

**Consolidated Statements of Financial Position**

(Unaudited)

Stated in thousands of dollars

As at	March 31, 2011	December 31, 2010	January 1, 2010
<b>Assets</b>		(note 16)	(note 16)
Current Assets:			
Cash and cash equivalents	\$ -	\$ 1,437	\$ -
Accounts receivable	16,056	12,404	4,061
Prepaid expenses and deposits	2,979	1,657	1,536
	<b>19,035</b>	15,498	5,597
Exploration and evaluation assets (note 6)	78,470	67,865	262
Petroleum and natural gas properties (note 7)	323,090	295,181	126,501
	<b>\$ 420,595</b>	\$ 378,544	\$ 132,360
<b>Liabilities</b>			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 38,112	\$ 31,738	\$ 10,628
Fair value of financial contracts (note 8)	3,789	2,570	221
Bank debt (note 9)	-	-	41,650
	<b>41,901</b>	34,308	52,499
Fair value of financial contracts (note 8)	1,388	-	-
Bank debt (note 9)	62,369	30,000	-
Flow through share premium liability	272	272	348
Deferred income taxes	30,085	30,011	16,191
Decommissioning obligations (note 10)	27,980	28,569	11,169
<b>Shareholders' equity</b>			
Share capital (note 11)	220,869	220,845	18,220
Contributed surplus	6,358	4,664	3,559
Performance warrants (note 11)	7,196	7,196	-
Retained earnings	22,177	22,679	30,374
	<b>256,600</b>	255,384	52,153
Commitments (note 14)			
Subsequent events (note 15)			
	<b>\$ 420,595</b>	\$ 378,544	\$ 132,360

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

**Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)**

(Unaudited)

Stated in thousands of dollars, except per share amounts

For the three months ended	March 31,	
	2011	2010
<b>Revenues:</b>		(note 16)
Petroleum and natural gas	\$ 25,872	\$ 13,978
Royalties	(3,665)	(1,884)
Realized gain (loss) on financial contracts (note 8)	(740)	232
Unrealized gain (loss) on financial contracts (note 8)	(2,607)	1,386
	<b>18,860</b>	<b>13,712</b>
<b>Expenses:</b>		
Operating	7,642	3,895
Transportation	1,162	777
General and administrative	2,175	1,101
Transaction costs	87	-
Stock-based compensation (note 11)	723	76
Bad debt provision	-	115
Depletion and depreciation	8,303	3,597
Finance expenses (note 12)	709	511
Gain on disposal of petroleum and natural gas properties	(1,513)	-
	<b>19,288</b>	<b>10,072</b>
Income (loss) before income taxes	(428)	3,640
Deferred income taxes	74	891
<b>Net income (loss) and comprehensive income (loss)</b>	<b>\$ (502)</b>	<b>\$ 2,749</b>
Income (loss) per share (note 11)		
Basic	\$ (0.01)	\$ 0.15
Diluted	\$ (0.01)	\$ 0.14

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

**Consolidated Statements of Changes in Shareholders' Equity**

(Unaudited)

Stated in thousands of dollars, except share amounts

	Number of common shares	Share capital	Contributed surplus	Performance warrants	Retained earnings	Total equity
Balance at January 1, 2010	17,836,277	\$ 18,220	\$ 3,559	\$ -	\$ 30,374	\$ 52,153
Net income for the period					2,749	2,749
Issue of common shares	926,933	2,781				2,781
Share issue costs (net of tax of \$57)		(158)				(158)
Stock-based compensation			76			76
Transfer on exercise of options		73	(73)			-
Options exercised	78,335	190				190
<b>Balance at March 31, 2010</b>	<b>18,841,545</b>	<b>\$ 21,106</b>	<b>\$ 3,562</b>	<b>\$ -</b>	<b>\$ 33,123</b>	<b>\$ 57,791</b>
Balance at December 31, 2010	56,094,547	\$ 220,845	\$ 4,664	\$ 7,196	\$ 22,679	\$ 255,384
Net income (loss) for the period					(502)	(502)
Stock-based compensation			1,696			1,696
Transfer on exercise of options		2	(2)			-
Options exercised	2,000	22				22
<b>Balance at March 31, 2011</b>	<b>56,096,547</b>	<b>\$ 220,869</b>	<b>\$ 6,358</b>	<b>\$ 7,196</b>	<b>\$ 22,177</b>	<b>\$ 256,600</b>

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

**Consolidated Statements of Cash Flows**

(Unaudited)

Stated in thousands of dollars

For the three months ended	March 31,	
	2011	2010
Cash provided by (used in)		
<b>Operating</b>		
Net income (loss)	\$ (502)	\$ 2,749
Gain on disposal of petroleum and natural gas properties	(1,513)	-
Unrealized loss (gain) on financial contracts	2,607	(1,386)
Finance expense	709	511
Interest expense	(448)	(420)
Bad debt provision	-	115
Depletion and depreciation	8,303	3,597
Decommissioning expenditures	(181)	(94)
Stock-based compensation	723	76
Deferred income taxes	74	891
Change in non-cash working capital (note 13)	(765)	(636)
Cash flow from operating activities	9,007	5,403
<b>Financing</b>		
Bank debt	32,369	(750)
Issues of common shares and performance warrants, net of issue	22	2,756
Cash flow from financing activities	32,391	2,006
<b>Investing</b>		
Petroleum and natural gas properties	(35,539)	(6,469)
Exploration and evaluation assets	(10,762)	-
Disposition of petroleum and natural gas properties	1,301	-
Change in non-cash working capital (note 13)	2,165	(940)
Cash flow used in investing activities	(42,835)	(7,409)
Change in cash	(1,437)	-
Cash, beginning of period	1,437	-
<b>Cash, end of period</b>	\$ -	\$ -

Cash is defined as cash and cash equivalents.

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

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Tabular amounts are in thousands of dollars, except share and per share data.

(Unaudited)

### 1. REPORTING ENTITY

Surge Energy Inc.'s (the "Corporation" or "Surge") business consists of the exploration, development and production of oil and gas from properties in western Canada and the northern United States. The interim consolidated financial statements include the accounts of the Corporation, its wholly-owned subsidiaries and partnerships. Surge's wholly-owned subsidiaries and partnerships are comprised of as follows:

- Surge General Partnership – Formed in Alberta, Canada
- 771129 Alberta Limited – Incorporated in Alberta, Canada
- 1413942 Alberta Limited – Incorporated in Alberta, Canada
- Surge Energy USA Inc. – Incorporated in Delaware, United States of America

### 2. BASIS OF PREPARATION

#### (a) Statement of compliance

These interim consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting". These are Surge's first International Financial Reporting Standards ("IFRS") interim consolidated financial statements for part of the period covered by the first IFRS annual financial statements and IFRS 1, "First-time Adoption of International Financial Reporting Standards" has been applied. These interim consolidated financial statements do not include all of the information required for full annual financial statements.

Surge's significant accounting policies under IFRS are presented in note 3. These policies have been retrospectively and consistently applied except where specific exemptions permitted an alternative treatment upon transition to IFRS in accordance with IFRS 1. The impact of the new standards, including reconciliations presenting the change from previous GAAP to IFRS as at January 1, 2010, as at and for the three months ended March 31, 2010 and as at and for the year ended December 31, 2010, is presented in note 16.

The interim consolidated financial statements were authorized for issuance by the Board of Directors on June 15, 2011.

#### (b) Basis of measurement

The interim consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value.

The methods used to measure fair values are discussed in note 4.

#### (c) Functional and presentation currency

These interim consolidated financial statements are presented in Canadian dollars, which is the Corporation's and its subsidiaries' functional currency, except Surge Energy USA Inc. which has a US dollar functional currency.

#### (d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

Estimates of recoverable quantities of proved and probable reserves include judgmental assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of complex geological and geophysical models in order to make an assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate proved plus probable reserves may change from period to period. Changes in reported reserves can impact asset carrying values, the provision for decommissioning liabilities and the recognition of deferred tax assets, due to changes in expected future cash flows. Reserve estimates are prepared in accordance with the Canadian Oil and Gas Evaluation Handbook and are reviewed by an independent qualified reserves evaluator and based on the guidance stipulated by National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities.

Significant areas of estimation, uncertainty and critical judgments in applying accounting policies that impact the amounts recognized in the interim financial statements include:

- Impairment testing – estimates of reserves, future commodity prices, future costs, production profiles, discount rates, market value of land.
- Depletion and depreciation – crude oil and natural gas reserves, including future prices, costs and reserve base to use on calculation of depletion.
- Decommissioning obligations – estimates relating to amounts, likelihood, timing, inflation and discount rates.
- Stock-based compensation – forfeiture rates, volatility and expected terms to exercise.
- Derivatives – expected future crude oil and natural gas prices and expected volatility in these prices; expected interest rates; expected future foreign exchange rates.
- Deferred tax – estimates of reversal of temporary differences, tax rates substantively enacted, and likelihood of assets being realized.
- Provisions and contingencies – estimates relating to onerous contracts, including discount rates associated with long-term contracts.

The Corporation makes judgments in determining its CGUs (to be defined hereafter) and evaluates the geography, geology, production profile and infrastructure of its assets in making such determinations, which are based on estimates of reserves. Based on this assessment, the Corporation's CGUs are generally composed of significant development areas. The Corporation reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of consolidation:

##### Subsidiaries

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the statement of income.

##### Jointly controlled operations and jointly controlled assets

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

##### Transactions eliminated on consolidation:

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

#### (b) Foreign currency

Transactions in foreign currencies are translated to the functional currencies of each entity at exchange rates prevailing on the date of each transaction. Monetary assets and liabilities denominated in foreign currencies are translated to each entity's functional currency at the period-end exchange rate. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of transaction. Foreign currency differences arising on translation are recognized in profit or loss. Foreign currency gains and losses are reported on a net basis.

The assets and liabilities of foreign operations are translated to Canadian dollars, the reporting currency, at the reporting date. The income and expense transactions of foreign operations are translated to Canadian dollars at exchange rates at the date of each transaction. Foreign currency differences on translation to the reporting currency are recognized directly in equity.

#### (c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and all investments that are highly liquid in nature and have a maturity date of three months or less.

#### (d) Petroleum and natural gas properties

##### Exploration and evaluation expenditures

Pre-license costs are recognized in the statement of income as incurred.

Exploration and evaluation costs, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized as either tangible or intangible exploration and evaluation assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven and/or probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proven and/or probable reserves have been discovered. Upon determination of proven and/or probable reserves, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to petroleum and natural gas properties.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units (CGUs), as detailed below.

#### Development and production costs

Items of petroleum and natural gas properties, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. The cost of development and production assets includes; transfers from exploration and evaluation assets, which generally include the cost to drill the well and the cost of the associated land upon determination of technical feasibility and commercial viability; the cost to complete and tie-in the wells; facility costs; the cost of recognizing provisions for future restoration and decommissioning; geological and geophysical costs; and directly attributable overheads.

Development and production assets are grouped into CGU's for impairment testing. When significant parts of an item of petroleum and natural gas properties have different useful lives, then they are accounted for as separate components.

Gains and losses on disposal of an item of petroleum and natural gas properties are determined by comparing the proceeds from disposal with the carrying amount of petroleum and natural gas properties and are recognized net in profit or loss.

#### Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of petroleum and natural gas properties are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of petroleum and natural gas properties are recognized in profit or loss as incurred.

#### Depletion and Depreciation

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the period to the related proved plus probable reserves, taking into account estimated future development costs necessary to bring those reserves into production and the estimated salvage value of the assets at the end of their useful lives. Future development costs are estimated taking into account the level of development required to produce the reserves.

Proved plus probable reserves are estimated annually by independent qualified reserve evaluators and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are



considered commercially producible. For interim financial statements internal estimates of changes in reserves and future development costs are used for determining depletion for the period. For purposes of this calculation, petroleum and gas reserves are converted to a common unit of measure on the basis of their relative energy content, where six thousand cubic feet of gas equals one barrel of oil or liquids.

Surge has deemed the estimated useful lives for gas processing plants, pipeline facilities, and compression facilities to be consistent with the reserve lives of the areas for which they serve. As a result, Surge includes the cost of these assets within their associated major component (area or group of areas) for the purpose of depletion using the unit of production method.

Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Corporation will obtain ownership by the end of the lease term.

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

#### (e) Impairment

##### Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is 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 estimated future cash flows of that asset.

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 share similar credit risk characteristics.

All impairment losses are recognized in the statement of income.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the statement of income.

##### Non-financial assets

The carrying amounts of the Corporation's non-financial assets, other than exploration and evaluations (E&E) assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to petroleum and natural gas properties, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGU's are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

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

#### (f) Provisions

##### Decommissioning obligations

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

Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation as at the reporting date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as accretion (within finance expense) whereas increases/decreases due to changes in the estimated future cash flows or changes in the discount rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

#### (g) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

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

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

#### (h) Stock-based compensation and warrant valuation

The Corporation uses the fair value method for valuing stock options and warrants. Under the fair value method, compensation costs attributable to all stock options and warrants granted are measured at fair value at the date of grant and expensed over the vesting period with a corresponding increase to contributed surplus or warrants. The fair value of each option or warrant granted is estimated using the Black-Scholes option pricing model that takes into account the grant

date, the exercise price and expected life of the option or warrant, the price of the underlying security, the expected volatility, the risk-free interest rate and dividends if any on the underlying security. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus or warrants is recorded as an increase to share capital and the contributed surplus or warrants balance is reduced.

The Corporation has included an estimated forfeiture rate for stock options or warrants that will not vest, which is adjusted for actual forfeitures as they occur and upon final vesting of the award.

#### **(i) Revenue recognition**

Revenue from the sale of petroleum and natural gas is recorded on a gross basis when title passes to an external party and collection is reasonably assured based on volumes delivered to customers at contractual delivery points and rates and when collection is reasonably assured. The costs associated with the delivery, including production costs, transportation and production based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

#### **(j) Finance income and expenses**

Finance expense comprises interest expense on borrowings, accretion of the discount on provisions and impairment losses recognized on financial assets.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Corporation's outstanding borrowings during the period.

Interest income is recognized as it accrues in profit or loss, using the effective interest method.

#### **(k) Per share information**

Per share amounts are calculated based on the weighted average number of common shares outstanding during the year. The diluted weighted average number of shares is adjusted for the dilutive effect of options and warrants. Under the treasury stock method, only "in the money" options and warrants are included in the weighted average diluted number of shares. It is also assumed that any proceeds obtained upon the exercise of options and warrants plus the unamortized portion of stock-based compensation would be used to purchase common shares at the average price during the period. The weighted average number of shares is then reduced by the number of shares acquired.

#### **(l) Flow-through shares**

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. On issuance the premium received on the flow-through shares, being the difference in price over a common share with no tax attributes, is recognized on the statement of financial position. As expenditures are incurred the deferred tax liability associated with the renounced tax deductions are recognized through profit and loss along with a pro-rata portion of the deferred premium.

#### **(m) Leased assets**

Leases where the Corporation assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Corporation's statement of financial position.

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

#### **(n) 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. Financial assets and financial liabilities are recognized on the statement of financial position at the time the Corporation becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument. The Corporation has made the following classifications:

- Cash and cash equivalents and accounts receivable are classified as loans and receivables and are initially measured at fair value plus directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Bank debt and accounts payable and accrued liabilities are classified as other liabilities and are initially measured at fair value less directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Derivative financial instruments that do not qualify as hedges, or are not designated as hedges on the statement of financial position, including risk management commodity contracts, are classified as fair value through profit or loss and are recorded and carried at fair value. The Corporation may use derivative financial instruments to manage economic exposure to market risks relating to commodity prices. The Corporation does not utilize derivative financial instruments for speculative purposes.

Transaction costs related to financial instruments classified as fair value through profit or loss are expensed as incurred. All other transaction costs related to financial instruments are recorded as part of the instrument and are amortized using the effective interest method.

Contracts that are entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the Corporation's expected purchase, sale or usage requirements (such as physical delivery commodity contracts) do not qualify as financial instruments and thus, are accounted for as executory contracts. These contracts are not fair valued on the statement of financial position. Settlements are recognized in the statement of income as they occur.

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

#### **(o) Comparative figures**

Certain comparative figures have been reclassified to conform with the current year's presentation.

#### **(p) Future Accounting Changes**

The following pronouncements from the IASB will become effective for financial reporting periods beginning on or after January 1, 2013 and have not yet been adopted by the Corporation. All of these new or revised standards permit early adoption with transitional arrangements depending upon the date of initial application:

- IFRS 9 - Financial Instruments addresses the classification and measurement of financial assets.
- IFRS 10 - Consolidated Financial Statements builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.
- IFRS 11 - Joint Arrangements establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.
- IFRS 12 Disclosure of Interest in Other Entities provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.
- IFRS 13 - Fair Value Measurement defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.
- IAS 27 - Separate Financial Statements revised the existing standard which addresses the presentation of parent company financial statements that are not consolidated financial statements.
- IAS 28 - Investments in Associate and Joint Ventures revised the existing standard and prescribes the accounting for investments and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

The Corporation has not completed its evaluation of the effect of adopting these standards on its financial statements.

#### 4. DETERMINATION OF FAIR VALUES

A number of the Corporation's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

##### (a) Petroleum and natural gas properties

The fair value of petroleum and natural gas properties recognized on acquisition is based on market values. The market value of petroleum and natural gas properties is the estimated amount for which petroleum and natural gas properties could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports.

The market value of other items of petroleum and natural gas properties is based on the quoted market prices for similar items.

##### (b) Cash and cash equivalents, accounts receivable, bank debt and accounts payable

The fair value of cash and cash equivalents, accounts receivable, bank debt and accounts payable is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At March 31, 2011 and December 31, 2010, the fair value of these balances approximated their carrying value due to their short term to maturity. Bank debt bears a floating rate of interest and therefore carrying values approximate fair value.

##### (d) Derivatives

The fair value of forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the statement of financial position date, using the remaining contracted oil and

natural gas volumes and a risk-free interest rate (based on published government rates). The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

**(e) Stock options**

The fair value of employee stock options is measured using a Black Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

**5. ACQUISITIONS**

**(a) Corinthian Energy Corp.**

Effective July 9, 2010, the Corporation acquired all of the issued and outstanding common shares of Corinthian Energy Corp. ("Corinthian"), a privately held junior oil and gas exploration company, in exchange for 16,025,529 common shares of Surge with an assigned value of \$85,737,000. The common shares have been ascribed a fair value of \$5.35 per common share issued, as determined based on the Corporation's closing share price at the date of closing, being July 9, 2010. In addition, Surge incurred transaction costs of \$1,009,000, which were expensed through the statement of income. The operations of Corinthian have been included in the results of Surge commencing July 9, 2010. The transaction was accounted for by the purchase method. The allocation of the purchase price, based on management's estimates of fair values, is as follows:

<b>Fair value of net assets acquired:</b>	
Petroleum and natural gas properties	\$ 74,996
Exploration and evaluation assets	53,981
Bank debt	(15,810)
Working capital	472
Decommissioning obligations	(13,748)
Deferred income tax liability	(14,154)
<b>Net assets acquired</b>	<b>\$ 85,737</b>
<b>Consideration:</b>	
Common shares (16,025,529 common shares)	\$ 85,737

**(b) Crystal Lake Resources Ltd.**

Effective July 19, 2010, Surge acquired all of the issued and outstanding common shares of Crystal Lake Resources Ltd. ("Crystal Lake"), a privately held junior oil and gas exploration company, in exchange for 288,639 common shares of Surge with an assigned value of \$1,498,000. The common shares have been ascribed a fair value of \$5.19 per common share issued, as determined based on the Corporation's closing share price at the date of closing being July 19, 2010. The operations of Crystal Lake have been included in the results of Surge commencing July 19, 2010. The allocation of the purchase price, based on management's estimates of fair values, is as follows:

<b>Fair value of net assets acquired:</b>	
Petroleum and natural gas properties	\$ 1,471
Working capital	40
Decommissioning obligations	(90)
Deferred income tax asset	77
<b>Net assets acquired</b>	<b>\$ 1,498</b>
<b>Consideration:</b>	
Common shares (288,639 common shares)	\$ 1,498

- (c) Effective November 1, 2010, Surge acquired certain petroleum and natural gas properties in the Valhalla region of Alberta, in exchange for cash of \$74.5 million of which \$27 million was recognized in E&E for the value of undeveloped assets and \$48.6 million in petroleum and natural gas properties, with associated decommissioning obligations of \$1.1 million.
- (d) On March 24, 2011, the Corporation acquired certain crude oil and natural gas assets for cash consideration of \$4.5 million of which \$1.1 million was recognized in E&E for the value of undeveloped land and \$3.4 million was recognized in petroleum and natural gas properties. In addition, the Corporation recorded a decommissioning provision of \$0.5 million in relation to the acquired assets.
- (e) On March 30, 2011, the Corporation acquired certain crude oil and natural gas assets for cash consideration of \$7.5 million of which \$5.3 was recognized in E&E for the value of undeveloped land and \$2.2 million was recognized in petroleum and natural gas properties. In addition, the Corporation recorded a decommissioning provision of \$0.2 million in relation to the acquired assets.

## 6. EXPLORATION AND EVALUATION ASSETS

	Total
<b>Cost:</b>	
Balance at January 1, 2010	\$ 262
Additions	22,232
Acquisitions	80,985
Transfer to petroleum and natural gas properties	(35,614)
<b>Balance at December 31, 2010</b>	<b>\$ 67,865</b>
Acquisitions	6,302
Additions	4,506
Dispositions	(46)
Transfer to petroleum and natural gas properties	(157)
<b>Balance at March 31, 2011</b>	<b>\$ 78,470</b>

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

**7. PETROLEUM AND NATURAL GAS PROPERTIES**

	Total
<b>Cost or deemed cost:</b>	
Balance at January 1, 2010	\$ 126,501
Acquisitions	105,150
Additions	41,995
Transfer from intangible exploration assets	35,614
Change in decommissioning obligations	1,181
Capitalized stock-based compensation	4,007
Disposals	(335)
<b>Balance at December 31, 2010</b>	<b>\$ 314,113</b>
Acquisitions	8,863
Additions	30,613
Transfer from intangible exploration assets	157
Change in decommissioning obligations	(1,175)
Capitalized stock-based compensation	973
Disposals	(3,336)
<b>Balance at March 31, 2011</b>	<b>\$ 350,208</b>

	Total
<b>Accumulated depletion and depreciation:</b>	
Balance at January 1, 2010	\$ -
Depletion and depreciation expense	(18,992)
Disposals	60
<b>Balance at December 31, 2010</b>	<b>(18,932)</b>
Depletion and depreciation expense	(8,303)
Disposals	117
<b>Balance at March 31, 2011</b>	<b>\$ (27,118)</b>

	Total
<b>Net book value:</b>	
Balance at January 1, 2010	\$ 126,501
Balance at December 31, 2010	\$ 295,181
Balance at March 31, 2011	\$ 323,090

The calculation of depletion and depreciation expense for the three months ended March 31, 2011 included an estimated \$79.4 million (2010 - \$22.1 million) for future development costs associated with proved plus probable reserves and excluded \$27.0 million (2010 - \$12.6 million) for the estimated salvage value of production equipment and facilities.

**Divestitures**

During the three months ended March 31, 2011, the Corporation disposed of certain assets for gross cash proceeds of \$1.3 million, resulting in a cash gain of \$1.0 million. Additionally, the Corporation disposed of certain assets in exchange for other non-cash assets for a non-cash gain of \$0.5 million. The assets received had an assigned fair value of \$3.6 million, all of which was recognized in petroleum and natural gas properties.



## 8. RISK MANAGEMENT CONTRACTS

As a means of managing commodity price volatility, the Corporation enters into various derivative financial instrument agreements and physical contracts.

The following table outlines the realized and unrealized losses on oil and gas commodity contracts for the period to date March 31, 2011:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C\$)	Index (Surge pays)	Unrealized gains (losses) (C\$1000)	Realized gains (losses) (C\$1000)
Jan 1 to Dec 31, 2011	Swap		\$ 80.00	WTI - NYMEX		(290)
Jan 1 to Dec 31, 2011	Call		\$ 96.55	WTI - NYMEX		31
Jan 1 to Dec 31, 2011	Call		\$ 78.40	WTI - NYMEX		(163)
Jan 1 to Dec 31, 2011	Swap		\$ 85.50	WTI - NYMEX		(166)
Jan 1 to Dec 31, 2011	Swap		\$ 80.00	WTI - NYMEX		(290)
Jan 1 to Dec 31, 2011	Call		\$ 91.00	WTI - NYMEX		74
Jan 1 to Dec 31, 2011	Call	500 GJs/d	\$ 6.55	AECO Monthly Average	1	-
Jan 1 to Dec 31, 2011	Put	500 GJs/d	\$ 5.00	AECO Monthly Average	(51)	64
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	\$ 80.00	WTI - NYMEX	(468)	-
Jan 1 to Dec 31, 2011	Call	250 bbls/d	\$ 96.55	WTI - NYMEX	425	-
Jan 1 to Dec 31, 2011	Call	125 bbls/d	\$ 78.40	WTI - NYMEX	(183)	-
Jan 1 to Dec 31, 2011	Put	250 bbls/d	\$ 78.40	WTI - NYMEX	(67)	-
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	\$ 85.50	WTI - NYMEX	(590)	-
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	\$ 80.00	WTI - NYMEX	(467)	-
Jan 1 to Dec 31, 2011	Call	250 bbls/d	\$ 91.00	WTI - NYMEX	465	-
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	\$ 97.00	WTI - NYMEX	(673)	-
Jan 1 to Dec 31, 2012	Call	63 bbls/d	\$ 80.00	WTI - NYMEX	(636)	-
Jan 1 to Dec 31, 2012	Put	250 bbls/d	\$ 90.00	WTI - NYMEX	351	-
Jan 1 to Dec 31, 2012	Call	250 bbls/d	\$ 89.95	WTI - NYMEX	1,881	-
Apr 1 to Dec 31, 2011	Call	250 bbls/d	\$ 84.35	WTI - NYMEX	1,510	-
Apr 1 to Dec 31, 2011	Swap	250 bbls/d	\$ 80.00	WTI - NYMEX	(1,714)	-
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	\$ 80.00	WTI - NYMEX	(2,194)	-
Jul 1 to Dec 31, 2011	Put	250 bbls/d	\$ 90.00	WTI - NYMEX	140	-
Jan 1 to Dec 31, 2012	Put	250 bbls/d	\$ 90.00	WTI - NYMEX	578	-
Jan 1 to Dec 31, 2012	Call	93 bbls/d	\$ 90.00	WTI - NYMEX	(695)	-
Jul 1 to Dec 31, 2011	Call	65 bbls/d	\$ 90.00	WTI - NYMEX	(220)	-
<b>Total</b>					<b>(2,607)</b>	<b>(740)</b>

The following table summarizes the sensitivity of the fair value of the Corporation's market risk management positions to fluctuations in both crude oil and natural gas prices. Both such fluctuations were evaluated independently, with all other variables held constant. In assessing the potential impact of these fluctuations, the Corporation believes that the volatilities presented below are reasonable measures. Fluctuations in crude oil and natural gas prices, which would impact the mark-to-market calculation of commodity contracts, could have had the following impact on the net earnings:

Net Earnings Impact for Year to Date March 31, 2011		
	Price Increase	Price Decrease
Crude Oil - Change of +/- \$1.00	\$ 385,749	\$ (385,749)
Natural Gas - Change of +/- \$0.50	\$ 41,250	\$ (41,250)

## 9. BANK DEBT

The Corporation has a \$120 million extendible, revolving term credit facility with a syndicate of Canadian banks bearing interest at bank rates. The facility is available on a revolving basis until July 13, 2011. On July 13, 2011, at the Corporation's discretion, the facility is available on a non-revolving basis for a one-year period, at the end of which time the facility would be due and payable. Alternatively, the facilities may be extended for a further 364-day period at the request of the Corporation and subject to the approval of the syndicate. As the available lending limits of the facilities are based on the syndicate's interpretation of the Corporation's reserves and future commodity prices, there can be no assurance that the amount of the available facilities will not decrease at the next scheduled review. Interest rates vary depending on the ratio of net debt to cash flow. The facility had an effective interest rate of prime plus 1.50 percent as at March 31, 2011 (March 31, 2010 – prime plus 1.25 percent).

The facility is secured by a general assignment of book debts, debentures of \$200.0 million with a floating charge over all assets of the Corporation with a negative pledge and undertaking to provide fixed charges on the major producing petroleum and natural gas properties at the request of the bank. Under the terms of the agreement, the Corporation is required to meet certain financial and engineering reporting requirements.

Under the terms of the agreement, the Corporation must maintain an adjusted working capital ratio of not less than 1.00:1.00 at all times. The working capital ratio is defined under the current credit facility as cash-based current assets, including the undrawn portion of the facility, to cash-based current liabilities, excluding any current bank indebtedness. The Corporation is compliant with this covenant at March 31, 2011.

## 10. DECOMMISSIONING OBLIGATIONS

The Corporation's decommissioning obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Corporation estimates the total undiscounted amount of cash flows required to settle its decommissioning obligations is approximately \$70.0 million (December 31, 2010 – \$66.1 million) which will be incurred between 2011 and 2059. The majority of these costs will be incurred between 2011 and 2037. A risk free rate of four percent (December 31, 2010 – four percent) and an inflation rate of two percent (December 31, 2010 – two percent) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	March 31, 2011	March 31, 2010
Balance, beginning of period	\$ 28,569	\$ 11,169
Liabilities related to acquisitions	656	-
Liabilities related to dispositions	(150)	-
Change in decommissioning obligations	(1,354)	92
Liabilities incurred	179	37
Accretion expense	261	91
Decommissioning expenditures	(181)	(94)
<b>Balance, end of period</b>	<b>\$ 27,980</b>	<b>\$ 11,295</b>

## 11. SHARE CAPITAL

### a) Authorized

Unlimited number of voting common shares.

Unlimited number of preferred shares, issuable in series.

### b) Stock Options

Under the Corporation's stock option plan, it may grant options to its officers, directors, employees and certain consultants for up to 5,609,655 common shares of the Corporation as at March 31, 2011. The exercise price of each option equals the market price of the Corporation's common shares at the date of grant. Options granted have a term of five years to maturity and vest as to one-third on each of the first, second and third anniversaries from the date of grant.

	2011		2010	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Oustanding at January 1	2,683,667	\$ 6.24	1,878,001	\$ 3.74
Granted	443,000	\$ 7.82	-	\$ -
Exercised	(2,000)	\$ 2.85	(78,335)	\$ 2.43
Forfeited	(43,000)	\$ 5.96	(20,000)	\$ 7.10
Oustanding at March 31	3,081,667	\$ 6.47	1,779,666	\$ 3.76
Exercisable at March 31	97,667	\$ 2.59	1,413,661	\$ 4.01

The following table summarizes stock options outstanding and exercisable at March 31, 2011.

Range of exercise prices	Number outstanding	Weighted average exercise price	Weighted average contractual life (years)	Number exercisable	Weighted average exercise price
\$1.00 to \$2.79	46,667	\$ 1.75	2.70	46,667	\$ 1.75
\$2.80 to \$4.59	49,000	\$ 3.20	3.74	49,000	\$ 3.20
\$4.60 to \$6.39	567,500	\$ 5.76	4.34	-	\$ -
\$6.40 to \$8.19	2,301,500	\$ 6.70	4.38	2,000	\$ 7.10
\$8.20 to \$10.00	117,000	\$ 8.40	4.97	-	\$ -
\$1.00 to \$10.00	3,081,667	\$ 6.47	4.36	97,667	\$ 2.59

### c) Performance warrants

The Corporation has 2,076,136 performance warrants outstanding (2,076,136 – December 31, 2010) that expire on April 13, 2015. As at March 31, 2011, all 2,076,136 performance warrants were vested and exercisable, and two-thirds held in escrow.

#### d) Stock-based compensation

A reconciliation of the stock-based compensation expense is provided below:

	March 31, 2011	March 31, 2010
Stock-based compensation on options	\$ 1,696	\$ 190
Capitalized stock-based compensation	(973)	(114)
<b>Total stock-based compensation expense</b>	<b>\$ 723</b>	<b>\$ 76</b>

The Corporation's stock-based compensation expense for the three months ended March 31, 2011 was \$0.7 million (March 31, 2010 - \$0.1 million). A Black-Scholes valuation model was applied to determine the fair value the options and performance warrants.

The following assumptions were used to calculate stock-based compensation on options granted for the three months ended March 31, 2011: zero dividend yield (March 31, 2010 – zero); expected volatility of 69 percent (March 31, 2010 – 69 percent); risk free rate of two percent (March 31, 2010 – two percent); and expected life of five years (2010 – five years). The weighted average fair value of options granted in the first three months of 2011 is \$4.58 per option (March 31, 2010 - nil).

#### e) Per share amounts

The following table summarizes the shares used in calculating the income per share:

	March 31, 2011	March 31, 2010
Weighted average number of shares - basic	56,094,747	18,576,487
Effect of dilutive stock options and performance warrants	-	457,033
Weighted average number of shares - diluted	56,094,747	19,033,520

In computing diluted per share amount at March 31, 2011, 3,081,667 options (March 31, 2010 – 1,779,666) and 2,076,136 performance warrants were excluded from the calculation as their effect was anti-dilutive.

## 12. FINANCE EXPENSES

	March 31, 2011	March 31, 2010
Interest on bank debt	\$ 448	\$ 420
Accretion of decommissioning obligations	261	91
<b>Finance expenses</b>	<b>\$ 709</b>	<b>\$ 511</b>

### 13. CASHFLOW INFORMATION

	March 31, 2011	March 31, 2010
Accounts receivable	\$ (3,652)	\$ (2,632)
Prepaid expenses and deposits	(1,322)	657
Accounts payable and accrued liabilities	6,374	399
Change in non-cash working capital	\$ 1,400	\$ (1,576)
These changes relate to the following activities		
Operating	\$ (765)	\$ (636)
Investing	2,165	(940)
	\$ 1,400	\$ (1,576)

### 14. COMMITMENTS

#### (a) Future minimum payments relating to operating lease and firm transport commitments

2011	\$ 1,395
2012	2,492
2013	1,804
2014	1,465
2015	1,404
2016+	2,129
<b>Total</b>	<b>\$ 10,689</b>

#### (b) Flow-through shares

In 2010, the Corporation issued a total of 681,819 flow-through common shares at \$4.40 per share as part of a flow-through unit for gross proceeds of \$3.0 million. The Corporation renounced these qualifying petroleum and natural gas expenditures effective December 31, 2010. As at March 31, 2011 Corporation had incurred \$0.8 million towards this flow-through share obligation and has until December 31, 2011 to incur the \$2.2 million of remaining expenditures.

### 15. SUBSEQUENT EVENTS

Subsequent to March 31, 2011, the Corporation entered into a three year interest rate contract with the following terms:

Term	Type (floating to fixed)	Amount (C\$)	Company Fixed Interest Rate (%) <sup>(1)</sup>	Counterparty Floating Rate Index
Jan 1, 2012 to Dec 31, 2014	Swap	\$50,000,000	2.74%	CAD-BA-CDOR
<b>Total</b>				

(1) The interest rate hedge is comprised of a range, beginning at 1.439% and escalating quarterly to a maximum of 3.952%.

On May 12, 2011, the Corporation acquired certain oil and gas properties for cash of approximately \$13.5 million.

## 16. TRANSITION TO IFRS

Surge's accounting policies under IFRS differ from those followed under previous GAAP as described in note 3. These accounting policies have been applied for the three months ended March 31, 2011, as well as to the opening statement of financial position on the transition date, January 1, 2010, the comparative information for the three months ended March 31, 2010 and the comparative information for the year ended December 31, 2010.

The adjustments arising from the application of IFRS to amounts on the statement of financial position on the transition date and on transactions prior to that date, were recognized as an adjustment to the Corporation's opening retained earnings category on the statement of financial position when appropriate.

On transition to IFRS on January 1, 2010 Surge used certain exemptions allowed under IFRS 1 "first time adoption of international reporting standards". The exemptions used were:

*Full Cost Accounting* – IFRS 1 allows an entity that used full cost accounting under its previous GAAP to elect, at the time of adoption to IFRS, to measure oil and gas assets in the development and production phases by allocating the amount determined under the entity's previous GAAP for those assets to the underlying assets pro rata using reserve volumes or reserve values as of that date. Surge has used reserve values as at January 1, 2010 to allocate the cost of development and production assets to Cash Generating Units (CGUs) and components.

*Business Combinations* – IFRS 1 allows an entity to use the IFRS rules for business combinations on a prospective basis rather than re-stating all business combinations.

*Share Based Compensation* – IFRS1 allows an entity an exemption on IFRS 2, "share-based payments", to equity instruments which vested before Surge' transition date to IFRS.

*Decommissioning Obligation* – as Surge elected to use the oil and gas exemption, a decommissioning obligation exemption was also used that allows for the re-measurement of decommissioning obligations on IFRS transition to be offset to retained earnings.

**IFRS OPENING STATEMENT OF FINANCIAL POSITION (RECONCILIATION OF EQUITY)**

<b>As at January 1, 2010</b> <b>(\$ thousands)</b>	<b>Previous GAAP</b>	<b>Effect of transition to IFRS</b>	<b>Note</b>	<b>IFRS</b>
<b>Assets</b>				
Current assets:				
Accounts receivable	\$ 4,061	\$ -		\$ 4,061
Prepaid expenses and deposits	1,536	-		1,536
	5,597	-		5,597
Exploration and evaluation assets	-	262	(a)	262
Petroleum and natural gas properties	126,763	(262)	(a)	126,501
	\$ 132,360	\$ -		\$ 132,360
<b>Liabilities</b>				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 10,628	\$ -		\$ 10,628
Fair value of financial contracts	221	-		221
Bank debt	41,650	-		41,650
	52,499	-		52,499
Flow-through share premium liability	-	348	(h)	348
Deferred income taxes	17,636	(1,445)	(f)	16,191
Decommissioning obligations	5,389	5,780	(c)	11,169
<b>Shareholders' equity</b>				
Share capital	16,209	2,011	(h)	18,220
Contributed surplus	3,559	-		3,559
Retained earnings (deficit)	37,068	(6,694)		30,374
	56,836	(4,683)		52,153
	\$ 132,360	\$ -		\$ 132,360

## STATEMENT OF FINANCIAL POSITION (RECONCILIATION OF EQUITY)

<b>As at March 31, 2010</b> <b>(\$ thousands)</b>	<b>Previous GAAP</b>	<b>Effect of transition to IFRS</b>	<b>Note</b>	<b>IFRS</b>
<b>Assets</b>				
Current assets:				
Accounts receivable	\$ 6,693	\$ -		\$ 6,693
Prepaid expenses and deposits	879	-		879
Fair value of financial contracts	1,165	-		1,165
	8,737	-		8,737
Exploration and evaluation assets	-	262	(a)	262
Petroleum and natural gas properties	128,599	787	(a), (c), (d)	129,386
	\$ 137,336	\$ 1,049		\$ 138,385
<b>Liabilities</b>				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 11,027	\$ -		\$ 11,027
Deferred income taxes	326	(326)		-
Bank debt	40,900	-		40,900
	52,253	(326)		51,927
Flow-through share premium liability	-	159	(h)	159
Deferred income taxes	18,476	(1,263)	(f)	17,213
Decommissioning obligations	5,389	5,906	(c)	11,295
<b>Shareholders' equity</b>				
Share capital	18,420	2,686	(h)	21,106
Contributed surplus	3,562	-		3,562
Retained earnings (deficit)	39,236	(6,113)		33,123
	61,218	(3,427)		57,791
	\$ 137,336	\$ 1,049		\$ 138,385



## STATEMENT OF FINANCIAL POSITION (RECONCILIATION OF EQUITY)

<b>As at December 31, 2010</b> <b>(\$ thousands)</b>	<b>Previous GAAP</b>	<b>IFRS Adjustments</b>	<b>Note</b>	<b>IFRS</b>
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 1,437	\$ -		\$ 1,437
Accounts receivable	12,404	-		12,404
Prepaid expenses and deposits	1,657	-		1,657
Deferred income taxes	681	(681)		-
	16,179	(681)		15,498
Exploration and evaluation assets	-	67,865	(a)	67,865
Petroleum and natural gas properties	361,398	(66,217)	(a), (b), (c), (e), (d)	295,181
	\$ 377,577	\$ 967		\$ 378,544
<b>Liabilities</b>				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 31,738	\$ -		\$ 31,738
Fair value of financial contracts	2,570	-		2,570
	34,308	-		34,308
Bank debt	30,000	-		30,000
Flow-through share premium liability	-	272	(h)	272
Deferred income taxes	35,239	(5,228)	(f)	30,011
Decommissioning obligations	11,994	16,575	(c)	28,569
<b>Shareholders' equity</b>				
Share capital	227,434	(6,589)	(h)	220,845
Contributed surplus	4,664	-		4,664
Performance warrants	7,196	-		7,196
Retained earnings (deficit)	26,742	(4,063)		22,679
	266,036	(10,652)		255,384
	\$ 377,577	\$ 967		\$ 378,544

**RECONCILIATION OF CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME FOR THE THREE MONTHS ENDED, MARCH 31, 2010**

<b>Three Months Ended March 31, 2010</b> <i>(\$ thousands, except per share amounts)</i>	<b>Previous GAAP</b>	<b>Effect of transition to IFRS</b>	<b>Note</b>	<b>IFRS</b>
<b>Revenues</b>				
Petroleum and natural gas	\$ 13,978	\$ -		\$ 13,978
Royalties	(1,884)	-		(1,884)
Realized gain on financial contracts	232	-		232
Unrealized gain on financial contracts	1,386	-		1,386
	13,712	-		13,712
<b>Expenses</b>				
Operating	3,895	-		3,895
Transportation	777	-		777
General and administrative	1,101	-		1,101
Interest expense	420	(420)	(g)	-
Finance expenses	-	511	(c), (g)	511
Stock-based compensation	76	-		76
Bad debt provision	115	-		115
Depletion and depreciation	4,612	(1,015)	(d), (g)	3,597
	10,996	(924)		10,072
Income before income taxes	2,716	924		3,640
Deferred income taxes	548	343	(f), (h)	891
<b>Net income and comprehensive income</b>	<b>\$ 2,168</b>	<b>\$ 581</b>		<b>\$ 2,749</b>
<b>Income per share</b>				
Basic	\$ 0.12	\$ 0.03		\$ 0.15
Diluted	\$ 0.11	\$ 0.03		\$ 0.14

**RECONCILIATION OF CONSOLIDATED STATEMENT OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE YEAR ENDED, DECEMBER 31, 2010**

<b>Year Ended December 31, 2010</b> <i>(\$ thousands, except per share amounts)</i>	<b>Previous GAAP</b>	<b>Effect of transition to</b>	<b>Note</b>	<b>IFRS</b>
<b>Revenues</b>				
Petroleum and natural gas	\$ 57,927	\$ -		\$ 57,927
Royalties	(8,122)	-		(8,122)
Realized gain on financial contracts	2,794	-		2,794
Unrealized loss on financial contracts	(2,349)	-		(2,349)
	50,250	-		50,250
<b>Expenses</b>				
Operating	16,841	-		16,841
Transportation	2,426	-		2,426
Restructuring costs	5,409	-		5,409
General and administrative	6,185	-		6,185
Transaction costs	-	1,009	(e)	1,009
Interest expense	998	(998)	(c), (g)	-
Gain on disposal of petroleum and natural gas properties	-	(1,156)		(1,156)
Finance expenses	-	1,717	(c), (g)	1,717
Stock-based compensation	5,351	-		5,351
Bad debt provision	506	-		506
Depletion and depreciation	23,681	(4,689)	(b), (d), (g)	18,992
	61,397	(4,117)		57,280
Income (loss) before income taxes	(11,147)	4,117		(7,030)
Deferred income taxes (reduction)	(821)	1,486	(f), (h)	665
<b>Net income (loss) and comprehensive income (loss)</b>	<b>\$ (10,326)</b>	<b>\$ 2,631</b>		<b>\$ (7,695)</b>
<b>Income (loss) per share</b>				
Basic	\$ (0.28)	\$ 0.07		\$ (0.21)
Diluted	\$ (0.28)	\$ 0.07		\$ (0.21)

## NOTES TO RECONCILIATIONS

### (a) IFRS 1 election for full cost oil and gas entities

The Corporation elected to use an IFRS 1 exemption whereby the previous GAAP full cost pool was used to measure exploration and evaluation assets and development and production assets on transition to IFRS as follows:

- (i) exploration and evaluation assets were reclassified from the full cost pool to intangible exploration assets at the amount that was recorded under previous GAAP; and
- (ii) the remaining full cost pool was allocated to the producing/development and respective CGU's assets and components pro rata using reserve values.

This resulted in a transfer of \$0.3 million to exploration and evaluation assets and a corresponding decrease in property, plant and equipment on transition.

As at December 31, 2010 the transfer was \$67.9 million, which included undeveloped land acquired in 2010 net of expiries as well as additional unproved interests acquired through corporate and asset acquisitions in 2010.

### (b) Impairment of property, plant and equipment ("PP&E")

In accordance with IFRS, impairment tests of PP&E must be performed at the CGU level as opposed to the entire PP&E balance which was required under the previous GAAP through the full cost ceiling test. Impairment is recognized if the carrying value exceeds the recoverable amount for a CGU. For Surge, the recoverable amount is determined using fair value less cost to sell based on discounted future cash flows of proved plus probable reserves using forecast prices and costs. There was no impairment to PP&E on transition as of January 1, 2010, or for the three months ended March 31, 2010.

For the year ended December 31, 2010, as a result of decreased forward natural gas prices which impacted the fair value less costs to sell derived from the Company's reserves, an impairment charge of \$1.2 million was recognized as additional depletion and depreciation expense.

PP&E impairments can be reversed in the future if the recoverable amount increases.

### (c) Decommissioning obligations

Under the previous GAAP asset retirement obligations were discounted at a credit adjusted risk free rate of eight to nine percent. Under IFRS the estimated cash flows to abandon and remediate the wells and facilities has been risk adjusted therefore the provision is discounted at the risk free rate of approximately three to four percent in effect at the end of each reporting period. The change in the decommissioning obligations each period as a result of changes in the discount rate will result in an offsetting charge to PP&E. Upon transition to IFRS the impact of this change was a \$5.8 million increase in the decommissioning obligations with a corresponding decrease to retained earnings on the statement of financial position.

As at March 31, 2010 the decommissioning obligations were \$5.9 million higher than under the previous GAAP due to the change in discount rate and its impact on the liabilities incurred or acquired during the first quarter of 2010.

As at December 31, 2010 the decommissioning obligations were \$16.6 million higher than under the previous GAAP due to the change in discount rate and its impact on the liabilities incurred or acquired during 2010.

As a result of the change in the discount rate, the decommissioning obligation accretion expense decreased by \$0.01 million during the three months ended March 31, 2010 and \$0.1 million during the year ended December 31, 2010 as the lower discount rate more than offset the impact of the higher obligation. In addition, under the previous GAAP accretion of the discount was included in depletion and depreciation expense. Under IFRS it is included in finance expenses.

#### (d) Depletion policy

Upon transition to IFRS, the Corporation adopted a policy of depleting oil and natural gas interests on a unit of production basis over proved plus probable reserves. The depletion policy under the previous GAAP was based on units of production over proved reserves. In addition, depletion was done on a single Canadian cost center under the previous GAAP. IFRS requires depletion and depreciation to be calculated based on individual components (ie. fields or combinations thereof).

There was no impact of this difference on adoption of IFRS at January 1, 2010 as a result of the IFRS 1 election, as discussed in note (a) above.

For the three months ended March 31, 2010 depleting the oil and natural gas interests over proved plus probable reserves resulted in a decrease to depletion and depreciation of \$1.0 million. For the year ended December 31, 2010 depletion and depreciation was reduced by \$4.7 million as a result of changes to the depletion calculation, including the impact of \$1.2 million of impairment.

For exploration and evaluation assets, the cost of undeveloped land that expires during the period is charged as additional depletion and depreciation expense.

#### (e) Business combinations

In accordance with IFRS, internal transaction costs incurred on a business combination are expensed. Under the previous GAAP, these costs were capitalized as part of the acquisition. As a result, \$1.0 million was charged to Transaction Costs for transaction costs incurred on the Corinthian Acquisition during the year ended December 31, 2010. The purchase price was reduced by \$8.74 million due to the re-valuation of common shares, however this was offset by a \$8.8 million increase in the valuation of the decommissioning liability under IFRS.

#### (f) Deferred income taxes

The adjustment to deferred income taxes on transition relates to the opening adjustment to the decommissioning obligations. The opening adjustment for the decommissioning obligations was charged through retained earnings on the statement of financial position thereby creating a temporary difference on the liability. The deferred income tax impact of the opening adjustment was a deferred income tax asset of \$1.4 million.

The deferred income tax impact of the March 31, 2010 adjustment was a deferred income tax asset of \$1.3 million.

The deferred income tax impact of the December 31, 2010 adjustment was a deferred income tax asset of \$5.2 million.

Under IFRS there is no requirement to separate the portion of deferred income taxes related to current assets or liabilities. The amounts previously classified as current have been reclassified to long-term. Adjustments to deferred income taxes have been made in regards to the adjustment noted above that resulted in a change to the temporary difference between tax and accounting values.

#### (g) Finance expenses

Under IFRS a separate line item is required in the statement of income and comprehensive income for finance expenses. The items under the previous GAAP that were reclassified to finance expenses were interest and accretion expense, which included the accretion on the decommissioning obligations.

#### (h) Flow through shares

Under IFRS, the premium received for a flow through share in excess of the average share price is required to be shown as a liability on the statement of financial position. Under the previous GAAP, the premium was recognized in share capital. Under IFRS, the flow through share premium is recognized as a reduction to deferred tax expense in the statement of

income. In addition, the tax costs of issuing the flow through shares related to the foregone tax attributes is recognized as a deferred tax expense as the expenditures under the flow through are incurred. The impact of the opening adjustment was an increase to share capital of \$2.0 million and a liability for \$0.3 million representing the premium on the December 2009 flow through share issuance that related to amounts unexpended at the date of transition.

**(i) Cashflow impact**

The transaction costs incurred on the Corinthian acquisition was classified under investing activities under previous GAAP, however under IFRS, it is classified as operating activity. There were no changes to financing activities.