Paramount resources ltd.

Consolidated Financial Statements
As at December 31, 2012 and 2011 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 independent 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 7, 2013

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, 2012 and 2011 and the consolidated statements of comprehensive loss, shareholders' equity and cash flows for the years ended December 31, 2012 and 2011, 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, 2012 and 2011 and its financial performance and its cash flows for the years ended December 31, 2012 and 2011 in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Calgary, Canada

7 March 2013

Chartered accountants

PARAMOUNT RESOURCES LTD.
Consolidated Balance Sheet
($ thousands)

As at December 31	Note	2012	2011
ASSETS			
Current assets			
Cash and cash equivalents	21	**$ 146,684**	$ 29,000
Accounts receivable	20	**32,790**	40,181
Risk management	20	**–**	184
Prepaid expenses and other		**2,504**	2,551
Assets held for sale	6	**12,433**	58,038
		194,411	129,954
Deposit	19	**20,234**	20,043
Exploration and evaluation	8	**405,090**	390,742
Property, plant and equipment, net	9	**1,078,451**	808,617
Equity-accounted investments	10	**90,977**	101,543
Investments in securities	11	**127,767**	153,840
Deferred income tax	19	**116,901**	117,548
Goodwill	12	**3,124**	3,426
		$ 2,036,955	$ 1,725,713
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Demand facilities	13	**$ 40,703**	$ 22,842
Accounts payable and accrued liabilities	20	**183,512**	136,820
Risk management	20	**–**	2,787
Liabilities associated with assets held for sale	6	**470**	13,040
		224,685	175,489
Long-term debt	14	**660,702**	427,186
Asset retirement obligations	15	**300,468**	299,202
		1,185,855	901,877
Commitments and contingencies	24		
Shareholders' equity			
Share capital	16	**921,680**	810,781
Accumulated deficit		**(165,527)**	(103,615)
Reserves	17	**94,947**	116,670
		851,100	823,836
		$ 2,036,955	$ 1,725,713

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	2012	2011
			(restated see note 4)
Petroleum and natural gas sales		**$ 185,662**	$ 213,356
Royalties		**(14,585)**	(17,400)
Revenue		**171,077**	195,956
Gain (loss) on financial commodity contracts	20	**2,487**	(1,699)
		173,564	194,257
Expenses			
Operating expense		**66,396**	62,443
Transportation		**21,774**	20,519
General and administrative		**18,140**	16,934
Stock-based compensation	1,18	**29,082**	21,462
Depletion and depreciation	9	**284,155**	369,997
Exploration and evaluation	8	**33,516**	27,156
Gain on sale of property, plant and equipment		**(26,432)**	(4,863)
Interest		**35,324**	34,109
Accretion of asset retirement obligations		**3,332**	7,887
Acquisition transaction costs		**–**	1,044
Foreign exchange		**1,583**	(949)
		466,870	555,739
Income from equity-accounted investments	10	**153,333**	1,201
Other income	5	**14,290**	24,392
Loss from continuing operations before tax		**(125,683)**	(335,889)
Income tax expense (recovery)	19		
Current		**789**	12
Deferred		**(34,339)**	(79,599)
		(33,550)	(79,587)
Loss from continuing operations		**(92,133)**	(256,302)
Income from discontinued operations, net of tax	4	**30,221**	24,312
Net loss		**$ (61,912)**	$ (231,990)
Other comprehensive income (loss), net of tax	17		
Change in market value of securities		**(42,830)**	(19,913)
Exchange differences on translation of US subsidiaries		**438**	1,197
		(42,392)	(18,716)
Comprehensive loss		**$ (104,304)**	$ (250,706)
Net income (loss) per common share ($/share)	16		
Basic – continuing operations		**(1.06)**	(3.27)
Basic – discontinued operations		**0.35**	0.31
Basic		**(0.71)**	(2.96)
Diluted – continuing operations		**(1.06)**	(3.27)
Diluted – discontinued operations		**0.35**	0.31
Diluted		**(0.71)**	(2.96)

See the accompanying notes to these Consolidated Financial Statements.

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

Year ended December 31	Note	2012	2011
Operating activities			
Net loss		$ (61,912)	$ (231,990)
Add (deduct):			
Items not involving cash	21	101,013	310,074
Dividends from equity-accounted investments		8,040	11,360
Asset retirement obligations settled	15	(8,002)	(7,520)
Current tax related to the sale of U.S. properties		3,931	–
Change in non-cash working capital		12,150	3,036
Cash from operating activities		55,220	84,960
Financing activities			
Net draw (repayment) of demand loans		17,861	(4,038)
Proceeds from Senior Notes, net of issue costs		294,135	70,899
Repayment of debt assumed on acquisitions	7	–	(37,824)
Net draw (repayment) of revolving long-term debt	14	(61,383)	61,383
Common shares issued, net of issue costs		124,465	268,627
Common shares purchased under stock incentive plan		(3,052)	(2,974)
Cash from financing activities		372,026	356,073
Investing activities			
Property, plant and equipment and exploration		(623,631)	(525,239)
Proceeds on sale of property, plant and equipment		45,231	45,385
Proceeds on sale of discontinued operations, net		66,498	–
Proceeds on sale of investment, net		181,718	16,129
Corporate acquisitions	7	–	(64,759)
Investments in securities		(13,023)	–
Investments in equity accounted investees		(1,650)	–
Change in non-cash working capital		36,008	41,769
Cash used in investing activities		(308,849)	(486,715)
Net increase (decrease)		118,397	(45,682)
Foreign exchange on cash and cash equivalents		(713)	23
Cash and cash equivalents, beginning of year		29,000	74,659
Cash and cash equivalents, end of year		$ 146,684	$ 29,000
Supplemental cash flow information	21		

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**	**2012**		2011	
		Shares (000's)		*Shares (000's)*	
Share Capital					
Balance, beginning of year		***85,414***	**$ 810,781**	*75,034*	$ 481,827
Issued		***4,432***	**110,896**	*8,316*	271,683
Issued on acquisition of ProspEx	7	**–**	**–**	*2,000*	57,280
Change in unvested common shares for stock incentive plan	18	***11***	**3**	*64*	(9)
Balance, end of year		***89,857***	**$ 921,680**	*85,414*	$ 810,781
Accumulated (Deficit) Earnings					
Balance, beginning of year			**$ (103,615)**		$ 128,375
Net loss			**(61,912)**		(231,990)
Balance, end of year			**$ (165,527)**		$ (103,615)
Reserves	17				
Balance, beginning of year			**$ 116,670**		$ 71,996
Other comprehensive loss			**(42,392)**		(18,716)
Contributed surplus			**20,669**		65,792
Stock-based compensation – investee options			**–**		(2,402)
Balance, end of year			**$ 94,947**		$ 116,670
Total Shareholders' Equity			**$ 851,100**		$ 823,836

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 properties are primarily located in Alberta, the Northwest Territories and British Columbia. 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: i) Principal Properties; ii) Strategic Investments; and iii) Corporate.

Paramount is the ultimate parent company of the consolidated group of companies and 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 of the Company, as at December 31, 2012 and December 31, 2011 and for the years then ended (the "Consolidated Financial Statements"), were authorized for issuance by Paramount's Board of Directors on March 7, 2013.

a) Basis of Preparation

These Consolidated Financial Statements comply in all material respects 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. The Company's accounting policies have been applied consistently to all years presented.

These Consolidated Financial Statements include the accounts of Paramount and its subsidiaries and partnerships, including Cavalier Energy Inc. ("Cavalier Energy"), Fox Drilling Inc. ("Fox Drilling"), Summit Resources, Inc. ("Summit") and Paramount Drilling U.S. LLC. All intercompany balances and transactions have been eliminated.

In May 2012, Paramount's wholly-owned subsidiary, Summit, closed the sale of all of its operated properties in North Dakota and all of its properties in Montana (the "Sold Properties"). Results of the Sold Properties have been presented as discontinued operations and prior year comparative results have been adjusted to conform to the current year's basis of presentation, refer to note 4.

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 Consolidated Financial Statements are described in Note 2.

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.

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 corresponding amounts of revenue are 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 Trilogy Energy Corp. ("Trilogy"), 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 Trilogy, MGM Energy and Paxton share common directors and/or members of management. The Company's remaining investments in other entities are accounted for as available-for-sale investments.

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 and pre-production 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 the costs of materials, machinery, labour, and directly attributable overhead in connection with their construction. 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, which extend up to 20 years.

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, which vary 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, 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. For oil and gas properties, the fair value less costs to sell is estimated based on expected after-tax future net cash flows 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.

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. 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. Costs incurred to affect the transaction are expensed.

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 (or group of CGUs), including goodwill, exceeds its estimated recoverable amount. Impairment charges relating to goodwill are not reversed in future periods.

For the purpose of testing goodwill for impairment, recoverable amounts for a CGU or group of CGUs are estimated on the same basis as used in testing the assets of that CGU for impairment.

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, after applying an estimated cost inflation factor, and is adjusted for the passage of time, which is recognized as accretion expense. Revisions to the timing, amount, and applicable discount and inflation rates 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 purpose 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. The measurement of a financial instrument in subsequent periods is dependent upon whether it 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. All of the Company's financial instruments have been classified as fair value through profit or loss except available-for-sale investments and long-term debt.

Fair value through profit or loss financial assets and financial liabilities are measured at fair value, and changes in fair values 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 are accumulated in other comprehensive income ("OCI") until the asset is realized, at which time the cumulative gain or loss is recognized net income. Held-to-maturity financial assets, loans and receivables and other financial liabilities, including related transaction costs, are measured at amortized cost using the effective interest method.

Other Comprehensive Income

For Paramount, 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 in the Consolidated Balance Sheet.

n) Income Taxes

Paramount follows the liability method of accounting for income taxes. Under this method, a deferred income tax asset or liability is recognized in respect 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 the underlying 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 was 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

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 the 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.

2. SIGNIFICANT ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGMENTS

The timely preparation of financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosures regarding contingent assets and liabilities. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Changes in judgments, estimates and assumptions based on new information could result in a material change to the carrying amount of assets or liabilities and have a material impact on revenue and expenses in future periods. The following is a description of the accounting judgments, estimates and assumptions that are considered significant:

Exploration and Evaluation Assets

The accounting for exploration and evaluation assets requires management to make judgments as to whether wells are classified as exploratory or development. Management must also determine whether exploratory wells have discovered economically recoverable quantities of reserves, which requires the quantity and value such reserves to be estimated. 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.

Determination of CGUs

The recoverability of the carrying value of oil and gas properties is assessed at the CGU level. Determination of the properties and other assets to be included within a particular CGU is based on management's judgment with respect to the integration between assets, shared infrastructure and cashflows. Changes in the assets comprising each CGU impacts recoverable amounts used in impairment assessments and 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. The fair value of individual assets is often required to be estimated, which may involve estimating the fair values of reserves and resources, tangible assets, undeveloped land, intangible assets and other assets acquired. These estimates incorporate assumptions using appropriate indicators of fair value, as determined by management. Changes in any of the estimates or assumptions 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 adjusts estimated amounts periodically as assumptions are changed to incorporate new information. Actual payments to settle the obligations may differ materially from amounts estimated.

Share-Based Payments

The Company estimates the grant date 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 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.

($ thousands, except as noted)

- **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. DISCONTINUED OPERATIONS

In May 2012, Paramount's wholly-owned subsidiary, Summit, closed the sale of all of its operated properties in North Dakota and all of its properties in Montana for after-tax cash proceeds of $66.5 million. These properties were included in the Company's Principal Properties business segment.

Details of income from discontinued operations are presented below:

Year ended December 31	**2012**	2011
Petroleum and natural gas sales	**$ 11,481**	$ 28,357
Royalties	**(1,945)**	(4,656)
Revenue	**9,536**	23,701
Expenses		
Operating expense and production tax	**3,455**	8,810
Depletion and depreciation	**1,398**	8,080
Exploration and evaluation	**(341)**	174
Gain on sale of property, plant and equipment	**–**	(37,158)
Accretion of asset retirement obligations	**51**	(513)
Foreign exchange	**–**	2,326
	4,563	(18,281)
Other income (expense)	**(13)**	136
Income from ordinary activities of discontinued operations before tax	**4,960**	42,118
Gain on sale of discontinued operations	**50,721**	–
Income from discontinued operations before tax	**55,681**	42,118
Income tax expense – discontinued operations		
Current	**3,931**	–
Deferred	**21,529**	17,806
	25,460	17,806
Income from discontinued operations	**$ 30,221**	$ 24,312

The cash flows from discontinued operations, including changes in related non-cash working capital items are as follows:

Year ended December 31	2012	2011
Operating	$ 11,450	$ 15,567
Investing	65,501	37,221
Cash flow from discontinued operations	**$ 76,951**	$ 52,788

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; 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 Paramount's wholly-owned subsidiary, Fox Drilling.

- **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.

($ thousands, except as noted)

Year ended December 31, 2012	**Principal Properties**	**Strategic Investments**	**Corporate**	**Inter-segment Eliminations**	**Total**
Revenue	$ 171,077	$ –	$ –	$ –	**$ 171,077**
Gain on financial commodity contracts	2,487	–	–	–	**2,487**
	173,564	–	–	–	**173,564**
Expenses					
Operating expense	66,396	–	–	–	**66,396**
Transportation	21,774	–	–	–	**21,774**
General and administrative	–	6,438	11,702	–	**18,140**
Stock-based compensation	–	10,879	18,203	–	**29,082**
Depletion and depreciation	282,101	4,657	338	(2,941)	**284,155**
Exploration and evaluation	32,038	1,478	–	–	**33,516**
Gain on sale of property, plant and equipment	(26,432)	–	–	–	**(26,432)**
Interest	–	1,499	33,825	–	**35,324**
Accretion of asset retirement obligations	3,310	22	–	–	**3,332**
Foreign exchange	–	18	1,565	–	**1,583**
	379,187	24,991	65,633	(2,941)	**466,870**
Income from equity-accounted investments	–	153,333	–	–	**153,333**
Other	11,483	–	–	–	**11,483**
Drilling rig revenue	–	20,884	–	(13,422)	**7,462**
Drilling rig expense	–	(10,841)	–	6,186	**(4,655)**
	(194,140)	138,385	(65,633)	(4,295)	**(125,683)**
Inter-segment eliminations	–	(4,295)	–	4,295	**–**
Segment income (loss)	$ (194,140)	$ 134,090	$ (65,633)	$ –	**(125,683)**
Income tax recovery					**33,550**
Income from discontinued operations					**30,221**
Net loss					**$ (61,912)**

Year ended December 31, 2011 (restated see note 4)	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	$ 195,956	$ –	$ –	$ –	$ 195,956
Loss on financial commodity contracts	(1,699)	–	–	–	(1,699)
	194,257	–	–	–	194,257
Expenses					
Operating expense	62,443	–	–	–	62,443
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	367,614	5,639	454	(3,710)	369,997
Exploration and evaluation	25,552	1,604	–	–	27,156
Gain on sale of property, plant and equipment	(4,863)	–	–	–	(4,863)
Interest	–	1,195	32,914	–	34,109
Accretion of asset retirement obligations	7,837	50	–	–	7,887
Acquisition transaction costs	–	–	1,044	–	1,044
Foreign exchange	–	(30)	(919)	–	(949)
	479,102	19,180	61,167	(3,710)	555,739
Income from equity-accounted investments	–	1,201	–	–	1,201
Other	4,995	15,703	–	–	20,698
Drilling rig revenue	–	22,376	–	(14,039)	8,337
Drilling rig expense	–	(11,072)	–	6,429	(4,643)
	(279,850)	9,028	(61,167)	(3,900)	(335,889)
Inter-segment eliminations	–	(3,900)	–	3,900	–
Segment income (loss)	$ (279,850)	$ 5,128	$ (61,167)	$ –	(335,889)
Income tax recovery					79,587
Income from discontinued operations					24,312
Net loss					$ (231,990)

($ thousands, except as noted)

Total Assets	**December 31, 2012**	December 31, 2011
Principal Properties	**$ 1,410,129**	$ 1,216,808
Strategic Investments	**342,967**	361,909
Corporate	**283,859**	146,996
	$ 2,036,955	$ 1,725,713

	2012			2011		
Geographical Information	**Canada**	**United States**	**Total**	Canada	United States	Total
Revenue	**$ 165,661**	**$ 5,416**	**$ 171,077**	$ 183,344	$ 12,612	$ 195,956
Exploration and evaluation assets	**405,056**	**34**	**405,090**	374,364	16,378	390,742
Property, plant and equipment, net	**1,077,116**	**1,335**	**1,078,451**	753,167	55,450	808,617
Goodwill	**3,124**	–	**3,124**	3,426	–	3,426

For the year ended December 31, 2012, the Company had sales to one customer which exceeded $30 million and to another customer which exceeded $21 million.

Other Income

Year ended December 31	**2012**	2011
Gain on investments	**$ –**	$ 15,703
Drilling rig revenue	**7,462**	8,337
Drilling rig expense	**(4,655)**	(4,643)
Other	**11,483**	4,995
	$ 14,290	$ 24,392

Other income for the year ended December 31, 2012 includes $6.2 million in respect of a business interruption insurance settlement related to an electrical equipment failure at one of the Company's facilities in the fourth quarter of 2011.

6. ASSETS HELD FOR SALE

	December 31, 2012	December 31, 2011		
	Principal Properties	Principal Properties	Trilogy	Total
Exploration and evaluation	**$ 12,270**	$ 5,052	$ –	$ 5,052
Property, plant and equipment, net	**163**	28,251	–	28,251
Equity-accounted investments	**–**	–	24,196	24,196
Goodwill	**–**	539	–	539
Asset retirement obligations	**$ (470)**	$ (13,040)	$ –	$ (13,040)

Assets Held For Sale – December 31, 2012

During the first quarter of 2013, Summit closed the sale of its non-operated joint venture operations and lands in North Dakota for $22.5 million, subject to closing adjustments. The carrying value of the properties and associated liabilities have been presented as assets held for sale as at December 31, 2012.

($ thousands, except as noted)

Assets Held For Sale – December 31, 2011

During the first quarter of 2012, Paramount closed sales of certain Canadian oil and gas properties within the Southern and Northern COUs for aggregate gross proceeds of $49.2 million, including a $4.0 million convertible debenture due February 2014. A $28.3 million before-tax gain on sale of property, plant and equipment was recorded in respect of these transactions.

In January 2012, the Company closed the sale of 5.0 million non-voting shares of Trilogy for net cash proceeds of $181.7 million, resulting in the recognition of a before-tax gain of $157.2 million which has been included in income from equity-accounted investments.

7. ACQUISITION

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.

($ thousands, except as noted)

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 in 2011 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 was 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, were 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 for the year ended December 31, 2011.

Between May 31, 2011 and December 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.

8. EXPLORATION AND EVALUATION

Year ended December 31	**2012**	2011
Balance, beginning of year	**$ 390,742**	$ 269,084
Additions	**166,214**	229,347
Transfer to assets held for sale	**(12,270)**	(5,052)
Corporate acquisitions	**–**	82,100
Transfers to property, plant and equipment	**(111,416)**	(161,853)
Dry hole	**(6,842)**	(2,371)
Expired lease costs	**(18,550)**	(18,195)
Dispositions	**(2,548)**	(3,052)
Foreign exchange	**(240)**	734
Balance, end of year	**$ 405,090**	$ 390,742

Additions to exploration and evaluation assets totaled $119.0 million (2011 - $207.5 million) for Principal Properties and $47.2 million (2011 - $21.8 million) for Strategic Investments.

Exploration and Evaluation Expense

Year ended December 31	**2012**	2011
Geological and geophysical	**$ 7,923**	$ 7,297
Dry hole	**6,880**	2,371
Expired lease costs	**18,713**	17,488
	$ 33,516	$ 27,156

($ thousands, except as noted)

9. PROPERTY, PLANT AND EQUIPMENT

Year ended December 31, 2012	**Petroleum and natural gas assets**	**Drilling rigs**	**Other**	**Total**
Cost				
Balance, December 31, 2011	$ 1,466,107	$ 51,471	$ 19,943	**$ 1,537,521**
Additions	426,808	32,889	446	**460,143**
Transfers to assets held for sale	(1,284)	–	–	**(1,284)**
Transfers from exploration and evaluation	111,416	–	–	**111,416**
Dispositions	(58,305)	–	–	**(58,305)**
Change in asset retirement provision	15,697	–	–	**15,697**
Currency translation differences	394	(260)	(15)	**119**
Cost, December 31, 2012	**1,960,833**	**84,100**	**20,374**	**2,065,307**
Accumulated depletion, depreciation and write-downs				
Balance, December 31, 2011	$ (696,630)	$ (13,899)	$ (18,375)	**$ (728,904)**
Transfer to assets held for sale	1,121	–	–	**1,121**
Depletion and depreciation	(148,174)	(4,630)	(367)	**(153,171)**
Write-downs	(135,278)	–	–	**(135,278)**
Dispositions	29,504	–	–	**29,504**
Currency translation differences	(242)	109	5	**(128)**
Accumulated depletion, depreciation and write-downs, December 31, 2012	**(949,699)**	**(18,420)**	**(18,737)**	**(986,856)**
Net book value, December 31, 2011	769,477	37,572	1,568	**808,617**
Net book value, December 31, 2012	**$ 1,011,134**	**$ 65,680**	**$ 1,637**	**$ 1,078,451**

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)
Transfers 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	(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

($ thousands, except as noted)

Depletion and Depreciation

Year ended December 31	2012	2011
Depletion and depreciation	**$ 151,772**	$ 148,385
Write-down of property, plant and equipment	**135,278**	215,156
Goodwill impairment	**302**	10,502
Inter-segment eliminations	**(3,197)**	(4,046)
	$ 284,155	$ 369,997

At December 31, 2012, $267.7 million (December 31, 2011 – $111.4 million) of capitalized costs related to incomplete development wells and infrastructure projects are currently not subject to depletion.

Additions to property, plant and equipment in 2012 were $426.8 million (2011 - $295.7 million) for Principal Properties, $32.9 million (2011 - $5.0 million) for Strategic Investments and $0.5 million (2011 – $0.1 million) for Corporate. Additions to property, plant and equipment include $4.6 million (2011 – $3.2 million) of capitalized interest for qualifying assets in the construction phase at a weighted average interest rate of eight percent (2011 – eight percent).

The Company recorded an impairment write-down related to its petroleum and natural gas assets of $135.3 million (2011 – $215.2 million) within the Principal Properties business segment. The impairment write-down was primarily related to the Bistcho/Cameron Hills and Clarke Lake CGUs in the Northern COU, the Elmworth CGU in the Grande Prairie COU and the Southern CGU (Chain), 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 the decline in forecast oil, natural gas, and natural gas liquids prices, higher well costs than reserves values assigned, and declines in reserves assigned due to well performance.

The 2011 impairment write-down was primarily related to the Elmworth CGU in the Grande Prairie COU, the Southern CGU (Chain) in Canada, and the Bistcho/Cameron CGU 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, 2012 (December 31, 2011 – 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)	2013	2014	2015	2016	2017	2018-2027	Thereafter
Natural Gas							
AECO ($/MMBtu)	3.35	3.85	4.35	4.70	5.10	5.45 -6.50	+2%/yr
Henry Hub (US$/MMBtu)	3.75	4.30	4.85	5.25	5.70	6.10 - 7.25	+2%/yr
Crude Oil							
Edmonton Light ($/Bbl)	87.50	90.50	92.60	94.50	96.40	98.30 -117.50	+2%/yr
WTI (US$/Bbl)	92.50	92.50	93.60	95.50	97.40	99.40-118.80	+2%/yr

The following benchmark prices were used in determining the 2011 impairment write-down:

(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 ($/Bbl)	99.00	99.00	101.50	102.30	103.20	104.20 - 120.50	+2%/yr
WTI (US$/Bbl)	97.50	97.50	100.00	100.80	101.70	102.70 - 118.80	+2%/yr

10. EQUITY ACCOUNTED INVESTMENTS

As at December 31		**2012**			2011	
	Shares (000's)	**Carrying Value**	**Market Value**(1)	*Shares (000's)*	Carrying Value	Market Value(1)
Trilogy(2)	***19,144***	**$ 82,419**	**$ 557,292**	*19,144*	$ 94,062	$ 719,253
MGM Energy	***54,147***	**2,299**	**13,537**	*43,834*	1,691	10,520
Paxton	***1,750***	**3,687**		*1,750*	4,015	
Other		**2,572**			1,775	
		$ 90,977			$ 101,543	

(1) Based on the year-end trading price.
(2) December 31, 2011 balances exclude 5.0 million non-voting shares of Trilogy classified within assets held for sale.

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

Year ended December 31			**2012**			2011	
	Equity income (loss)	**Dilution gain**	**Gain on sale**	**Total**	Equity income (loss)	Dilution gain	Total
Trilogy	**$ (3,725)**	**$ 416**	**$ 157,215**	**$ 153,906**	$ 1,945	$ 1,060	$ 3,005
MGM Energy	**(1,043)**	**–**	**–**	**(1,043)**	(1,481)	–	(1,481)
Paxton	**(328)**	**–**	**–**	**(328)**	(323)	–	(323)
Other	**798**	**–**	**–**	**798**	–	–	–
	$ (4,298)	**$ 416**	**$ 157,215**	**$ 153,333**	$ 141	$ 1,060	$ 1,201

Paramount recorded a $0.4 million dilution gain (2011 - $1.1 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, revenue and income of Trilogy, MGM Energy and Paxton. These amounts have been derived directly from Trilogy's published financial statements as at and for the years ended December 31, 2012 and 2011. 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 Trilogy.

As at December 31	2012	2011		
	Trilogy	Trilogy	MGM Energy[1]	Paxton[1]
Assets	**$ 1,395,111**	$ 1,260,364	$ 76,708	$ 24,557
Liabilities	**$ 908,712**	$ 729,919	$ 5,845	$ 62
Shares outstanding (thousands)	**116,674**	116,118	314,495	17,402
Paramount's equity interest	**16%**	21%	14%	10%

Year ended December 31	2012	2011		
Revenue	**$ 399,098**	$ 342,106	$ –	$ 103
Net income (loss)	**$ (12,133)**	$ 17,415	$ (160,859)	$ (3,103)

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 2012 financial statements were not finalized prior to completing these financial statements.

Trilogy had 7.3 million stock options outstanding (2.7 million exercisable) at December 31, 2012 at exercise prices ranging from $4.85 to $38.74 per share.

11. INVESTMENTS IN SECURITIES

As at December 31	2012		2011	
	Shares (000's)	***Market Value***	*Shares (000's)*	*Market Value*
MEG Energy Corp.	***3,700***	**$ 112,628**	*3,700*	$ 153,809
Other		**15,139**		31
		$ 127,767		$ 153,840

Paramount sold its investment in NuLoch Resources Inc., and shares in the successor company by acquisition, Magnum Hunter Resources Corp., through transactions in 2011 for aggregate gross proceeds of $15.8 million. The Company recognized aggregate gains of $11.1 million in other income, which previously had been recorded in OCI.

12. GOODWILL

As at December 31	2012	2011
Carrying value, beginning of year	**$ 3,426**	$ 8,012
Acquisitions	**–**	5,477
Adjustment to Redcliffe Exploration Inc. net assets acquired	**–**	978
Reclassified to assets held for sale	**–**	(539)
Impairment	**(302)**	(10,502)
Carrying value, end of year	**$ 3,124**	$ 3,426

The carrying amount of goodwill by COU is as follows:

As at December 31	2012	2011
Kaybob	**$ 3,124**	$ 3,124
Northern	**–**	302
	$ 3,124	$ 3,426

($ thousands, except as noted)

13. DEMAND FACILITIES

As at December 31	2012	2011
Drilling Rig Loan I	$ 17,766	$ 22,842
Drilling Rig Loan II	21,000	–
Cavalier Facility	1,937	–
	$ 40,703	$ 22,842

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 $12.6 million have been made to December 31, 2012. Unless demanded by the bank, scheduled principal repayments on Drilling Rig Loan I are $5.1 million in 2013, with the remaining outstanding balance 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 construction period, with scheduled principal repayments to commence in 2013. As of December 31, 2012, $21.0 million was drawn on Drilling Rig Loan II. Unless demanded by the bank, scheduled principal repayments on Drilling Rig Loan II are $3.5 million in 2013, $6.3 million in 2014, $6.3 million in 2015 and $4.9 million in 2016.

Recourse and security for Drilling Rig Loan I and Drilling Rig Loan II (the "Drilling Rig Loans") is limited to the drilling rigs and drilling contracts guaranteed by Paramount. 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 the Drilling Rig Loans for the year ended December 31, 2012 was 4.4 percent (2011 - 4.7 percent).

Cavalier 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 Cavalier Energy, 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. In March 2013, the size of the Cavalier Facility was increased to $40.0 million, with all other material terms remaining unchanged.

14. LONG-TERM DEBT

As at December 31	2012	2011
Bank credit facility	$ –	$ 61,383
8.25% Senior Notes due 2017	370,000	370,000
7.625% Senior Notes due 2019	300,000	–
	670,000	431,383
Unamortized financing costs net of premiums	(9,298)	(4,197)
	$ 660,702	$ 427,186

Bank Credit Facility

Paramount's $300 million bank credit facility (the "Facility") 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 November 30, 2013. 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 November 30, 2013 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 Loans 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, 2012, no amounts were drawn on the Facility (December 31, 2011 - $61.4 million). Paramount had undrawn letters of credit outstanding at December 31, 2012 totaling $42.7 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 due 2017 (the "2017 Senior Notes") at par.

In February 2011, Paramount completed a public offering of an additional $70 million principal amount of 2017 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 2017 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 2017 Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company. The Company has the right to redeem all or a portion of the 2017 Notes at par, plus accrued and unpaid interest to the date of redemption, plus a redemption premium, if applicable, which varies based on the date of redemption.

In December 2012, Paramount completed a public offering of $300 million principal amount of senior unsecured notes due 2019 (the "2019 Senior Notes") at par, of which $9.6 million principal amount was purchased by certain officers, management and associates of the Company.

The 2019 Senior Notes bear interest at 7.625 percent per annum, payable semi-annually in arrears on June 4 and December 4 in each year and mature on December 4, 2019. The 2019 Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company. The Company has the right to redeem all or a portion of the 2019 Notes at par, plus accrued and unpaid interest to the date of redemption, plus a redemption premium, if applicable, which varies based on the date of redemption.

($ thousands, except as noted)

15. ASSET RETIREMENT OBLIGATIONS

Year ended December 31	2012	2011
Asset retirement obligations, beginning of year	**$ 299,202**	$ 241,770
Retirement obligations incurred	**14,626**	23,463
Revisions to estimated retirement costs and discount rates	**441**	37,791
Obligations settled	**(8,002)**	(7,520)
Disposal of properties	**(8,500)**	(2,902)
Assumed on corporate acquisition	**–**	11,943
Accretion expense – continuing operations	**3,332**	7,887
Accretion expense – discontinued operations	**51**	(513)
Transfer to liabilities associated with assets held for sale	**(470)**	(13,040)
Transfer to current liabilities	**(280)**	–
Foreign exchange	**68**	323
Asset retirement obligations, end of year	**$ 300,468**	$ 299,202

Asset retirement obligations at December 31, 2012 were determined using a weighted average risk-free rate of 2.00 percent (December 31, 2011 – 2.25 percent) and an inflation rate of 2.00 percent (December 31, 2011 – 2.00 percent). These obligations will be settled over the useful lives of the assets, which extend up to 39 years.

16. SHARE CAPITAL

Paramount's authorized share capital consists of an unlimited number of Class A common shares ("Common Shares") without par value and an unlimited number of preferred shares issuable in series. At December 31, 2012, 89,857,478 Common Shares were outstanding, net of 74,396 Common Shares held in trust under the stock incentive plan, and no Preferred Shares were outstanding.

In September 2012 Paramount issued, to a company controlled by the Company's Chairman and Chief Executive Officer, 646,000 Common Shares on a "flow-through" basis in respect of Canadian exploration expenses ("CEE") at a price of $31.00 per share and 1,244,000 Common Shares on a "flow-through" basis in respect of Canadian development expenses ("CDE") at a price of $28.15 per share for aggregate proceeds of $55 million.

In October 2012 Paramount issued, pursuant to a public offering, 1,936,000 Common Shares on a "flow-through" basis in respect of CEE at a price of $31.00 per share and 356,000 Common Shares on a "flow-through" basis in respect of CDE at a price of $28.15 per share for aggregate gross proceeds of $70 million. Certain officers and management of the Company participated in this offering.

A liability of $19.8 million was recognized in accounts payable and accrued liabilities on the issuance of such flow-through shares in respect of the Company's obligation to renounce qualifying expenditures, of which $9.0 million has been reclassified as a deferred tax liability upon the incurrence of qualifying expenditures.

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 CDE 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 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 $2.4 million (2011 – $8.6 million) of transaction costs in respect of these equity offerings, net of tax benefits of $0.8 million (2011 – $2.9 million).

Weighted Average Common Shares Outstanding

Year Ended December 31	2012		2011	
	Shares (000's)	**Loss from continuing operations**	*Shares (000's)*	Loss from continuing operations
Loss from continuing operations – basic	***86,607***	**$ (92,133)**	*78,462*	$ (256,302)
Dilutive effect of Paramount Options	**–**	**–**	–	–
Loss from continuing operations - diluted	***86,607***	**$ (92,133)**	*78,462*	$ (256,302)

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 per share calculations when they are dilutive to income from continuing operations.

17. RESERVES

Reserves at December 31, 2012 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**	**Total Reserves**
Balance, December 31, 2011	$ 51,709	$ (831)	$ 65,792	**$ 116,670**
Other comprehensive income (loss)	(42,830)	438	–	**(42,392)**
Stock-based compensation expense	–	–	26,072	**26,072**
Stock options exercised	–	–	(5,403)	**(5,403)**
Balance, December 31, 2012	$ 8,879	$ (393)	$ 86,461	**$ 94,947**

	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

($ thousands, except as noted)

Other Comprehensive Income

Year ended December 31	2012	2011
Unrealized Loss on Securities		
Change in market value of securities	**$ (43,096)**	$ (7,109)
Reclassification of other comprehensive income to earnings	**–**	(15,693)
Deferred tax	**266**	2,889
	(42,830)	(19,913)
Translation of Foreign Subsidiaries		
Exchange differences on translation of US subsidiaries	**89**	(1,419)
Reclassification of other comprehensive income to earnings	**349**	2,965
Deferred tax	**–**	(349)
	438	1,197
Other Comprehensive Loss	**$ (42,392)**	$ (18,716)

18. SHARE-BASED PAYMENTS

Paramount Options

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

	2012		2011	
	Number	Weighted average exercise price	Number	Weighted average exercise price
		($/share)		($/share)
Balance, beginning of year	**5,767,450**	**$ 20.76**	5,006,300	$ 13.90
Granted	**1,340,000**	**34.01**	1,529,000	38.95
Exercised	**(258,600)**	**11.13**	(618,850)	10.80
Forfeited	**(171,000)**	**28.15**	(149,000)	17.74
Expired	**(10,000)**	**40.09**	–	–
Balance, end of year	**6,667,850**	**$ 23.58**	5,767,450	$ 20.76
Options exercisable, end of year	**2,862,134**	**$ 14.42**	1,832,218	$ 10.66

For options exercised in 2012, the weighted average market price of Paramount's Common Shares on the dates exercised was $34.46 (2011 - $35.46).

The weighted average remaining contractual life and exercise prices of Paramount Options outstanding as of December 31, 2012 are as follows:

	Awards Outstanding		
Exercise Prices	Number	Remaining contractual life	Weighted average exercise price
$6.87 - $10.00	2,170,300	0.7 years	$ 7.34
$10.01 - $20.00	689,050	2.3 years	$ 13.37
$20.01 - $30.00	1,119,500	3.3 years	$ 29.38
$30.01 - $40.09	2,689,000	4.8 years	$ 36.89
	6,667,850	**3.0 years**	**$ 23.58**

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	Options awarded in 2012
Weighted average exercise price per share	$ 14.67	$ 40.02	**$ 34.01**
Expected volatility	49.7%	47.8%	**45.3%**
Expected life of share options	2.3 years	4.7 years	**4.7 years**
Pre-vest forfeiture rate	4.6%	4.9%	**5.0%**
Risk-free interest rate	1.1%	1.2%	**1.3%**
Expected dividend yield	–	–	**–**
Weighted average fair value of awards	$ 18.69	$ 16.45	**$ 13.47**

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

Cavalier Energy granted 2.2 million Cavalier Options in 2012 (2011 – 2.5 million) which vest over three to five years. No exercises or cancellations have occurred to date.

The grant date fair value of Cavalier Options awarded was estimated using the Black-Scholes-Merton model, incorporating the following inputs: expected volatility 62.4% (2011 – 63.0%), expected life 6.5 years (2011 – 6.9 years), risk-free interest rate 1.5% (2011 – 1.6%), pre-vest forfeiture rate of nil (2011 – nil), and expected dividend yield of nil (2011 – nil).

The estimated expected life of the Cavalier Options is the term of the option. As Cavalier is a private entity, expected volatility is estimated based on the average historical volatility of the trading price of a group publicly traded oil sands companies which are comparable to Cavalier Energy over the most recent period that is generally commensurate with the expected term of the option.

Stock Incentive Plan – Shares Held in Trust

Year ended December 31	**2012**		2011	
	Shares (000's)		*Shares (000's)*	
Balance, beginning of year	***86***	**$ 419**	*150*	$ 410
Shares purchased	***124***	**3,052**	*101*	2,974
Change in vested and unvested shares	***(135)***	**(3,055)**	*(165)*	(2,965)
Balance, end of year	***75***	**$ 416**	*86*	$ 419

($ thousands, except as noted)

Employee Benefit Costs

Year ended December 31	2012	2011
Stock option plan	$ 26,072	$ 18,412
Stock incentive plan	3,010	3,050
Stock-based compensation expense	29,082	21,462
Salaries and benefits, net of recoveries	11,951	10,956
	$ 41,033	$ 32,418

19. INCOME TAX

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

Year ended December 31	2012	2011
Loss from continuing operations before tax	$ (125,683)	$ (335,889)
Effective Canadian statutory income tax rate	25.1%	26.6%
Expected income tax expense (recovery)	$ (31,546)	$ (89,346)
Change resulting from:		
Statutory and other rate differences	(2,469)	1,469
Income from equity-accounted investments	(22,441)	(3,096)
Investment in subsidiaries	2,643	–
Goodwill impairment	76	2,792
Flow-through share renunciations	8,759	4,625
Stock-based compensation	6,534	4,881
Non-deductible items and other	4,894	(912)
Income tax recovery	$ (33,550)	$ (79,587)

Components of Deferred Income Tax Asset (Liability)

As at December 31	2012	2011
Property, plant and equipment	$ (9,373)	$ (11,339)
Investments	(2,761)	(286)
Asset retirement obligations	75,515	80,105
Non-capital and net operating losses	50,466	42,131
Other	3,054	6,937
	$ 116,901	$ 117,548

Paramount has $208.6 million (2011 - $152.6 million) of unused tax losses expiring between 2014 and 2032. In addition, Paramount has $190.6 million (2011 - $167.4 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 will remain on account until the dispute is resolved.

($ thousands, except as noted)

20. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial Instruments

Financial instruments at December 31, 2012 consisted of cash and cash equivalents, accounts receivable, the Deposit, available-for-sale investments, the demand facilities, accounts payable and accrued 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.
- Publicly traded available-for-sale investments are carried at the period-end trading price.
- The carrying value of the demand facilities and long-term debt are measured at amortized cost.
- The 2017 Senior Notes had a market value of 104.1 percent of their principal amount at December 31, 2012 (December 31, 2011 – 103.1 percent).
- The 2019 Senior Notes had a market value of 100.3 percent of their principal amount at December 31, 2012.

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

Year ended December 31	**2012**	2011
Fair value, beginning of year	**$ (2,603)**	$ (693)
Changes in fair value	**2,487**	(1,699)
Settlements paid (received)	**116**	(211)
Fair value, end of year	**$ –**	$ (2,603)

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, 2012, Paramount's publicly traded available-for-sale investments were classified as level one 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, 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.

Foreign Currency Risk

Paramount is exposed to foreign currency risk on financial instruments denominated in US dollars including cash and cash equivalents, accounts receivable, 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 expenditures in US dollars.

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 2017 Senior Notes and 2019 Senior Notes bear interest at fixed rates 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, 2012 is limited to the carrying values of cash and cash equivalents and accounts receivable. 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, 2012, Paramount had balances due from one joint venture partner that represented approximately 10 percent of the Company's total accounts receivable.

($ thousands, except as noted)

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 24, contractual obligations related to financial liabilities are as follows:

	2013	2014	2015	2016	2017	Thereafter	Total
Drilling Rig Loans[1]	$ 10,458	$ 20,051	$ 6,798	$ 5,050	$ –	$ –	$ 42,357
Cavalier Facility[2]	1,937	–	–	–	–	–	1,937
Accounts payable and accrued liabilities[3]	172,705	–	–	–	–	–	172,705
Senior Notes[1]	53,400	53,400	53,400	53,400	421,895	344,058	979,553
	$ 238,500	**$ 73,451**	**$ 60,198**	**$ 58,450**	**$ 421,895**	**$ 344,058**	**$1,196,552**

[1]Including interest
[2]Excluding interest
[3]Excluding $10.8 million related to the Company's obligation to renounce qualifying expenditures for flow-through share issuances.

Accounts payable and accrued liabilities

As at December 31	2012	2011
Trade and accrued payables	**$ 163,891**	$ 127,042
Joint venture and royalties	**5,618**	2,374
Interest payable	**3,197**	1,510
Flow-through share renunciation obligations	**10,806**	5,894
	$ 183,512	$ 136,820

Terms and conditions of the above financial liabilities:

- Trade and accrued payables and joint venture payables are non-interest bearing and are normally settled within 30 – 60 days.
- Interest on the 2017 Senior Notes is payable semi-annually in arrears on June 13 and December 13 in each year.
- Interest on the 2019 Senior Notes is payable semi-annually in arrears on June 4 and December 4 in each year.

Accounts receivable

As at December 31	2012	2011
Revenue receivable	**$ 19,412**	$ 21,543
Joint venture receivable	**10,790**	13,420
GST and other	**2,588**	5,218
	$ 32,790	$ 40,181

($ thousands, except as noted)

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 receivables and the credit worthiness of the counterparties. As a result of this assessment, the Company determined that there was no impairment of joint venture receivables required. There were no significant non-current joint venture receivables as at December 31, 2012 and 2011.

21. CONSOLIDATED STATEMENTS OF CASH FLOWS – SELECTED INFORMATION

Items not involving cash

Year ended December 31	2012	2011
Financial commodity contracts	$ (2,603)	$ 1,910
Stock-based compensation	29,082	21,405
Depletion and depreciation	284,155	369,997
Exploration and evaluation	26,077	19,858
Gain on sale of property, plant, and equipment	(26,432)	(4,863)
Accretion of asset retirement obligations	3,332	7,887
Foreign exchange	1,497	(1,393)
Income from equity-accounted investments	(153,333)	(1,201)
Deferred income tax	(34,339)	(79,599)
Gain on sale of investments	–	(15,703)
Discontinued operations	(27,681)	(8,751)
Other	1,258	527
	$ 101,013	$ 310,074

Supplemental cash flow information

Year ended December 31	2012	2011
Interest paid	$ 36,424	$ 36,910
Current tax paid	$ 1,598	$ 45

Components of cash and cash equivalents

Year ended December 31	2012	2011
Cash	$ 4,575	$ 15,009
Cash equivalents	142,109	13,991
	$ 146,684	$ 29,000

22. 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

($ thousands, except as noted)

(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:

As at December 31	2012	2011
Working capital deficit (surplus)[1]	$ 31,432	$ 82,036
Credit Facility	–	61,383
Senior Notes[2]	670,000	370,000
Net Debt[3]	701,432	513,419
Share capital	921,680	810,781
Accumulated deficit	(165,527)	(103,615)
Reserves	94,947	116,670
Total Capital	**$ 1,552,532**	$ 1,337,255

(1) Excludes risk management assets and 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, 2012 - $10.8 million, December 31, 2011 - $5.9 million).
(2) Excludes unamortized issue premiums and financing costs.
(3) Net Debt excludes the deposit on account with the CRA, pending resolution of the Company's Notice of Objection (see Note 19).

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.

23. 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 2012, Paramount charged $0.4 million (2011 – $0.9 million) to Trilogy in respect of operational and administrative services. Also, Paramount received $8.0 million (2011 - $10.1 million) in dividends from Trilogy. As of December 31, 2012, Paramount had a receivable balance due from Trilogy of $0.9 million (2011 - $0.3 million).

Compensation of key management personnel

Year ended December 31	2012	2011
Salaries and benefits	$ 1,914	$ 2,159
Stock-based compensation	11,039	9,173
	$ 12,953	$ 11,332

($ thousands, except as noted)

24. COMMITMENTS AND CONTINGENCIES

Commitments

Paramount had the following commitments as at December 31, 2012:

	Within One Year	After one year but not more than 5 years	More than five years
Petroleum and natural gas transportation and processing commitments [1]	$ 17,142	$ 173,381	$ 217,210
Operating leases	2,786	7,414	8,753
Capital spending commitments[2]	12,789	–	–
	$ 32,717	**$ 180,795**	**$ 225,963**

(1) Certain of the transportation and processing commitments are secured by outstanding letters of credit totaling $27.3 million at December 31, 2012 (2011 - $12.8 million).
(2) Relates to contractual obligations for purchases of major equipment.

Operating lease commitment

Paramount's head office lease expires in 2022. The Company incurred office lease costs of $3.2 million in 2012 (2011 - $2.8 million).

Flow-Through Shares

As a result of flow through share issuances in 2012, Paramount is required to incur and renounce $57.5 million of CEE during 2013. Paramount has incurred sufficient qualifying expenditures to satisfy commitments associated with CDE flow-through shares issued in 2012 and the CEE and CDE flow-through shares issued in 2011.

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.

25. SUBSEQUENT EVENTS

In March 2013, Paramount sold its properties in the Bistcho area of Alberta and the Cameron Hills area of the Northwest Territories for approximately $9 million, subject to closing adjustments.