

Management's Report

The consolidated financial statements of Questerre Energy Corporation were prepared by management in accordance with International Financial Reporting Standards. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

Management has designed and maintains a system of internal accounting controls that provide reasonable assurance that all transactions are accurately recorded, that the financial statements reliably report the Company's operations and that the Company's assets are safeguarded. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. Such estimates are based on careful judgments made by management.

Ernst and Young LLP, an independent firm of Chartered Professional Accountants, to audit the consolidated financial statements of the Company and provide an independent opinion. They have conducted an independent examination of the Company's accounting records in order to express their opinion on the consolidated financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through its Audit Committee. The Audit Committee, which consists of non-management directors, has met with Ernst and Young LLP and management in order to determine that management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The Audit Committee has reported its findings to the Board of Directors, who have approved the consolidated financial statements.



Michael Binnion
President and Chief Executive Officer



Jason D'Silva
Chief Financial Officer

Calgary, Alberta, Canada
March 24, 2022

Independent Auditor's Report

To the Shareholders of Questerre Energy Corporation

Our Opinion

We have audited the consolidated financial statements of Questerre Energy Corporation (the Company), which comprise the consolidated balance sheet as at December 31, 2021, and the consolidated statement of net loss and comprehensive loss, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2021, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the consolidated financial statements of the current period. This matter was addressed in the context of the audit of the consolidated financial statements as a whole, and in forming the auditor's opinion thereon, and we do not provide a separate opinion on this matter. For the matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matter below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter	How our audit addressed the key audit matter
<i>Reversal of impairment of property and equipment</i> As at December 31, 2021, the carrying value of property, plant and equipment (PP&E) for the Western Canadian operating segment was \$140.1 million. For the year ended December 31, 2021, an impairment reversal of \$91.7 million was recorded with respect to PP&E in the Montney and Antler Cash Generating Units ("CGU"). Refer to Note 2(e) for a description of the Company's estimates and judgements relating to impairment and to Note 3(g) for a description of the Company's impairment of non-financial assets accounting policy. Refer to Note 8 for the Company's PP&E impairment disclosures. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount of a CGU that indicates a previous impairment loss no longer exists or may have decreased. Determining the amount of an impairment reversal requires an estimate of a CGU's respective recoverable amount. The recoverable amount of the CGUs was determined using a fair value less cost to sell model based on based on expected after-tax future net cash flows from the production of proved and probable reserve volumes using forecast commodity prices and costs, discounted using market-based rates. Proved and probable reserves were determined by the Company's independent petroleum engineers (management's experts). Auditing the Company's estimated recoverable amount was complex due to the subjective nature of the various management inputs and assumptions and the significant effect changes in these could have on the recoverable amount. Additionally, the evaluation of this estimate required specialized skills and knowledge. The primary inputs noted in the fair value less cost to sell model were the discount rate and the proved and probable reserve volumes, forecasted commodity prices, and forecasted	To test the Company's estimated recoverable amounts of the CGUs within the Western Canada operating segment, we performed the following procedures, among others: • Evaluated management's experts' competence, capability and objectivity as well as obtained an understanding of the work they performed. The appropriateness of their work as audit evidence was evaluated by considering the relevance and reasonableness of the methods and assumptions utilized. • Involved our internal valuation specialists to assess the methodology applied, and the various inputs utilized in determining the after-tax discount rate by referencing current industry, economic, and comparable company information, as well as company and cash-flow specific risk premiums; • With the assistance of our internal valuation specialists, we also compared the market capitalization to net assets and observed quantitative and qualitative reconciliations using market data and transactions; • Compared forecasted benchmark commodity pricing against historical realized prices and to other third-party price forecasts; • Assessed forecasted production, royalties, operating costs, and future development costs by comparing them to historical results; and • Evaluated the adequacy of the impairment note disclosure included in Note 8 of the accompanying consolidated financial statements in relation to this matter.

production royalties, operating and future development costs.

Other Matter

The consolidated financial statements of the Company for the year ended December 31, 2020, were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements on March 24, 2021.

Other Information

Management is responsible for the other information. The other information comprises:

- Management's discussion and analysis
- Annual report

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion & Analysis and the Annual Report prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise

from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare

circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Janet Huang.

/s/ Ernst and Young LLP

Chartered Professional Accountants

Calgary, Canada

March 24, 2022

Consolidated Balance Sheets

(\$ thousands)	Note	December 31, 2021	December 31, 2020
Assets			
Current Assets			
Cash and cash equivalents	5	\$ 8,531	\$ 10,404
Accounts receivable	6	4,016	2,683
Deposits and prepaid expenses		1,068	819
		13,615	13,906
Right-of-use assets	19	196	249
Investments	7	7,965	7,979
Property, plant and equipment	8	140,120	52,484
Exploration and evaluation assets	9	14,710	114,203
Restricted cash	13	7,658	7,356
		\$ 184,264	\$ 196,177
Liabilities			
Current Liabilities			
Lease liabilities	19	\$ 52	\$ 50
Accounts payable and accrued liabilities		8,361	6,186
Credit Facilities	13	3,420	15,427
		11,833	21,663
Lease liabilities	19	155	205
Contingent liabilities		1,820	1,820
Asset retirement obligation	12	21,495	20,369
		35,303	44,057
Shareholders' Equity			
Share capital	14	429,878	429,703
Contributed surplus		24,068	23,047
Accumulated other comprehensive loss		(527)	(473)
Deficit		(304,458)	(300,157)
		148,961	152,120
		\$ 184,264	\$ 196,177

Commitments (note 20)

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

Signed on behalf of the Board of Directors



Bjorn Inge Tonnessen, Director



Dennis Sykora, Director

Consolidated Statements of Net Loss and Comprehensive Loss

		For the year ended December 31,	
(\$ thousands, except per share amounts)	Note	2021	2020
Revenue			
Petroleum and natural gas revenues	15	\$ 30,404	\$ 21,924
Royalties		(1,869)	(1,315)
Petroleum and natural gas revenue, net of royalties		28,535	20,609
Expenses			
Direct operating		11,780	11,945
General and administrative		2,409	2,534
Depletion, depreciation and accretion	8,12,19	6,094	9,422
Impairment	9	12,111	113,019
Lease expiries	9	220	717
Share based compensation	11	476	489
Interest expense		433	619
Interest and other income		(680)	(503)
Loss before taxes		(4,308)	(117,633)
Deferred tax recovery	10	(7)	(10)
Net loss		(4,301)	(117,623)
Other Comprehensive Loss, Net of Tax			
<i>Items that may be reclassified subsequently to profit or loss:</i>			
Foreign currency translation adjustment		(17)	(20)
Loss on foreign exchange on investments	7	(37)	(240)
		(54)	(260)
Total Comprehensive Loss		\$ (4,355)	\$ (117,883)
Net Loss per Share			
Basic and diluted	14	\$ (0.01)	\$ (0.28)

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

Consolidated Statements of Changes in Equity

	For the year ended December 31,	
(\$ thousands)	2021	2020
Share Capital		
Balance, beginning of year	\$ 429,703	\$ 429,703
Options exercised	175	–
Balance, end of year	429,878	429,703
Contributed Surplus		
Balance, beginning of year	23,047	21,700
Share based compensation	1,021	1,347
Balance, end of year	24,068	23,047
Accumulated Other Comprehensive Loss		
Balance, beginning of year	(473)	(213)
Other comprehensive loss	(54)	(260)
Balance, end of year	(527)	(473)
Deficit		
Balance, beginning of year	(300,157)	(182,534)
Net loss	(4,301)	(117,623)
Balance, end of year	(304,458)	(300,157)
Total Shareholders' Equity	\$ 148,961	\$ 152,120

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

Consolidated Statements of Cash Flows

		For the years ended December 31,	
(\$ thousands)	Note	2021	2020
Operating Activities			
Net loss		\$ (4,301)	\$ (117,623)
Adjustments for:			
Depletion, depreciation and accretion	8,12	6,094	9,422
Impairment	8,9	12,111	113,019
Lease expiries	9	220	717
Share based compensation	11	476	489
Deferred tax recovery	10	(7)	(10)
Interest expense		433	619
Interest and other income		(359)	(428)
Abandonment expenditures	12	(190)	(59)
Adjusted funds flow from operations		14,477	6,146
Interest expense		(433)	(619)
Interest income		207	321
Change in non-cash working capital	18	(176)	560
Net cash from operating activities		14,075	6,408
Investing Activities			
Property, plant and equipment expenditures	8	(502)	(1,691)
Exploration and evaluation expenditures	9	(4,163)	(3,931)
Change in non-cash working capital	18	904	(4,528)
Net cash used in investing activities		(3,761)	(10,150)
Financing Activities			
Proceeds from issue of share capital		175	–
Principal portion of lease payments		(53)	(85)
Increase in credit facilities		17,993	24,550
Repayment of credit facilities		(30,000)	(25,500)
Net cash used in financing activities		(11,885)	(1,035)
Change in cash, cash equivalents and restricted cash		(1,571)	(4,777)
Cash, cash equivalents and restricted cash, beginning of year		17,760	22,537
Cash, cash equivalents and restricted cash, end of year		\$ 16,189	\$ 17,760

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

Notes to the Consolidated Financial Statements

For the years ended December 31, 2021 and 2020

1. Reporting Entity

Questerre Energy Corporation ("Questerre" or the "Company") is an energy technology and innovation company actively engaged in the acquisition, exploration and development of oil and gas projects, specifically, non-conventional projects such as tight oil, oil shale, shale oil and shale gas. The consolidated financial statements of the Company as at and for the years ended December 31, 2021 and 2020 comprise the Company and its wholly-owned subsidiaries in those periods owned. The Company wholly owns Questerre Energy Corporation/Jordan, which holds interests in the oil shale assets in Jordan.

Questerre is incorporated under the laws of the Province of Alberta and is domiciled in Canada. The address of its registered office is 1650, 801 Sixth Avenue SW, Calgary, Alberta.

a) Segmented Disclosure

Management has determined the operating segments based on information regularly reviewed for the purposes of decision making, allocating resources, and assessing operational performance by Questerre's chief operating decision makers comprising of the Chief Executive Officer and other members of executive management. The operating segments have been aggregated based on several factors including geographic location and stage of development as well as the assignment of reserves and resources.

The accounting policies applied by the segments are the same as those applied by the Company.

The Company's operating segments at year end are as follows:

- Western Canada – Exploration and development activities in Western Canada including Alberta, Saskatchewan and Manitoba with existing production of natural gas, crude oil and natural gas liquids.
- Quebec – Development of a significant natural gas discovery in the province with a focus on securing social acceptability and regulatory approvals for a clean technology energy project.
- Corporate & other – General and administrative resources to manage the respective operating segments. Includes exploration activities in the Kingdom of Jordan and an investment in Red Leaf Resources Inc. ("Red Leaf").

Segmented assets are those assets associated with each operating segment as recorded on the consolidated balance sheets.

The table below details the breakdown of assets by operating segment to the consolidated balance sheets and the reconciliation of income by operating segment to the consolidated statements of net income and comprehensive income.

(\$ thousands)	Western Canada	Quebec	Corporate & other	Consolidated
Assets by operating segment				
Exploration and Evaluation	\$ 8,855	\$ –	\$ 5,855	\$ 14,710
Property, Plant & Equipment	140,120	–	–	140,120
Other	5,084	7,658	16,691	29,433
Total Assets, December 31, 2021	\$ 154,059	\$ 7,658	\$ 22,546	\$ 184,263
Exploration and Evaluation	\$ 6,381	\$ 101,946	\$ 5,876	\$ 114,203
Property, Plant & Equipment	52,484	–	–	52,484
Other	3,502	7,356	18,632	29,490
Total Assets, December 31, 2020	\$ 62,367	\$ 109,302	\$ 24,508	\$ 196,177
Results by operating segment				
Revenues	\$ 28,535	\$ –	\$ –	\$ 28,535
Expenses	(29,699)	(506)	(2,638)	(32,843)
Segmented Loss, December 31, 2021	\$ (1,164)	\$ (506)	\$ (2,638)	\$ (4,308)
Deferred tax recovery				7
Total Loss, December 31, 2021				\$ (4,301)
Revenues	\$ 20,609	\$ –	\$ –	\$ 20,609
Expenses	(134,116)	(987)	(3,139)	(138,242)
Segmented Loss, December 31, 2020	\$ (113,507)	\$ (987)	\$ (3,139)	\$ (117,633)
Deferred tax recovery				10
Total Loss, December 31, 2020				\$ (117,623)

2. Basis of Preparation

a) Statement of compliance

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Boards (“IASB”). The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as at March 24, 2022, the date the Board of Directors approved the statements.

b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for financial assets classified as fair value through profit and loss which are measured at fair value with changes in fair value recorded in profit or loss and changes due to foreign exchange recorded through other comprehensive income or loss as disclosed in Note 3.

c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company’s functional currency. The Company has a wholly-owned subsidiary with a functional currency of the Jordanian Dinar.

d) Jointly controlled assets

The Company conducts many of its oil and gas production activities through jointly controlled operations. Interests in joint arrangements are classified as either joint operations or joint ventures, depending on the rights and obligations of the parties to the arrangement. Joint operations arise when the Company has rights to the assets and obligations for the liabilities of the arrangement. The Company recognizes its share of assets, liabilities, revenues and expenses of a joint operation. Joint ventures arise when the Company has rights to the net assets of the arrangement. Joint ventures are accounted for under the equity method.

e) Use of estimates and judgments

The preparation of consolidated financial statements 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. These estimates and judgments have risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

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.

Petroleum and natural gas reserves

All of Questerre's petroleum and natural gas reserves are evaluated and reported on by independent reserve engineers in accordance with the COGE Handbook and Canadian Securities Administrators' *National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities*. The estimation of reserves is a subjective process. Forecasts are based on engineering data, anticipated future commodity prices, expected production volumes, future operating and development costs, all of which are subject to numerous uncertainties and various interpretations. The Company expects that its estimates of reserves will change to reflect updated information. Reserve estimates can be revised upward or downward based on the results of future drilling, testing, production levels and changes in costs and commodity prices. These estimates are evaluated by independent reserve engineers at least annually.

Proved and probable reserves are estimated using independent reserve engineer reports 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. If probabilistic methods are used, there should be at least a 50 percent probability that the quantities actually recovered will equal or exceed the estimated proved plus probable reserves and there should be at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

Reserve estimates impact a number of areas, in particular, the valuation of property, plant and equipment, and the calculation of depletion.

Refer to Note 8 & 9 for carrying amounts of property, plant and equipment, exploration and evaluation assets.

Exploration and evaluation assets

The application of the Company's accounting policy for exploration and evaluation assets requires judgement in determining whether it is likely that future economic benefit exists when activities have not reached a stage where technical feasibility and commercial viability can be reasonably determined. In addition, Management uses judgement to determine when exploration and evaluation ("E&E") assets are reclassified to property, plant and equipment ("PP&E") assets.

Exploration and evaluation assets are subject to ongoing management review to confirm the continued intent to establish the technical feasibility and commercial viability of the assets. In making this determination, various factors are considered such as drilling results, future capital and operating expenditures, including judgement over the amount of economically recoverable resources, and whether the appropriate government, regulatory, or internal approvals are likely to be received.

Cash generating units ("CGU")

A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretations. Factors considered in the classification include geography and the way management monitors and makes decisions about its operations.

Refer to Note 8 for carrying amounts of property, plant and equipment.

Impairment of property, plant and equipment, exploration and evaluation and goodwill

The Company assesses its oil and gas properties, including exploration and evaluation assets, for possible impairment or reversal of previously recognized impairments if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable or indications that previously recognized losses should be reversed. Determining if there are facts and circumstances present that indicate that carrying values of the assets may not be recoverable requires management's judgment and analysis of the facts and circumstances.

The recoverable amounts of CGUs have been determined based on the higher of value in use ("VIU") and the fair value less costs of disposal ("FVLCD"). Significant assumptions the Company uses in estimating future cash flows for recoverable amounts are anticipated future commodity prices, quantities of reserves, expected production volumes, the discount rate, future operating and development costs and recent land transactions. Changes to these assumptions will affect the recoverable amounts of CGUs and may require a material adjustment to their related carrying value.

Goodwill is the excess of the purchase price paid over the fair value of the net assets acquired. Since goodwill results from purchase accounting, it is imprecise and requires judgment in the determination of the fair value of assets and liabilities. Goodwill is assessed for impairment at an operating segment level based on the recoverable amount for each CGU of the Company. Therefore, impairment of goodwill uses the same significant assumptions noted above for impairment of assets.

Asset retirement obligation

Determination of the Company's asset retirement obligation is based on Government regulations, operator estimates and internal estimates using current costs and technology in accordance with existing legislation and industry practice and must also estimate timing, a risk-free rate and inflation rate in the calculation. These estimates are subject to change over time and, as such, may impact the charge against profit or loss. The amount recognized is the present value of estimated future expenditures required to settle the obligation using a risk-free rate. The associated abandonment and retirement costs are capitalized as part of the carrying amount of the related asset. The capitalized amount is depleted on a unit of production basis in accordance with the Company's depletion policy. Changes to assumptions related to future expected costs, risk-free rates and timing may have a material impact on the amounts presented.

Refer to Note 12 for the carrying amounts related to the asset retirement obligation.

Share based compensation

The Company has a stock option plan enabling employees, officers and directors to receive Class "A" Common voting shares ("Common Shares") or cash at exercise prices equal to the market price or above on the date the option is granted. Notwithstanding, the Company has the right to only equity settle options. While the Company has equity settled options for the past nine years, it may change this in the future at its discretion. Under the equity settled method, compensation costs attributable to stock options granted to employees, officers or directors are measured at fair value using the Black-Scholes option pricing model. The assumptions used in the calculation are: the volatility of the stock price, risk-free rates of return and the expected lives of the options. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Changes to assumptions may have a material impact on the amounts presented.

For further detail refer to Note 11.

Income tax accounting

Deferred tax assets are recognized when it is considered probable that deductible temporary differences will be recovered in the foreseeable future. To the extent that future taxable income and the application of existing tax laws in each jurisdiction differ significantly from the Company's estimate, the ability of the Company to realize the deferred tax assets could be impacted.

The determination of the Company's income and other tax assets or liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax asset or liability may differ significantly from that estimated and recorded by management.

Refer to Note 10 for the carrying amounts related to deferred taxes.

Investment in Red Leaf

Questerre holds investments in certain private companies including its investment in Red Leaf.

The Company uses the equity method of accounting to reflect its ownership in Red Leaf. Under the equity method, the Company's initial and subsequent investments are recognized at cost and subsequently adjusted for the Company's share of Red Leaf's income or loss, less distributions received. The Company is deemed to have significant influence in Red Leaf on the basis that it holds more than 20% of the voting power and the ability to participate in the decision making process of Red Leaf through its current Board representation.

Refer to Note 7 for the carrying amounts related to the Company's investment in Red Leaf.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are considered.

The acquisition method of accounting is used to account for business combinations 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. Contingent consideration is included in the cost of acquisitions at fair value. Directly attributable transaction costs are expensed in the current period and reported within general and administrative expenses. 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 the acquisition is less than the fair value of the net assets acquired, the difference is recognized immediately in profit or loss.

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) Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

The Company classifies its financial instruments in the following categories, at initial recognition, depending on the purpose for which the instruments were acquired.

Financial assets and liabilities at fair value through profit or loss

A financial asset or liability is classified in this category if it is held for trading. Derivatives are also included in this category unless they are designated as hedges. The Company has designated its risk management contracts in this category.

Financial assets at amortized cost

Financial assets at amortized cost are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They include accounts receivable and deposits. These assets are included in current assets due to their short-term nature. They are recognized initially at the amount expected to be received, less, when material, a discount to reduce to fair value. Subsequently, they are measured at amortized cost using the effective interest method less a provision for impairment.

Cash and cash equivalents include deposits held with banks, less outstanding cheques, and short-term deposits with original maturities of one year or less.

Financial liabilities at amortized cost

Financial liabilities at amortized cost comprise credit facilities and accounts payable and accrued liabilities. Financial liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, financial liabilities are measured at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within twelve months.

c) Investments

For the purposes of testing for impairment, the Company measures the fair market value of Red Leaf by valuation techniques such as net asset value analysis. Judgment is required in measuring the fair value of the Company's investment in Red Leaf, which may result in material adjustments to its related carrying value.

d) Share capital

Common Shares are classified as equity. Incremental costs directly attributable to the issue of Common Shares are recognized as a deduction from equity, net of any tax effects.

e) Property, plant and equipment and exploration and evaluation assets

Recognition and measurement

Exploration and evaluation expenditures

Costs incurred prior to acquiring the legal rights to explore an area are recognized as exploration and evaluation expense in profit or loss.

Exploration and evaluation costs, including the costs of acquiring licenses, exploratory well expenditures, costs to evaluate the commercial potential of underlying resources and directly attributable general and administrative costs, are capitalized as exploration and evaluation assets. The costs are accumulated in cost centres by exploration area pending determination of technical feasibility and commercial viability. Gains and losses on exploration and evaluation assets are recognized on disposal through the income statement.

At each reporting period, exploration and evaluation assets are assessed for impairment to determine if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable based on several factors including the assignment of reserves. A review of each exploration license or field is carried out, at each reporting date, to ascertain whether technical feasibility and commercial viability has been achieved. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to property, plant and equipment.

Every reporting period, the Company evaluates individually significant exploration and evaluation wells for impairment, if there are specific impairment indicators evident at the well level. If technical feasibility and commercial viability of the well is not established, the well costs are written off. For insignificant wells, overall exploration and evaluation well indicators are evaluated. If there are indicators of impairment, the wells are tested for impairment at the CGU level.

Development and production costs

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Cost includes all costs required to acquire developed or producing oil and gas properties and to develop oil and gas properties. Development and production assets are grouped into CGUs for impairment testing.

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the property, plant and equipment and are recognized net within gain (loss) on divestures in profit or loss.

Exchanges of properties are measured at fair value, unless the transaction lacks commercial substance or fair value cannot be reliably measured. When the exchange is at fair value, a gain or loss is recognized in profit or loss.

Business Combinations

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and property, plant and equipment acquired generally require the

most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Assumptions are also required to determine the fair value of decommissioning obligations associated with the properties. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill (or gain from a bargain purchase) in the acquisition equation. Future profit (loss) can be affected as a result of changes in future depletion and depreciation or impairment.

Other property, plant and equipment

Expenditures related to workovers or betterments that improve the productive capacity or extend the life of an asset are capitalized. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment 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 based on estimated proved and probable reserves, considering estimated future development costs necessary to bring those reserves into production. These estimates are evaluated by independent reserve engineers at least annually.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the respective useful lives.

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

f) Goodwill

Goodwill arises on the acquisition of businesses, subsidiaries, associates and joint ventures. Goodwill is measured at cost less accumulated impairment losses. Goodwill is not amortized.

g) Impairment

Non-financial assets

The carrying amounts of the Company's non-financial assets, other than 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 and compared to the carrying amount. For goodwill an impairment test is completed each year, or when any indication of impairment exists.

For the purpose of impairment testing, assets are grouped together into CGUs. Goodwill, for the purpose of impairment testing, is assessed for impairment on an operating segment basis. The Company has three operating segments. Exploration and evaluation assets are allocated to related CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their reclassification to producing assets.

The recoverable amount of an asset or a CGU is the greater of its VIU and FVLCD. FVLCD is determined using discounted future cash flows of proved and probable reserves using an after tax discount rate for FVLCD. In determining FVLCD, recent market transactions are considered, if

available. In the absence of such transactions, the discounted cash flow model is used. In assessing VIU, 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.

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 CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other 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 or amortization, if no impairment loss had been recognized. Impairment reversals are recognized in profit or loss.

Impairment of financial assets

Questerre applies the simplified approach to providing for expected credit losses prescribed by IFRS 9 *Financial Instruments* ("IFRS 9") which permits the use of the lifetime expected loss provision for all trade receivables carried at amortized costs.

At each reporting date, the Company measures the lifetime expected loss provision taking into consideration Questerre's historical credit loss experience as well as forward-looking information in order to establish loss rates. The impairment loss (or reversal) is the amount of expected credit losses that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognized. Also refer to Note 6.

Share based compensation

The Company has issued options to directors, officers and employees.

The Company accounts for its stock-based compensation awards on the basis that they will be equity settled. Under the equity settled method, compensation costs attributable to stock options granted to employees, officers or directors are measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. The exercise of stock options is recorded as an increase in Common Shares with a corresponding reduction in contributed surplus. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

h) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the

expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Asset retirement obligation

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

Asset retirement obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the balance sheet date. The best estimate of the provision is recorded on a discounted basis using a risk-free interest rate. 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 of the asset retirement obligation whereas increases or decreases due to changes in the estimated future cash flows and risk-free rates are adjusted through property, plant and equipment or exploration and evaluation assets. Actual costs incurred upon settlement of the asset retirement obligations are charged against the provision.

i) Revenue from commodity sales and royalties

Questerre principally generates revenue from the sale of commodities, which include crude oil, natural gas, condensate and natural gas liquids ("NGLs"). Questerre also generates revenue from royalties on production from leases where it owns a working interest. Revenue associated with the sale of commodities is recognized when control is transferred from Questerre to its customers. Questerre's commodity sale contracts represent a series of distinct transactions. Questerre considers its performance obligations to be satisfied and control to be transferred when all of the following conditions are satisfied:

- Questerre has transferred title and physical possession of the commodity to the buyer;
- Questerre has transferred the significant risks and rewards of ownership of the commodity to the buyer; and
- Questerre has the present right to payment.

Revenue represents the Company's share of commodity sales net of royalty obligations to governments and other mineral interest owners. Questerre sells its production pursuant to variable priced contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under these contracts, the Company is required to deliver a variable volume of crude oil, natural gas, condensate or NGLs to the contract counterparty.

Revenue is recognized when a unit of production is delivered to the contract counterparty. The amount of revenue recognized is based on the agreed upon transaction price, whereby any variability in revenue is related specifically to the Company's efforts to deliver production. Therefore, the resulting revenue is allocated to the production delivered in the period during which the variability

occurs. Payment terms for Questerre's commodity sales contracts are on the 25th of the month following delivery. Questerre does not have any contracts where the period between the transfer of the promised goods or services to the customer and payment by the customer exceeds one year and therefore Questerre does not adjust its revenue transactions for the time value of money. The Company enters into contracts with customers that can have performance obligations that are unsatisfied, or partially unsatisfied, at the reporting date.

Royalty revenue is recognized as it accrues in accordance with the terms of the governing agreement, which is generally in the month when the product is produced with production volumes primarily marketed with the payor's production. Royalty revenue is measured at fair value of the consideration received when Management can reliably estimate the amount pursuant to the terms of the royalty agreement. An accrual is included in revenue and accounts receivable for amounts not received at the reporting date based on historical trends, new wells on stream and current market prices. Differences between the estimates and actual amounts received are adjusted and recorded in the period when the actual amounts are received.

j) Income tax

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 asset will be realized.

The effect of a change in enacted or substantively enacted income tax rates on future income tax assets and liabilities is recognized in profit or loss in the period that the change occurs unless the original entry was recorded to equity.

k) *Net profit or loss per share*

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are calculated using the weighted average number of shares outstanding, adjusted for the potential number of shares which may have a dilutive impact on

net profit. Potentially dilutive shares include stock options. The weighted average number of diluted shares is calculated in accordance with the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase Common Shares at the average market price.

Since the options may be settled in cash or shares at the Company's discretion and therefore there is no obligation to settle in cash, the share units are accounted for as equity-settled share based payment transactions and included in diluted profit per share if the effect is dilutive.

/) Leases

Under IFRS 16, the Company recognizes right-of-use assets and lease liabilities for most leases. Certain short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements and may continue to be treated as operating leases. The right-of-use assets recognized are subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use assets or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property and equipment. In addition, the right-of-use assets are periodically reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liabilities.

The lease liabilities are initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. The Company uses its incremental borrowing rate as the discount rate.

The lease liabilities are subsequently measured at amortized cost using the effective interest method. It is re-measured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option.

When the lease liabilities are re-measured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use assets or is recorded in profit or loss if the carrying amount of the right-of-use assets has been reduced to \$0. The Company presents right-of-use assets and lease liabilities separately in the balance sheet.

The application of IFRS 16 requires significant judgments and estimations to be made. Areas that require judgment include identifying whether a contract (or part of a contract) includes a lease, determining whether it is reasonably certain that an extension or termination option will be exercised, determining whether variable payments are in substance fixed, establishing whether there are multiple leases in an arrangement and determining the stand-alone amounts for lease and non-lease components. Other sources of estimation uncertainty in the application of IFRS 16 include estimating the lease term, determining the appropriate discount rate to apply to lease payments and assessing whether a right-of-use assets are impaired.

4. Changes in Accounting Policies and Disclosures

a) Future Accounting Pronouncements

In January 2021, the IASB issued amendments to IAS 1 Presentation of Financial Statements, to clarify its requirements for the presentation of liabilities as current or non-current in the consolidated balance sheet. The amendment is effective for periods beginning on or after January 1, 2023.

In May 2020, the IASB issued Onerous Contracts - Cost of Fulfilling a Contract, which made amendments to IAS 37 Provisions Contingent Liabilities and Contingent Assets. Effective January 1, 2022, the amendments specify which costs an entity includes in determining the cost of fulfilling a contract for the purpose of assessing whether the contract is onerous.

5. Cash and Cash Equivalents

	December 31, 2021	December 31, 2020
(\$ thousands)		
Bank balances	\$ 37	\$ 177
Short-term bank deposits	8,494	10,227
	\$ 8,531	\$ 10,404

6. Financial Risk Management and Determination of Fair Values

a) Overview

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as credit risk, liquidity risk and market risk. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure.

b) Fair value of financial instruments

The Company's financial instruments as at December 31, 2021 included cash and cash equivalents, accounts receivable, deposits, investments, credit facilities and accounts payable and accrued liabilities. As at December 31, 2021, the fair values of the Company's financial assets and liabilities equaled their carrying values due to the short-term maturity.

Disclosures about the inputs to fair value measurements are required, including their classification within a hierarchy that prioritizes the inputs to fair value measurement.

Level 1 Fair Value Measurements

Level 1 fair value measurements are based on unadjusted quoted market prices.

Level 2 Fair Value Measurements

Level 2 fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices.

Level 3 Fair Value Measurements

The net book value of PP&E recognized is based on historical cost until tested for impairment using market values. The market value of PP&E is the estimated amount for which PP&E 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 (included in PP&E) are generally estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions. The market value of E&E assets is estimated with reference to the market values of current arm's length transactions in comparable locations. Refer to Notes 8 and 9.

c) Credit risk

Credit risk represents the potential financial loss to the Company if a customer or counterparty to a financial instrument fails to meet or discharge their obligation to the Company. Credit risk arises principally from the Company's receivables from joint venture partners and oil and gas marketers. The carrying amounts of accounts receivable and cash and cash equivalents represent the maximum credit exposure.

Substantially all of the accounts receivable are with oil and natural gas marketers and joint venture partners in the oil and natural gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable counterparties and partners.

Accounts receivable related to the sale of the Company's petroleum and natural gas production is paid in the following month from major oil and natural gas marketing companies and the Company has not experienced any credit loss relating to these sales.

Receivables from joint venture partners are typically collected within one to three months of the joint venture bill being issued. The Company mitigates this risk by obtaining pre-approval of significant capital expenditures.

The Company's accounts receivables are aged as follows:

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Current	\$ 3,154	\$ 2,759
31 - 60 days	1	31
61 - 90 days	11	4
>90 days	1,012	177
Expected credit loss provision	(162)	(288)
	\$ 4,016	\$ 2,683

The Company does not anticipate any material default as it transacts with creditworthy customers and management does not expect any losses from non-performance by these customers. There are no material financial assets that the Company considers past due that are considered impaired.

Cash and cash equivalents include cash bank balances and short-term deposits. The Company manages the credit risk exposure by investing in Canadian banks and credit unions. Management does not expect any counterparty to fail to meet its obligations.

d) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's processes for managing liquidity risk include ensuring, to the extent possible, that it will have sufficient liquidity to meet its liabilities when they become due. The Company prepares annual capital expenditure budgets which are monitored and are updated as required. In addition, the Company requires authorizations for expenditures on projects to assist with the management of capital.

Since the Company operates in the upstream oil and natural gas industry, it requires sufficient cash to fund capital programs necessary to maintain or increase production, develop reserves and to potentially acquire strategic assets. The Company's capital programs are funded principally by cash obtained through its credit facilities, equity issuances and from operating activities. During times of low oil and natural gas prices or when cash resources may be limited, a portion of capital programs can generally be deferred, however, due to the long cycle times and the importance to future cash flow in maintaining the Company's production, it may be necessary to utilize alternative sources of capital to continue the Company's strategic investment plan during periods of low commodity prices. As a result, the Company frequently evaluates the options available with respect to sources of long and short-term capital resources. Occasionally, to the extent possible, the Company will use derivative instruments to manage cash flow in the event of commodity price declines.

The Company's financial obligations relates to amounts due under the credit facilities, including trade and other payables, which consist of invoices payable to trade suppliers relating to the office and field operating activities and its capital spending program. The Company processes invoices within a normal payment period and all amounts are due within the next 12 months.

The timing of cash outflows relating to financial liabilities as at December 31, 2021 and 2020 are as follows:

<i>(\$ thousands)</i>	Less than one year	One to three years	Subsequent years	Total
Credit Facilities	\$ 3,420	\$ –	\$ –	\$ 3,420
Trade and other liabilities	8,361	–	–	8,361
Lease Liabilities	52	150	5	207
Contingent Liabilities	–	1,820	–	1,820
December 31, 2021	\$ 11,833	\$ 1,970	\$ 5	\$ 13,808

<i>(\$ thousands)</i>	Less than one year	One to Three Years	Subsequent years	Total
Credit Facilities	\$ 15,427	\$ –	\$ –	\$ 15,427
Trade and other liabilities	6,186	–	–	6,186
Lease Liabilities	50	166	39	255
Contingent Liabilities	–	1,820	–	1,820
December 31, 2020	\$ 21,663	\$ 1,986	\$ 39	\$ 23,688

e) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's profit or loss or the value of the financial instruments. The objective of the Company is to mitigate exposure to these risks while maximizing returns to the Company.

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. Commodity prices for oil and natural gas are impacted not only by the relationship between the Canadian and United States dollar, but also world economic events that dictate the levels of supply and demand. The Company may enter into oil and natural gas contracts to protect, to the extent possible, its cash flow on future sales. The contracts reduce the volatility in sales revenue by locking in prices with respect to future deliveries of oil and natural gas.

As at December 31, 2021, the Company had no outstanding commodity risk management contracts.

Currency risk

All of Questerre's petroleum and natural gas sales are denominated in Canadian dollars; however, the underlying market prices for these commodities are impacted by the exchange rate between Canada and the United States. The Company also incurs expenditures in its Jordanian subsidiary that are denominated in Jordanian Dinar and United States dollars. As at December 31, 2021, the Company had no forward foreign exchange contracts in place.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. At December 31, 2021, the Company had credit facilities outstanding of \$3.4 million (December 31, 2020: \$15.4 million).

f) Capital management

The Company believes with its expected positive adjusted funds flow from operations and existing credit facilities in the near future it will be able to meet its foreseeable obligations in the normal course of operations. On an ongoing basis, the Company reviews its capital expenditures to ensure that funds flow from operations or access to credit facilities are available to fund these capital expenditures. To execute its current business plan including incurring capital expenditures related to the full participation in the current and future drilling programs it anticipates it will be require access to additional financial liquidity.

The volatility of commodity prices has a material impact on Questerre's adjusted funds flow from operations. Questerre attempts to mitigate the effect of lower prices by entering into risk management contracts, shutting in production in unusually low pricing environments, reallocating capital to more profitable areas and reducing capital spending based on results and other market considerations.

The Company considers its capital structure to include shareholders' equity and any outstanding amounts under its credit facilities. The Company will adjust its capital structure to minimize risk and its cost of capital through the issuance of shares, securing additional credit facilities and adjusting its capital spending as required. Questerre monitors its capital structure based on the current and projected funds flow from operations.

	December 31, 2021	December 31, 2020
(\$ thousands)		
Credit facilities	\$ 3,420	\$ 15,427
Shareholders' equity	148,961	152,120

7. Investment in Red Leaf

Red Leaf is a private Utah based oil shale and technology company whose principal assets are its proprietary EcoShale

technology to recover oil from shale and its oil shale leases in the state of Utah.

As at December 31, 2021, Questerre holds 132,292 common shares, representing approximately 41% of the common share capital of Red Leaf and 288 Series A Preferred Shares of Red Leaf representing approximately 16% of the issued and outstanding preferred shares capital of Red Leaf on a non-diluted basis.

Questerre has determined its investment in Red Leaf will be accounted for using the equity method. This is based on several criteria including its current equity interest in Red Leaf and ability to participate in the decision making process of Red Leaf through its current Board representation. The Company

measures the fair market value of its investment using a net asset value approach. The net asset value is calculated as the current assets of Red Leaf less abandonment liabilities, the accrued and unpaid dividends associated with the preferred shares and an estimate of research and development and general and administrative expenses for the upcoming fiscal year.

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Balance, beginning of year	\$ 7,979	\$ 8,439
Dividends received on preferred shares	–	(228)
Loss on foreign exchange	(14)	(232)
Balance, end of the year	\$ 7,965	\$ 7,979

The assets, liabilities and net loss of Red Leaf as of December 31, 2021 were comprised as follows:

	2021	2020
<i>(\$ thousands)⁽¹⁾</i>		
Cash and Cash Equivalents	\$ 26,770	\$ 24,756
Other Current Assets	268	282
Current Liabilities	617	646
Non-current liabilities	2,150	1,554
Net Loss ⁽²⁾	\$ (3,977)	\$ (12,884)

⁽¹⁾ Converted at an exchange rate of US\$1=C\$1.2678

⁽²⁾ Converted at an average exchange rate of US\$1=C\$1.2535

The issued and outstanding share capital of Red Leaf as of December 31, 2021 is comprised of the following:

	Issued and Outstanding	Questerre Ownership
Common Shares	319,728	132,292
Preferred Shares	1,795	288

The Series A Preferred Shares carry voting rights and dividends accrue on a cumulative basis, whether or not declared, at a rate of 8% per annum compounding annually. On the occurrence of a defined liquidation event, including certain reorganizations, takeovers, the sale of all or substantially all the assets of the company, and shareholder distributions, the Series A Preferred shareholders are entitled to an amount representing the original issue price plus any accrued dividends. As of December 31, 2021, this priority amount is approximately US\$1.2 million.

8. Property, Plant and Equipment

A reconciliation of the property, plant and equipment assets is detailed below.

<i>(\$ thousands)</i>	Total
Cost or deemed cost:	
Balance, December 31, 2019	\$ 285,740
Additions	2,496
Transfer from exploration and evaluation assets	2,687
Balance, December 31, 2020	290,923
Change to asset retirement	1,694
Balance, December 31, 2021	\$ 292,617

Accumulated depletion, depreciation and impairment losses:	
Balance, December 31, 2019	\$ 132,946
Depletion and depreciation	9,236
Impairment	96,257
Balance, December 31, 2020	238,439
Depletion and depreciation	5,794
Reversal of previous impairment	(91,736)
Balance, December 31, 2021	\$ 152,497

<i>(\$ thousands)</i>	Total
Net book value:	
At December 31, 2020	\$ 52,484
At December 31, 2021	\$ 140,120

During the years ended December 31, 2021 and 2020, the Company did not capitalize any administrative overhead or share based compensation expense directly related to development activities. Included in the December 31, 2021, depletion calculation are future development costs of \$271.3 million (December 31, 2020: \$267.8 million).

The Company assessed the carrying value of its PP&E as at December 31, 2021, for indicators of impairment or indicators to reverse previously recorded impairment. Based on this review, the Company's Montney and Antler CGUs were tested in accordance with the Company's accounting policy. The recoverable amount of the CGUs was estimated based on the FVLCD using a discounted cash flow model. Due to the higher future commodity prices, the Company recorded a reversal of \$91.7 million in impairment expense incurred in 2020. Of this amount, \$76 million was attributable to the Kakwa, Alberta CGU and \$15.7 million to the Antler, Saskatchewan CGU. No impairment reversals were recorded for the Company's other CGUs.

The estimates of FVLCD were determined using discount rates ranging from 11% to 13% (2020: 11% to 13%) and forecasted after tax cash flows based on proved plus probable reserves, with escalating

prices and future development costs. As at December 31, 2021, the future prices used to determine cash flows from crude oil and natural gas reserves were as follows:

	2022	2023	2024	2025	2026	Average Annual % Change Thereafter
WTI (US\$/barrel)	72.83	68.78	66.76	68.09	69.45	2.00
AECO (\$/MMbtu)	3.56	3.21	3.05	3.11	3.17	2.00

Effective March 31, 2020, the Company reviewed the carrying amounts of its oil and natural gas assets based on the material decline in commodity prices and the resulting decrease in forward benchmark commodity prices as of March 31, 2020, compared to December 31, 2019. Based on this review, the Company tested its CGUs for impairment in accordance with its accounting policy. The recoverable amount of the CGUs was estimated based on the FVLCD using a discounted cash flow model. The impairment testing concluded that the carrying amounts of Montney, Antler and Other Alberta CGUs exceeded their FVLCD. As a result, the Company recorded an impairment expense of \$96.3 million in aggregate. The amount attributable to the Montney, Antler and Other Alberta CGUs is respectively \$78.2 million, \$17.9 million, and \$0.2 million.

The estimates of FVLCD were determined using discount rates ranging from 11% to 13% and forecasted after tax cash flows based on proved plus probable reserves, with escalating prices and future development costs. As at March 31, 2020, the future prices used to determine cash flows from crude oil and natural gas reserves were as follows:

	2021	2022	2023	2024	2025	Average Annual % Change Thereafter
WTI (US\$/barrel)	40.45	49.17	53.28	55.66	56.87	2.00
AECO (\$/MMbtu)	2.20	2.38	2.45	2.53	2.60	2.00

9. Exploration and Evaluation Assets

Exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of technical feasibility and commercial viability. Additions represent the Company's share of costs incurred on exploration and evaluation assets during the period.

A reconciliation of the movements in exploration and evaluation assets is detailed below.

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Balance, beginning of year	\$ 114,203	\$ 127,081
Acquisition	–	263
Additions	4,719	4,811
Transfers to property, plant and equipment	–	(2,687)
Undeveloped lease impairments	0	(14,416)
Undeveloped lease expiries and farmouts	(220)	(717)
Foreign currency translation adjustment - Jordan	(145)	(132)
Balance, end of period	\$ 118,557	\$ 114,203

During the year ended December 31, 2021, the Company capitalized administrative overhead charges of \$1.1 million (2020: \$1.9 million) and \$0.67 million (2020: \$0.9 million) for capitalized share based compensation expense directly related to exploration and evaluation activities.

As a result of the introduction of Bill 21 - *An Act mainly to end petroleum exploration and production and the public financing of those activities*, the Company impaired the full carrying value of its Quebec exploration and evaluation assets of \$104 million.

The Company estimates qualifying exploration and development expenditures of \$164.6 million were incurred on its exploration licenses from 2006 to 2021. Of this amount \$156.7 million was incurred on permits where the Company is currently the operator, \$4 million was incurred on permits where it is non-operator and \$3.9 million incurred on permits that have been surrendered. In addition, the Company incurred mineral rentals and surface rentals totalling \$3.9 million and has placed deposits with the Government for abandonment and reclamation liabilities of \$7.2 million.

The Company will seek just compensation for the value of its licenses in the event the legislation is enacted and will object to the revocation of its licenses until just compensation is received.

Effective March 31, 2020, as a result of the decline in commodity prices and no future plans to pursue development of its wholly owned and operated exploration and evaluation assets in Kakwa, the Company impaired exploration and evaluation assets in Kakwa totaling \$14.4 million.

10. Deferred Income Taxes

The tax on the Company's net loss before taxes differs from the amount that would arise using the weighted average tax rate applicable to profits or losses of the consolidated entities as follows:

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Net loss before taxes	\$ (4,308)	\$ (117,633)
Combined federal and provincial tax rate	23.58%	24.47%
Computed "expected" deferred tax recovery	(1,016)	(28,785)
Increase in deferred taxes resulting from:		
Non-deductible differences and permanent items	241	831
Non-taxable portion of capital items	—	54
Change in deferred tax asset not recognized	775	26,077
Rate adjustments and other	—	1,823
Deferred tax expense	\$ —	\$ —

The Company evaluated the recoverability of its deferred tax assets using forecasted before-tax cash flows based on proved reserves, with escalating prices and future development costs obtained from an independent reserve evaluation report and a deduction for estimated general and administrative costs associated with these proved reserves. As a result, no deferred tax asset was recorded. The combined statutory tax rate was 23.58% in 2021 and 24.47% in 2020.

The movement in deferred tax assets and liabilities during the year, without taking into consideration the valuation allowances, are as follows:

<i>(\$ thousands)</i>	Petroleum and natural gas properties	Investments	Asset retirement obligation	Share issue costs	Non-capital losses	Capital losses
December 31, 2020	\$ 21,578	\$ 3,650	\$ 4,795	\$ 274	\$ 15,092	\$ 4,295
Change	3,670	(1)	276	(205)	(2,810)	7
December 31, 2021	\$ 25,248	\$ 3,649	\$ 5,071	\$ 69	\$ 12,282	\$ 4,302

The amount and timing of reversals of temporary differences will be dependent upon, among other things, the Company's future operating results, and acquisitions and dispositions of assets and liabilities.

Non-capital loss carry-forwards at December 31, 2021 expire from 2036 to 2040.

The following temporary differences have not been recognized:

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Petroleum and natural gas properties	\$ 107,061	\$ 91,655
Investments	30,944	31,006
Asset retirement obligation and leases	21,504	20,368
Share issue costs	294	1,016
Non-capital losses	52,084	64,107
Capital losses	36,488	36,488
Total	\$ 248,375	\$ 244,640

11. Share Based Compensation

The Company has a stock option program that provides for the issuance of options to purchase Common Shares to its directors, officers and employees at or above grant date market prices. The options granted under the plan generally vest evenly over a three-year period starting at the grant date or one year from the grant date. The grants generally expire five years from the grant date or five years from the commencement of vesting.

Under the Company's option plan, a put right is included that allows the optionee to settle options with cash or equity. Under the put right, the optionee will receive the net cash proceeds that is the excess of the closing price of the Common Shares at the day of the put notice over the exercise price of the option. The Company has the option to decline a put right exercise at any time. The Company does not intend to cash settle options in future periods.

For the year ended December 31, 2021, the Company cash settled 2.34 million expiring options for a payment of \$0.1 million (2020: Nil) representing the difference between the exercise and market price on the date of the settlement.

The number and weighted average exercise prices of stock options are as follows:

	Options Outstanding			Options Exercisable		
	Number of Options <i>(thousands)</i>	Weighted Average Years to Expiry	Weighted Average Exercise Price	Number of Options <i>(thousands)</i>	Weighted Average Years to Expiry	Weighted Average Exercise Price
\$0.15 - \$0.30	20,650	3.21	\$ 0.22	11,208	2.80	\$ 0.24
\$0.31 - \$0.50	3,157	1.58	0.48	3,158	1.58	0.48
\$0.51 - \$0.70	6,450	0.30	0.69	6,450	0.30	0.69
\$0.71 - \$0.90	50	0.89	0.71	50	0.89	0.71
	30,307	2.41	\$ 0.35	20,866	1.84	\$ 0.42

The following table summarizes information about stock options outstanding and exercisable at December 31, 2021:

	December 31, 2021		December 31, 2020	
	Number of Options (<i>thousands</i>)	Weighted Average Exercise Price	Number of Options (<i>thousands</i>)	Weighted Average Exercise Price
Outstanding, beginning of period	25,351	\$ 0.38	27,087	\$ 0.40
Granted	8,350	0.18	6,475	0.20
Forfeited	(2,344)	0.18	(846)	0.43
Expired	(50)	0.18	(7,365)	0.29
Exercised	(1,000)	0.18	—	—
Outstanding, end of period	30,307	\$ 0.35	25,351	\$ 0.38
Exercisable, end of period	20,866	\$ 0.42	16,191	\$ 0.42

The fair value of the liability was calculated using the Black-Scholes valuation model. The following weighted average assumptions were used in the model for options granted in 2021 and 2020:

	December 31, 2021	December 31, 2020
Weighted average fair value per award (\$)	0.14	0.14
Volatility (%)	104.47	90.43
Forfeiture rate (%)	11.02	11.57
Expected life (years)	5.00	5.00
Risk free interest rate (%)	0.42	1.31

This forfeiture rate estimate is adjusted to the actual forfeiture rate. Expected volatility and expected life is based on historical information.

12. Asset Retirement Obligation

The Company's asset retirement and abandonment obligations result from its ownership interest in oil and natural gas assets. The total asset retirement obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of the asset retirement obligation to be \$21.5 million as at December 31, 2021 (December 31, 2020: \$20.4 million) based on an undiscounted total future liability of \$24.9 million (December 31, 2020: \$22.1 million). These payments are expected to be made over the next 30 years. The average discount factor, being the risk-free rate related to the liabilities, is 1.31% (December 31, 2020: 0.65%). An inflation rate of 2% (December 31, 2020: 2%) over the varying lives of the assets is used to calculate the present value of the asset retirement obligation.

The following table provides a reconciliation of the Company's total asset retirement obligation:

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Balance, beginning of year	\$ 20,369	\$ 19,571
Liabilities settled	(190)	(59)
Revisions due to change in discount rates & estimates	1,069	756
Accretion	247	101
Balance, end of year	\$ 21,495	\$ 20,369

13. Credit Facility

Following a review conducted in the third quarter, the Company's facilities with a Canadian chartered bank were renewed at \$16 million. The credit facilities include a revolving operating demand facility of \$16 million ("Facility A"). Facility A can be used for general corporate purposes, ongoing operations, and capital expenditures within Canada. Any borrowing under the credit facilities, with the exception of letters of credit, bears interest at the bank's prime interest rate and an applicable basis point margin based on the ratio of debt to cash flow measured quarterly. The facilities are secured by a debenture with a first floating charge over all assets of the Company and a general assignment of books debts.

Under the terms of the credit facility, the Company has provided a covenant that it will maintain an Adjusted Working Capital Ratio greater than 1.0. The ratio is defined as current assets (excluding unrealized hedging gains and including undrawn Credit Facility A availability) to current liabilities (excluding bank debt outstanding and unrealized hedging losses). The Adjusted Working Capital Ratio at December 31, 2021 was 3.05 (2020: 2.95) and the covenant was met. At December 31, 2021, \$3.4 million (December 31, 2020: \$15.4 million) was drawn on Facility A with an effective average interest rate of 3.45% for 2021 (2020: 3.45%). As at December 31, 2021, the Company has outstanding letters of credit for \$7.7 million (2020: \$7.4 million) with the Quebec Government for abandonment costs. The letters of credit are secured by term deposits.

The following table reconciles the movement in the credit facilities during the year.

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Credit Facilities beginning of year	\$ 15,427	\$ 16,377
Drawdown from Credit Facilities	17,993	24,550
Repayment of Credit Facilities	(30,000)	(25,500)
Credit Facilities end of year	\$ 3,420	\$ 15,427

The credit facilities are a demand facility and can be reduced, amended or eliminated by the lender for reasons beyond the Company's control. Should the credit facilities, in fact, be reduced or eliminated, the Company would need to seek alternative credit facilities or consider the issuance of equity to enhance its liquidity. The next scheduled review will be in the second quarter of 2022.

14. Share Capital

The Company is authorized to issue an unlimited number of Common Shares. The Company is also authorized to issue an unlimited number of Class "B" Common voting shares and an unlimited number of preferred shares, issuable in one or more series. At December 31, 2021, there were no Class "B" common voting shares or preferred shares outstanding.

a) Issued and outstanding – Common Shares

	Number (thousands)	Amount (\$ thousands)
Balance, December 31, 2019	427,907	\$ 429,703
Shares returned to treasury	(391)	–
Balance, December 31, 2020	427,516	429,703
Options exercised	1,000	175
Balance, December 31, 2021	428,516	\$ 429,878

In the first quarter of 2020, the Company returned 0.4 million unclaimed Common Shares, related to prior corporate acquisitions, to treasury for no associated monetary consideration.

b) Per share amounts

Basic and diluted net loss per share is calculated as follows:

	December 31, 2021	December 31, 2020
<i>(thousands, except as noted)</i>		
Net loss	\$ (4,301)	\$ (117,623)
Issued Common Shares at beginning of year	427,516	427,907
Shares returned to treasury	–	(294)
Issued on exercised of options	518	–
Weighted average number of Common Shares outstanding (basic)	428,034	427,613
Basic and diluted net loss per share	\$ (0.01)	\$ (0.28)

Under the current stock option plan, options can be exchanged for Common Shares of the Company, or for cash at the Company's discretion. They are considered potentially dilutive and are included in the calculation of diluted net loss per share for the period. The average market value of the Common Shares for purposes of calculating the dilutive effect of options was based on quoted market prices for the period that the options were outstanding. At December 31, 2021, 30.3 million options (December 31, 2020: 25.4 million) were excluded from the diluted weighted average number of Common Shares outstanding calculation as their effect would have been anti-dilutive.

15. Petroleum and Natural Gas Revenue

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Oil and liquids	\$ 24,058	\$ 17,164
Natural gas	4,413	3,131
Royalty revenue	1,933	1,629
	\$ 30,404	\$ 21,924

16. Employee Salaries and Benefits

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Salaries, bonuses and other short-term benefits	\$ 1,572	\$ 1,381
Share based compensation	1,004	1,234
	\$ 2,576	\$ 2,615

Note: Salaries are net of Canada Emergency Wage Subsidy Federal Government assistance program.

17. Key Management Compensation

Key management includes directors and officers. The compensation paid or payable to key management is as follows:

	December 31, 2021	December 31, 2020
<i>(\$ thousands)</i>		
Salaries, bonuses, director fees and other short-term benefits	\$ 1,418	\$ 1,397
Share based compensation	1,098	1,276
	\$ 2,516	\$ 2,673

The Company has entered into written executive employment agreements with each of the officers of the Company. Each of these written agreements provides that in the event of a change of control of the Company, each of the officers is entitled to: (i) 18 months of then applicable base salary with 24 months for the CEO; and (ii) the vesting of all options to purchase Common Shares. In the event of a change in control, all options will vest and the severance payable to key management would have been \$2.1 million at December 31, 2021. This amount does not include accelerated share based compensation expense.

18. Supplemental Cash Flow Information

Changes in non-cash working capital are detailed below:

(\$ thousands)	December 31, 2021	December 31, 2020
Accounts receivable	\$ (1,333)	\$ 1,185
Deposits and prepaid expenses	(114)	62
Accounts payable and accrued liabilities	2,175	(5,215)
Change in non-cash working capital	\$ 728	\$ (3,968)
Related to:		
Operating activities	\$ (176)	\$ 560
Investing activities	904	(4,528)
	\$ 728	\$ (3,968)

Note: Change in accounts payable and accrued liabilities excludes forgiveness of debt related to Quebec Acquisition

19. Right-of-use Assets and Lease Liabilities

a) Right-of-use assets

(\$ thousands)	Real Estate	Other	Total
Cost			
Balance, January 1, 2019	\$ 198	\$ 25	\$ 223
Additions	218	–	218
Balance, December 31, 2020	\$ 416	\$ 25	\$ 441
Additions (net of prior lease termination)	–	–	–
Balance, December 31, 2021	\$ 416	\$ 25	\$ 441
Accumulated Depreciation			
Balance, January 1, 2019	\$ 104	\$ 4	\$ 108
Depreciation	80	5	85
Balance, December 31, 2020	\$ 184	\$ 9	\$ 193
Depreciation	48	5	53
Balance, December 31, 2021	\$ 232	\$ 14	\$ 246
Carrying value			
Balance, January 1, 2019	\$ 95	\$ 21	\$ 116
Additions, net of depreciation	138	(5)	133
Balance, December 31, 2020	\$ 233	\$ 16	\$ 249
Additions, net of depreciation	(48)	(5)	(53)
Balance, December 31, 2021	\$ 185	\$ 11	\$ 196

b) *Lease liabilities*

<i>(\$ thousands)</i>	
Balance, January 1, 2020	\$ 148
Additional leases acquired during period	218
Interest expense	7
Lease payments	(118)
Balance, December 31, 2020	\$ 255
Additional leases acquired during period	–
Interest expense	9
Lease payments	(57)
Balance, December 31, 2021	\$ 207
Current portion	52
Long term portion	155
Balance, December 31, 2021	\$ 207

Amounts related to lease liabilities recognized in profit or loss are as follows:

Interest expense on lease liabilities	\$ 9
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20. Commitments

A summary of the Company's net commitments at December 31, 2021 follows:

<i>(\$ thousands)</i>	2022	2023	2024	2025	Thereafter	Total
Transportation and Processing	\$ 2,977	\$ 3,162	\$ 2,884	\$ 2,015	\$ 1,240	\$ 12,278

21. Related Party Transactions

The Company paid fees of \$0.2 million (2020: \$0.1) to a law firm where a Director of the Company is currently a partner.