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 19, 2013. 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)

P. Daniel O'Neil

President and Chief Executive Officer

(Signed)

Maxwell A. W. Lof

Chief Financial Officer

March 19, 2013

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, 2012 and December 31, 2011, the consolidated statements of income (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, 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, 2012 and December 31, 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

(*Signed*) "KPMG LLP"

Chartered Accountants
Calgary, Canada
March 19, 2013

Consolidated Statements of Financial Position

Stated in thousand of dollars

As at	December 31, 2012	December 31, 2011
Assets		
Current Assets		
Accounts receivable	$ 25,260	$ 19,512
Fair value of financial contracts (note 9)	2,384	-
Prepaid expenses and deposits	2,508	4,948
	30,152	24,460
Exploration and evaluation assets (note 6)	70,726	47,719
Petroleum and natural gas properties (note 7)	575,483	437,854
Deferred income taxes (note 15)	5,083	-
Goodwill (note 6)	-	6,029
	$ 681,444	$ 516,062
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ 53,823	$ 49,467
Fair value of financial contracts (note 9)	957	2,151
	54,780	51,618
Fair value of financial contracts (note 9)	1,137	2,751
Bank debt (note 10)	194,523	72,197
Decommissioning obligations (note 11)	39,339	37,511
Deferred income taxes (note 15)	40,666	27,829
Shareholders' equity		
Share capital (note 12)	351,957	278,302
Contributed surplus	20,495	12,879
Performance warrants (note 12)	7,059	7,196
Accumulated other comprehensive income (loss)	(43)	1,005
Retained earnings (deficit)	(28,469)	24,774
	350,999	324,156
Contingencies (note 19)		
Subsequent events (note 20)		
	$ 681,444	$ 516,062

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, 2012	2011
Revenues		
Petroleum and natural gas (note 13)	$ 192,660	$ 131,492
Royalties (note 13)	(35,114)	(17,537)
Realized gain (loss) on financial contracts (note 9)	355	(3,519)
Unrealized gain (loss) on financial contracts (note 9)	5,192	(2,332)
	163,093	108,104
Expenses		
Operating	37,692	33,885
Transportation	7,330	4,860
General and administrative	10,838	9,515
Transaction costs	740	246
Stock-based compensation (note 12)	3,431	3,462
Depletion and depreciation (note 7)	69,262	39,491
Impairment (note 8)	98,775	9,000
Finance expense (note 14)	7,849	4,193
Gain on disposal of petroleum and natural gas properties (note 5)	(1,329)	(734)
	234,588	103,918
Income (loss) before income taxes	(71,495)	4,186
Deferred income tax expense (recovery) (note 15)	(18,252)	2,091
Net income (loss) for the year	$ (53,243)	$ 2,095
Other comprehensive income (loss):		
Currency translation adjustment	(1,048)	1,005
Other comprehensive income (loss) for the year	(1,048)	1,005
Total comprehensive income (loss) for the year	$ (54,291)	$ 3,100
Income (loss) per share (note 12)		
Basic	$ (0.75)	$ 0.04
Diluted	$ (0.75)	$ 0.04

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

Consolidated Statements 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 (deficit)	Total equity
Balance at January 1, 2011	56,094,547	$ 220,845	$ 4,664	$ 7,196	$ -	$ 22,679	$ 255,384
Net income for the year	-	-	-	-	-	2,095	2,095
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 exercised	47,168	198	-	-	-	-	198
Balance at December 31, 2011	63,040,987	$ 278,302	$ 12,879	$ 7,196	$ 1,005	$ 24,774	$ 324,156
Net loss for the year	-	-	-	-	-	(53,243)	(53,243)
Issued pursuant to acquisition	7,919,436	71,275	-	-	-	-	71,275
Other comprehensive loss	-	-	-	-	(1,048)	-	(1,048)
Share issue costs (net of tax of $30)	-	(92)	-	-	-	-	(92)
Stock-based compensation	-	-	8,423	-	-	-	8,423
Transfer on exercise of options & warrants	-	944	(807)	(137)	-	-	-
Options excercised	230,330	1,391	-	-	-	-	1,391
Warrants exercised	26,592	137	-	-	-	-	137
Balance at December 31, 2012	**71,217,345**	**$ 351,957**	**$ 20,495**	**$ 7,059**	**$ (43)**	**$ (28,469)**	**$ 350,999**

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, 2012	2011
Cash provided by (used in)		
Operating		
Net income (loss)	**$ (53,243)**	$ 2,095
Gain on disposal of petroleum and natural gas properties	**(1,329)**	(734)
Unrealized loss (gain) on financial contracts	**(5,192)**	2,332
Finance expense	**7,849**	4,193
Interest expense	**(6,808)**	(3,176)
Depletion and depreciation	**69,262**	39,491
Impairment	**98,775**	9,000
Decommissioning expenditures	**(2,261)**	(965)
Stock-based compensation	**3,431**	3,462
Deferred income tax expense (recovery)	**(18,252)**	2,091
Change in non-cash working capital (note 17)	**629**	(1,150)
Cash flow from operating activities	**92,861**	56,639
Financing		
Bank debt	**107,703**	42,197
Issue of common shares, net of issue costs	**1,406**	56,405
Cash flow from financing activities	**109,109**	98,602
Investing		
Petroleum and natural gas properties	**(155,110)**	(104,107)
Exploration and evaluation assets	**(25,604)**	(45,990)
Disposition of petroleum and natural gas properties	**4,016**	9,848
Acquistions (note 5)	**(27,847)**	(24,909)
Change in non-cash working capital (note 17)	**2,575**	8,480
Cash flow used in investing activities	**(201,970)**	(156,678)
Change in cash	**-**	(1,437)
Cash, beginning of the year	**-**	1,437
Cash, end of the year	**$ -**	$ -

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 office 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 with International Financial Reporting Standards ("IFRS") as issued by the IASB.

The consolidated financial statements were authorized for issuance by the Board of Directors on March 19, 2013.

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

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

Critical Judgments in Applying Accounting Policies

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the consolidated financial statements.

The Corporation's assets are aggregated into cash-generating units for the purpose of calculating impairment. Cash generating units ("CGU" or "CGUs") are based on an assessment of the unit's ability to generate independent cash inflows. The determination of these CGUs was based on management's judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality.

Judgments are required to assess when impairment indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of reserves, production rates, future oil and natural gas prices, future costs, discount rates, market value of land and other relevant assumptions.

The application of the Corporation's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves have been found in assessing if technical feasibility and commercial reserves have been achieved.

Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

Key Sources of Estimation Uncertainty

The following are key estimates and their assumptions made by management affecting the measurement of balances and transactions in these consolidated financial statements.

Estimation of recoverable quantities of proven and probable reserves include estimates and assumptions regarding future commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the decommissioning obligations, the economic feasibility of exploration and evaluation assets and the amounts reported for depletion, depreciation and amortization of property, plant and equipment. These reserve estimates are verified by third party professional engineers, who work with information provided by the Corporation to establish reserve determinations in accordance with National Instrument 51-101.

The Corporation estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require assumptions regarding removal date, future environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating cost, inflation estimates, future removal technologies in determining the removal cost, and the estimate of the liability specific discount rates to determine the present value of these cash flows.

In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of oil and gas properties based upon the estimation of recoverable quantities of proven and probable reserves being acquired.

The Corporation's estimate of stock-based compensation is dependent upon estimates of historic volatility and forfeiture rates.

The Corporation's estimate of the fair value of derivative financial instruments is dependent on estimated forward prices and volatility in those prices.

The deferred tax liability is based on estimates as to the timing of the reversal of temporary differences, substantively enacted tax rates and the likelihood of assets being realized.

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 other comprehensive income.

(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 are recognized in net income. Impairments of goodwill 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.

(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, effective date of January 1, 2015.
- 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, 2012 and December 31, 2011, the fair value of 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), 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 AND DIVESTITURES

Pradera Resources Inc.

Effective January 6, 2012, the Corporation acquired all of the issued and outstanding common shares of Pradera Resources Inc. (“Pradera”), a privately held junior oil and gas exploration company, in exchange 7,919,436 common shares of Surge with an assigned value of $71.3 million. The purpose of the acquisition was to expand the Corporation’s exposure to certain light oil plays. The common shares have been ascribed a fair value of $9.00 per common share issued, as determined based on the Corporation’s closing share price at the date of closing, being January 6, 2012. In addition, Surge incurred transaction costs of $0.4 million, which were expensed through the statement of income. The operations of Pradera have been included in the results of Surge commencing January 6, 2012. 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	$	127,230
Exploration and evaluation assets		2,660
Current assets		5,948
Current liabilities		(3,796)
Bank debt		(14,623)
Decommissioning obligations		(1,608)
Deferred income tax liability		(26,036)
Net assets acquired	$	89,775
Consideration:		
Cash	$	18,500
Common shares (7,919,436 at $9.00 per share)		71,275
Total consideration paid	$	89,775

Included in the statement of income (loss) and comprehensive income (loss) are the following amounts for the year ended December 31, 2012:

Amounts since acquisition		
Revenue	$	33,424
Income and comprehensive income		3,467

During the year, the Corporation made certain property acquisitions for total cash consideration of $9.3 million. These amounts have been booked as follows: $3.5 million to exploration and evaluation assets and $5.8 million to petroleum and natural gas properties.

During the year, the Corporation made certain property dispositions for total cash consideration of $4.0 million. This resulted in a gain on disposal of petroleum and natural gas properties of $1.3 million.

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

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 year.

Exploration & Evaluation Assets

	Total
Balance at January 1, 2011	67,865
Acquisitions	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
Acquisitions (note 5)	6,181
Additions	25,604
Change in foreign exchange rate	(102)
Transfer to petroleum and natural gas properties	(8,676)
Balance at December 31, 2012	**$ 70,726**

Goodwill

		Total
Balance at January 1, 2011		-
Additions		5,862
Change in foreign exchange rate		167
Balance at December 31, 2011	$	6,029
Impairment		(5,897)
Change in foreign exchange rate		(132)
Balance at December 31, 2012	**$**	**-**

7) PETROLEUM AND NATURAL GAS PROPERTIES

		Total
Balance at January 1, 2011	$	314,113
Acquisitions		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
Acquisitions (note 5)		133,056
Additions		156,995
Dispositions		(3,816)
Transfer from exploration and evaluation assets		8,676
Capitalized stock-based compensation		4,992
Change in foreign exchange rate		(822)
Balance at December 31, 2012	**$**	**803,883**

	Total
Accumulated depletion and depreciation	
Balance at January 1, 2011	($18,932)
Depletion and depreciation expense	(39,491)
Impairment	(9,000)
Disposals	475
Balance at December 31, 2011	($66,948)
Disposals	688
Impairment	(92,878)
Depletion and depreciation expense	(69,262)
Balance at December 31, 2012	**($228,400)**

	Total
Carrying amounts	
At December 31, 2011	$437,854
At December 31, 2012	$575,483

The calculation of depletion and depreciation expense for the year ended December 31, 2012 included an estimated $256.9 million (December 31, 2011 - $140.1 million) for future development costs associated with proved plus probable reserves and excluded $31.3 million (December 31, 2011 - $28.0 million) for the estimated salvage value of production equipment and facilities.

8) IMPAIRMENT

For the years ended		**December 31, 2012**		December 31, 2011
Petroleum and natural gas properties	**$**	**92,878**	$	9,000
E&E assets		**-**		-
Goodwill		**5,897**		-
Impairment Expense	**$**	**98,775**	$	9,000

At December 31, 2012, due to declining forward natural gas prices, reserve revisions, and adjustments to future costs, the Corporation tested certain natural gas and oil CGU's for impairment. The estimated recoverable amounts of the Corporation's CGU's were estimated as the fair value less costs to sell based on the net present value of before tax cash flows from oil and gas proved plus probable reserves estimated by the Corporation's third party reserve evaluators at rates ranging from eight to twelve percent. In determining the appropriate discount rate, the Corporation referenced recent market transactions completed on assets similar to those in the CGU. At December 31, 2012, it was determined that the net present value of certain CGU's exceeded the recoverable amount and the Corporation recorded a $92.9 million ($9.0 million – December 31, 2011) impairment charge.

For the purposes of impairment testing, goodwill is allocated to the CGUs to which it relates. All of the goodwill of $5.9 million is allocated to one CGU. An impairment test for this CGU as at December 31, 2012 was performed and impairment of $5.9 million was recorded. The impairment test was calculated using the fair value less costs to sell approach, which was determined using discounted future cash flows, at an eight percent discount rate, generated from the related independently evaluated reserves as outlined above.

The following table outlines forecasted commodity prices and exchange rates used in the Corporation's CGU and goodwill impairment tests at December 31, 2012. The forecast commodity prices are consistent with those used by the Corporation's external reserve evaluators and are a key assumption in assessing the recoverable amount. The reserve evaluators also include financial assumptions regarding royalty rates, operating costs, and future development capital that can significantly impact the recoverable amount which are assigned based on historic rates and future anticipated activities by Management.

Year	Medium and Light Crude Oil WTI Cushing Oklahoma 40˚ API (US$/bbl)	Medium and Light Crude Oil Edmonton Par Price 40˚ API ($/bbl)	Medium and Light Crude Oil Cromer Medium 29.3˚ API ($/bbl)	Natural Gas AECO Gas Price ($/MMBtu)	NGL Pentanes plus FOB Field Gate ($/bbl)	NGL Butanes FOB Field Gate ($/bbl)	Inflation rates (%/Yr)	Exchange rate ($US/$Cdn)
2013	89.63	84.55	77.79	3.31	90.53	63.02	1.5	1.001
2014	89.93	89.84	82.66	3.72	96.19	66.96	1.5	1.001
2015	88.29	88.21	81.15	3.91	94.44	65.74	1.5	1.001
2016	95.52	95.43	88.75	4.70	102.18	71.13	1.5	1.001
2017	96.96	96.87	90.09	5.32	103.71	72.20	1.5	1.001
2018	98.41	98.32	91.44	5.40	105.27	73.28	1.5	1.001
2019	99.89	99.79	92.81	5.49	106.85	74.38	1.5	1.001
2020	101.38	101.29	94.20	5.58	108.45	75.50	1.5	1.001
2021	102.91	102.81	95.61	5.67	110.08	76.63	1.5	1.001
2022	104.45	104.35	97.05	5.76	111.73	77.78	1.5	1.001

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, 2012, the Corporation’s receivables consisted of $18.4 million ($15.6 million – December 31, 2011) due from petroleum and natural gas marketers, $6.4 million ($3.9 million – December 31, 2011) due from joint venture partners, and $0.5 million (nil – December 31, 2011) of other receivables consisting primarily of cash calls receivable. 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 accounts receivable and fair value of financial contracts represent the maximum credit exposure. The Corporation has an allowance for doubtful accounts of $0.2 million (2011 - $0.2 million) at December 31, 2012, which is being applied against outstanding receivables.

The Corporation's most significant customers are six oil and natural gas marketers, accounting for approximately 89 percent of Surge's 2012 revenue.

As at December 31, 2012, 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, 2012	$ 25,260	$ 24,154	$ 1,106
	100%	96%	4%
December 31, 2011	$ 19,512	$ 17,801	$ 1,711
	100%	91%	9%

(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, 2013, could be potentially due in May 2014 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 $ 0.9996 Canadian (2011 – 1 USD: $ 0.9890 Canadian) and the exchange rate at December 31, 2012 was 1 USD equals $ 0.9949 Canadian dollar (2011 – 1 USD: $1.017 Canadian). At December 31, 2012 the total impact on net assets denominated in USD is approximately $87,000.

The Corporation had no forward exchange rate contracts in place as at or during the years ended December 31, 2012 and 2011.

(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 year ended December 31, 2012:

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C$)	Index (Surge pays) (C$)	Year ended December 31, 2012 Unrealized gains (losses) ($000s CDN)	Realized gains (losses) ($000s CDN)
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	$ 97.00	WTI - NYMEX	346	266
Jan 1 to Dec 31, 2012	Put	250 bbls/d	$ 80.00	WTI - NYMEX	524	-
Jan 1 to Dec 31, 2012	Call	62.5 bbls/d	$ 80.00	WTI - NYMEX	(206)	(322)
Jan 1 to Dec 31, 2012	Swap	250 bbls/d	$ 80.00	WTI - NYMEX	1,891	(1,289)
Jan 1 to Dec 31, 2012	Call	250 bbls/d	WTI - NYMEX	$ 89.95	(1,377)	483
Jan 1 to Dec 31, 2012	Put	250 bbls/d	$ 90.00	WTI - NYMEX	508	106
Jan 1 to Dec 31, 2012	Call	92.5 bbls/d	$ 90.00	WTI - NYMEX	(391)	(178)
Jan 1 to Dec 31, 2012	Put	500 bbls/d	$ 90.00	WTI - NYMEX	(783)	(302)
Jan 1 to Dec 31, 2012	Call	157.5 bbls/d	WTI - NYMEX	$ 90.00	865	132
Jan 1 to Dec 31, 2012	Swap	500 bbls/d	$ 85.00	WTI - NYMEX	2,873	(1,664)
Jan 1 to Dec 31, 2012	Call	500 bbls/d	WTI - NYMEX	$ 96.00	(1,960)	420
Apr 1 to Dec 31, 2012	Swap	500bbls/d	$ 90.00	WTI - NYMEX	-	(154)
Apr 1 to Dec 31, 2012	Call	500bbls/d	WTI - NYMEX	$ 96.00	-	99
Apr 1 to Dec 31, 2012	Swap	500bbls/d	$ 101.50	WTI - NYMEX	-	1,427
Jul 1 to Dec 31, 2012	Swap	500bbls/d	$ 95.00	WTI - NYMEX	-	501
Jul 1 to Dec 31, 2012	Call	500bbls/d	WTI - NYMEX	$ 99.80	-	-
Jan 1 to Dec 31, 2013	Swap	250bbls/d	$ 98.00	WTI - NYMEX	432	-
Jan 1 to Dec 31, 2013	Swap	250bbls/d	$ 95.00	WTI - NYMEX	160	-
Jan 1 to Dec 31, 2013	Swap	250 bbls/d	$ 85.00	WTI - NYMEX	(441)	-
Jan 1 to Dec 31, 2013	Call	250bbls/d	WTI - NYMEX	$ 95.00	439	-
Jan 1 to Mar 31, 2013	Swap	250bbls/d	$ 104.85	WTI - NYMEX	294	-
Jan 1 to Mar 31, 2013	Swap	500bbls/d	$ 95.00	WTI - NYMEX	214	-
Jan 1 to Mar 31, 2013	Call	315bbls/d	WTI - NYMEX	$ 95.00	(29)	-
Jan 1 to Mar 31, 2013	Swap	500bbls/d	$ 95.00	WTI - NYMEX	144	-
Jan 1 to Mar 31, 2013	Call	500bbls/d	WTI - NYMEX	$ 103.70	11	-
Apr 1 to Jun 30, 2013	Swap	250bbls/d	$ 105.05	WTI - NYMEX	270	-
Apr 1 to Jun 30, 2013	Swap	500bbls/d	$ 95.00	WTI - NYMEX	86	-
Apr 1 to Jun 30, 2013	Call	300bbls/d	WTI - NYMEX	$ 95.00	119	-
Jan 1 to Jun 30, 2013	Swap	500bbls/d	$ 90.00	WTI - NYMEX	(243)	-
Jan 1 to Jun 30, 2013	Call	380bbls/d	WTI - NYMEX	$ 90.00	391	-
Jan 1 to Jun 30, 2013	Swap	1,000 bbls/d	$ 90.00	WTI - NYMEX	(496)	-
Jan 1 to Jun 30, 2013	Call	1,000 bbls/d	WTI - NYMEX	$ 96.00	564	-
Apr 1 to Jun 30, 2013	Swap	500 bbls/d	$ 95.15	WTI - NYMEX	82	
Jul 1 to Dec 31, 2013	Swap	750 bbls/d	$ 94.97	WTI - NYMEX	168	
Jul 1 to Dec 31, 2013	Swap	1,000 bbls/d	$92.50 (USD)	WTI - NYMEX	(179)	
Jan 1 to Dec 31, 2014	Swap	1,000 bbls/d	$91.40 (USD)	WTI - NYMEX	(274)	
Total					**$ 4,002**	**$ (475)**

Term	Type (floating to fixed)	Volume	Differential (Surge receives) (C$)	Index (Surge pays) (C$)	Year ended December 31, 2012 Unrealized gains (losses) ($000s CDN)	Year ended December 31, 2012 Realized gains (losses) ($000s CDN)
Jan 1 to Mar 31, 2012	Swap	500 bbls/d	$ 13.25	Western Canadian Select	(102)	385
Jan 1 to Jun 30, 2012	Swap	250 bbls/d	$ 14.85	Western Canadian Select	(37)	401
Jun 1 to Jun 30, 2012	Swap	750 bbls/d	$ 17.50	Western Canadian Select	-	(23)
Jul 1 to Sep 30, 2012	Swap	500 bbls/d	$ 20.25	Western Canadian Select	-	67
Oct 1 to Dec 31, 2012	Swap	500 bbls/d	$ 23.15	Western Canadian Select	-	(237)
Oct 1 to Oct 31, 2012	Swap	500 bbls/d	$ 21.25	Western Canadian Select	-	(181)
Nov 1 to Dec 31, 2012	Swap	500 bbls/d	$ 20.50	Western Canadian Select	-	54
Oct 1 to Dec 31, 2012	Swap	2,000 bbls/d	$ -	Edmonton Sweet Crude	-	611
Total					**$ (139)**	**$ 1,077**

Term	Type (floating to fixed)	Volume	Swap Price (Surge receives) (C$)	Index (Surge pays) (C$)	Year ended December 31, 2012 Unrealized gains (losses) ($000s CDN)	Year ended December 31, 2012 Realized gains (losses) ($000s CDN)
Jan 1 to Dec 31, 2013	Swap	2,000 gj/d	$ 3.10	AECO	90	-
Jan 1 to Dec 31, 2013	Swap	1,000 gj/d	$ 3.05	AECO	27	-
Jan 1 to Dec 31, 2013	Swap	1,000 gj/d	$ 3.07	AECO	31	-
Jan 1 to Dec 31, 2013	Swap	2,000 gj/d	$ 3.25	AECO	199	-
Jan 1 to Dec 31, 2013	Swap	2,000 gj/d	$ 3.45	AECO	336	-
Jan 1 to Dec 31, 2014	Swap	2,000 gj/d	$ 3.60	AECO	95	-
Total					**$ 778**	**$ -**

The following table outlines the realized and unrealized losses on interest rate contracts for the year ended December 31, 2012:

					Year ended December 31, 2012	
Term	Type (floating to fixed)	Amount (C$)	Company Fixed Interest Rate (%) (1)	Counter party Floating Rate Index	Unrealized gain (loss) ($000s CDN)	Realized gain (loss) ($000s CDN)
Jan 1, 2012 to Dec 31, 2014	Swap	$ 50,000,000	2.74%	CAD-BA-CDOR	551	(247)

(1) The interest rate contract 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 and natural gas prices. All 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:

Net earnings impact for the period ended December 31, 2012	Price Increase	Price Decrease
Crude Oil - Change of +/- $1.00	$ (1,462)	$ 1,462
Natural Gas - Change of +/- $0.10	$ (283)	$ 283
Interest rate - Change of +/- 100 points	$ 387	$ (387)

(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 $351.0 million (2011 - $324.2 million), bank debt of $194.5 million (2011 - $72.2 million) and a working capital deficiency of $24.6 million (2011 - $27.2 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, 2012 and 2011 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.

10) BANK DEBT

The Corporation has a $290 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, 2013. On May 5, 2013, 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 2.00 percent as at December 31, 2012 (December 31, 2011 – prime plus 1.75 percent).

The facility is secured by a general assignment of book debts, debentures of $500.0 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, 2012.

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 $73.9 million (December 31, 2011 – $70.7 million) which will be incurred between 2013 and 2062. The majority of these costs will be incurred between 2013 and 2038. A risk free rate of 2.5 percent (December 31, 2011 – 2.5 percent) and an inflation rate of two percent (December 31, 2011 – two percent) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	December 31, 2012	December 31, 2011
Balance, beginning of year	**$ 37,511**	$ 28,569
Liabilities related to acquisitions (note 5)	**1,608**	799
Liabilities related to dispositions (note 5)	**(441)**	(1,110)
Change in foreign exchange rate	**(4)**	26
Change in decommissioning obligations rate	**-**	7,854
Liabilities incurred	**1,885**	1,321
Accretion expense	**1,041**	1,017
Decommissioning expenditures	**(2,261)**	(965)
Balance, end of year	**$ 39,339**	$ 37,511

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 7,121,734 common shares of the Corporation as at December 31, 2012. 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.

	December 31, 2012		December 31, 2011	
	Number of Options	**Weighted average exercise price**	Number of Options	Weighted average exercise price
Stock options oustanding, beginning of year	**4,948,999**	**$ 7.54**	2,683,667	$ 6.24
Granted	**2,433,450**	**$ 7.49**	2,355,500	$ 8.92
Exercised	**(230,330)**	**$ 6.04**	(47,168)	$ 3.95
Forfeited	**(571,418)**	**$ 8.11**	(43,000)	$ 5.96
Stock options oustanding, end of year	**6,580,701**	**$ 7.53**	4,948,999	$ 7.54
Exercisable at year-end	**2,132,742**	**$ 7.13**	899,484	$ 6.10

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

	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 to $2.99	26,666	$ 1.75	0.95	26,666	$ 1.75
$3 to $4.99	24,000	$ 3.20	1.98	24,000	$ 3.20
$5 to $6.99	2,209,167	$ 6.40	2.67	1,391,318	$ 6.41
$7 to $8.99	2,740,534	$ 7.51	4.30	182,002	$ 7.90
$9 to $11.15	1,580,334	$ 9.29	3.61	508,756	$ 9.28
$1 to $11.15	6,580,701	$ 7.53	3.56	2,132,742	$ 7.13

The weighted average share price at the date of exercise for share options exercised in 2012 was $8.27 (2011 - $ 9.37).

(c) Performance warrants

The Corporation has 2,047,272 performance warrants outstanding (December 31, 2011 – 2,073,864) that expire on April 13, 2015. As at December 31, 2012, all 2,047,272 performance warrants were vested and exercisable at a price of $5.17.

The weighted average share price at the date of exercise for performance warrants exercised in 2012 was $9.72 (2011 - $8.69).

(d) Stock-based compensation

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

	Years ended December 31, 2012	2011
Stock-based compensation on options	**$ 8,423**	$ 8,315
Capitalized stock-based compensation	**(4,992)**	(4,853)
Total stock-based compensation expense	**$ 3,431**	$ 3,462

The Corporation's stock-based compensation expense for the year ended December 31, 2012 was $3.4 million (December 31, 2011 - $3.5 million). A Black-Scholes valuation model was applied to determine the fair value of the options.

The following assumptions were used to calculate stock-based compensation on options granted for the year ended December 31, 2012: zero dividend yield (December 31, 2011 – zero); expected volatility of 69 percent (December 31, 2011 – 69 percent); risk free rate of two percent (December 31, 2011 – two percent); forfeiture rate of zero percent (December 31, 2011 – zero percent) and expected life of five years (December 31, 2011 – five years). The weighted average fair value of options granted in the year was $4.28 per option (December 31, 2011 - $5.21).

(e) Per share amounts

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

	Years ended December 31, 2012	2011
Weighted average number of shares - basic	**70,962,463**	57,621,515
Effect of dilutive stock options	**-**	1,136,328
Weighted average number of shares - diluted	**70,962,463**	58,757,843

In computing diluted per share amounts at December 31, 2012, 6,580,701 options (December 31, 2011 – nil) and 2,047,272 performance warrants (December 31, 2011 – nil) were excluded from the calculation as their effect was anti-dilutive.

13) PETROLEUM AND NATURAL GAS REVENUE, NET OF ROYALTIES

	Years ended December 31,			
		2012		2011
Oil	$	176,474	$	111,705
Natural Gas		16,129		19,548
Processing and other income		57		239
Less: Royalties		(35,114)		(17,537)
Total petroleum and natural gas revenue, net of royalties	$	157,546	$	113,955

14) FINANCE EXPENSE

	Years ended December 31,			
		2012		2011
Interest on bank debt	$	6,808	$	3,176
Accretion of decommissioning obligations		1,041		1,017
	$	7,849	$	4,193

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

	Years ended December 31,			
		2012		2011
Income (loss) before income taxes	$	(71,495)	$	4,186
Combined federal and provincial statutory rate		25.0%		26.5%
Expected income tax expense (recovery)	$	(17,874)	$	1,109
Difference resulting from:				
Flow-through shares		-		550
Changes in tax rates		(434)		42
Non-deductible stock-based compensation costs		858		917
Other		(802)		(255)
Sub-total		(18,252)		2,363
Flow-through share premium		-		(272)
Deferred income tax expense	$	(18,252)	$	2,091

The combined federal and provincial tax rate decreased from 26.5% in 2011 to 25.0% in 2012 as a result of the Canadian federal rate decreasing from 16.5% to 15% year over year.

b) Deferred income tax liability:

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

	Years ended December 31, 2012	2011
Petroleum and natural gas properties	**$ 32,977**	$ 44,683
Decommissioning obligations	**(9,835)**	(9,378)
Fair value of financial contracts	**73**	(1,225)
Deferred partnership income	**20,753**	14,236
Non-capital losses	**(6,704)**	(18,668)
Other	**(1,681)**	(1,819)
	$ 35,583	$ 27,829

The net deferred income tax liability is reflected on the Statement of Financial Position as a deferred tax asset of $5.1 million and a deferred tax liability of $40.7 million.

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

	January 1 2011	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)**

	December 31 2011	Recognized in equity	Business combinations	Recognized in profit or loss	December 31 2012
Property, plant and equiment	$ (44,683)	$ -	$ (26,438)	$ 38,144	**$ (32,977)**
Decomissioning obligations	9,378	-	402	55	**9,835**
Partnership deferral	(14,236)	-	-	(6,517)	**(20,753)**
Non-capital losses	18,668	-	-	(11,964)	**6,704**
Share issue costs and other	3,044	30	-	(1,466)	**1,608**
	$ (27,829)	$ 30	$ (26,036)	$ 18,252	**$ (35,583)**

16) KEY MANAGEMENT PERSONNEL COMPENSATION

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

	Years ended December 31, 2012	2011
Salaries and wages	**$ 1,914**	$ 1,536
Short-term employee benefits	**203**	378
Termination benefits	**390**	-
Stock-based payments (i)	**1,973**	1,731
	$ 4,480	$ 3,645

(i) Represents the amortization of stock-based compensation associated with options granted to key management personnel as recorded in the financial statements.

17) CASHFLOW INFORMATION

	Years ended December 31,	
	2012	2011
Accounts receivable	**$ (5,748)**	$ (7,108)
Prepaid expenses and deposits	**2,440**	(3,291)
Accounts payable and accrued liabilities	**4,360**	17,729
Working capital on acquisition (note 5)	**2,152**	-
Change in non-cash working capital	**$ 3,204**	$ 7,330
These changes relate to the following activities		
Operating	**$ 629**	$ (1,150)
Investing	**2,575**	8,480
	$ 3,204	$ 7,330

18) COMMITMENTS

Future minimum payments relating to operating lease and firm transport commitments

($000s)	
2013	$ 2,511
2014	2,212
2015	1,993
2016	1,514
2017	1,250
2018+	615
Total	**$ 10,095**

19) CONTINGENCIES

The Corporation is defending a legal action brought forth by a third party rights owner alleging that Surge is producing their gas from the Halfway formation as a result of cross-flow from the Halfway formation into the Corporation's Doig formation at Valhalla. If the defense against the action were to be unsuccessful, management does not expect the outcome of the action to have a material effect on the Corporation's financial position. The amount of potential damages and legal costs have not been determined due to the complex nature of the claim and calculations required to determine what amount would be owing due to the cross-flow.

20) SUBEQUENT EVENTS

(a) Subsequent to December 31, 2012, Surge entered into the following pricing contracts:

WTI Oil Contracts

	Term	Type	Volume	Price (C$) (Surge Receives)	Index (Surge pays)
1)	Jul 1, 2013 - Dec 31, 2013	Swap	350bbls/d	96.25	$USD WTI - NYMEX

EDM to WTI Oil Differential Contracts

	Term	Type	Volume	Differential (C$) (Surge Receives)	Index (Surge pays) (C$)
1)	Apr 1, 2013 - Dec 31, 2013	Swap	1,000bbls/d	8.35	TMX SW 1a (Edm-to-WTI)
2)	Apr 1, 2013 - Jun 30, 2013	Swap	1,000bbls/d	7.00	TMX SW 1a (Edm-to-WTI)
3)	Jul 1, 2013 - Dec 31, 2013	Swap	1,000bbls/d	7.50	TMX SW 1a (Edm-to-WTI)

AECO Gas Contracts

	Term	Type	Volume	Price (C$) (Surge Receives)	Index (Surge pays) (C$)
1)	Jan 1, 2014 - Dec 31, 2014	Swap	2,000 gj/d	3.40	AECO - Daily

21) GEOGRAPHICAL INFORMATION

As at and for the year ended December 31, 2012	Canada	USA	**Total**
Petroleum & natural gas revenue	$ 184,371	$ 8,289	**$ 192,660**
Petroleum & natural gas properties	549,489	25,994	**575,483**
Exporation & evaluation assets	67,388	3,338	**70,726**
Goodwill	-	-	**-**

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**