MANAGEMENT'S LETTER

Management is responsible for the integrity and objectivity of the information contained in this annual report and for the consistency between the financial statements and other financial and operating data contained elsewhere in the report. In the preparation of these statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected with all information available up to March 21, 2012. The financial statements have been prepared using policies and procedures established by management in accordance with Canadian generally accepted accounting principles and reflect fairly Surge's financial position, results of operations and cash flow.

KPMG LLP, independent auditors appointed by the shareholders, has examined the consolidated financial statements, and Sproule Associates Limited has reviewed the corporate reserves. Their examinations provide independent views as to the amounts and disclosures in the financial statements.

The Audit Committee, consisting exclusively of independent directors, has reviewed in detail the financial statements with management and the external auditors and has recommended their approval to the Board of Directors.

The Board of Directors has approved the financial statements and information as presented in this annual report.

(Signed)	*(Signed)*
P. Daniel O'Neil	Maxwell A. W. Lof
President and Chief Executive Officer	Chief Financial Officer

March 21, 2012

To the Shareholders of Surge Energy Inc.

We have audited the accompanying consolidated financial statements of Surge Energy Inc., which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, the consolidated statements of income (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Surge Energy Inc. as at December 31, 2011, December 31, 2010 and January 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

(*Signed*) "KPMG LLP"

Chartered Accountants
Calgary, Canada
March 21, 2012

Consolidated Statements of Financial Position

Stated in thousand of dollars

As at	December 31, 2011	December 31, 2010	January 1, 2010
Assets		(Note 21)	(Note 21)
Current Assets			
Cash and cash equivalents	$ -	$ 1,437	$ -
Accounts receivable	19,512	12,404	4,061
Prepaid expenses and deposits	4,948	1,657	1,536
	24,460	15,498	5,597
Exploration and evaluation assets (note 6)	47,719	67,865	262
Petroleum and natural gas properties (note 7)	437,854	295,181	126,501
Goodwill (note 6)	6,029	-	-
	$ 516,062	$ 378,544	$ 132,360
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	$ 49,467	$ 31,738	$ 10,628
Fair value of financial contracts (note 9)	2,151	2,570	221
Bank debt (note 10)	-	-	41,650
	51,618	34,308	52,499
Fair value of financial contracts (note 9)	2,751	-	-
Bank debt (note 10)	72,197	30,000	-
Flow through share premium liablility	-	272	348
Decommissioning obligations (note 11)	37,511	28,569	11,169
Deferred income taxes (note 15)	27,829	30,011	16,191
Shareholders' equity			
Share capital (note 12)	278,302	220,845	18,220
Contributed surplus	12,879	4,664	3,559
Performance warrants (note 12)	7,196	7,196	-
Accumulated other comprehensive income	1,005	-	-
Retained earnings	24,774	22,679	30,374
	324,156	255,384	52,153
Commitments (note 18)			
Subsequent events (note 19)			
	$ 516,062	$ 378,544	$ 132,360

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

Approved on behalf of the Board:

(Signed)
Keith MacDonald, Director

(Signed)
Peter Bannister, Director

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

Stated in thousands of dollars, except per share amounts

	Years ended December 31, 2011	2010
Revenues		(note 21)
Petroleum and natural gas (note 13)	**$ 131,492**	$ 57,927
Royalties (note 13)	**(17,537)**	(8,122)
Realized gain (loss) on financial contracts (note 9)	**(3,519)**	2,794
Unrealized loss on financial contracts (note 9)	**(2,332)**	(2,349)
	108,104	50,250
Expenses		
Operating	**33,885**	16,841
Transportation	**4,860**	2,426
Restructuring costs	**-**	5,409
General and administrative	**9,515**	6,691
Transaction costs	**246**	1,009
Stock-based compensation (note 12)	**3,462**	5,351
Depletion and depreciation (note 8)	**48,491**	18,992
Finance expense (note 14)	**4,193**	1,717
Gain on disposal of petroleum and natural gas properties	**(734)**	(1,156)
	103,918	57,280
Income (loss) before income taxes	**4,186**	(7,030)
Deferred income taxes (note 15)	**2,091**	665
Net income (loss) for the year	**$ 2,095**	$ (7,695)
Other comprehensive income:		
Currency translation adjustment	**1,005**	-
Other comprehensive income for the year	**1,005**	-
Total comprehensive income (loss) for the year	**$ 3,100**	$ (7,695)
Income (loss) per share (note 12)		
Basic	**$ 0.04**	$ (0.21)
Diluted	**$ 0.04**	$ (0.21)

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

Consolidated Statement of Changes in Shareholders' Equity

Stated in thousands of dollars, except share amounts

	Number of common shares	Share capital	Contributed surplus	Performance warrants	Accumulated other comprehensive income	Retained earnings	Total equity
Balance at January 1, 2010	17,836,277	$ 18,220	$ 3,559	$ -	$ -	$ 30,374	$ 52,153
Net loss for the year	-	-	-	-	-	(7,695)	(7,695)
Issue of common shares	11,735,569	67,501	-	-	-	-	67,501
Issued pursuant to short form prospectus	8,001,000	42,005	-	-	-	-	42,005
Performance warrants issued	-	-	-	7,196	-	-	7,196
Share issue costs, net of tax of $1,359	-	(3,670)	-	-	-	-	(3,670)
Issued pursuant to Corinthian acquisition	16,025,529	85,737	-	-	-	-	85,737
Issued pursuant to Crystal Lake acquisition	288,639	1,498	-	-	-	-	1,498
Stock-based compensation	-	-	3,106	-	-	-	3,106
Warrants exercised	672,199	2,689	-	-	-	-	2,689
Options exercised	1,535,334	4,864	-	-	-	-	4,864
Transfer on exercise of options	-	2,001	(2,001)	-	-	-	-
Balance at December 31, 2010	56,094,547	$ 220,845	$ 4,664	$ 7,196	$ -	$ 22,679	$ 255,384
Net income for the year	-	-	-	-	-	2,095	2,095
Accumulated other comprehensive income	-	-	-	-	1,005	-	1,005
Issued pursuant to short form prospectus	6,897,000	60,004	-	-	-	-	60,004
Share issue costs, net of tax of $952	-	(2,857)	-	-	-	-	(2,857)
Stock-based compensation	-	-	8,315	-	-	-	8,315
Transfer on exercise of options	-	100	(100)	-	-	-	-
Warrants exercised	2,272	12	-	-	-	-	12
Options excerised	47,168	198	-	-	-	-	198
Balance at December 31, 2011	**63,040,987**	**$ 278,302**	**$ 12,879**	**$ 7,196**	**$ 1,005**	**$ 24,774**	**$ 324,156**

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

Consolidated Statements of Cash Flows

Stated in thousands of dollars

	Years ended December 31, 2011	2010
Cash provided by (used in)		
Operating		
Net income (loss)	$ **2,095**	$ (7,695)
Gain on disposal of petroleum and natural gas properties	**(734)**	(1,156)
Unrealized loss on financial contracts	**2,332**	2,349
Finance expense	**4,193**	1,717
Interest expense	**(3,176)**	(998)
Depletion and depreciation	**48,491**	18,992
Decommissioning expenditures	**(965)**	(461)
Stock-based compensation	**3,462**	5,351
Deferred income taxes	**2,091**	665
Change in non-cash working capital (note 17)	**(1,150)**	(2,636)
Cash flow from operating activities	**56,639**	16,128
Financing		
Bank debt	**42,197**	(27,460)
Issues of common shares and performance warrants, net of issue costs	**56,405**	114,314
Cash flow from financing activities	**98,602**	86,854
Investing		
Petroleum and natural gas properties	**(104,107)**	(22,040)
Exploration and evaluation assets	**(45,990)**	(22,201)
Disposition of petroleum and natural gas properties	**9,848**	1,431
Acquistions (note 5)	**(24,909)**	(74,529)
Corporate property acquisition	**-**	
Change in non-cash working capital (note 17)	**8,480**	15,794
Cash flow used in investing activities	**(156,678)**	(101,545)
Change in cash	**(1,437)**	1,437
Cash, beginning of year	**1,437**	-
Cash, end of year	**$ -**	$ 1,437

Cash is defined as cash and cash equivalents.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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 address of Surge's registered offices is 2100, 635-8th Avenue SW, Calgary, Alberta, Canada, T2P 3M3. The consolidated financial statements include the accounts of the Corporation, its wholly-owned subsidiaries and partnerships. Surge's wholly-owned subsidiaries and partnerships are 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

The consolidated financial statements have been prepared in accordance International Financial Reporting Standards ("IFRS"). These are Surge's first annual consolidated financial statements, prepared in accordance with IFRS and IFRS 1, "First-time Adoption of International Financial Reporting Standards" has been applied.

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 and for the year ended December 31, 2010 is presented in note 21.

The consolidated financial statements were authorized for issuance by the Board of Directors on March 21, 2012.

(b) Basis of measurement

The 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

The 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 financial statements include:

- Impairment testing – estimates of reserves, future commodity prices, future costs, discount rates and the market value of land.
- Depletion and depreciation – estimates of reserves and future development used in the 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, expected interest rates and expected future foreign exchange rates and expected volatility in these variables.
- 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

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements, and have been applied consistently to the Corporation and its subsidiaries.

For presentation purposes operating expenses in the consolidated statement of income are presented as a combination of the function and nature in conformity with industry practice. Depletion and Depreciation are presented on separate basis by their nature, while general and administrative expenses are presented on a functional basis. Significant expenses such as salaries are presented by the nature in the notes to the consolidated financial statements.

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.

Development and production costs

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.

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 petroleum and natural gas properties, property swaps and farm-outs are determined by comparing the proceeds from disposal, or fair value of the asset received or given up, with the carrying amount of petroleum and natural gas properties and are recognized net in profit or loss.

Office equipment is depreciated using a declining balance method using rates from 20% to 100% dependent on the type of equipment.

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 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.

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

(e) Goodwill

The Corporation records goodwill relating to a business combination when the purchase price exceeds the fair value of the net identifiable assets and liabilities of the acquired business. Goodwill is reported at cost less any impairment.

(f) 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. 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 tested at the operating segment level.

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.

The goodwill balance is assessed for impairment annually or as events occur that could result in impairment. Goodwill is tested for impairment at an operating segment level by combining the carrying amounts of petroleum and natural gas properties, exploration and evaluation assets and goodwill and comparing this to the recoverable amount. The recoverable amount is the greater of fair value less cost to sell or value-in-use, as noted above.

Impairment charges, which are not tax affected, are recognized in net income. Impairments are not reversed.

(g) 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.

(h) 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.

(i) 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.

(j) 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.

(k) Finance income and expenses

Finance expense comprises interest expense on borrowings and accretion of the discount on provisions.

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.

(l) 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.

(m) 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.

(n) 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.

(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. 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 and interest rate 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 and interest rates. 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.

(p) Comparative figures

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

(q) 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 an 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 December 31, 2011 and December 31, 2010, the fair value of cash and cash equivalents, accounts receivable, and accounts payable 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.

(c) 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 amounts 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.

(d) 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

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 purpose of the acquisition was to order to expand the Corporation's exposure to certain light oil plays. The common shares have been ascribed a fair value of $5.35 per common share issued, as determined based on the Corporation's 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:

Fair value of net assets acquired:		
Petroleum and natural gas properties	$	74,996
Exploration and evaluation assets		54,011
Bank debt		(15,810)
Working capital		472
Decommissioning obligations		(13,748)
Deferred income tax liability		(14,184)
Net assets acquired	$	85,737
Consideration:		
Common shares (16,025,529 common shares)	$	85,737

If Corinthian had been acquired on January 1, 2010, the incremental consolidated entities revenue and loss recognized for the year ending December 31, 2010 and the pro forma results would have been as follows:

Year ended December 31, 2010		**As stated**		**Corinthian prior to July 9, 2010**		**Pro forma**
Revenue	$	57,927	$	9,303	$	67,230
Loss		(7,695)		(1,659)		(9,354)

Included in the 2010 consolidated statements of income (loss) and comprehensive income (loss) are the following amounts:

Amounts since acquisition		
Revenue	$	8,569
Income (loss) and comprehensive income (loss)		(1,528)

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 purpose of the acquisition was to order to expand the Corporation's exposure to certain light oil plays. The common shares have been ascribed a fair value of $5.19 per common share issued, as determined based on the Corporation's 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:

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

If Crystal Lake had been acquired on January 1, 2010, the incremental consolidated entities revenue and loss recognized for the year ending December 31, 2010 and the pro forma results would have been as follows:

Year ended December 31, 2010		**As stated**		**Crystal Lake prior to July 19, 2010**		**Pro forma**
Revenue	$	57,927	$	250	$	58,177
Income (loss)		(7,695)		2		(7,693)

Included in the 2010 consolidated statements of income (loss) and comprehensive income (loss) are the following amounts:

Amounts since acquisition		
Revenue	$	206
Income (loss) and comprehensive income (loss)		2

Valhalla

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. The purpose of the acquisition was to expand the Corporation's exposure to certain light oil plays. The allocation of the purchase price, based on management's estimates of fair values, is as follows:

Fair value of net assets acquired:		
Petroleum and natural gas properties	$	48,629
Exploration and evaluation assets		27,005
Decommissioning obligations		(1,105)
Net assets acquired	$	74,529
Consideration:		
Cash	$	74,529

If Valhalla had been acquired on January 1, 2010, the incremental consolidated entities revenue and loss recognized for the year ending December 31, 2010 and the pro forma results would have been as follows:

Year ended December 31, 2010	As stated	Valhalla prior to November 1, 2010	Pro forma
Revenue	$ 57,927	$ 9,321	$ 67,248
Income (loss)	(7,695)	2,403	(5,292)

Included in the 2010 consolidated statements of income (loss) and comprehensive income (loss) are the following amounts:

Amounts since acquisition	
Revenue	$ 1,834
Income (loss) and comprehensive income (loss)	473

Solara, Ritchie, and EOG Resources

Effective March 24, 2011, the Corporation acquired certain crude oil and natural gas assets ("Solara") for cash consideration of $4.0 million, in order to expand the Corporation's exposure to certain light oil plays.

Effective March 30, 2011, the Corporation acquired certain crude oil and natural gas assets ("Ritchie") for cash consideration of $7.3 million, in order to expand the Corporation's exposure to certain light oil plays in the USA.

Effective May 13, 2011, the Corporation acquired certain crude oil and natural gas assets ("EOG") for cash consideration of $13.6 million, in order to expand the Corporation's exposure to certain light oil plays in the USA. The goodwill relates to potential future petroleum and natural gas reserves.

Fair value of net assets acquired:	Solara	Ritchie	EOG	Total
Petroleum and natural gas properties	$ 3,510	$ 2,175	$ 1,349	$ 7,034
Exploration and evaluation assets	1,026	5,275	2,918	9,219
Deferred income tax assets	-	-	3,593	3,593
Goodwill	-	-	5,862	5,862
Decommissioning obligations	(497)	(157)	(145)	(799)
Net assets acquired	$ 4,039	$ 7,293	$ 13,577	$ 24,909
Consideration:				
Cash	$ 4,039	$ 7,293	$ 13,577	$ 24,909

Included in the consolidated statements of income (loss) and comprehensive income (loss) are the following amounts:

Amounts since acquisition	
Revenue	$ 2,954
Income (loss) and comprehensive income (loss)	1,377

If the Solara, Ritchie and EOG properties had been acquired on January 1, 2011, the incremental consolidated entities revenue and loss recognized for the year ending December 31, 2011 and the pro forma results would have been as follows:

Year ended December 31, 2011	As stated	Solara	Ritchie	EOG	Pro Forma
Revenue	$ 131,492	$ 369	$ 216	$ 571	$ 132,648
Income and comprehensive income	2,718	43	150	153	3,064

6) EXPLORATION AND EVALUATION ASSETS AND GOODWILL

Exploration and evaluation 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 exploration and evaluation assets during the period.

Exploration and Evaluation Assets

		Total
Cost		
Balance at January 1, 2010		$262
Additions		22,201
Acquisitions (note 5)		81,016
Transfer to petroleum and natural gas properties		(35,614)
Balance at December 31, 2010	$	67,865
Acquisitions (note 5)		9,219
Additions		45,990
Change in foreign exchange rate		375
Dispositions		(46)
Transfer to petroleum and natural gas properties		(75,684)
Balance at December 31, 2011	**$**	**47,719**

Goodwill

		Total
Cost		
Balance at December 31, 2010		-
Additions (note 5)	**$**	**5,862**
Change in foreign exchange rate		**167**
Balance at December 31, 2011	**$**	**6,029**

7) PETROLEUM AND NATURAL GAS PROPERTIES

		Total
Cost or deemed cost		
Balance at January 1, 2010	$	126,501
Acquisitions (note 5)		125,096
Additions		22,040
Transfer from exploration and evaluation assets		35,614
Change in decommissioning obligations		2,250
Capitalized stock-based compensation		2,998
Disposals		(386)
Balance at December 31, 2010	$	314,113
Acquisitions (note 5)		7,034
Additions		107,207
Transfer from exploration and evaluation assets		75,684
Change in decommissioning obligations		9,175
Capitalized stock-based compensation		4,853
Change in foreign exchange rate		489
Disposals		(13,753)
Balance at December 31, 2011	**$**	**504,802**

	Total
Accumulated depletion and depreciation	
Balance at January 1, 2010	$ -
Depletion and depreciation expense	(17,772)
Impairment	(1,220)
Disposals	60
Balance at December 31, 2010	($18,932)
Depletion and depreciation expense	(39,491)
Impairment	(9,000)
Disposals	475
Balance at December 31, 2011	**($66,948)**

	Total
Carrying amounts	
At January 1, 2010	126,501
At December 31, 2010	295,181
At December 31, 2011	**437,854**

The calculation of depletion and depreciation expense for the three months ended December 31, 2011 included an estimated $140.1 million (December 31, 2010 - $79.3 million) for future development costs associated with proved plus probable reserves and excluded $28.0 million (December 31, 2010 - $25.9 million) for the estimated salvage value of production equipment and facilities.

Divestitures

During the year ended December 31, 2011, the Corporation disposed of certain assets for gross cash proceeds of $9.8 million, resulting in a gain of $0.7 million (December 31, 2010 - $1.1 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 $3.1 million, all of which was recognized in petroleum and natural gas properties.

8) IMPAIRMENT

For the year ended	**December 31, 2011**	December 31, 2010
D&P assets	**$ 9,000**	$ 1,220
E&E assets	**-**	-
Goodwill	**-**	-
Impairment Expense	**$ 9,000**	$ 1,220

The estimated recoverable amounts used for impairment testing were based on the respective assets fair values, calculated using proved plus probable reserves discounted at 8 to 10 percent. A D&P asset impairment of $9.0 million ($1.2 million – December 31, 2010) was recorded for the year ended December 31, 2011 related to a natural gas focused CGU and reflects lower forecasted natural gas prices. An impairment test on this CGU was triggered due to a decline in natural gas pricing.

For the purposes of impairment testing, goodwill is allocated to the CGUs to which it relates. All of the goodwill of $6.0 million is allocated to the Williston Basin CGU. An impairment test for this CGU as at December 31, 2011 was performed and no impairment was recorded. The impairment test was calculated using the fair value less costs to sell approach, which was determined using discounted future cash flows generated from the related independently evaluated reserves.

The following table outlines forecasted commodity prices and exchange rates used in the Corporation's CGU and goodwill impairment tests at December 31, 2011. The forecast commodity prices are consistent with those used by the Corporation's external reserve evaluators.

	Medium and Light Crude Oil			Natural Gas	NGL			
Year	WTI Cushing Oklahoma 40˚ API (US$/bbl)	Edmonton Par Price 40˚ API ($/bbl)	Cromer Medium 29.3˚ API ($/bbl)	AECO Gas Price ($/MMBtu)	Pentanes plus FOB Field Gate ($/bbl)	Butanes FOB Field Gate ($/bbl)	Inflation rates (%/Yr)	Exchange rate ($US/$Cdn)
2012	98.07	96.87	90.09	3.16	103.57	72.20	2.0	1.012
2013	94.90	93.75	87.19	3.78	100.23	69.87	2.0	1.012
2014	92.00	90.89	84.52	4.13	97.17	67.74	2.0	1.012
2015	97.42	96.23	89.50	5.53	102.89	71.73	2.0	1.012
2016	99.37	98.16	91.29	5.65	104.94	73.16	2.0	1.012
2017	101.35	100.12	93.11	5.77	107.04	74.63	2.0	1.012
2018	103.38	102.12	94.98	5.90	109.18	76.12	2.0	1.012
2019	105.45	104.17	96.88	6.01	111.37	77.64	2.0	1.012
2020	107.56	106.25	98.81	6.14	113.59	79.19	2.0	1.012
2021	109.71	108.38	100.79	6.27	115.87	80.78	2.0	1.012

To result in a potential impairment charge to the Williston Basin CGU, the discount rate would have to be in excess of 15%, and future planned net cash flows would have to decrease by 20%.

9) FINANCIAL INSTRUMENTS OVERVIEW

The Corporation has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Corporation's exposure to each of the above risks, the Corporation's objectives, policies and processes for measuring and managing risk, and the Corporation's management of capital. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk management framework. The Board has implemented and monitors compliance with risk management policies. The Corporation's risk management policies are established to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation's activities.

(a) Credit Risk

Credit risk is the risk of financial loss to the Corporation if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the Corporation's receivables from joint venture partners and petroleum and natural gas marketers. As at December 31, 2011, the Corporation's receivables consisted of $15.6 million due from petroleum and natural gas marketers and $3.9 million due from joint venture partners. These amounts are presented net of the allowance for doubtful accounts.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Corporation attempts to mitigate credit risk by establishing marketing relationships with a variety of purchasers.

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Corporation attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Corporation does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however the Corporation does have the ability to withhold production from joint venture partners in the event of non-payment.

The carrying value of cash and accounts receivable represent the maximum credit exposure. The Corporation has an allowance for doubtful accounts of $0.2 million (2010 - $0.5 million) at December 31, 2011. During the year ended December 31, 2011, the Corporation allowed for no bad debts (2010 – $0.5 million) and applied $0.3 million of its allowance for doubtful accounts against outstanding receivables.

The Corporation's most significant customers are four Canadian oil and natural gas marketers, accounting for approximately 89 percent of Surge's 2011 revenue.

As at December 31, 2011, the Corporation estimates its total accounts receivables, net of the allowance for doubtful accounts, to be aged as follows:

Years ended	Total Receivables	Current	Past Due
December 31, 2011	$ 19,512	$ 17,801	$ 1,711
	100%	91%	9%
December 31, 2010	$ 12,404	$ 11,181	$ 1,223
	100%	90%	10%

(b) 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 actively manages its liquidity through cost control, debt and equity management policies. Such strategies include continuously monitoring forecast and actual cash flows, financing activities and available credit under existing banking arrangements. The nature of the oil and gas industry is very capital intensive. As a result, the Corporation prepares annual capital expenditure budgets and utilizes authorizations for expenditures for projects to manage capital expenditures. Management believes that future cash flows generated in the ordinary course of business will be adequate to settle the Corporation's liabilities as they come due.

Accounts payable are considered due to suppliers in one year or less while bank debt, which is subject to a renewal on or before May 5, 2012, could be potentially due within the next year if the facility is not renewed for a further 364-day period. Financial contracts are also due to be settled with the counter-parties at the estimated fair value on the statement of financial position.

(c) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Corporation's net income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Corporation utilizes financial derivative contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

(i) Foreign currency exchange risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange risks. Substantially all of the Corporation's petroleum and natural gas sales are denominated in Canadian dollars, with the exception of Surge's US operations in North Dakota. However, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar.

The average exchange rate during the year was 1 USD equals $ 0.989 Canadian (2010 – 1 USD: $ 1.0299 Canadian) and the exchange rate at December 31, 2011 was 1 USD equals $ 1.017 Canadian dollar (2010 – 1 USD: $0.9946 Canadian). At December 31, 2011 the total impact on net assets denominated in USD is approximately $374,000.

The Corporation had no forward exchange rate contracts in place as at or during the years ended December 31, 2011 and 2010.

(ii) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices.

The nature of the Corporation's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices and initiates instruments to manage exposure to these risks when it deems appropriate. 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 gains (losses) on oil and gas commodity contracts for the three months and year ended December 31, 2011:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C$)	Index (Surge pays) (C$)	Year ended Dec 31, 2011 Unrealized gains (losses) ($000s CDN)	Year ended Dec 31, 2011 Realized gains (losses) ($000s CDN)
Jan 1 to Dec 31, 2011	Call	500 GJs/d	$ 6.55	AECO Monthly Avg	1	-
Jan 1 to Dec 31, 2011	Put	500 GJs/d	$ 5.00	AECO Monthly Avg	(233)	277
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	$ 80.00	WTI - NYMEX	1,247	(1,278)
Jan 1 to Dec 31, 2011	Call	250 bbls/d	$ 96.55	WTI - NYMEX	(415)	166
Jan 1 to Dec 31, 2011	Call	125 bbls/d	$ 78.40	WTI - NYMEX	757	(712)
Jan 1 to Dec 31, 2011	Put	250 bbls/d	$ 78.40	WTI - NYMEX	(123)	-
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	$ 85.50	WTI - NYMEX	749	(531)
Jan 1 to Dec 31, 2011	Swap	250 bbls/d	$ 80.00	WTI - NYMEX	1,247	(1,278)
Jan 1 to Dec 31, 2011	Call	250 bbls/d	$ 91.00	WTI - NYMEX	(659)	416
Apr 1 to Dec 31, 2011	Call	250 bbls/d	$ 84.35	WTI - NYMEX	-	689
Apr 1 to Dec 31, 2011	Swap	250 bbls/d	$ 80.00	WTI - NYMEX	-	(988)
Jul 1 to Dec 31, 2011	Call	65 bbls/d	$ 90.00	WTI - NYMEX	-	(47)
Jul 1 to Dec 31, 2011	Put	250 bbls/d	$ 90.00	WTI - NYMEX	-	87
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	$ 97.00	WTI - NYMEX	(346)	-
Jan 1 to Dec 31, 2012	Call	63 bbls/d	$ 80.00	WTI - NYMEX	(524)	-
Jan 1 to Dec 31, 2012	Put	250 bbls/d	$ 80.00	WTI - NYMEX	206	-
Jan 1 to Dec 31, 2012	Call	250 bbls/d	$ 89.95	WTI - NYMEX	1,377	-
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	$ 80.00	WTI - NYMEX	(1,891)	-
Jan 1 to Dec 31, 2012	Put	250 bbls/d	$ 90.00	WTI - NYMEX	391	-
Jan 1 to Dec 31, 2012	Call	93 bbls/d	$ 90.00	WTI - NYMEX	(508)	-
Jan 1 to Dec 31, 2012	Put	500 bbls/d	$ 90.00	WTI - NYMEX	783	-
Jan 1 to Dec 31, 2012	Call	158 bbls/d	$ 90.00	WTI - NYMEX	(865)	-
Jan 1 to Dec 31, 2012	Call	500 bbls/d	$ 96.00	WTI - NYMEX	1,960	-
Jan 1 to Dec 31, 2012	Swap	500 bbls/d	$ 85.00	WTI - NYMEX	(2,873)	-
Jan 1 to Dec 31, 2013	Call	250 bbls/d	$ 98.00	WTI - NYMEX	(8)	-
Jan 1 to Dec 31, 2013	Swap	250 bbls/d	$ 85.00	WTI - NYMEX	(277)	-
Total					**$ (4)**	**$ (3,199)**

Term	Type (floating to fixed)	Volume	Differential (Surge receives) (C$)	Index (Surge pays) (C$)	Year ended Dec 31, 2011 Unrealized gains (losses) ($000s CDN)	Realized gains (losses) ($000s CDN)
Jan 1 to Mar 31, 2012	Swap	500 bbls/d	$ 13.25	Western Canadian Select	102	-
Jan 1 to Jun 30, 2012	Swap	250 bbls/d	$ 14.85	Western Canadian Select	37	-
Oct 1 to Dec 31, 2011	Swap	250 bbls/d	$ 14.00	Western Canadian Select	-	(320)
Total					**$ 139**	**$ (320)**

The following table outlines the realized and unrealized losses on interest rate contracts for three months and year ended December 31, 2011:

Term	Type (floating to fixed)	Amount (C$)	Company Fixed Interest Rate (%) [(1)]	Counter party Floating Rate Index	Year ended Dec 31, 2011 Unrealized loss ($000s CDN)	Realized loss ($000s CDN)
Jan 1, 2012 to Dec 31, 2014	Swap	$ 50,000,000	2.74%	CAD-BA-CDOR	(2,467)	-

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

The following table summarizes the sensitivity of the fair value of the Corporation's market risk management positions to fluctuations in interest rates and crude oil 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 interest rates, crude oil and natural gas prices, which would impact the mark-to-market calculation of commodity and interest rate contracts, could have had the following impact on net earnings:

	Price Increase	Price Decrease
Crude Oil - Change of +/- $1.00	$ (1,046)	$ 1,046
Interest rate - Change of +/- 100 points	$ (1,431)	$ 1,417

(d) Capital management

The Corporation's policy is to maintain a strong capital base so as to maintain investor, creditor, and market confidence and sustain the future development of the business. The Corporation manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Corporation considers its capital structure to include shareholder's equity of $323.8 million (2010 - $255.4 million), bank debt of $72.2 million (2010 - $30.0 million) and a working capital deficiency of $27.2 million (2010 - $18.8 million). In order to maintain or adjust capital structure, the Corporation may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

The Corporation monitors its capital based on the ratio of forecast net debt to forecast funds from operations. Net debt is defined as outstanding bank debt plus or minus cash-based working capital. Funds from operations is defined as cash flow from operating activities before changes in non-cash working capital. The Corporation's strategy is to maintain a one year forward looking forecast debt to forecast funds from operations ratio of less than two to one. This ratio may increase at certain times as a result of acquisitions or other capital spending. In order to facilitate the management of this ratio, the Corporation prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

(e) Fair value of financial instruments

The Corporation's financial instruments as at December 31, 2011 and 2010 include cash, accounts receivable, accounts payable and accrued liabilities, the fair value of financial contracts and bank debt. The fair value of cash, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts due to their short-terms to maturity.

The fair value of financial contracts is determined by discounting the difference between the contracted commodity price/interest rate and published forward commodity price/interest rate curves as at the statement of financial position date, using the remaining contracted notional volumes.

Bank debt, when outstanding, bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

The Corporation classifies its financial instruments recorded at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Corporation's financial contracts are considered level 2, while cash is considered level 1.

10) BANK DEBT

The Corporation has a $150 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 May 5, 2012. On May 5, 2012, 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 1.75 percent as at December 31, 2011 (December 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 December 31, 2011.

11) 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 $70.7 million (December 31, 2010 – $66.1 million) which will be incurred between 2012 and 2059. The majority of these costs will be incurred between 2012 and 2037. A risk free rate of three 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:

	December 31,	
	2011	2010
Balance, beginning of year	**$ 28,569**	$ 11,169
Liabilities related to acquisitions (note 5)	**799**	14,943
Liabilities related to dispositions	**(1,110)**	(51)
Change in foreign exchange rate	**26**	-
Change in decommissioning obligations	**7,854**	1,908
Liabilities incurred	**1,321**	342
Accretion expense	**1,017**	719
Decommissioning expenditures	**(965)**	(461)
Balance, end of year	**$ 37,511**	$ 28,569

12) 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 6,304,098 common shares of the Corporation as at December 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.

	Years ended December 31,					
	2011			2010		
	Number of Options	Weighted average exercise price		Number of Options	Weighted average exercise price	
Stock options oustanding, beginning of year	**2,683,667**	**$**	**6.24**	1,878,001	$	3.74
Granted	**2,355,499**	**$**	**8.92**	2,636,000	$	6.38
Exercised	**(47,168)**	**$**	**3.95**	(1,535,334)	$	3.17
Forfeited	**(43,000)**	**$**	**5.96**	(295,000)	$	6.61
Stock options oustanding, end of year	**4,948,998**	**$**	**7.54**	2,683,667	$	6.24
Exercisable at year-end	**899,484**	**$**	**6.10**	99,666	$	2.59

The following table summarizes stock options outstanding and exercisable at December 31, 2011:

	Options Outstanding				Options Exercisable		
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	26,666	$	1.75	1.95	26,666	$	1.75
$2.80 to $4.59	49,000	$	3.20	2.98	49,000	$	3.20
$4.60 to $6.39	551,000	$	5.77	3.59	172,662	$	5.79
$6.40 to $8.19	2,292,832	$	6.72	3.63	651,156	$	6.57
$8.20 to $11.00	2,029,500	$	9.13	4.54	-	$	-
$1.00 to $11.00	4,948,998	$	7.54	3.98	899,484	$	6.10

The weighted average share price at the date of exercise for share options exercised in 2011 was $9.37 (2010 - $ 6.96).

(c) Performance warrants

The Corporation has 2,073,864 performance warrants outstanding (December 31, 2010 – 2,076,136) that expire on April 13, 2015. As at December 31, 2011, all 2,073,864 performance warrants were vested and exercisable at a price of $5.17.

(d) Stock-based compensation

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

	Years ended December 31,			
	2011		2010	
Stock-based compensation on options	**$**	**8,315**	$	3,106
Stock-based compensation on performance warrants		**-**		4,912
Stock-based compensation on flow-through share premiums		**-**		331
Capitalized stock-based compensation		**(4,853)**		(2,998)
Total stock-based compensation expense	**$**	**3,462**	$	5,351

The Corporation's stock-based compensation expense for the year ended December 31, 2011 was $3.5 million (December 31, 2010 - $5.4 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 year ended December 31, 2011: zero dividend yield (December 31, 2010 – zero); expected volatility of 69 percent (December 31, 2010 – 69 percent); risk free rate of two percent (December 31, 2010 – two percent); forfeiture rate of zero percent (December 31, 2010 – zero percent) and expected life of five years (December 31, 2010 – five years). The weighted average fair value of options granted in the year of 2011 is $5.21 per option (December 31, 2010 - $3.79).

(e) Per share amounts

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

	Years ended December 31,	
	2011	2010
Weighted average number of shares - basic	**57,621,515**	36,467,864
Effect of dilutive stock options	**1,136,328**	-
Weighted average number of shares - diluted	**58,757,843**	36,467,864

In computing diluted per share amounts at December 31, 2011, nil options (December 31, 2010 – 2,683,667) and nil performance warrants (December 31, 2010 – 2,076,136) were excluded from the calculation as their effect was anti-dilutive.

13) PETROLEUM AND NATURAL GAS REVENUE

	Years ended December 31,	
	2011	2010
Oil	**$ 111,705**	$ 47,685
Natural Gas	**19,548**	10,029
Processing and other income	**239**	213
Less: Royalties	**(17,537)**	(8,122)
Total petroleum and natural gas revenue	**$ 113,955**	$ 49,805

14) FINANCE EXPENSE

	Years ended December 31,	
	2011	2010
Interest on bank debt	**$ 3,176**	$ 998
Accretion of decommissioning obligations	**1,017**	719
	$ 4,193	$ 1,717

15) INCOME TAXES

a) Deferred income tax expense

The provision for income tax expense in the financial statements differs from the result which would have been obtained by applying the combined federal and provincial income tax rate to the Corporation's income (loss) before income taxes. This difference results from the following items

		2011		2010
Income (loss) before income taxes	**$**	**4,186**	$	(6,524)
Combined federal and provincial statutory rate		**26.5%**		28%
Expected income tax expense (recovery)	**$**	**1,109**	$	(1,827)
Difference resulting from:				
Flow-through shares	**$**	**550**		843
Changes in tax rates	**$**	**42**		116
Non-deductible stock-based compensation costs	**$**	**917**		1,498
Other		**(255)**		442
Sub-total		**2,363**		1,072
Flow-through share premium		**(272)**		(407)
Deferred income tax expense	**$**	**2,091**	$	665

The combined federal and provincial tax rate decreased from 28% in 2010 to 26.5% in 2011 as a result of the Canadian federal rate decreasing from 18% to 16.5% year over year.

b) Deferred income tax liability:

The components of the Company's deferred income tax liability are as follows:

	Years ended December 31,			
		2011		2010
Petroleum and natural gas properties	**$**	**44,683**	$	32,295
Decommissioning obligations	**$**	**(9,378)**		(7,428)
Fair value of financial contracts	**$**	**(1,225)**		(681)
Deferred partnership income	**$**	**14,236**		11,822
Non-capital losses	**$**	**(18,668)**		(4,431)
Other		**(1,819)**		(1,566)
	$	**27,829**	$	30,011

The following table provides a continuity of the deferred income tax liability (asset):

	January 1 2010	Recognized in equity	Business combinations	Recognized in profit or loss	December 31 2010
Property, plant and equiment	$ (15,917)	$ -	$ (17,567)	$ 1,189	**$ (32,295)**
Decomissioning obligations	2,857	-	3,460	1,111	**7,428**
Partnership deferral	(3,535)	-	-	(8,287)	**(11,822)**
Non-capital losses	-	-	-	4,431	**4,431**
Share issue costs and other	404	1,359	-	484	**2,247**
	$ (16,191)	$ 1,359	$ (14,107)	$ (1,072)	**$ (30,011)**

	December 31 2010	Recognized in equity	Business combinations	Recognized in profit or loss	December 31 2011
Property, plant and equiment	$ (32,295)	$ -	$ 3,557	$ (15,945)	**$ (44,683)**
Decomissioning obligations	$ 7,428	-	36	1,914	**9,378**
Partnership deferral	$ (11,822)	-	-	(2,414)	**(14,236)**
Non-capital losses	$ 4,431	-	-	14,237	**18,668**
Share issue costs and other	$ 2,247	952	-	(155)	**3,044**
	$ (30,011)	$ 952	$ 3,593	$ (2,363)	**$ (27,829)**

16) KEY MANAGEMENT PERSONNEL COMPENSATION

Key Management Personnel includes the President and Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Vice President Land, Vice President Engineering, Vice President Business Development, and Vice President Exploration.

	Years ended December 31, 2011	2010
Salaries and wages	**$1,380**	$774
Short-term employee benefits, net of capitalization	**378**	175
Stock-based payments (i), net of capitalization	**456**	147
	$2,214	$1,096

Represents the amortization of stock-based compensation associated with options granted to executive officers as recorded in the financial statements.

17) CASHFLOW INFORMATION

	Years ended December 31,	
	2011	2010
Accounts receivable	**$ (7,108)**	$ (8,343)
Prepaid expenses and deposits	**(3,291)**	(121)
Accounts payable and accrued liabilities	**17,729**	21,110
Working capital acquired on acquistions (note 5)	**-**	512
Change in non-cash working capital	**$ 7,330**	$ 13,158
These changes relate to the following activities		
Operating	**$ (1,150)**	$ (2,636)
Investing	**8,480**	15,794
	$ 7,330	$ 13,158

18) COMMITMENTS

Future minimum payments relating to operating lease and firm transport commitments

Commitments	
($000s)	
2012	$ 2,256
2013	1,912
2014	1,622
2015	1,410
2016	909
2017+	1,204
Total	**$ 9,313**

19) SUBEQUENT EVENTS

(a) On January 6th, 2012 the Corporation acquired all of the outstanding shares of a private oil and gas company. As consideration, approximately 7.9 million common shares were issued at an approximate value of $71.3 million and a cash payment of $18.5 million was made. Furthermore, an approximate $14.4 million in working capital deficiency was acquired, for total consideration of approximately $104.2 million.

(b) Subsequent to the above acquisition, Surge's credit facility increased from $150 million at December 31, 2011 to $175 million.

(c) Subsequent to December 31, 2011, the Corporation entered into several financial oil contracts:

Term	Type	Volume	Swap price (C$) (Surge Receives)	Index (Surge pays) (C$)
Apr 1, 2012 - Dec 31, 2012	Swap	500bbls/d	101.50	WTI - NYMEX
Apr 1, 2012 - Dec 31, 2012	Swap	500bbls/d	90.00	WTI - NYMEX
Apr 1, 2012 - Dec 31, 2012	Call	500bbls/d	96.00	WTI - NYMEX
Jan 1, 2013 - Dec 31, 2013	Swap	250bbls/d	95.00	WTI - NYMEX
Jan 1, 2013 - Dec 31, 2013	Swap	250bbls/d	85.00	WTI - NYMEX
Jan 1, 2013 - Dec 31, 2013	Call	250bbls/d	95.00	WTI - NYMEX
Jan 1, 2013 - Mar 31, 2013	Swap	250bbls/d	104.85	WTI - NYMEX
Jan 1, 2013 - Mar 31, 2013	Swap	500bbls/d	95.00	WTI - NYMEX
Jan 1, 2013 - Mar 31, 2013	Call	315bbls/d	95.00	WTI - NYMEX
Apr 1, 2013 - Jun 30, 2013	Swap	250bbls/d	105.05	WTI - NYMEX
Apr 1, 2013 - Jun 30, 2013	Swap	500bbls/d	95.00	WTI - NYMEX
Apr 1, 2013 - Jun 30, 2013	Call	300bbls/d	95.00	WTI - NYMEX

20) GEOGRAPHICAL INFORMATION

As at and for the year ended December 31, 2011	Canada	USA	**Total**
Petroleum & natural gas revenue	$ 129,903	$ 1,589	**$ 131,492**
Petroleum & natural gas properties	434,330	3,524	**437,854**
Exporation & evaluation assets	39,526	8,193	**47,719**
Goodwill	-	6,029	**6,029**

21) 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 year ended December 31, 2011, as well as to the opening statement of financial position on the transition date, January 1, 2010 and the comparative information as at and 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 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 prior to the date of transition.

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

STATEMENT OF FINANCIAL POSITION (RECONCILIATION OF EQUITY)

As at December 31, 2010 *($ thousands)*	Previous GAAP	Effect of Transition to IFRS	Notes	IFRS
Assets				
Current Assets				
Cash and cash equivalents	**$ 1,437**	$ -		**$ 1,437**
Accounts receivable	**12,404**	-		**12,404**
Prepaid expenses and deposits	**1,657**	-		**1,657**
Fair value of financial contracts	**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), (d), (e)	**295,181**
	$ 377,577	$ 967		**$ 378,544**
Liabilities				
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 loan	**30,000**	-		**30,000**
Flow through share premium liablility	**-**	272	(h)	**272**
Deferred income taxes	**35,239**	(5,228)	(f)	**30,011**
Decommissioning obligations	**11,994**	16,575	(c)	**28,569**
Shareholders' equity				
Share capital	**227,434**	(6,589)	(e), (h)	**220,845**
Contributed surplus	**4,664**	-		**4,664**
Performance warrants	**7,196**	-		**7,196**
Retained earnings	**26,742**	(4,063)		**22,679**
	266,036	(10,652)		**255,384**
	$ 377,577	$ 967		**$ 378,544**

STATEMENT OF FINANCIAL POSITION (RECONCILIATION OF EQUITY)

As at January 1, 2010 ($ thousands)	**Previous GAAP**	**Effect of transition to IFRS**	**Note**	**IFRS**
Assets				
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
Liabilities				
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
Shareholders' equity				
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

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

($ thousands)	Previous GAAP	Effect of Transition to IFRS	Notes	IFRS
Revenues				
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**
Expenses				
Operating	**16,841**	-		**16,841**
Transportation	**2,426**	-		**2,426**
Restructuring costs	**5,409**	-		**5,409**
General and administrative	**6,691**	-		**6,691**
Transaction costs	**-**	1,009	(e)	**1,009**
Stock-based compensation	**5,351**	-		**5,351**
Depletion and depreciation	**23,681**	(4,689)	(b), (d), (g)	**18,992**
Interest expense	**998**	(998)	(g)	**-**
Finance expense	**-**	1,717	(c), (g)	**1,717**
Gain on disposal of petroleum and natural gas properties	**-**	(1,156)	(j)	**(1,156)**
	61,397	(4,117)		**57,280**
Loss before income taxes	**(11,147)**	4,117		**(7,030)**
Deferred income taxes expense (reduction)	**(821)**	1,486	(f), (h)	**665**
Net loss and comprehensive loss	**$ (10,326)**	$ 2,631		**$ (7,695)**
Loss per share				
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 and evaluation 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 at 10 percent 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.

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 Corporation'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 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 increased $0.1 million during the year ended December 31, 2010 as the lower discount rate only partially 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 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.

(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 $8.7 million due to the re-valuation of common shares based on the change in the valuation date to the closing date rather than announcement date; 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 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 and December 31, 2010.

(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.

(j) Gain or loss on disposition of property

Under the previous GAAP, full cost accounting gains and losses were not recognized upon disposition of oil and gas assets unless the disposition altered the rate of depletion by 20% or more. Under IFRS gains and losses are recognized based on the difference between the proceeds from disposition and the asset’s net carrying value.

For the year ended December 31, 2010 the Corporation recognized gains of $1.2 million in conjunction with asset dispositions. There were no gains recognized on asset dispositions under previous GAAP during 2010.