



Terra Energy Corp.

Condensed Consolidated Financial Statements
For the Three and Nine Months ended September 30, 2011

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Terra Energy Corp.
Condensed Consolidated Statements of Financial Position

As at, (unaudited) (\$ thousands)	September 30, 2011	December 31, 2010 <i>(note 16)</i>
Assets		
Current Assets		
Accounts receivable	\$ 7,510	\$ 14,324
Prepaid expenses	2,985	2,947
Risk management contracts <i>(note 3)</i>	1,465	400
	11,960	17,671
Non-Current Assets		
Exploration and evaluation assets <i>(note 6)</i>	33,924	40,049
Property, plant and equipment <i>(note 7)</i>	245,916	236,322
Total Assets	\$ 291,800	\$ 294,042
Liabilities and Shareholders' Equity		
Current Liabilities		
Bank overdraft <i>(note 9)</i>	\$ 2,649	\$ 3,511
Accounts payable and accrued liabilities	17,860	27,220
Current portion of finance lease obligation <i>(note 8)</i>	729	975
Current portion of decommissioning obligations <i>(note 10)</i>	30	200
	21,268	31,906
Long-term debt <i>(note 9)</i>	86,710	85,074
Decommissioning obligation <i>(note 10)</i>	25,999	21,068
Deferred income taxes	23,784	22,958
Total Liabilities	157,761	161,006
Shareholders' Equity		
Share capital <i>(note 11)</i>	116,397	116,494
Warrants <i>(note 11)</i>	-	3,253
Contributed surplus	16,941	12,826
Retained earnings	701	463
Total Shareholders' Equity	134,039	133,036
Total Liabilities and Shareholder's Equity	\$ 291,800	\$ 294,042

Terra Energy Corp.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(unaudited)	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
(\$ in thousands, except per share amounts)				
Revenue		(note 16)		(note 16)
Petroleum and natural gas	\$ 16,976	\$ 17,580	\$ 54,070	\$ 61,105
Royalties	(2,278)	(2,686)	(7,822)	(9,993)
Petroleum and natural gas revenues, net of royalties	14,698	14,894	46,248	51,112
Realized gain (loss) on derivative instruments (note 3)	3,115	(1,157)	6,561	(1,832)
Unrealized gain (loss) on derivative instruments (note 3)	(13)	940	672	154
	17,800	14,677	53,481	49,434
Gain on disposition of other assets	-	83	250	347
Total revenue and other income	17,800	14,760	53,731	49,781
Expenses				
Production	8,657	7,854	25,716	19,883
General and administrative	2,148	2,471	6,699	6,947
Share-based compensation (note 11)	54	225	903	1,545
Depletion, depreciation and amortization	5,840	6,186	16,878	18,658
Finance costs	1,153	864	3,652	2,362
Unrealized foreign exchange gain (note 3)	(224)	(664)	(393)	(128)
Realized foreign exchange gain (note 3)	(190)	(220)	(794)	(397)
	17,438	16,716	52,661	48,870
Income (loss) before income taxes	362	(1,956)	1,070	911
Income tax expense (recovery)				
Current tax expense	-	4	-	4
Deferred income tax expense (recovery)	2,063	(248)	825	672
	2,063	(244)	825	676
Net income (loss)	\$ (1,701)	(1,712)	245	235
Other comprehensive income (loss) after tax				
Unrealized gain on other assets (note 5)	-	(155)	-	229
Total comprehensive income (loss)	\$ (1,701)	\$ (1,867)	\$ 245	\$ 464
Income (loss) per share				
Basic	(0.02)	(0.02)	-	-
Diluted	(0.02)	(0.02)	-	-

Terra Energy Corp.

Condensed Consolidated Statements of Changes in Shareholders' Equity

(unaudited) (\$ in thousands)	Thousands of shares	Share capital	Warrants	Contributed surplus	Accumulated other comprehensive Income	Retained earnings	Shareholder's equity
Balance as at January 1, 2010	87,989	\$ 93,369	\$ 3,253	\$ 11,355	\$ (17)	\$ 3,015	\$ 110,975
Private placement, net of issue cost (note 11)	11,250	21,313	-	-	-	-	21,313
Flow-through shares (notes 11, 13)	-	(2,250)	-	-	-	-	(2,250)
Share-based compensation (note 11)	-	-	-	1,545	-	-	1,545
Exercise of options (note 11)	258	299	-	-	-	-	299
Fair value of stock options for shares issued on exercise (note 11)	-	156	-	(156)	-	-	-
Shares purchased for cancellation (note 11)	(971)	(1,011)	-	-	-	(502)	(1,513)
Other comprehensive income (note 5)	-	-	-	-	229	-	229
Issued as consideration	3,664	4,874	-	-	-	-	4,874
Net income	-	-	-	-	-	235	235
Balance as at September 30, 2010	102,190	\$ 116,750	\$ 3,253	\$ 12,744	\$ 212	\$ 2,748	\$ 135,707
Balance as at December 31, 2010	101,964	116,494	3,253	12,826	-	463	133,036
Share-based compensation (note 11)	-	-	-	903	-	-	903
Exercise of options (note 11)	64	69	-	-	-	-	69
Fair value of stock options for shares issued on exercise (note 11)	-	41	-	(41)	-	-	-
Share issue costs (note 11)	-	(5)	-	-	-	-	(5)
Expiry of warrants (note 11)	-	-	(3,253)	3,253	-	-	-
Shares purchased for cancellation (note 11)	(176)	(202)	-	-	-	(7)	(209)
Net income	-	-	-	-	-	245	245
Balance as at September 30, 2011	101,852	\$ 116,397	\$ -	\$ 16,941	\$ -	\$ 701	\$ 134,039

Terra Energy Corp.
Condensed Consolidated Statements of Cash Flows

(unaudited)	Three months ended September 30		Nine months ended September 30	
(\$ thousands)	2011	2010	2011	2010
Cash flows from operating activities				
Net income (loss) for the period	\$ (1,701)	\$ (1,712)	\$ 245	\$ 235
Items not affecting cash:				
Deferred income tax expense (recovery)	2,063	(248)	825	672
Accretion of decommissioning obligations	143	166	498	541
Share-based compensation	54	225	903	1,545
Unrealized (gain) loss on derivative instruments (note 3)	13	(940)	(672)	(154)
Unrealized gain on foreign exchange (note 3)	(224)	(664)	(393)	(128)
Gain on disposition of other assets (note 5)	-	(83)	(250)	(347)
Amortization of deferred credit	-	(17)	-	(50)
Decommissioning obligations settled	(73)	(54)	(251)	(416)
Depletion, depreciation and amortization	5,840	6,186	16,878	18,658
	6,115	2,859	17,783	20,556
Changes in non-cash working capital from operations (note 12)	5,221	3,638	(2,931)	3,706
	11,336	6,497	14,852	24,262
Cash flows from financing activities				
Proceeds from long-term financing	(2,794)	26,354	1,636	30,082
Increase (decrease) in bank overdraft	(1,014)	1,250	(862)	3,703
Repayment of finance lease obligation	(83)	(78)	(246)	(231)
Issuance of common shares, net of issuance costs	-	18	65	21,218
Repurchase of common shares	-	(215)	(209)	(1,513)
	(3,891)	27,329	384	53,259
Cash flows from investing activities				
Additions to exploration and evaluation, and property, plant and equipment	(6,529)	(13,911)	(17,381)	(44,014)
Acquisition of property, plant and equipment	-	(25,892)	-	(37,220)
Disposition of property, plant and equipment	-	-	1,548	-
Disposition of other assets	-	175	250	828
Changes in non-cash working capital from investing (note 12)	(916)	5,802	347	2,885
	(7,445)	(33,826)	(15,236)	(78,353)
Increase (decrease) in cash	-	-	-	-
Cash, beginning of period	-	-	-	-
Cash, end of period	\$ -	\$ -	\$ -	\$ -

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)**

Tabular amounts in thousands except per share amounts

I. BASIS OF PRESENTATION

Terra Energy Corp. ("Terra" or the "Corporation") is an oil and gas exploration, development and production Corporation based in Calgary, Alberta, Canada. The Corporation conducts its operations in the Western Canadian Sedimentary basin, primarily in the provinces of Alberta and British Columbia

In conjunction with the Corporation's annual audited consolidated financial statements to be issued under International Financial Reporting Standards ("IFRS") for the year ending December 31, 2011, these condensed consolidated financial statements present the Corporation's results of operations and financial position under IFRS. These condensed consolidated financial statements for the three and nine months ended September 30, 2011 have been prepared by management and reported in Canadian dollars in accordance with International Accounting Standard ("IAS") 34 - *Interim Financial Reporting*. Amounts relating to the three and nine months ended September 30, 2010 and as at December 31, 2010, were previously presented in accordance with Canadian generally accepted accounting principles ("GAAP"). These amounts have been restated as necessary to be compliant with our policies under IFRS. The condensed consolidated financial statements do not include all of the information required for full annual financial statements.

The condensed consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries, including Constar Resources Ltd., and Terra Energy Partnership. The latter is a general partnership between Terra Energy Corp. and Constar Resources Ltd.

The Corporation's significant accounting policies under IFRS are outlined in Note 2. These policies have been retroactively applied except where specific exemptions allow for alternative treatment upon transition to IFRS in accordance with IFRS 1- *First-time Adoption of International Financial Reporting Standards*. Note 16 of these condensed consolidated financial statements provides reconciliations of the effects of transition to IFRS from Canadian GAAP on the reported financial position, financial performance and cash flows of the Corporation.

The condensed consolidated financial statements were approved and authorized for issuance by the Board of Directors on November 10, 2011.

2. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates and Judgements

The preparation of condensed consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality.

The amounts recorded for depletion and amortization of oil and gas properties and equipment and amounts used in the calculation of impairment, are based on estimates of petroleum and natural gas reserves. The impairment test is based on estimates of proved and probable reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the condensed consolidated financial statements of changes and estimates in future periods could be significant.

The decommissioning liability and accretion of these costs are based on estimates of timing and cost of the decommissioning expenditures.

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)**

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The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options. This option valuation model requires the input of highly subjective assumptions including the expected stock price volatility. Because the Corporation's stock options and performance incentive warrants have characteristics significantly different from those of traded options and because the subjective input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

The consolidated financial statements include accruals based on the terms of existing joint venture agreements. Due to varying interpretations of the definition of terms in these agreements, the accruals made by management in this regard may be significantly different from those determined by the Corporation's joint venture partners. The effect on the consolidated financial statements resulting from such adjustments, if any, will be reflected prospectively.

Basis of Consolidation

The condensed consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries which are controlled by the Corporation. Control is achieved when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries acquired are included in the condensed consolidated financial statements from the date that control commences until the date such control ceases.

Basis of Measurement

The condensed consolidated financial statements have been prepared on the historical cost basis except for the following:

- Derivative financial instruments are measured at fair value; and
- Held for trading financial assets are measured at fair value with changes in fair value recorded in earnings.

The methods used to measure fair values are discussed in Note 3.

Functional and Presentation Currency

These condensed consolidated financial statements are presented in Canadian dollars, which is the Corporation's functional currency.

Exploration and Evaluation Assets and Property, Plant and Equipment*Pre-license Costs*

All costs incurred prior to the acquisition of an exploration license and leasehold property are expensed in the period in which they are incurred.

Exploration Expenditures

Once the legal right to explore has been acquired, costs directly associated with the exploration and evaluation of oil and gas reserves are initially capitalized as exploration and evaluation assets according to the nature of the asset. The costs are not depleted and are accumulated in cost centres by well, field or exploration area until technical feasibility and commercial viability is considered to be determined.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proved reserves are determined to exist. A review of each exploration license or field is carried out at least annually to determine whether reserves have been discovered. Upon determination of proved reserves, exploration and evaluation assets attributable to those reserves are tested for impairment and then reclassified from exploration and evaluation to a separate category within assets referred to as property, plant and equipment. If no reserves are found, and there are no further exploration plans for the area, the capitalized exploration costs are charged to expense.

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

Development Expenditures

Costs incurred subsequent to the determination of technical feasibility and commercial viability are recognized as property, plant and equipment. Expenditures on construction, installation or completion of infrastructure facilities such as platforms, pipelines and drilling of development wells, including unsuccessful development or delineation wells, is capitalized within property, plant and equipment.

Property, plant and equipment assets are grouped into cash-generating units (“CGU’s”) for impairment testing.

Gains and losses on disposal of an item of property, plant and equipment, including oil and gas properties, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment. The gain or loss is recognized on the condensed statement of operations.

Producing Oil and Gas Properties and Other

Property, plant and equipment are stated at cost, less accumulated depreciation and accumulated impairment loss. The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of any decommissioning obligation and if any, borrowing costs for qualifying assets.

Subsequent Costs

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

Depletion, Depreciation and Amortization

Oil and natural gas properties, including related pipelines, are depleted using the unit of production method by reference to the ratio of production in the period to the related proven and probable reserves, taking into account the estimated future development costs necessary to convert those reserves into production. These estimates are reviewed by independent reserve engineers at least annually. Facility costs are depreciated over 10 years.

The non-oil and natural gas assets are depreciated as follows:

Leasehold Improvements	over the term of the lease
Office Furniture and Equipment	20% per year
Computer Equipment	30% per year
Vehicles	30% per year

Impairment of Value

Under IFRS, indicators of impairment need to be assessed at each reporting period and an impairment test is only required if there are indicators of impairment. The Corporation is required to recognize an impairment loss if the carrying value exceeds the recoverable amount for a cash generating unit. An assessment is made at each reporting date

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as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indications exist, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depletion, depreciation and amortization had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss.

Decommissioning Obligations

Liabilities for decommissioning costs are recognized when the Corporation has an obligation to dismantle and remove a well, facility or an item of plant and to restore the site on which it is located. The liability is recognized at the discounted value for the future asset retirement costs associated with its oil and natural gas properties using the risk-free interest rate. The present value of the liability is capitalized as property, plant and equipment and is subsequently depleted as part of the asset. Any change in the present value of the estimated expenditure is reflected as an adjustment to the provision and corresponding property, plant and equipment. The unwinding of the discount is reflected as financing cost in the condensed consolidated statement of operations.

Revenue Recognition

Revenue from the sales of oil and gas are recognized when the risks and rewards of ownership pass to the purchaser, including delivery of the product, the selling price being fixed or determinable and collectability being reasonably assured.

Joint Venture Operations

Substantially all of the Corporation's oil and gas activities are conducted jointly with others. These condensed consolidated financial statements reflect only the Corporation's proportionate interest in such activities.

Financial Instruments

The Corporation classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Corporation's accounting policy for each category is as follows:

Fair value through profit or loss – This category comprises derivatives, or assets and/or liabilities acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried in the balance sheet at fair value with changes in fair value recognized in the statement of operations.

Loans and receivables – These assets are non-derivative financial assets with fixed or determinable payments. They are carried at cost less any provision for impairment. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. The Corporation's accounts receivables are classified as "loans and receivables".

Held-to-maturity investments – These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Corporation's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in the statement of operations.

Available-for-sale – Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized in other comprehensive income (loss). Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of

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the loss is removed from equity and recognized in the statement of operations. The Corporation's other assets are classified as "available-for-sale".

All derivative instruments except for those at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial asset, which are described above.

Other financial liabilities – This category includes bank overdrafts, accounts payables and accrued liabilities and long-term financing, all of which are recognized at amortized cost.

The Corporation uses derivative financial instruments to manage certain exposures to fluctuations in foreign currency exchange rates, interest rates and commodity prices as well as for trading purposes. Such derivative financial instruments are initially recognized at fair value on the date on which derivative contract entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Share-based Compensation

Equity-settled awards under the share-based incentive plan are measured at fair value at the date of grant and are expensed on a graded vesting basis over the performance period along with a corresponding increase in equity. A forfeiture rate is estimated on grant date and is adjusted to reflect the actual number of options that vest. The fair value at grant date is measured using an option pricing model taking into consideration management's best estimate of the expected life of the option and estimated number of shares that will eventually vest.

Per Share Amounts

Basic earnings per share is computed by dividing earnings by the weighted average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if stock options or warrants to purchase common shares were exercised and converted to common shares. The treasury stock method is used whereby any proceeds from the exercise of stock options or warrants are assumed to be used to purchase common shares of the Corporation at the average market price during the period.

Flow-through Shares

Periodically, the Corporation will finance certain of its exploration and development activities through the issuance of flow-through shares. Expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are to be renounced to investors in accordance with income tax legislation. Flow-through shares issued are recorded in share capital at the fair value of common shares on the date of issue with the premium recorded as a liability. Upon renunciation with the Canada Revenue Agency, the liability is reversed and a deferred income tax liability is recorded, with the net amount then recognized as deferred income tax expense.

Income Taxes

Current tax is the expected tax payable on the taxable income for the year. The Corporation's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases, and is accounted for using the liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that sufficient taxable profits will be available to recover the asset. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination.

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)**

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Provisions and Contingent Liabilities

Provisions are recognized when the Corporation has a present obligation as a result of a past event and it is probable that the Corporation is required to settle that obligation. Provisions are measured using management's best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events or where the amount of the obligation cannot be measured reliably. Contingent assets are not recognized, but are disclosed where an inflow of economic benefit is probable.

New Standards and Interpretations not yet Adopted

The Corporation has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Corporation:

IAS 12 Income Taxes

IAS 12 was amended in December 2010 to remove subjectivity in determining on which basis an entity measures the deferred tax relating to an asset. The amendment introduces a presumption that an entity will assess whether the carrying value of an asset will be recovered through the sale of the asset. The amendment to IAS 12 is effective for reporting periods beginning on or after January 1, 2012. The Corporation is currently evaluating the impact of this amendment to IAS 12 on its consolidated financial statements.

IAS 27 Separate Financial Statements

IAS 27 replaced the existing IAS 27 "Consolidated and Separate Financial Statements". IAS 27 contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. IAS 27 requires an entity preparing separate financial statements to account for those investments at cost or in accordance with IFRS 9 Financial Instruments. IAS 27 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

IAS 28 Investments in Associates and Joint Ventures

IAS 28 was amended in 2011 which prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this amendment to IAS 28 on its consolidated financial statements.

IFRS 9 Financial Instruments

IFRS 9 was issued in November 2009 and is the first step to replace current IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2015. The Corporation is currently evaluating the impact of IFRS 9 on its consolidated financial statements.

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Tabular amounts in thousands except per share amounts

IFRS 10 Consolidated Financial Statements

IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27 “Consolidated and Separate Financial Statements” and SIC-12 “Consolidation—Special Purpose Entities” and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

IFRS 11 Joint Arrangements

IFRS 11 establishes principles for financial reporting by parties to a joint arrangement. IFRS 11 supersedes current IAS 31 “Interests in Joint Ventures and SIC-13 Jointly Controlled Entities—Non-Monetary Contributions by Venturers” and is effective for annual periods beginning on or after January 1, 2013. The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

IFRS 13 Fair Value Measurements

IFRS 13 defines fair value, sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. The IFRS 13 applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in specified circumstances. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Corporation is currently evaluating the impact of this standard on its consolidated financial statements.

3. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT

The Corporation is exposed to financial risk on a range of financial instruments including accounts receivable, capital lease obligations, accounts payable and accrued liabilities, bank overdraft, long term financing and financial derivative contracts. The Corporation manages its exposure to financial risks by operating in a manner that minimizes its exposure to the extent practical. The main financial risks affecting the Corporation are discussed below.

Credit Risk

Credit risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. The Corporation’s accounts receivable at the balance sheet date arise from sales of crude oil, natural gas liquids and natural gas. Industry standard dictates that commodity sales are settled on the 25th day of the month following the month of production. The Corporation markets its oil and natural gas through several marketers so that the exposure to any one entity is minimized.

Joint venture receivables are generated from conducting joint operating or capital operations with joint venture partners. Collections from these operations are usually paid within three months of the joint venture bill being issued to the partner. Circumstances can arise which extend the terms of collection beyond this period as specific items on these

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joint venture billings may need to be resolved between partners. Smaller partners may be cash called to pay for their share of costs in advance of a project. The Corporation also has the ability to take measures such as withholding production volumes as recourse for collections on receivables.

The Corporation monitors receivable accounts and actively pursues collection and payment. Accounts receivables over 90 days are considered past due. If any accounts are considered impaired, they will be charged to an allowance for doubtful accounts. During the period ended September 30, 2011, there was no allowance for doubtful accounts recorded due to historical success of collecting receivables. The Corporation does not have any significant credit risk exposure with respect to accounts receivable to any single counterparty or any group of counterparties having similar characteristics.

The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Corporation considers past due and at risk of collection.

Interest Risk

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Corporation is exposed to interest rate risk as it can borrow funds at floating interest rates. The Corporation currently does not use interest rate hedges or fixed interest rate contracts to manage the Corporation's exposure to interest rate fluctuations.

At September 30, 2011, the increase or decrease in net income before taxes for each 1% change in interest rates on floating rate debt amounts to approximately \$867,000 (December 31, 2010 - \$851,000) per annum.

Commodity Price Risk

The Corporation is exposed to fluctuations in commodity prices for crude oil, natural gas and natural gas liquids. Commodity prices are affected by many factors including supply and demand.

The Corporation monitors these risks and, when appropriate, utilizes risk management contracts to manage its exposure to these risks. The Corporation had the following outstanding derivative financial instruments at September 30, 2011:

Natural Gas			
Contract type	Price	Volumes per day	Contract term
Financial	Sell \$4.00	5,000 GJ	April 1, 2011 to March 31, 2012
Financial	Sell \$4.00	5,000 GJ	April 1, 2011 to March 31, 2012
Financial – Basis Swap	\$(0.52) USD	912,500 MMBtu	January 1, 2013 to December 31, 2013
Financial – Basis Swap	\$(0.55) USD	2,737,500 MMBtu	January 1, 2013 to December 31, 2013
Financial – Basis Swap	\$(0.55) USD	2,737,500 MMBtu	January 1, 2014 to December 31, 2014
Financial – Basis Swap	\$(0.55) USD	2,737,500 MMBtu	January 1, 2015 to December 31, 2015

The mark-to-market adjustment of these contracts has been recognized as an asset of \$672,075 at September 30, 2011 (2010 - nil). A \$0.10 decrease in the natural gas price would result in an increase of \$1,095,000 to the mark-to-market adjustment.

Liquidity Risk

Liquidity risk includes the risk that, as a result of the Corporation's operational liquidity requirements:

- The Corporation will not have sufficient funds to settle a transaction on the due date; or
- The Corporation will be forced to sell financial assets at values which are less than what they are worth.

Terra Energy Corp.

Notes to the Condensed Consolidated Financial Statements

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Tabular amounts in thousands except per share amounts

The Corporation's operating cash requirements, including amounts projected to complete the Corporation's existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include, but are not limited to, available credit, oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects and regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. As these variables change, liquidity risks may necessitate the Corporation to conduct equity issues or obtain project debt financing. The Corporation also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses.

Following is a list of the financial liabilities at September 30, 2011, and their contractual maturities:

	Total	Current within 1 year	Within 1 to 3 years	Within 4 to 5 years
Bank overdraft	\$ 2,649	\$ 2,649	\$ -	\$ -
Accounts payable and accrued liabilities	17,860	17,860	-	-
Office lease	1,981	867	1,044	70
Long-term financing (note 9) ⁽¹⁾	86,710	-	86,710	-
Gathering and processing contracts	15,606	5,483	9,845	278
Finance lease obligation (note 8)	729	729	-	-
Total	\$ 125,535	\$ 27,588	\$ 97,599	\$ 348

⁽¹⁾ Excludes any interest related costs

Foreign Exchange Risk

The Corporation is exposed to fluctuations in foreign exchange rates which will have an impact on commodity prices, foreign denominated cash on hand, foreign denominated payables and foreign denominated long-term financing held by the Corporation.

Commodities are sold to marketers at prices that are commonly based upon reference prices denominated in a foreign currency. Any changes in the foreign exchange rates will have a direct impact on petroleum and natural gas revenue received by the Corporation. Foreign denominated cash held by the Corporation is subject to revaluations at period ends with any changes being reflected as realized foreign exchange gains and losses. Changes in the value of payables and long-term financing denominated in a foreign currency are reflected as unrealized foreign exchange gains and losses. Upon settlement, the unrealized foreign exchange gain or loss is reversed and a realized foreign exchange gain or loss is recorded.

At September 30, 2011, the Corporation had the following foreign exchange risk management contracts outstanding (amounts are not in thousands of dollars):

Option payout range CAD/U.S. dollar	U.S. dollar notional amount	Daily payout amount	Contract term
\$0.95 to \$1.135	\$5,000,000	CAD \$5,000	September 2010 - December 2011
\$0.95 to \$1.135	\$5,000,000	CAD \$5,000	January 2012 - May 2012

For each valuation day in which the exchange rate is within the option payout range, the Corporation will receive \$5,000 per day under each contract. For each valuation day in which the exchange rate is equal to or greater than the target level of \$1.135, the Corporation will sell U.S. \$5,000,000 at that rate financially settled in CAD against the monthly average for value spot. If the exchange rate is below the \$0.95 level on a valuation day, there is no exchange of funds. The mark-to-market adjustment of these contracts has been recognized as an asset of \$792,943 at September 30, 2011 (2010 - \$676,725).

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)**

Tabular amounts in thousands except per share amounts

Fair Value

The carrying values of the financial assets and financial liabilities approximate their fair value due to the short term to maturity of these instruments. The Corporation categorizes its financial instruments carried at fair value into one of three different levels depending on the observability of the inputs employed in the measurement.

Level 1

Level 1 includes assets and liabilities measured at fair value based on unadjusted quoted prices for identical assets or liabilities in active markets that are accessible at the measurement date. An active market for an asset or liability is considered to be a market where transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis. At September 30, 2011, the Corporation did not have any assets or liabilities which it valued using Level 1 inputs.

Level 2

Level 2 includes assets and liabilities measured at fair value using directly or indirectly observable inputs other than quoted prices included in Level 1. Level 2 valuations are based on inputs including quoted forward prices, time value, volatility factors and broker quotes that can be observed or corroborated in the market for the entire duration of the derivative instrument. At September 30, 2011, the Corporation valued all risk management contracts using Level 2 inputs.

As at September 30, 2011, risk management contract assets totaling of \$1,465,018 consist of unrealized gain on commodity contracts of \$672,075 and an unrealized gain on foreign exchange contracts of \$792,943.

Level 3

Level 3 includes all assets and liabilities measured at fair value based on inputs which are less observable, unavailable or where the observable data does not support a significant portion of the instrument's fair value. At September 30, 2011, the Corporation did not have any assets or liabilities which it valued using Level 3 inputs.

Capital Management

The Corporation's objective when managing capital is to safeguard its ability to continue as a going concern so that it can continue to provide returns to shareholders and benefits for other stakeholders. This objective remains unchanged from previous periods. The Corporation manages the capital structure, and makes adjustments to it, in light of changes in economic conditions and the risk characteristics of the underlying assets.

The Corporation's objective is met by retaining adequate equity to provide for the possibility that cash flows from assets will not be sufficient to meet future cash flow requirements.

The Board of Directors does not establish quantitative return on capital criteria for management. The Corporation defines capital as the aggregate of total equity, bank overdraft and long-term financing less cash and cash equivalents, which at September 30, 2011, was \$223,398,000 (December 31, 2010 - \$221,621,000).

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)***Tabular amounts in thousands except per share amounts*

4. RELATED PARTY TRANSACTIONS

Except as disclosed elsewhere in these condensed consolidated financial statements, the Corporation had the following related party transactions:

- a) The Corporation entered into transactions with the following related parties:

Borden Ladner Gervais LLP - a Director is a partner with the law firm.

- b) Transactions

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Expenses				
Legal consulting - Borden Ladner Gervais LLP	\$ 78	\$ 102	\$ 233	\$ 482
Other				
Recorded as part of oil and natural gas properties - Borden Ladner Gervais LLP	\$ -	\$ -	\$ -	\$ 87

Related party transactions are in the normal course of operations and have been valued in these condensed consolidated financial statements at the exchange amount which is the amount of consideration established and agreed to by the related parties and approximates amounts that would normally be charged to unrelated parties. At September 30, 2011, the Corporation had \$32,839 (December 31, 2010 - \$91,801) owing to the related party.

5. OTHER COMPREHENSIVE INCOME

At September 30, 2010, the Corporation held 1,894,400 common shares of a publicly traded company representing approximately 2.9% of the outstanding shares of the company. The Corporation had classified the investment as an "available for sale" financial asset with any changes in fair value being recognized in other comprehensive income. In the fourth quarter 2010, the Corporation sold all the remaining common shares of the publicly traded company. For the nine months ended September 30, 2010, the Corporation recognized a gain of \$229,000 (net of tax of \$29,000) in other comprehensive income.

Terra Energy Corp.
Notes to the Condensed Consolidated Financial Statements
For the three and nine months ended September 30, 2011 (unaudited)
Tabular amounts in thousands except per share amounts

6. EXPLORATION AND EVALUATION ASSETS

Balance as at January 1, 2010	\$	21,769
Additions to exploration and evaluation assets		19,630
Transfers to property, plant and equipment		(1,350)
Impairment		-
Balance as at December 31, 2010		40,049
<hr/>		
Balance as at January 1, 2011		40,049
Additions to exploration and evaluation assets		285
Transfers to property, plant and equipment		(6,410)
Impairment		-
Balance as at September 30, 2011	\$	33,924

Terra Energy Corp.

Notes to the Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2011 (unaudited)

Tabular amounts in thousands except per share amounts

7. PROPERTY, PLANT AND EQUIPMENT

	Vehicles	Office equipment	Computer equipment	Leasehold improvement	Finance lease equipment	Facilities	Oil and gas properties	Total
Cost								
Balance as at January 1, 2010	\$ 198	\$ 220	\$ 274	\$ 428	\$ 1,285	\$ 24,287	\$ 250,806	\$ 277,498
Additions	-	1	106	-	-	673	30,265	31,044
Asset acquisitions	-	-	-	-	-	-	42,305	42,305
Disposition	-	-	-	-	-	-	(1,428)	(1,428)
Transfers from exploration and evaluation	-	-	-	-	-	-	1,350	1,350
Changes in asset retirement obligations	-	-	-	-	-	-	6,765	6,765
Balance as at December 31, 2010	198	221	380	428	1,285	24,960	330,063	357,534
Additions	1	34	49	312	-	1,520	15,180	17,096
Asset acquisitions	-	-	-	-	-	-	-	-
Dispositions	-	-	-	-	-	-	(1,548)	(1,548)
Transfers from exploration and evaluation	-	-	-	-	-	-	6,410	6,410
Changes in asset retirement obligations	-	-	-	-	-	-	4,514	4,514
Balance as at Sept. 30, 2011	199	255	429	740	1,285	26,480	354,619	384,006

Accumulated Depreciation, Depletion and Amortization

Balance as at January 1, 2010	(91)	(111)	(123)	(329)	-	(7,764)	(87,333)	(95,751)
Depreciation and amortization for the year	(16)	(20)	(54)	(82)	(86)	(1,655)	(23,548)	(25,461)
Balance as at December 31, 2010	(107)	(131)	(177)	(411)	(86)	(9,419)	(110,881)	(121,212)
Depletion for the period	(9)	(14)	(45)	(18)	(63)	(1,336)	(15,393)	(16,878)
Balance as at Sept. 30, 2011	(116)	(145)	(222)	(429)	(149)	(10,755)	(126,274)	(138,090)

Net Book Value

Balance as at January 1, 2010	107	109	151	99	1,285	16,523	163,473	181,747
Balance as at December 31, 2010	91	90	203	17	1,199	15,541	219,181	236,322
Balance as at Sept. 30, 2011	\$ 83	\$ 110	\$ 207	\$ 311	\$ 1,136	\$ 15,725	\$ 228,345	\$ 245,916

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)***Tabular amounts in thousands except per share amounts*

8. FINANCE LEASE OBLIGATIONS

In 2009, the Corporation entered into a lease arrangement for certain capital equipment. The lease obligation bears interest at 6.51% and is secured by the related equipment. The lease term expires in December 2011, with a final purchase obligation of \$639,513 at which time ownership of the equipment will transfer to the Corporation.

At September 30, 2011, future minimum lease payments consist of the following:

Balance at July 1, 2011	\$	812
Less amount representing interest		(83)
Balance as at September 30, 2011 (current obligation)	\$	729

Fixed assets acquired through finance leases are capitalized in property, plant and equipment and depreciated over 15 years.

9. LONG-TERM FINANCING

The Corporation has a revolving line of credit, with a syndicate of chartered banks, of up to \$100 million (2010 - \$100 million), which bears interest at various rates determined by debt to EBITDA ratio. The interest rate charged at September 30, 2011 was 4.7% (2010 - 4.51%). The facility is secured by a general security agreement, a floating charge debenture in the amount of \$150 million and an unlimited liability guarantee by Terra Energy Corp., its subsidiary Constar Resources Ltd. and its affiliate Terra Energy Partnership. At September 30, 2011, the revolving line of credit was drawn down \$86,709,961. Outstanding cheques issued in the amount of \$2,648,806, are shown as bank overdraft until they clear against cash.

The Corporation's bank credit facility is structured as a 364 day revolving credit facility with a one year term out. If the credit facility is not renewed at maturity, the Corporation is required to pay the outstanding balance one year from the maturity. The lending arrangement is reviewed annually. The 2011 review was completed in June 2011 with the next annual review scheduled for June 2012. The June 2011 review resulted in the Corporation's current debt facility being re-affirmed at \$100 million under the same terms and conditions. Included in the credit facility is a Permitted Hedging clause, which allows the Corporation to enter into financial instruments in the ordinary course of business for hedging purposes. The financial instruments shall not exceed 60% of the underlying exposure with respect to Interest Hedging agreements, and with respect to Commodity Agreements, shall not exceed 75% of the daily production, net of royalties, for the first two years, and after the first two years, shall not exceed 50% of average daily production, net of royalties. In addition, the credit facility includes a change of control clause whereby in the event of any change of control, the creditor, at their discretion, may terminate the credit facility, and therefore, the entire amount outstanding would be due and payable upon demand.

As at September 30, 2011, the Corporation is in compliance with all of its banking covenants.

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)***Tabular amounts in thousands except per share amounts*

10. DECOMMISSIONING OBLIGATION

The undiscounted amount of expected cash flows required to settle the decommissioning obligation is estimated at \$29,826,000 (2010 - \$28,952,000). The liability for the expected cash flows, as reflected in the condensed consolidated financial statements, has been discounted at rates between 1.3% and 2.8% (2010 - 3.1% and 4.3%) utilizing an inflation rate of 2% (2011 - 2%).

The schedule below is a reconciliation of the Corporation's liability for the periods ended September 30, 2011 and December 31, 2010:

	2011	2010
Opening balance, beginning of period	\$ 21,268	\$ 15,200
Liabilities disposed		
Revisions to estimates	3,901	2,561
Liabilities settled	(251)	(1,351)
Liabilities incurred	613	4,185
Accretion	498	673
Ending balance, end of period	\$ 26,029	\$ 21,268

The costs attributable to these obligations are expected to be incurred between 2011 and 2041. The actual costs may differ from those estimated.

11. SHARE CAPITAL

a) Authorized

- i) Unlimited number of common voting shares
- ii) Unlimited number of preferred shares

b) Common Shares Issued and Outstanding

On March 24, 2010, the Corporation closed a "bought-deal" financing agreement of 5 million common shares at \$1.80 per common share and 6.25 million flow-through common shares at \$2.16 per flow-through common share, for aggregate gross proceeds of \$22,500,000. The total costs related to the issuance were \$1,186,673 (net of tax of \$394,360).

For the nine month period ended September 30, 2011, the Corporation purchased 176,200 common shares for a total cost of \$209,210 at an average price of \$1.19 per common share. Share capital was reduced by \$201,310 and the excess of \$7,900 was charged to retained earnings.

For the year ended December 31, 2010, the Corporation purchased 1,197,900 common shares for total costs of \$1,786,777, at an average price of \$1.49 per common share. Share capital was reduced by \$1,255,978 and the excess of \$530,799 was charged to retained earnings.

At September 30, 2011, there were no common share purchase warrants outstanding. The warrants were unexercised and expired during the quarter.

Terra Energy Corp.

Notes to the Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2011 (unaudited)

Tabular amounts in thousands except per share amounts

c) Stock Options

The Corporation's Employee Stock Option Plan provides for officers, directors, employees, and consultants to be granted options of up to 10% of the issued and outstanding common shares of the Corporation.

These options entitle the holder to purchase common shares of the Corporation subject to various vesting periods and other terms and conditions specified in the stock option plan.

Details of all options outstanding at September 30, 2011, are as follows:

	September 30, 2011		December 31, 2010	
(options in thousands)	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Employee stock options				
Balance, beginning of period	8,465	1.46	8,062	1.48
Granted	684	1.09	3,652	1.09
Exercised	(64)	(1.08)	(258)	1.16
Expired	(954)	(1.53)	(2,991)	1.54
Balance, end of period	8,131	1.42	8,465	1.46

During the nine months ended September 30, 2011, the Corporation granted options to officers, directors and employees to purchase 684,000 shares at prices ranging from \$1.07 to \$1.11 per common share. For the same period of 2010, options totaling 3,652,000 were issued at prices ranging between \$1.00 and \$1.72 per common share. The options outstanding at September 30, 2011, are as follows:

Range of exercise price	Weighted average remaining contract life	Outstanding September 30, 2011	Exercisable September 30, 2011
\$1.07 - \$1.30	3.09 years	1,478,000	1,065,000
\$1.31 - \$1.37	3.30 years	2,542,100	2,490,100
\$1.38 - \$1.50	3.86 years	1,954,000	1,907,000
\$1.51 - \$1.77	3.39 years	1,962,000	1,834,000
\$1.78 - \$1.85	3.62 years	136,400	128,400
\$1.86 - \$2.11	3.76 years	58,500	56,000
	3.38 years	8,131,000	7,480,500

d) Share-based Compensation

For stock options granted to employees, compensation expense of \$903,000 has been recorded for the nine months ended September 30, 2011, (2010 - \$1,545,000) with the offsetting charge to contributed surplus. The fair value of stock options granted in the period was estimated using a Black-Scholes option-pricing model with the following assumptions: Dividend yield Nil; expected volatility of 69% (2010 - 68%); risk-free interest rate of 2.0%; weighted average term of 3.4 years (2010 - 3.7 years); and a forfeiture rate of 15% (2010 - 10.5%).

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)***Tabular amounts in thousands except per share amounts*e) Flow-through Shares

The Corporation is required to incur exploration and development activities by December 31, 2011, of approximately \$13,500,000 as a result of flow-through shares issued in March 2010. At September 30, 2011, the Corporation had incurred qualifying expenditures of \$12,829,244 towards this obligation.

Per Share Amounts

The following table summarizes the calculation of basic net income and diluted net income per share.

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Net income available to common shareholders	\$ (1,701)	\$ (1,712)	\$ 245	\$ 235
Weighted-average number of common shares outstanding - basic	101,888	99,881	101,888	95,903
Dilutive effect of stock options and warrants	-	-	-	-
Weighted-average number of common shares outstanding - diluted	101,888	99,881	101,888	95,903
Net income (loss) per share (\$/share)				
Basic	(0.02)	(0.02)	-	-
Diluted	(0.02)	(0.02)	-	-

For the nine month period ended September 30, 2011, 8,131,000 stock options (2010 - 8,958,000) have been excluded from the calculation of diluted income per share, as they were anti-dilutive. Warrants totaling 7,000,000 were unexercised and expired during the third quarter of 2011, resulting in a reclassification of \$3,253,000 against contributed surplus. These warrants were anti-dilutive for the prior period ended September 30, 2010. There were no other changes to share capital during the third quarter of 2011.

12. SUPPLEMENTAL CASH FLOW INFORMATION

Change in non-cash working capital	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Accounts receivable	\$ 1,073	\$ (1,690)	\$ 6,814	\$ 2,672
Prepaid expenses	290	557	(38)	(321)
Accounts payable and accrued liabilities	2,942	10,573	(9,360)	4,240
Total non-cash working capital changes	4,305	9,440	(2,584)	6,591
Change in non-cash working capital from investing	(916)	5,802	347	2,885
Change in non-cash working capital from operations	5,221	3,638	(2,931)	3,706
	\$ 4,305	\$ 9,440	\$ (2,584)	\$ 6,591

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)***Tabular amounts in thousands except per share amounts*

13. BUSINESS COMBINATIONS

On September 1, 2010, the Corporation completed the acquisition of certain oil & gas assets, including 100% of the Square Creek gas field and 80,000 net acres of undeveloped land. The assets were acquired for consideration of \$25,900,000 cash and 3,664,444 common shares of the Corporation. In determining the consideration for this acquisition, the fair value of Terra Energy Corp. shares was \$1.33 per share based on the closing publicly traded prices on the closing date of September 1, 2010. The aggregate consideration for the acquisition of these assets consists of the following:

Common shares issued (3,664,444 at \$1.33 per share)	4,874
Cash	25,871
Total consideration for the acquisition	30,745

As of the acquisition date, the acquired asset's operating results have been included in the Corporation's revenues and expenses. For the period from September 1, 2010 to December 31, 2010, the acquired properties contributed revenue of \$4.4 million. If the acquisition had occurred on January 1, 2010, management estimates that the acquired properties would have generated revenue of \$13.1 million for the year ended December 31, 2010. It is not possible to determine the amount contributed to net income from the acquired properties at September 30, 2010 or at December 31 2010. No goodwill has been recognized as a result of the acquisition. The following summarizes the allocation of the aggregate consideration for the acquisition of these assets:

Purchase price allocation	
Prepaid expenses	270
Oil and gas properties	31,735
Decommissioning obligations	(1,260)
	30,745

14. COMMITMENTS AND CONTINGENCIES

- a) The Corporation is subject to certain office and equipment leases and gathering and processing contracts (see Note 3).
- b) The Corporation is involved in various claims arising in the normal course of business. While the outcome of these matters is uncertain, and there can be no assurance that such matters will be resolved in the Corporation's favour, the Corporation does not currently believe that the outcome of adverse decisions in any proceedings related to these matters or any amount which it may be required to pay would have a material adverse impact on its financial position, results of operations or liquidity.
- c) The Corporation had outstanding letters of credit to various parties for a total of \$505,744 which expire at various dates during 2011.
- d) The Corporation is required to incur qualifying exploration expenditures by December 31, 2011, of approximately \$13,500,000 as a result of flow-through shares issued in March, 2010. At September 30, 2011, the Corporation had incurred qualifying expenditures of approximately \$12,829,244

Terra Energy Corp.
Notes to the Condensed Consolidated Financial Statements
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Tabular amounts in thousands except per share amounts

15. SUBSEQUENT EVENTS

Subsequent to the end of September 30, 2011 the following transactions have transpired:

- a) Subsequent to September 30, 2011, the Corporation entered into the following financial commodity contracts:

Oil			
Contract type	Price	Volumes per day	Contract term
Financial	\$90.40 CAD	1,000 bbls	January 2012 to December 2012
Financial	\$93.10 CAD	1,000 bbls	December 2012
Financial	\$92.95 CAD	1,000 bbls	January 2013 to December 2013

- b) The Corporation has identified specific assets in western-central Alberta as available for sale. The assets which are being marketed are non-core and have no production or reserves attributed to them.
-

16. TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

As stated in Note 1, these condensed consolidated financial statements represent the condensed interim financial statements of the Corporation and its subsidiaries prepared in accordance with IFRS for the period ended September 30, 2011. As a result, these interim condensed consolidated financial statements have been prepared in accordance with IFRS 1- *First-time Adoption of International Financial Reporting Standards* and with IAS 34, *Interim Financial Reporting*. The first date at which IFRS was applied was January 1, 2010 ("Transition Date"). In preparing these financial statements in accordance with IFRS 1, the Corporation has:

- provided comparative financial information;
- applied the same accounting policies throughout all periods presented;
- retroactively applied all effective IFRS standards as of January 1, 2010, as required, and
- applied certain optional and mandatory exemptions as applicable for first time adopters of IFRS.

The Corporation's consolidated financial statements were previously prepared in accordance with Canadian GAAP.

IFRS 1 (First-time adoption of IFRS) Exemptions

The Corporation has applied the following IFRS 1 exemptions:

Property, Plant and Equipment

IFRS 1 allows an entity that used full cost accounting under Canadian GAAP to deem its January 1, 2010, IFRS upstream oil & natural gas asset to be equal to its Canadian GAAP historical net book value. On January 1, 2010, the IFRS exploration and evaluation costs are deemed to be equal to the Canadian GAAP unproved properties balance and IFRS development costs equal to the remaining full cost pool balance.

Terra Energy Corp.**Notes to the Condensed Consolidated Financial Statements****For the three and nine months ended September 30, 2011 (unaudited)**

Tabular amounts in thousands except per share amounts

Decommissioning Liabilities

As a result of the Corporation's use of the IFRS I exemption for decommissioning liabilities, the Corporation is required to revalue its January 1, 2010, decommissioning liabilities under IAS 37 using a risk-free rate and recognize the adjustment in retained earnings.

Share-based Compensation

The Corporation used the IFRS I exemption under which stock options vested prior to January 1, 2010, are not required to be restated.

Business Combinations

The IFRS I exemption allowed the Corporation to use the IFRS rules for business combination on a prospective basis rather than re-stating all business combinations. The Corporation made the election under IFRS I and did not apply IFRS 3, *Business Combinations*, to business combinations that occurred before January 1, 2010.

Leases

The Corporation took the IFRS I exemption for leases and did not apply IAS 17, *Leases* retroactively prior to January 1, 2010.

Borrowing Costs

The Corporation plans to capitalize borrowing costs when the capital projects are longer than one year. The Corporation has not previously had projects that took longer than one year and plans to apply IAS 23 borrowing costs prospectively.

The following reconciliations present the adjustments made to the Corporation's previous GAAP Financial statements to comply with IFRS I. Please refer to the notes that follow the detailed reconciliations.

Terra Energy Corp.

Reconciliation of Consolidated Statement of Financial Position from Canadian GAAP to IFRS

As at September 30, 2010 (unaudited)				
<i>(\$ in thousands)</i>	GAAP	Adjustments	Note	IFRS
Assets				
Current Assets				
Accounts receivable	\$ 12,847	\$ -		\$ 12,847
Prepaid expenses	3,027	-		3,027
Risk management contracts	128	-		128
Other assets	521	-		521
	16,523	-		16,523
Non-Current assets				
Exploration and evaluation assets	-	37,440	a	37,440
Property, plant and equipment	266,752	(27,759)	a	238,993
	283,275	9,681		292,956
Liabilities and Shareholders' Equity				
Current liabilities				
Bank overdraft	5,710	-		5,710
Accounts payable and accrued liabilities	22,160	-		22,160
Current portion of finance lease obligation	326	-		326
Decommissioning obligation	1,176	31	b	1,207
Risk management contracts				
	29,372	31		29,403
Deferred credit				
Long-term debt				
	84,472	-		84,472
Flow-through obligation				
	-	2,250	c	2,250
Finance lease obligation				
	729	-		729
Decommissioning obligation				
	12,088	7,496	b	19,584
Deferred income taxes				
	20,415	396	g	20,811
	147,076	10,173		157,249
Shareholder's Equity				
Share capital	110,267	6,483	c	116,750
Warrants	3,253	-		3,253
Contributed surplus	12,919	(175)	d	12,744
Retained earnings	9,548	(6,800)	b,c,d	2,748
Accumulated other comprehensive income	212	-		212
	136,199	(492)		135,707
	\$ 283,275	\$ 9,681		\$ 292,956

Terra Energy Corp.**Reconciliation of Consolidated Statements of Operations from Canadian GAAP to IFRS****For the three months ended September 30, 2010 (unaudited)**

<i>(\$ in thousands, except per share amounts)</i>	GAAP	Adjustments	Note	IFRS
Revenue				
Petroleum and natural gas	\$ 17,580	\$ -		\$ 17,580
Royalties	(2,686)	-		(2,686)
Petroleum and natural gas revenues, net of royalties	14,894	-		14,894
Realized loss on derivative instruments	(1,157)	-		(1,157)
Unrealized gain on derivative instruments	940	-		940
	14,677	-		14,677
Gain on disposition of other assets	83	-		83
Total revenue and other income	14,760	-		14,760
Expenses				
Production	7,854	-		7,854
General and administrative	2,318	153	f	2,471
Share-based compensation	251	(26)	d	225
Depletion, depreciation and amortization	8,977	(2,791)	a	6,186
Finance costs	942	(78)	b	864
Unrealized foreign exchange gain	(664)	-		(664)
Realized foreign exchange gain	(220)	-		(220)
	19,458	(2,742)		16,716
Loss before income taxes	(4,698)	2,742		(1,956)
Income tax expense				
Current tax expense	3	1		4
Deferred tax expense	(968)	720	g	(248)
	(965)	721		(244)
Income (loss) for the period	\$ (3,733)	\$ 2,021		\$ (1,712)

Terra Energy Corp.

Reconciliation of Consolidated Statements of Operations from Canadian GAAP to IFRS

For the nine months ended September 30, 2010
(unaudited)

<i>(\$ in thousands, except per share amounts)</i>	GAAP	Adjustments	Note	IFRS
Revenue				
Petroleum and natural gas	\$ 61,105	\$ -		\$ 61,105
Royalties	(9,993)	-		(9,993)
Petroleum and natural gas revenues, net of royalties	51,112	-		51,112
Realized gain (loss) on derivative instruments	(1,832)	-		(1,832)
Unrealized gain (loss) on derivative instruments	154	-		154
	49,434	-		49,434
Gain on disposition of other assets	347	-		347
Total revenue and other income	49,781	-		49,781
Expenses				
Production	19,883	-		19,883
General and administrative	6,488	459	f	6,947
Share-based compensation	1,673	(128)	d	1,545
Depletion, depreciation and amortization	26,242	(7,584)	a	18,658
Finance costs	2,494	(132)	b	2,362
Unrealized foreign exchange (gain) loss	(128)	-		(128)
Realized foreign exchange (gain) loss	(397)	-		(397)
	56,255	(7,385)		48,870
Loss before income taxes	(6,474)	7,385		911
Income tax expense				
Current tax expense	4	-		4
Deferred tax expense (recovery)	(999)	1,671	g	672
	(995)	1,671		676
Income (loss) for the period	\$ (5,479)	\$ 5,714		\$ 235

Terra Energy Corp.

Reconciliation of Consolidated Statements of Operations from Canadian GAAP to IFRS

As at December 31, 2010 (unaudited)

<i>(\$ in thousands)</i>	GAAP	Adjustments	Note	IFRS
Assets				
Current Assets				
Accounts receivable	\$ 14,324	\$ -		\$ 14,324
Prepaid expenses	2,947	-		2,947
Risk management contracts	400	-		400
	17,671	-		17,671
Non-Current Assets				
Exploration and evaluation assets	-	40,049	a	40,049
Property, plant and equipment	263,822	(27,500)	a,b	236,322
	\$ 281,493	\$ 12,549		\$ 294,042
Liabilities				
Current liabilities				
Bank overdraft	\$ 3,511	\$ -		\$ 3,511
Accounts payable and accrued liabilities	27,220	-		27,220
Current portion of finance lease obligation	975	-		975
Decommissioning obligations	200	-		200
Risk management contracts	-	-		-
	31,906	-		31,906
Deferred credit				
Long-term debt	85,074	-		85,074
Finance lease obligation	-	-		-
Decommissioning obligation	13,462	7,606	b	21,068
Deferred income taxes	18,476	4,482	c,g	22,958
	148,918	12,088		161,006
Shareholder's Equity				
Share capital	110,012	6,482	c	116,494
Warrants	3,253	-		3,253
Contributed surplus	13,024	(198)	d	12,826
Retained earnings	6,286	(5,823)	d	463
Accumulated other comprehensive income	-	-		-
Total Liabilities and Equity	132,575	461		133,036
	\$ 281,493	\$ 12,549		\$ 294,042

Terra Energy Corp.**Notes to Consolidated Financial Statements****For the Three and Nine months ended September 30, 2011 (unaudited)**

Tabular amounts in thousands, except per share amounts

In addition to exemptions discussed previously, the following notes explain the significant differences between the historical Canadian GAAP accounting policies and IFRS accounting policies applied by the Corporation.

a) **Oil and Natural Gas Properties**

Under Canadian GAAP, the Corporation followed the CICA guideline on full cost accounting in which all costs directly associated with the acquisition of, the exploration for, and the development of natural and crude oil reserves are capitalized on a country-by-country basis. Upon transition to IFRS, the Corporation adopted new accounting policies for upstream activities, including pre-exploration costs, exploration and evaluation costs and development costs.

Pre-exploration costs are those expenditures incurred prior to obtaining the legal right to explore and must be expensed under IFRS. Under GAAP, the Corporation capitalized and depleted pre-exploration costs.

Exploration and evaluation costs are those expenditures for an area or a project for which technical feasibility and commercial viability have not yet been determined. Under IFRS, the Corporation initially capitalizes these costs as Exploration and Evaluation assets on the balance sheet. When the area or project is determined to be technically feasible and commercially viable, the costs are transferred to PP&E. Unrecoverable exploration and evaluation costs associated with an area or project are expensed.

Development costs include those expenditures for areas or projects where technical feasibility and commercial viability has been determined. Under IFRS, the Corporation continues to capitalize these costs within PP&E on the balance sheet.

IFRS requires the development costs to be depleted on a unit-of-production basis over a smaller production unit instead of the country cost centre level previously utilized under Canadian GAAP. Canadian GAAP required proved reserves to be used for the depletion calculation. Under IFRS, the Corporation has elected to use proved and probable reserves for the depletion calculation.

For the nine months ended September 30, 2010, the change in depleting the petroleum and natural gas properties over proved plus probable reserves resulted in a decrease to depletion expense of \$7,584,726 and for the three months ended September 30, 2010 the depletion expense decreased \$2,791,098. For the year ended December 31, 2010, the decrease to depletion expense was \$10,261,365.

Under IFRS, upstream divestitures will generally result in a gain or loss recognized in net earnings. Under Canadian GAAP, proceeds of divestitures were normally deducted from the full cost pool without recognition of gain or loss unless the deduction would result in a change to the depletion rate of 20% or greater, in which case a gain or loss is recorded.

Under Canadian GAAP, the Corporation was required to recognize an impairment loss if the carrying value exceeds the undiscounted cash flow from proved reserves for the country cost centre. If an impairment loss was to be recognized, it was then measured at the amount the carrying value exceeds the sum of the fair value of the proved and probable reserves and the costs of unproved properties.

Under IFRS, indicators of impairment need to be assessed at each reporting period and an impairment test is only required if there are indicators of impairment. The Corporation is required to recognize an impairment loss if the carrying value exceeds the recoverable amount for a cash generating unit. Under IFRS, the recoverable amount is the higher of fair value less cost to sell and value in use. Impairment losses, other than goodwill, are reversed under IFRS when there is an increase in the recoverable amount. A cash generating unit is defined as the smallest identifiable asset or group of assets that generate largely independent cash flows. The Corporation has identified two CGUs, which could change over time.

On transition to IFRS on January 1, 2010, the Corporation transferred to exploration and evaluation assets \$21,769,411 of undeveloped land with an offsetting decrease to property, plant and equipment. At September 30, 2010, the amount transferred was \$37,440,303 and for the year ended December 31, 2010, the amount transferred was \$40,049,103.

Terra Energy Corp.

Notes to Consolidated Financial Statements

For the Three and Nine months ended September 30, 2011 (unaudited)

Tabular amounts in thousands, except per share amounts

b) Decommissioning Liabilities

Under Canadian GAAP, asset retirement obligation (“ARO”) was measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. Existing liabilities were not re-measured using current discount rates. Under IFRS, decommissioning liability is the best estimate of expenditures expected to be required to settle the present obligation at the end of the period. If there are uncertainties surrounding the amount recognized as a provision then the obligation is estimated by weighting all possible outcomes by their associated probabilities. The discount rate used for decommissioning liability is a risk free rate as the estimated provision is adjusted to reflect risks specific to the liability. Under Canadian GAAP, the Corporation used a credit-adjusted risk free rate. Under IFRS, the unwinding of the discount rate is charged as interest expense versus accretion expense under Canadian GAAP.

On transition to IFRS on January 1, 2010, this resulted in an increase to the ARO of \$5,104,039 and a corresponding decrease to retained earnings. At September 30, 2010, the decommissioning liability was \$7,527,956 higher than under Canadian GAAP due to the change in discount rate. At December 31, 2010, the decommissioning liability was \$7,606,315 higher than under Canadian GAAP due to the change in discount rate.

The change in the discount rate also resulted in a decrease to accretion expense of \$131,833 for the nine months ended September 30, 2010 and \$304,349 for the year ended December 31, 2010.

c) Flow-through Shares

Flow-through shares are a unique Canadian tax incentive which is the subject of specific guidance under GAAP. The premium paid for the flow-through shares in excess of the market value of the shares without the flow-through features at the time of issue is credited to share capital. When the renouncement is made share capital is reduced and deferred income tax liability is credited. Under IFRS, the flow-through share premium is recorded as a liability at the time of flow-through share issuance. Upon renunciation of flow-through shares, the other liability is reversed and tax expense and deferred tax liability recorded.

Upon transition to IFRS on January 1, 2010, the impact of the change in accounting policy for flow-through shares resulted in an increase to share capital of \$8,732,776 and a corresponding decrease to retained earnings.

In March 2010, the Corporation issued flow-through shares and under IFRS recorded a liability of \$2,250,000 and a reduction of share capital.

At December 31, 2010, the flow-through share expenditures were renounced. As a result, under IFRS, the liability of \$2,250,000 was reversed with an increase to deferred income tax liability of \$3,375,000 and the net amount of \$1,125,000 charged to deferred income tax expense.

d) Share-based Compensation

IFRS 2 share-based payments requires for options given to employees to be fair valued using a model such as the Black-Scholes model. IFRS also requires the use of an estimated forfeiture rate at the grant date and update it throughout the vesting period. Under Canadian GAAP, the Corporation used the actual forfeiture rate in calculating fair value.

The impact on transition to IFRS at January 1, 2010, was a decrease to contributed surplus of \$47,761 and a corresponding increase to retained earnings. For the nine months ended September 30, 2010, the impact was a decrease to share-based compensation expense of \$127,994, a decrease to contributed surplus of \$175,755 and an increase to opening retained earnings of \$47,761.

For the year ended December 31, 2010, contributed surplus decreased by \$198,425, share-based compensation expense decreased by \$150,664 and opening retained earnings increased by \$47,761.

Terra Energy Corp.

Notes to Consolidated Financial Statements

For the Three and Nine months ended September 30, 2011 (unaudited)

Tabular amounts in thousands, except per share amounts

e) Business Combinations

IFRS 3 defines the acquisition date to be the date on which the acquirer obtains control over the acquired entity or business, and the fair value of net identifiable assets and consideration transferred to be measured at that date. Contingent consideration is also recognized. IFRS 3 requires negative goodwill be recognized immediately in profit or loss and also requires the acquirer to recognize the acquiree's identifiable assets, liabilities and contingent liabilities at their fair value at the acquisition date, thus resulting in any non-controlling interest in acquiree being stated at the non-controlling interest's portion of the net fair values of those items. Transaction costs are excluded from the purchase price.

f) Indirect Overhead Charges

Under IFRS, only directly attributable overhead costs can be capitalized to property, plant and equipment. For the nine months ended September 30, 2010, \$458,776 of indirect overhead costs were moved from property, plant and equipment back to general and administrative expense. For the year ended December 31, 2010, the amount reclassified to general and administrative expense was \$518,863.

g) Deferred Income Taxes

On transition to IFRS on January 1, 2010, the adjustment to decommissioning liabilities resulted in a decrease of \$1,275,875 to deferred tax liability.

For the nine months ended September 30, 2010 and year ended December 31, 2010, adjustments to deferred income taxes have been made as a result of the various other adjustments discussed above.