



**Paramount**  
*resources ltd.*

**Consolidated Financial Statements**  
**As at December 31, 2014 and 2013 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 Company's Board of Directors. The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and include certain estimates that reflect Management's best judgments. If alternate accounting methods exist, Management has chosen those policies it considers the most appropriate in the circumstances. Financial information contained throughout the Company's annual report, including Management's Discussion and Analysis, 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 transactions are accurately recorded, that all necessary transactions are recorded to permit the preparation and presentation 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, which is comprised entirely of non-Management directors. 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. 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.

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 Board of Directors, 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 5, 2015

## 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 31 December, 2014 and 2013, and the consolidated statements of comprehensive loss, shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the 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 auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

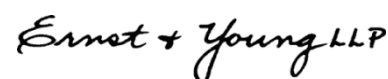
We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Paramount Resources Ltd. as at 31 December, 2014 and 2013 and of its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Calgary, Canada

March 5, 2015

The signature of Ernst & Young LLP is written in a cursive, handwritten style.

Chartered Accountants

## CONSOLIDATED BALANCE SHEET

(\$ thousands)

As at December 31	Note	2014	2013
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	20	18,320	10,703
Accounts receivable	19	57,040	39,300
Prepaid expenses and other		4,883	2,252
		80,243	52,255
Deposit	18	20,643	20,437
Exploration and evaluation	7	567,420	429,911
Property, plant and equipment, net	8	2,168,565	1,573,011
Equity-accounted investments	9	82,444	104,314
Investments in securities	10	102,894	145,661
Deferred income tax	18	152,487	119,090
Goodwill	5,11	24,733	3,124
		3,199,429	2,447,803
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Demand facilities	12	81,530	75,550
Accounts payable and accrued liabilities	19	266,847	213,581
Risk management	19	–	3,972
		348,377	293,103
Long-term debt	13	1,210,355	882,603
Asset retirement obligations	14	287,415	239,853
		1,846,147	1,415,559
Commitments and contingencies	23		
<b>Shareholders' equity</b>			
Share capital	15	1,603,436	1,169,178
Accumulated deficit		(296,326)	(224,612)
Reserves	16	46,172	87,678
		1,353,282	1,032,244
		3,199,429	2,447,803

See the accompanying notes to these Consolidated Financial Statements.

On behalf of the Board of Directors

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

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

March 5, 2015

## CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS

(\$ thousands, except as noted)

Year ended December 31	Note	2014	2013
Petroleum and natural gas sales		349,995	230,722
Royalties		(17,542)	(10,814)
<b>Revenue</b>		<b>332,453</b>	<b>219,908</b>
<b>Gain (loss) on financial commodity contracts</b>	19	<b>2,852</b>	<b>(3,972)</b>
		<b>335,305</b>	<b>215,936</b>
<b>Expenses</b>			
Operating expense		71,279	68,615
Transportation and NGLs processing		35,896	23,782
General and administrative		23,877	19,481
Stock-based compensation	17	25,373	25,851
Depletion and depreciation	8	229,819	152,935
Exploration and evaluation	7	30,007	35,537
Gain on sale of property, plant and equipment		(95,691)	(32,688)
Interest and financing		70,599	52,639
Accretion of asset retirement obligations	14	5,936	3,099
Foreign exchange		568	528
		<b>397,663</b>	<b>349,779</b>
Income (loss) from equity-accounted investments	9	(3,399)	21,378
Write-down of investments in securities	10	(15,645)	(3,628)
Other income	4	6,686	10,385
<b>Loss from continuing operations before tax</b>		<b>(74,716)</b>	<b>(105,708)</b>
<b>Income tax expense (recovery)</b>	18		
Current		(45)	4,983
Deferred		(2,957)	(23,576)
		<b>(3,002)</b>	<b>(18,593)</b>
<b>Loss from continuing operations</b>		<b>(71,714)</b>	<b>(87,115)</b>
<b>Income from discontinued operations, net of tax</b>	6	<b>–</b>	<b>28,030</b>
<b>Net loss</b>		<b>(71,714)</b>	<b>(59,085)</b>
<b>Other comprehensive income (loss), net of tax</b>	16		
Items that may be reclassified to net income or loss			
Change in market value of securities		(42,475)	3,908
Exchange differences on translation of US subsidiaries		–	393
		<b>(42,475)</b>	<b>4,301</b>
<b>Comprehensive loss</b>		<b>(114,189)</b>	<b>(54,784)</b>
<b>Net income (loss) per common share (\$/share)</b>	15		
Basic and diluted – continuing operations		(0.71)	(0.93)
Basic and diluted – discontinued operations		–	0.30
Basic and diluted		<b>(0.71)</b>	<b>(0.63)</b>

See the accompanying notes to these Consolidated Financial Statements.

## CONSOLIDATED STATEMENT OF CASH FLOWS

(\$ thousands)

Year ended December 31	Note	2014	2013
<b>Operating activities</b>			
Net loss		(71,714)	(59,085)
Add (deduct):			
Items not involving cash	20	192,829	109,550
Dividends from equity-accounted investments		7,371	8,040
Asset retirement obligations settled	14	(4,576)	(6,336)
Current tax related to the sale of U.S. properties		–	4,915
Change in non-cash working capital		(5,406)	(12,171)
Cash from operating activities		118,504	44,913
<b>Financing activities</b>			
Net draw of demand facilities	12	5,980	34,847
Net draw of revolving long-term debt	13	325,847	71,826
Proceeds from Senior Notes, net of issue costs	13	–	148,507
Common shares issued, net of issue costs		355,392	217,369
Common shares purchased under stock incentive plan		(4,617)	(3,998)
Cash from financing activities		682,602	468,551
<b>Investing activities</b>			
Property, plant and equipment and exploration		(941,470)	(736,172)
Proceeds on sale of property, plant and equipment		99,957	37,875
Proceeds on sale of discontinued operations, net		–	9,062
Cash of MGM Energy Corp. on acquisition	5	3,200	–
Proceeds on sale of investment, net		10,179	10,097
Investments in securities		(5,000)	(9,915)
Change in non-cash working capital		39,549	38,730
Cash used in investing activities		(793,585)	(650,323)
Net increase (decrease)		7,521	(136,859)
Foreign exchange on cash and cash equivalents		96	878
Cash and cash equivalents, beginning of year		10,703	146,684
<b>Cash and cash equivalents, end of year</b>		<b>18,320</b>	<b>10,703</b>
<b>Supplemental cash flow information</b>	20		

See the accompanying notes to these Consolidated Financial Statements.

## CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(\$ thousands, except as noted)

Year ended December 31		2014		2013	
	Note	Shares (000's)		Shares (000's)	
<b>Share Capital</b>					
Balance, beginning of year		96,993	1,169,178	89,857	921,680
Issued		6,704	364,884	7,133	247,582
Issued on acquisition of MGM Energy Corp.	5	1,128	69,382	-	-
Change in unvested common shares for stock incentive plan	17	18	(8)	3	(84)
<b>Balance, end of year</b>		<b>104,843</b>	<b>1,603,436</b>	<b>96,993</b>	<b>1,169,178</b>
<b>Accumulated Deficit</b>					
Balance, beginning of year			(224,612)		(165,527)
Net loss			(71,714)		(59,085)
<b>Balance, end of year</b>			<b>(296,326)</b>		<b>(224,612)</b>
<b>Reserves</b>					
Balance, beginning of year	16		87,678		94,947
Other comprehensive income (loss)			(42,475)		4,301
Contributed surplus			969		(11,570)
<b>Balance, end of year</b>			<b>46,172</b>		<b>87,678</b>
<b>Total Shareholders' Equity</b>			<b>1,353,282</b>		<b>1,032,244</b>

See the accompanying notes to these Consolidated Financial Statements.

(Tabular amounts stated in \$ thousands, except as noted)

## 1. Significant Accounting Policies

Paramount Resources Ltd. ("Paramount" or the "Company") is an independent, publicly traded, Canadian corporation that explores for and develops conventional petroleum and natural gas prospects, pursues long-term non-conventional exploration and pre-development projects and holds a portfolio of investments in other entities. Paramount's principal properties are primarily located in Alberta and British Columbia. Paramount's operations are divided into three business segments which have been 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 a 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. The consolidated group includes the following wholly-owned subsidiaries: Paramount Resources, a partnership, Fox Drilling Limited Partnership ("Fox Drilling") and Cavalier Energy Inc. ("Cavalier"). Paramount also holds a 15 percent equity interest in Trilogy Energy Corp. ("Trilogy"), which is accounted for using the equity method of investment accounting along with certain other investees.

These consolidated financial statements of the Company, as at December 31, 2014 and December 31, 2013 and for the years then ended (the "Consolidated Financial Statements"), were authorized for issuance by Paramount's Board of Directors on March 5, 2015.

### Basis of Preparation

These Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") 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. Amounts included in these Consolidated Financial Statements are stated in thousands of Canadian dollars, unless otherwise noted. Certain comparative figures have been reclassified to conform with the current year's presentation.

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

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.

### a) 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.

## **b) 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.

## **c) Trade and Other Receivables**

Accounts receivable are recorded as corresponding amounts of revenue are recognized or costs are incurred in connection with joint operations. 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.

## **d) 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 determine commercial viability, 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.

The Company's exploration and evaluation ("E&E") assets include oil sands and carbonate bitumen properties, and shale gas lands within the Strategic Investments business segment. 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. Net cashflows from the sale of production from shale gas exploration wells are applied against the capitalized costs of the shale gas projects to which they relate until the overall project is deemed commercially viable.

When a project has been determined to be technically feasible and commercially viable, the 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.

## **e) Property, Plant and Equipment**

Petroleum and natural gas assets 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 estimated asset retirement costs.

Paramount's Rigs are carried at cost, net of accumulated depreciation. 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 ("PP&E"), 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 estimated volumes of proved developed reserves using the unit-of-production method. For purposes of these calculations, volumes of 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 40 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 1,095 to 3,650 drilling days.

#### **f) Impairment of Non-Financial Assets**

Carrying values of the Company's non-financial assets 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. If the carrying value of an asset exceeds its estimated recoverable amount, an impairment charge is recognized.

For the purpose of impairment testing, PP&E 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. E&E assets are aggregated and tested at the operating segment level.

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 generally 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. When it is determined that there has been a subsequent increase in the recoverable amount ascribed to an oil and gas property 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.

#### **g) Joint Arrangements**

Paramount conducts its exploration and development activities independently, as well as jointly with others through jointly controlled assets and operations. Paramount recognizes its proportionate share of the revenues, expenses, assets, and liabilities of joint operations. All of the Company's interests in joint arrangements are accounted for as joint operations. Interests in joint ventures are accounted for using the equity method of accounting. The Company does not currently have any interests in joint ventures.

## **h) Equity-Accounted Investments**

Investments in entities over which Paramount has significant influence are accounted for using the equity method. An investor is presumed to have significant influence where it holds 20 percent or more of the voting power over an investee, or where significant influence can be clearly demonstrated. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control of the entity. Factors that may demonstrate significant influence include representation on the board of directors of the investee, interchange of management personnel and participation in determining the significant policies of the investee.

Under the equity method, an equity investment is recognized at cost on acquisition, with the carrying amount subsequently increased or decreased to reflect the investor's proportionate share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investor's investment. When necessary, adjustments are made to investee financial statements to align accounting policies of investees with those applied by the Company in its Consolidated Financial Statements.

## **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 paid 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 complete the transaction are expensed.

Goodwill is tested for impairment at least annually, or when a potential impairment indicator is identified. To test goodwill for impairment, the carrying value of a CGU (or group of CGUs), including allocated goodwill, is compared to that 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.

## **j) Capitalized 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 incurred.

## **k) Asset Retirement Obligations**

Asset retirement obligations arise from legal obligations to retire assets including oil and gas wells, gathering systems, processing plants and access roads at the end of their productive lives. The present value of an asset retirement obligation is recognized in the Consolidated Balance Sheet when incurred and a reasonable estimate of the settlement amount can be made. 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, anticipated cost, discount rate and inflation rate relating to the estimated liability are accounted for prospectively by recording an adjustment to the asset retirement obligation liability, with a corresponding adjustment to the carrying value of the related asset. The present values 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 a property is fully complete.

### **l) Foreign Currency Translation**

Paramount's functional and presentation currency is the Canadian dollar. Functional currencies of the Company's subsidiaries are determined by the nature and location of their operations and amounts included in their individual financial statements are measured in that functional currency. The functional currency of the Company's United States subsidiaries was changed to the Canadian dollar following the sale of the Company's remaining United States properties in the first quarter of 2013.

### **m) Financial Instruments and Other Comprehensive Income**

#### *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. All of the Company's financial instruments have been classified as fair value through profit or loss, except investments in securities and long-term debt. Paramount does not presently employ hedge accounting for any of its financial instruments.

Fair value through profit or loss financial assets and financial liabilities, including derivative financial instruments, are measured at fair value and changes in fair values over time are recognized in earnings. 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 or impaired, at which time the cumulative gain or loss is recognized in net earnings. 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 securities, which are classified as available-for-sale financial instruments. The amounts recorded in OCI each period are 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.

An impairment charge is recognized in respect of an available-for-sale financial instrument where its fair value decreases below its carrying value, and the decline is considered to be significant or prolonged. Subsequent increases in the fair value of an available-for-sale financial instrument are recognized in OCI.

### **n) Estimates of Fair Value**

Inputs used to estimate fair values incorporated in the preparation of the Consolidated Financial Statements are categorized into three levels in a fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three levels are defined below:

Level One – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that can be accessed at the measurement date.

Level Two – Inputs are based on information other than quoted prices included within Level One that are observable for the asset or liability, either directly or indirectly, including:

- a) quoted prices for similar assets or liabilities in active markets;
- b) quoted prices for identical or similar assets or liabilities in markets that are not active;
- c) inputs other than quoted prices that are observable for the asset or liability, for example:
  - i. interest rates and yield curves observable at commonly quoted intervals;
  - ii. implied volatilities; and
  - iii. credit spreads; and
- d) market-corroborated inputs.

Level Three – Inputs are unobservable. Unobservable inputs are developed using the best information available in the circumstances, which may incorporate Paramount's own internally generated data.

#### **o) 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 deferred tax expense in the period in which the change occurs.

Deferred income tax assets are recognized to the extent future realization 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.

#### **p) 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 associated with the flow-through feature of the securities. Proceeds are first allocated to share capital based on the market price of Common Shares on the date the offering is priced, with the balance recorded in accounts payable and accrued liabilities based on the difference between the issue price and the market price of Common Shares. 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.

#### **q) 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.

The Company accounts for Paramount Options as equity-settled stock-based compensation transactions. 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 Paramount 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 has elapsed and the estimated 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 Paramount Options that ultimately vest. Upon the exercise of a Paramount Option, the Company transfers the cumulative amount recognized in Contributed Surplus in respect of the award to Share Capital.

#### *Cavalier Stock Option Plan*

Cavalier has a stock option plan that enables its Board of Directors to grant to key employees and directors options to acquire common shares of Cavalier ("Cavalier Options"). 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 to settle Cavalier Options in common shares of Cavalier or in cash, at the discretion of Cavalier. 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 an award 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.

#### **r) Net Loss Per Share**

Basic net loss per share is calculated by dividing net loss by the weighted average number of Common Shares outstanding during the year. Diluted net loss per share is calculated by adjusting the weighted average number of Common Shares outstanding for potentially dilutive Common Shares related to the Paramount stock option plan. The number of dilutive Common Shares is determined using the treasury method. As Paramount Options can be exchanged for Common Shares, they are considered potentially dilutive and are included in the Company's diluted loss per share when they are dilutive to income from continuing operations.

## **2. Significant Accounting Estimates, Assumptions & 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 regularly 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 or Development**

The Company is required to apply judgment when designating the nature of a project as exploration and evaluation or development, which requires an assessment of the geological characteristics and other factors related to each project.

## **Exploration and Evaluation Assets**

The accounting for exploration and evaluation costs requires management to make judgments as to whether exploratory projects have discovered economically recoverable quantities of reserves, which requires the quantity and value of such reserves to be estimated. Previous estimates are sometimes revised as new information becomes available. Where it is determined that an exploratory project did not discover economically recoverable resources, the costs are written-off as exploration and evaluation expense.

If hydrocarbons are encountered, but further appraisal activity is required, the exploratory costs remain capitalized as long as sufficient progress is being made in assessing whether the recovery of the resources is economically viable. 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 for development plans. Exploration and evaluation assets are subject to ongoing technical, commercial and management review to confirm the continued intent to develop and extract the underlying resources. When management is making this assessment, changes to project economics, expected quantities of resources, expected production techniques, drilling results and estimated capital expenditures and production costs are important factors. Where it is determined that an exploratory project is not economically viable, the costs are written-off as exploration and evaluation expense.

## **Estimates of Recoverable Amounts**

Estimates of recoverable amounts used in impairment tests often incorporate level three hierarchy inputs including estimated volumes and future net cash flows from oil and natural gas reserves, contingent resource estimates and internal and external market metrics used to estimate value based comparable transactions and assets. By their nature, such estimates are subject to measurement uncertainty. Changes in such estimates, and differences between actual and estimated amounts, could have a material impact on earnings.

## **Reserves Estimates**

Reserve engineering is an inherently complex and subjective process of estimating underground accumulations of petroleum and natural gas resources. 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 assumptions 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 earnings.

### **Determination of CGUs**

The recoverability of the carrying value of oil and gas properties is generally 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 earnings.

### **Business Combinations**

To account for an acquisition as a business combination, management is required to exercise judgment in determining whether the assets acquired and liabilities assumed constitute a business. A business consists of an integrated set of assets and activities, comprised of inputs and processes, that is capable of being conducted and managed as a business by a market participant. An integrated set of assets and activities in the development stage may not have outputs. The Company's acquisition of MGM Energy Corp. ("MGM Energy") was accounted for as a business combination because, even though MGM Energy had not yet generated revenues, management made the judgment that the assets and activities acquired were capable of being managed as a business.

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 paid 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. 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 earnings.

### **Equity Accounted Investments**

The Company accounts for its investments in certain entities under the equity method of investment accounting although it holds less than 20 percent of the voting power because, in Management's judgment, it has significant influence as a result of common directors and members of senior management.

### **Investments in Securities**

The Company's investments in securities that are accounted for as available-for-sale financial instruments are assessed at the end of each reporting period to determine whether there is any objective evidence of impairment. Management is required to exercise judgment to determine whether a decrease in the fair value of an investment below its carrying value is significant or prolonged, which would require an impairment charge to be recognized.

### **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 earnings.

## **3. Changes in Accounting Standards**

Effective January 1, 2014, the Company adopted IFRIC 21 – Levies and amendments to IAS 32 – Financial Instruments: Presentation, which clarified the application of offsetting rules. There has been no impact on the recognized assets, liabilities, or comprehensive income of the Company on the adoption of these standards.

### **Future Changes in Accounting Standards**

In May 2014, the International Accounting Standards Board ("IASB") issued IFRS 15 – Revenue From Contracts With Customers, which establishes a single revenue recognition framework that applies to contracts with customers. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. IFRS 15 is effective for years beginning on or after January 1, 2017. The Company has not yet determined the impact of the IFRS on the Consolidated Financial Statements.

In July 2014, the IASB issued IFRS 9 – Financial Instruments, which sets out the recognition and measurement requirements for financial instruments and some contracts to buy or sell non-financial items. IFRS 9 proposes a single model of classifying and measuring financial assets and liabilities and provides for only two classification categories: amortized cost and fair value. IFRS 9 is effective for years beginning on or after January 1, 2018. The Company has not yet determined the impact of the IFRS on the Consolidated Financial Statements.

## 4. Segmented Information

Paramount's operations are reported by business segment, which have been established by Management to assist in resource allocation, to assess operating performance and to achieve long-term strategic objectives. The segments are divided based on the nature of activities and the Company's management structure:

- **Principal Properties:** Principal properties include the Company's four Corporate Operating Units, which are involved in the exploration, development, production and marketing of natural gas, crude oil and natural gas liquids, generally having similar economic characteristics.
- **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 commercial production, but a longer-term value proposition based on spin-outs, dispositions, or future revenue generation, including oil sands and carbonate interests held by Cavalier, and prospective shale gas acreage; and (iii) drilling rigs owned by 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.

Year ended December 31, 2014	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	332,453	-	-	-	332,453
Gain on financial commodity contracts	2,852	-	-	-	2,852
	335,305	-	-	-	335,305
<b>Expenses</b>					
Operating expense	71,279	-	-	-	71,279
Transportation and NGLs processing	35,896	-	-	-	35,896
General and administrative	-	7,827	16,050	-	23,877
Stock-based compensation	-	5,828	19,545	-	25,373
Depletion and depreciation	229,108	11,190	170	(10,649)	229,819
Exploration and evaluation	23,214	6,793	-	-	30,007
(Gain) loss on sale of property, plant and equipment	(95,734)	43	-	-	(95,691)
Interest and financing	-	2,686	67,913	-	70,599
Other	5,859	77	568	-	6,504
	269,622	34,444	104,246	(10,649)	397,663
Loss from equity-accounted investments	-	(3,399)	-	-	(3,399)
Write-down of investments in securities	-	(15,645)	-	-	(15,645)
Other	980	5,154	229	-	6,363
Drilling rig revenue	-	47,221	-	(46,682)	539
Drilling rig expense	-	(22,179)	-	21,963	(216)
	66,663	(23,292)	(104,017)	(14,070)	(74,716)
<b>Inter-segment eliminations</b>	-	(14,070)	-	14,070	-
<b>Segment income (loss)</b>	66,663	(37,362)	(104,017)	-	(74,716)
Income tax recovery					3,002
<b>Net loss</b>					(71,714)

Year ended December 31, 2013	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	219,908	-	-	-	219,908
Loss on financial commodity contracts	(3,972)	-	-	-	(3,972)
	215,936	-	-	-	215,936
Expenses					
Operating expense	68,615	-	-	-	68,615
Transportation and NGLs processing	23,782	-	-	-	23,782
General and administrative	-	6,765	12,716	-	19,481
Stock-based compensation	-	7,166	18,685	-	25,851
Depletion and depreciation	150,633	9,913	685	(8,296)	152,935
Exploration and evaluation	34,692	845	-	-	35,537
Gain on sale of property, plant and equipment	(32,275)	(413)	-	-	(32,688)
Interest and financing	-	2,400	50,239	-	52,639
Other	3,082	17	528	-	3,627
	248,529	26,693	82,853	(8,296)	349,779
Income from equity-accounted investments	-	21,378	-	-	21,378
Write-down of investments in securities	-	(3,628)	-	-	(3,628)
Other	4,419	3,656	-	-	8,075
Drilling rig revenue	-	42,465	-	(38,279)	4,186
Drilling rig expense	-	(19,351)	-	17,475	(1,876)
	(28,174)	17,827	(82,853)	(12,508)	(105,708)
Inter-segment eliminations	-	(12,508)	-	12,508	-
Segment income (loss)	(28,174)	5,319	(82,853)	-	(105,708)
Income tax recovery					18,593
Income from discontinued operations, net of tax					28,030
Net loss					(59,085)

For the year ended December 31, 2014, the Company had sales of \$101.1 million, \$45.6 million and \$42.6 million to three customers which exceeded ten percent of its total revenue.

### Total Assets

As at December 31	2014	2013
Principal Properties	2,449,073	1,772,049
Strategic Investments	559,027	520,983
Corporate	191,329	154,771
	3,199,429	2,447,803

### Other Income

Year ended December 31	2014	2013
Gain on sale of investments	5,154	3,656
Drilling rig revenue	539	4,186
Drilling rig expense	(216)	(1,876)
Other	1,209	4,419
	6,686	10,385

## 5. Acquisition

### MGM Energy Corp.

On June 11, 2014, Paramount acquired all 338.3 million issued and outstanding common shares of MGM Energy not already owned in exchange for the issuance by Paramount of 1.1 million Common Shares, based on an exchange ratio of one Common Share of Paramount for every 300 common shares of MGM Energy. Immediately prior to the acquisition, Paramount owned 54.1 million common shares of MGM Energy (14 percent voting interest). MGM Energy was a publicly-traded development-stage energy company, the principal business of which was to acquire, exploit and produce oil and natural gas in northern Canada. MGM Energy did not generate revenues and, except for limited periods of testing, MGM Energy's assets have not been placed on production. The acquisition of MGM Energy increased the Company's exploratory land holdings in the Northwest Territories. These financial statements include the results of operations of the acquired business for the period following the closing of the transaction.

The acquisition of MGM Energy 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:

Cash	3,200
Accounts receivable	234
Prepaid expenses	76
Exploration and evaluation assets	13,909
Deferred income tax asset	48,420
Goodwill	21,609
Accounts payable and accrued liabilities	(108)
Asset retirement obligations	(6,856)
<b>Net assets acquired</b>	<b>80,484</b>
Paramount Common Shares issued <sup>(1)</sup>	69,382
Fair value of MGM Energy shares previously held <sup>(2)</sup>	11,102
<b>Total</b>	<b>80,484</b>

(1) Based on 1.1 million Paramount Common Shares issued and the acquisition date closing price of Paramount Common Shares of \$61.52 per share.

(2) Based on 54.1 million MGM Energy common shares held by Paramount prior to the acquisition and the acquisition date closing price of MGM Energy common shares of \$0.205 per share.

On the acquisition of MGM Energy, a gain of \$10.8 million related to the MGM Energy common shares held by Paramount at the acquisition date was recognized in income from equity-accounted investments, based on the closing market price of the MGM Energy common shares of \$0.205 per share. Goodwill recorded on the acquisition is the result of an increase in the trading price of Paramount's Common Shares between the date the Company offered to acquire MGM Energy and the date the transaction closed. The goodwill recognized in the transaction is not deductible for tax purposes. The net assets acquired, including goodwill, have been allocated to the Strategic Investments business segment.

## 6. Discontinued Operations

In March 2013, Paramount sold its properties in the Bistcho area of Alberta and the Cameron Hills area of the Northwest Territories for net proceeds of \$9.1 million. These properties were included in the Company's Principal Properties business segment. Amounts related to these properties from January 1, 2013 to their sale in March 2013 have been classified as discontinued operations and are excluded from the results of the Company's continuing operations.

Details of the income from discontinued operations are presented below:

Year ended December 31	2013
Petroleum and natural gas sales	1,796
Royalties	(24)
Revenue	1,772
Expenses	
Operating expense	2,841
Transportation and NGLs processing	233
Depletion and depreciation	267
Exploration and evaluation	29
	3,370
Loss from ordinary activities of discontinued operations before tax	(1,598)
Gain on sale of discontinued operations	38,985
Income from discontinued operations before tax	37,387
Deferred income tax expense – discontinued operations	9,357
Income from discontinued operations	28,030

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

Year ended December 31	2013
Operating	(926)
Investing	9,062
Cash flow from discontinued operations	8,136

## 7. Exploration and Evaluation

Year ended December 31	2014	2013
Balance, beginning of year	429,911	405,090
Additions	295,949	203,642
Transfers to property, plant and equipment	(143,217)	(137,355)
Corporate acquisition	13,909	–
Dry hole	(4,719)	(13,862)
Expired lease costs	(12,780)	(14,429)
Dispositions	(11,633)	(13,143)
Foreign exchange	–	(32)
Balance, end of year	567,420	429,911

Additions to exploration and evaluation assets totaled \$224.3 million (2013 – \$125.9 million) for Principal Properties and \$71.7 million (2013 – \$77.7 million) for Strategic Investments.

## Exploration and Evaluation Expense

Year ended December 31	2014	2013
Geological and geophysical	12,498	7,101
Dry hole	4,729	14,007
Expired lease costs	12,780	14,429
	<b>30,007</b>	<b>35,537</b>

## 8. Property, Plant and Equipment

Year ended December 31, 2014	Petroleum and natural gas assets	Drilling rigs	Other	Total
<b>Cost</b>				
Balance, December 31, 2013	2,489,356	101,517	27,173	2,618,046
Additions	641,649	25,893	1,212	668,754
Transfers from exploration and evaluation	143,217	–	–	143,217
Dispositions	(144,822)	–	(303)	(145,125)
Change in asset retirement provision	60,527	–	–	60,527
<b>Cost, December 31, 2014</b>	<b>3,189,927</b>	<b>127,410</b>	<b>28,082</b>	<b>3,345,419</b>
<b>Accumulated depletion, depreciation and write-downs</b>				
Balance, December 31, 2013	(997,486)	(27,802)	(19,747)	(1,045,035)
Depletion and depreciation	(196,349)	(10,920)	(1,001)	(208,270)
Write-downs	(32,755)	–	–	(32,755)
Dispositions	108,994	–	212	109,206
<b>Accumulated depletion, depreciation and write-downs, December 31, 2014</b>	<b>(1,117,596)</b>	<b>(38,722)</b>	<b>(20,536)</b>	<b>(1,176,854)</b>
Net book value, December 31, 2013	1,491,870	73,715	7,426	1,573,011
<b>Net book value, December 31, 2014</b>	<b>2,072,331</b>	<b>88,688</b>	<b>7,546</b>	<b>2,168,565</b>

Year ended December 31, 2013	Petroleum and natural gas assets	Drilling rigs	Other	Total
<b>Cost</b>				
Balance, December 31, 2012	1,960,833	84,100	20,374	2,065,307
Additions	528,519	17,417	7,461	553,397
Transfers from exploration and evaluation	137,355	–	–	137,355
Dispositions	(126,129)	–	(682)	(126,811)
Change in asset retirement provision	(11,220)	–	–	(11,220)
Currency translation differences	(2)	–	20	18
<b>Cost, December 31, 2013</b>	<b>2,489,356</b>	<b>101,517</b>	<b>27,173</b>	<b>2,618,046</b>
<b>Accumulated depletion, depreciation and write-downs</b>				
Balance, December 31, 2012	(949,699)	(18,420)	(18,737)	(986,856)
Depletion and depreciation	(145,014)	(9,382)	(1,218)	(155,614)
Write-downs	(6,279)	–	–	(6,279)
Dispositions	103,507	–	220	103,727
Currency translation differences	(1)	–	(12)	(13)
<b>Accumulated depletion, depreciation and write-downs, December 31, 2013</b>	<b>(997,486)</b>	<b>(27,802)</b>	<b>(19,747)</b>	<b>(1,045,035)</b>
Net book value, December 31, 2012	1,011,134	65,680	1,637	1,078,451
<b>Net book value, December 31, 2013</b>	<b>1,491,870</b>	<b>73,715</b>	<b>7,426</b>	<b>1,573,011</b>

## Depletion and Depreciation

Year ended December 31	2014	2013
Depletion and depreciation	209,126	155,701
Write-down of property, plant and equipment	32,755	6,519
Inter-segment eliminations	(12,062)	(9,285)
	229,819	152,935

At December 31, 2014, \$252.6 million (December 31, 2013 – \$343.7 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 2014 were \$640.3 million (2013 – \$523.8 million) for Principal Properties, \$26.7 million (2013 – \$22.1 million) for Strategic Investments and \$1.8 million (2013 – \$7.5 million) for Corporate. Additions to property, plant and equipment include \$14.5 million (2013 – \$12.7 million) of capitalized interest for major facilities in the construction phase at a weighted average interest rate of 7.3 percent (2013 – 7.9 percent).

In the first quarter of 2014, the Company sold its properties in the Chain-Delia area of Alberta in exchange for \$11.7 million in common shares of Marquee Energy Ltd. ("Marquee"). In the second quarter of 2014, Paramount sold a 50 percent working interest in its Birch properties in northeast British Columbia for \$91.5 million cash.

In the first quarter of 2013, Paramount's wholly-owned subsidiary Summit Resources, Inc. sold its non-operated joint operations and lands in North Dakota for proceeds of US\$21.8 million.

The Company recorded an impairment write-down of \$32.8 million at December 31, 2014 related to petroleum and natural gas assets in the Southern CGU. These properties are included within the Principal Properties business segment. The impairment write-down was recorded because the carrying value of the Southern CGU properties exceeded their recoverable amounts, which were estimated based on expected discounted net cash flows from the production of proved and probable reserves. The impairments resulted from a combination of higher well costs than reserves values assigned and decreases in estimated future net revenues due to lower forecasted future oil and natural gas prices.

Recoverable amounts were estimated on a fair value less costs to sell basis, using a discounted cash flow method which is an approach commonly used by market participants to value oil and gas properties (Level 3 fair value inputs). Cash flows were projected over the expected remaining productive life of the Southern CGU's reserves, at an after-tax discount rate of 10 percent, resulting in an estimated recoverable amount of \$20.6 million. 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)	2015	2016	2017	2018	2019	2020-2029	Thereafter
Natural Gas							
AECO (\$/MMBtu)	3.50	4.00	4.25	4.50	4.70	5.00 – 6.50	+2%/yr
Henry Hub (US\$/MMBtu)	3.30	3.80	4.05	4.30	4.55	4.85 – 6.30	+2%/yr
Crude Oil							
Edmonton Light (\$/Bbl)	68.60	83.20	88.90	94.60	99.60	104.70 – 125.30	+2%/yr
WTI (US\$/Bbl)	65.00	75.00	80.00	84.90	89.30	93.80 – 112.20	+2%/yr

The Company recorded a net impairment write-down of its petroleum and natural gas assets in 2013 of \$6.5 million, comprised of a \$19.6 million write-down related to the Southern CGU and a \$17.7 million write-down related to the Northern CGU, net of an impairment reversal of \$30.8 million related to the Grande Prairie CGU. These properties are included within the Principal Properties business segment.

The 2013 impairment write-downs in the Southern and Northern CGUs were recorded because the carrying value of their properties exceeded their recoverable amounts, which were estimated based on expected discounted net cash flows from the production of proved and probable reserves. The impairments resulted from a combination of declines in reserves assigned due to well performance and, in the Southern CGU, the sale of properties with recoverable amounts that exceeded their carrying values.

The 2013 reversal of previously recorded impairment write-downs in the Grande Prairie CGU resulted from increases in reserves assigned to the CGU. The reversal was recorded to the extent that the recoverable amount ascribed to the Grande Prairie CGU exceeded the carrying value of its properties.

Following the sale of the Cameron Hills and Bistcho properties in the first quarter of 2013 and the decline in reserves assigned to the remaining properties in the Northern CGU as at December 31, 2013, Paramount determined that its remaining Northern properties no longer constituted a significant CGU. As a result, the remaining Northern properties have been included within the Grande Prairie CGU subsequent to December 31, 2013.

## 9. Equity-Accounted Investments

As at December 31	2014			2013		
	Shares (000's)	Carrying Value	Market Value <sup>(1)</sup>	Shares (000's)	Carrying Value	Market Value <sup>(1)</sup>
Trilogy	19,144	79,879	151,432	19,144	97,391	528,383
MGM Energy	-	-	-	54,147	1,212	8,664
Other		2,565			5,711	
		82,444			104,314	

(1) Based on the period-end trading price.

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

Year ended December 31	2014	2013
Equity loss	(11,508)	(4,297)
Dilution gain	257	25,675
Write-down of other equity-accounted investment	(2,938)	-
Gain on MGM Energy acquisition (Note 5)	10,790	-
	(3,399)	21,378

As at December 31, 2014, Paramount owned a 15 percent equity interest in Trilogy (December 31, 2013 – 15 percent). Trilogy is a petroleum and natural gas-focused Canadian energy corporation that develops, produces and sells natural gas, crude oil and natural gas liquids, primarily in the province of Alberta. Trilogy is a publicly listed entity in Canada with its common shares trading on the Toronto Stock Exchange. The following tables summarize the assets, liabilities, equity, revenue and income of Trilogy and Paramount's investment in Trilogy:

As at December 31	2014	2013
Current assets	56,478	73,221
Non-current assets <sup>(1)</sup>	1,563,333	1,481,860
Current liabilities	(106,941)	(138,744)
Non-current liabilities	(939,877)	(742,136)
Equity	572,993	674,201
Multiply by: Paramount's equity interest	15.2%	15.3%
Paramount's proportionate share of equity	87,161	103,113
Less: portion of share-based compensation recorded in equity of Trilogly	(7,282)	(5,722)
Carrying value of Paramount's investment	79,879	97,391

(1) Includes adjustments to Trilogly's carrying values required in the application of the equity method of investment accounting for shares of Trilogly purchased by the Company in the open market in prior years. Excluding such adjustments, Trilogly's non-current assets as at December 31, 2014 totaled \$1,562,475 (2013 - \$1,473,508) and equity totaled \$572,135 (2013 - \$665,849).

Year ended December 31	2014	2013
Revenue	549,037	489,819
Comprehensive loss <sup>(1)</sup>	(68,534)	(17,397)
Paramount's share of Trilogly's comprehensive loss	(10,408)	(2,660)

(1) Includes amortization of the adjustments to Trilogly's non-current assets required in the application of the equity method of investment accounting for shares of Trilogly purchased by the Company in prior years in the open market. Excluding such adjustments, Trilogly's comprehensive loss for the year ended December 31, 2014 was \$61,011 (2013 - comprehensive income \$11,467).

Trilogly had 8.2 million stock options outstanding (3.3 million exercisable) at December 31, 2014 at exercise prices ranging from \$4.85 to \$38.74 per share.

For the year ended December 31, 2014, Paramount received cash dividends from Trilogly of \$7.4 million (2013 - \$8.0 million).

Income from equity-accounted investments for the year ended December 31, 2014 also includes \$0.3 million (2013 - \$25.7 million) of dilution gains related to the Company's investment in Trilogly as a result of common shares issued by Trilogly during the year.

The aggregate carrying amount of the Company's other equity-accounted investments at December 31, 2014 was \$2.6 million (December 31, 2013 - \$6.9 million) and Paramount's share of the income or loss of those investees for the year ended December 31, 2014 was an aggregate net loss of \$1.1 million (2013 - net loss of \$1.6 million).

## 10. Investments in Securities

As at December 31	2014		2013	
	Shares (000's)	Market Value	Shares (000's)	Market Value
MEG Energy Corp.	3,700	72,335	3,700	113,257
Other <sup>(1)</sup>		30,559		32,404
		102,894		145,661

(1) Includes investments in Marquee, RMP Energy Inc., Strategic Oil & Gas Ltd., and other public and private corporations.

At December 31, 2014 aggregate unrealized losses of \$15.6 million related to the Company's investments in Marquee, Strategic Oil & Gas Ltd. and other securities previously recorded in OCI were charged to net earnings as a result of significant decreases in the market prices of the securities at the end of the year.

## 11. Goodwill

As at December 31	2014	2013
Carrying value, beginning of year	3,124	3,124
Acquisition	21,609	-
Carrying value, end of year	24,733	3,124

The carrying amount of goodwill at December 31, 2014 includes \$21.6 million related to the MGM Energy acquisition and \$3.1 million related to the Kaybob CGU. Goodwill recognized in respect of the MGM Energy acquisition was allocated to a group of GGUs within the Strategic Investments business segment.

Goodwill was assessed for impairment as at December 31, 2014 based on recoverable amounts estimated using fair value less costs to sell. Recoverable amounts in respect of Strategic Investments CGUs with allocated goodwill were estimated using level three hierarchy inputs including third-party estimates of fair value, third-party reserves and resource estimates and internally generated estimates. The recoverable amount for the Kaybob CGU was estimated on the basis described in Note 1(f). No reasonably possible change in assumptions would cause goodwill to become impaired in either CGU.

## 12. Demand Facilities

As at December 31	2014	2013
Fox Drilling Facility	50,940	53,000
Cavalier Facility	30,590	22,550
	81,530	75,550

### Fox Drilling Facility

The Fox Drilling Facility is divided into two tranches. The first tranche ("Fox Tranche A") is a non-revolving demand loan with a principal amount of \$45.8 million outstanding at December 31, 2014. Scheduled principal repayments on Fox Tranche A are \$8.2 million in each of 2015, 2016 and 2017, with the remaining outstanding balance payable in 2018.

The second tranche ("Fox Tranche B") is a non-revolving demand loan with a credit limit of \$27.0 million that is available to be drawn to fund the construction of two new drilling rigs. At December 31, 2014, \$5.1 million was drawn under Fox Tranche B. Once construction of the new drilling rigs is completed in 2015, scheduled quarterly principal repayments will commence over a five year term.

Recourse and security for the Fox Drilling Facility is limited to Fox Drilling's rigs, including the new drilling rigs being constructed, and drilling contracts with 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 Fox Drilling Facility for the year ended December 31, 2014 was 4.4 percent (2013 – 4.4 percent).

### Cavalier Facility

Cavalier has a \$40.0 million demand loan facility with a syndicate of Canadian banks (the "Cavalier Facility"). Drawings on the Cavalier Facility bear interest at the lenders' prime lending rates, US base rates, or bankers' acceptance rates, as selected at the discretion of the Company, plus an applicable margin. The Cavalier Facility is non-recourse to Paramount and is secured by all of the assets of Cavalier,

including oil sands and carbonate bitumen lands. The effective interest rate on the Cavalier Facility for the year ended December 31, 2014 was 3.5 percent (2013 – 3.4 percent).

### 13. Long-Term Debt

As at December 31	2014	2013
Bank credit facility	397,673	71,826
8¼% Senior Notes due 2017	370,000	370,000
7½% Senior Notes due 2019	450,000	450,000
	1,217,673	891,826
Unamortized financing costs, net of premiums	(7,318)	(9,223)
	1,210,355	882,603

#### Bank Credit Facility

Paramount's bank credit facility (the "Facility") was increased in 2014 from \$600 million to \$900 million, which is available in two tranches. The first tranche ("Tranche A") has a credit limit and lender commitments of \$800 million and is available on a revolving basis to November 30, 2015. 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 \$100 million and is due November 30, 2015 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 Fox Drilling Facility and the Cavalier Facility. Balances drawn under Tranche B are secured by the pledge of certain of the Company's equity investments from time-to-time.

Borrowings under the Facility bear interest at the lenders' prime lending rates, US base rates, bankers' acceptance rates, or LIBOR rates, as selected at the discretion of the Company, plus an applicable margin which is dependent upon the Company's debt-to-cash flow ratio, the tranche under which borrowings are made and the total amount drawn. 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, the value attributed by lenders to Paramount's other property, and the market value of equity investments pledged by Paramount from time-to-time under Tranche B, among other factors.

As at December 31, 2014, \$397.7 million was drawn on Tranche A and Tranche B was undrawn. Paramount had undrawn letters of credit outstanding at December 31, 2014 totaling \$55.2 million that reduce the amount available to the Company.

#### Senior Notes

Paramount has \$370 million aggregate principal amount of senior unsecured notes due 2017 (the "2017 Senior Notes") outstanding. The 2017 Senior Notes bear interest at 8¼ 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 Senior 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 aggregate principal amount of senior unsecured notes due 2019 (the "2019 Senior Notes") at par. In December 2013, Paramount completed a public offering of an additional \$150 million aggregate principal amount of 2019 Senior Notes at a price of \$1,007.50 per \$1,000 principal amount. Certain officers, management and associates of the Company purchased an aggregate \$17.9 million principal amount of 2019 Senior Notes under the two offerings.

The 2019 Senior Notes bear interest at 7<sup>5</sup>/<sub>8</sub> 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 Senior 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.

## 14. Asset Retirement Obligations

Year ended December 31	2014	2013
Asset retirement obligations, beginning of year	239,853	300,468
Retirement obligations incurred	23,190	35,749
Revisions to estimated retirement costs	6,126	(9,952)
Change in discount rates	40,164	(35,369)
Obligations settled	(4,576)	(6,336)
Dispositions	(30,134)	(48,087)
Assumed on corporate acquisition	6,856	–
Accretion expense	5,936	3,099
Other	–	281
<b>Asset retirement obligations, end of year</b>	<b>287,415</b>	<b>239,853</b>

At December 31, 2014, the estimated undiscounted asset retirement obligations were \$287.4 million (December 31, 2013 - \$281.3 million), which have been discounted using a weighted average risk-free rate of 2.00 percent (December 31, 2013 – 3.00 percent) and an inflation rate of 2.00 percent (December 31, 2013 – 2.00 percent). These obligations will be settled over the useful lives of the assets, which extend up to 47 years.

## 15. Share Capital

Paramount's authorized share capital consists of an unlimited number of Common Shares without par value and an unlimited number of preferred shares issuable in series. At December 31, 2014, 104,843,846 Common Shares were outstanding, net of 54,199 Common Shares held in trust under the stock incentive program, and no preferred shares were outstanding.

In July 2014, Paramount issued 4,600,000 Common Shares at a price of \$60.00 per share and 900,000 Common Shares on a "flow-through" basis in respect of Canadian exploration expenses ("CEE") at a price of \$74.40 per share for aggregate gross proceeds of \$343.0 million pursuant to a public offering. Concurrent with the public offering, Paramount issued 100,000 Common Shares on a "flow-through" basis in respect of CEE ("FTS") at a price of \$74.40 per share to Paramount's Chairman and Chief Executive Officer for gross proceeds of \$7.4 million. On issuance of the flow-through shares, a liability of \$14.4 million was recognized in accounts payable and accrued liabilities in respect of the Company's obligation to renounce qualifying expenditures. The Company incurred \$10.7 million of transaction costs in respect of these equity offerings, net of tax benefits of \$3.6 million.

In October 2013, Paramount issued 1,115,000 FTS at a price of \$44.00 per share for gross proceeds of \$49.1 million, pursuant to a public offering. Concurrent with the public offering, Paramount issued FTS at a price of \$44.00 per share to the Company's Chairman and Chief Executive Officer and President and Chief Operating Officer and/or companies controlled by them for gross proceeds of approximately \$10 million, and to certain other directors, officers, and employees of Paramount and other persons for gross proceeds of approximately \$1 million. On issuance of the flow-through shares, a liability of \$11.8 million was recognized in accounts payable and accrued liabilities in respect of the Company's obligation to renounce qualifying expenditures.

In May 2013, Paramount issued 4,025,000 Common Shares at a price of \$37.50 per share for gross proceeds of \$150.9 million pursuant to a public offering.

The Company incurred \$6.4 million of transaction costs in respect of the 2013 equity offerings, net of tax benefits of \$2.1 million.

### Weighted Average Common Shares

Year ended December 31	2014		2013	
	Wtd. Avg Shares (000's)	Loss from continuing operations	Wtd. Avg Shares (000's)	Loss from continuing operations
Loss from continuing operations – basic	101,090	(71,714)	93,708	(87,115)
Dilutive effect of Paramount options	–	–	–	–
Loss from continuing operations – diluted	101,090	(71,714)	93,708	(87,115)

## 16. Reserves

Reserves at December 31, 2014 include unrealized gains and losses related to changes in the market value of the Company's investments in securities and contributed surplus amounts in respect of Paramount Options and Cavalier Options. The changes in reserves are as follows:

Year ended December 31, 2014	Unrealized gains (losses) on securities	Contributed surplus	Total reserves
Balance, beginning of year	12,787	74,891	87,678
Other comprehensive loss	(42,475)	–	(42,475)
Stock-based compensation	–	21,439	21,439
Stock options exercised	–	(20,470)	(20,470)
Balance, end of year	(29,688)	75,860	46,172

Year ended December 31, 2013	Translation of foreign subsidiaries	Unrealized gains on securities	Contributed surplus	Total reserves
Balance, beginning of year	(393)	8,879	86,461	94,947
Other comprehensive income	393	3,908	–	4,301
Stock-based compensation	–	–	28,252	28,252
Stock options exercised	–	–	(39,822)	(39,822)
Balance, end of year	–	12,787	74,891	87,678

## Other Comprehensive Income (Loss)

Year ended December 31	2014	2013
<b>Unrealized gain (loss) on securities</b>		
Change in market value of securities	(53,664)	636
Reclassification of other comprehensive loss to earnings	10,918	3,628
Deferred tax	271	(356)
	(42,475)	3,908
<b>Translation of foreign subsidiaries</b>		
Exchange differences on translation of US subsidiaries	-	(587)
Reclassification of other comprehensive income to earnings	-	980
	-	393
<b>Other comprehensive income (loss)</b>	<b>(42,475)</b>	<b>4,301</b>

## 17. Share-Based Compensation

### Paramount Options

Changes in outstanding Paramount Options are as follows:

	2014		2013	
	Number	Weighted average exercise price (\$/share)	Number	Weighted average exercise price (\$/share)
Balance, beginning of year	6,632,200	31.20	6,667,850	23.58
Granted	1,922,500	33.22	1,865,000	37.37
Exercised <sup>(1)</sup>	(1,107,350)	17.22	(1,747,650)	8.66
Forfeited	(171,500)	35.67	(153,000)	31.98
<b>Balance, end of year</b>	<b>7,275,850</b>	<b>33.75</b>	<b>6,632,200</b>	<b>31.20</b>
<b>Options exercisable, end of year</b>	<b>2,592,750</b>	<b>31.58</b>	<b>2,407,250</b>	<b>24.21</b>

(1) For options exercised in 2014, the weighted average market price of Paramount's Common Shares on the dates exercised was \$48.09 (2013 - \$36.25).

The weighted average remaining contractual life and exercise prices of Paramount Options outstanding as of December 31, 2014 are as follows:

Exercise Prices	Awards Outstanding		
	Number	Remaining contractual life (years)	Weighted average exercise price
\$13.20 - \$20.00	434,450	0.3	13.42
\$20.01 - \$30.00	2,514,250	3.9	29.71
\$30.01 - \$35.00	1,297,900	3.3	34.00
\$35.01 - \$40.00	1,689,500	4.3	37.76
\$40.01 - \$64.47	1,339,750	2.8	42.63
	7,275,850	3.5	33.75

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

	Options awarded in 2014	Options awarded in 2013
Weighted average exercise price (\$ / share)	33.22	37.37
Expected volatility (%)	35.0	36.1
Expected life of share options (years)	4.6	4.6
Pre-vest annual forfeiture rate (%)	5.7	5.6
Risk-free interest rate (%)	1.3	1.6
Expected dividend yield (%)	–	–
Weighted average fair value of awards per share (\$ / share)	10.24	12.13

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

During 2014, Cavalier granted 1.7 million Cavalier Options, which vest over five years. A total of 0.2 million previously issued Cavalier Options were cancelled during the year, resulting in a net balance of 5.8 million Cavalier Options outstanding at December 31, 2014.

The grant date fair value of Cavalier Options awarded was estimated using the Black-Scholes-Merton model, incorporating the following inputs: expected volatility 58.3% (2013 – 60.8%), expected life 6.8 years (2013 – 6.0 years), risk-free interest rate of 1.8% (2013 – 2.0%), pre-vest forfeiture rate of nil (2013 – nil), and expected dividend yield of nil (2013 – nil).

The expected life of the Cavalier Options is the term of the option. As Cavalier is a private company, expected volatility is estimated based on the average historical volatility of the trading price of a group of publicly traded oil sands companies which are comparable to Cavalier 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	2014		2013	
	Shares (000's)	Shares (000's)	Shares (000's)	Shares (000's)
Balance, beginning of year	72	500	75	416
Shares purchased	92	4,617	113	3,998
Change in vested and unvested shares	(110)	(4,609)	(116)	(3,914)
Balance, end of year	54	508	72	500

## Employee Benefit Costs

Year ended December 31	2014	2013
Stock option plan	20,290	21,347
Stock incentive plan	5,083	4,504
Stock-based compensation expense	25,373	25,851
Salaries and benefits, net of recoveries	16,178	13,392
	41,551	39,243

## 18. Income Tax

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

Year ended December 31	2014	2013
Loss from continuing operations before tax	(74,716)	(105,708)
Effective Canadian statutory income tax rate	25.0 %	25.0 %
Expected income tax recovery	(18,679)	(26,427)
Effect on income taxes of:		
Statutory and other rate differences	284	2,707
Income from equity-accounted investments	850	(5,344)
Write-down of investments in securities	3,911	907
Investment in subsidiaries	-	2,186
Flow-through share renunciations	5,870	4,223
Stock-based compensation	5,072	5,337
Non-deductible items and other	(310)	(2,182)
Income tax recovery	(3,002)	(18,593)

The following table summarizes the temporary differences that give rise to the net deferred income tax asset:

As at December 31	2014	2013
Property, plant and equipment	(209,850)	(91,934)
Investments	(357)	(4,188)
Asset retirement obligations	71,872	60,006
Non-capital losses	285,166	150,514
Other	5,656	4,692
Deferred tax asset	152,487	119,090

The following table summarizes the movements of the deferred income tax asset during the year:

Year ended December 31	2014	2013
Balance, beginning of year	119,090	116,901
Deferred income tax recovery	2,957	14,219
Deferred income tax recovery (expense) included in other comprehensive income	271	(356)
Flow-through share renunciations	(20,671)	(13,008)
Share issuance costs	3,553	2,139
Business combinations and other	47,287	805
<b>Balance, end of year</b>	<b>152,487</b>	<b>119,090</b>

Paramount has \$1,141.3 million (2013 – \$601.5 million) of unused tax losses expiring between 2025 and 2034. In addition, Paramount has \$233.8 million (2013 – \$180.0 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 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 strongly 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.

## 19. Financial Instruments and Risk Management

### Financial Instruments

Financial instruments at December 31, 2014 consisted of cash and cash equivalents, accounts receivable, the Deposit, investments in securities, the demand facilities, accounts payable and accrued liabilities and long-term debt.

#### *Fair Values of Financial Assets and Liabilities*

The following methods and assumptions are used to estimate the fair values for financial instruments carried at fair value in the Company's financial statements:

- Cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments. The fair value of the Deposit approximates its carrying amount.
- Risk management assets and liabilities outstanding from time-to-time are carried at fair values, which are estimated using a market approach incorporating level two fair value hierarchy inputs, including forward market curves and price quotes for similar instruments provided by financial institutions.
- Publicly-traded investments in securities are carried at their period-end trading price, which are level one fair value hierarchy inputs.

#### *Liabilities Carried at Amortized Cost*

The carrying value of the demand facilities and long-term debt, including the Senior Notes, are measured at amortized cost. The 2017 Senior Notes had a market value of 97.3 percent of their principal amount at December 31, 2014 (December 31, 2013 – 103.5 percent). The 2019 Senior Notes had a market value of 93.6 percent of their principal amount at December 31, 2014 (December 31, 2013 – 101.0 percent). The market values of the Company's Senior Notes were estimated using a market approach incorporating prices quoted from financial institutions which are level two fair value hierarchy inputs.

## Risk Management

For the year ended December 31, 2014, the Company entered into financial commodity contracts in respect of its natural gas and oil sales. Changes in the fair value of oil and natural gas risk management assets and liabilities are as follows:

Year ended December 31	2014	2013
Fair value, beginning of year	(3,972)	-
Changes in fair value	2,852	(3,972)
Settlements paid	1,120	-
Fair value, end of year	-	(3,972)

The Company did not have any financial commodity contracts in place at December 31, 2014.

Paramount is exposed to market risks where the fair values or future cash flows of financial instruments fluctuate because of changes in underlying market prices.

### *Commodity Price Risk*

Paramount uses financial and physical commodity price contracts from time-to-time to manage exposure to commodity price volatility. The Company is exposed to commodity price risk on these instruments, as changes in underlying commodity prices will impact the market values of the contracts and ultimately the amounts received or paid upon settlement.

### *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 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 natural gas liquids. 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. A one percent increase or decrease in interest rates would have impacted Paramount's net earnings for the year ended December 31, 2014 by approximately \$2.7 million (2013 – \$0.8 million) based on the average floating rate credit facility balances outstanding during the year. 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, 2014 is limited to the carrying value of accounts receivable. Accounts receivable include balances due from customers and partners in the oil and gas industry and are subject to normal industry credit risk. At December 31, 2014, Paramount had no balances due from partners that represented more than 10 percent of the Company's total accounts receivable.

### *Liquidity Risk*

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

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

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

	2015	2016	2017	2018	2019	Thereafter	Total
Accounts payable & accrued liabilities <sup>(1)</sup>	263,571	–	–	–	–	–	263,571
Cavalier Facility <sup>(2)</sup>	30,590	–	–	–	–	–	30,590
Credit Facility <sup>(3)</sup>	19,088	416,762	–	–	–	–	435,850
Fox Drilling Facility <sup>(3)</sup>	10,740	10,999	10,521	22,959	859	2,371	58,449
Senior Notes <sup>(3)</sup>	64,838	64,838	433,249	34,313	481,680	–	1,078,918
	<b>388,827</b>	<b>492,599</b>	<b>443,770</b>	<b>57,272</b>	<b>482,539</b>	<b>2,371</b>	<b>1,867,378</b>

(1) Excluding \$3.3 million related to the Company's obligation to renounce qualifying expenditures for flow-through share issuances.

(2) Excluding interest.

(3) Including interest.

### **Accounts Payable and Accrued Liabilities**

As at December 31	2014	2013
Trade and accrued payables	252,349	191,783
Joint operation and other	7,178	8,208
Interest payable	4,044	4,044
Flow-through share renunciation obligations	3,276	9,546
	<b>266,847</b>	213,581

Terms and conditions of the above financial liabilities:

- Trade and accrued payables and joint operation and other 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	2014	2013
Revenue receivable	33,972	20,214
Joint operation receivable	17,655	12,361
GST and other	5,413	6,725
	57,040	39,300

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

In determining the recoverability of joint operation receivables, the Company performs a risk analysis considering the type and age of the outstanding receivables and the credit worthiness of the counterparties. The Company has determined that there was no impairment of joint operation receivables as at December 31, 2014. There were no significant non-current joint operation receivables as at December 31, 2014 and 2013.

## 20. Consolidated Statement of Cash Flows Selected Information

### Items Not Involving Cash

Year ended December 31	2014	2013
Financial commodity contracts	(3,972)	3,972
Stock-based compensation	25,373	25,851
Depletion and depreciation	229,819	152,935
Exploration and evaluation	17,509	28,436
Gain on sale of property, plant, and equipment	(95,691)	(32,688)
Accretion of asset retirement obligations	5,936	3,099
Foreign exchange	1,058	599
(Income) loss from equity-accounted investments	3,399	(21,378)
Write-down of investments in securities	15,645	3,628
Gain on sale of investments	(5,154)	(3,656)
Deferred income tax	(2,957)	(23,576)
Discontinued operations	–	(29,361)
Other	1,864	1,689
	192,829	109,550

### Supplemental Cash Flow Information

Year ended December 31	2014	2013
Interest paid	79,263	58,338
Current tax paid	402	8,117

### Components of Cash and Cash Equivalents

As at December 31	2014	2013
Cash	18,320	10,703
Cash equivalents	–	–
	18,320	10,703

## 21. Capital Structure

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

- i. maintain a flexible capital structure which optimizes the cost of capital at an acceptable level of risk;
- ii. maintain sufficient liquidity to support ongoing operations, capital expenditure programs, strategic initiatives, and the repayment of debt obligations when due; and
- iii. maximize shareholder returns.

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

Paramount's capital structure consists of the following:

As at December 31	2014	2013
Adjusted working capital deficit <sup>(1)</sup>	183,328	151,780
Demand facilities	81,530	75,550
Facility	397,673	71,826
Senior Notes <sup>(2)</sup>	820,000	820,000
Net Debt <sup>(3)</sup>	1,482,531	1,119,156
Share capital	1,603,436	1,169,178
Accumulated deficit	(296,326)	(224,612)
Reserves	46,172	87,678
<b>Total Capital</b>	<b>2,835,813</b>	<b>2,151,400</b>

(1) Adjusted working capital excludes accounts payable and accrued liabilities related to the Company's obligation to renounce qualifying expenditures for flow-through share issuances (December 31, 2014 - \$3.3 million, December 31, 2013 - \$9.5 million), risk management assets and liabilities, and demand facilities.

(2) Excludes unamortized issue premiums and financing costs.

(3) Net Debt excludes the \$20 million deposit on account with the CRA, pending resolution of the Company's Notice of Objection (See Note 18).

Paramount is not subject to financial maintenance covenants under the terms of the Facility or the Senior Notes. The agreements include certain restrictions on Paramount's ability to repurchase equity, issue or refinance debt, acquire or dispose of assets, and pay dividends.

## 22. Related Party Transactions

### Service Agreements

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

During 2014, Paramount charged \$0.6 million (2013 – \$0.4 million) to Trilogy in respect of operational and administrative services. Paramount charged \$0.6 million (2013 – \$3.0 million) to Trilogy and was charged \$1.6 million (2013 – \$0.8 million) by Trilogy in respect of joint operations. Also, Paramount received \$7.4 million (2013 – \$8.0 million) in dividends from Trilogy. As of December 31, 2014, Paramount had a net payable balance due to Trilogy of \$0.3 million (2013 – net receivable of \$0.3 million).

## Compensation of Key Management Personnel

Year ended December 31	2014	2013
Salaries and benefits	1,899	1,857
Stock-based compensation	10,658	9,980
	12,557	11,837

## 23. Commitments and Contingencies

Paramount had the following commitments as at December 31, 2014:

	Within one year	After one year but not more than five years	More than five years
Petroleum and natural gas transportation and processing commitments <sup>(1)</sup>	81,994	490,425	741,331
Operating leases	10,439	19,748	5,067
Capital spending commitments and other <sup>(2)</sup>	19,326	3,359	190
	111,759	513,532	746,588

(1) Certain of the transportation and processing commitments are secured by outstanding letters of credit totaling \$41.2 million at December 31, 2014 (2013 - \$32.3 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 \$3.7 million in 2014 (2013 – \$3.5 million).

### Flow-Through Shares

As a result of flow-through share issuances in 2014, Paramount is required to incur, on or before December 31, 2015, \$74.4 million of CEE, of which \$57.5 million was incurred as of December 31, 2014. Paramount has incurred sufficient qualifying expenditures to satisfy commitments associated with CEE flow-through shares issued in 2013.

### 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 and royalty filings are subject to subsequent government audit and potential reassessments. Accordingly, the final liability may differ materially from amounts estimated and recorded.