

## MANAGEMENT'S REPORT

The preparation of the accompanying consolidated financial statements is the responsibility of Management. The consolidated financial statements have been prepared by Management in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. Financial information contained throughout all other financial and operating data is consistent with these consolidated financial statements.

Management is responsible for the integrity and objectivity of the financial statements. Where necessary, the financial statements include estimates, which are based on Management's informed judgements.

Management has established systems of internal controls, which are designed to provide reasonable assurance those assets, are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

Under the supervision of our Chief Executive Officer and our Chief Financial Officer, Management has conducted an evaluation of the effectiveness of our internal control over financial reporting. Management has concluded that as of December 31, 2011, our internal controls were effective. Because of the inherent limitations, internal controls over financial reporting may not prevent or detect misstatements and even those systems determined to be effective can provide only reasonable assurance with respect to the financial statement preparation and presentation.

The Board of Directors is responsible for ensuring Management fulfils its responsibilities for financial reporting and internal control. It exercises its responsibilities primarily through the Audit Committee, all of whose members are non-management directors. The Audit Committee has reviewed the consolidated financial statements with Management and the auditors and has reported to the Board of Directors which have approved the consolidated financial statements.

KPMG LLP are independent auditors appointed by NuVista's shareholders. The auditors have considered, for the purposes of determining the nature, timing and extent of their audit procedures, the Company's internal controls and have audited the consolidated financial statements in accordance with generally accepted auditing standards to enable them to express an opinion on the fairness of the financial statements.



Jonathan A. Wright  
President and Chief Executive Officer



Robert F. Froese  
Vice President, Finance and Chief Financial Officer

March 2, 2012

## **To the Shareholders of NuVista Energy Ltd.**

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

### ***Management's responsibility for the consolidated statements***

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

### ***Auditors' responsibility***

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

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

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

### ***Opinion***

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

*KPMG LLP*

Chartered Accountants  
Calgary, Canada  
March 2, 2012

**NUVISTA ENERGY LTD.**

**Consolidated Statements of Financial Position**

| (\$Cdn thousands)                                 | December 31,<br>2011 | December 31,<br>2010<br>(note 20) | January 1,<br>2010<br>(note 20) |
|---|----------------------|-----------------------------------|---------------------------------|
| <b>Assets</b>                                     |                      |                                   |                                 |
| Current assets                                    |                      |                                   |                                 |
| Cash and cash equivalents                         | \$ -                 | \$ -                              | \$ -                            |
| Accounts receivable and prepaids                  | 50,350               | 55,144                            | 69,238                          |
|   | <b>50,350</b>        | 55,144                            | 69,238                          |
| Exploration and evaluation assets (note 5)        | 132,398              | 141,852                           | 128,175                         |
| Property, plant and equipment (note 6)            | 1,182,166            | 1,302,249                         | 1,273,278                       |
| Goodwill (note 7)                                 | 8,791                | 34,579                            | 64,331                          |
| <b>Total assets</b>                               | <b>\$1,373,705</b>   | <b>\$1,533,824</b>                | <b>\$1,535,022</b>              |
| <b>Liabilities</b>                                |                      |                                   |                                 |
| Current liabilities                               |                      |                                   |                                 |
| Accounts payable and accrued liabilities          | \$ 67,710            | \$ 56,183                         | \$ 52,358                       |
| Dividends payable                                 | -                    | 4,438                             | -                               |
| Commodity derivative liabilities (note 16)        | 9,316                | 1,256                             | 2,593                           |
|   | <b>77,026</b>        | 61,877                            | 54,951                          |
| Long-term debt (note 8)                           | 289,431              | 438,566                           | 384,623                         |
| Compensation liabilities (note 14)                | 300                  | 619                               | 516                             |
| Commodity derivative liabilities (note 16)        | 6,304                | 4,084                             | -                               |
| Asset retirement obligations (note 9)             | 174,741              | 128,259                           | 118,812                         |
| Deferred tax liabilities (note 11)                | 70,355               | 107,267                           | 117,940                         |
|   | <b>618,157</b>       | 740,672                           | 676,842                         |
| <b>Shareholders' equity</b>                       |                      |                                   |                                 |
| Share capital (note 12)                           | 790,340              | 689,757                           | 685,269                         |
| Contributed surplus                               | 32,165               | 26,552                            | 18,690                          |
| Retained earnings (deficit)                       | (66,957)             | 76,843                            | 154,221                         |
|   | <b>755,548</b>       | 793,152                           | 858,180                         |
| <b>Total liabilities and shareholders' equity</b> | <b>\$1,373,705</b>   | <b>\$1,533,824</b>                | <b>\$1,535,022</b>              |

Subsequent event (note 16)

Commitments (note 18)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



W. Peter Comber, Director



Pentti O. Karkkainen, Director

**NUVISTA ENERGY LTD.****Consolidated Statements of Earnings (Loss) and Comprehensive Income (Loss)**

(\$Cdn thousands, except per share amounts)

| <b>Year ended December 31,</b>                                | <b>2011</b>        | <b>2010</b> |
|---|--------------------|-------------|
| <b>Revenues</b>   |                    |             |
| Oil and natural gas   | <b>\$369,234</b>   | \$373,327   |
| Royalties   | <b>(43,195)</b>    | (57,347)    |
|   | <b>326,039</b>     | 315,980     |
| Realized loss on commodity derivatives<br>(note 16)           | <b>(10,763)</b>    | (5,239)     |
| Unrealized loss on commodity derivatives<br>(note 16)         | <b>(10,280)</b>    | (2,747)     |
|   | <b>304,996</b>     | 307,994     |
| <b>Expenses</b>   |                    |             |
| Operating   | <b>103,704</b>     | 94,237      |
| Transportation  | <b>10,455</b>      | 8,588       |
| General and administrative                                    | <b>19,769</b>      | 19,173      |
| Share-based compensation (note 14)                            | <b>5,881</b>       | 7,595       |
| Depletion, depreciation, amortization and impairment (note 6) | <b>307,206</b>     | 184,783     |
| Goodwill impairments (note 7)                                 | <b>25,788</b>      | 29,752      |
| Exploration and evaluation (note 5)                           | <b>24,248</b>      | 16,898      |
| Gain on property dispositions (note 5,6)                      | <b>(33,115)</b>    | (5,070)     |
| Interest  | <b>16,612</b>      | 17,713      |
| Accretion (note 9)  | <b>4,659</b>       | 4,639       |
|   | <b>485,207</b>     | 378,308     |
| <b>Loss before taxes</b>                                      | <b>(180,211)</b>   | (70,314)    |
| Deferred income tax reduction (note 11)                       | <b>36,411</b>      | 10,659      |
| <b>Net loss and comprehensive loss</b>                        | <b>\$(143,800)</b> | \$(59,655)  |
| <b>Loss per share (note 13)</b>                               |                    |             |
| Basic   | <b>\$ (1.47)</b>   | \$ (0.67)   |
| Diluted   | <b>\$ (1.47)</b>   | \$ (0.67)   |

See accompanying notes to consolidated financial statements.

**NUVISTA ENERGY LTD.**

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

(\$Cdn thousands)

| <b>Year ended December 31,</b>   | <b>2011</b>        | <b>2010</b> |
|--|--------------------|-------------|
| <b>Share capital</b> (note 12)   |                    |             |
| Balance, beginning of year   | <b>\$689,757</b>   | \$685,269   |
| Issued for cash  | <b>100,751</b>     | -           |
| Dividend re-investment plan  | <b>771</b>         | 1,618       |
| Exercise of stock options  | <b>394</b>         | 2,233       |
| Share-based compensation   | <b>134</b>         | 678         |
| Share issue costs, net of deferred tax benefit of \$0.5 million<br>(2010 – \$0.01 million) | <b>(1,467)</b>     | (41)        |
| Balance, end of year   | <b>\$790,340</b>   | \$689,757   |
| <b>Contributed surplus</b>   |                    |             |
| Balance, beginning of year   | <b>\$26,552</b>    | \$18,690    |
| Share-based compensation   | <b>5,747</b>       | 8,540       |
| Exercise of stock options  | <b>(134)</b>       | (678)       |
| Balance, end of year   | <b>\$32,165</b>    | \$26,552    |
| <b>Retained earnings (deficit)</b>   |                    |             |
| Balance, beginning of year   | <b>\$ 76,843</b>   | \$154,221   |
| Net loss   | <b>(143,800)</b>   | (59,655)    |
| Dividends  | <b>-</b>           | (17,723)    |
| Balance, end of year   | <b>\$ (66,957)</b> | \$ 76,843   |
| <b>Total shareholders' equity</b>  | <b>\$ 755,548</b>  | \$793,152   |

See accompanying notes to consolidated financial statements.

**NUVISTA ENERGY LTD.**

**Consolidated Statements of Cash Flows**

(\$Cdn thousands)

| <b>Year ended December 31,</b>                       | <b>2011</b>        | <b>2010</b> |
|--|--------------------|-------------|
| <b>Cash provided by (used in)</b>                    |                    |             |
| <b>Operating activities</b>                          |                    |             |
| Net loss   | <b>\$(143,800)</b> | \$(59,655)  |
| Items not requiring cash from operations:            |                    |             |
| Depletion, depreciation, amortization and impairment | <b>307,206</b>     | 184,783     |
| Goodwill impairments                                 | <b>25,788</b>      | 29,752      |
| Exploration and evaluation                           | <b>24,248</b>      | 16,898      |
| Gain on property dispositions                        | <b>(33,115)</b>    | (5,070)     |
| Share-based compensation                             | <b>5,164</b>       | 6,556       |
| Unrealized loss on commodity derivatives             | <b>10,280</b>      | 2,747       |
| Deferred income tax reduction                        | <b>(36,411)</b>    | (10,659)    |
| Accretion  | <b>4,659</b>       | 4,639       |
| Asset retirement expenditures                        | <b>(7,120)</b>     | (7,740)     |
| Change in non-cash working capital                   | <b>3,369</b>       | 5,204       |
|  | <b>160,268</b>     | 167,455     |
| <b>Financing activities</b>                          |                    |             |
| Issue of share capital, net of share issue costs     | <b>99,178</b>      | 2,178       |
| Increase (repayment) in long-term debt               | <b>(149,135)</b>   | 53,943      |
| Dividends paid                                       | <b>(3,667)</b>     | (11,667)    |
|  | <b>(53,624)</b>    | 44,454      |
| <b>Investing activities</b>                          |                    |             |
| Property, plant and equipment expenditures           | <b>(132,473)</b>   | (152,953)   |
| Property acquisitions                                | <b>(4,524)</b>     | (18,357)    |
| Proceeds on property dispositions                    | <b>42,444</b>      | -           |
| Exploration and evaluation expenditures              | <b>(24,833)</b>    | (53,740)    |
| Change in non-cash working capital                   | <b>12,742</b>      | 13,141      |
|  | <b>(106,644)</b>   | (211,909)   |
| Change in cash and cash equivalents                  | -                  | -           |
| Cash and cash equivalents, beginning of year         | -                  | -           |
| <b>Cash and cash equivalents, end of year</b>        | <b>\$ -</b>        | <b>\$ -</b> |
| Cash interest paid                                   | <b>\$17,109</b>    | \$17,883    |

See accompanying notes to consolidated financial statements.

**NUVISTA ENERGY LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Year ended December 31, 2011 with comparative figures for 2010. All tabular amounts are in thousands of Canadian dollars, except share and per share amounts, unless otherwise stated.

**1. Corporate information**

NuVista Energy Ltd. (“NuVista” or the “Company”) is a publicly traded company incorporated under the laws of Alberta. The Company is an oil and natural gas company actively engaged in the exploration for and the development and production of oil and natural gas reserves.

The address of the Company’s registered office is 3500, 700 – 2nd Street S.W., Calgary, Alberta, Canada, T2P 2W2.

**2. Basis of preparation**

(a) Statement of compliance

The consolidated financial statements represent the Company’s initial presentation of its results and financial position under International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board and have been prepared using accounting policies consistent with IFRS. Significant accounting policies under IFRS are presented in note 3. These policies have been retrospectively and consistently applied, except where specific exemptions permitted an alternative treatment upon transition to IFRS in accordance with IFRS 1, “First-time Adoption of International Financial Reporting Standards”. The impact of the new standards, including reconciliations, present the change from previously reported Canadian generally accepted accounting principles (“Previous GAAP”) to IFRS as at January 1, 2010, as at and for the year ended December 31, 2010 is presented in note 20.

These consolidated financial statements were approved and authorized for issuance by the Board of Directors on March 2, 2012.

(b) Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis, except for compensation liabilities and derivative financial instruments that have been measured at fair value with the changes in fair value recorded in net earnings.

(c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company’s and its subsidiaries’ functional currency.

(d) Use of estimates and judgments

The preparation of the 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. 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. Significant estimates and judgments made by management in the preparation of these consolidated financial statements are outlined below:

(i) Reserve estimates

Oil and natural gas reserves are used in the calculation of depletion and impairment. Reserve estimates are based on engineering data, estimated future prices, expected future rates of production and the timing of future capital expenditures, all of which are subject to many uncertainties and interpretations. The Company expects that, over time, its reserve estimates will be revised upward or downward based on updated information such as the results of future drilling, testing and production levels and may be affected by changes in commodity prices.

(ii) Asset retirement obligations

Asset retirement obligations are recognized for the future decommissioning and restoration of property, plant and equipment. These obligations are based on estimated costs, which take into account the anticipated method and extent of restoration and technological advances. Actual costs are uncertain and estimates can vary as a result of changes to relevant laws and regulations, the emergence of new technology, operating experience and prices. The expected timing of future decommissioning and restoration may change due to certain factors, including reserve life. Changes to assumptions related to future expected costs, discount rates and timing may have a material impact on the amounts presented.

(iii) Fair value of financial instruments

The fair value of financial instruments, that are not traded in an active market, is determined by using valuation techniques. The Company uses its judgment to select a variety of methods and makes assumptions that are mainly based on market conditions existing at the end of the reporting period. The Company uses directly and indirectly observable inputs in measuring the value of the financial instruments that are not traded in active markets, including quoted commodity prices and volatility, interest rate yield curves and foreign exchange rates.

(iv) Share-based compensation

Compensation expense recognized for share-based compensation plans are accrued over the vesting period based on fair values. Fair values are determined using observable share prices and/or the Black-Scholes option pricing model based on significant assumptions such as expected volatility and estimated forfeiture rates. For restricted stock units incentive plans, fair values are determined at each reporting date and periodic changes are recognized as compensation costs with a corresponding change to compensation liability.

(v) Cash generating units

Cash generating units are defined as the lowest grouping of integrated assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or group of assets. The classification of assets into cash generating units requires significant judgment and interpretations with respect to the integration between assets, the existence of active markets, external users, shared infrastructures and the way in which management monitors the Company's operations.

(vi) Income taxes

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company and its subsidiaries operate are subject to change. As such, income taxes are subject to measurement uncertainty.



### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements by the Company and its subsidiaries.

#### (a) Principles of consolidation

The consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries.

Intercompany balances and transactions between the Company and its subsidiaries are eliminated on consolidation.

#### (b) 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 so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

#### (c) Joint interest

A portion of exploration, development and production activities are conducted jointly with others under contractual arrangement and, accordingly, the Company only reflects its proportionate interest in such activities.

#### (d) Exploration and evaluation assets

Exploration and evaluation ("E&E") expenditures are initially capitalized within "Exploration and evaluation assets". E&E costs may include the costs of acquiring licenses, technical services and studies, seismic acquisition, exploration drilling and testing costs and directly attributable general and administrative costs. Costs incurred prior to having obtained the legal right to explore an area are charged to net earnings as exploration and evaluation expenditures in the period in which they are incurred.

E&E assets are not depreciated. These costs are accumulated in cost centers by well or areas and are carried forward until the existence (or otherwise) of commercial reserves has been determined. The Company defines commercial reserves as the existence of proved and/ or probable reserves which are determined to be technically feasible and commercially viable to extract.

E&E assets are assessed for impairment if: (i) sufficient data exists to determine technical feasibility and commercial viability; and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. The recoverable amount of an asset is defined as the higher of fair value less costs to sell and value in use. E&E assets are tested for impairment at the operating segment level.

If proved and/ or probable reserves have been discovered, E&E assets are first tested for impairment prior to the reclassification to property, plant and equipment. The carrying value, after any impairment loss, of the relevant E&E assets and associated undeveloped land is then reclassified as development and production assets within property, plant and equipment.

Any impairment loss on E&E assets, unsuccessful E&E costs and the cost of undeveloped land that has expired are charged to net earnings as exploration and evaluation expense.

(e) Property, plant and equipment

Development and production assets

Items of property, plant and equipment which include oil and gas development and production assets and corporate assets are measured at cost less accumulated depletion, depreciation, amortization and impairment. Development and production assets are accumulated on an area-by-area basis and represent the cost of developing the commercial reserves discovered and bringing them into production, together with the E&E expenditures incurred in finding commercial reserves transferred from E&E assets as outlined above.

An impairment test is performed whenever events and circumstances arising during the development and production phase indicate that the carrying value of a development and production asset may exceed its recoverable amount. The carrying value is compared against the expected recoverable amount of the asset, defined as the greater of fair value less costs to sell and its value in use. Fair value less costs to sell is determined as the amount that would be obtained for the sale of a cash generating unit ("CGU") in an arm's length transaction between knowledgeable and willing parties. Fair value less costs to sell may be determined by using discounted future net cash flows of proved and probable reserves using forecast prices and costs. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset. If any indications of impairment exists, the Company performs an impairment test related to the assets. Individual assets or areas are grouped for impairment assessment purposes into CGU's, which are the lowest level at which there are identifiable cash inflows that are largely independent of the cash inflows of other groups of assets.

Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down to its recoverable amount. The impairment loss is recorded within depletion, depreciation, amortization and impairment expense in net earnings. Impairments are reversed when events or circumstances give rise to changes in the estimate of the recoverable amount since the period the impairment was recorded. An impairment loss is reversed only to the extent that the CGU's carrying amount does not exceed the carrying amount that would have been determined, net of depletion, if no impairment loss had been recognized.

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as oil and natural gas assets only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in net earnings as incurred. Such capitalized oil and natural gas asset generally represents costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on an area basis. 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 net earnings as incurred.

(f) Depletion, depreciation amortization and impairment

The costs of development and production assets are depleted on an area level using the unit-of-production method by reference to the ratio of production in the period to the related proved and probable reserves of the area, taking into account estimated future development costs necessary to bring those reserves into production and the estimated salvage value of the assets at the end of their useful lives. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers annually.

Other property, plant and equipment are stated at cost less accumulated depletion, depreciation, amortization and any impairment in value. When significant parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) and depreciated over their useful lives. Costs associated with workovers are depreciated over two years and plant turnarounds and overhauls are depreciated over five years. The assets' useful lives and residual

values are assessed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

(g) Asset purchases and disposals

Transactions involving the purchase of an individual area, or a group of areas, that do not qualify as a business combination, are treated as asset purchases irrespective of whether the specific transactions involved the transfer of the areas directly or the transfer of an incorporated entity. Accordingly, no goodwill arises and the consideration is allocated to the assets and liabilities purchased on an appropriate basis.

Proceeds on disposal are compared to the specific exploration and evaluation asset or development and production assets disposed of and any surplus or shortfall is recorded as a gain or loss on disposal in net earnings.

(h) Business combinations

Determining whether an acquisition meets the definition of a business combination or represents an asset purchase requires judgment on a case by case basis. Business combinations are accounted for using the acquisition method. The acquired identifiable assets and liabilities are measured at their fair value at the date of acquisition. Any excess of the purchase price over the recognized amount (generally the fair value) of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the recognized amount of the net assets acquired is recorded as a bargain purchase gain in net earnings. Associated transactions costs are expensed when incurred.

(i) Goodwill

Goodwill represents the excess of purchase price over the fair value of net assets acquired in a business combination. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill is allocated to the CGUs that are expected to benefit from the synergies of the combination. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the CGU to which the goodwill relates. The recoverable amounts are determined based on the greater of its fair value less costs to sell or value in use. Where the recoverable amount of the CGU is less than the carrying amount, an impairment loss is recognized. Impairment losses are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the development and production assets on a pro rata basis. Any impairment loss on goodwill is not reversed.

(j) Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of 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. Provisions are not recognized for future operating losses.

Asset retirement obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. An obligation is recognized for the estimated cost of abandonment and site restoration, by discounting expected future cash flows required to settle the obligation using a risk free rate, with a corresponding amount capitalized as asset retirement costs in property, plant and equipment. These asset retirement costs are subsequently depleted on a unit-of-production basis over the life of the proved and probable reserves. The obligation is adjusted each reporting period to reflect the passage of time

and changes to the estimated future cash flows underlying the obligation. The increase in the obligation due to the passage of time is recognized as accretion expense and changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the obligations are charged against the liability.

(k) Revenue recognition

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party.

(l) Financial instruments

(i) Non-derivative financial instruments

Financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as “fair value through profit or loss”, “loans and receivables”, “available-for-sale”, “held-to-maturity”, or “other financial liabilities” as defined by the accounting standard. Financial assets and financial liabilities at “fair value through profit or loss” are either classified as “held for trading” or “designated at fair value through profit or loss” and are measured at fair value with changes in those fair values recognized in net earnings. Financial assets classified as “loans and receivables”, “held-to-maturity”, and “other financial liabilities” are measured at amortized cost using the effective interest method of amortization. Financial assets classified as “available-for-sale” are measured at fair value, with changes in fair value recognized in other comprehensive income.

Financial assets, excluding derivative instruments, are classified as “loans and receivables”. Financial liabilities, excluding derivative instruments, are classified as “other financial liabilities”. All derivative instruments are classified as “fair value through profit or loss”.

(ii) Derivative financial instruments

The Company has entered into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the statement of financial position at fair value. Transaction costs are recognized in net earnings when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are recognized in net earnings.

The Company has accounted for its forward physical delivery sales contracts and power contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items, in accordance with its expected purchase, sale or usage requirements as executory contracts. As such, these contracts are not considered to be derivative financial instruments and have not been recorded at fair value on the statement of financial position. Realized gains or losses from natural gas and oil commodity physical sales contracts are recognized in oil and natural gas revenue as the contracts are settled. Realized gains or losses from power commodity contracts are recognized in operating costs as the related power contracts are settled.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized in net earnings.

(m) Share capital

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

(n) Share-based compensation

The Company has three types of incentive plans: stock options, restricted stock units (“RSU”) and restricted share awards (“RSA”) that may be granted to directors, officers and employees.

The Company’s stock option plan provides the stock option holder with the right to purchase common shares. The Company uses the fair value method for valuing stock option grants using the Black-Scholes option pricing model. Under this method, the compensation cost attributable to all share options granted is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. A forfeiture rate is estimated on the grant date and is subsequently adjusted each period to reflect the actual number of options that are expected to vest.

The Company’s RSU plan entitles participants to receive cash based on the Company’s share price at the time of vesting. A liability for expected cash payments is accrued over the vesting period based on the market price of the Company’s common shares. Compensation expense is recorded in net earnings as share-based compensation.

The RSA incentive plan allows a holder of the RSA to receive common shares upon vesting. This fair value is recognized as share-based compensation expense over the vesting period with a corresponding increase to contributed surplus. The amount of the compensation expense is reduced by an estimated forfeiture rate determined at the date of the grant. Upon vesting of the RSAs, the previously recognized value in contributed surplus will be recorded as an increase to share capital.

(o) Income taxes

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

Deferred tax is recognized on the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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.

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

Deferred income tax expense is recognized in the statement of earnings except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

(p) Earnings per share

Basic earnings per share is calculated by dividing the net earnings or losses attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period.

Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised into common shares. The Company calculates the dilutive impact of common shares assuming the proceeds received from the pro forma exercise in-the-money share options are used to purchase common shares at average market prices.

(q) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and short-term investments that are highly liquid in nature and have an original maturity date of three months or less.

#### 4. Future accounting changes

As of January 1, 2013, the Company will be required to adopt the following standards as issued by the IASB (“International Accounting Standards Board”). The Company is evaluating the impact that these standards may have on our results of operations and financial position.

- IFRS 10, “Consolidated Financial Statements” – In May 2011, the IASB issued IFRS 10 which is the IASB’s project to replace Standing Interpretations Committee 12, “Consolidation – Special Purpose Entities” and the consolidation requirements of IAS 27, “Consolidated and Separate Financial Statements”. The new standard eliminates the current risk and rewards approach and established control as the single basis for determining the consolidation of an entity.
- IFRS 11, “Joint Arrangements” – In May 2011, the IASB issued IFRS 11 to replace IAS 131, “Interest in Joint Ventures”. The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to equity accounted. Under IAS 31, joint ventures could be proportionately accounted.
- IFRS 12, “Disclosure of Interests in Other Entities” – In May 2011, the IASB issued IFRS 12 which outlines the required disclosures for interests in subsidiaries and joint arrangements. The new disclosures require information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity’s interests in subsidiaries and joint arrangements.
- IFRS 13, “Fair Value Measurement” – In May 2011, the IASB issued IFRS 13 which provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.

As of January 1, 2015, the Company will be required to adopt IFRS 9, “Financial Instruments”. The IASB issued IFRS 9, which is the first phase of the IASB’s project to replace IAS 39, “Financial Instruments: Recognition and Measurement”. The new standard replaces the current multiple classification and measurement models for financial asset and liabilities with a single model that has only two classification categories: amortized cost and fair value. Portions of the standard remain in development and the full impact of the standard on the Company’s consolidated financial statements will not be known until the project is complete.

## 5. Exploration and evaluation assets

|   | 2011             | 2010             |
|---|------------------|------------------|
| Balance, beginning of year                    | \$141,852        | \$128,175        |
| Additions                                     | 24,833           | 53,740           |
| Acquisitions                                  | 3,754            | -                |
| Dispositions                                  | (655)            | (180)            |
| Transfers to property, plant and equipment    | (13,138)         | (22,985)         |
| Expiries (exploration and evaluation expense) | (13,848)         | (16,898)         |
| Unsuccessful exploration and evaluation costs | (10,400)         | -                |
| Balance, end of year                          | <b>\$132,398</b> | <b>\$141,852</b> |

## 6. Property, plant and equipment

|  | 2011               | 2010               |
|--|--------------------|--------------------|
| <b>Cost</b>                                      |                    |                    |
| Balance, beginning of year                       | \$1,487,032        | \$1,273,278        |
| Additions  | 136,857            | 166,636            |
| Acquisitions                                     | 4,524              | 18,510             |
| Dispositions                                     | (29,438)           | -                  |
| Change in asset retirement obligations (note 9)  | 50,446             | 3,951              |
| Capitalized share-based compensation             | 476                | 1,672              |
| Transfers from exploration and evaluation assets | 13,138             | 22,985             |
| Balance, end of year                             | <b>\$1,663,035</b> | <b>\$1,487,032</b> |

|   | 2011             | 2010             |
|---|------------------|------------------|
| <b>Accumulated depletion, depreciation, amortization and impairment</b> |                  |                  |
| Balance, beginning of year  | \$184,783        | \$ -             |
| Depletion and depreciation expense                                      | 159,499          | 160,994          |
| Dispositions  | (11,120)         | -                |
| Impairments (net of reversals)  | 147,707          | 23,789           |
| Balance, end of year  | <b>\$480,869</b> | <b>\$184,783</b> |

|                            | 2011               | 2010               |
|----------------------------|--------------------|--------------------|
| <b>Net book value</b>      |                    |                    |
| Balance, beginning of year | \$1,302,249        | \$1,273,278        |
| Balance, end of year       | <b>\$1,182,166</b> | <b>\$1,302,249</b> |

An impairment test was performed on the Company's natural gas producing assets at December 31, 2011 due to a decrease in the forward price curve for natural gas at January 1, 2012 compared to the prior year. The Company recognized an impairment charge (net of reversals) of \$147.7 million (2010 – \$23.8 million) related to four natural gas CGUs in Northern and Eastern Alberta and in Saskatchewan, which has been included as depletion, depreciation, amortization and impairment expense on the statement of earnings. The recoverable amount was determined using a fair value less costs to sell methodology with the expected future cash flows based on proved and probable reserves using a pre-tax discount rate of 10% (2010 – 10%), based on the independent external reserves report. The following benchmark reference prices, as forecasted by the independent external reserves evaluator were used:

## Benchmark reference price forecasts

|                                      | 2012  | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | Thereafter |
|--------------------------------------|-------|--------|--------|--------|--------|--------|--------|--------|--------|------------|
| WTI<br>(US\$/Bbl) <sup>(1)</sup>     | 97.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 101.35 | 103.38 | 105.45 | +2%/yr     |
| AECO<br>(Cdn\$/MMbtu) <sup>(1)</sup> | 3.49  | 4.13   | 4.59   | 5.05   | 5.51   | 5.97   | 6.21   | 6.33   | 6.46   | +2%/yr     |

<sup>(1)</sup> Price forecast, effective January 1, 2012.

A change in the discount rate of 2% would result in a change to the impairment charge of \$89.2 million for the year ended December 31, 2011.

## 7. Goodwill

|                            | 2011     | 2010     |
|----------------------------|----------|----------|
| Balance, beginning of year | \$34,579 | \$64,331 |
| Impairments                | (25,788) | (29,752) |
| Balance, end of year       | \$ 8,791 | \$34,579 |

The Company completed its annual goodwill impairment test at December 31, 2011 at the CGU level and recognized a goodwill impairment charge of \$25.8 million (2010 – \$29.8 million) for a natural gas CGU located in the deep basin area of Alberta. In assessing whether goodwill has been impaired, the carrying amount of each CGU (including goodwill) is compared with the recoverable amount of the CGU. The recoverable amount was determined using the fair value less costs to sell methodology based on discounted future cash flows generated from proved and probable oil and natural gas reserves, as described in note 6. A pre-tax discount rate of 10% (2010 – 10%) and forecast pricing was used in the calculation. A change in the discount rate of 2% would have no additional impact to goodwill impairment.

## 8. Long-term debt

As at December 31, 2011 the Company had a \$440 million (2010 – \$510 million) extendible revolving term credit facility available from a syndicate of Canadian chartered banks. Borrowing under the credit facility may be made by prime loans, bankers' acceptances and/or US libor advances. These advances bear interest at the bank's prime rate and/or at money market rates plus a borrowing margin. The credit facility is secured by a first floating charge debenture, general assignment of book debts and the Company's oil and natural gas properties and equipment. The credit facility has a 364-day revolving period and is subject to an annual review by the lenders, at which time a lender can extend the revolving period or can request conversion to a one year term loan. NuVista completed the semi-annual review of its borrowing base in November 2011 with its lenders and the lenders approved a request for a revolving extendible credit facility with a maximum borrowing amount of \$440 million. During the term period, no principal payments would be required until April 29, 2013. As such, this credit facility is classified as long-term. As at December 31, 2011, the Company had drawn \$289.4 million (2010 – \$438.6 million).

## 9. Asset retirement obligations

The Company's asset retirement obligations are based on estimated costs to reclaim and abandon ownership interests in oil and natural gas assets including well sites, gathering systems and processing facilities. At December 31, 2011, the estimated total undiscounted amount of cash flows required to settle the Company's asset retirement obligations is \$276.3 million (2010 – \$232.4 million), which is estimated to be incurred over the next 51 years. A year end risk-free rate of 2.49% (2010 – 3.52%) and an inflation rate of 2% (2010 – 2%)



were used to calculate the net present value of the asset retirement obligations. The increase in the change in estimates is primarily due to a decrease in the risk-free rate and increases in cost estimates and timing of abandonment expenditures. A reconciliation of the asset retirement obligations is provided below:

|                            | 2011             | 2010      |
|----------------------------|------------------|-----------|
| Balance, beginning of year | \$128,259        | \$118,812 |
| Accretion expense          | 4,659            | 4,639     |
| Liabilities incurred       | 7,501            | 7,069     |
| Liabilities acquired       | 2,498            | 1,166     |
| Liabilities disposed       | (2,070)          | -         |
| Change in estimates        | 41,014           | 4,313     |
| Liabilities settled        | (7,120)          | (7,740)   |
| Balance, end of year       | <b>\$174,741</b> | \$128,259 |

## 10. Personnel expenses

(a) The aggregate payroll expense of employees and executive management recognized is as follows:

|   | 2011            | 2010     |
|---|-----------------|----------|
| Salaries, wages and benefits              | \$21,996        | \$23,361 |
| Share-based payments                      | 6,528           | 10,078   |
| Total employee remuneration               | \$28,524        | \$33,439 |
| Capitalized portion of total remuneration | <b>\$ 3,520</b> | \$ 5,763 |

Personnel expenses directly attributed to capital activities have been capitalized and included in property, plant and equipment and exploration and evaluation assets.

(b) Key management personnel includes the Board of Directors, executive officers and vice presidents of the Company. Key management personnel compensation is comprised of the following:

|  | 2011           | 2010    |
|--|----------------|---------|
| Salaries, wages and short-term benefits  | \$3,690        | \$3,442 |
| Termination and post employment benefits | 897            | 735     |
| Share-based payments <sup>(1)</sup>      | 306            | 654     |
| Total executive officers remuneration    | <b>\$4,893</b> | \$4,831 |

<sup>(1)</sup> Represents the amortization of stock-based compensation expense as recorded in the consolidated financial statements.

## 11. Deferred income tax expense

The tax provision differs from the amount computed by applying the combined Canadian federal and provincial statutory income tax rates to income before deferred income tax expense as follows:

|   | 2011               | 2010               |
|---|--------------------|--------------------|
| Loss before tax                         | \$ (180,211)       | \$ (70,314)        |
| Expected tax rate <sup>(1)</sup>        | 26.7%              | 28.3%              |
| Expected income tax reduction           | (48,116)           | (19,899)           |
| Effect of change in corporate tax rates | 1,935              | 1,855              |
| Non-deductible expenses                 | 8,456              | 6,319              |
| Change in estimated pool balances       | 800                | 486                |
| Other                                   | 514                | 580                |
| <b>Total income tax reduction</b>       | <b>\$ (36,411)</b> | <b>\$ (10,659)</b> |

<sup>(1)</sup> The combined Federal/ Provincial tax rate lowered to 26.7% in 2011 from 28.3% in 2010 due to the Federal rate decreasing from 18% in 2010 to 16.5% in 2011.

The significant components of net deferred income tax liability are as follows:

|                                     | 2011             | 2010              |
|-------------------------------------|------------------|-------------------|
| Deferred tax liabilities            |                  |                   |
| Oil and natural gas properties      | \$ 48,497        | \$ 39,296         |
| Facilities and well equipment       | 34,635           | 43,653            |
| Partnership deferral                | 73,370           | 83,464            |
|                                     | <b>156,502</b>   | <b>166,413</b>    |
| Deferred tax assets                 |                  |                   |
| Asset retirement obligations        | (44,268)         | (32,591)          |
| Share issue costs                   | (748)            | (775)             |
| Commodity derivative contracts      | (4,271)          | (1,773)           |
| Non-capital losses                  | (36,860)         | (24,007)          |
| Other                               | -                | -                 |
| <b>Net deferred tax liabilities</b> | <b>\$ 70,355</b> | <b>\$ 107,267</b> |

A continuity of the net deferred tax liability is detailed in the following tables:

| <b>Asset (liability)</b>       | <b>Balance<br/>January 1,<br/>2010</b> | <b>Recognized in<br/>profit or loss</b> | <b>Recognized in<br/>equity</b> | <b>Balance<br/>December 31,<br/>2010</b> |
|--------------------------------|--|---|---------------------------------|--|
| Oil and natural gas properties | \$ (116,449)                           | \$ 77,153                               | \$ -                            | \$ (39,296)                              |
| Facilities and well equipment  | (35,587)                               | (8,066)                                 | -                               | (43,653)                                 |
| Partnership deferral           | -                                      | (83,464)                                | -                               | (83,464)                                 |
| Asset retirement obligations   | 30,772                                 | 1,819                                   | -                               | 32,591                                   |
| Share issue costs              | 1,817                                  | (1,042)                                 | -                               | 775                                      |
| Commodity derivative contracts | 1,470                                  | 303                                     | -                               | 1,773                                    |
| Non-capital losses             | -                                      | 24,007                                  | -                               | 24,007                                   |
| Other                          | 37                                     | (51)                                    | 14                              | -  |
| <b>Total</b>                   | <b>\$ (117,940)</b>                    | <b>\$ 10,659</b>                        | <b>\$ 14</b>                    | <b>\$ (107,267)</b>                      |

| <b>Asset (liability)</b>       | <b>Balance<br/>January 1,<br/>2011</b> | <b>Recognized in<br/>profit or loss</b> | <b>Recognized in<br/>equity</b> | <b>Balance<br/>December 31,<br/>2011</b> |
|--------------------------------|--|---|---------------------------------|--|
| Oil and natural gas properties | \$ (39,296)                            | \$ (9,201)                              | \$ -                            | \$ (48,497)                              |
| Facilities and well equipment  | (43,653)                               | 9,018                                   | -                               | (34,635)                                 |
| Partnership deferral           | (83,464)                               | 10,094                                  | -                               | (73,370)                                 |
| Asset retirement obligations   | 32,591                                 | 11,677                                  | -                               | 44,268                                   |
| Share issue costs              | 775                                    | (528)                                   | 501                             | 748                                      |
| Commodity derivative contracts | 1,773                                  | 2,498                                   | -                               | 4,271                                    |
| Non-capital losses             | 24,007                                 | 12,853                                  | -                               | 36,860                                   |
| <b>Total</b>                   | <b>\$ (107,267)</b>                    | <b>\$ 36,411</b>                        | <b>\$ 501</b>                   | <b>\$ (70,355)</b>                       |

## 12. Share capital

At December 31, 2011, the Company was authorized to issue an unlimited number of voting Common Shares and 1,200,000 non-voting Class B Performance Shares (none of which have been issued).

### Common Shares

|   | <b>2011</b>       |                  | <b>2010</b>   |               |
|---|-------------------|------------------|---------------|---------------|
|   | <b>Number</b>     | <b>Amount</b>    | <b>Number</b> | <b>Amount</b> |
| Balance, beginning of year  | <b>88,759,802</b> | <b>\$689,757</b> | 88,360,757    | \$685,269     |
| Issued for cash   | <b>10,614,000</b> | <b>100,751</b>   | -             | -             |
| Dividend re-investment plan ("DRIP")  | <b>89,945</b>     | <b>771</b>       | 158,121       | 1,618         |
| Exercise of stock options   | <b>49,608</b>     | <b>394</b>       | 240,924       | 2,233         |
| Share-based compensation  | -                 | <b>134</b>       | -             | 678           |
| Share issue costs, net of deferred tax benefit of \$0.5 million (2010 – \$0.01 million) | -                 | <b>(1,467)</b>   | -             | (41)          |
| <b>Balance, end of year</b>   | <b>99,513,355</b> | <b>\$790,340</b> | 88,759,802    | \$689,757     |

In the first quarter of 2011, the Company completed a private placement and a public offering with a syndicate of underwriters for the issuance of an aggregate of 10,500,000 common shares for aggregate gross proceeds of \$99.8 million.

During the year ended December 31, 2011, the Company issued 89,945 (2010 – 158,121) common shares in payment of \$0.8 million (2010- \$1.6 million) of dividends for shareholders that elected to participate in the DRIP. The dividend was terminated in the first quarter of 2011.

## 13. Earnings per share

The following table summarizes the weighted average common shares used in calculating earnings per share:

| <b>(thousands of shares)</b>               | <b>2011</b>   | <b>2010</b> |
|--|---------------|-------------|
| Weighted average common shares outstanding |               |             |
| Basic                                      | <b>97,557</b> | 88,583      |
| Diluted                                    | <b>97,557</b> | 88,583      |

For the year ended December 31, 2011 and December 31, 2010 all stock options and restricted share awards outstanding were anti-dilutive and were not included in the diluted common share calculation. For the

year ended December 31, 2011 7,115,228 (2010 – 6,590,485) stock options and restricted share awards were excluded from the calculation of diluted earnings per share as these options were anti-dilutive.

#### 14. Share-based compensation

##### Stock options

The Company has established a stock option plan whereby officers, directors and employees may be granted options to purchase common shares. Options granted prior to December 2008 vest at the rate of 25% per year and expire two years from the vesting date. Options subsequently granted vest at the rate of 1/3 per year and expire 2.5 years after the vesting date. The total stock options outstanding plus the Class B Performance Shares cannot exceed 10% of the outstanding common shares. The summary of stock option transactions is as follows:

|  |                          | <b>2011</b>                            |                   | 2010                            |
|--|--------------------------|--|-------------------|---------------------------------|
|  | <b>Number of options</b> | <b>Weighted Average exercise price</b> | Number of options | Weighted Average exercise price |
| Balance, beginning of year                       | 7,515,098                | \$12.29                                | 6,574,823         | \$13.16                         |
| Granted  | 2,460,385                | 7.72                                   | 2,449,840         | 10.46                           |
| Exercised  | (49,608)                 | 7.94                                   | (240,924)         | 9.27                            |
| Forfeited  | (1,645,462)              | 11.84                                  | (705,391)         | 13.36                           |
| Expired  | (991,814)                | 14.98                                  | (563,250)         | 14.42                           |
| Balance, end of year                             | 7,288,599                | \$10.51                                | 7,515,098         | \$12.29                         |
| Weighted average share price on date of exercise | 49,608                   | \$ 9.61                                | 240,924           | \$12.60                         |

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

|                         | Options outstanding           |                                   |                                 | Options exercisable           |                                 |  |
|-------------------------|-------------------------------|-----------------------------------|---------------------------------|-------------------------------|---------------------------------|--|
|                         | Number of options outstanding | Weighted average contractual life | Weighted average exercise price | Number of options exercisable | Weighted average exercise price |  |
| Range of exercise price |                               |                                   |                                 |                               |                                 |  |
| \$4.45 to \$9.99        | 3,338,462                     | 3.5                               | \$ 7.88                         | 691,589                       | \$ 8.21                         |  |
| \$10.00 to \$14.99      | 3,101,446                     | 2.1                               | 11.81                           | 1,894,016                     | 12.16                           |  |
| \$15.00 to \$19.02      | 848,691                       | 1.2                               | 16.14                           | 617,895                       | 16.22                           |  |
| \$4.45 to \$19.02       | 7,288,599                     | 2.6                               | \$10.51                         | 3,203,500                     | \$12.09                         |  |

The Company uses the fair value based method for the determination of the share-based compensation costs. The fair value of each option granted during the year was estimated on the date of grant using the Black-Scholes option pricing model.

The weighted average fair value and weighted average assumptions used to fair value the options are as follows:

|  | 2011        | 2010 |
|--|-------------|------|
| Risk-free interest rate (%)              | 1.8         | 2.3  |
| Expected volatility (%)                  | 40          | 40   |
| Expected life (years)                    | 4.4         | 4.4  |
| Forfeiture rate (%)                      | 10          | 10   |
| Dividend (\$ per share)                  | -           | 0.20 |
| Fair value at grant date (\$ per option) | <b>2.73</b> | 3.24 |

For the year ended December 31, 2011, share-based compensation of \$5.0 million (2010 – \$6.6 million) was recorded in net earnings and \$0.5 million (2010 – \$1.4 million) was capitalized.

#### Restricted stock units

In January 2008, the Board of Directors approved a Restricted Stock Unit (“RSU”) Incentive Plan for employees and officers. Each RSU entitles participants to receive cash equal to the market value of the equivalent number of shares of the Company. Until November 2009, the RSUs became payable as they vested over three years. In November 2009, the Board of Directors amended the Plan. All RSUs granted subsequent to November 2009 vest and become payable two years after the date the RSUs are issued.

The compensation expense was calculated using the fair value method based on the trading price of the Company’s shares at the end of each reporting year. The following table summarizes the change in the number of RSUs:

|                            | 2011             | 2010      |
|----------------------------|------------------|-----------|
| Balance, beginning of year | <b>452,931</b>   | 414,791   |
| Settled                    | <b>(131,649)</b> | (210,704) |
| Granted                    | <b>252,240</b>   | 270,505   |
| Forfeited                  | <b>(94,654)</b>  | (21,661)  |
| Balance, end of year       | <b>478,868</b>   | 452,931   |

The following table summarizes the change in compensation liability relating to the RSUs:

|   | 2011           | 2010    |
|---|----------------|---------|
| Balance, beginning of year  | <b>\$1,532</b> | \$2,651 |
| Change in accrued compensation liabilities  | <b>(290)</b>   | (1,119) |
| Balance, end of year  | <b>\$1,242</b> | \$1,532 |
| Compensation liabilities – current (included in accounts payable and accrued liabilities) | <b>\$ 942</b>  | \$ 913  |
| Compensation liabilities – non-current  | <b>\$ 300</b>  | \$ 619  |

For the year ended December 31, 2011, cash payments of \$1.1 million (2010 – \$2.3 million) were made relating to the RSU Incentive Plan. For the year ended December 31, 2011, the Company recorded compensation expense related to RSUs of \$0.7 million (2010 – \$1.0 million) and capitalized (\$0.1 million) (2010 – \$(0.4) million) with a corresponding change recorded in compensation liabilities.

#### Restricted share awards

The Company has established a Restricted Share Award (“RSA”) Incentive Plan for employees and officers which allows the Board of Directors to grant RSAs. The RSAs will vest in one or two years from the date of grant. A holder of an RSA will receive common shares upon vesting. The RSA Incentive Plan is subject to

shareholder approval at the Annual General Meeting on May 10, 2012.

The fair value of RSAs is determined on the grant date based on the weighted average trading price of the five days preceding the grant date. This fair value is recognized as share-based compensation expense over the vesting period with a corresponding increase to contributed surplus. The amount of the compensation expense is reduced by an estimated forfeiture rate determined at the date of the grant. Upon vesting of the RSAs and settlement in common shares, the previously recognized value in contributed surplus will be recorded as an increase to share capital. The fair value of the RSAs granted during the year was based on the December 31, 2011 closing trading price of \$5.24 per share award as the grant date has not occurred until shareholder approval. For the year ended December 31, 2011, the Company recorded compensation expense related to RSAs of \$0.2 million and capitalized \$0.1 million with a corresponding offset recorded in contributed surplus.

The following table summarizes the change in the number of RSAs:

|                            | 2011           | 2010 |
|----------------------------|----------------|------|
| Balance, beginning of year | -              | -    |
| Settled                    | -              | -    |
| Granted                    | <b>237,050</b> | -    |
| Forfeited                  | -              | -    |
| Balance, end of year       | <b>237,050</b> | -    |

## 15. Capital risk management

The Company's objectives when managing capital are: (i) to deploy capital to provide an appropriate return on investment to its shareholders; (ii) to maintain financial flexibility in order to preserve its ability to meet financial obligations; and (iii) to maintain a capital structure that provides financial flexibility to execute on strategic opportunities throughout the business cycle.

The Company's strategy is designed and formulated to maintain a flexible capital structure consistent with the objectives as stated above and to respond to changes in economic conditions and the risk characteristics of the underlying assets. The Company considers its capital structure to include share capital, long-term debt and working capital. In order to maintain or adjust its capital structure, the Company may issue new shares, raise debt, refinance existing debt and adjust capital spending.

A key measure the Company utilizes in evaluating its capital structure is the ratio of net debt to trailing 12 months funds from operations. The ratio is calculated as net debt, defined as outstanding long-term debt plus or minus working capital adjusted for the current portion of commodity derivative assets or liabilities divided by cash flow from operations before asset retirement expenditures and changes in non-cash working capital for the preceding twelve month period. The Company's strategy is to maintain a net debt to trailing twelve months funds from operations ratio of less than 2.0:1. At December 31, 2011, the Company had a ratio of net debt to trailing 12 months funds from operations of 1.9 (2010 – 2.6:1). The actual ratio may fluctuate on a quarterly basis above or below our target due to a number of factors including timing of acquisitions, dispositions and commodity prices.

|  | 2011             | 2010      |
|--|------------------|-----------|
| Long-term debt                                       | <b>\$289,431</b> | \$438,566 |
| Accounts payable and accrued liabilities             | <b>67,710</b>    | 56,183    |
| Dividends payable                                    | -                | 4,438     |
| Add (deduct):  |                  |           |
| Cash and cash equivalents                            | -                | -         |
| Accounts receivable and prepaids                     | <b>(50,350)</b>  | (55,144)  |
| Net debt obligations                                 | <b>\$306,791</b> | \$444,043 |
| Trailing 12 months funds from operations             | <b>\$164,019</b> | \$169,991 |
| Net debt to trailing 12 months funds from operations | <b>1.9</b>       | 2.6       |

In order to maintain a flexible capital structure, during the year the Company issued 10,500,000 common shares for gross proceeds of \$99.8 million, terminated its dividend payments and adjusted its capital program to ensure that 2011 capital expenditures would be lower than forecast cash flow. In addition, during the year ended December 31, 2011, NuVista completed certain property dispositions for total cash consideration of \$42.4 million.

The Company's share capital is not subject to external restrictions, however the credit facility borrowing commitment is based on the lender's semi-annual review of the Company's oil and natural gas reserves. The Company is subject to various covenants under its credit facility. Compliance with these covenants is monitored on a regular basis and as at December 31, 2011, the Company was in compliance with all covenants. There were no changes to the Company's approach to capital management during the year.

## 16. Risk management activities

### (a) Financial instruments

The Company's financial instruments recognized on the consolidated statement of financial position consists of cash and cash equivalents, accounts receivable, commodity derivative contracts, dividend payable, accounts payable and accrued liabilities, compensation liability and long-term debt. The carrying value of the bank debt approximates its fair value as it bears interest at market rates. Except for the commodity derivative contracts, as they are recorded at fair value, carrying values reflect the current fair value of the Company's financial instruments due to their short-term maturities. The estimated fair values of recognized financial instruments have been determined based on the Company's assessment of available market information and appropriate methodologies, through comparisons to similar instruments, or third party quotes.

The Company classifies fair value measurements according to the following hierarchy based on the amount of observable inputs used to value the instrument.

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

The Company's cash and cash equivalents are classified as Level 1 and commodity derivative contracts

as Level 2. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

(b) Risk management contracts

The following is a summary of financial instruments outstanding as at December 31, 2011:

|   | <b>Volume</b>  | <b>Pricing</b>    | <b>Premium</b> | <b>Remaining term</b>      |
|---|----------------|-------------------|----------------|----------------------------|
| <b>WTI crude oil contracts</b>              |                |                   |                |                            |
| Put option                                  | 2,000 Bbls/d   | Cdn \$88.55/Bbl   | Cdn \$9.43/Bbl | Jan 1, 2012 - Mar 31, 2012 |
| Fixed price swap                            | 2,000 Bbls/d   | Cdn \$89.93/Bbl   |                | Jan 1, 2012 - Mar 31, 2012 |
| Fixed price swap                            | 3,000 Bbls/d   | Cdn \$87.62/Bbl   |                | Apr 1, 2012 - Jun 30, 2012 |
| Fixed price swap                            | 2,000 Bbls/d   | Cdn \$82.68/Bbl   |                | Jul 1, 2012 - Sep 30, 2012 |
| Fixed price swap                            | 2,000 Bbls/d   | Cdn \$82.68/Bbl   |                | Oct 1, 2012 - Dec 31, 2012 |
| Fixed price swap                            | 1,000 Bbls/d   | Cdn \$83.00/Bbl   |                | Jan 1, 2013 - Mar 31, 2013 |
| <b>WTI heavy oil differential contracts</b> |                |                   |                |                            |
| WCS differential                            | 3,000 Bbls/d   | US \$(13.85)/Bbl  |                | Jan 1, 2012 - Jun 30, 2012 |
| <b>NYMEX natural gas contracts</b>          |                |                   |                |                            |
| AECO differential                           | 30,000 MMBtu/d | US \$(0.51)/MMBtu |                | Jan 1, 2012 - Mar 31, 2012 |
| AECO differential                           | 20,000 MMBtu/d | US \$(0.59)/MMBtu |                | Apr 1, 2012 - Oct 31, 2012 |

Subsequent to December 31, 2011, the following financial instruments have been entered into:

|                                | <b>Volume</b> | <b>Pricing</b>   | <b>Premium</b> | <b>Remaining term</b>      |
|--------------------------------|---------------|------------------|----------------|----------------------------|
| <b>WTI crude oil contracts</b> |               |                  |                |                            |
| Put option                     | 250 Bbls/d    | Cdn \$108.70/Bbl | Cdn \$6.58/Bbl | Apr 1, 2012 - Sep 30, 2012 |
| Fixed price                    | 250 Bbls/d    | Cdn \$101.10/Bbl |                | Apr 1, 2012 - Mar 31, 2013 |

The following is a reconciliation of movement in the fair value of unrealized commodity risk management contracts:

|   | <b>2011</b>       | <b>2010</b> |
|---|-------------------|-------------|
| Fair value of contracts, beginning of year        | <b>\$ (5,340)</b> | \$(2,593)   |
| Change in the fair value of contracts in the year | <b>(21,043)</b>   | (7,986)     |
| Fair value of contracts realized in the year      | <b>10,763</b>     | 5,239       |
| Fair value of contracts, end of year              | <b>\$(15,620)</b> | \$(5,340)   |
| Commodity derivative liabilities – current        | <b>\$ (9,316)</b> | \$(1,256)   |
| Commodity derivative liabilities – long term      | <b>\$ (6,304)</b> | \$(4,084)   |

(c) Physical purchase and sale contracts

The following is a summary of physical purchase and sale contracts outstanding as at December 31, 2011:



|                              | Volume     | Pricing         | Remaining term             |
|------------------------------|------------|-----------------|----------------------------|
| <b>Natural gas contracts</b> |            |                 |                            |
| AECO fixed price swap        | 5,000 GJ/d | Cdn \$3.41/GJ   | Jan 1, 2012 – Nov 30, 2012 |
| <b>Electricity contracts</b> |            |                 |                            |
| Fixed price                  | 4.0 Mwh    | Cdn \$65.64/Mwh | Jan 1, 2012 – Dec 31, 2013 |

(d) Financial risk management

In the normal course of business, the Company is exposed 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 Board of Directors oversees management's establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls and to monitor risks and adherence to market conditions and the Company's activities.

(i) Credit risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. The Company is exposed to credit risk with respect to its accounts receivables. Most of the Company's accounts receivable arise from transactions with joint interest partners and oil and natural gas sales with oil and natural gas marketers. The Company mitigates its credit risk by entering into contracts with established counterparties that have strong credit ratings and reviewing its exposure to individual counterparties on a regular basis.

The carrying amount of accounts receivable and cash and cash equivalents represents the maximum credit exposure risk to the Company. As at December 31, 2011, the accounts receivable balance was \$40.8 million of which \$2.1 million of accounts receivable were past due. The Company considers all amounts greater than 90 days past due. These past due accounts receivable are considered to be collectible. When determining whether past due accounts are uncollectible, the Company factors in the past credit history of the counterparties. The Company did not have accounts receivable balances owing from counterparties that constituted more than 10% of the total revenue during the year ended December 31, 2011.

(ii) 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 manages its liquidity through continuously monitoring cash flows from operating activities, review of the actual capital expenditure program, managing maturity profiles of financial assets and financial liabilities, maintaining a revolving credit facility with sufficient capacity, and managing its commodity price risk management program. These activities ensure that the Company has sufficient funds to meet its financial obligations when due.

The timing of cash flows relating to financial liabilities as at December 31, 2011 is as follows:

|  | <b>Total</b>     | 1<br>year | 2 to 3<br>years | 4 to 5<br>years | Beyond<br>5 years |
|--|------------------|-----------|-----------------|-----------------|-------------------|
| Accounts payable and accrued liabilities | <b>\$ 67,710</b> | \$67,710  | \$ -            | \$-             | \$-               |
| Long-term debt                           | <b>289,431</b>   | -         | 289,431         | -               | -                 |
| Compensation liabilities                 | <b>300</b>       | -         | 300             | -               | -                 |
| <b>Total financial liabilities</b>       | <b>\$357,441</b> | \$67,710  | \$289,731       | \$-             | \$-               |

(iii) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in commodity price risk, currency risk, and interest rate risk. The Company is engaged in oil and gas exploration, development and production activities in Canada and as a result has significant exposure to commodity price risk. The Company has adopted a disciplined commodity price risk management program as part of its overall financial management strategy. The Board of Directors has a commodity price risk management limit of up to a maximum of 60% of forecast production volumes, net of royalties. The Company considers all of these transactions to be economic hedges but does not designate them as hedges for accounting purposes.

(a) Commodity price risk

Commodity price risk is the risk that the fair value of financial instruments will fluctuate as a result of changes in commodity prices. The Company manages the risks associated with changes in commodity prices through the use of various financial derivative and physical delivery sales contracts. The financial derivative contracts are considered financial instruments but the physical delivery sales contracts are excluded from the definition of financial instruments as discussed in note 3(m)(ii). The Company uses financial instruments and physical delivery sales contracts to manage oil and natural gas commodity price risk.

(b) Currency risk

Currency risk is the risk that the fair value of a financial instrument will fluctuate as a result of changes in foreign exchange rates. The Company's financial instruments are only indirectly exposed to currency risk as the underlying commodity prices in Canada for oil and natural gas are impacted by changes in exchange rate between the Canadian and United States dollars.

(c) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows will fluctuate because of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank loan which bears a floating rate of interest. The Company had no interest rate swap or financial contracts in place as at or during the year ended December 31, 2011.

(d) Financial instrument sensitivities

The following table summarizes the annualized sensitivities of the Company's earnings to changes in the fair value of financial instruments outstanding at December 31, 2011, resulting in changes from the specified variable, with all other variables held constant. Changes in the fair value generally cannot be extrapolated because the relationship of a change in an assumption to the change in fair value may not be linear.

| Impact on earnings                     | 2011      |
|--|-----------|
| <b>Commodity price risk</b>            |           |
| Increase in Cdn\$ WTI – oil \$10/Bbl   | \$(5,500) |
| Decrease in Cdn\$ WTI – oil \$10/Bbl   | 5,626     |
| Increase in Cdn\$ AECO – gas \$0.50/GJ | (3,732)   |
| Decrease in Cdn\$ AECO – gas \$0.50/GJ | 3,849     |
| <b>Interest rate risk</b>              |           |
| Increase in interest rate – 1%         | \$(3,349) |
| Decrease in interest rate – 1%         | \$3,349   |

## 17. Significant subsidiaries

The Company has the following significant wholly owned subsidiaries, all of which are incorporated in Canada:

| Name of company                 | Percentage | Country of operation |
|---------------------------------|------------|----------------------|
| NuVista Resources Ltd.          | 100%       | Canada               |
| NuVista Partnership             | 100%       | Canada               |
| NuVista Resources Partnership   | 100%       | Canada               |
| NuVista 2009 Energy Partnership | 100%       | Canada               |
| 1364364 Alberta Ltd.            | 100%       | Canada               |

## 18. Commitments

The following is a summary of the Company's contractual obligations and commitments as at December 31, 2011:

|                               | Total            | 2012           | 2013             | 2014            | 2015           | 2016           | Thereafter     |
|-------------------------------|------------------|----------------|------------------|-----------------|----------------|----------------|----------------|
| Transportation                | \$ 8,877         | \$3,002        | \$ 2,429         | \$ 2,039        | \$1,190        | \$ 188         | \$ 29          |
| Office lease                  | 15,211           | 3,070          | 2,497            | 2,496           | 2,491          | 2,540          | 2,117          |
| Purchase contracts            | 277              | 277            | -                | -               | -              | -              | -              |
| Physical power                | 4,600            | 2,300          | 2,300            | -               | -              | -              | -              |
| Long-term debt <sup>(1)</sup> | 289,431          | -              | 289,431          | -               | -              | -              | -              |
| <b>Total commitments</b>      | <b>\$318,396</b> | <b>\$8,649</b> | <b>\$296,657</b> | <b>\$ 4,535</b> | <b>\$3,681</b> | <b>\$2,728</b> | <b>\$2,146</b> |

<sup>(1)</sup> Based on the new credit facility agreement entered into in May 2011 and renewed in November 2011, no principal payments would be required until April 29, 2013.

## 19. Presentation of expenses

The Company's consolidated statement of earnings (loss) and comprehensive income (loss) is prepared primarily by nature of expense, with the exception of employee compensation costs which are included in both operating capitalized in property, plant and equipment and general and administrative expenses.

## 20. Explanation of transition to IFRS

For all periods up to and including the year ended December 31, 2010, the Company prepared its consolidated financial statements in accordance with Previous GAAP. These consolidated financial statements, as at and for the year ended December 31, 2011, are required to be prepared in accordance with IFRS.

Accordingly, the Company has prepared consolidated financial statements which comply with IFRS applicable for periods beginning on or after January 1, 2011 and the significant accounting policies adopted are shown in note 3. In preparing these consolidated financial statements, the Company has started from an opening statement of financial position date of January 1, 2010, the Company's date of transition to IFRS, and made those changes in accounting policies and other restatements required by IFRS 1 for the first time adoption of IFRS. This note explains the adjustments made by the Company in restating its Previous GAAP consolidated statement of financial position as at January 1, 2010 and its Previous GAAP consolidated financial statements for the year ended December 31, 2010.

IFRS 1, "First-Time Adoption of International Financial Reporting Standards" allows first-time adopters certain exemptions from retrospective application of certain IFRS. The Company has applied the following exemptions:

(i) Oil and gas deemed cost exemption for full cost companies

Certain oil and gas assets in property, plant and equipment on the consolidated statement of financial position were recognized and measured on a full cost basis in accordance with Previous GAAP using the IFRS 1 exemption. The Company has elected to measure its properties at the amount determined under Previous GAAP as at January 1, 2010. Costs included in the full cost pool on January 1, 2010 were allocated on a pro-rata basis to the underlying assets on the basis of proved and probable reserve values as at January 1, 2010. Exploration and evaluation assets were valued at the amount that was recorded under Previous GAAP. Associated asset retirement costs were also measured at their carrying value under Previous GAAP while all asset retirement obligations were measured using a risk free rate, with a corresponding adjustment to opening retained earnings.

(ii) Business combinations

A first-time adopter may elect not to apply IFRS 3, "Business Combinations" retrospectively to past business combinations before the date of transition to IFRS. The Company has elected to take this exemption and as a result, IFRS 3 has not been applied to business combinations that occurred before January 1, 2010.

(iii) Share-based payments

IFRS 2, "Share-based Payments" has not been applied to equity instruments related to share-based compensation arrangements that were granted on or before November 7, 2002, nor has it been applied to equity instruments granted after November 7, 2002 that vested before January 1, 2010. For cash-settled share-based payment transactions, the Company has not applied IFRS 2 to liabilities that were settled before January 1, 2010.

(iv) Borrowing costs

Contained within IFRS 1 is an exemption to not apply IAS 23, "Borrowing Costs" retrospectively, but to allow first-time adopters to elect to capitalize borrowing costs relating to all qualifying assets on or after a designated effective date. The Company has designated the effective date to be January 1, 2010, the date of transition to IFRS. There was no impact pursuant to the application of this exemption.

Reconciliation of equity from Previous GAAP to IFRS at the date of transition to IFRS – January 1, 2010:

| (\$Cdn thousands)                                 | Previous<br>GAAP   | Effect of<br>transition to<br>IFRS | IFRS               |
|---|--------------------|------------------------------------|--------------------|
| <b>Assets</b>                                     |                    |                                    |                    |
| Current assets                                    |                    |                                    |                    |
| Cash and cash equivalents                         | \$ -               | \$ -                               | \$ -               |
| Accounts receivable and prepaids                  | 69,238             | -                                  | 69,238             |
| Deferred tax assets (i)                           | 1,336              | (1,336)                            | -                  |
|   | 70,574             | (1,336)                            | 69,238             |
| Exploration and evaluation assets (a)             | -                  | 128,175                            | 128,175            |
| Property, plant and equipment (a)                 | 1,401,453          | (128,175)                          | 1,273,278          |
| Goodwill (e)                                      | 83,716             | (19,385)                           | 64,331             |
| <b>Total assets</b>                               | <b>\$1,555,743</b> | <b>\$(20,721)</b>                  | <b>\$1,535,022</b> |
| <b>Liabilities</b>                                |                    |                                    |                    |
| Current liabilities                               |                    |                                    |                    |
| Accounts payable and accrued liabilities (c)      | \$ 52,362          | \$ (4)                             | \$ 52,358          |
| Commodity derivative liabilities                  | 2,593              | -                                  | 2,593              |
|   | 54,955             | (4)                                | 54,951             |
| Long-term debt                                    | 384,623            | -                                  | 384,623            |
| Compensation liabilities (c)                      | 604                | (88)                               | 516                |
| Asset retirement obligations (b)                  | 61,816             | 56,996                             | 118,812            |
| Deferred tax liabilities (a,b,c,h,i)              | 134,052            | (16,112)                           | 117,940            |
|   | 636,050            | 40,792                             | 676,842            |
| <b>Shareholders' equity</b>                       |                    |                                    |                    |
| Share capital                                     | 685,269            | -                                  | 685,269            |
| Contributed surplus                               | 18,690             | -                                  | 18,690             |
| Retained earnings (a,b,c,e)                       | 215,734            | (61,513)                           | 154,221            |
|   | 919,693            | (61,513)                           | 858,180            |
| <b>Total liabilities and shareholders' equity</b> | <b>\$1,555,743</b> | <b>\$(20,721)</b>                  | <b>\$1,535,022</b> |

Reconciliation of equity as at December 31, 2010:

| (\$Cdn thousands)                                 | Previous<br>GAAP   | Effect of<br>transition to<br>IFRS | IFRS               |
|---|--------------------|------------------------------------|--------------------|
| <b>Assets</b>                                     |                    |                                    |                    |
| Current assets                                    |                    |                                    |                    |
| Cash and cash equivalents                         | \$ -               | \$ -                               | \$ -               |
| Accounts receivable and prepaids                  | 55,144             | -                                  | 55,144             |
| Deferred tax assets (i)                           | 593                | (593)                              | -                  |
|   | 55,737             | (593)                              | 55,144             |
| Exploration and evaluation assets (a,c,f,g)       | -                  | 141,852                            | 141,852            |
| Property, plant and equipment (a,b,d,e)           | 1,457,615          | (155,366)                          | 1,302,249          |
| Goodwill (e)                                      | 83,716             | (49,137)                           | 34,579             |
| <b>Total assets</b>                               | <b>\$1,597,068</b> | <b>\$ (63,244)</b>                 | <b>\$1,533,824</b> |
| <b>Liabilities</b>                                |                    |                                    |                    |
| Current liabilities                               |                    |                                    |                    |
| Accounts payable and accrued liabilities (c)      | \$ 56,233          | \$ (50)                            | \$ 56,183          |
| Dividends payable                                 | 4,438              | -                                  | 4,438              |
| Commodity derivative liabilities                  | 1,256              | -                                  | 1,256              |
|   | 61,927             | (50)                               | 61,877             |
| Long-term debt                                    | 438,566            | -                                  | 438,566            |
| Compensation liabilities (c)                      | 705                | (86)                               | 619                |
| Commodity derivative liabilities                  | 4,084              | -                                  | 4,084              |
| Asset retirement obligations (b)                  | 62,673             | 65,586                             | 128,259            |
| Deferred tax liabilities (h,i)                    | 128,782            | (21,515)                           | 107,267            |
|   | 696,737            | 43,935                             | 740,672            |
| <b>Shareholders' equity</b>                       |                    |                                    |                    |
| Share capital                                     | 689,757            | -                                  | 689,757            |
| Contributed surplus                               | 26,552             | -                                  | 26,552             |
| Retained earnings (b,c,d,e,f,g,h)                 | 184,022            | (107,179)                          | 76,843             |
|   | 900,331            | (107,179)                          | 793,152            |
| <b>Total liabilities and shareholders' equity</b> | <b>\$1,597,068</b> | <b>\$ (63,244)</b>                 | <b>\$1,533,824</b> |

Reconciliation of consolidated statement of net loss and comprehensive loss for the year ended December 31, 2010:

| (\$Cdn thousands)  | Previous<br>GAAP   | Effect of<br>transition to<br>IFRS | IFRS              |
|--|--------------------|------------------------------------|-------------------|
| <b>Revenues</b>  |                    |                                    |                   |
| Oil and natural gas  | \$ 373,327         | \$ -                               | \$373,327         |
| Royalties  | (57,347)           | -                                  | (57,347)          |
|  | 315,980            | -                                  | 315,980           |
| Realized loss on commodity derivatives                     | (5,239)            | -                                  | (5,239)           |
| Unrealized loss on commodity derivatives                   | (2,747)            | -                                  | (2,747)           |
|  | 307,994            | -                                  | 307,994           |
| <b>Expenses</b>  |                    |                                    |                   |
| Operating  | 94,237             | -                                  | 94,237            |
| Transportation   | 8,588              | -                                  | 8,588             |
| General and administrative                                 | 19,173             | -                                  | 19,173            |
| Share-based compensation (c)                               | 7,629              | (34)                               | 7,595             |
| Depletion, depreciation, amortization and impairment (d,e) | 179,739            | 5,044                              | 184,783           |
| Goodwill impairments (e)                                   | -                  | 29,752                             | 29,752            |
| Exploration and evaluation (f)                             | -                  | 16,898                             | 16,898            |
| Gain on property dispositions (g)                          | -                  | (5,070)                            | (5,070)           |
| Interest   | 17,713             | -                                  | 17,713            |
| Accretion (b)  | -                  | 4,639                              | 4,639             |
|  | 327,079            | 51,229                             | 378,308           |
| <b>Loss before taxes</b>                                   | (19,085)           | (51,229)                           | (70,314)          |
| Deferred income tax reduction (h)                          | (5,096)            | (5,563)                            | (10,659)          |
| <b>Net loss and comprehensive loss</b>                     | <b>\$ (13,989)</b> | <b>\$(45,666)</b>                  | <b>\$(59,655)</b> |
| <b>Loss per share</b>                                      |                    |                                    |                   |
| Basic  | \$ (0.16)          |                                    | \$ (0.67)         |
| Diluted  | \$ (0.16)          |                                    | \$ (0.67)         |

## Notes to reconciliations

The following conventions are used in the reconciling tables below: asset, liability, equity and expense accounts: increase (decrease).

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

The deemed cost election within IFRS 1 allows entities using the full cost method of accounting under Previous GAAP to elect that the deemed costs of their oil and gas assets be based on historical carrying values determined under their Previous GAAP. The Company has applied this exemption upon transition to IFRS as follows:

- (i) Exploration and evaluation assets were valued at the amount that was recorded under Previous GAAP; and
- (ii) Oil and gas development and production assets within property, plant and equipment were determined by allocating the net book value under Previous GAAP pro rata using proved and probable reserve values.

The following amount was reclassified to exploration and evaluation assets from property, plant and equipment:

| As at                             | December 31,<br>2010 | January 1,<br>2010 |
|-----------------------------------|----------------------|--------------------|
| Exploration and evaluation assets | 141,852              | 128,175            |
| Property, plant and equipment     | (141,852)            | (128,175)          |

### (b) Asset retirement obligations

Under IFRS, a provision is recognized when a company has a legal or constructive obligation for asset retirement costs. The liability is required to be revalued at each reporting period using a current liability specific discount rate that reflects the time value of money. The unwinding of discount due to the passage of time is reflected as an accretion expense in net earnings. Under Previous GAAP, a liability was recognized when a legal obligation existed. The obligations were discounted at a credit adjusted risk free rate.

As a result of applying the IFRS 1 election for full cost oil and gas entities, any adjustments to the asset retirement obligations at the date of transition are recognized directly in retained earnings. Subsequent adjustments to the obligation are made to the carrying amount of the asset retirement costs in property, plant and equipment.

| For the year ended            | December 31,<br>2010 | January 1,<br>2010 |
|-------------------------------|----------------------|--------------------|
| Property, plant and equipment | 8,596                | -                  |
| Asset retirement obligations  | 8,590                | 56,996             |
| Deferred tax liabilities      | -                    | (14,800)           |
| Retained earnings             | 6                    | (42,196)           |
| Accretion expense             | (6)                  | -                  |

### (c) Share-based payments

Under Previous GAAP, the Company recognized an expense related to share-based payments using the graded-vesting method where each tranche of an award with different vesting dates was considered a separate grant for the calculation of fair value, and the resulting fair value was amortized over the vesting period of the respective tranches. This methodology is consistent with IFRS. IFRS also requires that forfeiture estimates be recognized on the grant date and revised for actual experiences in subsequent periods. Under Previous GAAP, RSU forfeitures of awards were recognized as they occurred. The Company has incorporated an estimated forfeiture rate for RSU awards at the date of grant to comply with



IFRS requirements.

|  | December 31,<br>2010 | January 1,<br>2010 |
|--|----------------------|--------------------|
| For the year ended                       |                      |                    |
| Exploration and evaluation assets        | (10)                 | -                  |
| Accounts payable and accrued liabilities | (46)                 | (4)                |
| Compensation liabilities                 | 2                    | (88)               |
| Deferred taxes                           | -                    | 24                 |
| Retained earnings                        | 34                   | 68                 |
| Share-based compensation                 | (34)                 | -                  |

(d) Depletion, depreciation and amortization

Upon transition to IFRS, the Company adopted a policy of depleting oil and natural gas assets on a unit-of-production method on an area-by-area basis over proved and probable reserves. The depletion policy under Previous GAAP was based on a unit-of-production basis over proved reserves. In addition depletion was calculated under one cost centre under Previous GAAP. There was also a difference in accounting for depreciation. Under IFRS, the Company capitalized the cost of work-overs and major plant turnarounds and overhauls and depreciates these costs over their useful lives of two years and five years, respectively. Under Previous GAAP, the costs of work-overs were depleted in the full cost pool and costs for plant turnarounds were depreciated at a rate of 20% per year.

|  | December 31,<br>2010 | January 1,<br>2010 |
|--|----------------------|--------------------|
| For the year ended                                   |                      |                    |
| Property, plant and equipment                        | 18,745               | -                  |
| Retained earnings                                    | 18,745               | -                  |
| Depletion, depreciation, amortization and impairment | (18,745)             | -                  |

(e) Impairments

Under IFRS, an impairment loss is recognized when the carrying value exceeds the recoverable amount, determined to be the higher of fair value less costs to sell or value in use, on a CGU level. Impairments recognized under IFRS are reversed when there has been a subsequent increase in the recoverable amount. The impairment reversal is increased to its revised recoverable amount, net of any depletion that would have been charged as if no impairment loss had been recognized. Under Previous GAAP an impairment test was calculated under one cost center by comparing the asset's estimated undiscounted future cash flows to the carrying amount. If impairment was indicated, then the discounted cash flows were prepared to quantify the amount of impairment. No impairment loss was recognized under Previous GAAP at December 31, 2010. The following table summarizes the impairment loss calculated under IFRS using fair value less costs to sell valuation based on a discounted cash flow:

|  | December 31,<br>2010 | January 1,<br>2010 |
|--|----------------------|--------------------|
| For the year ended                                   |                      |                    |
| Property, plant and equipment                        | (23,789)             | -                  |
| Goodwill   | (29,752)             | (19,385)           |
| Retained earnings                                    | (53,541)             | (19,385)           |
| Depletion, depreciation, amortization and impairment | 23,789               | -                  |
| Goodwill impairments                                 | 29,752               | -                  |

(f) Exploration and evaluation expenditures

Under IFRS, there is a separate line item in net earnings for exploration and evaluation expenditures. The Company's policy is to expense undeveloped land where the lease term has expired. Under Previous GAAP, this balance remained capitalized in property, plant and equipment. The Company recorded exploration and evaluation expenditures related to land expiries as follows:

| For the year ended                      | December 31,<br>2010 | January 1,<br>2010 |
|---|----------------------|--------------------|
| Exploration and evaluation assets       | (16,898)             | -                  |
| Retained earnings                       | (16,898)             | -                  |
| Exploration and evaluation expenditures | 16,898               | -                  |

(g) Gains and losses on disposal

Under IFRS, gains and losses are recorded on disposals of assets and are calculated as the difference between the proceeds and the net book value of the asset disposed. Under Previous GAAP, proceeds from divestitures were deducted from the full cost pool without recognition of a gain or loss unless the deduction resulted in a change in the depletion rate of 20 percent or greater, in which case a gain or loss was recorded. For the year ended December 31, 2010, the Company recognized a \$5.1 million gain on disposal under IFRS.

(h) Income taxes

Deferred income taxes have been adjusted to reflect the tax effect arising from the differences between IFRS and Previous GAAP. The impact of deferred income tax expense and a corresponding increase to the Company's Previous GAAP net earnings are as follows:

| For the year ended           | December 31,<br>2010 | January 1,<br>2010 |
|------------------------------|----------------------|--------------------|
| Deferred tax liabilities     | (5,563)              | (14,800)           |
| Retained earnings            | 5,563                | 14,800             |
| Deferred income tax expenses | (5,563)              | -                  |

(i) Reclassification of current portion of deferred income taxes

Under IFRS, deferred income tax balances are classified as long-term, irrespective of the classification of the assets or liabilities to which the deferred income tax relates or the expected timing of reversal. Under Previous GAAP, deferred income tax relating to current assets or current liabilities must be classified as current. Accordingly, current deferred income tax assets reported under Previous GAAP have been reclassified as non-current under IFRS as follows:

| As at                            | December 31,<br>2010 | January 1,<br>2010 |
|----------------------------------|----------------------|--------------------|
| Current deferred tax assets      | (593)                | (1,336)            |
| Current deferred tax liabilities | -                    | -                  |
| Deferred tax liabilities         | (593)                | (1,336)            |

(j) Cash flows

The transition from Previous GAAP to IFRS had no significant effect on the reported cash flows generated by the Company.