Paramount
resources ltd.

Consolidated Financial Statements
As at December 31, 2011 and 2010 and for the years then ended

Management's Report

The accompanying Consolidated Financial Statements of Paramount Resources Ltd. (the "Company") are the responsibility of Management and have been approved by the Board of Directors. The Consolidated Financial Statements have been prepared by Management in Canadian dollars in accordance with International Financial Reporting Standards and include certain estimates that reflect Management's best judgments. When alternative accounting methods exist, Management has chosen those it considers most appropriate in the circumstances. Financial information contained throughout the Company's annual report is consistent with these Consolidated Financial Statements.

Management is also responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The Company's internal control system was designed to provide reasonable assurance that all transactions are accurately recorded, that transactions are recorded as necessary to permit preparation of financial statements in accordance with International Financial Reporting Standards, and that the Company's assets are safeguarded.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through the Audit Committee. The Audit Committee meets regularly with Management and the independent auditors to ensure that Management's responsibilities are properly discharged and to review the Consolidated Financial Statements. The Audit Committee reports its findings to the Board of Directors for consideration when approving the annual Consolidated Financial Statements for issuance to the shareholders. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors. The Audit Committee of the Board of Directors is comprised entirely of non-management directors.

Ernst & Young LLP, independent auditors appointed by the shareholders of the Company, conducts an examination of the Consolidated Financial Statements in accordance with Canadian Generally Accepted Auditing Standards. Ernst & Young LLP has full and free access to the Audit Committee and Management.

/s/ Clayton H. Riddell
Clayton H. Riddell
Chief Executive Officer

/s/ Bernard K. Lee
Bernard K. Lee
Chief Financial Officer

March 6, 2012

INDEPENDENT AUDITORS' REPORT

To the shareholders of Paramount Resources Ltd.:

We have audited the accompanying consolidated financial statements of Paramount Resources Ltd. which comprise the consolidated balance sheets as at December 31, 2011 and 2010, and January 1, 2010, and the consolidated statements of comprehensive loss, shareholders equity and cash flows for the years ended December 31, 2011 and 2010, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' 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 auditors 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 financial position of Paramount Resources Ltd. as at December 31, 2011 and 2010, and January 1, 2010, and its financial performance and its cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Calgary, Canada

6 March 2012

Chartered accountants

PARAMOUNT RESOURCES LTD.
Consolidated Balance Sheet
($ thousands)

As at	Note	December 31 2011	December 31 2010 (note 24)	January 1 2010 (note 24)
ASSETS				
Current assets				
Cash and cash equivalents	20	**$ 29,000**	$ 74,659	$ 93,238
Accounts receivable	19	**40,181**	33,280	23,488
Risk management	19	**184**	–	2,187
Prepaid expenses and other		**2,551**	2,572	2,301
Assets held for sale	6	**58,038**	–	–
		129,954	110,511	121,214
Deposit	18	**20,043**	19,788	–
Exploration and evaluation	7	**390,742**	269,084	151,283
Property, plant and equipment, net	8	**808,617**	580,334	503,106
Equity-accounted investments	9	**101,543**	138,300	113,471
Investments in securities	10	**153,840**	189,717	115,383
Deferred income tax	18	**117,548**	75,575	32,423
Goodwill	11	**3,426**	8,012	–
		$ 1,725,713	$ 1,391,321	$ 1,036,880
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Demand facilities	12	**$ 22,842**	$ 26,880	$ 29,380
Accounts payable and accrued liabilities	19	**136,820**	84,928	48,571
Risk management	19	**2,787**	693	–
Stock-based compensation	1,17	**–**	46,187	13,827
Liabilities associated with assets held for sale	6	**13,040**	–	–
		175,489	158,688	91,778
Long-term debt	13	**427,186**	294,205	93,655
Asset retirement obligations	14	**299,202**	241,770	195,088
Stock-based compensation	1,17	**–**	14,460	4,721
Deferred income tax	18	**–**	–	10,034
		901,877	709,123	395,276
Commitments and contingencies	23			
Shareholders' equity				
Share capital	15	**810,781**	481,827	418,191
Accumulated (deficit) earnings		**(103,615)**	128,375	218,386
Reserves	16	**116,670**	71,996	5,027
		823,836	682,198	641,604
		$ 1,725,713	$ 1,391,321	$ 1,036,880

See the accompanying notes to these Consolidated Financial Statements.

On behalf of the Board

/s/ J.H.T. Riddell
J.H.T. Riddell, Director

/s/ J.C. Gorman
J.C. Gorman, Director

PARAMOUNT RESOURCES LTD.
Consolidated Statement of Comprehensive Loss
($ thousands, except as noted)

Year ended December 31	Note	2011	2010 (note 24)
Petroleum and natural gas sales		$ 241,713	$ 184,395
Royalties		(22,056)	(21,227)
Revenue		219,657	163,168
Gain (loss) on financial commodity contracts	19	(1,699)	10,047
		217,958	173,215
Expenses			
Operating expense and production tax		71,253	50,892
Transportation		20,519	17,219
General and administrative		16,934	15,150
Stock-based compensation	1,17	21,462	55,278
Depletion and depreciation	8	378,077	160,650
Exploration and evaluation	7	27,330	42,721
Gain on sale of property, plant and equipment		(42,021)	(380)
Interest		34,109	13,560
Accretion of asset retirement obligations		7,374	7,975
Debt extinguishment		–	1,708
Acquisition transaction costs		1,044	267
Foreign exchange		1,377	(298)
		537,458	364,742
Income from equity-accounted investments	9	1,201	35,999
Other income	5,10	24,528	4,784
Net loss before tax		(293,771)	(150,744)
Income tax expense (recovery)	18		
Current		12	213
Deferred		(61,793)	(60,946)
		(61,781)	(60,733)
Net loss		$ (231,990)	$ (90,011)
Other comprehensive income (loss), net of tax	16		
Change in market value of securities		(19,913)	68,434
Exchange differences on translation of US subsidiaries		1,197	(2,028)
		(18,716)	66,406
Comprehensive loss		$ (250,706)	$ (23,605)
Net loss per common share ($/share)	15		
Basic and diluted		$ (2.96)	$ (1.24)

See the accompanying notes to these Consolidated Financial Statements.

PARAMOUNT RESOURCES LTD.
Consolidated Statement of Cash Flows
($ thousands)

Year ended December 31	Note	2011	2010 (note 24)
Operating activities			
Net loss		**$ (231,990)**	$ (90,011)
Add (deduct)			
Items not involving cash	20	**310,074**	161,171
Dividends from equity accounted investments		**11,360**	12,986
Asset retirement obligations settled	14	**(7,520)**	(3,209)
Debt extinguishment costs		**–**	1,708
Change in non-cash working capital		**3,036**	(23,467)
Cash from operating activities		**84,960**	59,178
Financing activities			
Drilling rig loan repayments		**(4,038)**	(2,500)
Proceeds from Senior Notes, net of issue costs		**70,899**	294,171
Repayment of US Senior Notes		**–**	(92,234)
Repayment of debt assumed on acquisitions	4	**(37,824)**	(10,521)
Net draw of revolving long-term debt	13	**61,383**	–
Common shares issued, net of issue costs		**268,627**	62,989
Common shares purchased under stock incentive plan		**(2,974)**	(2,901)
Cash from financing activities		**356,073**	249,004
Investing activities			
Property, plant and equipment and exploration		**(525,239)**	(289,969)
Proceeds on sale of property, plant and equipment		**45,385**	1,196
Proceeds on sale of investment		**16,129**	–
Corporate acquisitions	4	**(64,759)**	(46,172)
Investments in securities		**–**	(9,648)
Equity accounted investments		**–**	(1,452)
Deposit	18	**–**	(19,788)
Change in non-cash working capital		**41,769**	40,138
Cash used in investing activities		**(486,715)**	(325,695)
Net decrease		**(45,682)**	(17,513)
Foreign exchange on cash and cash equivalents		**23**	(1,066)
Cash and cash equivalents, beginning of year		**74,659**	93,238
Cash and cash equivalents, end of year		**$ 29,000**	$ 74,659
Supplemental cash flow information	20		

See the accompanying notes to these Consolidated Financial Statements.

PARAMOUNT RESOURCES LTD.

Consolidated Statement of Shareholders' Equity

($ thousands, except as noted)

Year ended December 31	Note	2011		2010	
		Shares (000's)		*Shares (000's)*	
Share Capital					(note 24)
Balance, beginning of year		***75,034***	**$ 481,827**	*72,058*	$ 418,191
Issued		***8,316***	**271,683**	*2,948*	63,734
Issued on acquisition of ProspEx	4	***2,000***	**57,280**	–	–
Change in unvested common shares for stock incentive plan	17	***64***	**(9)**	*28*	(98)
Balance, end of year		***85,414***	**$ 810,781**	*75,034*	$ 481,827
Accumulated (Deficit) Earnings					
Balance, beginning of year			**$ 128,375**		$ 218,386
Net loss			**(231,990)**		(90,011)
Balance, end of year			**$ (103,615)**		$ 128,375
Reserves	16				
Balance, beginning of year			**$ 71,996**		$ 5,027
Other comprehensive income (loss)			**(18,716)**		66,406
Contributed surplus			**65,792**		–
Stock-based compensation - investee options			**(2,402)**		563
Balance, end of year			**$ 116,670**		$ 71,996
Total Shareholders' Equity			**$ 823,836**		$ 682,198

See the accompanying notes to these Consolidated Financial Statements.

1. SIGNIFICANT ACCOUNTING POLICIES

Paramount Resources Ltd. ("Paramount" or the "Company") is an independent, publicly traded, Canadian corporation that explores for and develops conventional petroleum and natural gas prospects, pursues long-term non-conventional exploration and pre-development projects and holds a portfolio of investments in other entities. Paramount's principal properties are located in Alberta, the Northwest Territories and British Columbia in Canada, and in North Dakota and Montana in the United States. Paramount is the ultimate parent company of the consolidated group of companies. Paramount has divided its operations into three business segments: Principal Properties, Strategic Investments and Corporate.

Paramount Resources Ltd. is incorporated and domiciled in Canada. The address of its registered office is 4700, 888 3rd Street S.W., Calgary, Alberta, Canada, T2P 5C5.

These Consolidated Financial Statements were authorized for issuance by the Board of Directors of Paramount Resources Ltd. on March 6, 2012.

a) Basis of Preparation

These Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), are stated in Canadian dollars and have been prepared on a historical cost basis, except for certain financial instruments. These Consolidated Financial Statements include the accounts of Paramount and its subsidiaries and partnerships, including Summit Resources, Inc., Cavalier Energy Inc., Paramount Drilling U.S. LLC. and Fox Drilling Inc.

Canadian Generally Accepted Accounted Principles ("GAAP"), as issued by the Canadian Institute of Chartered Accountants, were converted to IFRS effective for fiscal years beginning on or after January 1, 2011. These Consolidated Financial Statements represent Paramount's initial presentation of its annual results of operations and financial position under IFRS, and include transition disclosures as required by IFRS 1 - First-time Adoption of IFRS. In order to prepare comparative information, the Company has applied IFRS as of January 1, 2010 (the "Transition Date") and the accounting, estimation and valuation policies adopted on conversion to IFRS, as described below, have been consistently applied to all periods presented herein. A reconciliation of comparative amounts included herein to amounts previously published in accordance with Canadian GAAP in effect prior to January 1, 2011 ("Previous GAAP") has been provided in Note 24.

The preparation of these Consolidated Financial Statements requires the use of certain accounting estimates and also requires management to exercise judgment in applying the Company's accounting policies. Areas involving a higher degree of judgment or complexity, and areas where assumptions and estimates are significant to the financial statements are described in Note 2.

The financial statements of Paramount's subsidiaries and partnerships are prepared for the same reporting periods as the parent in accordance with the Company's accounting policies. All intercompany balances and transactions have been eliminated.

b) Revenue Recognition

Petroleum and natural gas sales revenues are recognized when title passes to third parties and the significant risks and rewards of ownership have been transferred.

Drilling services are billed to customers on a per-day basis and revenues are recognized as services are rendered and collectability is reasonably assured. When the Company's drilling rigs (the "Rigs") drill on a property owned by Paramount, the Company capitalizes its working interest share of the drilling expenses, and eliminates the associated drilling revenue.

Interest revenue is recognized as earned, using the effective interest method.

c) Cash and Cash Equivalents

Cash and cash equivalents are recorded at cost and include short-term investments with maturities of three months or less from the date of acquisition.

d) Trade and Other Receivables

Accounts receivable are recorded as revenue is recognized or costs are incurred on behalf of partners. An allowance for doubtful accounts is recognized based on management's best estimate of accounts that may not be collectible, which is reviewed and adjusted on a quarterly basis.

e) Equity-Accounted Investments

Investments in entities in which Paramount does not have direct or joint control over strategic operating, investing, and financing decisions, but over which it has significant influence, are accounted for using the equity method. Under this method, the Company recognizes its proportionate share of the earnings of investees in its earnings. As dividends are received, the carrying value of Paramount's investment in the investee is reduced. The Company is generally considered to have significant influence over an investee where its equity interest exceeds 20 percent, or where significant influence can be clearly demonstrated. Paramount accounts for its investments in MGM Energy Corp. ("MGM Energy") and Paxton Corporation ("Paxton") using the equity method, even though it holds less than a 20 percent interest in these corporations, because the Company and each of MGM Energy and Paxton share common directors and/or members of management. All other investments are accounted for as financial instruments.

The carrying values of the Company's equity accounted investments are reviewed at each reporting date to determine whether any indicators of impairment are present. If an indicator of impairment is identified, the recoverable amount of the investment is estimated. If the carrying value of the investment exceeds the estimated recoverable amount, an impairment charge is recognized.

f) Joint Arrangements

Paramount recognizes its proportionate interest of the revenues, expenses, assets, and liabilities of jointly controlled assets.

g) Exploration and Evaluation

Costs related to the exploration for and evaluation of hydrocarbon resources, including costs of drilling and completing exploratory wells, acquiring unproved property and estimated asset retirement costs, are initially capitalized, pending determination of technical feasibility and commercial viability. If hydrocarbons are found, but further appraisal activity is required to conclude whether they are economically recoverable, the costs continue to be recognized as an asset. All such costs are subject to technical, commercial, and management review at least annually to confirm the continued intent to develop the discovery. All direct costs related to pre-development activities in connection with oil sands properties are considered pre-operating and are capitalized, including the costs to acquire mineral rights, conduct

delineation drilling, and design and construct plant and equipment. When a project has been determined to be technically feasible and commercially viable, the exploration and evaluation ("E&E") costs are transferred to petroleum and natural gas assets, subject to an impairment assessment. When the Company determines that a project is no longer viable, its carrying value is charged to earnings.

Exploratory geological and geophysical costs, pre-license costs, and annual lease rentals are expensed as incurred.

h) Oil and Gas Properties and Other Property, Plant and Equipment

Oil and gas properties are carried at cost, net of accumulated depletion, depreciation and impairments, and include costs related to drilling and completing development wells, infrastructure construction, successful E&E projects and asset retirement.

Paramount's Rigs are carried at cost, net of accumulated depreciation and include costs of material, machinery, labour, and directly attributable overhead. Costs incurred to improve the capabilities of the Rigs, extend their useful lives or replace significant components are capitalized. When a significant component is replaced, the carrying value of the replaced part is written off. Costs incurred to maintain and repair the Rigs are expensed as incurred.

Other property, plant and equipment, including leasehold improvements, are carried at cost net of accumulated depreciation.

Depletion and Depreciation

Capitalized costs of proved oil and gas properties are depleted over proved developed reserves using the unit-of-production method. For purposes of these calculations, natural gas production and reserves are converted to barrels on an energy equivalent basis. Depletion rates are revised annually or more frequently when events dictate. E&E costs are not depleted.

Capitalized costs of gathering systems and production equipment are depleted on a unit-of-production basis over the proved developed reserves of the field to which they relate. Capitalized costs of processing plants are depreciated on a straight line basis over their expected useful lives.

Leasehold improvements are depreciated over the term of the lease. Other assets are depreciated using the declining balance method at rates varying from 35 to 50 percent.

The Rigs are depreciated by component over their expected useful lives, varying from 1,000 to 3,600 drilling days.

Impairment of Non-Financial Assets

The carrying values of the Company's non-financial assets, excluding goodwill, are reviewed at each reporting date to determine whether any indicators of impairment are present. If an indicator of impairment is identified, the asset's recoverable amount is estimated. For the purpose of impairment testing, assets are tested individually or, in certain circumstances, assets are grouped together into a cash-generating unit ("CGU"), which consists of the smallest group of assets that generate cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its fair value less costs to sell and its value in use. In assessing fair value less costs to sell, the Company estimates the value a potential purchaser would ascribe to an asset or CGU, by estimating its expected discounted after-tax future net cash flows. For oil

and gas properties, discounted after-tax future net cash flows are generally determined using forecast commodity prices and costs over the expected economic life of proved and probable reserves, discounted using market-based rates. 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 or CGU. If the carrying value of an asset or CGU exceeds its estimated recoverable amount, an impairment charge is recognized.

When it is determined that there has been a subsequent increase in the recoverable amount ascribed to an asset or CGU, reversals of impairments are recognized net of any depletion and depreciation that would have been recorded since the date of the impairment charge.

Alberta Drilling Royalty Credits

Paramount recognized Alberta drilling royalty credits as a reduction to the cost of drilling wells. The credits were recognized as they were earned, as determined by well depth, to the extent the Company anticipated being able to use the credits to reduce crown royalties.

i) Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method of accounting. Under this method, the net identifiable assets acquired are measured at fair value on acquisition date. Costs incurred to affect the transaction are expensed. Any excess of the consideration transferred over the fair value of the net identifiable assets acquired is recognized as goodwill. Any deficiency in the consideration transferred versus the fair value of the net identifiable assets acquired is recognized in earnings.

Goodwill is tested for impairment at least annually, or when a potential impairment indicator is identified. In testing goodwill for impairment, the carrying value of a CGU (or group of CGUs), including allocated goodwill, is compared to the CGU's (or group of CGUs') estimated recoverable amount. An impairment charge is recognized to the extent that the carrying amount of the CGU including goodwill exceeds its estimated recoverable amount. Impairment charges relating to goodwill are not reversed in future periods.

Recoverable amounts are determined based on the greater of a CGU's fair value less costs to sell and value in use. In assessing fair value less costs to sell, the Company estimates the value a potential purchaser would ascribe to the CGU by estimating the CGU's expected discounted after-tax future net cash flows. Discounted after-tax future net cash flows are generally determined using forecast commodity prices and costs over the expected economic life of proved and probable reserves, discounted using market-based rates. 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 CGU.

j) Borrowing Costs

Borrowing costs directly associated with the acquisition, construction or production of a qualifying asset are capitalized while the asset is being constructed or otherwise prepared for its intended productive use. All other borrowing costs are recognized as an expense in the period in which they are incurred.

k) Asset Retirement Obligations

Asset retirement obligations include those legal obligations where Paramount will be required to retire assets including oil and gas wells, gathering systems, processing plants and access roads at the end of their productive lives. The Company recognizes the present value of an asset retirement obligation in the

period in which it is incurred and when its fair value can be reasonably estimated. The present value of the obligation is determined using the applicable period-end risk free discount rate and is adjusted for the passage of time, which is recognized as accretion expense. Revisions to the timing, amount or applicable discount rate relating to the estimated liability are accounted for prospectively by recording an adjustment to the asset retirement obligation liability, with a corresponding adjustment to the carrying value of the related asset. The present value of estimated future asset retirement costs are capitalized as part of the related long-lived asset and depreciated on the same basis as the underlying asset.

Actual costs incurred to retire assets are applied against the asset retirement obligation liability. Differences between the actual costs incurred and the liability accrued are recognized in earnings when reclamation of the area is completed.

l) Foreign Currency Translation

Paramount's functional and presentation currency is the Canadian dollar. The functional currencies of subsidiaries of the Company are determined by the nature and location of their operations, and amounts included in their individual financial statements are measured in that functional currency.

Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at average monthly exchange rates. Monetary assets and liabilities of the Company and its Canadian subsidiaries that are denominated in foreign currencies are translated into Canadian dollars at the period-end exchange rate. Gains or losses are recognized in net income.

For the purposes of consolidation, the assets and liabilities of the Company's foreign subsidiaries are translated into Canadian dollars using the period-end exchange rate. Cumulative translation gains and losses related to the translation of foreign subsidiaries are accumulated in reserves. When the Company reduces its net investment in a foreign subsidiary, the corresponding amount of the cumulative translation gain or loss is recognized in net income.

m) Financial Instruments, Comprehensive Income and Hedges

Paramount periodically uses derivative instruments such as forwards, swaps and options to manage its exposure to fluctuations in petroleum and natural gas prices, foreign exchange rates, and interest rates.

Financial Instruments

Financial instruments are measured at fair value on initial recognition. Measurement in subsequent periods is dependent upon whether the financial instrument has been classified as "fair value through profit or loss", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the relevant standard. Paramount does not presently employ hedge accounting for any of its financial instruments.

Fair value through profit or loss financial assets and financial liabilities are measured at fair value, and changes in fair values over time are recognized in earnings. Derivative financial instruments are classified as fair value through profit or loss unless designated for hedge accounting. Available-for-sale financial assets are measured at fair value, and changes in fair values over time are recognized in other comprehensive income ("OCI"). Held-to-maturity financial assets, loans and receivables and other financial liabilities, including transaction costs, are measured at amortized cost using the effective interest method.

Other Comprehensive Income

For Paramount, other comprehensive income ("OCI") is comprised of changes in the market value of investments in available-for-sale securities and foreign exchange translation gains and losses relating to the Company's United States subsidiaries. OCI is presented in the Consolidated Statement of Comprehensive Loss. The cumulative changes in OCI are included in reserves, which is presented within shareholders' equity.

n) Income Taxes

Paramount follows the liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the effect of any temporary difference between the carrying amount of an asset or liability reported in the Consolidated Financial Statements and its respective tax basis, using substantively enacted income tax rates. Deferred income tax balances are adjusted to reflect changes in substantively enacted income tax rates expected to apply when assets are realized or liabilities are settled, with adjustments being recognized in the period in which the change occurs.

Deferred income tax assets are recognized to the extent future recovery is probable. Deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

o) Flow-Through Shares

The proceeds of flow-through share issuances are allocated between the sale of Paramount's Class A Common Shares ("Common Shares") and the sale of tax benefits on initial recognition, with share capital being increased based on the market price of Common Shares on the date the offering is priced and accounts payable and accrued liabilities being increased based on the difference between the issue price of the flow-through shares and the market price of Common Shares on the date the offering is priced.

As qualifying expenditures intended for renunciation to subscribers are incurred, the Company recognizes a deferred tax liability, reduces the accounts payable and accrued liabilities amount and records any difference as deferred tax expense.

p) Stock-Based Compensation

Paramount Stock Option Plan

Paramount has a stock option plan that enables the Board of Directors or its Compensation Committee to grant to key employees and directors options to acquire Common Shares of the Company ("Paramount Options"). Paramount Options generally vest over five years and expire within six years after the grant date. The provisions of the plan permit the Company to settle the options in Common Shares of the Company or in cash.

Prior to October 1, 2011, Paramount accounted for Paramount Options as cash-settled awards, where a liability was recognized initially based on the grant date fair value of the options. The liability was subsequently adjusted each period for vesting and changes in the fair value of the options, until the options were exercised, surrendered or expired, with an offsetting entry to stock-based compensation expense. The fair value of the options were determined using the Black-Scholes-Merton model. When options were exercised for Common Shares, the consideration paid by the option holder and the previously recognized liability associated with the options were recorded as an increase to share capital.

When options were surrendered for cash, the cash settlement was applied against the liability and any difference was recognized as stock-based compensation expense.

As of October 1, 2011, the Company accounts for Paramount Options as equity-settled stock-based compensation transactions, where the grant date fair value of stock options awarded is recognized as stock-based compensation expense over the vesting period, with a corresponding increase in Contributed Surplus. The grant date fair value of stock options is estimated using the Black-Scholes-Merton model and such value is not adjusted in future periods. The amount of stock-based compensation expense recognized each period reflects the portion of the vesting term that elapsed and an estimate of the number of options that are expected to vest. That estimate is adjusted each period such that the cumulative amount recognized on the vesting date reflects the actual number of stock options that ultimately vest. Upon the exercise of a Paramount Option, the Company transfers the cumulative amount recognized in respect of the award from Contributed Surplus to Share Capital.

Paramount previously accounted for Paramount options as cash-settled awards due to its past practice of accepting requests to settle Paramount Options with a cash payment. In recent years, the Company has not been granting requests to settle Paramount Options in cash, and does not expect to do so in the future. As a result, Paramount has accounted for Paramount Options as equity-settled stock-based compensation transactions from of October 1, 2011. The change in accounting method resulted in the reclassification of the September 30, 2011 stock-based compensation liability of $68.7 million to Contributed Surplus.

Cavalier Energy Stock Option Plan

In the fourth quarter of 2011, Paramount reorganized all of its oil sands and carbonate bitumen interests into a new wholly-owned subsidiary, Cavalier Energy Inc. ("Cavalier Energy"). Cavalier Energy has a stock option plan that enables its Board of Directors to grant to key employees and directors options ("Cavalier Options") to acquire common shares of Cavalier Energy. Cavalier Options generally vest over five years and expire within seven years after the grant date. The provisions of the stock option plan permit Cavalier Energy to settle Cavalier Options in common shares of Cavalier Energy or in cash, at the discretion of Cavalier Energy. Cavalier Options are accounted for as equity-settled stock-based compensation transactions.

Stock Incentive Plan

Paramount’s stock incentive plan ("SIP") provides that rights to Common Shares may be awarded to employees annually. Common Shares are purchased in the open market and held by an independent trustee until completion of the vesting period. Generally, one third of an award vests immediately, with the remaining tranches vesting annually over two years. The unvested portion of the awards is initially recorded as a reduction of share capital. The cost of the unvested Common Shares is then recognized over the vesting period as stock-based compensation expense, with a corresponding increase to Paramount’s share capital.

q) Non-current assets held for sale

Non-current assets are reclassified as assets held for sale: (i) when it is expected that their carrying amount will be recovered principally through sale rather than from continuing use; (ii) such assets are available for immediate sale in their present condition subject only to terms that are usual and customary for the sale of such property; and (iii) the completion of the transaction is highly probable. The property is measured at the lower of carrying amount or fair value less costs to sell. Non-current assets held for sale are not depreciated or amortized.

An impairment loss is recognized for any write-down of the asset to its fair value less costs to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognized in the Statement of Comprehensive Loss.

2. SIGNIFICANT ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGMENTS

The timely preparation of financial statements requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and disclosures regarding contingent assets and liabilities. The following is a discussion of the accounting estimates, assumptions and judgments that are considered significant:

Exploration and Evaluation Assets

The accounting for exploration and evaluation assets requires management to make certain judgments based on assumptions and estimates as to future events and circumstances, including the designation of wells as being exploratory or development and whether exploratory wells have discovered economically recoverable quantities of reserves. Designations are sometimes revised as new information becomes available.

If an exploratory well encounters hydrocarbons, but further appraisal activity is required in order to conclude whether the hydrocarbons are economically recoverable, the well costs remain capitalized as long as sufficient progress is being made in assessing the economic and operating viability of the well. Criteria utilized in making this determination include evaluation of the reservoir characteristics and hydrocarbon properties, expected additional development activities, and regulatory matters. The concept of "sufficient progress" is a judgmental area, and it is possible to have exploratory costs remain capitalized for several years while additional drilling is performed or the Company seeks government, regulatory or partner approval of development plans.

Where it is determined that an exploratory well or project is unsuccessful, the costs are written-off as exploration and evaluation expense.

Reserves Estimates

Reserve engineering is an inherently complex and subjective process of estimating underground accumulations of petroleum and natural gas. The process relies on judgments based on the interpretation of available geological, geophysical, engineering and production data. The accuracy of a reserves estimate is a function of the quality and quantity of available data, the interpretation of that data, the accuracy of various economic factors and the judgment of those preparing the estimate. Because these estimates depend on many assumptions, all of which may differ from actual results, reserves estimates, commodity price estimates and estimates of future net revenue will be different from the sales volumes ultimately recovered and net revenues actually realized. Changes in market conditions, regulatory matters and the results of subsequent drilling, testing and production may require revisions to the original estimates.

Estimates of reserves impact: (i) the assessment of whether a new well has found economically recoverable reserves; (ii) depletion rates; and (iii) the estimated recoverable amount of petroleum and natural gas properties used in impairment assessments, all of which could have a material impact on net income.

Business Combinations

Business combinations are accounted for using the acquisition method of accounting, where the net identifiable assets acquired are recorded at fair value. Any excess of the consideration transferred over the fair value of the net identifiable assets acquired is recognized as goodwill. Any deficiency in the consideration transferred versus the fair value of the net identifiable assets acquired is recognized in earnings. Estimates of fair value require management to make assumptions about future events, including reserves estimates. These assumptions are based on management's judgments regarding the use of appropriate indicators of fair value. Changes in any of the assumptions or estimates used in determining the fair value of the net identifiable assets acquired may impact the carrying values assigned and net income.

Asset Retirement Obligations

Estimates of asset retirement costs are based on assumptions regarding the methods, timing, economic environment and regulatory standards that are expected to exist at the time assets are retired. Management applies judgment in determining such assumptions and adjusts estimated amounts periodically to incorporate new information. Accordingly, actual payments to settle the obligations may differ materially from amounts estimated.

Share-Based Payments

The Company estimates the value of stock options awarded using the Black-Scholes-Merton model. The inputs used to determine the estimated value of the options are based on management's assumptions regarding share price volatility, the expected life of the options, expected forfeiture rates and future interest rates. By their nature, these inputs are subject to measurement uncertainty and require management to exercise judgment in determining which assumptions are the most appropriate.

Income Taxes

Accounting for income taxes is a complex process requiring management to interpret frequently changing laws and regulations and make judgments related to the application of tax law, estimate the timing of temporary difference reversals, and estimate the realization of tax assets. All tax filings are subject to subsequent government audits and potential reassessment. These interpretations and judgments and changes related to them impact current and deferred tax provisions, deferred income tax assets and liabilities and net income.

3. FUTURE CHANGES IN ACCOUNTING STANDARDS

As of January 1, 2013, Paramount will be required to adopt certain standards and amendments issued by the International Accounting Standards Board ("IASB") as described below, for which the Company is currently assessing the impact on its Consolidated Financial Statements:

- **IFRS 10, "Consolidated Financial Statements"** 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"** is the result of the IASB's project to replace IAS 31, "Interests 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. The Company expects its joint venture arrangements will continue to meet the definition of "joint operations" and that proportionate consolidation of such arrangements will continue under the new standard.

- **IFRS 12, "Disclosure of Interests in Other Entities"** outlines the required disclosures for interests in subsidiaries and joint arrangements. The new standard requires disclosure of 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"** 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.

In December 2011 the IASB approved a proposal to move the effective date for the adoption of IFRS 9, "Financial Instruments: Classification and Measurement" to January 1, 2015. This new standard, which reflects the first phase of the IASB's work on the replacement of IAS 39, "Financial Instruments – Recognition and Measurement" applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39.

4. ACQUISITIONS

ProspEx Resources Ltd.

On May 31, 2011, Paramount acquired all 54.9 million of the issued and outstanding common shares of ProspEx Resources Ltd. ("ProspEx") not already owned for consideration of $64.8 million cash and the issuance by Paramount of 2.0 million Common Shares. Immediately prior to the acquisition, Paramount owned 5.6 million shares of ProspEx (nine percent voting interest). ProspEx was a publicly traded energy company with the majority of its properties located in Alberta. The acquisition of ProspEx increased Paramount's Deep Basin land holdings in the Kakwa, Elmworth and Wapiti areas of Alberta. These financial statements include the results of operations of the acquired business for the period following the closing of the transaction on May 31, 2011.

The acquisition of ProspEx was accounted for using the acquisition method whereby all of the assets acquired and liabilities assumed were recorded at fair value. The following table summarizes the net assets acquired:

Accounts receivable	$	10,423
Exploration and evaluation		82,100
Property, plant, and equipment		107,148
Goodwill		5,477
Accounts payable and accrued liabilities		(10,355)
Bank debt		(37,824)
Asset retirement obligations		(11,943)
Deferred income tax liability		(10,610)
Other		279
Net assets acquired	**$**	**134,695**

Cash paid	$	64,759
Paramount Common Shares issued (1)		57,280
Fair value of ProspEx shares previously held (2)		12,656
Total	**$**	**134,695**

(1) Based on 2.0 million Paramount Common Shares issued and the acquisition date closing price of Paramount Common Shares of $28.64 per share.
(2) Based on 5.6 million ProspEx shares held by Paramount prior to the acquisition and the acquisition date closing price of ProspEx common shares of $2.25 per share.

Accounts receivable included $4.1 million of revenue receivable and $6.3 million of joint venture receivables. Accounts payable included $10.4 million of trade payables.

Upon the acquisition of ProspEx, a gain of $4.4 million related to the ProspEx shares held by Paramount at the acquisition date was recognized in other income based on the closing market price of the ProspEx common shares of $2.25. The gain had previously been recorded in other comprehensive income. Goodwill recorded on the acquisition of ProspEx is primarily related to the Company's recognition of deferred income tax liabilities. The goodwill recognized in the transaction is not deductible for tax purposes. The net assets acquired, including goodwill, have been allocated to the Principal Properties business segment.

Paramount incurred $1.0 million of transaction costs related to the acquisition, which were recognized in acquisition transaction costs in the Statement of Comprehensive Loss.

Since May 31, 2011, the Company recorded $15.4 million of petroleum and natural gas sales in respect of properties added through the ProspEx acquisition. If the acquisition of ProspEx had been completed on January 1, 2011, Paramount's petroleum and natural gas sales for the year ended December 31, 2011 would have been $258.6 million (unaudited). The impact of the acquisition on net income for the period is impracticable to determine.

Redcliffe Exploration Inc.

On June 29, 2010, Paramount acquired, for cash consideration of $46.2 million, all 109.9 million issued and outstanding Class A shares of Redcliffe Exploration Inc. ("Redcliffe") that it did not already own, including 340,000 Class A shares owned by certain officers of Paramount. Immediately prior to the acquisition, Paramount owned 23.5 million Class A shares of Redcliffe. Redcliffe was a Calgary based company with interests in petroleum and natural gas properties primarily in the Karr-Gold Creek and Greater Pembina areas of Alberta. These financial statements include the results of operations of the acquired business for the period following the closing of the transaction on June 29, 2010.

The acquisition of Redcliffe was accounted for using the acquisition method whereby all of the assets acquired and liabilities assumed were recorded at fair value. The following table summarizes the net assets acquired:

Accounts receivable	$ 2,995
Exploration and evaluation	29,754
Property, plant, and equipment	37,189
Goodwill	11,589
Accounts payable and accrued liabilities	(3,701)
Bank debt	(10,521)
Asset retirement obligations	(8,541)
Deferred income tax liability	(2,716)
Net assets acquired	$ 56,048

Cash paid	$ 46,172
Fair value of Redcliffe shares previously held[1]	9,876
Total	$ 56,048

(1) Based on 23.5 million Redcliffe shares held by Paramount prior to the acquisition and the acquisition date closing price of Redcliffe shares of $0.42 per share.

Upon the acquisition of Redcliffe, a gain of $3.5 million previously recorded in Paramount's OCI related to its investment in Redcliffe was reclassified to other income. Goodwill recorded on the acquisition of Redcliffe is primarily related to the Company's recognition of asset retirement obligations and deferred income tax liabilities. Goodwill recorded on the acquisition of Redcliffe is not deductible for tax purposes. The net assets acquired, including goodwill, have been allocated to the Principal Properties business segment.

Paramount incurred $0.3 million of transaction costs related to the Redcliffe acquisition, which were recognized in acquisition transaction costs in the Statement of Comprehensive Loss.

If the acquisition of Redcliffe had been completed on January 1, 2010, Paramount's petroleum and natural gas sales for the twelve months ended December 31, 2010 would have been $190.6 million (unaudited). From the date of acquisition to December 31, 2010, petroleum and natural gas sales related to properties acquired through the Redcliffe acquisition were $4.2 million (unaudited). The impact of the acquisition on net income for the period is impracticable to determine.

5. SEGMENTED INFORMATION

Paramount's operations are divided into three business segments established by management to assist in resource allocation, to assess operating performance and to achieve long-term strategic objectives:

- **Principal Properties:** Principal properties consist of: (i) the Kaybob Corporate Operating Unit ("COU"), which includes properties in West Central Alberta; (ii) the Grande Prairie COU, which includes properties in the Peace River Arch area of Alberta; (iii) the Southern COU, which includes properties in Southern Alberta, Saskatchewan, North Dakota, and Montana; and (iv) the Northern COU, which includes properties in Northern Alberta, the Northwest Territories and Northeast British Columbia.

- **Strategic Investments:** Strategic investments include: (i) investments in other entities, including affiliates; (ii) investments in exploration and development stage assets, where there is no near-term expectation of production or revenue, but a longer-term value proposition based on spin-outs, dispositions, or future revenue generation, including oil sands and carbonate resources held by Paramount's wholly-owned subsidiary, Cavalier Energy, and prospective shale gas acreage; and (iii) drilling rigs owned by Fox Drilling Inc. and Paramount Drilling U.S. L.L.C., wholly-owned subsidiaries of the Company.

- **Corporate:** Corporate is comprised of income and expense items, including general and administrative expense and interest expense, which have not been specifically allocated to Principal Properties or Strategic Investments.

Year ended December 31, 2011	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	$ 219,657	$ –	$ –	$ –	**$ 219,657**
Loss on financial commodity contracts	(1,699)	–	–	–	**(1,699)**
	217,958	–	–	–	**217,958**
Expenses					
Operating expense and production tax	71,253	–	–	–	**71,253**
Transportation	20,519	–	–	–	**20,519**
General and administrative	–	4,880	12,054	–	**16,934**
Stock-based compensation	–	5,842	15,620	–	**21,462**
Depletion and depreciation	375,694	5,639	454	(3,710)	**378,077**
Exploration and evaluation	25,726	1,604	–	–	**27,330**
Gain on sale of property, plant and equipment	(42,021)	–	–	–	**(42,021)**
Interest	–	1,195	32,914	–	**34,109**
Accretion of asset retirement obligations	7,324	50	–	–	**7,374**
Acquisition transaction costs	–	–	1,044	–	**1,044**
Foreign exchange	–	(30)	1,407	–	**1,377**
	458,495	19,180	63,493	(3,710)	**537,458**
Income from equity-accounted investments	–	1,201	–	–	**1,201**
Other	5,131	15,703	–	–	**20,834**
Drilling rig revenue	–	22,376	–	(14,039)	**8,337**
Drilling rig expense	–	(11,072)	–	6,429	**(4,643)**
	(235,406)	9,028	(63,493)	(3,900)	**(293,771)**
Inter-segment eliminations	–	(3,900)	–	3,900	**–**
Segment earnings (loss)	$ (235,406)	$ 5,128	$ (63,493)	$ –	**(293,771)**
Income tax recovery					**61,781**
Net loss					**$ (231,990)**

Year ended December 31, 2010	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	$ 163,168	$ –	$ –	$ –	$ 163,168
Gain on financial commodity contracts	10,047	–	–	–	10,047
	173,215	–	–	–	173,215
Expenses					
Operating expense and production tax	50,892	–	–	–	50,892
Transportation	17,219	–	–	–	17,219
General and administrative	–	3,602	11,548	–	15,150
Stock-based compensation	–	16,583	38,695	–	55,278
Depletion and depreciation	158,909	3,781	716	(2,756)	160,650
Exploration and evaluation	41,819	902	–	–	42,721
Gain on sale of property, plant and equipment	(380)	–	–	–	(380)
Interest	–	1,243	12,317	–	13,560
Accretion of asset retirement obligations	7,917	58	–	–	7,975
Debt extinguishment	–	–	1,708	–	1,708
Acquisition transaction costs	–	–	267	–	267
Foreign exchange	–	(57)	(241)	–	(298)
	276,376	26,112	65,010	(2,756)	364,742
Income from equity-accounted investments	–	35,999	–	–	35,999
Other	1,066	2,600	(109)	–	3,557
Drilling rig revenue	–	13,425	–	(9,534)	3,891
Drilling rig expense	–	(8,001)	–	5,337	(2,664)
	(102,095)	17,911	(65,119)	(1,441)	(150,744)
Inter-segment eliminations	–	(1,441)	–	1,441	–
Segment earnings (loss)	$ (102,095)	$ 16,470	$ (65,119)	$ –	(150,744)
Income tax recovery					60,733
Net loss					$ (90,011)

Total Assets	**December 31, 2011**	December 31, 2010	January 1, 2010
Principal Properties	**$ 1,216,808**	$ 816,279	$ 634,860
Strategic Investments	**361,909**	397,009	286,392
Corporate	**146,996**	178,033	115,628
	$ 1,725,713	$ 1,391,321	$ 1,036,880

	2011			2010		
Geographical Information	**Canada**	**United States**	**Total**	Canada	United States	Total
Revenue	**$ 183,344**	**$ 36,313**	**$ 219,657**	$ 131,607	$ 31,561	$ 163,168
Exploration and evaluation assets	**374,364**	**16,378**	**390,742**	247,009	22,075	269,084
Property, plant and equipment, net	**753,167**	**55,450**	**808,617**	513,689	66,645	580,334
Goodwill	**$ 3,426**	**$ –**	**$ 3,426**	$ 8,012	$ –	$ 8,012

For the year ended December 31, 2011, the Company had sales to two customers which exceeded $30 million and to one customer which exceeded $20 million.

Other Income

Year ended December 31	**2011**	2010
Gain on investments	**$ 15,703**	$ 3,499
Write-down of investments	**–**	(899)
Drilling revenue	**8,337**	3,891
Drilling rig expense	**(4,643)**	(2,664)
Other	**5,131**	957
	$ 24,528	$ 4,784

6. ASSETS HELD FOR SALE

During the fourth quarter of 2011, the Company entered into an agreement with a syndicate of underwriters to sell five million non-voting shares of Trilogy Energy Corp. ("Trilogy") for gross proceeds of $189.5 million. The sale closed in January 2012.

During the fourth quarter of 2011, Paramount entered into agreements to sell certain oil and gas properties within the Southern and Northern COUs for aggregate gross proceeds of approximately $50 million. The transactions closed in early-2012.

The December 31, 2011 carrying value of assets held for sale and related liabilities are as follows:

	Principal Properties	**Trilogy**	**Total**
Exploration and evaluation	$ 5,052	$ –	**$ 5,052**
Property, plant and equipment, net	28,251	–	**28,251**
Equity-accounted investments	–	24,196	**24,196**
Goodwill	539	–	**539**
Asset retirement obligations	$ (13,040)	$ –	**$ (13,040)**

7. EXPLORATION AND EVALUATION

Year ended December 31	**2011**	2010
Balance, beginning of year	**$ 269,084**	$ 151,283
Additions	**229,347**	175,495
Transfer to assets held for sale	**(5,052)**	–
Corporate acquisitions	**82,100**	29,754
Transfers to property, plant and equipment	**(161,853)**	(51,828)
Impairment	**–**	(1,739)
Dry hole	**(2,371)**	(8,479)
Expired lease costs	**(18,195)**	(24,248)
Dispositions	**(3,052)**	(586)
Foreign exchange	**734**	(568)
Balance, end of year	**$ 390,742**	$ 269,084

Additions to exploration and evaluation assets totaled $207.5 million (2010 - $160.4 million) for Principal Properties and $21.8 million (2010 - $15.1 million) for Strategic Investments.

Exploration and Evaluation Expense

Year ended December 31	2011	2010
Geological and geophysical	**$ 6,764**	$ 10,719
Dry hole	**2,371**	7,754
Expired lease costs	**18,195**	24,248
	$ 27,330	$ 42,721

8. PROPERTY, PLANT AND EQUIPMENT

Year ended December 31, 2011	Petroleum and natural gas assets	Drilling rigs	Other	Total
Cost				
Balance, December 31, 2010	$ 873,822	$ 46,146	$ 19,850	**$ 939,818**
Additions	295,733	4,974	81	**300,788**
Corporate acquisitions	107,148	–	–	**107,148**
Transfer to assets held for sale	(29,859)	–	–	**(29,859)**
Transfer from exploration and evaluation	161,853	–	–	**161,853**
Dispositions	(4,943)	–	–	**(4,943)**
Change in asset retirement provision	61,125	–	–	**61,125**
Currency translation differences	1,228	351	12	**1,591**
Cost, December 31, 2011	**1,466,107**	**51,471**	**19,943**	**1,537,521**
Accumulated depletion, depreciation and write-downs				
Balance, December 31, 2010	$ (333,455)	$ (8,157)	$ (17,872)	**$ (359,484)**
Transfer to assets held for sale	1,608	–	–	**1,608**
Depletion and depreciation	(150,372)	(5,595)	(498)	**(156,465)**
Write-downs, net	(215,156)	–	–	**(215,156)**
Dispositions	1,217	–	–	**1,217**
Currency translation differences	(472)	(147)	(5)	**(624)**
Accumulated depletion, depreciation and write-downs, December 31, 2011	(696,630)	(13,899)	(18,375)	**(728,904)**
Net book value, December 31, 2010	540,367	37,989	1,978	**580,334**
Net book value, December 31, 2011	**$ 769,477**	**$ 37,572**	**$ 1,568**	**$ 808,617**

Year ended December 31, 2010	Petroleum and natural gas assets	Drilling rigs	Other	Total
Cost				
Balance, January 1, 2010	$ 641,265	$ 46,840	$ 19,720	$ 707,825
Additions	118,457	1,208	161	119,826
Corporate acquisitions	37,189	–	–	37,189
Transfer from exploration and evaluation	51,828	–	–	51,828
Dispositions	(6,342)	(1,121)	–	(7,463)
Change in asset retirement provision	34,063	–	–	34,063
Currency translation differences	(2,638)	(781)	(31)	(3,450)
Cost, December 31, 2010	873,822	46,146	19,850	939,818
Accumulated depletion, depreciation and write-downs				
Balance, January 1, 2010	$ (184,315)	$ (3,274)	$ (17,130)	$ (204,719)
Depletion and depreciation	(100,982)	(5,135)	(751)	(106,868)
Write-downs, net	(54,350)	–	–	(54,350)
Dispositions	5,896	–	–	5,896
Currency translation differences	296	252	9	557
Accumulated depletion, depreciation and write-downs, December 31, 2010	(333,455)	(8,157)	(17,872)	(359,484)
Net book value, January 1, 2010	456,950	43,566	2,590	503,106
Net book value, December 31, 2010	$ 540,367	$ 37,989	$ 1,978	$ 580,334

Depletion and Depreciation

Year ended December 31	**2011**	2010
Depletion and depreciation	**$ 156,465**	$ 106,868
Write-down of property, plant and equipment	**215,156**	54,350
Goodwill impairment	**10,502**	3,577
Inter-segment eliminations	**(4,046)**	(4,145)
	$ 378,077	$ 160,650

At December 31, 2011, $111.4 million (December 31, 2010 – $20.0 million) of capitalized costs related to incomplete development wells and infrastructure projects are currently not subject to depletion.

Additions to property, plant and equipment include $3.2 million of capitalized interest for qualifying assets in the construction phase (2010 – nil) at a weighted average interest rate of eight percent. Additions were $295.7 million (2010 - $118.6 million) for Principal Properties, $5.0 million (2010 - $1.2 million) for Strategic Investments and $0.1 million (2010 – $0.2 million) for Corporate.

The Company recorded an impairment write-down related to its petroleum and natural gas assets of $215.2 million (2010 – $54.4 million) within the principal properties segment. The impairment write-down was primarily related to the Elmworth CGU (Karr–Gold Creek and Valhalla) in the Grande Prairie COU, the Southern CGU (Chain and Delia) in Canada, and the Bistcho/Pedigree CGU (Bistcho and Cameron Hills) in the Northern COU, where the carrying value of the properties exceeded their expected discounted cash flows from the production of estimated proved and probable reserves. The impairment resulted from a combination of declines in reserves assigned due to well performance and the decline in forecast natural gas prices.

Write-downs were recognized to the extent that the carrying value of each CGU exceeded its expected recoverable amount. The recoverable amount was estimated on a fair value less costs to sell basis using a discounted cash flow method, which is an approach commonly employed by market participants to

value oil and gas properties. Cash flows were projected over the expected remaining life of each CGU's reserves, at an after-tax discount rate of eight percent at December 31, 2011 (December 31, 2010 – eight percent). The forecast prices used to determine the recoverable amount reflect the following benchmark prices, adjusted for basis differentials to determine local reference prices, transportation costs and quality:

(Average for the period)	2012	2013	2014	2015	2016	2017-2026	Thereafter
Natural Gas							
AECO ($/MMBtu)	3.50	4.20	4.70	5.10	5.55	5.90 - 7.55	+2%/yr
Henry Hub (US$/MMBtu)	3.75	4.50	5.05	5.50	5.95	6.35 - 8.10	+2%/yr
Crude Oil							
Edmonton - Light Sweet ($/Bbl)	99.00	99.00	101.50	102.30	103.20	104.20 - 120.50	+2%/yr
WTI (US$/Bbl)	97.50	97.50	100.00	100.80	101.70	102.70 - 118.80	+2%/yr

9. EQUITY ACCOUNTED INVESTMENTS

	December 31, 2011			December 31, 2010			January 1, 2010		
	Shares (000's)	**Carrying Value**	**Market Value[(1)]**	*Shares (000's)*	Carrying Value	Market Value[(1)]	*Shares (000's)*	Carrying Value	Market Value[(1)]
Trilogy	***19,144***[(2)]	**$ 94,062**	**$ 719,253**	*24,144*	$ 125,746	$ 296,975	*23,995*	$ 98,773	$ 206,114
MGM Energy	***43,834***	**1,691**	**10,520**	*43,834*	5,222	8,767	*43,834*	5,844	12,493
Paxton	***1,750***	**4,015**		*1,750*	4,338		*1,750*	4,574	
Other		**1,775**			2,994			4,280	
		$ 101,543			$ 138,300			$ 113,471	

(1) Based on the period-end trading price of publicly traded entities.
(2) Excludes 5 million Trilogy shares classified within assets held for sale.

Income (loss) from equity-accounted investments is composed of the following:

Year ended December 31	**2011**			2010		
	Equity income (loss)	**Dilution gain**	**Total**	Equity income (loss)	Dilution gain	Total
Trilogy	**$ 1,945**	**$ 1,060**	**$ 3,005**	$ 32,415	$ 4,109	$ 36,524
MGM Energy	**(1,481)**	**–**	**(1,481)**	(1,041)	209	(832)
Paxton	**(323)**	**–**	**(323)**	(240)	–	(240)
Other	**–**	**–**	**–**	547	–	547
	$ 141	**$ 1,060**	**$ 1,201**	$ 31,681	$ 4,318	$ 35,999

Paramount recorded a $1.1 million dilution gain (2010 - $4.1 million) in respect of its investment in Trilogy as a result of shares issued by the investee related to stock option exercises.

The following table summarizes the assets, liabilities, revenues and income/loss of Trilogy, MGM Energy and Paxton. The amounts summarized have been derived directly from Trilogy's published financial statements as at and for the years ended December 31, 2011 and 2010 and from MGM Energy's and Paxton's financial statements as at and for the period ended December 31, 2010. The amounts presented do not include Paramount's adjustments in applying the equity method of investment accounting. As a result, these amounts cannot be used directly to derive Paramount's equity income and net investment in these entities.

As at December 31	2011	2010		
	Trilogy	Trilogy	MGM Energy[1]	Paxton[1]
Assets	**$ 1,260,364**	$ 1,081,448	$ 236,137	$ 27,527
Liabilities	**$ 729,919**	$ 540,629	$ 5,187	$ 65
Shares outstanding (thousands)	**116,118**	114,741	314,495	17,402
Paramount's equity interest	**21%**	21%	14%	10%

Year ended December 31	2011	2010		
Revenue	**$ 342,106**	$ 246,124	$ –	$ –
Net income (loss)	**$ 17,415**	$ 178,242	$ (19,744)	$ (2,876)

Note: Readers are cautioned that Paramount does not have any direct or indirect interest in or right to the investee's assets or revenue, nor does Paramount have any direct or indirect obligation in respect of or liability for the expenses or obligations of such entities.
(1) MGM Energy's and Paxton's 2011 financial statements were not finalized prior to completing these financial statements.

Trilogy had 6.0 million stock options outstanding (1.7 million exercisable) at December 31, 2011 at exercise prices ranging from $4.85 to $38.74 per share.

10. INVESTMENTS IN SECURITIES

	December 31, 2011		December 31, 2010		January 1, 2010	
	Shares (000's)		*Shares (000's)*		*Shares (000's)*	
MEG Energy Corp.	***3,700***	**$ 153,809**	*3,700*	$ 168,313	*3,700*	$ 101,750
NuLoch Resources Inc. ("NuLoch")	**–**	**–**	*6,579*	13,684	*6,579*	5,921
ProspEx	**–**	**–**	*5,625*	7,369	–	–
Redcliffe	**–**	**–**	–	–	*19,667*	7,210
Other		***31***		351		502
		$ 153,840		$ 189,717		$ 115,383

In April 2011, Paramount sold 3.3 million of the NuLoch shares it held for cash proceeds of $8.1 million. The Company recognized a gain on the disposition of $5.7 million, which previously had been recorded in other comprehensive income. In May 2011, NuLoch was acquired by Magnum Hunter Resources Corp. ("Magnum Hunter") and each of the remaining 3.3 million NuLoch shares held by Paramount was exchanged for 0.3304 of a common share of Magnum Hunter, resulting in Paramount receiving 1.1 million common shares of Magnum Hunter. An accumulated unrealized gain of $5.3 million that had been recorded in other comprehensive income in respect of the NuLoch shares exchanged by Paramount was recognized in other income. In July 2011, Paramount sold all 1.1 million of the Magnum Hunter shares it held for cash proceeds of $7.7 million. The Company recognized a gain on the disposition of $0.1 million, which previously had been recorded in other comprehensive income.

11. GOODWILL

	December 31, 2011	December 31, 2010	January 1, 2010
Carrying value, beginning of year	**$ 8,012**	$ –	$ –
Acquisitions	**5,477**	11,589	–
Adjustment to Redcliffe net assets acquired	**978**	–	–
Reclassified to assets held for sale	**(539)**	–	–
Impairment	**(10,502)**	(3,577)	–
Carrying value, end of year	**$ 3,426**	$ 8,012	$ –

For the year ended December 31, 2011, there were additions to goodwill of $5.5 million in respect of the ProspEx acquisition and $1.0 million in respect of additional liabilities of Redcliffe that existed at the date of acquisition.

For the purpose of testing goodwill for impairment, the recoverable amount of each CGU was determined on the same basis as used in determining the recoverable amount of that CGU for the purpose of testing its property, plant and equipment assets for impairment.

The carrying amount of goodwill allocated to each of the COUs is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Grande Prairie	**$ –**	$ 7,464	$ –
Kaybob	**3,124**	548	–
Southern	**–**	–	–
Northern	**302**	–	–
	$ 3,426	$ 8,012	$ –

12. DEMAND FACILITIES

Drilling Rig Loans

In 2009, Paramount entered into a $30.4 million non-revolving demand loan facility with a Canadian bank ("Drilling Rig Loan I"). The loan was drawn in full at closing and aggregate principal payments of $7.5 million have been made to December 31, 2011. Unless demanded by the bank, annual scheduled principal repayments are $5.1 million in each of 2012 and 2013, with the remaining outstanding balance of $12.6 million payable in 2014.

In January 2012, Paramount entered into a new $30.0 million non-revolving demand loan facility with the same Canadian bank to partially fund the construction of two new triple-sized walking rigs ("Drilling Rig Loan II"). Advances on Drilling Rig Loan II are available during the year-long construction period with scheduled principal repayments to commence in 2013. Drilling Rig Loan II is currently undrawn.

Recourse and security for Drilling Rig Loan I and Drilling Rig Loan II is limited to the three existing drilling rigs, the two rigs to be constructed, and drilling contracts guaranteed by Paramount. The carrying value of the three existing rigs is $37.6 million (2010 - $38.0 million). Interest is payable at the bank's prime lending rate or bankers acceptance rate, as selected at the discretion of the Company, plus an applicable margin. The effective interest rate on Drilling Rig Loan I for the period ended December 31, 2011 was 4.7 percent (2010 - 4.2 percent).

Cavalier Energy Facility

In January 2012, Cavalier Energy entered into a $21.0 million demand loan facility with a syndicate of Canadian banks (the "Cavalier Facility"). The Cavalier Facility bears interest at the lenders' prime lending rates, US base rates, or bankers' acceptance rates, as selected at the discretion of Paramount, plus an applicable margin. The Cavalier Facility is non-recourse to Paramount and is secured by all of the assets of Cavalier Energy, including oil sands and carbonate bitumen lands.

13. LONG-TERM DEBT

	December 31, 2011	December 31, 2010	January 1, 2010
Canadian Dollar Denominated Debt			
Bank credit facility	**$ 61,383**	$ –	$ –
8 ¼ percent Senior Notes due 2017	**370,000**	300,000	–
U.S. Dollar Denominated Debt			
8 ½ percent US Senior Notes due 2013	**–**	–	94,394
	431,383	300,000	94,394
Unamortized financing costs net of premiums	**(4,197)**	(5,795)	(739)
	$ 427,186	$ 294,205	$ 93,655

Bank Credit Facility

In June 2011, Paramount renewed its bank credit facility (the "Facility"), increasing the total credit limit from $160 million to $300 million, which is available in two tranches. The first tranche ("Tranche A") has a borrowing base and lender commitments of $225 million and is available on a revolving basis to June 30, 2012. In the event the revolving period is not extended, Tranche A would be available on a non-revolving basis for an additional year, at which time it would be due and payable. The second tranche ("Tranche B") is available on a revolving basis, has a credit limit of up to $75 million and is due June 30, 2012 in the event the due date is not earlier extended. The Facility is secured by a first fixed and floating charge over substantially all of the assets of Paramount, excluding assets securing the Drilling Rig Loan and the Cavalier Facility. Balances drawn under Tranche B are secured by the pledge of certain of the Company's equity investments.

The Facility bears interest at the lenders' prime lending rates, US base rates, bankers' acceptance or LIBOR rates, as selected at the discretion of Paramount, plus an applicable margin which is dependent upon the Company's debt to cash flow ratio and the tranche under which borrowings are made. The maximum amount that Paramount may borrow under the Facility is subject to periodic review, and is dependent upon the Company's reserves, lenders' projections of future commodity prices and the market value of equity investments pledged by Paramount from time-to-time under Tranche B, among other factors. Increases in the borrowing base and lender commitments under Tranche A reduce the credit limit under Tranche B by an equivalent amount.

At December 31, 2011, $61.4 million (December 31, 2010 – nil) was drawn on Tranche A of the Facility. Paramount had undrawn letters of credit outstanding at December 31, 2011 totaling $26.3 million that reduce the amount available to the Company.

Senior Notes

In December 2010, Paramount completed a public offering of $300 million principal amount of senior unsecured notes ("Senior Notes") at par, of which $11.4 million principal amount was purchased by certain directors, associates, officers, and management of the Company.

In February 2011, Paramount completed a public offering of an additional $70 million principal amount of Senior Notes at a price of $1,030 per $1,000 principal amount, of which $1.4 million principal amount was purchased by an entity that is controlled by the Company's Chairman and Chief Executive Officer. The Senior Notes bear interest at 8.25 percent per annum, payable semi-annually in arrears on June 13 and December 13 in each year and mature on December 13, 2017. The Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company.

The Company may redeem all or any portion of the Senior Notes at any time on or prior to December 13, 2013 at par, plus accrued and unpaid interest, plus a redemption premium equal to the greater of: (i) one percent; and (ii) a make-whole amount based on the then current yield of a Government of Canada bond with a similar maturity. Paramount may also redeem up to an aggregate of 35 percent of the Senior Notes with the net cash proceeds of an equity offering at any time prior to December 13, 2013, at par plus a redemption premium of 8.25 percent. On or after December 13, 2013, the Company may redeem some or all of the Senior Notes at par plus a redemption premium, if applicable, of up to 4.125 percent depending on when redeemed, plus accrued and unpaid interest.

US Senior Notes

During the fourth quarter of 2010, Paramount's obligations under the indenture governing its US$90.2 million principal amount of 8.5 percent US senior notes ("US Senior Notes") were discharged as a result of Paramount: (i) purchasing US$64.2 million principal amount of US Senior Notes pursuant to a tender offer; (ii) delivering all US Senior Notes held by the Company to the trustee for cancellation; (iii) issuing a redemption notice for US$26.0 million principal amount of US Senior Notes not tendered under the tender offer (the "Redeemed Notes"); and (iv) irrevocably depositing sufficient cash with the trustee to pay all amounts due on the Redeemed Notes on the January 31, 2011 redemption date.

14. ASSET RETIREMENT OBLIGATIONS

Year ended December 31	2011	2010
Asset retirement obligations, beginning of year	**$ 241,770**	$ 195,088
Retirement obligations incurred	**23,463**	25,691
Revisions to estimated retirement costs and discount rates	**37,791**	17,819
Obligations settled	**(7,520)**	(3,209)
Disposal of properties	**(2,902)**	(9,638)
Assumed on corporate acquisition	**11,943**	8,541
Accretion expense	**7,374**	7,975
Transfer to liabilities associated with assets held for sale	**(13,040)**	–
Foreign exchange	**323**	(497)
Asset retirement obligations, end of year	**$ 299,202**	$ 241,770

The asset retirement obligation at December 31, 2011 has been determined using a weighted average risk-free rate of 2.25 percent (2010 – 4.0 percent). These obligations will be settled over the useful lives of the assets, which extend up to 42 years.

15. SHARE CAPITAL

Weighted Average Common Shares Outstanding

	2011		2010	
	Shares (000's)		*Shares (000's)*	
Net loss – basic	***78,462***	**$ (231,990)**	*72,705*	$ (90,011)
Dilutive effect of Paramount options	–	–	–	–
Net loss – diluted	***78,462***	**$ (231,990)**	*72,705*	$ (90,011)

Outstanding Paramount Options can be exchanged for the Company's Common Shares in accordance with the terms of the stock option plan. As a result, they are considered potentially dilutive and are included in the calculation of Paramount's diluted net income per share calculation when they are dilutive for the period.

In April 2011, Paramount issued 1,500,000 Common Shares at a price of $32.50 per share for gross proceeds of $48.8 million pursuant to a public offering. In April 2011, Paramount also issued 150,000 Common Shares on a "flow-through" basis in respect of Canadian development expenses at a price of $36.50 per share for gross proceeds of $5.5 million to a company controlled by the Company's Chairman and Chief Executive Officer. In May 2011, the Company issued 2,000,000 Common Shares in connection with the ProspEx acquisition. In October 2011, Paramount issued 1,450,000 Common Shares on a "flow-through" basis in respect of Canadian exploration expenses ("CEE") pursuant to a public offering at a price of $40.50 per share for gross proceeds of $58.7 million. Also in October 2011, the Company issued 100,000 Common Shares on a "flow-through" basis in respect of CEE at a price of $40.50 per share for gross proceeds of $4.1 million to companies controlled by the Company's Chairman and Chief Executive Officer. In November 2011, Paramount issued 4,500,000 Common Shares at a price of $34.75 per share for gross proceeds of $156.4 million through a public offering.

The Company incurred $8.6 million (2010 – $1.0 million) of transaction costs in respect of these equity offerings, net of tax of $2.9 million (2010 – $0.4 million).

16. RESERVES

Reserves at December 31, 2011 include unrealized gains on the Company's investments in available-for-sale securities, foreign exchange differences on the translation of foreign subsidiaries' balances, and contributed surplus amounts in respect of Paramount Options and Cavalier Options. The changes in reserves are as follows:

	Unrealized Gains on Securities	**Translation of Foreign Subsidiaries**	**Contributed Surplus**	**Stock-based compensation – investee options**	**Total Reserves**
Balance, December 31, 2010	$ 71,622	$ (2,028)	$ –	$ 2,402	**$ 71,996**
Other comprehensive income (loss)	(19,913)	1,197	–	–	**(18,716)**
Stock-based compensation liability reclassified	–	–	68,728	–	**68,728**
Stock-based compensation expense	–	–	4,185	–	**4,185**
Stock options exercised	–	–	(7,121)	–	**(7,121)**
Reclassification to equity-accounted investments	–	–	–	(2,402)	**(2,402)**
Balance, December 31, 2011	$ 51,709	$ (831)	$ 65,792	$ –	**$116,670**

	Unrealized Gains on Securities	Translation of Foreign Subsidiaries	Contributed Surplus	Stock-based compensation – investee options	Total Reserves
Balance, January 1, 2010	$ 3,188	$ –	$ –	$ 1,839	$ 5,027
Other comprehensive income (loss)	68,434	(2,028)	–	–	66,406
Stock-based compensation related to equity-accounted investments	–	–	–	563	563
Balance, December 31, 2010	$ 71,622	$ (2,028)	$ –	$ 2,402	$ 71,996

Other Comprehensive Income (Loss)

Year ended December 31	2011	2010
Unrealized Gain (Loss) on Securities		
Change in market value of securities	**$ (7,109)**	$ 75,090
Reclassification of other comprehensive income to earnings	**(15,693)**	(3,499)
Deferred tax	**2,889**	(3,157)
	(19,913)	68,434
Translation of Foreign Subsidiaries		
Exchange differences on translation of US subsidiaries	**(1,419)**	(2,749)
Reclassification of other comprehensive loss to earnings	**2,965**	–
Deferred tax	**(349)**	721
	1,197	(2,028)
Other comprehensive income (loss)	**$ (18,716)**	$ 66,406

17. SHARE-BASED PAYMENTS

Paramount Options

Changes in the Company's outstanding options are as follows:

	2011		2010	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		($/share)		($/share)
Balance, beginning of year	**5,006,300**	**$ 13.90**	4,571,500	$ 8.61
Granted	**1,529,000**	**38.95**	1,276,500	28.98
Exercised	**(618,850)**	**10.80**	(683,700)	7.90
Forfeited	**(149,000)**	**17.74**	(158,000)	8.74
Balance, end of year	**5,767,450**	**$ 20.76**	5,006,300	$ 13.90
Options exercisable, end of year	**1,832,218**	**$ 10.66**	1,367,301	$ 8.13

For options exercised in 2011, the weighted average market price of Paramount's Common Shares on the dates exercised was $35.46 (2010 - $21.95).

The weighted average remaining contractual life and exercise prices of Paramount Options outstanding as of December 31, 2011 are as follows:

		Awards Outstanding	
Exercise Prices	**Number**	**Remaining Contractual Life**	**Weighted average exercise price**
$6.87 – $10.00	2,378,200	1.8	$ 7.34
$10.01 – $20.00	751,050	3.3	$ 13.38
$20.01 – $30.00	1,185,200	4.3	$ 29.39
$30.01 – $40.09	1,453,000	5.3	$ 39.51
	5,767,450	**3.4**	**$ 20.76**

The fair value of Paramount Options has been estimated using the Black-Scholes-Merton model incorporating the following weighted average inputs:

	Options re-measured at September 30, 2011	Options awarded between October 1, 2011 and December 31, 2011
Weighted average exercise price	$ 14.67	$ 40.02
Expected volatility	49.7 %	47.8 %
Expected life of share options	2.3 years	4.7 years
Pre-vest forfeiture rate	4.6 %	4.9 %
Risk-free interest rate	1.1 %	1.2 %
Expected dividend yield	nil	nil
Weighted average fair value of awards	$ 18.69	$ 16.45

The estimated expected life of the Paramount Options is based on historical exercise patterns. The expected volatility is estimated based on the historical volatility of the trading price of the Company's Common Shares over the most recent period that is generally commensurate with the expected term of the option.

Cavalier Options

In November 2011, 2.5 million Cavalier Options were granted to Cavalier Energy management and directors having a term of seven years and vesting over four to five years. No exercises or cancellations have occurred to date.

Stock Incentive Plan

Year ended December 31	**2011**		2010	
Stock incentive plan shares held in trust	***Shares (000's)***		*Shares (000's)*	
Balance, beginning of year	***150***	**$ 410**	*178*	$ 312
Shares purchased	***101***	**2,974**	*178*	2,901
Change in vested and unvested shares	***(165)***	**(2,965)**	*(206)*	(2,803)
Balance, end of year	***86***	**$ 419**	*150*	$ 410

Employee Benefit Costs

Year ended December 31	**2011**	2010
Stock option plan	**$ 18,412**	$ 51,642
Stock incentive plan	**3,050**	3,636
Stock-based compensation expense	**21,462**	55,278
Salaries and benefits, net of recoveries	**10,956**	10,125
	$ 32,418	$ 65,403

18. DEFERRED INCOME TAX

The following table reconciles income taxes calculated at the Canadian statutory rate to Paramount's recorded income tax recovery:

Year ended December 31		**2011**		2010
Earnings (loss) before tax	**$**	**(293,771)**	$	(150,744)
Effective Canadian statutory income tax rate		**26.6%**		28.1%
Expected income tax expense (recovery)	**$**	**(78,143)**	$	(42,359)
Increase (decrease) resulting from:				
Statutory and other rate differences		**8,067**		(17,242)
Gain on investments		**(2,777)**		(983)
Income from equity-accounted investments		**(319)**		(10,116)
Goodwill impairment		**2,792**		1,005
Flow-through share renunciations		**4,625**		6,417
Stock-based compensation		**4,881**		14,494
Non-deductible items and other		**(907)**		(11,949)
Income tax expense (recovery)	**$**	**(61,781)**	$	(60,733)

Components of Deferred Income Tax Asset (Liability)

As at December 31		**2011**		2010
Property, plant and equipment	**$**	**(11,339)**	$	(20,743)
Investments		**(286)**		(3,308)
Asset retirement obligations		**80,105**		62,404
Non-capital and net operating losses		**42,131**		27,523
Other		**6,937**		9,699
	$	**117,548**	$	75,575

Paramount has $152.6 million (2010 - $100.1 million) of unused tax losses expiring between 2014 and 2031. In addition, Paramount has $167.4 million (2010 - $156.9 million) of deductible temporary differences in respect of investments for which no deferred income tax asset has been recognized. Deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences and unutilized tax losses can be applied. A deferred tax asset related to the carry forward of unutilized tax losses has been recorded as the Company expects that future taxable profits, through a combination of future operating results and gains realized on the disposition of assets, will be sufficient to utilize the deferred tax asset.

In October 2010, the Company received reassessments from the Canada Revenue Agency (the "CRA") and provincial tax authorities of its income taxes relating to a prior year transaction (the "Reassessments"). Paramount disagrees with the Reassessments and has filed notices of objection with the CRA and provincial tax authorities. Despite its disagreement, and as a condition of its right to proceed with its objection to the Reassessments, the Company was required to deposit approximately $20 million with the CRA, which amount will remain on account until the dispute is resolved.

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial Instruments

Financial instruments at December 31, 2011 consisted of cash and cash equivalents, accounts receivable, the Deposit, available-for-sale investments, the Drilling Rig Loan, accounts payable and accrued liabilities, risk management assets and liabilities, and long-term debt.

Fair Values of Financial Assets and Liabilities

The fair value of financial assets and liabilities are included in the Consolidated Financial Statements at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation or sale. The following methods and assumptions were used to estimate the fair values:

- Cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments. The fair value of the Deposit approximates its carrying amount.
- Risk management assets and liabilities are carried at fair values, which are based on forward market curves and compared to quotes provided by financial institutions.
- Publicly traded available-for-sale investments are carried at the period-end trading price.
- The carrying value of the Drilling Rig Loan and long-term debt are measured at amortized cost. The Senior Notes had a market value of 103.1 percent of their principal amount at December 31, 2011.

Risk management financial instruments outstanding at December 31, 2011 are as follows:

Instruments	Notional	Average Fixed Price	Fair Value	Remaining Term
Oil – NYMEX WTI Swap	500 Bbl/d	US $101.01/Bbl	**$ 139**	January – May 2012
Oil – NYMEX WTI Collar	500 Bbl/d	Floor – US $85.00/Bbl Ceiling – US $116.85/Bbl	**45**	January – May 2012
Oil – NYMEX WTI Swap	500 Bbl/d	US $101.65/Bbl	**223**	January – June 2012
Oil – NYMEX WTI Swap	500 Bbl/d	US $97.25/Bbl	**(288)**	January – December 2012
Oil – NYMEX WTI Swap	1,000 Bbl/d	US $91.50/Bbl	**(2,722)**	January – December 2012
			$ (2,603)	

Changes in the fair value of risk management assets and liabilities are as follows:

Year ended December 31	**2011**	2010
Fair value, beginning of year	**$ (693)**	$ 2,187
Changes in fair value	**(1,699)**	10,047
Settlements received	**(211)**	(12,927)
Fair value, end of year	**$ (2,603)**	$ (693)

Fair Value Hierarchy

Paramount uses a three-level hierarchy for determining the fair value of financial instruments, which is based upon the transparency of inputs used in the valuation of financial instruments recognized at fair value. The three levels are defined as follows:

- Level one – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level two – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level three – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

At December 31, 2011, Paramount's publicly traded available-for-sale investments were classified as level 1 fair values and risk management assets and liabilities were classified as level 2 fair values.

Risk Management

Paramount is exposed to market risks where the fair values or future cash flows of financial instruments fluctuate because of underlying changes in market prices. The principal market risks impacting Paramount are commodity price risk, foreign currency risk, interest rate risk, equity price risk, credit risk and liquidity risk. Paramount periodically uses derivative instruments such as forwards, swaps and options to manage its exposure to fluctuations in crude oil and natural gas prices, foreign exchange rates, and interest rates.

Commodity Price Risk

At December 31, 2011, assuming all other variables are held constant, a 10 percent increase or decrease in the applicable forward market curves would have had the following impact on Paramount's net earnings from changes in the fair value of financial commodity contracts:

	10% increase	**10% decrease**
Crude Oil	$ (5,000)	$ 5,000

Foreign Currency Risk

Paramount is exposed to foreign currency risk on financial instruments denominated in US dollars including cash and cash equivalents, accounts receivable, risk management assets and liabilities, and accounts payable and accrued liabilities.

Sales prices of natural gas, crude oil, and natural gas liquids ("NGLs") are determined with reference to US benchmark prices, therefore a strengthening of the Canadian dollar relative to the US dollar will decrease the revenue received for natural gas, crude oil, and NGLs. Paramount's expenditures are primarily in Canadian dollars but include capital and operating expenditures in US dollars, largely related to the Company's US operations.

Interest Rate Risk

Paramount is exposed to interest rate risk from time to time on outstanding balances on its floating rate bank credit facilities, and on interest bearing cash and cash equivalents. Paramount's Senior Notes bear interest at a fixed rate and are subject to fair value changes as market interest rates change.

Equity Price Risk

Paramount is exposed to equity price risk associated with changes in the market value of its investments.

Credit Risk

Paramount is exposed to credit risk on its financial instruments where a financial loss would be experienced if a counterparty to a financial asset failed to meet its obligations. The Company manages credit risk by endeavoring to enter into contracts with counterparties that possess high credit ratings, employing net settlement agreements, employing letters of credit, and limiting available credit when necessary. The maximum credit risk exposure at December 31, 2011 is limited to the carrying values of cash and cash equivalents, accounts receivable and risk management assets. Accounts receivable include balances due from customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risk. At December 31, 2011, Paramount had balances due from one joint venture partner that represented more than 10 percent of the Company's total accounts receivable.

Liquidity Risk

Liquidity risk is the risk that Paramount will be unable to meet its financial obligations. The Company manages liquidity risk by ensuring that it has sufficient cash and cash equivalents, credit facilities and other financial resources available to meet its obligations.

The Company forecasts cash flows for a period of at least 12 months to identify financial requirements. These requirements are met through a combination of cash flows from operations, credit facilities, dispositions of assets, and accessing capital markets.

In addition to commitments disclosed in Note 23, contractual obligations related to financial liabilities are as follows:

	2012	2013	2014	2015	2016	Thereafter	Total
Drilling Rig Loan I[1]	$ 6,092	$ 5,274	$ 12,983	$ –	$ –	$ –	$ 24,349
Accounts payable and accrued liabilities	136,820	–	–	–	–	–	136,820
Risk management liabilities	2,787	–	–	–	–	–	2,787
Credit Facility[1]	3,253	63,010		–	–	–	66,263
Senior Notes[1]	30,525	30,525	30,525	30,525	30,525	399,354	551,979
	$179,477	$ 98,809	$ 43,508	$ 30,525	$ 30,525	$ 399,354	$782,198

[1]Including interest

Accounts payable and accrued liabilities

	December 31, 2011	December 31, 2010	January 1, 2010
Trade and accrued payables	**$ 119,172**	$ 69,965	$ 31,917
Joint venture and royalties	**2,374**	4,525	10,902
Interest payable	**1,510**	1,288	3,343
Flow-through share renunciation obligations	**5,894**	6,122	2,409
Other	**7,870**	3,028	–
Total accounts payable and accrued liabilities	**$ 136,820**	$ 84,928	$ 48,571

Terms and conditions of the above financial liabilities:

- Trade and accrued payables, joint venture payables and other are non-interest bearing and are normally settled on 60-day terms.
- Interest payable on Senior Notes is payable semi-annually in arrears on June 13 and December 13 in each year.

Accounts receivable

	December 31, 2011	December 31, 2010	January 1, 2010
Revenue receivable	**$ 21,363**	$ 17,907	$ 16,583
Joint venture receivable	**13,600**	11,964	6,407
GST and other	**5,218**	3,409	498
Total accounts receivable	**$ 40,181**	$ 33,280	$ 23,488

Joint venture receivables are non-interest bearing and are generally on 30 day terms.

In determining the recoverability of joint venture receivables, the Company performs a risk analysis considering the type and age of the outstanding receivable and the credit worthiness of the counterparties. As a result of this assessment, the Company determined that there was no impairment required in joint venture receivable. There were no significant non-current joint venture receivables as at December 31, 2011 and 2010.

20. CONSOLIDATED STATEMENTS OF CASH FLOWS – SELECTED INFORMATION

Items not involving cash

Year ended December 31	2011	2010
Financial commodity contracts	$ 1,910	$ 2,880
Stock-based compensation	21,405	55,217
Depletion and depreciation	378,077	160,650
Exploration and evaluation	20,566	34,548
(Gain) on sale of property, plant, and equipment	(42,021)	(380)
Accretion of asset retirement obligations	7,374	7,975
Foreign exchange	933	(568)
(Income) from equity accounted investments	(1,201)	(35,999)
Deferred income tax	(61,793)	(60,946)
Gain on investments	(15,703)	(3,499)
Other	527	1,293
	$ 310,074	$ 161,171

Supplemental cash flow information

Year ended December 31	2011	2010
Interest paid	$ 36,910	$ 15,615
Current tax paid	$ 45	$ 368

Components of cash and cash equivalents

As at December 31	2011	2010
Cash	$ 15,009	$ 29,679
Bankers' acceptances	13,991	44,980
	$ 29,000	$ 74,659

21. CAPITAL STRUCTURE

Paramount's primary objectives in managing its capital structure are to:

(i) maintain a flexible capital structure which optimizes the cost of capital at an acceptable level of risk;

(ii) maintain sufficient liquidity to support ongoing operations, capital expenditure programs, strategic initiatives, and the repayment of debt obligations when due; and

(iii) maximize shareholder returns.

Paramount manages its capital structure to support current and future business plans and periodically adjusts the structure in response to changes in economic conditions and the risk characteristics of the Company's underlying assets and operations. Paramount monitors metrics such as the Company's debt-to-equity and debt-to-cash flow ratios, among others, to measure the status of its capital structure. The Company has not established fixed quantitative thresholds for such metrics. The capital structure may be adjusted by issuing or repurchasing shares, issuing or repurchasing debt, refinancing existing debt, modifying capital spending programs, and disposing of assets, the availability of any such means being dependent upon market conditions.

Paramount's capital structure consists of the following:

	December 31, 2011	December 31, 2010	January 1, 2010
Working capital deficit (surplus)[1]	**$ 82,036**	$ (4,825)	$ (43,485)
Credit Facility	**61,383**	–	–
Senior Notes[2]	**370,000**	300,000	–
US Senior Notes	**–**	–	94,394
Net Debt[3]	**513,419**	295,175	50,909
Share capital	**810,781**	481,827	418,191
Accumulated (deficit) earnings	**(103,615)**	128,375	218,386
Reserves	**116,670**	71,966	5,027
Total Capital	**$ 1,337,255**	$ 977,343	$ 692,513

(1) Excludes risk management assets and liabilities, stock-based compensation liabilities, assets and liabilities held for sale and accounts payable and accrued liabilities related to the Company's obligation to renounce qualifying expenditures for flow-through share issuances (December 31, 2011 - $5.9 million, December 31, 2010 - $6.1 million, January 1, 2010 - $2.4 million).
(2) Excludes unamortized financing costs.
(3) Net Debt excludes the deposit on account with the CRA, pending resolution of the Company's Notice of Objection (see Note 18).

Paramount is subject to covenants under its bank Facility and Senior Notes agreements which contain certain restrictions on Paramount's ability to repurchase equity, issue or refinance debt, acquire or dispose of assets, and pay dividends.

22. RELATED PARTY TRANSACTIONS

Service Agreements

Paramount engages in transactions with Trilogy, MGM Energy, Paxton and Perpetual Energy Inc. in the normal course of business, including joint venture operations. Paramount is considered related to Trilogy, MGM Energy, Paxton and Perpetual Energy Inc. because of common significant influence. All transactions between Paramount and the entities are recorded at their exchange amounts.

During 2011, Paramount charged $0.9 million (2010 – $0.5 million) to Trilogy in respect of operational and administrative services. Also, Paramount received $10.1 million (2010: $10.5 million) in annual dividends from Trilogy. As of December 31, 2011, Paramount had a receivable balance due from Trilogy of $0.3 million (2010: $0.3 million).

Compensation of key management personnel

Year ended December 31	**2011**	2010
Salaries and benefits	**$ 2,159**	$ 2,031
Stock-based compensation	**9,173**	29,918
	$ 11,332	$ 31,949

23. COMMITMENTS AND CONTINGENCIES

Commitments

Paramount had the following commitments as at December 31, 2011:

	Within One Year	After one year but not more than 5 years	More than five years
Pipeline transportation commitments [1]	$ 16,353	$ 60,947	$ 55,512
Operating leases	3,569	7,055	10,554
Capital spending commitments[2]	54,174	–	–
Total	$ 74,096	$ 68,002	$ 66,066

(1) Certain of the pipeline transportation commitments are secured by outstanding letters of credit totaling $12.8 million at December 31, 2011 (2010 - $10.4 million).
(2) Relates to contractual obligations for purchases of major equipment.

Operating lease commitment

During the year, the company renewed and extended its head office lease to 2022. The Company incurred office lease costs of $2.8 million in 2011 (2010 - $2.3 million).

Flow-Through Shares

As a result of flow through share issuances in the fourth quarter of 2011, Paramount is required to incur and renounce $29.7 million of Canadian Exploration Expense during 2012.

Contingencies

Paramount is a party to various legal claims associated with the ordinary conduct of its business. Paramount does not anticipate that these claims will have a material impact on its financial position.

Tax and royalty legislation and regulations, and government interpretation and administration thereof, continually changes. As a result, there are often tax and royalty matters under review by relevant government authorities. All tax filings are subject to subsequent government audit and potential reassessments. Accordingly, the final liability may differ materially from amounts estimated and recorded.

24. RECONCILIATION TO PREVIOUS GAAP

GAAP in Canada was converted to IFRS as of January 1, 2011, and Paramount's accounting policies have been modified to comply with the new standards. The transition provisions of IFRS require changes to accounting policies to be applied on a retroactive basis, except for certain mandatory and optional exemptions. Paramount has elected to apply the following exemptions:

a) the exemption to measure certain assets at fair value on transition to IFRS and subsequently deem that fair value to be historical cost;

b) the exemption to deem cumulative foreign exchange translation differences related to foreign subsidiaries as of January 1, 2010 to be nil;

c) the exemption that permits amounts recorded in respect of options settled prior to January 1, 2010 not to be retrospectively restated;

d) the exemption that permits business combinations completed prior to January 1, 2010 not to be restated. Paramount's initial business combination recorded in accordance with IFRS 3, "Business Combinations" was the acquisition of Redcliffe in June 2010;

e) the exemption to measure asset retirement obligations at the Transition Date in accordance with IFRS 1;

f) the exemption to assess lease arrangements using the facts and circumstances as of the Transition Date under International Financial Reporting Interpretations Committee Interpretation 4, "Determining whether an Arrangement contains a Lease"; and

g) the exemption that permits borrowing costs directly attributable to the acquisition or construction of qualifying assets not to be capitalized on a retroactive basis prior to January 1, 2010.

The following information reconciles the 2010 comparative amounts included in these Consolidated Financial Statements to the amounts previously published in accordance with Previous GAAP:

The following table summarizes the adjustments to Paramount's December 31, 2009 balance sheet prepared under Previous GAAP to the Company's Transition Date balance sheet prepared in accordance with IFRS:

	December 31, 2009 Previous GAAP	Reclasses (24 a)	PPE (24 b)	ARO (24 c)	FX (24 d)	SBC (24 e)	FTS (24 f)	Equity Accounting (24 g)	Deferred Tax (24 h)	Net Transition Date Adjustments	January 1, 2010 IFRS
ASSETS											
Current assets	**$ 121,214**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 121,214**
Exploration and evaluation	**–**	152,170	–	–	(887)	–	–	–	–	151,283	**151,283**
Property, plant and equipment, net	**716,235**	(152,170)	(65,412)	8,563	(4,110)	–	–	–	–	(213,129)	**503,106**
Investments	**234,586**	(234,586)	–	–	–	–	–	–	–	(234,586)	**–**
Equity-accounted investments	**–**	119,203	–	–	–	–	–	(7,611)	1,879	113,471	**113,471**
Investments in securities	**–**	115,383	–	–	–	–	–	–	–	115,383	**115,383**
Deferred income tax	**29,940**	–	–	–	–	–	–	–	2,483	2,483	**32,423**
	$ 1,101,975	$ –	$ (65,412)	$ 8,563	$ (4,997)	$ –	$ –	$ (7,611)	$ 4,362	$ (65,095)	**$1,036,880**
LIABILITIES AND SHAREHOLDERS' EQUITY											
Current liabilities											
Drilling rig loan	**$ 29,380**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 29,380**
Accounts payable and accrued liabilities	**46,162**	–	–	–	–	–	2,409	–	–	2,409	**48,571**
Stock-based compensation	**11,441**	–	–	–	–	2,386	–	–	–	2,386	**13,827**
	86,983	–	–	–	–	2,386	2,409	–	–	4,795	**91,778**
Long-term debt	**93,655**	–	–	–	–	–	–	–	–	–	**93,655**
Asset retirement obligations	**103,462**	–	–	91,626	–	–	–	–	–	91,626	**195,088**
Stock-based compensation	**3,771**	–	–	–	–	950	–	–	–	950	**4,721**
Deferred income tax	**41,194**	–	–	–	–	–	2,879	–	(34,039)	(31,160)	**10,034**
	329,065	–	–	91,626	–	3,336	5,288	–	(34,039)	66,211	**395,276**
Shareholders' Equity											
Share capital	**393,087**	–	–	–	–	–	25,104	–	–	25,104	**418,191**
Retained earnings	**373,745**	–	(65,412)	(83,063)	(4,997)	(3,336)	(30,392)	(6,560)	38,401	(155,359)	**218,386**
Reserves	**–**	6,078	–	–	–	–	–	(1,051)	–	5,027	**5,027**
Contributed surplus	**2,890**	(2,890)	–	–	–	–	–	–	–	(2,890)	**–**
Accumulated other comprehensive income	**3,188**	(3,188)	–	–	–	–	–	–	–	(3,188)	**–**
	772,910	–	(65,412)	(83,063)	(4,997)	(3,336)	(5,288)	(7,611)	38,401	(131,306)	**641,604**
	$ 1,101,975	$ –	$ (65,412)	$ 8,563	$ (4,997)	$ –	$ –	$ (7,611)	$ 4,362	$ (65,095)	**$1,036,880**

The following table summarizes the adjustments to Paramount's December 31, 2010 balance sheet prepared under Previous GAAP to the Company's balance sheet prepared in accordance with IFRS:

	December 31, 2010 Previous GAAP	Transition Date Adjustments	Reclasses (24 a)	PPE (24 b)	ARO (24 c)	FX (24 d)	SBC (24 e)	FTS (24 f)	Equity Accounting (24 g)	Deferred Tax (24 h)	December 31, 2010 IFRS
ASSETS											
Current assets	**$ 110,511**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 110,511**
Deposit	**19,788**	–	–	–	–	–	–	–	–	–	**19,788**
Exploration and evaluation	**–**	151,283	118,214	(128)	285	(570)	–	–	–	–	**269,084**
Property, plant and equipment, net	**884,525**	(213,129)	(118,214)	12,889	17,153	(2,890)	–	–	–	–	**580,334**
Investments	**305,288**	(234,586)	(70,702)	–	–	–	–	–	–	–	**–**
Equity-accounted investments	**–**	113,471	(3,632)	–	–	–	–	–	30,340	(1,879)	**138,300**
Investments in securities	**–**	115,383	74,334	–	–	–	–	–	–	–	**189,717**
Deferred income tax	**48,489**	33,643	–	–	995	–	–	(3,803)	–	(3,749)	**75,575**
Goodwill	**8,623**	–	–	(3,577)	2,966	–	–	–	–	–	**8,012**
	$1,377,224	$ (33,935)	$ –	$ 9,184	$ 21,399	$ (3,460)	$ –	$ (3,803)	$ 30,340	$ (5,628)	**$1,391,321**
LIABILITIES AND SHAREHOLDERS' EQUITY											
Current liabilities											
Drilling rig loan	**$ 26,880**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 26,880**
Accounts payable and accrued liabilities	**78,806**	2,409	–	–	–	–	–	3,713	–	–	**84,928**
Risk management	**693**	–	–	–	–	–	–	–	–	–	**693**
Stock-based compensation	**45,232**	2,386	–	–	–	–	(1,431)	–	–	–	**46,187**
	151,611	4,795	–	–	–	–	(1,431)	3,713	–	–	**158,688**
Long-term debt	**294,205**	–	–	–	–	–	–	–	–	–	**294,205**
Asset retirement obligations	**130,564**	91,626	–	–	19,580	–	–	–	–	–	**241,770**
Stock-based compensation	**15,110**	950	–	–	–	–	(1,600)	–	–	–	**14,460**
	591,490	97,371	–	–	19,580	–	(3,031)	3,713	–	–	**709,123**
Shareholders' Equity											
Share capital	**458,895**	25,104	–	–	–	–	–	(2,172)	–	–	**481,827**
Retained earnings	**251,277**	(155,359)	(503)	9,184	1,507	–	3,486	(5,344)	30,372	(6,245)	**128,375**
Reserves	**–**	5,027	69,987	–	312	(3,460)	(455)	–	(32)	617	**71,996**
Contributed surplus	**3,940**	(2,890)	(1,050)	–	–	–	–	–	–	–	**–**
Accumulated other comprehensive income	**71,622**	(3,188)	(68,434)	–	–	–	–	–	–	–	**–**
	785,734	(131,306)	–	9,184	1,819	(3,460)	3,031	(7,516)	30,340	(5,628)	**682,198**
	$1,377,224	$ (33,935)	$ –	$ 9,184	$ 21,399	$ (3,460)	$ –	$ (3,803)	$ 30,340	$ (5,628)	**$1,391,321**

The following table summarizes the adjustments to Paramount's comprehensive loss for the year-ended December 31, 2010 prepared under Previous GAAP to the Company's comprehensive loss prepared in accordance with IFRS:

Year ended December 31, 2010	Previous GAAP	Reclasses	PPE	ARO	FX	SBC	FTS	Equity Accounting	Deferred Tax	IFRS
		(24 a)	(24 b)	(24 c)	(24 d)	(24 e)	(24 f)	(24 g)	(24 h)	
Petroleum and natural gas sales	**$ 184,395**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 184,395**
Royalties	**(21,227)**	–	–	–	–	–	–	–	–	**(21,227)**
Revenue	**163,168**	–	–	–	–	–	–	–	–	**163,168**
Gain on financial commodity contracts	**10,047**	–	–	–	–	–	–	–	–	**10,047**
	173,215	–	–	–	–	–	–	–	–	**173,215**
Expenses										
Operating expense and production tax	**50,892**	–	–	–	–	–	–	–	–	**50,892**
Transportation	**17,219**	–	–	–	–	–	–	–	–	**17,219**
General and administrative	**15,150**	–	–	–	–	–	–	–	–	**15,150**
Stock-based compensation	**58,764**	–	–	–	–	(3,486)	–	–	–	**55,278**
Depletion and depreciation	**178,007**	(8,022)	(9,335)	–	–	–	–	–	–	**160,650**
Exploration	**8,829**	(8,829)	–	–	–	–	–	–	–	**–**
Dry hole	**9,492**	(9,492)	–	–	–	–	–	–	–	**–**
Gain on sale of property, plant and equipment	**(3)**	–	–	(377)	–	–	–	–	–	**(380)**
Write-down of petroleum and natural gas assets	**25,332**	(25,332)	–	–	–	–	–	–	–	**–**
Interest	**13,560**	–	–	–	–	–	–	–	–	**13,560**
Foreign exchange	**(801)**	503	–	–	–	–	–	–	–	**(298)**
Debt extinguishment	**1,708**	–	–	–	–	–	–	–	–	**1,708**
Exploration and evaluation	**–**	42,570	151	–	–	–	–	–	–	**42,721**
Acquisition transaction costs	**267**	–	–	–	–	–	–	–	–	**267**
Accretion of asset retirement obligations	**–**	9,105	–	(1,130)	–	–	–	–	–	**7,975**
	378,416	503	(9,184)	(1,507)	–	(3,486)	–	–	–	**364,742**
Income from investments	**8,227**	(2,600)	–	–	–	–	–	30,372	–	**35,999**
Other income	**2,184**	2,600	–	–	–	–	–	–	–	**4,784**
Loss before tax	**(194,790)**	(503)	9,184	1,507	–	3,486	–	30,372	–	**(150,744)**
Income tax expense (recovery)										
Current	**213**	–	–	–	–	–	–	–	–	**213**
Deferred	**(72,535)**	–	–	–	–	–	5,344	–	6,245	**(60,946)**
	(72,322)	–	–	–	–	–	5,344	–	6,245	**(60,733)**
Net loss	**$ (122,468)**	(503)	9,184	1,507	–	3,486	(5,344)	30,372	(6,245)	**(90,011)**
Other comprehensive income (loss), net of tax										
Change in market value of securities	**71,602**	–	–	–	–	–	–	–	–	**71,602**
Exchange differences on translation of US subsidiaries	**–**	503	–	312	(3,460)	–	–	–	617	**(2,028)**
Reclass of accumulated (gains) to earnings	**(3,168)**	–	–	–	–	–	–	–	–	**(3,168)**
Comprehensive loss	**$ (54,034)**	$ –	$ 9,184	$ 1,819	$ (3,460)	$ 3,486	$ (5,344)	$ 30,372	$ (5,628)	**$ (23,605)**

a) Reclassifications ("Reclasses")

i. Balance Sheet

Exploration and Evaluation Assets

At the Transition Date, exploration and evaluation assets having a carrying value of $152.2 million, primarily consisting of costs related to undeveloped land and incomplete exploratory drilling projects, were reclassified from property, plant and equipment to exploration and evaluation. For the twelve months ended December 31, 2010, $118.2 million of net additions were reclassified from property, plant, and equipment to exploration and evaluation.

Equity Accounted Investments

At the Transition Date, equity accounted investments having an aggregate carrying value of $119.2 million, were reclassified from investments to equity accounted investments. For the twelve months ended December 31, 2010, the $3.6 million net change in the carrying value of equity accounted investments was reclassified from investments to equity accounted investments.

Investments in Securities

At the Transition Date, investments in the securities of entities that are accounted for as available-for-sale investments, having an aggregate carrying value of $115.4 million, were reclassified from investments to investments in securities. For the twelve months ended December 31, 2010, the change in the carrying value of investments in securities of $74.3 million was reclassified from investments to investments in securities.

Reserves

At the Transition Date, the contributed surplus balance of $2.9 million and accumulated other comprehensive income balance of $3.2 million that were presented as individual line items on the balance sheet under Previous GAAP were reclassified to reserves under IFRS. For the twelve months ended December 31, 2010, the aggregate $69.5 million change in contributed surplus and accumulated other comprehensive income was reclassified to reserves. Foreign exchange on the translation of US subsidiaries of $0.5 million was reclassified from foreign exchange expense to reserves for the twelve months ended December 31, 2010.

ii. Statement of Comprehensive Income

Exploration Expense

Exploration expense of $8.8 million and dry hole expense of $9.5 million that were presented as individual line items under Previous GAAP are now included in exploration and evaluation expense under IFRS.

Depletion and Depreciation

Write-offs of the cost of expired mineral leases in respect of undeveloped properties of $24.2 million were included in depletion and depreciation expense under Previous GAAP but are included in exploration and evaluation expense under IFRS.

Accretion expense of $9.1 million related to asset retirement obligations was included in depletion, depreciation and accretion under Previous GAAP but is presented separately under IFRS.

The write-down of petroleum and natural gas properties of $25.3 million was presented as an individual item under Previous GAAP but is included in depletion and depreciation under IFRS.

Other Income

The gain on sale of available-for-sale investments of $3.5 million and the write-down of investments of $0.9 million that were included in income (loss) from investments under Previous GAAP are now included in other income under IFRS.

b) Property, Plant, and Equipment ("PPE")

Under IFRS, the type and method of calculating petroleum and natural gas reserves used in determining depletion on a unit-of-production basis is not specifically prescribed. Under Previous GAAP, the Company was required to use a reserve estimate based on average commodity prices of the preceding year. On Transition Date, Paramount changed its reserves estimates for calculating depletion to use proved developed reserves based on forecast commodity prices.

IFRS requires an asset or CGU to be written down when its carrying value exceeds its recoverable amount. The recoverable amount is defined as the greater of value in use and fair value less costs to sell. Under Previous GAAP, a two-step approach was used to determine impairment write-downs: (i) the carrying value of a property was compared to its expected undiscounted before-tax cash flows, and (ii) where the carrying value exceeded the expected undiscounted before-tax cash flows, an impairment write-down was calculated based on the difference between the property's carrying value and its expected discounted before-tax cash flows. The IFRS method of determining impairments resulted in the recognition of additional impairment write-downs of petroleum and natural gas properties of $65.4 million on Transition Date. For the twelve months ended December 31, 2010, additional write-downs of $32.6 million were recognized, including a goodwill impairment charge of $3.6 million. Depletion expense in 2010 was reduced by $41.9 million under IFRS due to reduced carrying values of petroleum and natural gas properties as a result of IFRS impairment adjustments and the change in the reserves used in calculating unit-of-production depletion. The net IFRS adjustments to depletion and impairment write-down amounts resulted in a net increase of $12.9 million in property, plant and equipment during the year ended December 31, 2010.

At Transition Date, the additional impairment write-downs primarily related to the Northern and Kaybob COUs. At December 31, 2010 the additional impairment write-downs related to the Northern, Southern, and Grande Prairie COUs. Write-downs were recognized to the extent that the carrying value of each CGU exceeded its expected recoverable amount. The recoverable amount was estimated on a fair value less costs to sell basis using a discounted cash flow method, which is an approach commonly employed by market participants to value oil and gas properties. Cash flows were projected over the expected productive life of each CGU's reserves, at an after-tax discount rate of eight percent at December 31, 2010 (Transition Date – ten percent).

The $3.6 million write-down of goodwill at December 31, 2010 related to goodwill associated with properties in the Southern COU.

On Transition Date, the fair value of certain CGUs was deemed to be historical cost. The aggregate fair value of such CGUs was $378.7 million compared to an aggregate carrying value under Previous GAAP of $447.7 million.

c) Asset Retirement Obligations ("ARO")

Under IFRS, the Company's policy is to re-measure asset retirement obligations at each reporting date using the period-end risk-free rate. Under Previous GAAP, credit-adjusted risk-free rates were applied to each obligation when initially recognized, and that rate was not adjusted for changes in discount rates in future periods. On Transition Date, the Company recorded a $91.6 million increase in the asset retirement obligation liability due to the decrease in discount rates, from approximately eight percent under Previous GAAP to four percent under IFRS. The increase in the asset retirement obligation liability was recognized as an increase in the carrying value of the related asset where the asset was not part of a CGU for which its fair value had been deemed historical cost, otherwise the increase was recognized in retained earnings. Net additions to the ARO liability in 2010 were increased by $19.6 million primarily due to the change in discount rates, which included a $4.0 million increase to the ARO liability recognized in respect of the Redcliffe acquisition. The change in discount rates decreased 2010 accretion expense by $1.1 million.

d) Foreign Exchange Translation ("FX")

Under IFRS, assets and liabilities of subsidiaries with functional currencies that are not the presentation currency are translated at the exchange rate in effect at the end of the reporting period and the resulting exchange differences are recognized in other comprehensive income. Under Previous GAAP, the assets and liabilities of the Company's integrated foreign operations were translated into Canadian dollars using the temporal method, where non-monetary items were translated at historical exchange rates and monetary assets and liabilities were translated at the exchange rate in effect at the end of the reporting period, with resulting exchange differences recognized in earnings.

On Transition Date, the change of translation method resulted in a decrease in the carrying amount of Paramount's property, plant and equipment assets of $4.1 million and a decrease in exploration and evaluation assets of $0.9 million. For the twelve months ended December 31, 2010, the change in translation methods resulted in a further $2.9 million decrease in the carrying value of the Company's property, plant, and equipment assets and a further $0.6 million decrease in the carrying value of exploration and evaluation assets. The impact on OCI for the twelve months ended December 31, 2010 as a result of the change in translation method was a decrease of $3.5 million.

e) Stock-based Compensation ("SBC")

Until September 30, 2011, Paramount's stock-based compensation liability related to Paramount Options under IFRS was re-measured at the end of each period using the Black-Scholes-Merton fair value option pricing model. Under Previous GAAP, the stock-based compensation liability was re-measured at the end of each period using the intrinsic value method, where the liability was calculated based on the amount by which the market price of the Company's Common Shares exceeded the exercise price of outstanding options. As a result of the change in valuation method, Paramount's stock-based compensation liability increased by $3.3 million on Transition Date. For the twelve months ended December 31, 2010 the stock-based compensation liability increased by $0.3 million, including the increase on Transition Date of $3.3 million and the decrease for 2010 adjustments of $3.0 million

compared to Previous GAAP. The impact on 2010 stock-based compensation expense for the year ended December 31, 2010 was a decrease of $3.5 million.

f) Flow-through Shares ("FTS")

Under IFRS, proceeds from the issuance of flow-through shares are allocated between the sale of the shares, which are recorded in share capital, and the sale of the tax benefits, which are initially recorded as an accrued liability. The allocation is made based on the difference between the issue price of flow-through shares and the market price of the Common Shares on the date the offering is priced. The liability related to the sale of the tax benefits is reversed as qualifying expenditures intended for renunciation to subscribers are incurred, and a deferred tax liability is recorded. The difference between the deferred tax liability recorded and the liability related to the sale of tax benefits is recognized as deferred tax expense. Under Previous GAAP, when flow-through shares were issued, they were recorded in share capital based on proceeds received. Upon filing the renunciation documents with the tax authorities, a future tax liability was recognized and share capital was reduced for the tax effect of expenditures renounced to subscribers. The IFRS adjustment on Transition Date associated with flow-through shares was to increase share capital by $25.1 million, reduce retained earnings by $30.4 million, increase the deferred tax liability by $2.9 million, and increase accrued liabilities by $2.4 million. For the twelve months ended December 31, 2010, additional IFRS adjustments were made to decrease share capital by $2.2 million, reduce retained earnings by $5.3 million, increase accrued liabilities by $3.7 million and decrease the deferred income tax asset balance by $3.8 million.

g) Equity Accounted Investments ("Equity Accounting")

The equity method of accounting requires an investor to adjust the carrying value of its investment in an investee for the investor's proportionate share of changes in the investee's net assets. On Transition Date, the carrying value of Paramount's equity accounted investments was decreased by an aggregate of $7.6 million to reflect Paramount's proportionate share of the adjustments Trilogy and MGM Energy recorded in respect of their IFRS transitions. For the twelve months ended December 31, 2010, the carrying values of Paramount's equity accounted investments were increased by $30.3 million due to adjustments recorded by Trilogy and MGM Energy. Income from equity-accounted investments for the year ended 2010 increased by $30.4 million.

h) Deferred Income Tax ("Deferred Tax")

On Transition Date, the Company's deferred income tax asset balance was increased by $2.5 million, the deferred income tax liability balance was decreased by $34.0 million, and the equity accounted investments balance was increased by $1.9 million to reflect the tax impacts of the IFRS adjustments as described in the preceding discussion. For the twelve months ended December 31, 2010, the deferred income tax asset balance was decreased by $3.7 million, the equity accounted investments balance was decreased by $1.9 million and deferred income tax expense was increased by $6.2 million. The deferred income tax on foreign exchange differences on translation of the US subsidiaries was $0.6 million for the twelve months ended December 31, 2010.

The following table reconciles the Consolidated Statement of Cash Flows prepared under Previous GAAP to the Company's statements of Cash Flows prepared in accordance with IFRS:

Year ended December 31		**2010**
Cash from operating activities under Previous GAAP	$	63,383
Adjustments under IFRS:		
Exploration costs		(8,172)
Common shares purchased under stock incentive plan		2,901
Foreign exchange on cash and cash equivalents		1,066
Cash from operating activities under IFRS	**$**	**59,178**
Cash from financing activities under Previous GAAP	$	251,905
Adjustment under IFRS:		
Common shares purchased under stock incentive plan		(2,901)
Cash from financing activities under IFRS	**$**	**249,004**
Cash used in investing activities under Previous GAAP	$	(333,867)
Adjustment under IFRS:		
Exploration costs		8,172
Cash used in investing activities under IFRS	**$**	**(325,695)**
Net decrease		**(17,513)**
Foreign exchange on cash and cash equivalents		(1,066)
Cash and cash equivalents, beginning of year	$	93,238
Cash and cash equivalents, end of year	**$**	**74,659**