretion on convertible Class B share liability (note 13)	**(1,122,087)**	(327,540)
Accretion on convertible debentures (note 14)	**(885,558)**	(52,396)
	(6,568,496)	(513,216)
Net finance expense	**(6,568,496)**	(501,920)

17. Income tax

a) Deferred income tax recovery

The following table reconciles income taxes calculated at the Canadian statutory rate with the recorded income tax provision included in the statement of loss:

Year ended December 31,	**2013**	2012
	$	$
Loss before income taxes	**(2,850,299)**	(5,235,832)
Canadian statutory tax rate	**25.0%**	25.0%
Expected income tax recovery	**(712,575)**	(1,308,958)
Increase (decrease) in income taxes resulting from:		
Expenses not deductible for tax purposes	**2,250**	90,119
Share-based compensation	**38,500**	27,361
Reversal of flow-through share premium	**-**	(966,970)
Flow-through expenditures incurred	**-**	447,238
Deferred income tax recovery	**(671,825)**	(1,711,210)

b) Deferred income taxes

Temporary differences that give rise to deferred income taxes are as follows:

As at December 31,	**2013**	2012
	$	$
Deferred tax assets		
Non-capital loss carry-forward	**1,141,438**	724,849
Share issuance costs	**189,321**	117,002
Cumulative eligible capital	**231,146**	248,545
Risk management contracts	**401,564**	-
Decommissioning provision	**8,676,520**	39,050
Deferred tax liabilities		
Office lease	**(40,567)**	-
P&E and E&E assets	**(9,449,233)**	(739,985)
Convertible debentures	**(408,722)**	(39,297)
Convertible Class B share liability	**(117,491)**	(398,013)
Net deferred tax asset (liability)	**623,976**	(47,849)

For purposes of the above table, deferred income tax liabilities are shown net of offsetting deferred income tax assets where these occur in the same jurisdiction.

c) Tax pools

The Corporation has available the following estimated non-capital loss carry-forwards for which a deferred tax asset is recognized in the financial statements:

	$
Expiry	
2030	112,821
2031	863,155
2032	1,923,420
2033	1,666,356
Total	**4,565,752**

d) Tax pools

Movement in the deferred tax liability or asset during the year ended December 31, 2013:

	Balance December 31, 2012	Recognized in loss	Recognized against flow-through share premium	Recognized directly in equity	**Balance December 31, 2013**
	$	$	$	$	**$**
P&E and E&E assets	(739,985)	(8,709,248)	-	-	**(9,449,233)**
Risk management contracts	-	401,565	-	-	**401,564**
Decommissioning provisions	39,050	8,637,469	-	-	**8,676,519**
Cumulative eligible capital	248,545	(17,399)	-	-	**231,146**
Non-capital tax losses	724,849	416,589	-	-	**1,141,438**
Share issuance costs	117,002	72,319	-	-	**189,321**
Convertible Class B share liability	(398,013)	280,522	-	-	**(117,491)**
Office lease asset	-	(40,567)	-	-	**(40,567)**
Convertible debentures	(39,297)	(369,425)	-	-	**(408,722)**
Deferred tax asset (liability)	(47,849)	671,825	-	-	**623,976**

Movement in the deferred tax liability or asset during the year ended December 31, 2012:

	Balance January 1, 2012	Recognized in loss	Recognized against flow-through share premium	Recognized directly in equity	**Balance December 31, 2012**
	$	$	$	$	**$**
P&E and E&E assets	(690,820)	(49,165)	-	-	**(739,985)**
Decommissioning provisions	32,074	6,976	-	-	**39,050**
Cumulative eligible capital	-	248,545	-	-	**248,545**
Non-capital tax losses	243,994	480,855	-	-	**724,849**
Share issuance costs	138,580	(21,578)	-	-	**117,002**
Convertible Class B share liability	(479,897)	81,884	-	-	**(398,013)**
Exploration expenditures	-	966,970	(966,970)	-	**-**
Convertible debentures	-	(3,277)	-	(36,020)	**(39,297)**
Deferred tax liability	(756,069)	1,711,210	(966,970)	(36,020)	**(47,849)**

18. Supplemental cash flow information

Changes in non-cash working capital are comprised of:

	Year ended December 31,	
	2013	2012
	$	$
Cash flows related to:		
Accounts receivable	**(8,055,920)**	(58,607)
Deposits and prepaid expenses	**(555,922)**	(6,948)
Accounts payable and accrued liabilities	**11,924,669**	(1,597,058)
Flow-through share commitments	**(1,840,817)**	1,840,817
	1,472,010	178,204
Acquired non-cash working capital items:		
Office lease (note 5)	**312,944**	-
Office lease amortization	**(150,677)**	-
Accrued liabilities assumed (note 5)	**(200,000)**	-
Changes in non-cash working capital	**1,434,277**	178,204
Relating to:		
Operating activities	**(1,121,125)**	1,835,842
Investing activities	**2,789,417**	(1,672,679)
Financing activities	**(234,015)**	15,041
	1,434,277	178,204

Cash and cash equivalents at December 31, 2013 is comprised of bank balances in Canadian financial institutions.

19. Related-party transactions

i. A director of Questfire is a partner of a law firm that provides legal services to Questfire. Legal fees in the amount of $328,738 in the year ended December 31, 2013 (year ended December 31, 2012 - $80,339) were incurred by Questfire to the law firm, of which $30,000 (year ended December 31, 2012 - $34,000) was charged to debenture issuance costs, $75,061 (year ended December 31, 2012 - $46,339) to general and administrative expenses, $175,999 (year ended December 31, 2012 - $Nil) to transaction costs and $47,678 (year ended December 31, 2012 - $Nil) to financing expense. At December 31, 2013, $21,230 (December 31, 2012 - $24,824) related to these amounts was included in accounts payable and accrued liabilities and was due under normal credit terms.

ii. Key management includes executive officers and non-executive directors. The compensation paid or payable to key management for services is shown below:

Year ended December 31,	**2013**	2012
	$	$
Salaries and other short-term employee benefits	**1,410,000**	750,000
Share-based compensation	**63,769**	109,443
	1,473,769	859,443

Total personnel expenses for employees, directors and management included in general and administrative expenses, and exploration and evaluation expenses on the statement of loss is $1,878,045 and $350,000, respectively (year ended December 31, 2012 - $562,652 and $250,000, respectively).

20. Commitments

At December 31, 2013, the Corporation is committed under a lease on its office premises expiring July 31, 2014 for future minimum rental payments, excluding estimated operating costs, of $252,415 for 2014.

21. Subsequent events

i. On March 4, 2014, the Corporation entered into a new office lease agreement, commencing August 1, 2014 for a period of five years with future minimum rental payments, excluding estimated operating costs, of $167,340 for 2014, $401,616 for each of 2015, 2016, 2017, and 2018, and $234,276 for 2019.

ii. On March 26, 2014, the Corporation executed an agreement with Advantage to repurchase all of the 2013 Debentures (note 14) that were issued as part of the acquisition as described in note 5(a). These debentures were repurchased for $13.6 million, which will result in a gain of approximately $17-18 million that will be recognized in the first quarter of 2014. Questfire also agreed that it would make an offer to purchase, by way of Issuer Bid, all of its 2,055,840 issued and outstanding Class B shares at a purchase price of $2.60 per share, which has been mailed to shareholders. Advantage has agreed to tender all of its 1,500,000 Class B shares to the Issuer Bid.

   Concurrent with the above transactions, the Corporation entered into a facilities joint venture agreement with Stream Asset Financial Questfire LP ("SAFQ LP"), effective March 26, 2014. The Corporation received $15.0 million, which was used to fund the aforementioned repurchases, in exchange for beneficial ownership of Questfire's natural gas processing facilities at Lookout Butte and Medicine Hat, Alberta. Questfire will operate the facilities and continue to process its Lookout Butte and Medicine Hat natural gas production through the facilities. The Corporation will pay an annual facility tariff fee of $2,326,300 for 17.5 years, after which beneficial ownership will be transferred back to Questfire.

Questfire has the option to terminate the JVA on payment of an amount which will provide SAFQ LP with an annual compound annual yield on its investment of 13.25 percent for a minimum of 48 months or until the option is exercised. Upon the payment of aggregate processing fees to SAFQ LP of a minimum of 130 percent of its investment, SAFQ LP will have the option to sell back to Questfire its interest in the facilities for the sum equal to the total remaining scheduled processing payments using a 17.5 percent discount rate back to the time of exercise of the option by SAFQ LP.

This transaction effectively leaves substantially all of the economic risks and rewards of ownership with Questfire and will be accounted for similar to a sale and leaseback transaction, whereby Questfire will continue to record the facility as property and equipment on its balance sheet and will account for the $15.0 million sale price and the annual facility tariff fee payments as debt and interest expense respectively.

iii. The Corporation negotiated with a syndicate of Canadian banks for the provision, effective March 26, 2014, of a revised revolving credit facility in the amount of $55.0 million (replacing the existing $60.0 million revolving credit facility as described in note 10) and a new $5.0 million non-revolving development demand line. The $55.0 million revolving credit facility will be revised to $52.5 million on September 30, 2014, and $50.0 million on December 31, 2014.

The financial and reporting covenants, security and interest rates remain the same as in the previous revolving credit facility. In addition, a new operational covenant requires the Corporation to enter into hedging contracts for at least 50 percent of its forecast natural gas production for 2015 and 2016, at a price equal to or above $3.00 per GJ, before July 1, 2014.