Management's Responsibility for Financial Information

The accompanying financial statements and all information in the MD&A have been prepared by management and approved by the Board of Directors of Cequence Energy. The financial statements have been prepared in accordance with International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgments. Management is responsible for the accuracy, integrity and objectivity of the financial statements within reasonable limits of materiality and for the consistency of financial data included in the text of the MD&A with that in the financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls designed to provide reasonable assurance that accounting records are reliable, transactions are properly authorized and assets are safeguarded from loss or unauthorized use. The Audit Committee is appointed by the Board of Directors, with all of its members being independent directors. The Audit Committee meets with management, as well as with the external auditors, to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the financial statements and the auditor's report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the financial statements for presentation to the shareholders. The external auditors have direct access to the Audit Committee of the Board of Directors.

The financial statements have been audited independently by Deloitte LLP on behalf of the Company in accordance with generally accepted auditing standards. Their report outlines the nature of their audits and expresses their opinion on the financial statements.

"signed"
Paul Wanklyn
President and Chief Executive Officer
March 7, 2013

"signed"
Dave Gillis
Chief Financial Officer

Independent Auditor's Report

To the Shareholders of Cequence Energy Ltd.

We have audited the accompanying consolidated financial statements of Cequence Energy Ltd., which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011, and the consolidated statements of comprehensive loss, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's 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 the auditor's 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, the auditor considers 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 financial position of Cequence Energy Ltd. as at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Deloitte LLP

Chartered Accountants

March 7, 2013

Calgary, Canada

Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

	December 31, 2012	December 31, 2011
	$	$
ASSETS		
CURRENT		
Cash	–	380
Accounts receivable (Note 6)	**16,084**	21,032
Deposits and prepaid expenses (Note 18)	**3,428**	3,231
Commodity contracts (Note 19)	**694**	–
	20,206	24,643
Exploration and evaluation assets (Note 4)	**13,829**	6,221
Property and equipment (Note 4)	**439,059**	409,729
Deposits and prepaid expenses (Note 18)	**1,901**	2,456
Commodity contracts (Note 19)	**63**	–
Deferred income taxes (Note 14)	**44,266**	48,316
	519,324	491,365
LIABILITIES		
CURRENT		
Demand credit facilities (Note 5)	**23,191**	11,618
Accounts payable and accrued liabilities (Note 7)	**42,190**	64,467
Other liabilities (Note 8)	**4,459**	5,289
	69,840	81,374
Provisions (Note 13)	**33,059**	28,942
	102,899	110,316
CONTINGENCIES AND COMMITMENTS (Note 18)		
SUBSEQUENT EVENT (Note 23)		
SHAREHOLDERS' EQUITY		
Share capital (Note 15)	**606,703**	559,371
Contributed surplus	**22,556**	16,839
Deficit	**(212,834)**	(195,161)
	416,425	381,049
	519,324	491,365

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

APPROVED BY THE BOARD

"signed"
Donald Archibald, Director

"signed"
Brian Felesky, Director

Consolidated Statements of Comprehensive Loss

(Expressed in thousands of Canadian dollars except per share amounts)

	Year ended December 31, 2012	2011
	$	$
REVENUE		
Production revenue (Note 9)	**71,049**	87,347
Gain on derivative financial instruments (Note 19)	**596**	906
	71,645	88,253
EXPENSES		
Depletion, depreciation and impairment (Note 4)	**66,458**	59,560
General and administrative (Note 12)	**7,105**	7,325
Finance costs (Note 11)	**2,725**	3,276
Operating costs	**24,440**	29,673
Share based payment (Note 16)	**5,717**	6,758
Transportation	**6,702**	7,153
Other income (Note 10)	**(23,794)**	(4,013)
	89,353	109,732
LOSS BEFORE INCOME TAXES	**(17,708)**	(21,479)
INCOME TAXES (Note 14)	**(35)**	(1,321)
NET LOSS AND COMPREHENSIVE LOSS	**(17,673)**	(20,158)
Loss per share, basic and diluted (Note 17)	**$ (0.10)**	$ (0.14)

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

Consolidated Statements of Changes in Equity

(Expressed in thousands of Canadian dollars)

	Year ended December 31,	
	2012	2011
	$	$
SHARE CAPITAL		
Common Shares (Note 15)		
Balance, beginning of year	**559,371**	452,526
Proceeds from shares issued in public offerings	**39,514**	98,338
Proceeds from shares issued in private placements	**10,438**	2,649
Shares issued on exercise of stock options	**–**	1,794
Shares issued on exercise of the 2011 Warrants	**–**	8,663
Share issue costs, net of tax of $874 (2011 – $1,531)	**(2,620)**	(4,599)
Balance, end of year	**606,703**	559,371
CONTRIBUTED SURPLUS		
Balance, beginning of year	**16,839**	10,681
Share based payment expense (Note 16)	**5,717**	6,758
Exercise of stock options (Note 15)	**–**	(600)
Balance, end of year	**22,556**	16,839
DEFICIT		
Balance, beginning of year	**(195,161)**	(175,003)
Comprehensive loss	**(17,673)**	(20,158)
Balance, end of year	**(212,834)**	(195,161)
TOTAL EQUITY	**416,425**	381,049

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

Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars)

	Year ended December 31, 2012	2011
	$	$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net loss	**(17,673)**	(20,158)
Adjustments for non-cash items:		
Depletion, depreciation and impairment	**66,458**	59,560
Finance costs related to provisions (Note 11)	**725**	905
Share based payments (Note 16)	**5,717**	6,758
Amortization of transaction costs on financial instruments (Note 11)	**–**	443
Unrealized gain on derivative financial instruments (Note 19)	**(757)**	–
Costs related to onerous contracts (Note 13)	**(321)**	1,138
Gain on sale of assets (Note 4)	**(20,390)**	(5,077)
Deferred income tax recovery (Note 14)	**(35)**	(1,307)
Decommissioning liabilities expenditures (Note 13)	**(904)**	(955)
Net change in non-cash working capital (Note 20)	**4,950**	(4,607)
	37,770	36,700
INVESTING		
Property and equipment and exploration and evaluation assets expenditures	**(91,658)**	(149,601)
Acquisitions	**(7,404)**	(22,150)
Proceeds from sale of assets	**20,662**	45,173
Net change in non-cash working capital (Note 20)	**(22,186)**	24,976
	(100,586)	(101,602)
FINANCING		
Proceeds from demand credit facilities (Note 5)	**41,521**	46,305
Repayment of demand credit facilities (Note 5)	**(29,948)**	(91,812)
Transaction costs on demand credit facilities (Note 5)	**–**	(57)
Issue of common shares (Note 15)	**54,092**	115,597
Share issue costs (Note 15)	**(3,494)**	(6,130)
Net change in non-cash working capital (Note 20)	**265**	58
	62,436	63,961
NET DECREASE IN CASH	**(380)**	(941)
CASH, BEGINNING OF YEAR	**380**	1,321
CASH, END OF YEAR	**–**	380
SUPPLEMENTARY INFORMATION		
Income taxes paid	**–**	14
Interest paid	**2,061**	1,852

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

Notes to the Consolidated Financial Statements

Year ended December 31, 2012 with 2011 comparatives
(All figures expressed in thousands except per share amounts unless otherwise noted)

1. Nature and Description of the Company

Cequence Energy Ltd. (the "Company" or "Cequence") is incorporated under the laws of Alberta with common shares that are widely held and listed on the Toronto Stock Exchange. Cequence is engaged in the acquisition, exploration and production of petroleum and natural gas reserves in Western Canada. The registered office of the Company is located at Suite 3100, 525 – 8th Ave. SW, Calgary, Alberta, T2P 1G1.

These consolidated financial statements ("consolidated financial statements") include all assets, liabilities, revenues and expenses of Cequence and its wholly-owned subsidiary, 1175043 Alberta Ltd. Effective January 1, 2011, Cequence Acquisitions Ltd., a wholly-owned subsidiary of the Company, was amalgamated with Cequence and the combined entity was continued as Cequence Energy Ltd.

2. Significant Accounting Policies

Statement of compliance and authorization

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by the Company's Board of Directors on March 7, 2013.

Basis of presentation

The consolidated financial statements have been prepared using historical costs, except for financial instruments carried at fair value, on a going concern basis and have been presented in Canadian dollars, which is also the Company's functional currency. The accounting policies set out below have been applied consistently in all material respects.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its consolidated subsidiaries, which are the entities over which the Company has control. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefit from its activities. All intercompany transactions and balances are eliminated on consolidation.

Business combinations

The acquisition method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Acquisition-related costs are recognized in comprehensive income (loss) as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable assets and liabilities acquired and contingent liabilities for which a provision is provided is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized as a bargain purchase gain in comprehensive income (loss). Results of subsidiaries are included in the consolidated statement of comprehensive income (loss) from the closing date of acquisition.

Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets and financial liabilities are recognized on the consolidated balance sheet at the time the Company becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument.

The Company has made the following classifications:

- Cash is classified as a financial asset recorded at fair value through profit or loss and is carried at fair value. Gains and losses from revaluation are recognized in comprehensive income (loss).
- Accounts receivable are classified as loans and receivables and are initially measured at fair value plus directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Demand credit facilities, accounts payable and accrued liabilities are classified as other liabilities and are initially measured at fair value less directly attributable transaction costs. Subsequently, they are recorded at amortized cost using the effective interest method.
- Derivative instruments, including embedded derivative instruments, that do not qualify as hedges, or are not designated as hedges for accounting purposes, including commodity contracts, are classified as fair value through profit or loss and are recorded and carried at fair value with changes in fair value recognized in comprehensive income (loss). Derivative instruments are used by the Company to manage economic exposure to market risks relating to commodity prices. Cequence's policy is to not utilize derivative financial instruments for speculative purposes.

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

Contracts that are entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the Company's expected purchase, sale or usage requirements (such as physical delivery commodity contracts) do not qualify as financial instruments and thus, are accounted for in accordance with other applicable standards and are not recorded as assets or liabilities.

IFRS establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described below:

Level 1: Values based on quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measure in its entirety.

Impairment of financial assets

Financial assets, other than those classified as fair value through profit or loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been negatively affected.

For financial assets carried at amortized cost, the amount of the impairment loss recognized in comprehensive income (loss) is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are recognized in comprehensive income (loss). Changes in the carrying amount of the allowance accounts are recognized in comprehensive income (loss).

Property and equipment and exploration and evaluation assets

Recognition and measurement

Exploration and evaluation expenditures

Pre-license costs, geological and geophysical costs are recognized in comprehensive income (loss) as incurred.

Exploration and evaluation ("E&E") costs, including the costs of acquiring licenses, drilling exploratory wells and other directly attributable costs, are initially capitalized as E&E assets to the extent that they do not relate to a field with proven reserves attributed. The costs are accumulated in cost centers by field or exploration area pending determination of technical feasibility and commercial viability.

The Company enters into E&E farm-in arrangements to fund a portion of the partner's (farmor's) exploration and/or future development expenditures ("carried interests"). These expenditures are reflected in the consolidated financial statements when the exploration and development work progresses. For E&E farm-out arrangements where the farmee correspondingly undertakes to fund carried interests as part of the consideration no gain or loss is recognized by the Company.

E&E assets are assessed for impairment if sufficient data exists to determine technical feasibility and commercial viability, or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist and are capable of economic production. A review of each exploration field is carried out, at least annually, to ascertain whether proven reserves have been discovered that are capable of economic production. Upon determination of proven reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to development and production assets included in property and equipment.

Development and production costs

Items of property and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses, net of any reversals.

Development and production assets are grouped into Cash Generating Units ("CGUs") for impairment testing. CGUs are defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Company evaluates the geography, geology, production profile and infrastructure of its assets in determining its CGUs. Based on this assessment, Cequence's CGUs are generally composed of significant development areas. The Company reviews the composition of its CGUs at each reporting date to assess whether any changes are required in light of new facts and circumstances.

When significant parts of an item of property and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the related property and equipment and are recognized net within "other expense (income)".

Subsequent costs

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

Depletion and depreciation

The net carrying value of development and production assets plus future development costs on proved plus probable reserves is depleted using the unit of production method based on proved and probable reserves, gross of royalties, as determined by independent engineers, on an area by area basis. For the purpose of this calculation, production and reserves of petroleum and natural gas are converted to a common unit of measurement on the basis of their relative energy content, where six thousand cubic feet of natural gas equates to one barrel of oil. Costs are only depleted once production in a given area begins.

Cequence depletes separately, where applicable, any significant components within development and production assets, such as fields, processing facilities and pipelines, which are significant in relation to the total cost of a development and production asset and have a different useful life than such assets.

Other property and equipment and other intangible assets are amortized over 3 to 5 years on a straight line basis.

Impairment

The carrying amounts of all assets, other than financial assets and deferred tax assets, are reviewed at each reporting date to determine whether there is indication of an impairment loss. If any such indication exists, the asset's recoverable amount is estimated.

For any asset that does not generate largely independent cash flows, the recoverable amount is determined for the CGU to which the asset belongs. If the carrying amount of an asset (or CGU) exceeds its recoverable amount, the asset (or CGU) is written down.

The recoverability of the carrying amount of an E&E asset is dependent on successful development and commercial exploitation, or alternatively, sale of the respective area of interest. Where a potential impairment is indicated, an assessment is performed for each field or area to which the E&E expenditure is attributed. To the extent that capitalized expenditures are not expected to be recovered, the excess of the carrying amount over the recoverable amount is recognized immediately in comprehensive income (loss).

The recoverable amount of a development and production asset (or CGU) or other intangible asset (or CGU) is determined as the higher of its value in use and fair value less cost to sell. Value in use is determined by estimating future cash flows after taking into account the risks specific to the asset (or group of assets within a CGU) and discounting them to their present value using a pre-tax discount rate that reflects the current market assessment of the time value of money. In determining fair value less cost to sell, an appropriate valuation model is used. These calculations are corroborated by external valuation metrics or other available fair value indicators wherever possible.

Where the carrying amount of a development and production asset (or CGU) or other intangible asset (or CGU) exceeds its recoverable amount, the excess is recognized immediately in comprehensive income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or depletion, if no impairment loss had been recognized.

Provisions

Provisions are recognized when the Company has a present obligation as a result of a past event that can be estimated with reasonable certainty and are measured at the amount that the Company would rationally pay to be relieved of the present obligation. To the extent that provisions are estimated using a present value technique, such amounts are determined by discounting the expected future cash flows at a risk-free pre-tax rate and adjusting the liability for the risks specific to the liability.

Decommissioning liabilities

The Company records the present value of the estimated cost of legal and constructive obligations to restore operating locations in the period in which the obligation arises. The nature of restoration activities includes the removal of facilities, abandonment of wells and restoration of affected areas. Provision is made for the estimated cost of restoration and capitalized in the relevant asset category.

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

Onerous contracts

Present obligations arising under onerous contracts are recognized and measured as provisions. An onerous contract is considered to exist where the Company has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received from the contract.

Jointly controlled assets

A significant portion of the Company's oil and natural gas activities involve jointly controlled assets and any related liabilities incurred. The consolidated financial statements include the Company's share of these jointly controlled assets and liabilities and a proportionate share of the relevant revenues and related costs, classified according to their nature.

Share based payments

The Company has a stock option plan and issues stock options to directors, officers, employees and other service providers. Compensation costs attributable to stock options granted are measured at fair value at the date of grant and are expensed over the vesting period, using a graded vesting schedule, with a corresponding increase in contributed surplus. When stock options are exercised, the cash proceeds together with the amount previously recorded as contributed surplus are recorded as share capital. The Company incorporates an estimated forfeiture rate for stock options that will not vest, and subsequently adjusts for actual forfeitures as they occur.

Revenue

Revenue from the sale of petroleum and natural gas is recognized when the risks and rewards of ownership of the product are transferred to the customer, based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded. Revenue is measured net of related royalties.

Revenue from interest income is recognized as it accrues, using the effective interest method.

Flow-through shares

The Company, from time to time, issues flow-through shares to finance a portion of its capital expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. The difference between the value ascribed to flow-through shares issued and the value that would have been received for common shares at the date of issuance of the flow-through shares is initially recognized as a liability on the consolidated balance sheet. When the expenditures are renounced and incurred, the liability is drawn down, a deferred income tax liability is recorded equal to the estimated amount of deferred income tax payable by the Company as a result of the renunciation, and the difference is recognized as income tax expense.

Earnings per share

Basic per share amounts are computed by dividing the net income (loss) by the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated giving effect to the potential dilution that would occur if stock options and warrants were exercised. The dilutive effect of stock options and warrants is calculated with the assumption that proceeds received from the exercise of options and warrants for which the exercise price is less than the market price plus the unamortized portion of share based payments are used to repurchase common shares at the average market price for the period.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable income for the year. Taxable income differs from income as reported in the consolidated statement of comprehensive income (loss) because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income. Deferred tax liabilities are generally recognized for all taxable temporary differences.

Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which such deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither taxable income nor the accounting income.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred tax are recognized as an expense or income in comprehensive income (loss), except when they relate to items that are recognized outside profit or loss (whether in other comprehensive income or directly in equity), in which case the tax is also recognized outside profit or loss, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is included in the accounting for the business combination.

Significant accounting judgments, estimates and assumptions

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amount of assets, liabilities, and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In particular, information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements are described in the following notes:

Note 4: Property and equipment and exploration and evaluation assets

Note 13: Provisions

Note 16: Share based payment plans

Note 18: Contingencies and commitments

Note 19: Financial instruments and risk management

Estimates of recoverable quantities of proved and probable reserves include assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of geological and geophysical models in order to make an assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact asset carrying values, the provision for decommissioning liabilities and the recognition of deferred tax assets, due to changes in expected future cash flows. Reserve estimates are prepared in accordance with the Canadian Oil and Gas Evaluation Handbook and are reviewed by third party reservoir engineers.

The amounts recorded for depletion and depreciation of property and equipment, the provision for decommissioning liabilities, and the valuation of property and equipment are based on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices, future costs and the remaining lives and period of future benefit of the related assets.

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

Costs associated with acquiring oil and natural gas licenses and exploratory drilling are accumulated as E&E assets pending determination of technical feasibility and commercial viability. Establishment of technical feasibility and commercial viability is subject to judgement which management has determined to be based on the allocation of commercial reserves to the exploration area. Upon determination of commercial reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to development and production assets included in property and equipment.

The amount recorded as decommissioning liabilities is based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, market conditions, discovery and analysis of site conditions and changes in technology.

The amounts recorded for deferred income tax assets and deferred tax expense (recovery) are based on estimates of the probability of the Company utilizing certain tax pools and assets which, in turn, is dependent on estimates of proved and probable reserves, production rates, future petroleum and natural gas prices, and changes in legislation, tax rates and interpretations by taxation authorities.

The fair value of derivative contracts is estimated, wherever possible, based on quoted market prices, and if not available, on estimates from third-party brokers. Another significant assumption used by the Company in determining the fair value of derivatives is market data or assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. The actual settlement of derivatives could differ materially from the value recorded and could impact future results.

The above judgments, estimates and assumptions relate primarily to unsettled transactions and events as of the date of the consolidated financial statements. Actual results could differ from these estimates and the differences could be material.

3. Future Accounting Pronouncements

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective.

As of January 1, 2015, the Company will be required to adopt IFRS 9, "Financial Instruments", which is the result of 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 assets and liabilities with a single model that has only two classification categories: amortized cost and fair value.

As of January 1, 2013, Cequence will be required to adopt the following standards and amendments, as issued by the IASB:

- IFRS 10, "Consolidated Financial Statements", which is the result of 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 establishes control as the single basis for determining the consolidation of an entity.
- IFRS 11, "Joint Arrangements", which is the result of the IASB's project to replace IAS 31, "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 be equity accounted. Under IAS 31, joint ventures could be proportionately accounted.
- IFRS 12, "Disclosure of Interests in Other Entities", 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", 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.

The Company is currently evaluating the impact of adoption of these standards and the effect on Cequence's consolidated financial statements has not yet been determined.

4. Property and Equipment and Exploration and Evaluation Assets

Cost:	Property and equipment	E&E assets	Total
Balance at December 31, 2010	420,368	–	420,368
Additions	144,918	6,221	151,139
Decommissioning obligation additions	7,651	–	7,651
Acquisitions	25,540	–	25,540
Disposals	(57,273)	–	(57,273)
Balance at December 31, 2011	541,204	6,221	547,425
Additions	**91,231**	**427**	**91,658**
Change in decommissioning obligation estimates	**4,720**	**–**	**4,720**
Acquisitions	**641**	**7,181**	**7,822**
Disposals	**(1,440)**	**–**	**(1,440)**
Balance at December 31, 2012	**636,356**	**13,829**	**650,185**

	Property and equipment	E&E assets	Total
Depletion, depreciation and impairment:			
Balance at December 31, 2010	(78,567)	–	(78,567)
Depletion and depreciation	(41,228)	–	(41,228)
Impairment loss	(18,332)	–	(18,332)
Disposals	6,652	–	6,652
Balance at December 31, 2011	(131,475)	–	(131,475)
Depletion and depreciation	**(39,564)**	**–**	**(39,564)**
Impairment loss	**(26,894)**	**–**	**(26,894)**
Disposals	**636**	**–**	**636**
Balance at December 31, 2012	**(197,297)**	**–**	**(197,297)**
Carrying amounts:			
At December 31, 2011	**409,729**	6,221	415,950
At December 31, 2012	**439,059**	**13,829**	**452,888**

Costs subject to depletion include $631,687 of estimated future capital costs (2011 – $426,485).

The Company's credit facilities are secured by a demand debenture with a first floating charge over all assets of the Company (see note 5).

E&E assets consist of the Company's exploration projects which are pending the determination of proven reserves that are capable of economic production. Costs consist primarily of undeveloped land and drilling costs until the drilling of the well is complete and proven reserves which are capable of economic production have been established.

Impairment

The Company reviewed each CGU comprising its property and equipment at December 31, 2012 for indicators of impairment and determined that indicators were present, related to decreases to future natural gas prices used to estimate the value in use and fair value less cost to sell of each of the Company's CGUs.

As a result, impairment tests were carried out at December 31, 2012. The recoverable amounts of each of the Company's CGUs at December 31, 2012 were estimated as their value in use, based on the net present value of discounted future cash flows from oil and gas reserves, as estimated by the Company's independent reserves evaluator. Consideration was also given to acquisition metrics of recent transactions completed on similar assets to those contained within the relevant CGU.

The benchmark escalated prices on which the December 31, 2012 impairment tests are based are as follows:

	Natural Gas AECO Spot	Condensate Edmonton Pentanes Plus	Crude Oil Edmonton Par
	($/mmbtu)	($/bbl)	($/bbl)
2013	3.38	96.63	85.00
2014	3.83	97.91	91.50
2015	4.28	97.76	94.00
2016	4.72	100.36	96.50
2017	4.95	100.36	96.50
2018	5.22	100.36	96.50
2019	5.32	101.44	97.54
2020	5.43	103.49	99.51
2021	5.54	105.58	101.52
2022	5.64	107.71	103.57

Prices increase at a rate of approximately 2.0 percent per year for natural gas, condensate and crude oil after 2022. Adjustments were made to the benchmark prices, for purposes of the impairment tests, to reflect varied delivery points and quality differentials in the products delivered.

Results of the Company's impairment tests at December 31, 2012 and 2011 are as follows:

	2012	2011
Northeast British Columbia	**14,931**	4,770
Peace River Arch	**11,963**	13,562
Deep Basin	**–**	–
Total	**26,894**	18,332

For the quarter ended December 31, 2012, a one percent increase in the discount rate applied to the Company's future estimated cash flows would result in an additional impairment of $1,057 (2011 – $4,220), whereas a ten percent decrease in forward benchmark natural gas prices would result in additional impairment of $5,484 (2011 – $21,838) recognized in comprehensive loss for the year ended December 31, 2012.

Sale of assets

During the year ended December 31, 2012, the Company completed the sales of certain undeveloped land and gas-weighted properties located in Northwest Alberta for total cash consideration of $20,662, subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $20,390.

During the year ended December 31, 2011, the Company completed sales of certain oil and gas properties in Alberta and British Columbia for total cash consideration of $43,482, subject to final adjustments. The sales resulted in a gain recognized in comprehensive loss of $5,077.

5. Demand Credit Facilities

The Company has two credit facilities with a syndicate of Canadian chartered banks. Credit facility A is a $90,000 (December 31, 2011 – $100,000) extendible revolving term credit facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and Libor Loans. Credit facility B is a $10,000 (December 31, 2011 – $10,000) operating facility by way of prime loans, U.S. Base Rate Loans, Banker's Acceptances and letters of credit. Prime loans and U.S. Base Rate Loans on these facilities bear interest at the bank prime rate or U.S. Base Rate, respectively, plus 1.0 percent to 2.5 percent on a sliding scale, depending on the Company's debt to adjusted EBITDA ratio (ranging from being less than or equal to 1.0:1.0 to greater than 2.5:1.0). Banker's Acceptances, Libor Loans and letters of credit on these facilities bear interest at the Banker's Acceptance rate, Libor rate or letter of credit rate, as applicable, plus 2.0 percent to 3.5 percent based on the same sliding scale as above. The credit facilities may be extended and revolve beyond the initial one-year period, if requested by the Company and accepted by the lenders. If the credit facilities do not continue to revolve, the facilities will convert to a 366-day non-revolving term loan facility.

Both credit facilities, and the amount available for draws under the facilities, are subject to periodic review by the bank and are secured by a general assignment of book debts and a $250,000 demand debenture with a first floating charge over all assets of the Company. The Company is permitted to hedge up to 67 percent of its production under the lending agreement. As at December 31, 2012, the Company has drawn $23,191 under the extendible revolving term credit facility and $nil under the operating facility (December 31, 2011 – $11,618 and $nil for the revolving and operating facilities, respectively) and is in compliance with all covenants. The effective interest rate, including standby fees and commitment fees, for the year ended December 31, 2012 was 4.41 percent (2011 – 5.40 percent). The next scheduled review is to take place in May 2013.

During the year ended December 31, 2012 the Company capitalized transaction costs related to its credit facilities of $nil (2011 – $57).

6. Accounts Receivable

	December 31, 2012	December 31, 2011
Trade receivables	**7,852**	13,015
Allowance for doubtful accounts	**(515)**	(551)
Net trade receivables	**7,337**	12,464
Accrued revenue	**7,627**	6,332
Other receivables	**1,120**	2,236
Total accounts receivable	**16,084**	21,032

7. Accounts Payable and Accrued Liabilities

	December 31, 2012	December 31, 2011
Accounts payable	**17,657**	36,267
Accrued liabilities	**24,533**	28,200
Total accounts payable and accrued liabilities	**42,190**	64,467

8. Other Liabilities

	December 31, 2012	December 31, 2011
Obligations related to onerous contracts – current (Note 13)	**317**	331
Obligations related to flow-through shares (Note 15)	**4,142**	4,958
Total other liabilities	**4,459**	5,289

9. Production Revenue

	Year ended December 31,	
	2012	2011
Sales of oil and natural gas	**75,811**	101,090
Royalties	**(4,762)**	(13,743)
Total production revenue	**71,049**	87,347

10. Other Income

	Year ended December 31, 2012	2011
Gain on sale of property and equipment	**(20,390)**	(5,077)
Termination fee net of transaction costs	**(3,347)**	–
Provisions related to onerous contracts (Note 13)	**–**	1,138
Other	**(57)**	(74)
Total other income	**(23,794)**	(4,013)

In June 2012, Cequence and Open Range Energy Corp. ("Open Range") entered into an arrangement agreement whereby Cequence agreed to acquire all of the outstanding common shares of Open Range. In July 2012, Open Range accepted a superior proposal from another publicly traded Canadian oil and gas company and in accordance with the terms of the arrangement agreement, Open Range paid to Cequence a termination fee of $4,600. Transaction costs of $1,253 were incurred by the Company with respect to this arrangement agreement during 2012. The net amount of $3,347 has been included in other income for the year ended December 31, 2012.

11. Finance Costs

	Year ended December 31, 2012	2011
Interest expense on demand credit facilities (including stand-by fees and commitment fees of $307 (2011 – $544))	**2,000**	1,928
Accretion expense on provisions	**725**	905
Amortization of transaction costs on financial instruments	**–**	443
Total finance costs	**2,725**	3,276

12. Compensation Costs And Key Management Personnel Expenses

Total wages, salaries, benefits and other personnel costs included in comprehensive loss for the year ended December 31, 2012 were $4,493 (2011 – $5,775).

The aggregate expense of key management personnel, defined as the Company's chief executive officer, chief operating officer, chief financial officer and the Company's Board of Directors, was as follows:

	Year ended December 31, 2012	2011
Wages, salaries, benefits and other personnel costs	**1,137**	1,187
Share based payments [i]	**1,146**	2,495
Total remuneration	**2,283**	3,682

[i] Represents the total fair value of share based payment awards granted to officers and directors in the year of grant, as determined using a Black-Scholes option pricing model (see note 16).

13. Provisions

Decommissioning liabilities

The following table summarizes the changes in decommissioning liabilities for the years ended December 31, 2012 and 2011:

	2012	2011
Balance, beginning of year	**28,135**	26,130
Acquisitions	**417**	1,539
Property dispositions (Note 4)	**(533)**	(7,135)
Accretion expense	**730**	905
Liabilities incurred	**1,775**	3,217
Abandonment costs incurred	**(904)**	(955)
Revisions in estimated cash flows	**2,078**	(21)
Revisions due to change in discount rates	**866**	4,455
Balance, end of year	**32,564**	28,135

The Company's decommissioning liabilities result from its ownership in oil and natural gas assets including well sites, facilities and gathering systems. The total estimated, undiscounted cash flows, inflated at 2 percent, required to settle the obligations are $47,549 (2011 – $42,659). These cash flows have been discounted using a risk-free interest rate of 2.37 percent (2011 – 2.50 percent) based on Government of Canada long-term benchmark bonds. The Company expects these obligations to be settled in approximately 1 to 50 years (2011 – 2 to 30 years). As at December 31, 2012, no funds have been set aside to settle these liabilities.

Onerous contracts

As at December 31, 2012, the Company recognized a provision related to an onerous lease contract of $812 (2011 – $1,138). The provision for onerous lease contract represents the present value of the future lease obligations that the Company is presently obligated to make under a non-cancellable onerous operating lease contract, less revenue expected to be earned on the lease, including estimated future sub-lease revenue. The total estimated, undiscounted cash flows, required to settle the obligations are $830 (2011 – $1,164). These cash flows have been discounted using a risk-free interest rate of 1.20 percent (2011 – 0.99 percent) based on Government of Canada three year benchmark bonds.

Cequence expects to reduce the provision by $317 in the year ended December 31, 2013, which amount is included with other liabilities in the consolidated balance sheet (see note 8). The portion of the provision expected to be realized in the period subsequent to December 31, 2013 of $495 is carried with provisions as a non-current liability in the consolidated balance sheet as at December 31, 2012. During the year ended December 31, 2012, the Company recognized a reduction to finance costs of $5 (2011 – $nil) to account for accretion and changes in estimates and rates related to onerous contracts. The estimate may vary as a result of changes in the utilization of the lease premises and the sub-lease arrangements, where applicable. The unexpired term of the leases at December 31, 2012 is 31 months.

14. Income Taxes

The following table sets forth the components of the Company's deferred income tax asset:

	December 31, 2012	December 31, 2011
Excess (deficiency) of net book value of property and equipment and provisions over related tax pools	**(3,664)**	13,605
Non-capital loss carry-forwards	**36,969**	23,659
Scientific research and development expenses and investment tax credits	**8,602**	8,602
Other tax assets	**2,359**	2,450
Total net deferred income tax assets	**44,266**	48,316

At December 31, 2012, Cequence has total tax pools of $608,300 (2011 – $591,296) including non-capital loss carry-forwards, investment tax credit carry-forwards and Scientific Research and Experimental Development ("SRED") expenses available to reduce future years' income for tax purposes. Deferred income tax assets have been recognized to the extent that estimated future taxable profits are sufficient to realize the deferred income tax assets in the allowable timeframes. As at December 31, 2012, a deferred income tax asset has not been recognized on $18,600 (2011 – $18,600) of deductible temporary differences in respect of certain successored resources properties; the deductible temporary differences do not expire. The Scientific Research and Development expenses of approximately $22,704 available for carry-forward do not expire (2011 – $22,704). The non-capital loss carry-forwards expire in 1 to 20 years and the investment tax credit carry-forwards expire in 7 to 11 years.

Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial tax rates of 25.0 percent (2011 – 26.5 percent) to loss before income taxes as follows:

	Year ended December 31, **2012**	2011
Expected income tax recovery	**(4,427)**	(5,692)
Effect of share based payments	**1,429**	1,791
Change in value of reserves and losses due to reassessments	**–**	(258)
Change in effective tax rate applied	**–**	1,039
Effect of renunciation of flow-through shares (Note 15)	**2,960**	1,395
Other	**3**	418
Deferred income tax recovery	**(35)**	(1,307)
Current income tax recovery	**–**	(14)
Income tax recovery	**(35)**	(1,321)

Movements in deferred income tax balances are as follows:

	Balance, Dec. 31, 2011	Recognized in comprehensive loss	Recognized in liabilities	Recognized in equity	**Balance Dec. 31, 2012**
Property and equipment and provisions	13,605	(12,121)	(4,959)	–	**(3,475)**
Unrealized gain on financial instruments	–	(189)	–	–	**(189)**
Non-capital losses	23,659	13,310	–	–	**36,969**
SRED expenses and investment tax credits	8,602	–	–	–	**8,602**
Other	2,450	(965)	–	874	**2,359**
Total	48,316	35	(4,959)	874	**44,266**

	Balance, Dec. 31, 2010	Recognized in comprehensive loss	Recognized in liabilities	Recognized in equity	Balance Dec. 31, 2011
Property and equipment and provisions	12,798	2,669	(1,862)	–	13,605
Non-capital losses	24,211	(552)	–	–	23,659
SRED expenses and investment tax credits	8,616	(14)	–	–	8,602
Other	1,715	(796)	–	1,531	2,450
Total	47,340	1,307	(1,862)	1,531	48,316

15. Share Capital

Cequence has an unlimited number of common voting shares and common non-voting shares with no par value authorized.

	Year ended December 31, 2012		Year ended December 31, 2011	
	Number	**Stated Value**	Number	Stated Value
	(000s)	**$**	(000s)	$
Issued common voting shares				
Balance, beginning of year	**161,856**	**559,371**	128,750	452,526
Common shares	**21,269**	**25,523**	25,358	84,229
Flow-through common shares	**17,485**	**24,429**	4,898	16,758
Common shares on exercise of stock options	–	–	600	1,794
Common shares on exercise of warrants	–	–	2,250	8,663
	200,610	**609,323**	161,856	563,970
Share issue costs, net of taxes of $874 (2011 – $1,531)	–	**(2,620)**	–	(4,599)
Balance, end of year	**200,610**	**606,703**	161,856	559,371
Warrants				
Balance, beginning of year	**2,250**	–	4,500	–
Cancelled	**(2,250)**	–	–	–
Exercised	–	–	(2,250)	–
Balance, end of year	–	–	2,250	–

On November 30, 2010, the Company completed the sale, on a private placement basis, of 2,250 units at a price of $2.00 per unit for total gross proceeds of $4,500. Each unit entitles the holder to:

- one common voting share on a CDE "flow-through" basis;
- one warrant to purchase one common voting share on a CDE "flow-through" basis at any time on or after August 1, 2011 and prior to August 15, 2011 at a price set as a 10 percent premium to the 10 day volume weighted average trading price of the Company's shares on the TSX for the period July 18, 2011 to July 29, 2011 (the "2011 Warrants"); and
- one warrant to purchase one common voting share on a CDE "flow-through" basis at any time on or after August 1, 2012 and prior to August 15, 2012 at a price set as a 10 percent premium to the 10 day volume weighted average trading price of the Company's shares on the TSX for the period July 18, 2012 to July 31, 2012 (the "2012 Warrants).

The purchaser unconditionally committed to exercise the 2011 Warrants prior to August 15, 2011 and Cequence exercised the option to hold 1,500 of the shares initially issued in escrow until such time as the 2011 Warrants were exercised. If the 2011 Warrants were not exercised, the shares held in escrow were to be cancellable at no cost to Cequence and no redress to the shareholder. The 2012 Warrants were conditional on the exercise of the 2011 Warrants and if the 2011 Warrants were not exercised in accordance with their terms, the 2012 Warrants were to become null and void. The 2011 Warrants were exercised in accordance with their terms in the year ended December 31, 2011 (see below). No value has been attributed to the 2011 Warrants or 2012 Warrants as the underlying common voting shares are issuable at a fixed premium to the prevailing value of the stock at the time of issuance. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures.

The above transaction resulted in an increase to share capital of $3,886 and the recognition of an obligation related to flow-through shares of $614 included with other liabilities in the consolidated balance sheet at December 31, 2010. In accordance with the terms of the agreement and pursuant to certain provisions of the Income Tax Act (Canada), the Company renounced, for income tax purposes, development expenditures of $3,000 to the holders of the flow-through common shares effective December 31, 2010. Deferred income tax of approximately $752 associated with renouncing the expenditures was recorded on the date of renunciation in the first quarter of 2011, obligation on flow-through shares of $409 was drawn down and the difference was recognized as deferred income tax recovery in comprehensive loss. As at December 31, 2011, the Company has incurred all of the qualifying expenditures.

On March 17, 2011, the Company completed the sale of 13,398 common voting shares at a price of $2.85 per share for total gross proceeds of $38,183.

On March 17, 2011, the Company completed the sale of 2,100 common voting shares on a CEE "flow-through" basis at $3.50 per share for total gross proceeds of $7,350. Under the terms of the respective agreements, Cequence is required to renounce $7,350 of CEE expenditures in February 2012. The above transaction resulted in an increase to share capital of $5,985 and the recognition of an obligation related to flow-through shares of $1,365 included with other liabilities in the consolidated balance sheet at December 31, 2011. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures.

On June 20, 2011, a total of 600 stock options were exercised resulting in the issuance of 600 common voting shares at $1.99 per share for total gross proceeds of $1,194. The exercise of stock options further resulted in a reduction to contributed surplus of $600 and a commensurate increase to share capital to account for stock based compensation previously expensed related to the exercised options.

On August 15, 2011, 2,250 2011 Warrants were exercised for 2,250 common voting shares on a CDE "flow-through" basis at $4.36 per share for total gross proceeds of $9,801. The shares were issued on exercise of the 2011 Warrants, as discussed above. In accordance with the exercise of the 2011 Warrants, 1,500 common voting shares initially held in escrow were released on August 15, 2011. The exercise of the 2011 Warrants also qualifies the remaining 2,250 2012 Warrants for exercise in 2012. Under the terms of the respective agreement, Cequence is required to renounce $9,801 of CDE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures. The above transaction resulted in an increase to share capital of $8,663 and the recognition of an obligation related to flow-through shares of $1,138 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On August 18, 2011, the Company completed the sale of 11,960 common voting shares at a price of $3.85 per share for total gross proceeds of $46,046 and 2,110 common voting shares on a CEE "flow-through" basis at $4.75 per share for total gross proceeds of $10,023. Under the terms of the respective agreements, Cequence is required to renounce $10,023 of CEE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CEE expenditures. The above transaction resulted in an increase to share capital of $8,124 and the recognition of an obligation related to flow-through shares of $1,899 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On October 5, 2011, the Company completed the sale of 688 common voting shares on a CDE "flow-through" basis at $4.36 per share for total gross proceeds of $3,000. Under the terms of the respective agreements, Cequence is required to renounce $3,000 of CDE expenditures in February 2012. As at December 31, 2011, the Company has incurred all of the qualifying CDE expenditures. The above transaction resulted in an increase to share capital of $2,649 and the recognition of an obligation related to flow-through shares of $351 included with other liabilities in the consolidated balance sheet at December 31, 2011.

On March 8, 2012, the Company's 2012 Warrants were cancelled at no cost to Cequence and no redress to the shareholder.

On June 20, 2012, the Company completed the sale of 11,684 common voting shares at a price of $1.20 per share for gross proceeds of $14,020. On July 12, 2012, the Company further completed the sale of 1,252 common voting shares at a price of $1.20 per share for gross proceeds of $1,503 related to the exercise of an over-allotment option on the above issuance.

On June 20, 2012, the Company completed the sale of 4,850 common voting shares on a CEE "flow-through" basis at $1.45 per share for gross proceeds of $7,033 as well as 3,800 common voting shares on a CDE "flow-through" basis at $1.32 per share for gross proceeds of $5,016, resulting in a total issuance of 8,650 common voting shares for total gross proceeds of $12,049. The above transaction resulted in an increase to share capital of $10,380 and the recognition of an obligation related to flow-through shares of $1,669 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $7,033 and development expenditures of $5,016 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company has incurred all qualifying CEE and CDE expenditures.

On June 22, 2012, the Company completed the sale, on a private placement basis, of 8,333 common voting shares at a price of $1.20 per share for gross proceeds of $10,000.

On December 5, 2012, the Company completed the public sale of 8,560 common voting shares on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $16,007. On December 21, 2012, the Company completed a private placement sale of 275 common voting shares to certain officers and directors on a CEE "flow-through" basis at $1.87 per share for gross proceeds of $514. The private placement transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. The above transactions resulted in an increase to share capital of $14,048 and the recognition of an obligation related to flow-through shares of $2,473 included with other liabilities at December 31, 2012. In accordance with the terms of the related agreements and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, exploration expenditures of $16,521 to the holders of the flow-through common shares effective December 31, 2012. As at December 31, 2012, the Company has yet to incur any qualifying CEE expenditures.

16. Share Based Payment Plans

Stock options

The Company has a stock option plan for directors, officers, employees and consultants of the Company and its subsidiaries. The number of common shares granted with respect to options may not exceed a rolling maximum of 10 percent of the Company's outstanding common shares. Options typically vest over a three year period, expire five years from the date of grant and are settled by issuing shares of the Company.

During the year ended December 31, 2012, the Company issued 5,118 stock options at prices ranging from $1.24 to $1.95 to employees and directors. The options have a five year life and one-third vest annually commencing one year following the grant date.

A summary of the inputs used to value stock options is as follows:

	2012	2011
Risk-free interest rate	**1.3% – 1.6%**	1.3% – 2.8%
Expected life of options	**5 years**	5 years
Expected volatility	**60%**	60%
Expected dividend rate	**0%**	0%
Expected forfeiture rate	**15%**	15%
Weighted average fair value	**$ 0.65**	$ 1.91

Expected volatility is determined by reference to the Company's industry peers as, due largely to changes in the size and structure of the Company in recent years, this was determined to be a more meaningful measure than the historical volatility of the Company's shares.

A summary of the status of the Company's stock option plan and changes during the year ended December 31, 2012 and 2011 is as follows:

		2012		2011
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
	(000s)	**$**	(000s)	$
Outstanding, beginning of year	**13,094**	**2.54**	9,713	1.99
Granted	**5,118**	**1.30**	4,221	3.69
Forfeited	**(923)**	**2.20**	(240)	1.99
Exercised	**–**	**–**	(600)	1.99
Outstanding, end of year	**17,289**	**2.19**	13,094	2.54

The following table summarizes information about stock options outstanding at December 31, 2012:

		Options outstanding		Options exercisable	
	Weighted average exercise price	Number of options outstanding	Weighed average contractual life remaining	Number of options	Weighted average exercise price
	$	(000s)	(years)	(000s)	$
1.24 – 1.99	1.73	13,230	3.4	5,501	1.98
2.96 – 3.94	3.69	4,059	3.5	1,353	3.69
	2.19	17,289	3.4	6,854	2.32

During the year ended December 31, 2012, $5,717 (2011 – $6,758) in share based payment expense related to equity-settled stock options has been recognized in comprehensive loss.

17. Loss Per Share

Loss per share has been calculated based on the weighted average number of common shares outstanding during the year. No stock options or warrants have been included in the calculation of diluted shares outstanding for the year ended December 31, 2012 (2011 – none) as their inclusion would be anti-dilutive. The following table reconciles the denominators used for the basic and diluted loss per share calculations.

	Year ended December 31,	
	2012	2011
Basic weighted average shares	**178,209**	147,558
Effect of dilutive stock options and warrants	**–**	–
Diluted weighted average shares	**178,209**	147,558

18. Contingencies and Commitments

	2013	2014	2015	2016	2017+	Total
Office leases	1,133	922	187	–	–	2,242
Drilling services	1,903	–	–	–	–	1,903
Pipeline transportation	1,684	1,684	1,541	–	–	4,909
Total	4,720	2,606	1,728	–	–	9,054

The pipeline transportation contract expires on November 30, 2015.

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company has committed to use a drilling rig for 360 days over the two years following commencement of use of the drilling rig at current market rates. The commitment is drawn down when the rig is in use, whether by Cequence or third parties. Cequence expects to meet the commitment in the required time.

During the year ended December 31, 2011, the Company entered into a drilling service agreement whereby the Company made a deposit of $3,500 to obtain a right of first refusal on the use of two drilling rigs over the five years following the date that use of the rigs commences. The deposit is to be applied as the Company incurs costs related to the use of the drilling rigs and $1,020 has been drawn down at December 31, 2012. Cequence expects to reduce the deposit by $579 in the year ended December 31, 2013, which amount is included with deposits and prepaid expenses at December 31, 2012. The portion of the outstanding deposit expected to be drawn down in the period subsequent to December 31, 2013 of $1,901 is carried as a non-current asset at December 31, 2012.

During the year ended December 31, 2012, the Company recognized $1,451 (2011 – $1,311) of expense related to office leases, included with general and administrative expense.

19. Financial Instruments and Risk Management

The Company's financial instruments, including derivative financial instruments and embedded derivative financial instruments, recognized in the consolidated balance sheets consist of cash, accounts receivable, commodity contracts, demand credit facilities and accounts payable and accrued liabilities.

The Company's accounts receivable, demand credit facilities and accounts payable and accrued liabilities approximate their carrying values due to their short terms to maturity and the floating interest rate on the Company's debt.

The Company's fair value hierarchy for those assets and liabilities measured at fair value as of December 31, 2012 comprises cash, which is considered a level 1 financial instrument and commodity contracts. Cequence's commodity contracts are measured at level 2 under the Company's fair value hierarchy as of December 31, 2012. The fair value of commodity contracts is determined by discounting the remaining contracted petroleum and natural gas volumes by the difference between the contracted price and published forward price curves as at the balance sheet date.

The nature of these financial instruments and the Company's operations expose the Company to market risk, credit risk and liquidity risk. The Company manages its exposure to these risks by operating in a manner that minimizes these risks. Senior management employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Company's business objectives and risk tolerance levels. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has established policies in setting risk limits and controls and monitors these risks in relation to market conditions.

Market Risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's comprehensive income (loss) to the extent the Company has outstanding financial instruments. The objective of the Company is to mitigate market risk exposures within acceptable limits, while maximizing returns.

Commodity price risk

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices and initiates instruments to manage exposure to these risks when it deems appropriate. As a means of managing commodity price volatility, the Company enters into various derivative financial instrument agreements and physical contracts. The fair values of the derivative financial instruments are based on mark-to-market assessments and estimates of fair value and are recorded on the consolidated balance sheet as either an asset or liability with the change in fair value recognized in comprehensive income (loss).

During the year ended December 31, 2012, the Company entered into several commodity derivative financial instrument contracts. The following information presents all outstanding positions for commodity derivative financial instruments at December 31, 2012:

Term	Product	Type	Volume	Price	Basis
January 1, 2013 to December 31, 2013	Gas	Swap	2,000 GJ/day	$2.84	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.09	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.00	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	5,000 GJ/day	$3.10	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.24	AECO
January 1, 2013 to December 31, 2013	Gas	Swap	2,500 GJ/day	$3.40	AECO
January 1, 2014 to September 30, 2014	Gas	Swap	2,500 GJ/day	$3.51	AECO
January 1, 2013 to December 31, 2013	Oil	Sold Call	200 bbls/day	$110.00 USD	WTI

For the year ended December 31, 2012, realized loss from commodity derivative contracts recognized in comprehensive loss were $161 (2011 – $906 gain).

The fair value of the commodity contracts outstanding at December 31, 2012 was a current asset of $694, non-current asset of $63 (2011 – $nil).

For the year ended December 31, 2012 the Company recorded an unrealized gain of $757 from derivative commodity contracts (2011 – $nil).

As at December 31, 2012, an increase in gas price of $0.50/gj results in a decrease in the fair value of the commodity contracts of $3,475 ($2,606 after tax) and a commensurate decrease to comprehensive loss.

Foreign exchange risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices are referenced to U.S. dollar denominated prices. As at December 31, 2012 the Company had no forward, foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies (2011 – nil).

Interest rate risk

The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facilities. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company has no interest rate swaps or financial contracts in place as at or during the year ended December 31, 2012 (2011 – nil).

As at December 31, 2012 a 1 percent change in interest rates on the Company's outstanding debt, with all other variables constant, would result in a change in comprehensive loss of $232 ($174 after tax) (2011 – $116 ($85 after tax)).

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 obligation. The Company is exposed to credit risk with respect to its accounts receivable and cash.

The majority of the Company's accounts receivable are due from joint venture partners in the oil and gas industry and from marketers of the Company's petroleum and natural gas production. 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.

As at December 31, 2012, the accounts receivable balance was $16,084 of which $4,009 was past due. The Company considers all amounts greater than 90 days past due. These past due accounts are considered to be collectible, except as provided in the allowance for doubtful accounts. When determining whether past due accounts are uncollectible, the Company factors in the past credit history of the counterparties. At December 31, 2012, the Company has an allowance for doubtful accounts of $515 (2011 – $551). As at December 31, 2012, 44.0 percent (2011 – 33.0) of the total receivables balance is due from marketers of the Company's oil and natural gas production. A reconciliation of the Company's allowance for doubtful accounts is as follows:

	Year ended December 31,	
	2012	2011
Balance, beginning of year	**551**	490
Amounts collected	**(36)**	(37)
Amounts written off to accounts receivable	–	(4)
Additional provision	–	102
Balance, end of year	**515**	551

As at December 31, 2012, the maximum exposure to credit risk was $16,841 (2011 – $21,412) being the carrying value of the Company's accounts receivable and commodity contract assets.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The nature of the oil and gas industry is capital intensive and the Company maintains and monitors a certain level of cash flow to finance operating and capital expenditures. Refer to note 21 for disclosure related to the management of capital.

The expected timing of cash flows relating to financial liabilities as at December 31, 2012 is as follows:

	< 1 Year	1 – 2 Years	2 – 5 Years	Thereafter
Demand credit facilities	–	–	23,191	–
Accounts payable and accrued liabilities	42,190	–	–	–
	42,190	–	23,191	–

20. Changes in Non-Cash Working Capital

	Year ended December 31, 2012	2011
Accounts receivable	**4,948**	(4,593)
Deposits and prepaid expenses	**358**	(3,207)
Accounts payable and accrued liabilities	**(22,277)**	28,227
Net change in non-cash working capital	**(16,971)**	20,427
Allocated to:		
Operating activities	**4,950**	(4,607)
Investing activities	**(22,186)**	24,976
Financing activities	**265**	58
	(16,971)	20,427

21. Capital Management

Cequence's objectives are to maintain a flexible capital structure in order to meet its financial obligations and to execute on strategic opportunities throughout the business cycle. The Company's capital comprises shareholders' equity, demand credit facilities and working capital. Cequence manages the capital structure and makes adjustments in light of economic conditions and the risk characteristics of the underlying assets.

In order to maintain or adjust the capital structure, Cequence may issue new common shares, issue new debt or replace existing debt, adjust capital expenditures and acquire or dispose of assets.

The Company evaluates its capital structure based on net debt to cash flow from operating activities and the current credit available to Cequence compared to its budgeted capital expenditures.

Net debt to cash flow provides a measure of the Company's ability to manage its debt levels under current operating conditions. The ratio is calculated as net debt, defined as current debt and working capital excluding commodity derivative assets or liabilities and other liabilities, divided by cash flow from operations before decommissioning liabilities expenditures and changes in non-cash working capital for the most recent quarter.

At December 31, 2012 Cequence has a net debt and working capital deficiency of $45,869 (2011 – $51,442).

It is the Company's objective to maintain a net debt to annualized cash flow ratio of less than 2:1. As at December 31, 2012, the ratio was calculated as 1:1 (2011 – 1.3:1) based on annualized fourth quarter results.

The Company's current borrowing capacity is based on the lenders' semi-annual review of the Company's oil and natural gas reserves. The Company is also subject to various restrictions, including being permitted to hedge up to 67 percent of its production under the lending agreement. Compliance with these restrictions is monitored on a regular basis and at December 31, 2012 Cequence was in compliance with all such restrictions.

22. Related Parties

An executive of the Company is a member of the Board of Directors of an entity that is a supplier of seismic services to Cequence. The Company incurred a total of $nil with this vendor in the year ended December 31, 2012 (2011 – $26). These transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties, and is equal to fair value. As at December 31, 2012, no amounts are included in accounts payable and accrued liabilities related to these transactions (2011 – $nil).

23. Subsequent Event

On February 25, 2013, the Company entered into agreements to acquire interests in oil and gas properties located in the Simonette and Resthaven areas of Alberta. As consideration for the assets, Cequence will transfer its interest in its non-operated oil and gas properties located in the Fir area, and issue an aggregate of 10,300,000 Cequence common shares to the Corporation. Completion of the transaction is expected to occur in mid April 2013 and is subject to the satisfaction of several conditions, including receipt of the applicable court, stock exchange and regulatory approvals as well as the approval by the vendor's shareholders. There can be no assurance provided that this transaction will close as described.