

# 2011



## Full Year & Fourth Quarter

For the full year & three month periods ending December 31, 2011

## SELECTED INFORMATION

The table below provides a summary of Harvest's financial and operating results for the three months and years ended December 31, 2011 and 2010.

	Three Months Ended		Year Ended	
	Dec. 31, 2011	Dec. 31, 2010	Dec. 31, 2011	Dec. 31, 2010
<b>FINANCIAL</b>				
Revenues <sup>(1)</sup>	<b>1,462,535</b>	1,301,348	<b>4,330,869</b>	3,958,204
Cash from operating activities	<b>144,625</b>	142,134	<b>560,489</b>	439,184
Net loss	<b>(73,885)</b>	(12,333)	<b>(104,657)</b>	(81,163)
Bank loan	<b>355,575</b>	11,379	<b>355,575</b>	11,379
Convertible debentures	<b>742,067</b>	745,257	<b>742,067</b>	745,257
Senior notes	<b>495,674</b>	482,389	<b>495,674</b>	482,389
Total financial debt <sup>(2)</sup>	<b>1,593,316</b>	1,239,025	<b>1,593,316</b>	1,239,025
Total assets	<b>6,284,370</b>	5,388,740	<b>6,284,370</b>	5,388,740
<b>UPSTREAM OPERATIONS</b>				
Daily sales volumes (boe/d)	<b>61,324</b>	50,054	<b>57,161</b>	49,397
Average realized price				
Oil and NGLs (\$/bbl) <sup>(3)</sup>	<b>84.82</b>	68.67	<b>79.60</b>	67.34
Gas (\$/mcf)	<b>3.42</b>	3.81	<b>3.83</b>	4.21
Operating netback prior to hedging (\$/boe) <sup>(2)</sup>	<b>36.57</b>	32.07	<b>34.54</b>	32.02
Capital asset additions (excluding acquisitions)	<b>179,634</b>	147,890	<b>733,380</b>	403,848
Property and business acquisitions (dispositions), net	<b>(7,971)</b>	(797)	<b>505,355</b>	175,657
Abandonment and reclamation expenditures	<b>9,938</b>	6,444	<b>22,110</b>	20,257
Net wells drilled	<b>39.4</b>	41.6	<b>214.3</b>	141.4
Net undeveloped land acquired in business combinations (acres) <sup>(4)</sup>	-	-	<b>223,405</b>	57,509
Net undeveloped land additions (acres)	<b>19,549</b>	49,769	<b>164,349</b>	124,479
<b>DOWNSTREAM OPERATIONS</b>				
Average daily throughput (bbl/d)	<b>88,824</b>	111,317	<b>66,417</b>	86,142
Average refining margin (loss) (US\$/bbl)	<b>(4.14)</b>	6.13	<b>5.28</b>	5.13
Capital asset additions	<b>37,532</b>	32,591	<b>284,244</b>	71,234

(1) Revenues are net of royalties and the effective portion of Harvest's realized crude oil hedges.

(2) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

(3) Excludes the effect of risk management contracts designated as hedges.

(4) Excludes carried interest lands acquired in business combinations.

## MESSAGE TO STAKEHOLDERS

During 2011 Harvest focused on developing and growing our business through: (i) acquisition and the organic development of our extensive Upstream asset base; (ii) effective management and execution of our BlackGold SAGD oil sands project; and (iii) cost-effective, low risk projects within our Downstream business.

The first quarter of 2011 was a successful quarter for Harvest as we closed a significant acquisition of producing assets in western Canada. In addition, the results of our winter drilling program in northern Alberta contributed to Harvest setting record production levels. Our Downstream refining business experienced exceptional performance during the first quarter of 2011 as throughput averaged near capacity, taking advantage of refining margins which were the highest since the first quarter of 2009.

Harvest encountered operational setbacks in the Upstream business when the non-operated Rainbow pipeline experienced a line break in April and production from the northern Alberta areas was seriously restricted. In response to the line break, we utilized alternative transportation to move as much production as possible from the affected areas to other markets until pipeline service was restored in September. As well, unusually wet weather hampered operations and drilling activities related to our Saskatchewan properties.

Following these operational setbacks, Harvest's Upstream operations achieved the highest production levels for the year during the fourth quarter, which was further enhanced by the continued strength of crude oil prices.

Downstream operations began a scheduled maintenance turnaround in May; the scope and time required grew over the course of the project. The turnaround and catalyst enhancement activities were completed in August. These position Harvest for strong and continuous performance, eliminating a planned turnaround in 2012 with no scheduled downtime until 2013. The Downstream refinery operations returned to regular operations in the fourth quarter, reflecting slightly reduced throughput levels to better manage the very low gasoline crack margins prevalent in late 2011.

Moving forward into 2012, we believe the quality and strength of our operations, enhanced by the skill and technical expertise of our employees, are the keys to our success. Our asset base consists of valuable upside potential in both Upstream and Downstream businesses. Through 2012 we will continue to develop value through organic development, the use of innovative technologies, acquisition opportunities in the Upstream and cost efficient projects with attractive rates of return in the Downstream.

Thank you for your continued interest in, and support of, Harvest Operations Corp. We look forward to reporting on our future progress and direction in the quarters to come as we evolve and grow, maintaining our position as a leading Canadian oil and gas company.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited consolidated financial statements of Harvest Operations Corp. ("Harvest", "we", "us", "our" or the "Company") for the year ended December 31, 2011, together with the accompanying notes. The information and opinions concerning our future outlook are based on information available at February 29, 2012.

On January 1, 2011, Harvest adopted International Financial Reporting Standards ("IFRS"). Harvest's previously reported consolidated financial statements prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP") have been adjusted to be in compliance with IFRS on January 1, 2010, the transition date.

In this MD&A, all dollar amounts are expressed in Canadian dollars unless otherwise indicated. Tabular amounts are in thousands of dollars, except where noted. Natural gas volumes are converted to barrels of oil equivalent ("boe") using the ratio of six thousand cubic feet ("mcf") of natural gas to one barrel of oil ("bbl"). Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf to 1 bbl is based on an energy equivalent conversion method primarily applicable at the burner tip and does not represent a value equivalent at the wellhead. In accordance with Canadian practice, petroleum and natural gas revenues are reported on a gross basis before deduction of Crown and other royalties. In addition to disclosing reserves under the requirements of National Instrument ("NI") 51-101, Harvest also discloses reserves on a company interest basis which is not a term defined under NI 51-101. This information may not be comparable to similar measures by other issuers.

## ADDITIONAL INFORMATION

Further information concerning Harvest, including its unaudited interim consolidated financial statements and Annual Information Form ("AIF") can be found on SEDAR at [www.sedar.com](http://www.sedar.com) or at [www.harvestenergy.ca](http://www.harvestenergy.ca). Information can also be found by contacting our Investor Relations department at (403) 265-1178 or at 1-866-666-1178.

## ADVISORY

This MD&A contains non-GAAP measures and forward-looking information about our current expectations, estimates and projections. Readers are cautioned that the MD&A should be read in conjunction with the "Non-GAAP Measures" and "Forward-Looking Information" sections at the end of this MD&A.

## REVIEW OF OVERALL PERFORMANCE

Harvest is an integrated energy company with a petroleum and natural gas business focused on the exploration, development and production of assets in western Canada ("Upstream") and a refining and marketing business focused on the safe operation of a medium gravity sour crude oil hydrocracking refinery and a retail and wholesale petroleum marketing business both located in the Province of Newfoundland and Labrador ("Downstream"). Harvest is a wholly owned subsidiary of Korea National Oil Corporation ("KNOC"). Our earnings and cash flow from operating activities are largely determined by the realized prices for our crude oil and natural gas production as well as refined product crack spreads.

### Upstream

- Sales volumes for the year ended December 31, 2011 increased by 7,764 boe/d compared to 2010 primarily due to additional production from recently acquired properties, partially offset by production reductions due to the Plains Rainbow Pipeline outage during the summer of 2011.
- Harvest's operating netback prior to hedging was \$34.54/boe for the year ended December 31, 2011, an increase of \$2.52/boe or 8% from 2010, reflecting higher prices in oil and natural gas liquids ("NGLs") partially offset by lower natural gas prices and increased operating and transportation expenses.
- Capital spending of \$733.4 million during 2011 includes the drilling of 251.0 gross (214.3 net) wells with a success rate of approximately 98%.
- On February 28, 2011, Harvest successfully closed the acquisition of assets from Hunt Oil Company of Canada, Inc. ("Hunt") for cash consideration of \$511.0 million. Since the date of acquisition to December 31, 2011, the Hunt assets have contributed \$133.0 million of revenue.

### Downstream

- Throughput volume averaged 66,417 bbl/d for the year ended December 31, 2011, a decrease of 19,725 bbl/d as compared to 2010 due to planned maintenance of the refinery units as well as a reduction in throughput rates due to declining refining margins in the fourth quarter of 2011. Refining gross margin averaged \$5.28/bbl for the year ended 2011, an increase of \$0.15/bbl from 2010.
- Operating loss totaled \$140.5 million for the year ended December 31, 2011 as compared to an operating loss of \$94.7 million in 2010. The increase in operating loss is primarily due to lower throughput and higher feedstock costs and purchased energy expenses.
- 2011 capital spending was \$284.2 million, of which \$102.4 million was spent on plant turnaround, \$62.6 million on the debottlenecking project, \$32.2 million on catalyst replacement, \$26.0 million on piping and tubing replacement and the remainder on various capital improvement projects.
- A new supply and offtake agreement ("SOA") was signed on October 11, 2011 with Macquarie Energy Canada Ltd. ("Macquarie") to supply feedstocks and purchase certain finished products from the Company effective November 1, 2011. The prior contract with Vitol Refining S.A. ("Vitol") terminated at the end of October 2011.

### Corporate

- During 2011, Harvest received a capital injection of \$505.4 million from KNOC to fund the asset acquisition from Hunt.
- On April 29, 2011, Harvest successfully extended the credit facility agreement by two years to April 30, 2015. The minimum rate charged on the credit facility also decreased by 25 bps to 175 bps over the bankers' acceptance rates.
- On December 16, 2011, the credit facility was further amended to increase the capacity of the facility from \$500.0 million to \$800.0 million and the minimum rate charged on the credit facility decreased from 175 bps to 160 bps over bankers' acceptance rates.

## UPSTREAM OPERATIONS

### Summary of Financial and Operating Results

	Three Months Ended December 31		Year Ended December 31	
	2011	2010	2011	2010
<b>FINANCIAL</b>				
Petroleum and natural gas sales <sup>(1)</sup>	363,628	258,013	1,286,866	1,007,004
Royalties	(56,038)	(38,102)	(195,452)	(154,757)
Revenues	307,590	219,911	1,091,414	852,247
<b>Expenses</b>				
Operating	96,425	69,649	350,456	265,593
Transportation and marketing	5,740	2,634	29,626	9,394
Realized (gains) losses on risk management contracts <sup>(2)</sup>	(2,085)	718	(6,000)	1,808
Operating netback after hedging <sup>(3)</sup>	207,510	146,910	717,332	575,452
General and administrative	17,844	11,440	60,804	45,303
Depreciation, depletion and amortization	149,345	118,183	535,692	470,641
Exploration and evaluation	7,003	11	18,289	3,300
Impairment of property, plant and equipment	-	13,661	-	13,661
Unrealized (gains) losses on risk management contracts <sup>(4)</sup>	3,466	(1,086)	(746)	(2,358)
Gains on disposition of property, plant and equipment	(7,138)	(129)	(7,883)	(741)
	36,990	4,830	111,176	45,646
Capital asset additions (excluding acquisitions)	179,634	147,890	733,380	403,848
Property and business acquisitions (dispositions), net	(7,971)	(797)	505,355	175,657
Abandonment and reclamation expenditures	9,938	6,444	22,110	20,257
<b>OPERATING</b>				
Light / medium oil (bbl/d)	26,106	24,079	24,380	24,077
Heavy oil (bbl/d)	9,521	9,433	8,992	9,253
Natural gas liquids (bbl/d)	5,440	2,736	5,062	2,587
Natural gas (mcf/d)	121,547	82,837	112,360	80,881
Total (boe/d)	61,324	50,054	57,161	49,397

(1) Inclusive of the effective portion of Harvest's realized crude oil hedges.

(2) Realized (gains) losses on risk management contracts include the settlement amounts for power derivative contracts and the ineffective portion of realized crude oil hedges.

(3) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

(4) Unrealized (gains) losses on risk management contracts reflect the change in fair value of the power derivative contracts and the ineffective portion of crude oil hedges.



## Commodity Price Environment

	Three Months Ended December 31			Year Ended December 31		
	2011	2010	Change	2011	2010	Change
West Texas Intermediate crude oil (US\$/bbl)	<b>94.06</b>	85.17	10%	<b>95.12</b>	79.53	20%
Edmonton light crude oil (\$/bbl)	<b>97.51</b>	80.40	21%	<b>95.18</b>	77.58	23%
Bow River blend crude oil (\$/bbl)	<b>87.04</b>	68.90	26%	<b>78.41</b>	68.25	15%
AECO natural gas daily (\$/mcf)	<b>3.17</b>	3.62	(12%)	<b>3.62</b>	4.00	(10%)
U.S. / Canadian dollar exchange rate	<b>0.977</b>	0.987	(1%)	<b>1.011</b>	0.971	4%
Differential Benchmarks						
Bow River blend differential to Edmonton Par (\$/bbl)	<b>10.47</b>	11.50	(9%)	<b>16.77</b>	9.33	80%
Bow River blend differential as a % of Edmonton Par	<b>10.7%</b>	14.3%	(25%)	<b>17.6%</b>	12.0%	47%

The average WTI benchmark price for the three months and year ended December 31, 2011 was 10% and 20% higher than the same periods in 2010, respectively. The average Edmonton light crude oil price ("Edmonton Par") increased in the fourth quarter as well as for the year ended December 31, 2011 due to the higher WTI prices and improvement of the light sweet differential, partially offset by the strengthening of the Canadian dollar on an annual average basis.

On an annual basis, the Bow River heavy oil differential relative to Edmonton Par widened in 2011 as compared to 2010; however, the differential decreased during the fourth quarter of 2011 and was narrower than in the fourth quarter of 2010. Heavy oil differentials fluctuate based on a combination of factors including the level of heavy oil inventories, pipeline capacity to deliver heavy crude to U.S. markets and the seasonal demand for heavy oil. The Bow River blend crude oil price ("Bow River") increased in 2011 with the higher WTI prices, and was partially offset by the stronger Canadian dollar and wider Bow River differential.

## Realized Commodity Prices

	Three Months Ended December 31			Year Ended December 31		
	2011	2010	Change	2011	2010	Change
Light to medium oil prior to hedging (\$/bbl)	<b>89.90</b>	73.44	22%	<b>85.67</b>	71.09	21%
Heavy oil (\$/bbl)	<b>79.28</b>	58.82	35%	<b>69.71</b>	59.94	16%
Natural gas liquids (\$/bbl)	<b>70.14</b>	60.69	16%	<b>67.92</b>	58.83	15%
Natural gas (\$/mcf)	<b>3.42</b>	3.81	(10%)	<b>3.83</b>	4.21	(9%)
Average realized price prior to hedging (\$/boe) <sup>(1)</sup>	<b>64.61</b>	56.03	15%	<b>62.13</b>	55.85	11%
Light to medium oil after hedging (\$/bbl) <sup>(2)</sup>	<b>89.52</b>	73.44	22%	<b>84.61</b>	71.09	19%
Average realized price after hedging (\$/boe) <sup>(1) (2)</sup>	<b>64.45</b>	56.03	15%	<b>61.68</b>	55.85	10%

(1) Inclusive of sulphur revenue

(2) Inclusive of the realized gains (losses) from crude oil contracts designated as hedges. Foreign exchange swaps and power contracts are excluded from the realized price.

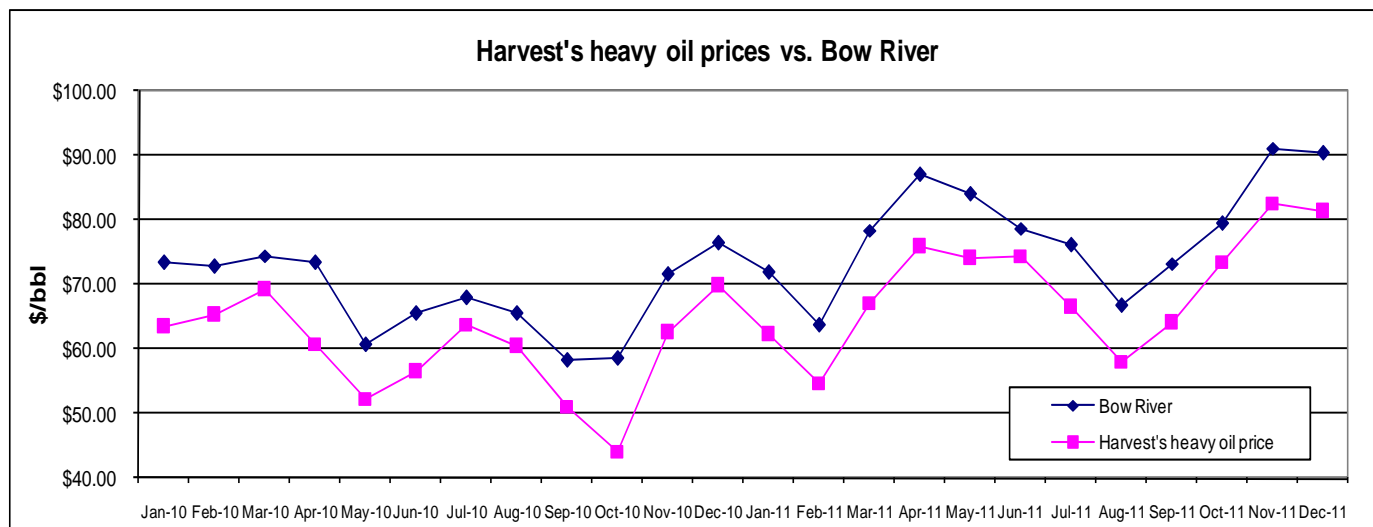
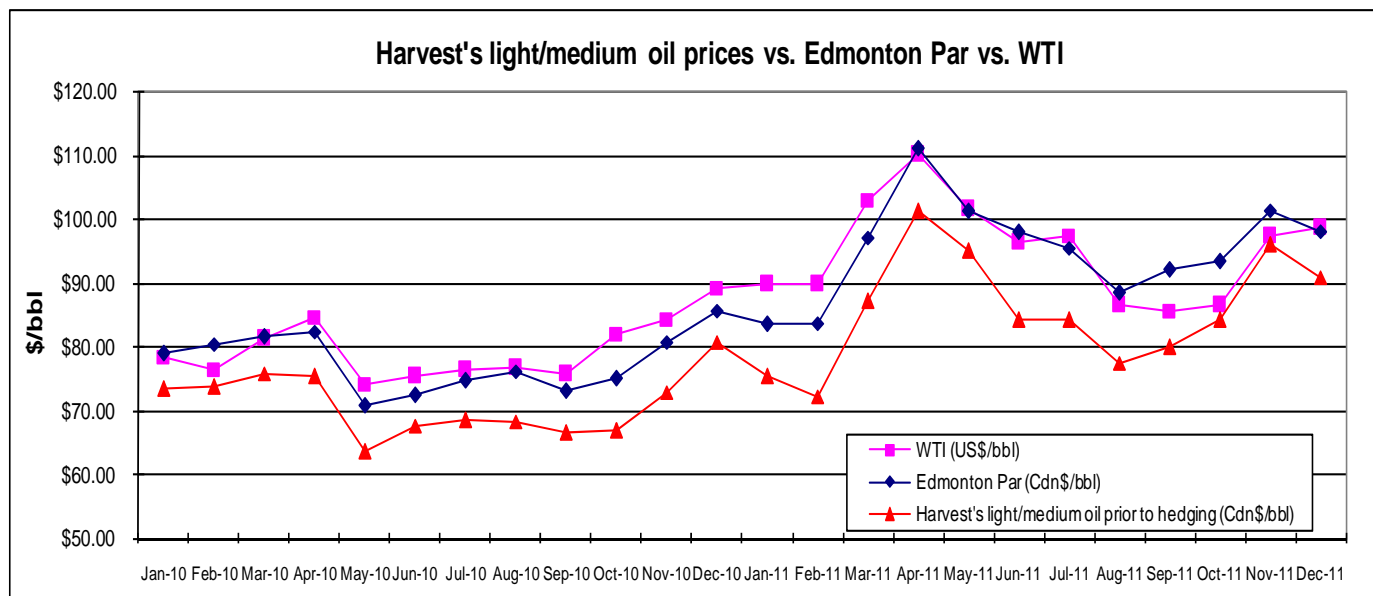
Prior to hedging activities, our realized prices for light to medium oil for the three months and year ended December 31, 2011 increased by 22% and 21%, respectively, compared to the same periods in 2010. This is consistent with the upward movement in Edmonton Par prices in 2011.

In order to manage commodity price volatility effects on cash flow, Harvest has entered into various crude oil fixed-for-floating swaps. The impact of this hedging activity resulted in a decrease of \$0.38/bbl (2010 - \$nil) in Harvest's realized light to medium oil price in the fourth quarter of 2011, and a decrease of \$1.06/bbl (2010 - \$nil) for the year ended December 31, 2011. Please see "Cash Flow Risk Management" section in this MD&A for further discussion with respect to our cash flow risk management program.

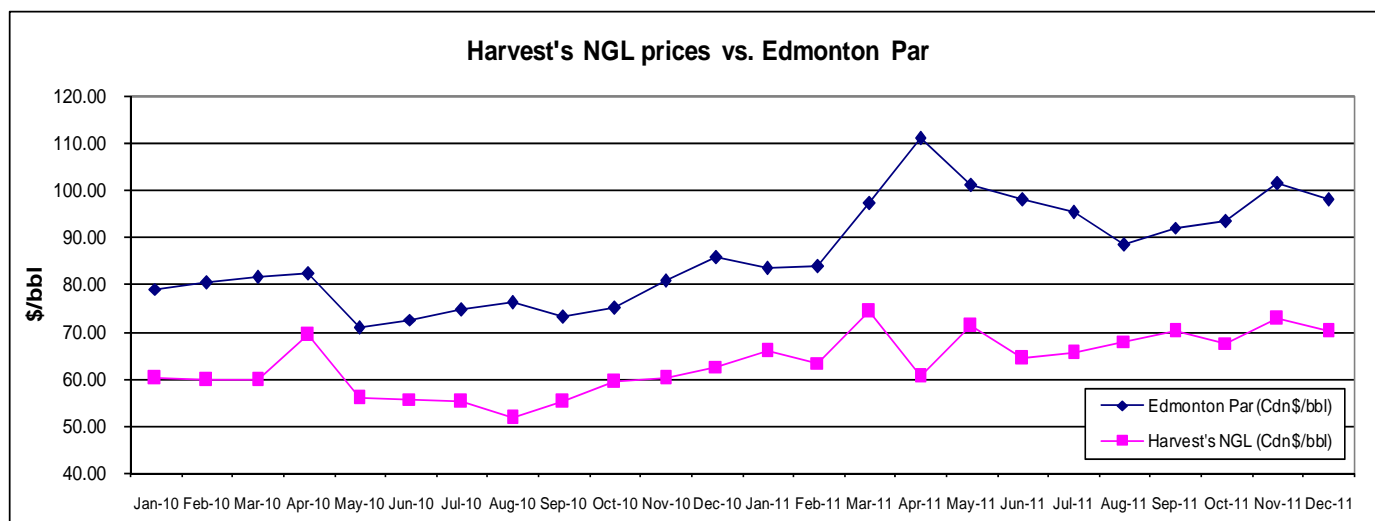
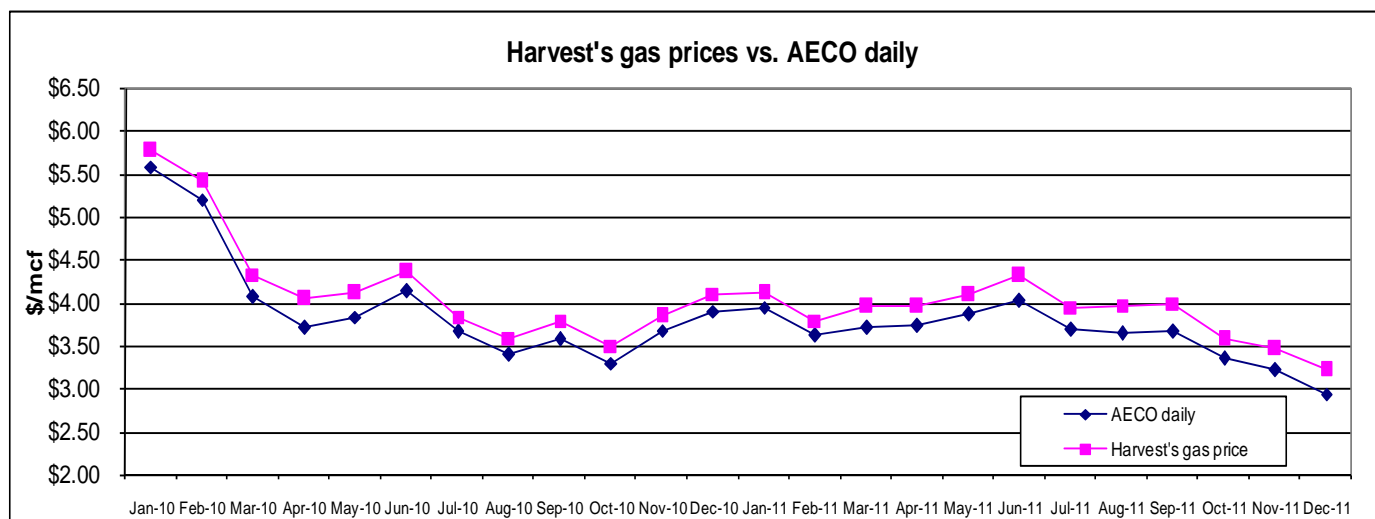
Harvest's realized heavy oil prices for the three months and year ended December 31, 2011 increased by 35% and 16%, respectively, mainly due to the increase in the Bow River prices.

For the three months and year ended December 31, 2011, our realized prices for natural gas liquids increased by 16% and 15%, respectively, reflecting the increase in natural gas liquids commodity prices.

The realized prices for Harvest's natural gas decreased by 10% in the fourth quarter of 2011 and 9% for the year of 2011, reflecting the downward movement in AECO benchmark prices.







## Sales Volumes

The average daily sales volumes by product were as follows:

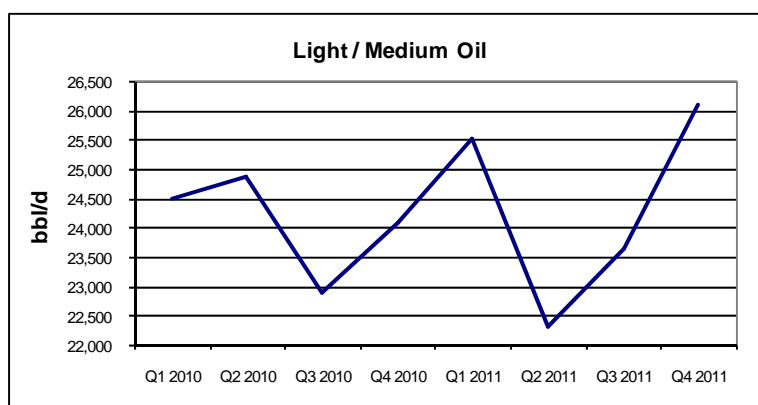
	Three months Ended December 31				
	2011		2010		% Volume Change
	Volume	Weighting	Volume	Weighting	
Light to medium oil (bbl/d) <sup>(1)</sup>	26,106	43%	24,079	48%	8%
Heavy oil (bbl/d)	9,521	16%	9,433	19%	1%
Natural gas liquids (bbl/d)	5,440	9%	2,736	5%	99%
Total liquids (bbl/d)	41,067	68%	36,248	72%	13%
Natural gas (mcf/d)	121,547	32%	82,837	28%	47%
Total oil equivalent (boe/d)	61,324	100%	50,054	100%	23%

(1) Harvest classifies our oil production, except that produced from Hay River, as light to medium and heavy according to NI 51-101 guidance. The oil produced from Hay River has an average API of 24° (medium grade) and is classified as a light to medium oil; notwithstanding that, it benefits from a heavy oil royalty regime and therefore would be classified as heavy oil according to NI 51-101.

	Year Ended December 31				
	2011		2010		% Volume Change
	Volume	Weighting	Volume	Weighting	
Light to medium oil (bbl/d) <sup>(1)</sup>	<b>24,380</b>	<b>43%</b>	24,077	49%	1%
Heavy oil (bbl/d)	<b>8,992</b>	<b>16%</b>	9,253	19%	-3%
Natural gas liquids (bbl/d)	<b>5,062</b>	<b>9%</b>	2,587	5%	96%
Total liquids (bbl/d)	<b>38,434</b>	<b>68%</b>	35,917	73%	7%
Natural gas (mcf/d)	<b>112,360</b>	<b>32%</b>	80,881	27%	39%
Total oil equivalent (boe/d)	<b>57,161</b>	<b>100%</b>	49,397	100%	16%

(1) Harvest classifies our oil production, except that produced from Hay River, as light to medium and heavy according to NI 51-101 guidance. The oil produced from Hay River has an average API of 24° (medium grade) and is classified as a light to medium oil; notwithstanding that, it benefits from a heavy oil royalty regime and therefore would be classified as heavy oil according to NI 51-101.

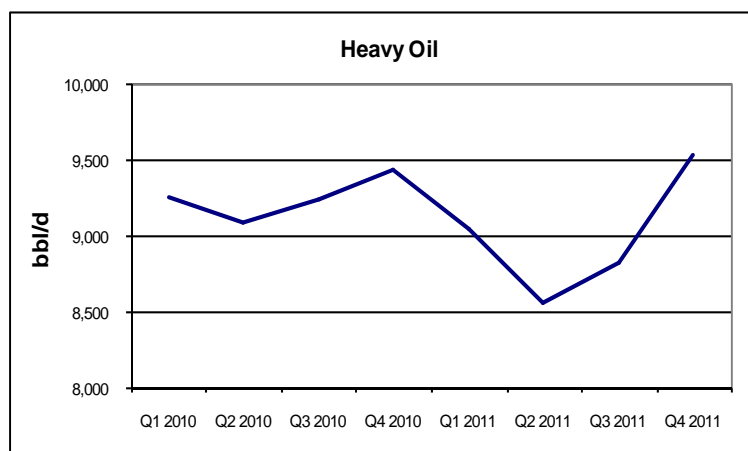
Total sales volumes were 61,324 boe/d for the fourth quarter of 2011 and 57,161 boe/d for the year ended December 31, 2011, an increase of 23% and 16% respectively, compared to the same periods in 2010. These increases were primarily attributable to the acquisition of the Hunt assets at the end of February 2011.

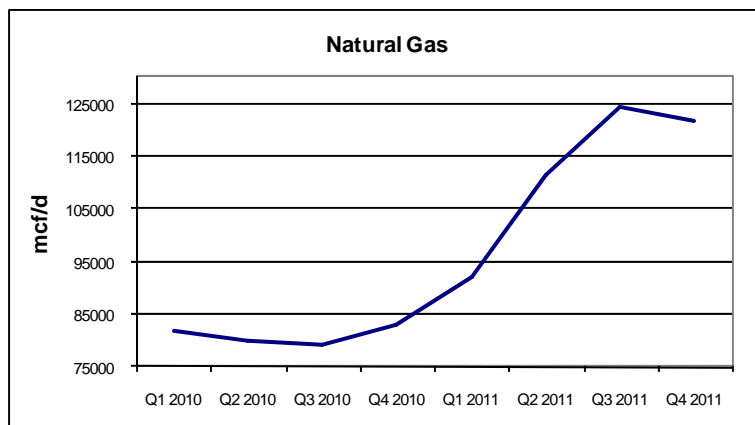


In the fourth quarter of 2011, Harvest's average daily sales of light/medium oil were 26,106 bbl/d, reflecting an increase of 8% from the same quarter in 2010. The increase was primarily due to the acquisition of the Hunt assets in the first quarter of 2011.

Harvest's year-to-date light/medium oil sales increased by 1% from 2010 to 24,380 bbl/d. The increase reflects a full year of production from assets acquired in the third quarter of 2010 as well as ten months of production from assets acquired from Hunt in 2011. Sales in 2011 were negatively impacted by the Plains Rainbow Pipeline outage, fires at Red Earth and flooding in southeast Saskatchewan during the summer of 2011.

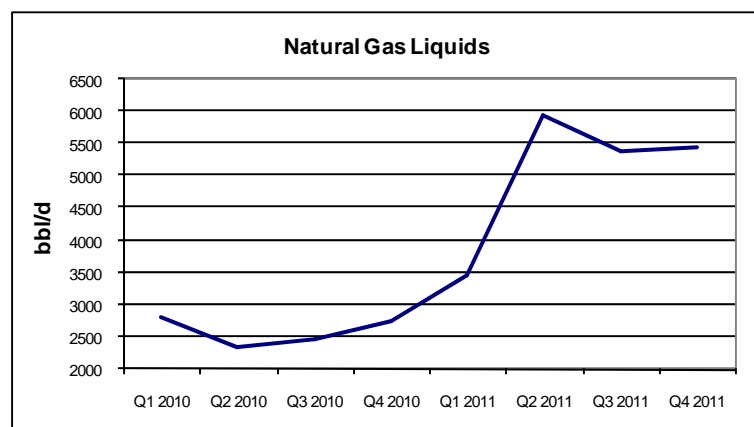
Heavy oil sales for the fourth quarter of 2011 remained consistent with the same quarter in 2010 but decreased by 3% for the year ended December 31, 2011 compared to 2010. The decrease was primarily due to natural declines and minor production interruptions during the first and second quarter of 2011, partially offset by production increases resulting from Harvest's capital program.





Natural gas sales averaged 121,547 mcf/d during the fourth quarter of 2011 reflecting a 38,710 mcf/d (47%) increase from the fourth quarter of 2010. For the year ended December 31, 2011, natural gas sales increased by 31,479 mcf/d (39%), compared to 2010. These increases were mainly due to the acquisition of the Hunt assets at the end of February 2011.

Natural gas liquids sales for the three months and year ended December 31, 2011 increased by 99% and 96% respectively, compared to the same periods in 2010. Similar to the increases in natural gas sales volumes, these increases were mainly due to the acquisition of the Hunt assets at the end of February 2011.



## Revenues

	Three Months Ended December 31			Year Ended December 31		
	2011	2010	Change	2011	2010	Change
Light / medium oil sales after hedging <sup>(1)</sup>	214,994	162,685	32%	752,898	624,778	21%
Heavy oil sales	69,444	51,048	36%	228,794	202,445	13%
Natural gas sales	38,226	29,003	32%	156,942	124,226	26%
Natural gas liquids sales	35,103	15,239	130%	125,507	55,385	127%
Other <sup>(2)</sup>	5,861	38	100%	22,725	170	100%
Petroleum and natural gas sales	363,628	258,013	41%	1,286,866	1,007,004	28%
Royalties	(56,038)	(38,102)	47%	(195,452)	(154,757)	26%
<b>Revenues</b>	<b>307,590</b>	<b>219,911</b>	<b>40%</b>	<b>1,091,414</b>	<b>852,247</b>	<b>28%</b>

(1) Inclusive of the effective portion of realized gains (losses) from crude oil contracts designated as hedges.

(2) Inclusive of sulphur revenue and miscellaneous income.

Harvest's revenue is subject to changes in sales volumes, commodity prices and currency exchange rates. In the fourth quarter of 2011, total petroleum and natural gas sales increased by \$105.6 million, compared to the fourth quarter of 2010, mainly due to the increase in sales volumes and realized prices for oil and natural gas liquids. For the year ended December 31, 2011, total petroleum and natural gas sales increased by \$279.9 million. The 28% increase in annual revenues is attributable to the 10% increase in realized prices after hedging activities, the 16% increase in sales volumes and the increase in sulphur revenue from the acquired Hunt assets. Sulphur revenue represented \$21.3 million (2010 - \$0.2 million) of the total in other revenues for the year ended December 31, 2011.

### Royalties

Harvest pays Crown, freehold and overriding royalties to the owners of mineral rights from which production is generated. These royalties vary for each property and product and our Crown royalties are based on a sliding scale dependent on production volumes and commodity prices.

Royalties as a percentage of gross revenue for the fourth quarter of 2011 were 15.4% as compared to 14.8% in the same quarter of 2010. The increase is mainly due to the higher oil prices in the fourth quarter of 2011. The annual royalties as a percentage of gross revenue for 2011 were 15.2%, slightly below the 2010 percentage of 15.4%.

### Operating and Transportation Expenses

	Three Months Ended December 31				
	2011	\$/boe	2010	\$/boe	\$/boe Change
Power and purchased energy	22,087	3.91	15,412	3.35	0.56
Well servicing	17,606	3.12	13,366	2.90	0.22
Repairs and maintenance	17,476	3.10	10,932	2.37	0.73
Lease rentals and property tax	9,704	1.72	7,233	1.57	0.15
Labor - internal	6,843	1.21	5,419	1.18	0.03
Labor - contract	5,173	0.92	4,146	0.90	0.02
Chemicals	3,941	0.70	2,636	0.57	0.13
Trucking	3,793	0.67	2,535	0.55	0.12
Processing and other fees	9,825	1.74	2,902	0.63	1.11
Other	(23)	-	5,068	1.10	(1.10)
Total operating expenses	96,425	17.09	69,649	15.12	1.97
Transportation and marketing	5,740	1.02	2,634	0.57	0.45

	Year Ended December 31				
	2011	\$/boe	2010	\$/boe	\$/boe Change
Power and purchased energy	83,092	3.98	59,106	3.28	0.70
Well servicing	61,592	2.95	50,427	2.80	0.15
Repairs and maintenance	60,038	2.88	43,720	2.42	0.46
Lease rentals and property tax	34,728	1.66	30,637	1.70	(0.04)
Labor - internal	28,137	1.35	22,641	1.26	0.09
Labor - contract	19,378	0.93	15,966	0.89	0.04
Chemicals	15,360	0.74	12,981	0.72	0.02
Trucking	13,261	0.64	9,645	0.53	0.11
Processing and other fees	22,643	1.09	13,538	0.75	0.34
Other	12,227	0.58	6,932	0.38	0.20
Total operating expenses	350,456	16.80	265,593	14.73	2.07
Transportation and marketing	29,626	1.42	9,394	0.52	0.90

Operating expenses for the fourth quarter of 2011 totaled \$96.4 million, an increase of \$26.8 million compared to the same quarter in 2010. The increase in operating expenses is attributable to the acquisition of assets in the first quarter of 2011 combined with increased repairs and maintenance activities and power and purchased energy costs. Operating expenses on a per barrel basis increased to \$17.09/boe as compared to \$15.12/boe in the fourth quarter of 2010. The 13% increase on a per barrel basis is substantially attributed to higher processing and other fees, repairs and maintenance, power and purchased energy and well servicing costs.

On a year-to-date basis, operating expenses for 2011 totaled \$350.5 million, an increase of \$84.9 million when compared to 2010, mainly due to acquisition of assets in 2011 and higher power and purchased energy, repairs and maintenance, and well servicing costs. On a per barrel basis, year-to-date operating expenses increased by \$2.07/boe (14%) which is mainly attributable to higher power and purchased energy, repairs and maintenance, and processing costs.

(\$/boe)	Three Months Ended December 31			Year Ended December 31		
	2011	2010	Change	2011	2010	Change
Power and purchased energy costs	<b>3.91</b>	3.35	0.56	<b>3.98</b>	3.28	0.70
Realized (gains) losses on electricity risk management contracts	<b>(0.34)</b>	0.16	(0.50)	<b>(0.37)</b>	0.10	(0.47)
Net power and purchased energy costs	<b>3.57</b>	3.51	0.06	<b>3.61</b>	3.38	0.23
Alberta Power Pool electricity price (\$/MWh)	<b>76.42</b>	45.97	30.45	<b>76.65</b>	50.78	25.87

Power and purchased energy costs, comprised primarily of electric power costs, represented approximately 24% (2010 – 22%) of our total operating expenses for the year ended December 31, 2011. The 43% increase from the fourth quarter of 2010 is mainly attributable to the higher Alberta electricity price. The power and purchased energy costs for the year ended December 31, 2011 totaled \$83.1 million, an increase of 41% compared to 2010, mainly attributable to the higher average Alberta electricity price of \$76.65/MWh for the year (2010 - \$50.78/MWh).

Transportation and marketing expenses relate primarily to delivery of natural gas to Alberta's natural gas sales hub, the AECO Storage Hub, and the cost of trucking clean crude oil to pipeline receipt points. As a result, the total dollar amount of costs generally fluctuates in relation to our sales volumes. Transportation and marketing expenses increased by \$0.45/boe or \$3.1 million in the fourth quarter of 2011 compared to the fourth quarter of 2010, primarily due to the acquisition of assets in the first quarter of 2011. The \$0.90/boe or \$20.2 million year-to-date increase is mainly due to Harvest incurring higher oil trucking costs at Hay River and Red Earth in response to the outage of the Plains Rainbow Pipeline during the summer of 2011 combined with the 2011 acquisition of assets.

#### Operating Netback<sup>(1)</sup>

(\$/boe)	Three Months Ended December 31			Year Ended December 31		
	2011	2010	\$/boe Change	2011	2010	\$/boe Change
Petroleum and natural gas sales prior to hedging	<b>64.61</b>	56.03	8.58	<b>62.13</b>	55.85	6.28
Royalties	<b>(9.93)</b>	(8.27)	(1.66)	<b>(9.37)</b>	(8.58)	(0.79)
Operating expenses	<b>(17.09)</b>	(15.12)	(1.97)	<b>(16.80)</b>	(14.73)	(2.07)
Transportation expenses	<b>(1.02)</b>	(0.57)	(0.45)	<b>(1.42)</b>	(0.52)	(0.90)
Operating netback prior to hedging <sup>(1)</sup>	<b>36.57</b>	32.07	4.50	<b>34.54</b>	32.02	2.52
Hedging gains (losses) <sup>(2)</sup>	<b>0.21</b>	(0.16)	0.37	<b>(0.16)</b>	(0.10)	(0.06)
Operating netback after hedging <sup>(1)</sup>	<b>36.78</b>	31.91	4.87	<b>34.38</b>	31.92	2.46

(1) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

(2) Hedging gains (losses) include the settlement amounts for crude oil and power contracts.

Harvest's operating netback represents the net amount realized on a per boe basis after deducting directly related costs. In the fourth quarter of 2011, our operating netback prior to hedging increased by \$4.50/boe or 14% compared to 2010. On an annual basis, our 2011 operating netback prior to hedging increased by \$2.52/boe or 8% over 2010. The increase is primarily attributable to increases in realized commodity prices, partially offset by increases in royalties, operating expenses and transportation expenses.

#### General and Administrative ("G&A") Expense

	Three Months Ended December 31		Year Ended December 31	
	2011	2010	2011	2010
G&A expenses	<b>17,844</b>	11,440	<b>60,804</b>	45,303
G&A per boe (\$/boe)	<b>3.16</b>	2.48	<b>2.91</b>	2.51

For the fourth quarter of 2011, G&A expenses increased by \$6.4 million (56%) compared to the same period in the prior year. For 2011, G&A expenses increased by 34% compared to 2010. The increase in G&A is primarily due to increased salary expense, partially resulting from the acquisition of assets in 2011. Approximately 90% of the G&A expenses are related to salaries and other employee

related costs. Harvest does not have a stock option program, however there is a long-term incentive program, which is a cash settled plan that has been included in the G&A expense.

### Depletion, Depreciation and Amortization ("DD&A") Expense

	Three Months Ended December 31		Year Ended December 31	
	2011	2010	2011	2010
DD&A	149,345	118,183	535,692	470,641
DD&A per boe (\$/boe)	26.47	25.66	25.68	26.10

DD&A expenses for the three months and year ended December 31, 2011 increased by \$31.2 million and \$65.1 million respectively, compared to 2010, mainly due to higher sales volumes.

### Capital Asset Additions

	Three Months Ended December 31		Year Ended December 31	
	2011	2010	2011	2010
Drilling and completion	98,609	85,280	386,454	222,964
Well equipment, pipelines and facilities	46,002	35,756	195,062	107,933
Geological and geophysical	480	874	15,694	12,719
Land and undeveloped lease rentals	751	6,954	17,959	23,388
Corporate	160	1,508	2,218	1,935
Other	2,832	78	14,753	13,853
Total additions before BlackGold	148,834	130,450	632,140	382,792
BlackGold oil sands ("BlackGold")				
Drilling and completion	8,194	70	23,443	70
Well equipment, pipelines and facilities	19,607	15,146	70,146	18,299
Geological and geophysical	8	445	135	445
Other	2,991	1,779	7,516	2,242
Total BlackGold additions	30,800	17,440	101,240	21,056
Total additions excluding acquisitions	179,634	147,890	733,380	403,848

Below is a summary of the wells drilled by Harvest and the related drilling and completion expenditures in 2011. Harvest's overall success ratio for 2011 was approximately 98%.

Area	December 31, 2011					
	Three Months Ended			Year Ended		
	Gross	Net	\$	Gross	Net	\$
Hay River	6.0	6.0	\$16,869	44.0	44.0	\$55,720
Red Earth	9.0	8.2	22,004	38.0	34.8	98,642
Rimbey/Markerville/West Central	11.0	7.3	22,593	39.0	21.5	74,139
Lloydminster Heavy Oil/Hayter/Murray Lake	2.0	2.0	1,677	35.0	32.5	23,197
Kindersley	9.0	8.8	9,183	30.0	28.1	39,057
SE Saskatchewan	1.0	1.0	2,419	13.0	13.0	17,049
Suffield	-	-	-	9.0	9.0	9,550
Peace Arch	-	-	-	8.0	3.1	7,331
Deep Basin	3.0	1.5	12,876	5.0	3.0	26,714
Other areas	7.0	4.6	10,988	18.0	13.3	35,055
Total before BlackGold	48.0	39.4	\$98,609	239.0	202.3	\$386,454
BlackGold oil sands	-	-	8,194	12.0	12.0	23,443
Total	48.0	39.4	\$106,803	251.0	214.3	\$409,897



During 2011, Harvest drilled a total of 251 gross (214.3 net) wells (2010 – 171 gross; 141.4 net wells) with an overall success ratio of 98%. Of the total wells drilled in 2011, Harvest drilled 180 gross (160.5 net) oil wells, 37 gross (21.0 net) gas wells, 30 gross (29.8 net) service wells and 4 gross (3.0 net) dry and abandoned wells. Capital asset additions, excluding BlackGold oil sands, for the year totaled \$632.1 million (2010 - \$382.8 million). The increase in additions compared to 2010 is mainly due to a more active drilling program in the Company's large resource oil pools as well as drilling on new lands acquired from Hunt in 2011. In addition, Harvest spent approximately \$80.2 million to equip and tie-in wells, \$8.3 million to build a compressor station in Crossfield and \$3.1 million to build a new trucking terminal in the Hay River area.

In Hay River, Harvest drilled 44 gross wells pursuing medium gravity oil in the Bluesky formation. At Red Earth, Harvest drilled 38 gross wells including 30 gross horizontal wells into the Slave Point light oil formation using multi-stage fracturing technology. Other active oil drilling areas included Kindersley and southeast Saskatchewan where 43 gross wells were drilled. In the Peace Arch area, Harvest drilled 8 gross wells mainly targeting the oil bearing formation with stage stimulated horizontal wells. The Company's heavy oil drilling program included 44 gross wells in the Lloydminster, Suffield, Hayter and Murray Lake areas. Harvest also drilled 5 gross liquids rich gas wells in the Falher formation in the Deep Basin area. In Rimbey, Markerville and West Central, Harvest drilled 39 gross gas wells pursuing a variety of formations with the Glauconitic formation in the Hoadley trend being the most dominated play.

Harvest also invested in Enhanced Oil Recovery ("EOR") projects using polymer flooding technology during the year with focus in the Wainwright and Suffield areas. We expect our 2012 production to increase in these areas as a result of the polymer injection.

The fourth quarter of 2011 was more active for Harvest when compared to the same quarter in 2010. Total capital asset additions, excluding BlackGold, for the three months ended December 31, 2011 was \$148.8 million, an increase of \$18.4 million from the same period in 2010. Spending was up in drilling and well equipment as Harvest accelerated its 2012 winter drilling program for Hay River and Red Earth. Harvest also continued to equip and tie-in wells drilled in the third quarter of 2011.

During the fourth quarter of 2011, Harvest drilled 48 gross (39.4 net) horizontal and vertical wells with an overall success ratio of 98%. Of the wells drilled in the fourth quarter, Harvest drilled 33 gross (30.2 net) oil wells, 14 gross (8.2 net) gas wells and 1 gross (1.0 net) dry and abandoned well. Harvest was most active drilling high netback light oil stage stimulated horizontal wells in the Red Earth and Kindersley areas. A total of 18 gross wells were drilled in Red Earth and Kindersley. Other active oil drilling areas included Lloydminster, southeast Saskatchewan, Cecil, and Hay River where we drilled 12 gross horizontal wells. During the fourth quarter, Harvest also drilled 13 gross liquids rich gas wells and 1 gross dry and abandoned well in the Deep Basin and Rimbey areas.

#### BlackGold oil sands

The BlackGold oil sands project continued to progress through 2011. During the fourth quarter of 2011, Harvest began drilling the surface holes for the first steam assisted gravity drainage ("SAGD") well pairs which are expected to be finished in early 2012. In 2011, Harvest invested a total of \$101.2 million (2010 - \$21.1 million) in the BlackGold oil sands project for engineering and procurement and drilling of 12 observation wells as well as the construction of the central processing facility and well pads.

#### **Decommissioning Liabilities**

Harvest's Upstream decommissioning liabilities at December 31, 2011 were \$672.7 million (2010 - \$652.6 million) for future remediation, abandonment, and reclamation of Harvest's oil and gas properties. The increase of \$20.1 million during 2011 was a result of \$38.0 million of liabilities acquired from Hunt, new liabilities of \$28.4 million incurred on new drills, accretion of \$23.2 million, partially offset by a revision of estimates of \$46.6 million and \$22.1 million of reclamation and abandonment expenditures. The total of our decommissioning liabilities are based on management's best estimate of costs to remediate, reclaim, and abandon our wells and facilities. The costs will be incurred over the operating lives of the assets with the majority being at or after the end of reserve life. Please refer to the "Contractual Obligations and Commitments" section of this MD&A for the payments due for each of the next five years and thereafter in respect of our decommissioning liabilities.

#### **Goodwill**

Goodwill is recorded when the purchase price of an acquired business exceeds the fair value of the net identifiable assets and liabilities of that acquired business. At December 31, 2011, Harvest had \$404.9 million (2010 - \$404.9 million) of goodwill on the balance sheet related to the Upstream segment. The goodwill balance is assessed annually for impairment or more frequently if events or changes in circumstances occur that would reasonably be expected to reduce the fair value of the acquired business to a level below its carrying amount. Management has assessed goodwill for impairment and determined that there is no impairment at December 31, 2011.



## DOWNSTREAM OPERATIONS

### Summary of Financial and Operational Results

	Three Months Ended December 31		Year Ended December 31	
	2011	2010	2011	2010
<b>FINANCIAL</b>				
Refined products sales <sup>(1)</sup>	1,154,945	1,081,437	3,239,455	3,105,957
Purchased products for processing and resale <sup>(1)</sup>	1,169,360	1,005,653	3,055,236	2,893,805
Gross margin (loss) <sup>(2)</sup>	(14,415)	75,784	184,219	212,152
<b>Expenses</b>				
Operating	32,517	27,313	108,400	109,514
Power and purchased energy	49,515	40,504	117,275	106,126
Marketing	1,064	1,544	6,293	6,366
General and administrative	441	441	1,764	1,764
Depreciation and amortization	26,798	20,553	91,006	83,091
Operating loss <sup>(2)</sup>	(124,750)	(14,571)	(140,519)	(94,709)
Capital asset additions	37,532	32,591	284,244	71,234
<b>OPERATING</b>				
Feedstock volume (bbl/d) <sup>(3)</sup>	88,824	111,317	66,417	86,142
Yield (% of throughput volume) <sup>(4)</sup>				
Gasoline and related products	33%	35%	32%	31%
Ultra low sulphur diesel and jet fuel	44%	39%	41%	36%
High sulphur fuel oil	23%	26%	25%	31%
Total	100%	100%	98%	98%
Average refining gross margin (loss) (US\$/bbl) <sup>(5)</sup>	(4.14)	6.13	5.28	5.13

(1) Refined product sales and purchased products for processing and resale are net of intra-segment sales of \$144.8 million and \$507.8 million for the three and twelve months ended December 31, 2011, respectively (2010 - \$118.7 million and \$443.6 million), reflecting the refined products produced by the refinery and sold by the marketing division.

(2) These are non-GAAP measures; please refer to "Non-GAAP Measures" in this MD&A.

(3) Barrels per day are calculated using total barrels of crude oil feedstock and vacuum gas oil.

(4) Based on production volumes after adjusting for changes in inventory held for resale.

(5) Average refining gross margin is calculated based on per barrel of feedstock throughput.

### Refining Benchmark Prices

	Three Months Ended December 31			Year Ended December 31		
	2011	2010	Change	2011	2010	Change
WTI crude oil (US\$/bbl)	94.06	85.17	10%	95.12	79.53	20%
Brent crude oil (US\$/bbl)	109.08	87.32	25%	110.89	80.40	38%
Mars premium (discount) (US\$/bbl)	12.76	(0.96)	1429%	12.39	(1.40)	985%
RBOB crack spread (US\$/bbl)	16.03	8.00	100%	23.40	9.58	144%
Heating Oil crack spread (US\$/bbl)	30.96	13.98	121%	29.03	10.50	176%
High Sulphur Fuel Oil premium (discount) (US\$/bbl)	4.53	(11.25)	140%	1.75	(8.96)	120%
U.S. / Canadian dollar exchange rate	0.977	0.987	(1%)	1.011	0.971	4%

## Summary of Gross Margins

Three Months Ended December 31						
	2011			2010		
	Volumes (bbls)	(US\$/bbl)		Volumes (bbls)	(US\$/bbl)	
<b>Refinery</b>						
<b>Sales</b>						
Gasoline products	355,840	3,160	110.02	384,268	4,037	93.95
Distillates	500,560	3,868	126.43	436,703	4,330	99.54
High sulphur fuel oil	251,006	2,504	97.94	226,922	3,084	72.62
Total sales	1,107,406	9,532	113.51	1,047,893	11,451	90.32
<b>Feedstock<sup>(1)</sup></b>						
Middle Eastern	701,068	5,777	118.56	607,721	7,019	85.46
Russian	176,935	1,446	119.55	211,780	2,453	85.21
South American	-	-	-	33,867	423	79.02
	878,003	7,223	118.76	853,368	9,895	85.12
Vacuum Gas Oil ("VGO")	125,109	949	128.8	31,367	347	89.22
Total feedstock	1,003,112	8,172	119.93	884,735	10,242	85.26
Other <sup>(2)</sup>	138,958			99,575		
Total feedstock and other costs	1,142,070			984,310		
<b>Refinery gross margin (loss)<sup>(3)</sup></b>	<b>(34,664)</b>	<b>(4.14)</b>		63,583		6.13
<b>Marketing</b>						
Sales	192,368			152,195		
Cost of products sold	172,119			139,994		
<b>Marketing gross margin<sup>(3)</sup></b>	<b>20,249</b>			12,201		
<b>Total gross margin (loss)<sup>(3)</sup></b>	<b>(14,415)</b>			75,784		

Year Ended December 31						
	2011			2010		
	Volumes (bbls)	(US\$/bbl)		Volumes (bbls)	(US\$/bbl)	
<b>Refinery</b>						
<b>Sales</b>						
Gasoline products	1,055,020	9,309	114.58	985,737	10,838	88.31
Distillates	1,385,985	11,073	126.54	1,251,160	13,188	92.12
High sulphur fuel oil	628,518	6,679	95.14	744,628	10,195	70.92
Total sales	3,069,523	27,061	114.68	2,981,525	34,221	84.6
<b>Feedstock<sup>(1)</sup></b>						
Middle Eastern	2,172,600	20,938	104.9	1,713,780	21,456	77.56
Russian	178,246	1,460	123.43	485,884	5,884	80.18
South American	-	-	-	211,318	2,978	68.9
	2,350,846	22,398	106.11	2,410,982	30,318	77.22
Vacuum Gas Oil ("VGO")	220,656	1,844	120.98	95,519	1,124	82.52
Total feedstock	2,571,502	24,242	107.24	2,506,501	31,442	77.41
Other <sup>(2)</sup>	371,463			308,928		
Total feedstock and other costs	2,942,965			2,815,429		
<b>Refinery gross margin<sup>(3)</sup></b>	<b>126,558</b>	<b>5.28</b>		166,096		5.13
<b>Marketing</b>						
Sales	677,738			568,001		
Cost of products sold	620,077			521,945		
<b>Marketing gross margin<sup>(3)</sup></b>	<b>57,661</b>			46,056		
<b>Total gross margin<sup>(3)</sup></b>	<b>184,219</b>			212,152		

(1) Cost of feedstock includes all costs of transporting the crude oil to the refinery in Newfoundland.

(2) Includes inventory adjustments, additives and blendstocks and purchase of product for local sales

(3) This is a non-GAAP measure; please refer to "Non-GAAP Measures" in this MD&A.

Feedstock throughput averaged 88,824 bbl/d in the fourth quarter of 2011, a decrease of 20% from 111,317 bbl/d in the fourth quarter of the prior year, reflecting the strategic decision to reduce rates in light of declining refining margins. The daily average throughput rate for the year ended December 31, 2011 is 23% lower than the prior year as a consequence of an extended planned maintenance shutdown in 2011, the pre-start-up and commissioning of the new heat exchangers for the platformer and naphtha hydrotreater units and a reduction in throughput rates in the fourth quarter of 2011 due to declining refining margins.

The Downstream operations' refining gross margin is impacted by several factors including the configuration of the refinery product yields, timing of sales under the SOA, transportation costs, location differentials, quality differentials and variability in throughput volume over a given period of time. Product pricing under the SOA is based primarily on New York Harbour reference prices whereas feedstock costs are determined by crude oil reference prices and feedstock crude quality.

Refinery sales increased by \$59.5 million in the fourth quarter of 2011 from \$1,047.9 million in the same quarter of 2010 and increased \$88.0 million for the year ended December 31, 2011 as compared to the prior year mainly as a result of higher market prices on refined products that have been partially offset by lower sales volumes.

The cost of our feedstock in the fourth quarter of 2011 was a US\$25.87/bbl premium to the benchmark WTI as compared to a premium of US\$0.09/bbl in the same period of the prior year. Similarly, the cost of feedstock for the year ended December 31, 2011 was a US\$12.12/bbl premium to the benchmark WTI as compared to a discount of US\$2.12/bbl in 2010. The change from a discount to a premium in 2011 is a result of the wide spread between WTI and Brent.

The decrease in the refinery gross margin of \$98.2 million for the three months ended December 31, 2011 as compared to the prior year reflects lower throughput volumes and the negative impact of the high cost of crude oil at a time when product prices were falling. For the year ended December 31, 2011, refinery gross margin decreased by 24% as compared to the prior year mainly as a result of the fourth quarter negative refining margins.

The relatively strong Canadian dollar in 2011 has also reduced the contribution from our refinery operations as compared to the prior year as substantially all of the gross margin, cost of purchased energy and marketing expense are transacted in U.S. dollars.

The gross margin from the marketing operations is comprised of the margin from both the retail and wholesale distribution of gasoline and home heating fuels as well as the revenues from marine services including tugboat revenues, and for 2011, the inclusion of the US\$10 million settlement from the business interruption claim relating to the fire in the first quarter of 2010.

## Operating Expenses

	Three Months Ended December 31					
	2011			2010		
	Refining	Marketing	Total	Refining	Marketing	Total
Operating cost	26,634	5,883	32,517	22,965	4,348	27,313
Power and purchased energy	49,515	-	49,515	40,504	-	40,504
	76,149	5,883	82,032	63,469	4,348	67,817
(\$/bbl of feedstock throughput)						
Operating cost	3.26	-	-	2.24	-	-
Power and purchased energy	6.06	-	-	3.96	-	-
	9.32	-	-	6.2	-	-

	Year Ended December 31					
	2011			2010		
	Refining	Marketing	Total	Refining	Marketing	Total
Operating cost	88,424	19,976	108,400	92,655	16,859	109,514
Power and purchased energy	117,275	-	117,275	106,126	-	106,126
	205,699	19,976	225,675	198,781	16,859	215,640
(\$/bbl of feedstock throughput)						
Operating cost	3.65	-	-	2.95	-	-
Power and purchased energy	4.84	-	-	3.37	-	-
	8.49	-	-	6.32	-	-

The refining operating cost per barrel of feedstock throughput increased by 46% and 24% for the three months and year ended December 31, 2011 respectively, as compared to the same periods in the prior year, reflecting lower throughput volumes in 2011. Power and purchased energy, consisting of low sulphur fuel oil ("LSFO") and electricity, is required to provide heat and power to refinery operations. The power and purchased energy cost per barrel of feedstock throughput increased by 53% from the fourth quarter of 2010 and 44% from the year ended December 31, 2010. The increase in costs is mainly the result of higher prices in 2011, and is partially offset by lower consumption due to lower feedstock throughput.

### Capital Asset Additions

Capital asset additions for the three months and year ended December 31, 2011 totaled \$37.5 million and \$284.2 million, respectively (2010 - \$32.6 million and \$71.2 million), relating to various capital improvement projects including \$8.6 million and \$62.6 million, respectively (2010 - \$16.2 million and \$38.1 million), for the debottlenecking project. Other additions in 2011 include turnaround costs of \$102.4 million, catalyst replacement of \$32.2 million, tubing and piping replacement of \$26.0 million and other significant capital work completed during the turnaround period.

### Depreciation and Amortization Expense

	Three Months Ended December 31		Year Ended December 31	
	2011	2010	2011	2010
Refining	25,952	19,674	87,346	79,615
Marketing	846	879	3,660	3,476
Total depreciation and amortization	26,798	20,553	91,006	83,091

The process units are amortized over an average useful life of 20 to 30 years and turnaround costs are amortized to the next scheduled turnaround. The increase in refining depreciation in 2011 as compared to 2010 is a consequence of the increased capital and turnaround expenditures completed during the year.

### Decommissioning Liabilities

Harvest's Downstream decommissioning liabilities result from our ownership of the refinery and marketing assets. At December 31, 2011, Harvest's Downstream decommissioning liabilities were \$14.6 million (2010 - \$10.4 million), relating to the reclamation and abandonment of these assets with an expected abandonment date of 2069.

## RISK MANAGEMENT, FINANCING AND OTHER

### Cash Flow Risk Management

The Company enters into crude oil and foreign exchange contracts to reduce the volatility of cash flows from some of its forecast sales. Harvest designates all of its crude oil derivative contracts and certain foreign exchange contracts as cash flow hedges, which are entered into for periods consistent with the forecast petroleum sales. Harvest also enters into electricity price swap contracts to manage some of its price risk exposures. These swap contracts are not designated as hedges and are entered into for periods consistent with forecast electricity purchases. The following is a summary of Harvest's risk management contracts outstanding at December 31, 2011:

Contracts Designated as Hedges				
Contract Quantity	Type of Contract	Term	Contract Price	Fair Value
4,200 bbls/day	Crude oil price swap	2012	US \$111.37/bbl	\$19,718
US \$468/day	Foreign exchange swap	2012	\$1.0236 Cdn/US	444
Total				\$20,162

Any gains and losses recognized on risk management contracts are generally recorded in net income except for when hedge accounting is applied. When risk management contracts qualify for hedge accounting, the fair value of the hedges is recorded in risk management contracts assets or liabilities. The changes in the fair value are reported in other comprehensive income ("OCI") until the settlement of the contracts, except for the ineffective portion of the changes which is reported in net income. Upon settlement of the contracts, the gains or losses previously reported in OCI are reclassified to net income.

The following is a summary of Harvest's realized and unrealized (gains) losses on risk management contracts:

Three Months Ended December 31						
	2011			2010		
	Power	Currency	Total	Power	Currency	Total
<b>Contracts not designated as hedges</b>						
Realized (gains) losses	(1,937)	-	(1,937)	718	-	718
Unrealized (gains) losses	2,461	163	2,624	(1,980)	192	(1,788)
(Gains) losses recognized in net income	524	163	687	(1,262)	192	(1,070)
<b>Contracts designated as hedges</b>						
	Crude Oil			Crude Oil		
Realized (gains) losses						
Reclassified from OCI to revenues, net of tax			685			-
Ineffective portion recognized in net income			(148)			-
			537			-
Unrealized (gains) losses						
Recognized in OCI, net of tax			33,411			5,020
Ineffective portion recognized in net income			842			702
			34,253			5,722
Net (gains) losses recognized in net income outside of revenues			1,381			(368)
Year Ended December 31						
	2011			2010		
	Power	Currency	Total	Power	Currency	Total
<b>Contracts not designated as hedges</b>						
Realized (gains) losses	(7,730)	-	(7,730)	1,808	-	1,808
Unrealized (gains) losses	1,008	-	1,008	(3,060)	-	(3,060)
(Gains) losses recognized in net income	(6,722)	-	(6,722)	(1,252)	-	(1,252)
<b>Contracts designated as hedges</b>						
	Crude Oil			Crude Oil		
Realized (gains) losses						
Reclassified from OCI to revenues, net of tax			7,050			-
Ineffective portion recognized in net income			1,730			-
			8,780			-
Unrealized (gains) losses						
Recognized in OCI, net of tax			(26,471)			5,020
Ineffective portion recognized in net income			(1,754)			702
			(28,225)			5,722
Net (gains) losses recognized in net income outside of revenues			(6,746)			(550)

	Three Months Ended December 31		Year Ended December 31	
	2011	2010	2011	2010
Bank loan	<b>2,946</b>	703	<b>7,972</b>	4,947
Convertible debentures	<b>12,456</b>	12,800	<b>49,706</b>	51,926
Senior notes	<b>9,266</b>	8,521	<b>35,657</b>	20,897
Amortization of deferred finance charges	<b>214</b>	281	<b>881</b>	750
Interest and other financing charges	<b>24,882</b>	22,305	<b>94,216</b>	78,520
Capitalized interest	<b>(2,746)</b>	(397)	<b>(8,640)</b>	(397)
	<b>22,136</b>	21,908	<b>85,576</b>	78,123
Accretion of decommissioning liabilities	<b>5,889</b>	5,609	<b>23,551</b>	22,685
Total finance costs	<b>28,025</b>	27,517	<b>109,127</b>	100,808

Interest and other financing charges for the three months and year ended December 31, 2011, including the amortization of related financing costs, increased by \$2.6 million (12%) and \$15.7 million (20%) respectively, compared to 2010.

Interest expense on Harvest's bank loan for the three and twelve months ended December 31, 2011 increased by \$2.2 million and \$3.0 million respectively, due to the increase in the amount of loan principal outstanding. The effective interest rate for interest charges on our bank loan for the three months and year ended December 31, 2011 was 3.10% and 3.03% respectively, compared to 3.74% and 3.65% in 2010.

Interest expense on senior notes increased by 9% and 71% for the three months and year ended December 31, 2011 respectively, compared to 2010. The year-to-date increase is due to the higher principal balance of the 67/8% senior notes issued in the fourth quarter of 2010, as compared to the 77/8% senior notes that were fully redeemed by the end of 2010.

During the three months and year ended December 31, 2011, interest expense of \$2.7 million and \$8.6 respectively, was capitalized to the BlackGold project and the Downstream debottlenecking project (2010 - \$0.4 million).

### Currency Exchange

Currency exchange gains and losses are attributed to the changes in the value of the Canadian dollar relative to the U.S. dollar on our U.S. dollar denominated 67/8% Senior Notes and on any U.S. dollar denominated monetary assets or liabilities. At December 31, 2011, the Canadian dollar had strengthened compared to September 30, 2011, resulting in an unrealized foreign exchange gain of \$7.6 million (2010 - \$3.4 million gain) for the fourth quarter of 2011. For the year of 2011, Harvest recognized an unrealized foreign exchange loss of \$2.6 million (2010 - \$1.9 million gain) as a result of the weakening of the Canadian dollar relative to the U.S. dollar from \$0.99 Cdn/U.S. at December 31, 2010 to \$1.02 Cdn/U.S. at December 31, 2011. Harvest recognized a realized foreign exchange loss of \$2.7 million (2010 - \$6.8 million gain) and gain of \$6.5 million (2010 - \$1.5 million gain) for the three months and year ended December 31, 2011 respectively, as a result of the settlement of U.S. dollar denominated transactions.

The cumulative translation adjustment recognized in other comprehensive income represents the translation of the Downstream operations' U.S. dollar functional currency financial statements to Canadian dollars. During the three months and year ended December 31, 2011, Downstream operations recognized a net cumulative translation loss of \$28.8 million and gain of \$21.5 million respectively (2010 - losses of \$32.1 million and \$45.9 million). The net cumulative translation loss in the fourth quarter of 2011 resulted from the strengthening of the Canadian dollar relative to the U.S. dollar at December 31, 2011 compared to September 30, 2011. Conversely, the Canadian dollar relative to the U.S. dollar weakened at December 31, 2011 compared to December 31, 2010, resulting in a net cumulative translation gain for the year of 2011. As Downstream operations' functional currency is denominated in U.S. dollars, the strengthening of the U.S. dollar would result in gains from decommissioning liabilities, pension obligations, accounts payable and other balances that are denominated in Canadian dollars, which partially offset the unrealized losses recognized on the senior notes and Upstream U.S. dollar denominated monetary items.

### Deferred Income Taxes

For the three months and year ended December 31, 2011, Harvest recorded a deferred income tax recovery of \$37.0 million and \$29.9 million respectively (2010 - recovery of \$14.7 million and \$65.1 million). Our deferred income tax liability will fluctuate during



each accounting period to reflect changes in the temporary differences between the book value and tax basis of assets as well as legislative tax rate changes. Currently, the principal source of our temporary differences is the net book value of the Company's property, plant and equipment and the unclaimed tax pools.

### Related Party Transactions

The following provides a summary of the related party transactions between Harvest and KNOC in 2010 and 2011:

- On August 6, 2010, Harvest acquired the BlackGold oil sands project assets from KNOC for \$374.2 million, representing the fair value of the assets acquired. The acquisition was paid for with the issuance of shares to KNOC.
- Harvest has a Global Technology and Research Centre ("GTRC"), which is used as a training facility for KNOC personnel. For the year ended December 31, 2011, Harvest billed KNOC and certain subsidiaries of KNOC for a total of \$1.6 million (2010 – \$0.2 million) primarily related to technical services provided by Harvest's GTRC. As at December 31, 2011, \$1.1 million (2010 - \$0.1 million) remains outstanding from KNOC in accounts receivable.
- For the year ended December 31, 2011, amounts billed by KNOC to Harvest totaled \$0.6 million (2010 – \$nil). The amounts billed were mainly related to reimbursement to KNOC for secondees salaries paid by KNOC on behalf of Harvest. As at December 31, 2011, \$0.6 million (2010 - \$nil) remains outstanding in accounts payable.
- As at September 30, 2011, North Atlantic had committed to purchase \$322.5 million of crude feedstock from KNOC, which Macquarie has taken over under the SOA.

### LIQUIDITY

Harvest manages its cash requirements by optimizing the capital structure of the Company and maintaining sufficient liquid financial resources to cost-effectively fund obligations as they come due. The Company's liquidity needs are met through the following sources: cash generated from operations, borrowings under our long-term credit facility, long-term debt issuances and capital injections by KNOC. Harvest's primary uses of funds are operating expenses, capital expenditures, and interest and principal payments on debt instruments.

Cash flow from operating activities for the year ended December 31, 2011 was \$560.5 million, compared to \$439.2 million in 2010. For the year ended December 31, 2011, the change in non-cash working capital relating to operating activities was a surplus of \$51.1 million (2010 – surplus of \$32.3 million), and \$22.1 million (2010 - \$20.3 million) was incurred in the settlement of decommissioning liabilities. During 2011, Harvest's financing activities provided \$848.8 million of cash, including \$505.4 million of capital injection from KNOC and \$343.3 million of net borrowings from the credit facility. Harvest funded \$1,013.2 million of capital additions and net asset acquisition activities in 2011 with cash generated from operating activities and financing activities. The acquisition of the Hunt assets in 2011 was funded primarily by the capital injection from KNOC.

Harvest had a working capital deficiency of \$265.6 million as at December 31, 2011, as compared to a \$20.3 million deficiency at December 31, 2010. The negative working capital in 2011 was primarily related to the classification of \$107.1 million of convertible debentures as current liabilities, the use of the \$40 million deposit paid in 2010 for the Hunt assets acquisition, and accrued liabilities relating to capital expenditures during the period, partially offset by increased assets arising from the risk management contracts. The Company's working capital is expected to fluctuate from time to time, and will be funded from cash flows from operations and borrowings from the credit facility, as required.

Future development activities and acquisitions in our Upstream business as well as the maintenance program in our Downstream business will likely be funded from cash flow from operating activities, while we will generally rely on funding more significant acquisitions and growth initiatives from some combination of cash flow from operating activities, issuances of incremental debt and capital injections from KNOC. Should incremental debt not be available to us through debt capital markets, our ability to make the necessary expenditures to enhance or expand our assets may be impaired. Harvest's liquidity is closely related to its ability to generate cash from operating activities, which is affected by changes in commodity prices, market demands for petroleum and natural gas products and the operating performances of both our Upstream and Downstream assets. Harvest enters into risk management contracts (refer to the "Cash Flow Risk Management" section of this MD&A) to protect the Company from cash flow fluctuations due to commodity price changes.

Through a combination of cash available at December 31, 2011, cash from operating activities and available undrawn credit facility, it is anticipated that Harvest will have adequate liquidity to fund future operations, debt repayments and forecasted capital



expenditures (excluding any major acquisitions). Our 2012 capital program, excluding acquisitions for Upstream and Downstream, is budgeted to be \$770 million. Harvest has the ability to modify our capital program in response to changes in commodity prices, market conditions, and cash flows. Refer to the "Contractual Obligations and Commitments" section of this MD&A for Harvest's future commitments and the discussion below on certain significant items.

### BlackGold Oil Sands Project

Harvest signed an engineering, procurement and construction ("EPC") contract in 2010 for phase 1 of the BlackGold project, of which \$92.4 million (including a \$31.1 million deposit) has been paid to the end of 2011. Together with capital expenditures relating to drilling and completion of 12 wells, Harvest has invested \$122.3 million since acquiring the assets in 2010. For 2012, \$215 million of the capital expenditure program is allocated to the continued development of BlackGold. Harvest plans to fund the capital expenditures with cash flows from operating activities and the undrawn credit facility.

The Company is engaging in an active drilling program under which the drilling of 30 wells (15 well pairs) are expected to be completed between now and the end of 2012. During the fourth quarter of 2011, Harvest began drilling the first SAGD well with completion expected in early 2012. Other near-term activities include completion of the detailed engineering work, site preparation and the commencement of major equipment fabrication. While work continues on phase 1, phase 2 of the project, which is targeted to increase production capacity to 30,000 bbl/d, is in the regulatory approval process. The BlackGold project faces similar cost and schedule pressures as other oil sand projects, including shortage of skilled labor, rising costs, and logistics issues surrounding module transportation; phase 1 production is now expected to start in 2014.

### Supply and Offtake Agreement ("SOA")

In April 2011, Vitol provided Harvest a six-month notice to terminate the SOA at the end of October 2011. On October 11, 2011, the Company entered into a new SOA with Macquarie. Effective November 1, 2011, Macquarie started supplying the Company with feedstocks and purchasing certain finished products from the Company. The Company provides storage tanks for the feedstock and finished products and is accountable for services related to the storage and handling of the feedstock and finished products at the refinery, including vessel loading and offloading. The new SOA is an evergreen arrangement with an initial one year term.

The supply and off take agreement also requires both Harvest and Maquarie's parent, Macquarie Bank Ltd, to provide reciprocal guarantees of US\$75 million to each other in order to mitigate the risk of either counter party being unable to settle a net payable amount.

### Contractual Obligations and Commitments

Harvest has recurring and ongoing contractual obligations and commitments entered into in the normal course of operations including the purchase of assets and services, operating agreements, transportation commitments, sales commitments, royalty obligations, and land lease obligations. As at the end of December 31, 2011, Harvest has the following significant contractual commitments:

	Payments Due by Period				Total
	1 year	2-3 years	4-5 years	After 5 years	
Debt repayments <sup>(1)</sup>	106,796	390,598	595,464	508,500	1,601,358
Debt interest payments <sup>(1)</sup>	92,360	139,745	79,182	26,220	337,507
Purchase commitments <sup>(2)</sup>	207,207	48,409	1,143	-	256,759
Operating leases	9,368	15,267	2,187	564	27,386
Transportation agreements <sup>(3)</sup>	13,936	22,606	9,680	317	46,539
Feedstock and other purchase commitments <sup>(4)</sup>	776,092	-	-	-	776,092
Employee benefits <sup>(5)</sup>	4,534	7,828	4,944	3,837	21,143
Decommissioning liabilities <sup>(6)</sup>	12,782	58,989	33,805	1,343,584	1,449,160
<b>Total</b>	<b>1,223,075</b>	<b>683,442</b>	<b>726,405</b>	<b>1,883,022</b>	<b>4,515,944</b>

(1) Assumes constant foreign exchange rate.

(2) Relates to drilling commitments, AFE commitments, BlackGold capital commitment and Downstream capital commitments.

(3) Relates to firm transportation commitments.

(4) Includes commitments to purchase refinery crude stock and refined products for resale under the SOA with Macquarie.

(5) Relates to the expected contributions to employee benefit plans and employee long-term incentive plan payments.

(6) Represents the undiscounted obligation by period.

### Off Balance Sheet Arrangements

As at December 31, 2011, Harvest has no off balance sheet arrangements in place.

## CAPITAL RESOURCES

The following table summarizes our capital structure as at December 31, 2011 and December 31, 2010 and provides the key financial ratios defined in Harvest's credit facility agreement.

	December 31, 2011	December 31, 2010
<b>Debts</b>		
Bank loan <sup>(1)</sup>	\$ 358,885	\$ 14,000
Convertible debentures, at principal amount	733,973	733,973
Senior notes, at principal amount (US\$500 million) <sup>(2)</sup>	508,500	497,300
	<b>1,601,358</b>	<b>1,245,273</b>
<b>Shareholder's Equity</b>		
386,078,649 common shares issued at December 31, 2011 <sup>(3)</sup>	3,453,644	-
335,535,047 common shares issued at December 31, 2010	-	3,016,855
	<b>\$5,055,002</b>	<b>\$4,262,128</b>
<b>Financial Ratios</b> <sup>(4) (5)</sup>		
Secured Debt to Annualized EBITDA <sup>(6)</sup>	<b>0.73</b>	0.06
Total Debt to Annualized EBITDA <sup>(7)</sup>	<b>2.72</b>	2.39
Secured Debt to Total Capitalization <sup>(6) (8)</sup>	<b>10%</b>	1%
Total Debt to Total Capitalization <sup>(7) (8)</sup>	<b>36%</b>	31%

(1) The bank loan net of deferred financing costs is \$355.6 million (2010 - \$11.4 million).

(2) Principal amount converted at the period end exchange rate.

(3) As at February 29, 2012, the number of common shares issued is 386,078,649.

(4) Calculated based on Harvest's credit facility covenant requirements (see note 10 of the December 31, 2011 financial statements).

(5) The financial ratios and their components are non-GAAP measures; please refer to the "Non-GAAP Measures" section of this MD&A.

(6) Secured debt includes bank loan of \$355.6 million (2010 - \$11.4 million), letters of credit of \$8.7 million (2010 - \$2.5 million), and guarantees of \$92.1 million (2010 - \$15.1 million) at December 31, 2011.

(7) Total debt includes the secured debt, convertible debentures of \$742.1 million (2010 - \$745.3 million) and senior notes of \$495.7 million (2010 - \$482.4 million) at December 31, 2011.

(8) Total capitalization includes total debt and shareholder's equity less equity attributed to BlackGold of \$459.9 million at December 31, 2011 and 2010.

During 2011, Harvest maintained a corporate credit rating of BB- (Stable outlook) and Ba2 (Stable outlook) from Standard and Poor's Rating Services ("S&P") and Moody's Investors Service ("Moody's") respectively. Our credit rating for the 67/8% senior notes from S&P and Moody's also remained unchanged from the prior year at "BB-" and "Ba1".

### Bank Loan

At the time of the purchase of Harvest Energy Trust ("Trust") by KNOC Canada on December 22, 2009, the Trust had renegotiated a temporary credit facility of \$600 million with the maturity date of April 30, 2010. On April 30, 2010, Harvest entered into an amended and extended credit facility maturing April 30, 2013 and the facility was reduced from \$600 million to \$500 million.

On April 29, 2011, Harvest further extended the term of its credit facility by 2 years to April 30, 2015. The minimum rate charged on the credit facility was amended on April 29, 2011, decreasing the floating rate from 200 bps to 175 bps over bankers' acceptance rates, to the extent that Harvest's secured debt to EBITDA ratio remains below or equal to one.

On December 16, 2011, the credit facility was amended to increase the capacity of the facility from \$500 million to \$800 million and the minimum rate charged on the credit facility decreased further from 175 bps to 160 bps over bankers' acceptance rates. The determination of the financial covenants remains unchanged and is in note 10 of the December 31, 2011, audited consolidated financial statements. At December 31, 2011, Harvest is in compliance with all covenants under the credit facility.

As at December 31, 2011, Harvest had \$441.1 million of unutilized borrowing capacity under the credit facility. The unused borrowing capacity and the option to increase the capacity limit to \$1.0 billion provide Harvest the flexibility to manage fluctuations in its liquidity needs.

### Convertible Debentures

At December 31, 2011, Harvest had \$734.0 million (2010 - \$734.0 million) of principal amount of convertible debentures issued in four series with the earliest maturity date in 2012. As a result of KNOC's acquisition of Harvest Energy Trust in 2009, the debentures

are no longer convertible into units but investors would receive \$10.00 for each unit notionally received based on each series conversion rate. Because every series of debentures carry a conversion price that exceeds \$10.00 per unit, it is assumed that no investor would exercise their conversion option.

The debentures may be redeemed by Harvest at its option in whole or in part prior to their respective redemption dates. The redemption price for the first redemption period is at a price equal to \$1,050 per debenture and at \$1,025 per debenture during the second redemption period. After the second redemption period, the debentures are redeemable at par. Any redemption will include accrued and unpaid interest at such time. Please refer to note 12 of the December 31, 2011, audited consolidated financial statements for details of the redemption periods.

The 6.4% series convertible debentures with a face value of \$106.8 million will be maturing on October 31, 2012. Harvest plans to repay the debenture holders on maturity date through a combination of cash on hand, incremental borrowing from the credit facility, debt issuance and capital injection.

### **Senior Notes**

Harvest had \$508.5 million (2010 - \$497.3 million) of principal amount of senior notes outstanding at December 31, 2011. These notes are guaranteed by all of Harvest's existing and future restricted subsidiaries that guarantee the credit facility and future restricted subsidiaries that guarantee certain debt. Prior to maturity, redemptions are permitted in whole or in part, at any time at a redemption price equal to the greater of 100% of the principal amount redeemed and the make-whole redemption premium plus any unpaid interest to the redemption date. Harvest may also redeem all of the notes at any time in the event that certain changes affecting Canadian withholding taxes occur.

The covenants of the senior notes, among other things, restrict the sale of assets, restrict Harvest's ability to enter into certain types of transactions with affiliates and restrict Harvest's ability to pay dividends or make other restricted payments. It also restricts the incurrence of additional indebtedness if such issuance would result in an interest coverage ratio as defined of less than 2.0 to 1. Notwithstanding the interest coverage ratio limitation, the incurrence of additional secured indebtedness under the credit facility may be limited to the greater of \$1.0 billion and 15% of total assets. At December 31, 2011, Harvest is in compliance with all covenants under the senior notes. Interest coverage ratio is a defined term within the senior notes agreement and is considered a non-GAAP measure which may not be comparable with similar non-GAAP measures used by other entities. Please refer to the "Non-GAAP measures" section of this MD&A.

## SUMMARY OF QUARTERLY RESULTS

The following table and discussion highlights our fourth quarter of 2011 results relative to the preceding 7 quarters:

	2011				2010			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>FINANCIAL</b>								
Revenues	<b>1,462,535</b>	837,381	782,030	1,248,923	1,301,348	1,001,203	1,067,341	588,312
Net income (loss)	<b>(73,885)</b>	(49,204)	(19,529)	37,961	(12,333)	(26,082)	(22,796)	(19,952)
Cash from operating activities	<b>144,625</b>	161,499	107,588	146,777	142,134	97,412	121,830	77,808
Total long-term financial debt	<b>1,486,170</b>	1,509,773	1,384,862	1,244,825	1,239,024	1,251,658	1,153,972	1,150,321
Total assets	<b>6,284,370</b>	6,483,568	6,121,547	6,041,118	5,388,740	5,303,486	4,764,141	4,757,865
<b>OPERATIONS</b>								
<b>Upstream</b>								
Daily sales volumes (boe/d)	<b>61,324</b>	58,548	55,338	53,331	50,054	47,777	49,597	50,178
Realized price prior to hedges (\$/boe)	<b>64.61</b>	57.85	66.73	59.19	56.03	52.71	54.41	60.17
<b>Downstream</b>								
Average daily throughput (bbl/d)	<b>88,824</b>	41,756	38,016	97,438	111,317	96,514	94,833	41,016
Average refining margin (loss) (\$US/bbl)	<b>(4.14)</b>	10.44	8.09	10.96	6.13	3.02	8.56	-

The quarterly revenues and cash from operating activities are mainly impacted by the Upstream sales volumes, realized prices and operating expenses and Downstream throughput volumes, cost of feedstock and realized prices. Significant items that impacted Harvest's quarterly revenues include:

- Revenues were the highest in the fourth quarter of 2011, followed by the fourth quarter of 2010, reflecting higher commodity prices and stronger sales volumes in the Upstream operations. Revenues were the lowest in the first quarter of 2010, primarily due to the shutdown of the refinery units due to a fire and the relating repairs in the Downstream operations.
- The lower revenue in the second and third quarters of 2011 was due to lower Downstream sales as a result of lower throughput due to a planned shutdown, partially offset by increased Upstream sales from the Hunt assets and higher commodity prices.
- The increasing Upstream sales volumes since the third quarter of 2010 were mainly attributable to the acquisition of oil and gas assets in the third quarter of 2010 and first quarter of 2011.
- Downstream's refining margin/bbl increased in the first and third quarter of 2011, reflecting the improving global refining crack spreads. The decrease in the second quarter of 2011 is due to a planned shutdown of the refinery units. In the fourth quarter of 2011, Downstream realized a loss reflecting the high cost of crude oil feedstock and decreasing gasoline prices.

Net income (loss) reflects both cash and non-cash items. Changes in non-cash items including deferred income tax, DD&A expense, accretion of decommissioning liabilities, impairment of long-lived assets, unrealized foreign exchange gains and losses, and unrealized gains and losses on risk management contracts impact net income (loss) from period to period. For these reasons, the net income (loss) may not necessarily reflect the same trends as revenues or cash from operating activities, nor is it expected to.

Total assets increased from the second quarter of 2010 to the third quarter of 2010 due to the acquisition of the BlackGold assets in August 2010 and certain oil and gas assets in September 2010. The increase in the first quarter of 2011 was due to the acquisition of the Hunt assets and Harvest's active winter drilling programs. The third quarter of 2011 increase was due to Harvest's active capital programs, the Downstream exchange adjustment on capital assets denominated in Canadian dollars and the value of risk management contracts at that time. The decrease in total assets in the fourth quarter of 2011 was mainly due to a reduction in net book value associated with depletion and depreciation charges.

**OUTLOOK**

Harvest actively monitors commodity prices and overall market conditions on an ongoing basis and will continue to manage commodity price volatility through a combination of prudent capital expenditures funded largely through operating cash flows, maintaining a solid balance sheet and hedging commodity prices as appropriate to support our strategy.

**Upstream**

Harvest's Upstream operations (excluding BlackGold) has a capital budget of approximately \$435 million for 2012. Of the Upstream budget, approximately 65% will be allocated to drilling activities. Harvest plans to drill 155 wells in 2012 with the majority of the activity taking place within the first few months of the year in a very active winter drilling program. We will also continue investing in Enhanced Oil Recovery ("EOR") and optimization activities with approximately 15% of the Upstream budget.

Our focus will continue to be on our oil weighted and NGLs rich natural gas assets as our asset base is predominantly large pools of light/medium and heavy crude oils that have significant opportunity for development through drilling or optimization. This is complemented by liquids-rich natural gas opportunities with attractive economics, despite low natural gas prices. We expect production volume from the Upstream operations to average 60,000 boe/d for 2012, weighted approximately 30% percent natural gas and 70% percent crude oil and NGLs.

Cost guidance for 2012 includes royalties at 16% of revenue, operating costs to average approximately \$15.00/boe and general & administrative costs averaging \$2.80/boe.

Harvest has allocated 2012 capital spending of \$215 million for the BlackGold oil sands project. The 2012 activities for the BlackGold team will be module assembly, facility construction and an active drilling program in which 30 wells (15 SAGD well pairs) are currently underway. First oil production of 10,000 bbl/d is expected in 2014 and we anticipate ERCB approval in 2012 for an additional 20,000 bbl/d for phase 2 expansion of the project.

**Downstream**

Harvest's Downstream operations have a 2012 capital budget of \$120 million. Approximately 50% is earmarked for projects involving low cost and simple debottlenecking of existing process units and tanks to enhance distillate yields and improve operating costs, energy efficiency and operating reliability. We have also budgeted approximately 25% for mandatory maintenance projects with the remainder on smaller value-add projects.

Harvest anticipates throughput volume to average 100,000 to 106,000 bbl/d in 2012, with operating costs and purchased energy costs aggregating to approximately \$7.00/bbl.

**Corporate**

Harvest maintains a strong credit rating and healthy balance sheet which includes our convertible debentures, 6% senior notes, and extendible revolving credit facility, balanced with KNOC-held equity. Our exposure to interest rate fluctuations will continue to be managed through maintaining a mix of financing that carries both floating and fixed interest rates. We will extend maturities as appropriate when our obligations mature or become eligible for repayment.

At December 31, 2011, Harvest had \$734.0 million of principal amount of convertible debentures issued in four series. On October 31, 2012, Harvest's 6.40% convertible debentures (TSX: HTE.DB.D) will mature in the amount of \$106.8 million. This series of debentures is currently redeemable at par, as are next year's maturing series of 7.25% debentures. At maturity, Harvest plans to repay the indebtedness through a combination of cash on hand, undrawn credit facility, debt issuance and capital injection.

While we do not speculate on commodity prices or refining margin, we do enter into risk management contracts from time-to-time to mitigate some portion of our price volatility with the objective of stabilizing our cash flow from operating activities. For the remainder of 2012, we have 4,200 bbl/d of WTI hedges under contract with an average price of US \$111.37/bbl.

Future development activities and acquisitions in our Upstream business, as well as the maintenance and optimization program in our Downstream business, will be funded substantially from cash generated by operating activities. Funding of more significant acquisitions and growth initiatives will generally rely on a combination of cash from operating activities, incremental debt and capital injections from KNOC.

Harvest is focused on environmental, health and safety issues both in the Upstream and in the Downstream segments of our business. We use responsible practices to ensure the protection of people and the environment. Safety is at the core of our operations and is of utmost importance as we strive to always protect our people, our neighbors and the environment that we all share. As a result, we continue to show better than industry average performance on many EH&S measures in our businesses.

**CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Significant estimates and judgments made by management in the preparation of these consolidated financial statements are outlined below:

***Reserves***

The provision for depletion and depreciation of Upstream assets is calculated on the unit-of-production method based on proved developed reserves. As well, reserve estimates impact net income through the application of impairment tests. Revisions or changes in the reserve estimates can have either a positive or a negative impact on net income and property, plant and equipment ("PP&E").

The process of estimating reserves is complex and requires significant judgments based on available geological, geophysical, engineering and economic data. In the process of estimating the recoverable oil and natural gas reserves and related future net cash flows, Harvest incorporates many factors and assumptions, such as:

- expected reservoir characteristics based on geological, geophysical and engineering assessments;
- future production rates based on historical performance and expected future operating and investment activities;
- future commodity prices and quality differentials;
- discount rates; and
- future development costs.

On an annual basis, the Company engages qualified, independent reserve evaluators to evaluate Harvest's reserve data.

***Impairment of long-lived assets***

Long-lived assets (goodwill, PP&E and exploration and evaluation assets) are aggregated into cash-generating units ("CGUs") based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company's CGUs is subject to significant judgment; product type, internal operational teams, geology and geography were key factors considered when grouping Harvest's oil and gas assets into the CGUs.

The recoverable amounts of CGUs and individual assets are determined based on the higher of value-in-use calculations and estimated fair values less costs to sell. To determine the recoverable amounts, Harvest uses reserve estimates and future commodity prices for the Upstream operations and expected future refining margins and capital spending plans for the Downstream operations. The estimates of future commodity prices, refining margins and discount rates require significant judgments.

During the year ended December 31, 2011, Harvest recorded an impairment loss of \$nil (2010 - \$13.7 million) to PP&E. An increase of 50 bps in the pre-tax discount rate would result in an impairment of \$38.4 million, while a 10% decrease in gross margin would result in an impairment of \$222.3 million in Downstream PP&E.

***Exploration and evaluation ("E&E") assets***

The decision to transfer assets from E&E to PP&E is dependent on the technical feasibility and commercial viability of the related E&E projects. Such decision is subject to management's judgment and use of estimates such as reserves, future commodity prices and discount rates.

***Decommissioning liabilities***

In the determination of decommissioning liabilities, management is required to make a significant number of estimates and assumptions with respect to activities that will occur in the future including the ultimate settlement amounts, inflation factors, risk-free discount rates, timing of settlement, emergence of new restoration techniques and expected changes in legal, regulatory, environmental and political environments. The decommissioning liabilities also result in an increase to the carrying cost of the related PP&E. The obligation accretes to a higher amount with the passage of time as it is determined using present values. A change in any one of the assumptions could impact the estimated future obligation and in return, net income and PP&E.

***Employee benefits***

Harvest's Downstream operations maintains a defined benefit pension plan and provides certain post-retirement health care benefits, which cover the majority of its Downstream employees and their surviving spouses. An independent actuary determines the costs of the Company's employee future benefit programs using certain management assumptions and estimates such as, the expected plan investment performance, salary escalation, retirement ages of employees, expected health care costs, employee



turnover, discount rates and return on plan assets. The obligation and expense recorded related to Harvest's employee future benefit plans could increase or decrease if there were to be a change in these estimates.

The Company also maintains a long-term incentive plan which is a performance-based program. As a result, the compensation costs accrued for the plan are subject to the estimation of what the ultimate payout will be and are subject to management's judgment as to whether or not the performance criteria will be met.

#### *Consideration transferred*

Business acquisitions are accounted for using the acquisition method. Under this method, the consideration transferred is allocated to the assets acquired and the liabilities assumed based on the fair values at the time of the acquisition. In determining the fair value of the assets and liabilities, Harvest is often required to make assumptions and estimates, such as reserves, future commodity prices, future refining margins, fair value of undeveloped land, discount rates, decommissioning liabilities and possible outcome of any assumed contingencies. Changes in any of these assumptions would impact amounts assigned to assets and liabilities and goodwill in the consideration transferred allocation and as a result, future net income.

#### *Risk management contracts*

Derivative risk management contracts are valued using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, interest rate curves and forward rate curves of the underlying commodity. Changes in any of these assumptions would impact the fair value of the risk management contracts and as a result, future net income and other comprehensive income. For risk management contracts designated as hedges, changes in the abovementioned assumptions may impact hedge effectiveness assessment and Harvest's ability to continue applying hedge accounting.

#### *Income taxes*

Tax interpretations, regulations and legislation in the various jurisdictions in which Harvest and its subsidiaries operate are subject to change. The Company is also subject to income tax audits and reassessments which may change its provision for income taxes. Therefore, the determination of income taxes is by nature complex, and requires making certain estimates and assumptions.

Harvest recognizes the net deferred tax benefit related to deferred tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred tax assets requires the Company to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted.

#### *Contingencies*

Contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

### **TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")**

On January 1, 2011, Harvest adopted IFRS, with January 1, 2010 as the transition date. The adoption of IFRS has not led to any significant changes in Harvest's Upstream operating netback, Downstream operating loss and debt covenants ratios. Further information on the IFRS impacts is provided in note 2, "Basis of Presentation and Significant Accounting Policies", of the audited consolidated financial statements for the year ended December 31, 2011 and the "Critical Accounting Estimates" section of this MD&A. Please refer to note 27, "First Time Adoption of IFRS", in the audited consolidated financial statements for the year ended December 31, 2011 for reconciliations of shareholder's equity, net loss and other comprehensive loss reported under previous GAAP and IFRS.

IFRS 1 allows certain optional exemptions from full retrospective application and other elections on transition. Note 27, "First Time Adoption of IFRS", in the audited consolidated financial statements for the year ended December 31, 2011 states the exemptions taken by the Company. Certain exemptions were made by Harvest based on financial data available to Harvest and to increase comparability with our peer group.



## RECENT PRONOUNCEMENTS

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

- On January 1, 2015, Harvest will be required to adopt IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. Restatement of comparative period financial statements is not required upon initial application; however, modified disclosures on transition from the classification and measurement requirements of IAS 39 to IFRS 9 are required. Harvest is in the process of determining the potential impact of the adoption of this new standard.
- In May 2011, the IASB issued the following new standards, which are effective for annual periods beginning on or after January 1, 2013:
  - IFRS 10, "Consolidated Financial Statements", replaces the consolidation requirements in SIC-12, "Consolidation – Special Purpose Entities" and a portion of IAS 27. IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess. IFRS 10 requires retrospective application and early adoption is permitted.
  - IFRS 11, "Joint Arrangements", focuses on the rights and obligations of the joint arrangement, rather than its legal form (as is currently the case) and requires a single method to account for interests in jointly controlled entities (equity method). This standard requires retrospective application and early adoption is permitted.
  - IFRS 12, "Disclosure of Interest in Other Entities", is a comprehensive standard on disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, structure entities and other off balance sheet interests. IFRS 12 requires retrospective application and early adoption is permitted.
  - IFRS 13, "Fair Value Measurement", provides a consistent definition of fair value, establishes a single framework for determining fair value and introduces requirements for disclosures related to fair value measurement. IFRS 13 applies prospectively from the beginning of the annual period in which the standard is adopted. Early adoption is permitted.

Harvest is assessing the potential financial statement impact from adopting these new standards.

- On June 16, 2011, the IASB issued an amendment to IAS 19, "Employee Benefits", which changes the recognition and measurement of defined benefit pension expense and termination benefits and expands disclosure requirements for all employee benefit plans. The new standard is required to be adopted for periods beginning on or after January 1, 2013. Harvest is currently assessing the financial statement impact of the new standard.
- The IASB issued an amendment to IAS 1, "Presentation of Financial Statements" on June 16, 2011, which requires separating items presented in other comprehensive income between those that are recycled to income and those that are not. The standard is required to be adopted for periods beginning on or after July 1, 2012. The adoption of this standard should not have a material impact on the Company's consolidated financial statements.
- In December 2011, the IASB issued amendments to IFRS 7 "Financial Instruments: Disclosures" and IAS 32, "Financial Instruments: Presentation" to clarify the current offsetting model and develop common disclosure requirements. Amendments to IFRS 7 are effective for annual periods beginning on or after January 1, 2013. Retrospective application is required and early adoption is permitted. Amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014. Retrospective application is required. Harvest is currently assessing the financial statement impact of the new standard.

## OPERATIONAL AND OTHER BUSINESS RISKS

Both Harvest's Upstream and Downstream operations are conducted in the same business environment as most other operators in the respective businesses and the business risks are very similar. Harvest has a risk management committee that meets on a regular basis to assess and manage operational and business risks and has a corporate Environment, Health and Safety ("EH&S") policy. We intend to continue executing our business plan to create value. The following summarizes the significant risks:

### Risks Associated with Commodity Prices

#### Upstream

- Prices received for petroleum and natural gas have fluctuated widely in recent years. Natural gas prices have experienced significant declines since 2010. Decreases in commodity prices could reduce Harvest's earnings and cash flow and may result in

shut-in of certain properties. Low commodity prices may also result in asset impairment. Harvest manages commodity price risks by entering into various commodity price risk management contracts. Refer to the "Cash Flow Risk Management" section of this MD&A for further information.

#### *Downstream*

- The market prices for crude oil and refined products have fluctuated significantly, the direction of the fluctuations may not match and the relative magnitude may be different resulting in volatile refining margins.

#### **Risks Associated with Operations**

##### *Upstream*

- The markets for petroleum and natural gas produced in western Canada are dependent upon available capacity to refine crude oil and process natural gas as well as pipeline or other capacity to transport the products to consumers.
- The production of petroleum and natural gas may involve a significant use of electrical power and since deregulation of the electric system in Alberta, electrical power prices in Alberta have been volatile. Increases in power prices could reduce our cash flow and earnings. From time to time, Harvest may enter into electricity price swaps to manage our exposure to power price volatility.

##### *Downstream*

- Fluctuations in global demand and supply for crude oil and refined products could impact the Company's margins.
- Crude oil feedstock is delivered to our refinery via waterborne vessels which could experience delays due to weather, accidents, government regulations or third party actions.
- Our refinery is a single train, integrated, interdependent facility which could experience a major interruption caused by an accident or severe weather damage. These potential interruptions may reduce or eliminate our cash flow.
- The refinery utilizes a SOA to facilitate the supply of crude feedstock to the refinery and the offtake of refined products. This agreement has termination rights and replacement arrangements may not be as favorable and may result in an increase in costs.
- There are risks and uncertainties affecting construction or planned maintenance schedules and costs, including the availability of materials, equipment, qualified personnel, impacts of competing projects drawing on the same resources during the same time period; and the potential for disruptions to operations and construction projects. Accordingly, actual costs can be materially different from estimates and could have a material adverse effect on our costs, results of operations and cash flows. In addition, maintenance activities may not improve operational performance or the outputs of related facilities and construction projects may not deliver anticipated results.
- Collective agreements with our employees and the United Steel Workers of America may not prevent a strike or work stoppage and future agreements may result in an increase in operating costs.

#### **Risks Associated with Reserve Estimates**

- The reservoir and recovery information in reserve reports prepared by our independent reserve evaluators are estimates and actual production and recovery rates may vary from the estimates and the variations may be significant.
- Prices paid for acquisitions are based in part on reserve report estimates and the assumptions made preparing the reserve reports are subject to change as well as geological and engineering uncertainty. The actual reserves acquired may be lower than expected, which could adversely impact our cash flow and earnings.

#### **Risks Associated with the Oil Sands Project**

- The BlackGold oil sands project is exposed to the risks associated with major construction projects. These risks include the possibility that the project will not be completed on budget, on time and/or will not achieve the design objectives. This would have a significant impact on the financial results of the project.
- The oil sands project is subject to government regulations. Phase 2 of the BlackGold oil sands project is subject to approval by the regulatory bodies and the delay of approval could impact Harvest's ability and/or timing of reaching the targeted production of 30,000 bbl/d as well as the financial results of the project.

#### **Risks Associated with Environment, Health & Safety ("EH&S")**

- The operations of petroleum and natural gas properties involves a number of operating and natural hazards which may result in blowouts, environmental damage and other unexpected and/or dangerous conditions.

- The operations of petroleum and natural gas properties as well as the refinery are subject to environmental regulation pursuant to local, provincial and federal legislation. Changes in these regulations could have a material adverse effect as regards to operating costs and capital costs. A breach of such legislation may result in the imposition of fines as well as higher operating standards that may increase costs.
- The production of aviation fuels in our Downstream operations subjects us to liability should contaminants in the fuel result in aircraft engines being damaged and/or aircraft crashes.
- Our refining operations, which include the transportation and storage of a significant amount of crude oil and refined products, are adjacent to environmentally sensitive coastal waters, and are subject to hazards such as fires, explosions, spills and mechanical failures, any of which may result in personal injury, damage to our property and/or the property of others along with significant other liabilities in connection with a discharge of materials. We regularly perform stack sampling, soil, vegetation, and fresh and ocean water tests, and we have monitoring stations to record the air quality in three adjacent communities, as well as at the refinery perimeter.

Harvest's corporate EH&S manual has a number of specific policies to minimize the risk of environmental contamination, including emergency response should an incident occur. If areas of higher risk are identified, Harvest will undertake to analyze and recommend changes to reduce the risk including replacement of specific infrastructure. In addition, our business units conduct emergency response training on a regular basis in all of our operating fields to ensure a high level of response capability when placed in a challenging situation. We also perform safety and environmental audits of our operating facilities. In addition to the above, Harvest maintains business interruption insurance, commercial general liability insurance as well as specific environmental liability insurance, in amounts consistent with industry standards.

#### **Risks Associated with Liquidity**

- Absent capital reinvestment or acquisition, Harvest's reserves and production levels from petroleum and natural gas properties will decline over time as a result of natural declines. As a result, cash generated from operating these properties may decline.
- Fluctuations in interest rates on our current and/or future financing arrangements may result in significant increases in our borrowing costs.
- Harvest is required to comply with covenants under the credit facility and the senior notes. In the event that the Company does not comply with the covenants, its access to capital may be restricted or repayment may be required.
- Although the Company monitors the credit worthiness of third parties it contracts with through a formal risk management policy, there can be no assurance that the Company will not experience a loss for nonperformance by any counterparty with whom it has a commercial relationship. Such events may result in material adverse consequences on the business of the Company.
- Our Downstream operations are relying on the creditworthiness of Macquarie for the purchase of feedstock and should their creditworthiness deteriorate, crude oil suppliers may restrict the sale of crude oil to Macquarie.

Harvest monitors our cash flow projections and covenants on a routine basis and will adjust our development plans accordingly in response to changes in commodity prices and cash flows.

#### **General Business Risks**

- The operation of petroleum and natural gas properties as well as the refinery requires physical access for people and equipment on a regular basis which could be affected by weather, accidents, government regulations or third party actions.
- Skilled labor is necessary to run operations and there is a risk that we may have difficulty in sourcing skilled labor which could lead to increased operating and capital costs.
- The loss of a member of our senior management team and/or key technical operations employee could result in a disruption to either our Upstream or Downstream operations.
- Our crude oil sales and refining margins are denominated in US dollars while we incur costs in Canadian dollars which results in a currency exchange exposure.
- The operations of Harvest, including the refinery, operate under permits issued by the federal and provincial governments and these permits must be renewed periodically. The federal and provincial governments may make operating requirements more stringent which may require additional spending.
- Income tax laws, other laws or government incentive programs relating to the oil and gas industry, may in the future be changed or interpreted in a manner that affects Harvest or its stakeholders.

**CHANGES IN REGULATORY ENVIRONMENT**

The oil and gas industry is subject to extensive regulations imposed by many levels of government in Canada. Harvest currently operates in Alberta, British Columbia, Saskatchewan, and Newfoundland, all of which have different legislations and royalty programs which may be amended from time to time. A change in the royalty programs or legislations may have adverse impacts on Harvest's future earnings and cash flows.

The following summarizes some of the changes to Harvest's regulatory environment during 2011:

**Alberta**

On April 5, 2011, the Government of Alberta released their draft of the Lower Athabasca Regional Plan ("LARP"), which was developed as part of the land-use framework under the Alberta Land Stewardship Act. The draft was subsequently updated on August 29, 2011 based on feedback and consultation received from stakeholders. The LARP outlines management frameworks for protecting, monitoring, evaluating and reporting air, surface water and groundwater quality by setting strict environmental limits. In addition, conservation areas will increase by approximately 16% to a total of 22% of the region's land base. Based on a preliminary assessment, the proposed new conservation areas do not appear to affect Harvest. The LARP is currently awaiting approval by the legislature.

**Saskatchewan**

On June 22, 2011, the government announced its new Upstream Petroleum Industry Associated Gas Conservation Standards, which are designed to reduce emissions from the flaring and venting of associated gas. The standards establish a specified limit for the amount of natural gas that can be flared and vented from an oil well or associated facility. If that limit is exceeded, the producer is required to conserve and store the associated gas for their own use or sale. The standards will come into effect July 1, 2012 for new wells and facilities licensed on or after that date, and July 1, 2015 for existing wells and facilities. Harvest does not anticipate material compliance costs as we currently have infrastructure in place to conserve gas in most of our operated areas in Saskatchewan.

**Newfoundland**

The Federal Renewable Fuel Regulations were published in the Canada Gazette, April 10, 2010. At that time an exemption was provided for the addition of ethanol to gasoline sold in Newfoundland and Labrador and on June 20, 2011 a further exemption was provided for the requirements for renewable content in diesel fuel and heating distillate oil sold in Newfoundland and Labrador. These exemptions benefit our Downstream operations by providing relief from the Federal Renewable Fuel Regulations.

**Climate Change Regulations**

The Canadian Government has indicated its commitment to reduce greenhouse gas emissions and will be making changes to environmental legislation relating to air contaminants and renewable fuels but has provided no specific target guidelines or policies that relate to the oil and gas industry. Such legislation could have potentially adverse effects on both Harvest's Upstream and Downstream financial results. Harvest will participate in the discussion of any initiatives whether at a Federal or Provincial government level, and will be able to determine if there is any financial impact once guidelines are established.

In 2011, the Government of Newfoundland and Labrador published its Climate Change Action Plan. The Province, in collaboration with the Conference of New England Governors and Eastern Canadian Premiers, has committed to reduce regional GHG emissions to 1990 levels by 2010, to reduce regional GHG emissions to 10% below 1990 levels by 2020; and to reduce regional GHG emissions to 75-85% below 2001 levels by 2050.

Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict the impact of those requirements on our operations and financial performance at this time. On an ongoing basis, Harvest continues to undertake projects that reduce emission of greenhouse gases, such as evaluating the injection of carbon dioxide into oil reservoirs and the further capture of fugitive emissions in our field operations as part of our annual capital program.

**DISCLOSURE CONTROLS AND PROCEDURES**

Under the supervision of the Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures as of December 31, 2011 as defined under the rules adopted by the Canadian securities regulatory authorities and the U.S. Securities and Exchange Commission. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that as of December 31, 2011, the disclosure controls and procedures were effective to ensure that information required to be disclosed by Harvest in reports that it files or submits to Canadian and U.S. securities

authorities was recorded, processed, summarized and reported within the time period specified in Canadian and U.S. securities laws and was accumulated and communicated to management, including its Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined under National Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes. Management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2011. The evaluation was based on the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2011.

In connection with the adoption of IFRS, Harvest established additional internal controls over financial reporting, as necessary, to review and validate the conversion to IFRS and relevant transitional activities including restatement of comparative financial information for 2010 and related disclosures. There were no other significant changes in internal controls over financial reporting for the period ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Because of its inherent limitations, disclosure controls and procedures and internal control over financial reporting may not prevent or detect misstatements, errors or fraud. Control systems, no matter how well conceived or operated, can provide only reasonable, but not absolute, assurance that the objectives of the control systems are met.

### **NON-GAAP MEASURES**

Throughout this MD&A, the Company has referred to certain measures of financial performance that are not specifically defined under IFRS, hereinafter referred to as "GAAP", such as "operating netbacks", "operating netback prior to/after hedging", "operating income (loss)", "gross margin (loss)", "total debt", "total financial debt", "total capitalization", "EBITDA", "secured debt to annualized EBITDA", "total debt to annualized EBITDA", "secured debt to total capitalization", "total debt to total capitalization" and "interest coverage ratio".

"Operating netbacks" are reported on a per boe basis and used extensively in the Canadian energy sector for comparative purposes. "Operating netbacks" include revenues, operating expenses, transportation and marketing expenses, and realized gains or losses on risk management contracts. "Gross margin (loss)" is commonly used in the refining industry to reflect the net funds received from the sale of refined products after considering the cost to purchase the feedstock and is calculated by deducting purchased products for resale and processing from total revenue. "Operating income (loss)" is commonly used for comparative purposes in the petroleum and natural gas and refining industries to reflect operating results before items not directly related to operations. "Total debt", "total financial debt", "total capitalization", and "EBITDA" are used to assist management in assessing liquidity and the Company's ability to meet financial obligations. "Secured debt to annualized EBITDA", "total debt to annualized EBITDA", "secured debt to total capitalization", "total debt to total capitalization" and "interest coverage ratio" are terms defined in Harvest's credit facility and senior notes agreements for the purpose of calculation of our financial covenants. The non-GAAP measures do not have any standardized meaning prescribed by GAAP and may not be comparable to similar measures used by other issuers. The determination of the non-GAAP measures have been illustrated throughout this MD&A, with reconciliations to IFRS measures and/or account balances, except for EBITDA which is shown below.



### Reconciliation of EBITDA

EBITDA is defined in Harvest's credit facility agreement as earnings before finance costs, income tax expense or recovery, DD&A, exploration and evaluation costs, impairment of assets, unrealized gains or losses on risk management contracts, unrealized gains or losses on foreign exchange, gains or losses on disposition of assets and other non-cash items. The following is a reconciliation of EBITDA to the nearest GAAP measure net loss:

	Year Ended December 31	
	2011	2010
Net loss	(104,657)	(81,163)
DD&A	626,698	553,732
Unrealized gains on risk management contracts	(746)	(2,358)
Unrealized (gains) losses on foreign exchange	2,555	(1,875)
Unsuccessful exploration and evaluation costs	17,757	2,858
Impairment of PP&E	-	13,661
Gains on disposition of PP&E	(7,883)	(741)
Income tax recovery	(29,827)	(65,309)
Other non-cash items	4,795	(1,093)
Finance costs	109,127	100,808
EBITDA <sup>(1)</sup>	617,819	518,520

(1) As stipulated by the credit facility agreement, annualized EBITDA is a twelve month rolling EBITDA which also includes net income impact from acquisition or disposition as if the transaction had been effected at the beginning of the period. As such, 2011 annualized EBITDA is \$5.0 million (2010 – \$9.8 million) higher than EBITDA.

### FORWARD-LOOKING INFORMATION

This MD&A highlights significant business results and statistics from our consolidated financial statements for the year ended December 31, 2011 and the accompanying notes thereto. In the interest of providing our lenders and potential lenders with information regarding Harvest, including our assessment of our future plans and operations, this MD&A contains forward-looking statements that involve risks and uncertainties.

Such risks and uncertainties include, but are not limited to: risks associated with conventional petroleum and natural gas operations; risks associated with refining and marketing operations; risks associated with the construction of the oil sands project; the volatility in commodity prices, interest rates and currency exchange rates; risks associated with realizing the value of acquisitions; general economic, market and business conditions; changes in environmental legislation and regulations; the availability of sufficient capital from internal and external sources; and, such other risks and uncertainties described from time to time in our regulatory reports and filings made with securities regulators.

Forward-looking statements in this MD&A include, but are not limited to, the forward looking statements made in the "Outlook" section as well as statements made throughout with reference to production volumes, refinery throughput volumes, royalty rates, operating costs, commodity prices, administrative costs, price risk management activities, acquisitions and dispositions, capital spending, reserve estimates, access to credit facilities, income taxes, cash from operating activities, and regulatory changes. For this purpose, any statements that are contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements often contain terms such as "may", "will", "should", "anticipate", "expect", "target", "plan", "potential", "intend", and similar expressions.

Readers are cautioned not to place undue reliance on forward-looking statements as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. Although we consider such information reasonable at the time of preparation, it may prove to be incorrect and actual results may differ materially from those anticipated. Harvest assumes no obligation to update forward-looking statements should circumstances, estimates or opinions change, except as required by law. Forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

**MANAGEMENT'S REPORT**

In management's opinion, the accompanying consolidated financial statements of Harvest Operations Corp. (the "Company") have been prepared within reasonable limits of materiality and in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. Since a precise determination of many assets and liabilities is dependent on future events, the preparation of financial statements necessarily involves the use of estimates and approximations. These have been made using careful judgment and with all information available up to February 29, 2012. Management is responsible for the consistency, therewith, of all other financial and operating data presented in Management's Discussion and Analysis for the year ended December 31, 2011.

To meet our responsibility for reliable and accurate financial statements, management has established and monitors internal controls, which are designed to provide reasonable assurance that financial information is relevant, reliable and accurate, and that assets are safeguarded and transactions are executed in accordance with management's authorization.

Under the supervision of our Chief Executive Officer and our Chief Financial Officer, we have conducted an evaluation of the effectiveness of our internal control over financial reporting based on the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. We have concluded that as of December 31, 2011, our internal controls over financial reporting were effective.

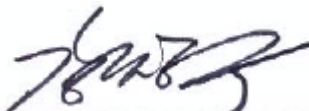
Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements and even those systems determined to be effective can provide only reasonable assurance with respect to the financial statement preparation and presentation.

The consolidated financial statements have been examined by our auditors, Ernst & Young LLP. Their responsibility is to express a professional opinion on the fair presentation of the consolidated financial statements prepared in accordance with International Financial Reporting Standards. The Auditors' Report outlines the scope of their examination and sets forth their opinion on our financial statements.

The Board of Directors is responsible for approving the consolidated financial statements. The Board fulfills its responsibilities related to financial reporting mainly through the Audit Committee. The Audit Committee consists exclusively of independent directors and includes at least one director with financial expertise. The Audit Committee meets regularly with management and the external auditors to discuss reporting and governance issues and ensures each party is discharging its responsibilities. The Audit Committee has reviewed these financial statements with management and the auditors and has recommended their approval to the Board of Directors. The Board of Directors has approved the consolidated financial statements of the Company.



Myunghuhn Yi  
President and Chief Executive Officer  
Harvest Operations Corp.



Chang-Koo Kang  
Chief Financial Officer  
Harvest Operations Corp.

Calgary, Alberta  
February 29, 2012





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## **INDEPENDENT AUDITORS' REPORT**

To the Shareholder of Harvest Operations Corp.

We have audited the accompanying comparative information of Harvest Operations Corp., which comprise the consolidated statements of financial position as at December 31, 2010 and January 1, 2010, the consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for the year ended December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information, including Note 27, which explains how the transition from pre-changeover Canadian generally accepted accounting principles to International Financial Reporting Standards as issued by the International Accounting Standards Board affected the entity's reported consolidated financial position, financial performance and cash flows.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, 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 audit. We conducted our audit 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 our 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, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### ***Opinion***

In our opinion, the comparative information in these consolidated financial statements present fairly, in all material respects, the consolidated financial positions of Harvest Operations Corp. as at December 31, 2010 and January 1, 2010, and its consolidated financial performance and its consolidated cash flows for the year ended December 31, 2010 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

***Other matter***

The consolidated statement of financial position as at December 31, 2011, the consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for the year ended December 31, 2011 and notes, comprising a summary of significant accounting policies and other explanatory information, are audited by another auditor who expressed an unmodified opinion on February 29, 2012.

***KPMG LLP***

Chartered Accountants

February 29, 2012

Calgary Canada

## INDEPENDENT AUDITORS' REPORT

To the Directors and the Shareholder of Harvest Operations Corp.:

We have audited the accompanying consolidated financial statements of Harvest Operations Corp., which comprise the consolidated statement of financial position as at December 31, 2011, and the consolidated statements of comprehensive loss, changes in shareholder's equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the consolidated financial statements

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

### Auditors' responsibility

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

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

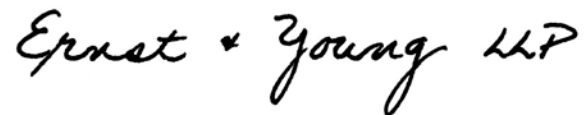
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Harvest Operations Corp. as at December 31, 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

### Comparative Information

Without modifying our opinion, we draw attention to Note 27 to the consolidated financial statements which describes that Harvest Operations Corp. adopted International Financial Reporting Standards on January 1, 2011 with a transition date of January 1, 2010. These standards were applied retrospectively by management to the comparative information in these financial statements, including the consolidated statements of financial position as at December 31, 2010 and January 1, 2010, and the consolidated statements of comprehensive loss, changes in shareholder's equity and cash flows for the year ended December 31, 2010, and related disclosures. The financial statements of Harvest Operations Corp. for these periods were audited by another auditor who expressed an unmodified opinion on those statements on February 29, 2012.



Chartered accountants

Calgary, Canada  
February 29, 2012

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(thousands of Canadian dollars)	Notes	December 31, 2011	December 31, 2010	January 1, 2010
<b>Assets</b>				
Current assets				
Cash and cash equivalents	4	\$ 6,607	\$ 18,906	\$ —
Accounts receivable and other	23, 26	212,252	213,931	178,662
Inventories	5	60,952	75,517	86,819
Prepaid expenses		18,526	55,071	15,551
Risk management contracts	23	20,162	1,007	—
		<b>318,499</b>	<b>364,432</b>	<b>281,032</b>
Non-current assets				
Long-term deposit	25	24,925	30,603	—
Investment tax credits and other		53,994	44,339	2,177
Deferred income tax asset	20	—	1,633	—
Exploration and evaluation assets	6	74,517	59,554	36,034
Property, plant and equipment	7	5,400,387	4,483,236	4,054,619
Other long-term asset		7,105	—	—
Goodwill	8	404,943	404,943	404,943
		<b>5,965,871</b>	<b>5,024,308</b>	<b>4,497,773</b>
<b>Total assets</b>		<b>\$ 6,284,370</b>	<b>\$ 5,388,740</b>	<b>\$ 4,778,805</b>
<b>Liabilities</b>				
Current liabilities				
Bank loan	10, 23	\$ —	\$ —	\$ 428,017
Accounts payable and accrued liabilities	26	464,148	360,487	205,378
Current portion of convertible debentures	12	107,146	—	182,806
Current portion of senior notes	11	—	—	42,921
Current portion of decommissioning liabilities	9	12,782	16,672	11,710
Risk management contracts	23	—	7,553	2,052
		<b>584,076</b>	<b>384,712</b>	<b>872,884</b>
Non-current liabilities				
Bank loan	10, 23	355,575	11,379	—
Convertible debentures	12	634,921	745,257	748,261
Senior notes	11, 23	495,674	482,389	222,456
Decommissioning liabilities	9	674,522	646,347	555,776
Post-employment benefit obligations	21	25,958	20,365	17,453
Deferred credits and other		5,093	293	357
Deferred income tax liability	20	54,907	81,143	142,105
		<b>2,246,650</b>	<b>1,987,173</b>	<b>1,686,408</b>
<b>Total liabilities</b>		<b>2,830,726</b>	<b>2,371,885</b>	<b>2,559,292</b>
<b>Shareholder's equity</b>				
Shareholder's capital	13	3,860,786	3,355,350	2,422,688
Deficit		(388,995)	(284,338)	(203,175)
Accumulated other comprehensive loss	22	(18,147)	(54,157)	—
<b>Total shareholder's equity</b>		<b>3,453,644</b>	<b>3,016,855</b>	<b>2,219,513</b>
<b>Total liabilities and shareholder's equity</b>		<b>\$ 6,284,370</b>	<b>\$ 5,388,740</b>	<b>\$ 4,778,805</b>

Commitments and contingencies [Note 25]

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

On behalf of the Board of Directors:



William D. Robertson, Director



J. Richard Harris, Director

## CONSOLIDATED STATEMENTS OF AND COMPREHENSIVE LOSS

For the years ended December 31,  
(thousands of Canadian dollars)

	Notes	2011	2010
Petroleum, natural gas, and refined products sales		\$ 4,526,321	\$ 4,112,961
Royalties		(195,452)	(154,757)
<b>Revenues</b>	15	<b>4,330,869</b>	<b>3,958,204</b>
<b>Expenses</b>			
Purchased products for processing and resale		3,055,236	2,893,805
Operating	16	576,131	481,233
Transportation and marketing		35,919	15,760
General and administrative	16	62,568	47,067
Depletion, depreciation and amortization		626,698	553,732
Exploration and evaluation	6	18,289	3,300
Gains on disposition of property, plant and equipment		(7,883)	(741)
Finance costs	17	109,127	100,808
Risk management contracts gains	23	(6,746)	(550)
Foreign exchange gains	18	(3,986)	(3,399)
Impairment on property, plant and equipment	7	—	13,661
<b>Loss before income tax</b>		<b>(134,484)</b>	<b>(146,472)</b>
Income tax recovery	20	(29,827)	(65,309)
<b>Net loss</b>		<b>(104,657)</b>	<b>(81,163)</b>
<b>Other comprehensive income (loss)</b>			
Gains (losses) on derivatives designated as cash flow hedges, net of tax	22, 23	19,421	(5,020)
Gains (losses) on foreign currency translation	22	21,480	(45,920)
Actuarial loss, net of tax	21, 22	(4,891)	(3,217)
<b>Comprehensive loss</b>		<b>\$ (68,647)</b>	<b>\$ (135,320)</b>

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

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY**

<i>(thousands of Canadian dollars)</i>	Notes	Shareholder's Capital	Deficit	Accumulated Other Comprehensive Loss	Total Shareholder's Equity
Balance at December 31, 2010		\$ 3,355,350	\$(284,338)	\$ (54,157)	\$3,016,855
Issue of share capital for cash	3, 13	505,436	—	—	505,436
Gains on derivatives designated as cash flow hedges, net of tax	22	—	—	19,421	19,421
Gains on foreign currency translation	22	—	—	21,480	21,480
Actuarial loss, net of tax	21, 22	—	—	(4,891)	(4,891)
Net loss		—	(104,657)	—	(104,657)
<b>Balance at December 31, 2011</b>		<b>\$ 3,860,786</b>	<b>\$ (388,995)</b>	<b>\$ (18,147)</b>	<b>\$3,453,644</b>
Balance at January 1, 2010		\$ 2,422,688	\$(203,175)	\$ —	\$2,219,513
Issue of share capital for cash	13	932,662	—	—	932,662
Losses on derivatives designated as cash flow hedges, net of tax	22	—	—	(5,020)	(5,020)
Losses on foreign currency translation	22	—	—	(45,920)	(45,920)
Actuarial loss, net of tax	21, 22	—	—	(3,217)	(3,217)
Net loss		—	(81,163)	—	(81,163)
Balance at December 31, 2010		\$ 3,355,350	\$(284,338)	\$ (54,157)	\$3,016,855

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



## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,

(thousands of Canadian dollars)

	Notes	2011	2010
<b>Cash provided by (used in)</b>			
<b>Operating Activities</b>			
Net loss for the period		\$ (104,657)	\$ (81,163)
Items not requiring cash			
Depletion, depreciation and amortization		626,698	553,732
Accretion of decommissioning liabilities	9, 17	23,551	22,685
Unrealized gains on risk management contracts	23	(746)	(2,358)
Unrealized (gains) losses on foreign exchange	18	2,555	(1,875)
Non-cash interest income		(652)	(7,029)
Unsuccessful exploration and evaluation costs	6	17,757	2,858
Impairment of property, plant and equipment	7	—	13,661
Gains on disposition of property, plant and equipment		(7,883)	(741)
Deferred income tax recovery	20	(29,880)	(65,097)
Other non-cash items		4,795	(1,093)
Realized foreign exchange gain on senior note redemptions		—	(6,438)
Settlement of decommissioning liabilities	9	(22,110)	(20,257)
Change in non-cash working capital	19	51,061	32,299
		<b>560,489</b>	<b>439,184</b>
<b>Financing Activities</b>			
Issue of common shares, net of issue costs	3,13	505,436	558,493
Bank borrowing (repayments), net		343,315	(416,743)
Issue of seniors notes, net of issue costs	11	—	495,935
Redemptions of senior notes	11	—	(256,931)
Redemptions of convertible debentures	12	—	(180,193)
Change in non-cash working capital	19	—	1,952
		<b>848,751</b>	<b>202,513</b>
<b>Investing Activities</b>			
Business acquisitions	3	(509,829)	(145,144)
Additions to property, plant and equipment	7	(966,741)	(428,085)
Additions to exploration and evaluation	6	(50,883)	(46,997)
Additions to other long term assets		(7,413)	—
Property dispositions (acquisitions), net		4,474	(30,513)
Change in non-cash working capital	19	108,747	22,503
		<b>(1,421,645)</b>	<b>(628,236)</b>
Change in cash and cash equivalents		<b>(12,405)</b>	<b>13,461</b>
Effect of exchange rate changes on cash and cash equivalents		<b>106</b>	<b>5,445</b>
Cash and cash equivalents, beginning of year		<b>18,906</b>	<b>—</b>
Cash and cash equivalents, end of year		<b>\$ 6,607</b>	<b>\$ 18,906</b>
Interest paid		\$ 75,858	\$ 66,917
Income tax paid (received), net		\$ 53	\$ (212)

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010 and 2011

*(amounts in thousands of Canadian dollars unless otherwise indicated)*

### 1. Nature of Operations and Structure of the Company

Harvest Operations Corp. ("Harvest" or the "Company") is an integrated energy company with petroleum and natural gas operations focused on the operation and further development of assets in western Canada ("Upstream") and a medium gravity sour crude hydrocracking refinery and retail and wholesale petroleum marketing business both located in the Province of Newfoundland and Labrador ("Downstream"). Harvest's Downstream business operates under its wholly owned subsidiary, North Atlantic Refining Limited ("North Atlantic").

Harvest is a wholly owned subsidiary of Korea National Oil Corporation ("KNOC"). The Company is incorporated and domiciled in Canada.

These consolidated financial statements were approved and authorized for issue by the Board of Directors on February 29, 2012.

Harvest's principal place of business is located at 2100, 330 – 5th Avenue SW, Calgary, Alberta, Canada T2P 0L4.

### 2. Basis of Presentation and Significant Accounting Policies

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

Prior to January 1, 2011, Harvest reported its consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") as set out in the Handbook of the Canadian Institute of Chartered Accountants. Effective January 1, 2011, the Company commenced reporting under IFRS. In these consolidated financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

Subject to certain transition elections disclosed in note 27, Harvest has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented. Note 27 discloses the impact of the transition to IFRS on the Company's reported financial position, operating results and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010 reported under Canadian GAAP. Comparative figures for 2010 in these consolidated financial statements have been restated to give effect to these changes.

#### (a) Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis except for held for trading financial assets and derivative financial instruments, which are measured at fair value.

#### (b) Functional and Presentation Currency

In these consolidated financial statements, unless otherwise indicated, all dollar amounts are expressed in Canadian dollars, which is the Company's functional currency. All references to U.S. \$ are to United States dollars.

#### (c) Use of Estimates and Judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Significant estimates and judgments made by management in the preparation of these consolidated financial statements are outlined below:

##### (i) Reserves

The provision for depletion and depreciation of Upstream assets is calculated on the unit-of-production method based on proved developed reserves. As well, reserve estimates impact net income through the application of impairment tests. Revisions or changes in the reserve estimates can have either a positive or a negative impact on net income and property, plant and equipment ("PP&E").

The process of estimating reserves is complex and requires significant judgments based on available geological, geophysical, engineering and economic data. In the process of estimating the recoverable oil and natural gas reserves and related future net cash flows, Harvest incorporates many factors and assumptions, such as:

- expected reservoir characteristics based on geological, geophysical and engineering assessments;
- future production rates based on historical performance and expected future operating and investment activities;
- future commodity prices and quality differentials;
- discount rates; and
- future development costs.

On an annual basis, the Company engages qualified, independent reserve evaluators to evaluate Harvest's reserve data.

*(ii) Impairment of long-lived assets*

Long-lived assets (goodwill, PP&E and exploration and evaluation assets) are aggregated into cash-generating units ("CGUs") based on their ability to generate largely independent cash flows and are used for impairment testing. The determination of the Company's CGUs is subject to significant judgment; product type, internal operational teams, geology and geography were key factors considered when grouping Harvest's oil and gas assets into the CGUs.

PP&E is tested for impairment when indications of impairment exist. PP&E impairment indicators include decreases in commodity prices, production, reserves and operating results, cost overruns and construction delays. E&E impairment indicators include expiration of the right to explore and cessation of exploration in specific areas, lack of potential for commercial viability and technical feasibility and when E&E costs are not expected to be recovered from successful development of an area. The determination of whether such indicators exist requires significant judgment.

The recoverable amounts of CGUs and individual assets are determined based on the higher of value-in-use calculations and estimated fair values less costs to sell. To determine the recoverable amounts, Harvest uses reserve estimates and future commodity prices for the Upstream operations and expected future refining margins and capital spending plans for the Downstream operations. The estimates of future commodity prices, refining margins and discount rates require significant judgments.

*(iii) Exploration and evaluation ("E&E") assets*

The decision to transfer assets from E&E to PP&E is dependent on the technical feasibility and commercial viability of the related E&E projects. Such decision is subject to management's judgment and use of estimates such as reserves, future commodity prices and discount rates.

*(iv) Decommissioning liabilities*

In the determination of decommissioning liabilities, management is required to make a significant number of estimates and assumptions with respect to activities that will occur in the future including the ultimate settlement amounts, inflation factors, risk-free discount rates, timing of settlement, emergence of new restoration techniques and expected changes in legal, regulatory, environmental and political environments. The decommissioning liabilities also result in an increase to the carrying cost of the related PP&E. The obligation accretes to a higher amount with the passage of time as it is determined using present values. A change in any one of the assumptions could impact the estimated future obligation and in return, net income and PP&E.

*(v) Employee benefits*

Harvest's Downstream operations maintains a defined benefit pension plan and provides certain post-retirement health care benefits, which cover the majority of its Downstream employees and their surviving spouses. An independent actuary determines the costs of the Company's employee future benefit programs using certain management assumptions and estimates such as, the expected plan investment performance, salary escalation, retirement ages of employees, expected health care costs, employee turnover, discount rates and return on plan assets. The obligation and expense recorded related to Harvest's employee future benefit plans could increase or decrease if there were to be a change in these estimates.

The Company also maintains a long-term incentive plan which is a performance-based program. As a result, the compensation costs accrued for the plan are subject to the estimation of what the ultimate payout will be and are subject to management's judgment as to whether or not the performance criteria will be met.

*(vi) Consideration transferred*

Business acquisitions are accounted for using the acquisition method. Under this method, the consideration transferred is allocated to the assets acquired and the liabilities assumed based on the fair values at the time of the acquisition. In determining the fair value of the assets and liabilities, Harvest is often required to make assumptions and estimates, such as reserves, future commodity prices, future refining margins, fair value of undeveloped land, discount rates, decommissioning

liabilities and possible outcome of any assumed contingencies. Changes in any of these assumptions would impact amounts assigned to assets and liabilities and goodwill in the consideration transferred allocation and as a result, future net income.

*(vii) Risk management contracts*

Derivative risk management contracts are valued using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, interest rate curves and forward rate curves of the underlying commodity. Changes in any of these assumptions would impact fair value of the risk management contracts and as a result, future net income and other comprehensive income. For risk management contracts designated as hedges, changes in the above mentioned assumptions may impact hedge effectiveness assessment and Harvest's ability to continue applying hedge accounting.

*(viii) Income taxes*

Tax interpretations, regulations and legislation in the various jurisdictions in which Harvest and its subsidiaries operate are subject to change. The Company is also subject to income tax audits and reassessments which may change its provision for income taxes. Therefore, the determination of income taxes is by nature complex, and requires making certain estimates and assumptions.

Harvest recognizes the net deferred tax benefit related to deferred tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred tax assets requires the Company to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted.

*(ix) Contingencies*

Contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

## **Significant Accounting Policies**

### ***(a) Consolidation***

These consolidated financial statements include the accounts of Harvest and its subsidiaries. All inter-entity transactions and balances have been eliminated upon consolidation. Subsidiaries are fully consolidated from the date of acquisition, being the date on which Harvest obtains control, and continue to be consolidated until the date that such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as Harvest, using consistent accounting policies.

Harvest conducts substantially all of its Upstream petroleum and natural gas production activities through jointly controlled assets. The consolidated financial statements reflect only Harvest's proportionate interest in such activities.

### ***(b) Revenue Recognition***

Revenues associated with the sale of crude petroleum, natural gas, natural gas liquids and refined products are recognized when title passes to customers and payment has either been received or collection is reasonably certain. Revenues for retail services are recorded when the services are provided. Revenues are measured at the fair value of the consideration received or receivable.

The sales price of residential home heating fuels and automotive gasoline and diesel within the Province of Newfoundland and Labrador is subject to regulation under the Petroleum Products Act. The Petroleum Products Pricing Commissioner sets the maximum wholesale and retail prices that a wholesaler and a retailer may charge and sets the maximum mark-up between the wholesale price to the retailer and the retail price to the consumer. Prices are set biweekly using a price adjustment formula based on an allowable premium with an interruption formula. The full effect of rate regulation is reflected in the product sales revenue.

### ***(c) Inventories***

Inventories are carried at the lower of cost or net realizable value. The costs of inventory are determined using the weighted average cost method. The valuation of inventory is reviewed at the end of each month. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write-down is reversed. The reversal is

limited to the amount of the original write-down. The costs of parts and supplies inventories are determined under the average cost method.

**(d) Property, Plant, and Equipment ("PP&E") and Exploration and Evaluation ("E&E") Assets**

*(i) Upstream*

Exploration and evaluation expenditures

Prior to acquiring the legal rights to explore an area, all costs are charged directly to the statement of comprehensive loss as E&E expense.

Once the legal rights to explore are acquired, all costs directly associated with the E&E are capitalized. E&E costs are those expenditures incurred for identifying, exploring and evaluating new pools in an area where technical feasibility and commercial viability has not yet been determined. These costs include acquisition of land and mineral leases, geological and geophysical costs, decommissioning costs, E&E drilling, sampling, appraisals and directly attributable general and administrative costs. All such costs are subject to technical, commercial and management review to confirm the continued intent to develop. When this is no longer the case, the costs are charged to net income as E&E expense. When technical feasibility and commercial viability are established, the relevant expenditure is transferred to PP&E after impairment is assessed and any resulting impairment loss is recognized.

E&E assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, E&E assets are allocated to CGUs. The impairment of E&E assets, and any eventual reversal thereof, is recognized as E&E expense in the statement of comprehensive loss.

Development and production costs

The Upstream PP&E generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or an area basis (major components). Development costs include property acquisitions, development drilling, completion, gathering and infrastructure, decommissioning costs and transfers of E&E assets.

Major capital maintenance projects are capitalized but general maintenance and repair costs are charged against income. All other expenditures are recognized in net income as incurred. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of PP&E are recognized in net income as incurred.

Depletion, Depreciation and Amortization

Costs accumulated within each major component of PP&E are depleted using the unit-of-production method by reference to the ratio of production in the period to the related proved developed reserves. Costs of major development projects are excluded from the costs subject to depletion until they are available for use.

Corporate and administrative assets are depreciated on a straight-line basis over the individual assets' useful lives.

Disposal of assets

Gains and losses on disposal of an item of PP&E are determined by comparing the proceeds from disposal with the carrying amount of PP&E and are recognized in the period of disposal.

For exchanges that involve only unproven properties, the exchange is accounted for at cost. Exchanges of development and production assets are measured at fair value unless the exchange transaction lacks commercial substance if neither the fair value of the assets given up nor the assets received can be reliably estimated.

*(ii) Downstream*

PP&E related to the refining assets are recorded at cost. General maintenance and repair costs are expensed as incurred. Major replacements and capital maintenance projects such as turnaround costs are capitalized. Improvements that increase or prolong the service life or capacity of an asset are capitalized. Any gains or losses on disposal of individual assets are recognized in the year of disposal.

### Depreciation

When significant parts of an item of PP&E have different useful lives, they are accounted for as separate items (major components). Depreciation of recorded cost less the residual value is provided on a straight-line basis over the estimated useful life of the major components as set out below.

<b>Asset</b>	<b>Period</b>
Refining and production plant:	
Processing equipment	5 – 35 years
Structures	15 – 20 years
Catalysts and turnarounds	2 – 8 years
Tugs	25 years
Vehicles	2 – 7 years
Office and computer equipment	3 – 5 years

### *(iii) Impairment of Property, Plant and Equipment and Exploration and Evaluation Assets*

Harvest assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, Harvest estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value-in-use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. In such case, an impairment test is performed at the CGU level. A CGU is a group of assets that Harvest aggregates based on their ability to generate largely independent cash flows.

Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. To determine value-in-use, the Company estimates the present value of the future net cash flows expected to derive from the continued use of the asset or CGU. Discount rates that reflect the market assessments of the time value of money and the risks specific to the asset or CGU are used. In determining fair value less costs to sell, discounted cash flows and recent market transactions are taken into account, if available. These calculations are corroborated by valuation multiples or other available fair value indicators.

Impairment losses are recognized in those expense categories consistent with the function of the impaired asset. Impairment losses recognized in respect of a CGU are allocated to reduce the carrying amount of the assets in the unit on a pro rata basis.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been an improvement in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior periods. Such reversal is recognized in the net income.

### **(e) Capitalized interest**

Interest on major development projects is capitalized until the project is complete using the weighted-average interest rate on all of Harvest's borrowings. Capitalized interest is limited to the actual interest incurred.

### **(f) Business Combinations and Goodwill**

Business combinations are accounted for using the acquisition method. The cost of an acquisition including any contingent consideration, is measured as the aggregate of the consideration transferred at acquisition date fair value. The acquired identifiable net assets are measured at their fair value at the date of acquisition. Any excess of the consideration transferred over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the consideration transferred below the fair value of the net assets acquired is recorded as a gain in net income. Associated transaction costs are expensed when incurred.

Those petroleum reserves and resources that are able to be reliably valued are recognized in the assessment of fair values on acquisition. The fair value of oil and natural gas interests is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on reserve estimates. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.



For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to groups of CGUs that are expected to benefit from the combination. Goodwill is carried at cost less impairment and is not amortized.

An impairment loss in respect of goodwill is not reversed. Goodwill is assessed for impairment annually at year-end or more frequently if events occur that could result in impairment. The recoverable amount is determined by calculating the recoverable amount of the group of CGUs goodwill has been allocated to. The excess of the carrying value of goodwill over the recoverable amount is then recognized as impairment and charged to income in the period in which it occurs.

**(g) Provisions**

*(i) General*

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current discount rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

*(ii) Decommissioning Liabilities*

Harvest recognizes the present value of any decommissioning liabilities as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and normal use of the assets. Harvest uses a risk-free rate to estimate the present value of the expenditure required to settle the present obligation at the reporting date. The associated decommissioning costs are capitalized as part of the carrying amount of the related asset and the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligation are charged against the decommissioning liabilities.

*(iii) Contingencies*

A contingency is disclosed where the existence of an obligation will only be confirmed by future events, or where the amount of a present obligation cannot be measured reliably or will likely not result in an economic outflow. Contingent assets are only disclosed when the inflow of economic benefits is probable.

**(h) Income Taxes**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in net income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax liabilities and assets are generally not recognized for temporary differences arising on:

- investments in subsidiaries and associates and interests in joint ventures;
- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which is not a business combination.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, and Harvest intends to settle current tax liabilities and assets on a net basis.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

**(i) Post-Employment Benefits**

Harvest's Downstream operations maintains a defined benefit plan and provides certain post-retirement health care benefits, which cover the majority of its employees and their surviving spouses. The cost of providing the defined pension benefits and other post-retirement benefits is actuarially determined using the projected unit credit method reflecting management's best estimates of discount rates, rate of return on plan assets, rate of compensation increase, retirement ages of employees, and expected health care costs. Post-employment benefit expense includes the cost of benefits earned during the current year, the interest cost on the obligations and the expected return on plan assets.

Pension plan assets are measured at fair values with the difference between the fair value of the plan assets and the total employee benefit obligation recorded on the balance sheet. Actuarial gains or losses are recognized in other comprehensive income immediately.

**(j) Currency Translation**

Foreign currency-denominated transactions are translated to the respective functional currencies of Harvest's entities at exchange rates at the date of the transactions. Non-monetary items measured at historical cost are not subsequently re-translated. Monetary assets and liabilities denominated in foreign currencies are converted into Harvest's functional currencies at the exchange rate at the reporting date. Conversion gains and losses on monetary items are included in net income in the period in which they arise.

Harvest's Downstream operations' functional currency is the U.S. dollar, while Harvest's presentation currency is the Canadian dollar. Therefore, the Downstream operations' assets and liabilities are translated at the period-end exchange rates, while revenues and expenses are translated using monthly average rates. Translation gains and losses relating to the foreign operations are included in accumulated other comprehensive income as a separate component of shareholder's equity.

**(k) Financial Instruments**

Harvest recognizes financial assets and financial liabilities, including derivatives, on the consolidated statements of financial position when the Company becomes a party to the contract. Financial liabilities are removed from the consolidated financial statements when the liability is extinguished either through settlement of or release from the obligation of the underlying liability. Financial assets are derecognised when (1) the rights to receive cash flows from the assets have expired or (2) the Company has transferred its rights to receive cash flows from the assets or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Company has transferred substantially all the risks and rewards of the assets, or (b) the Company has neither transferred nor retained substantially all the risks and rewards of the assets, but has transferred control of the asset.

The Company initially measures all financial instruments at fair value. Subsequent measurement of the financial instruments is based on their classification. Financial assets are classified into the following categories: held for trading, available for sale, held-to-maturity investments and loans and receivables. Financial liabilities are classified as held for trading or other financial liabilities.

Financial assets and financial liabilities classified as held for trading are measured at fair value with changes in those fair values recognized in net income. Financial assets classified as either held-to-maturity or loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Financial assets classified as available-for-sale are measured at fair values with changes in those fair values recognized in other comprehensive income.

Transaction costs relating to financial instruments classified as held for trading are expensed in net income in the period that they are incurred. For transaction costs that are directly attributable to the acquisition or issuance of financial instruments not classified as held for trading, they are included in the costs of the financial instruments upon initial recognition.

Harvest assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired, as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

**(l) Hedges**

Harvest uses derivative financial instruments such as foreign currency contracts and financial commodity contracts to hedge its foreign currency risks and commodity price risks. Such derivative financial instruments are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. Any gains or losses

arising from changes in the fair value of derivatives are recorded in net income, except for the effective portion of cash flow hedges, which is recognized in other comprehensive income.

At the inception of a hedge relationship, Harvest formally designates and documents the hedge relationship to which the Company intends to apply hedge accounting. The designation document includes the risk management objective and strategy for undertaking the hedge, the identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Company will assess the hedge effectiveness. Upon designation and at each reporting date, Harvest assesses hedge effectiveness by comparing the changes in the hedging instrument's fair value or cash flows and the changes in the hedged item's fair value or cash flows attributable to the hedged risk. Only if such hedges are highly effective in achieving offsetting changes in fair value or cash flows will Harvest continue to apply hedge accounting.

The effective portion of the gain or loss on the hedging instrument is recognized directly in other comprehensive income, while any ineffective portion is recognized immediately in net income. Amounts recognized in other comprehensive income are transferred to the statement of comprehensive loss when the hedged transaction affects net income, such as when the hedged forecasted transaction occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, the amounts recognized in other comprehensive income are transferred to the initial carrying amount of the nonfinancial asset or liability.

If the forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognized in other comprehensive income is transferred to net income. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, any cumulative gains or losses previously recognized in other comprehensive income remain in other comprehensive income until the forecast transaction affects net income.

**(m) Cash and Cash Equivalents**

Cash and cash equivalents are comprised of cash and investments with a maturity date of three months or less and are recorded at fair value.

**(n) Investment Tax Credits**

Harvest is entitled to certain investment tax credits on qualifying manufacturing capital expenditures relating to its Downstream operations. These credits are recorded as a reduction of the cost of the related asset. The benefits are recognized when the Company has complied with the terms and conditions of applicable tax legislation provided there is reasonable assurance of realization.

**(o) Leases**

Leases or other arrangements entered into for the use of an asset are classified as either finance or operating leases. Finance leases transfer to the Company substantially all of the risks and benefits incidental to ownership of the leased item. Finance leases are capitalized at the commencement of the lease term at the lower of the fair value of the leased asset or the present value of the minimum lease payments. Capitalized leased assets are amortized over the shorter of the estimated useful life of the assets and the lease term. Operating lease payments are recognized as an expense in the income statement on a straight line basis over the lease term.

**(p) Recent Pronouncements**

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

- On January 1, 2015, Harvest will be required to adopt IFRS 9, "Financial Instruments", which is the result of the first phase of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. Restatement of comparative period financial statements is not required upon initial application; however, modified disclosures on transition from the classification and measurement requirements of IAS 39 to IFRS 9 are required. Harvest is in the process of determining the potential impact of the adoption of this new standard.
- In May 2011, the IASB issued the following new standards, which are effective for annual periods beginning on or after January 1, 2013:
- IFRS 10, "Consolidated Financial Statements", replaces the consolidation requirements in SIC-12, "Consolidation – Special Purpose Entities" and a portion of IAS 27. IFRS 10 builds on existing

- Principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess. IFRS 10 requires retrospective application and early adoption is permitted.
- IFRS 11, “Joint Arrangements”, focuses on the rights and obligations of the joint arrangement, rather than its legal form (as is currently the case) and requires a single method to account for interests in jointly controlled entities (equity method). This standard requires retrospective application and early adoption is permitted.
- IFRS 12, “Disclosure of Interest in Other Entities”, is a comprehensive standard on disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, structure entities and other off balance sheet interests. IFRS 12 requires retrospective application and early adoption is permitted.
- IFRS 13, “Fair Value Measurement”, provides a consistent definition of fair value, establishes a single framework for determining fair value and introduces requirements for disclosures related to fair value measurement. IFRS 13 applies prospectively from the beginning of the annual period in which the standard is adopted. Early adoption is permitted.

Harvest is assessing the potential financial statement impact from adopting these new standards.

- On June 16, 2011, the IASB issued an amendment to IAS 19, “Employee Benefits”, which changes the recognition and measurement of defined benefit pension expense and termination benefits and expands disclosure requirements for all employee benefit plans. The new standard is required to be adopted for periods beginning on or after January 1, 2013. Harvest is currently assessing the financial statement impact of the new standard.
- The IASB issued an amendment to IAS 1, “Presentation of Financial Statements” on June 16, 2011, which requires separating items presented in other comprehensive income between those that are recycled to income and those that are not. The standard is required to be adopted for periods beginning on or after July 1, 2012. The adoption of this standard should not have a material impact on the Company’s consolidated financial statements.
- In December 2011, the IASB issued amendments to IFRS 7 “Financial Instruments: Disclosures” and IAS 32, “Financial Instruments: Presentation” to clarify the current offsetting model and develop common disclosure requirements. Amendments to IFRS 7 are effective for annual periods beginning on or after January 1, 2013. Retrospective application is required and early adoption is permitted. Amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014. Retrospective application is required. Harvest is currently assessing the financial statement impact of the new standard.

### 3. Acquisitions

#### a) Hunt Acquisition

On February 28, 2011, Harvest acquired certain petroleum and natural gas assets of Hunt Oil Company of Canada, Inc. and Hunt Oil Alberta, Inc. (collectively "Hunt") for total cash consideration of \$511.0 million. KNOC provided \$505.4 million of equity to fund the acquisition and acquisition costs were \$1.3 million (2010 - \$0.1 million) for the year ended December 31, 2011. An additional \$25 million is payable to Hunt in the event that Canadian natural gas prices exceed certain pre-determined levels in 2012. This potential payable is considered contingent consideration and is required to be fair valued. Based on forecast gas prices, the probability of incurring this payment was assessed as low; as such no fair value was assigned on the allocation of consideration transferred. The Company's assessment of this contingent liability remained the same at December 31, 2011 whereby no provision was recorded.

Hunt reimbursed Harvest for costs associated with restoring production as well as the lost revenues net of operating costs relating to certain properties between October 1, 2010 and April 3, 2011, when production was resumed. A portion of the reimbursement could have reverted to Hunt if the future net revenue earned by Harvest during the six months after April 3, 2011 exceeded the reimbursed amount. Subsequent to the six-month period, it was agreed that no refund of the reimbursement was necessary.

The acquisition was accounted for as a business combination. The fair values of identifiable assets and liabilities, including interim adjustments as at the date of acquisition were:

Property, plant and equipment	\$	530,946
Evaluation and exploration assets		18,627
Decommissioning liabilities		(38,030)
Other liabilities		(500)
Cash consideration	\$	511,043

The final review of the fair value of the purchase price allocation was completed at December 31, 2011.

From the date of acquisition, the Hunt assets have contributed \$133.0 million of revenue and \$96.6 million to Harvest's earnings before depletion and income tax in 2011. If the acquisition had been completed on the first day of 2011, Harvest's revenues for the year ended December 31, 2011 would have been \$14.6 million higher and the earnings before depletion and income tax would have been \$7.4 million higher.

#### b) Petroleum and Natural Gas Assets

On September 30, 2010, Harvest acquired certain petroleum and natural gas assets including the remaining 40% interest in an operating partnership for total cash consideration of \$144.2 million. The acquisition was accounted for as a business combination and acquisition costs were \$0.2 million (2010 - \$0.3 million) for the year ended December 31, 2011. The fair values of identifiable assets and liabilities as at the date of acquisition were:

Property, plant and equipment	\$	166,966
Evaluation and exploration assets		587
Decommissioning liabilities		(18,358)
Deferred tax liabilities		(5,032)
Total cash consideration	\$	144,163

The assets have contributed \$8.4 million of revenue and \$6.0 million to Harvest's earnings before depletion and income tax from the date of acquisition to December 31, 2010. If the acquisition had been completed on the first day of 2010, Harvest's revenues for the year would have been \$27.1 million higher and the earnings before depletion and income tax would have been \$16.6 million higher.

The final statement of adjustments was received in 2011 and as a result, the property, plant and equipment balance decreased as compared to the provisional value by an immaterial amount. Therefore the 2010 comparative financial statements were not restated. The decrease in depletion, depreciation and amortization as a result of the revised property, plant and equipment balance was also not material.

#### 4. Cash and Cash Equivalents

	December 31, 2011	December 31, 2010	January 1, 2010
Cash on hand and at banks	\$ 6,607	\$ 7,906	\$ –
Short-term deposits	–	11,000	–
	\$ 6,607	\$ 18,906	\$ –

#### 5. Inventories

	December 31, 2011	December 31, 2010	January 1, 2010
Petroleum products			
Upstream – pipeline fill	\$ 1,325	\$ 1,010	\$ 1,183
Downstream	56,298	70,586	81,240
Total petroleum product inventory	57,623	71,596	82,423
Parts and supplies	3,329	3,921	4,396
	\$ 60,952	\$ 75,517	\$ 86,819

#### 6. Exploration and Evaluation Assets (“E&E”)

As at January 1, 2010	\$ 36,034
Additions	46,997
Acquisition	–
Dispositions	(971)
Unsuccessful exploration and evaluation costs	(2,858)
Transfer to property, plant and equipment	(19,648)
As at December 31, 2010	\$ 59,554
Additions	50,883
Acquisition	18,627
Dispositions	(717)
Unsuccessful exploration & evaluation costs	(17,757)
Transfer to property, plant & equipment	(36,073)
<b>As at December 31, 2011</b>	<b>\$ 74,517</b>

	Year Ended December 31	
	2011	2010
Pre-licensing costs	\$ 532	\$ 442
Unsuccessful E&E costs	17,757	2,858
E&E expense	\$ 18,289	\$ 3,300



**7. Property, Plant and Equipment ("PP&E")**

	Upstream	Downstream	Total
Cost:			
As at January 1, 2010	\$ 2,940,877	\$ 1,113,742	\$ 4,054,619
Additions	356,788	71,297	428,085
Acquisitions	574,941	—	574,941
Change in decommissioning liabilities	71,838	2,407	74,245
Transfers from E&E	19,648	—	19,648
Exchange adjustment	—	(63,037)	(63,037)
Disposals	63	(49)	14
Investment tax credits	—	(42,475)	(42,475)
As at December 31, 2010	3,964,155	1,081,885	5,046,040
Additions	682,497	284,244	966,741
Acquisitions	533,963	—	533,963
Change in decommissioning liabilities	(18,245)	3,767	(14,478)
Transfers from E&E	36,073	—	36,073
Exchange adjustment	—	36,928	36,928
Disposals	(882)	(18,031)	(18,913)
Investment tax credits	—	(10,187)	(10,187)
<b>As at December 31, 2011</b>	<b>\$ 5,197,561</b>	<b>\$ 1,378,606</b>	<b>\$ 6,576,167</b>
Accumulated depletion, amortization, depreciation and impairment losses:			
As at January 1, 2010	\$ —	\$ —	\$ —
Depreciation, depletion and amortization	470,641	83,091	553,732
Impairment	13,661	—	13,661
Exchange adjustment	—	(4,589)	(4,589)
As at December 31, 2010	484,302	78,502	562,804
Depreciation, depletion and amortization	535,384	91,006	626,390
Disposals	—	(18,031)	(18,031)
Exchange adjustment	—	4,617	4,617
<b>As at December 31, 2011</b>	<b>\$ 1,019,686</b>	<b>\$ 156,094</b>	<b>\$ 1,175,780</b>
Net Book Value:			
<b>As at December 31, 2011</b>	<b>\$ 4,177,875</b>	<b>\$ 1,222,512</b>	<b>\$ 5,400,387</b>
As at December 31, 2010	\$ 3,479,853	\$ 1,003,383	\$ 4,483,236
As at January 1, 2010	\$ 2,940,877	\$ 1,113,742	\$ 4,054,619

General and administrative costs of \$22.2 million (2010 - \$14.6 million) and interest of \$4.5 million (2010 - \$0.4 million) have been capitalized in Upstream PP&E for the year ended December 31, 2011. Interest of \$4.1 million (2010 - \$nil) have been capitalized in Downstream PP&E during the year ended December 31, 2011. Capitalized interest measured using a weighted average interest rate of 6.65% (2010 - 6.50%) arose from the BlackGold oil sands project ("BlackGold") and Downstream debottlenecking project.

At December 31, 2011 the following costs were excluded from the asset base subject to depreciation, depletion and amortization: Downstream major parts inventory of \$7.5 million (2010 - \$6.8 million), Downstream assets under construction of \$102.5 million (2010 - \$68.8 million) and Upstream BlackGold oil sands project assets of \$497.2 million (2010 - \$385.3 million). For the year ended December 31, 2011, an investment tax credit of \$10.2 million (2010 - \$42.5 million) was applied against Downstream assets.

During the year ended December 31, 2011, Harvest recorded an impairment loss of \$nil to PP&E. An increase of 50 bps in the pre-tax discount rate would result in an impairment of \$38.4 million, while a 10% decrease in gross margin would result in an impairment of \$222.3 million in Downstream PP&E. During the year ended December 31, 2010, Harvest recorded a \$13.7 million

impairment related to certain Upstream properties in Southern Alberta to reflect declining forecasted gas prices which resulted in lower estimated future cash flows using a pre-tax discount rate of 12%. The recoverable amount is based on the assets' value-in-use, estimated using the net present value of the future cash flow.

## 8. Goodwill

Goodwill of \$404.9 million (2010 - \$404.9 million) has been allocated to the Upstream operating segment. In assessing whether goodwill has been impaired, the carrying amount (including goodwill) is compared with the recoverable amount of the Upstream operating segment. At December 31, 2011, the recoverable amount was determined by using the expected cash flows generated from the projected oil and natural gas production profiles up to the expected dates of cessation of production. The key assumptions required to estimate the recoverable amount are the oil and natural gas prices, production volumes and the discount rate. The values assigned to the key assumptions represent management's assessment of future trends in the oil and gas industry based on both external and internal sources. A pre-tax discount rate of 10% (and the following forward commodity price estimates) were used in the goodwill impairment calculation:

Year	WTI Crude Oil (\$US/bbl) <sup>(1)</sup>	AECO Gas (\$Cdn/Mmbtu) <sup>(1)</sup>	US\$/Cdn\$ Exchange Rate <sup>(1)</sup>
2012	97.50	3.50	0.975
2013	97.50	4.20	0.975
2014	100.00	4.70	0.975
2015	100.80	5.10	0.975
2016	101.70	5.55	0.975
2017	102.70	5.90	0.975
2018	103.60	6.25	0.975
2019	104.50	6.45	0.975
2020	105.40	6.70	0.975
2021	107.60	6.85	0.975
2022	109.70	6.95	0.975
2023	111.90	7.05	0.975
2024	114.10	7.20	0.975
2025	116.40	7.40	0.975
2026	118.80	7.55	0.975
Thereafter <sup>(2)</sup>	+2%/year	+2%/year	0.975

(1) Source: McDaniel & Associates Consultants Ltd, effective January 1, 2012.

(2) Percentage change represents the change in each year after 2026 to the end of the reserve life.

## 9. Decommissioning Liabilities

Harvest's decommissioning liabilities arise from its net ownership interests in petroleum and natural gas assets including well sites, gathering systems, pipeline, processing facilities and Downstream refining and marketing assets and its legal obligations to retire and reclaim them. Harvest estimates the total undiscounted amount of cash flows required to settle its decommissioning liabilities to be approximately \$1.4 billion at December 31, 2011 (2010 - \$1.2 billion), which will be incurred between 2012 and 2072. A risk-free discount rate of 3.0% (2010 - 3.4%) and inflation rate of 1.7% (2010 - 1.7%) were used to calculate the fair value of the decommissioning liabilities. Revisions in decommissioning liabilities in 2011 resulted from changes in the discount rates, estimated abandonment dates and estimated costs, while 2010 revisions resulted from a change in the discount rate. However, actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning work required, which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain. A reconciliation of the decommissioning liabilities is provided below:

	Upstream	Downstream	Total
Balance at January 1, 2010	\$ 559,810	\$ 7,676	\$ 567,486
Liabilities assumed on acquisitions	22,393	—	22,393
Liabilities incurred	9,316	—	9,316
Settled during the period	(20,257)	—	(20,257)
Revisions (change in estimate)	58,989	2,407	61,396
Accretion	22,342	343	22,685
Balance at December 31, 2010	652,593	10,426	663,019
Liabilities assumed on acquisitions	38,030	—	38,030
Liabilities incurred	28,382	—	28,382
Settled during the period	(22,110)	—	(22,110)
Revisions (change in estimate)	(46,627)	3,767	(42,860)
Disposals	(708)	—	(708)
Accretion	23,151	400	23,551
<b>Balance at December 31, 2011</b>	<b>\$ 672,711</b>	<b>\$ 14,593</b>	<b>\$ 687,304</b>
Current portion of decommissioning liabilities	\$ 12,782	\$ —	\$ 12,782
Non-current portion of decommissioning liabilities	659,929	14,593	674,522
<b>Balance at December 31, 2011</b>	<b>\$ 672,711</b>	<b>\$ 14,593</b>	<b>\$ 687,304</b>

## 10. Bank Loan

At the time of the purchase of Harvest Energy Trust ("Trust") by KNOC Canada on December 22, 2009, the Trust had renegotiated a temporary credit facility of \$600 million with the maturity date of April 30, 2010. At January 1, 2010, \$428 million was drawn under the credit facility. On April 30, 2010, Harvest entered into an amended and extended credit facility maturing April 30, 2013 and the facility was reduced from \$600 million to \$500 million.

On April 29, 2011, Harvest further extended the term of its credit facility by 2 years to April 30, 2015. Harvest pays a floating interest rate under its credit facility, which is determined by a grid based on the Company's secured debt (excluding 67/8% senior notes and convertible debentures) to earnings before interest, taxes, depletion, amortization and other non-cash items ("EBITDA"). The minimum rate charged on the credit facility was amended on April 29, 2011, decreasing the floating rate from 200 bps to 175 bps over bankers' acceptance rates, to the extent that Harvest's secured debt to EBITDA ratio remains below or equal to one.

On December 16, 2011, the credit facility was amended to increase the capacity of the facility from \$500 million to \$800 million and the minimum rate charged on the credit facility decreased further from 175 bps to 160 bps over bankers' acceptance rates. The determination of the financial covenants remains unchanged and is disclosed below. At December 31, 2011, Harvest had \$358.9 million drawn from the \$800 million available under the credit facility (2010 - \$14 million).

The credit facility is secured by a first floating charge over all of the assets of Harvest's operating subsidiaries plus a first mortgage security interest on the Downstream operation's refinery assets. The most restrictive covenants of Harvest's credit

facility include an aggregate limitation of \$25 million on financial assistance and/or capital contributions to parties other than those included in the first floating charge, a limitation to carrying on business in countries that are not members of the Organization of Economic Co-operation and Development and a limitation on the payment of distributions to the shareholder in certain circumstances such as an event of default. The credit facility requires standby fees on undrawn amounts and interest on amounts borrowed at varying rates depending on Harvest's ratio of secured debt (excluding the 67/8% senior notes and convertible debentures) to its EBITDA. In addition to the availability under this facility being limited by the borrowing base covenant of the 67/8% senior notes described in note 11, availability is subject to the following quarterly financial covenants as defined in the credit facility agreement:

	Covenant	December 31, 2011	December 31, 2010
Secured debt <sup>(1)</sup> to Annualized EBITDA	3.0 to 1.0 or less	<b>0.73</b>	0.06
Total debt <sup>(2)</sup> to Annualized EBITDA	3.5 to 1.0 or less	<b>2.72</b>	2.39
Secured debt <sup>(1)</sup> to Capitalization <sup>(3)</sup>	50% or less	<b>10%</b>	1%
Total debt <sup>(2)</sup> to Capitalization <sup>(3)</sup>	55% or less	<b>36%</b>	31%

(1) Secured debt consists of letters of credit of \$8.7 million (2010 – \$2.5 million), bank loan of \$355.6 million (2010 - \$11.4 million) and guarantees of \$92.1 million (2010 - \$15.5 million) at December 31, 2011.

(2) Total debt consists of secured debt, convertible debentures and senior notes.

(3) Capitalization consists of total debt and shareholder's equity less equity for BlackGold of \$459.9 million at December 31, 2010 and 2011.

For the year ended December 31, 2011 interest charges on the bank loan aggregated to \$5.7 million (2010 - \$5.7 million) reflecting an effective interest rate of 3.0% (2010 – 3.7%).

## 11. Senior Notes

On October 4, 2010, Harvest issued US\$500 million of 67/8% senior notes for net cash proceeds of US\$484.6 million. The senior notes are unsecured with interest payable semi-annually on April 1 and October 1 and mature on October 1, 2017. The senior notes are unconditionally guaranteed by Harvest and all of its wholly-owned subsidiaries that guarantee the revolving credit facility and every future restricted subsidiary that guarantees certain debt. The notes are redeemable at a redemption price equal to 100% of the principal amount of the notes being redeemed plus a make-whole redemption premium, plus accrued and unpaid interest to the redemption date. Harvest may also redeem the notes at any time in the event that certain changes affecting Canadian withholding taxes occur.

There are covenants restricting, among other things, the sale of assets and the incurrence of additional indebtedness if such issuance would result in an interest coverage ratio, as defined, of less than 2.0 to 1. Notwithstanding the interest coverage ratio limitation, the incurrence of additional indebtedness under the credit facilities may be limited by the borrowing base covenant and certain other specific circumstances. The covenant restricts Harvest's incurrence of indebtedness under the credit facility in an aggregate principal amount not to exceed the greater of \$1.0 billion and 15% of total assets. In addition, the covenants of the senior notes restrict the amount of dividends Harvest can pay to shareholders; no dividends have been paid during the year ended December 31, 2011.

In 2010, Harvest redeemed the US\$250 million of 77/8% senior notes for total consideration of \$256.9 million.

## 12. Convertible Debentures

Harvest has four series of convertible unsecured subordinated debentures outstanding. Interest on the debentures is payable semi-annually in arrears in equal installments on dates prescribed by each series.

As a result of KNOC'S acquisition of Harvest Energy Trust, in 2009, the debentures are no longer convertible into units but investors would receive \$10.00 for each unit notionally received based on each series conversion rate. Because every series of debentures carry a conversion price that exceeds \$10.00 per unit, it is assumed that no investor would exercise their conversion option.

The debentures may be redeemed by Harvest at its option in whole or in part prior to their respective redemption dates. The redemption price for the first redemption period is at a price equal to \$1,050 per debenture and at \$1,025 per debenture during the second redemption period. After the second redemption period, the debentures are redeemable at par. Any redemption will include accrued and unpaid interest at such time.

The following is a summary of the four series of convertible debentures:

Series	Interest Rate	Conversion price / share	Maturity	First redemption period	Second redemption period
D	6.40%	\$ 46.00	Oct. 31, 2012	Nov. 1/08-Oct. 31/09	Nov. 1/09-Oct. 31/10
E	7.25%	\$ 32.20	Sept. 30, 2013	Oct. 1/09-Sept. 30/10	Oct. 1/10-Sept. 30/11
F	7.25%	\$ 27.25	Feb. 28, 2014	Mar. 1/10-Feb. 28/11	Mar. 1/11-Feb. 29/12
G	7.50%	\$ 27.40	May 31, 2015	Jun. 1/11-May 31/12	Jun. 1/12-May 31/13

The following table summarizes the face value, carrying amount and fair value of the convertible debentures

December 31, 2011				December 31, 2010			January 1, 2010		
Series	Face Value	Carrying Amount	Fair Value	Face Value	Carrying Amount	Fair Value	Face Value	Carrying Amount	Fair Value
B	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 37,062	\$ 37,562	\$ 37,562
D	106,796	107,146	108,184	106,796	107,544	108,291	174,626	176,460	176,460
E	330,548	333,346	337,159	330,548	334,804	339,142	379,256	385,703	385,703
F	60,050	60,616	61,551	60,050	60,851	61,912	73,222	74,467	74,467
G	236,579	240,959	245,451	236,579	242,058	248,763	250,000	256,875	256,875
	733,973	742,067	752,345	733,973	745,257	758,108	914,166	931,067	931,067

The KNOC acquisition of the Trust triggered the “change of control” provision included within the convertible debentures’ indentures, which required Harvest to make an offer to purchase 100% of the outstanding convertible debentures for cash consideration of 101% of the principal amount thereof plus accrued and unpaid interest. Harvest made these offers on January 20, 2010 and by March 4, 2010 all of the offers had expired. The following redemptions were made:

- Series B: \$13.3 million principal amount tendered, leaving a principal balance of \$23.8 million maturing on December 31, 2010
- Series D: \$67.8 million principal amount tendered leaving a principal balance of \$106.8 million outstanding
- Series E: \$48.7 million principal amount tendered leaving a principal balance of \$330.5 million outstanding
- Series F: \$13.2 million principal amount tendered leaving a principal balance of \$60.1 million outstanding
- Series G: \$13.4 million principal amount tendered leaving a principal balance of \$236.6 million outstanding

### 13. Shareholder’s Capital

#### (a) Authorized

The authorized capital consists of an unlimited number of common shares with no par value and an unlimited number of preferred shares issuable in series.

#### (b) Number of Common Shares Issued

Outstanding at January 1, 2010	242,268,802
Issued to KNOC at \$10.00 per share to fund debt repayment	46,567,852
Issued to KNOC at \$10.00 per share for BlackGold consideration [Note 26]	37,416,913
Issued to KNOC at \$10.00 per share for BlackGold project development	4,700,000
Issued to KNOC at \$10.00 per share for BlackGold project development	3,868,600
Issued to KNOC at \$10.00 per share for KNOC Global Technology and Research centre	712,880
Outstanding at December 31, 2010	335,535,047
Issued to KNOC at \$10.00 per share for Hunt acquisition	50,543,602
<b>Outstanding at December 31, 2011</b>	<b>386,078,649</b>

#### 14. Capital Structure

Harvest considers its capital structure to be its credit facility, senior notes, convertible debentures and shareholder's equity.

	December 31, 2011	December 31, 2010	January 1, 2010
Bank loan <sup>(1)</sup>	\$ 358,885	\$ 14,000	\$ 428,017
6 <sup>7/8</sup> % senior notes <sup>(1)(2)</sup>	508,500	497,300	-
7 <sup>7/8</sup> % senior notes <sup>(1)(2)</sup>	-	-	262,750
Principal amount of convertible <sup>(1)</sup> debentures	733,973	733,973	914,166
	<b>1,601,358</b>	<b>1,245,273</b>	<b>1,604,933</b>
Shareholder's equity	<b>3,453,644</b>	<b>3,016,855</b>	<b>2,219,513</b>
	<b>\$ 5,055,002</b>	<b>\$ 4,262,128</b>	<b>\$ 3,824,446</b>

(1) Excludes deferred financing costs.

(2) Face value converted at the period end exchange rate.

Harvest's primary objective in its management of capital resources is to have access to capital to fund its financial obligations as well as future growth. Harvest monitors its capital structure and makes adjustments according to market conditions to remain flexible while meeting these objectives. Accordingly, Harvest may adjust its capital spending programs, issue equity, issue new debt or repay existing debt.

Harvest evaluates its capital structure using the following financial ratios: bank loan to twelve month trailing EBITDA and total debt to total debt plus shareholder's equity. These ratios are also included in the externally imposed capital requirements per the Company's credit facility, senior notes and convertible debentures; Harvest was in compliance with all debt covenants at December 31, 2011.

#### 15. Revenue and Other Income

	Year Ended December 31	
	2011	2010
Crude oil and natural gas sales, net of royalty	\$ 1,100,838	\$ 852,247
Refinery products sales	3,239,455	3,105,957
Effective portion of realized crude oil hedges	(9,424)	-
	<b>\$ 4,330,869</b>	<b>\$ 3,958,204</b>

#### 16. Operating and General and Administrative ("G&A") Expenses

	Year Ended December 31					
	2011			2010		
Operating expenses	Upstream	Downstream	Total	Upstream	Downstream	Total
Power and purchased energy	\$ 83,092	\$ 117,275	\$ 200,367	\$ 59,106	\$ 106,126	\$165,232
Well servicing	61,592	-	61,592	50,427	-	50,427
Repairs and maintenance	60,038	20,407	80,445	43,720	22,341	66,061
Lease rentals and property taxes	34,728	-	34,728	30,637	-	30,637
Salaries and benefits	28,137	58,907	87,044	22,641	60,959	83,600
Professional and consultation fees	19,378	4,519	23,897	15,966	3,784	19,750
Chemicals	15,360	-	15,360	12,981	-	12,981
Processing fees	22,643	-	22,643	13,538	-	13,538
Trucking	13,261	-	13,261	9,645	-	9,645
Other	12,227	24,567	36,794	6,932	22,430	29,362
	<b>\$ 350,456</b>	<b>\$ 225,675</b>	<b>\$ 576,131</b>	<b>\$ 265,593</b>	<b>\$ 215,640</b>	<b>\$481,233</b>



	Year Ended December 31	
	2011	2010
General and administrative expenses		
Salaries and benefits	\$ 59,543	\$ 44,545
Professional and consultation fees	7,864	8,387
Other	18,512	9,334
G&A capitalized and recovery	(23,351)	(15,199)
	\$ 62,568	\$ 47,067

#### 17. Finance Costs

	Year Ended December 31	
	2011	2010
Interest and other finance charges	\$ 94,216	\$ 78,520
Accretion of decommissioning liabilities	23,551	22,685
Less: capitalized interest	(8,640)	(397)
	\$ 109,127	\$ 100,808

#### 18. Foreign Exchange

	Year Ended December 31	
	2011	2010
Realized (gains) losses on foreign exchange	\$ (6,541)	\$ (1,524)
Unrealized (gains) losses on foreign exchange	2,555	(1,875)
	\$ (3,986)	\$ (3,399)

#### 19. Supplemental Cash Flow Information

	Year Ended December 31	
	2011	2010
Source (use) of cash:		
Accounts receivable and other	\$ 1,679	\$ (35,269)
Prepaid expenses (including long-term deposit)	42,223	(70,123)
Inventories	14,565	11,302
Accounts payable	103,661	155,109
Net changes in non-cash working capital	162,128	61,019
Changes relating to operating activities	51,061	32,299
Changes relating to financing activities	-	1,952
Changes relating to investing activities	108,747	22,503
Add: Non-cash changes	2,320	4,265
	\$ 162,128	\$ 61,019

#### 20. Income Taxes

	Year Ended December 31	
	2011	2010
Current income tax expense (recovery)	\$ 53	\$ (212)
Deferred income tax ("DIT") recovery	(29,880)	(65,097)
	\$ (29,827)	\$ (65,309)

The income tax recovery varies from the amount that would be computed by applying the relevant Canadian income tax rates to reported losses before taxes as follows:

	Year Ended December 31	
	2011	2010
Loss before income tax	\$ (134,484)	\$ (146,472)
Combined Canadian federal and provincial statutory income tax rate	28.08%	28.25%
Computed income tax recovery at statutory rates	(37,763)	(41,378)
Increased expense (recovery) resulting from the following:		
Difference between current and expected tax rates	13,894	(12,862)
Foreign exchange impact not recognized in income	7,848	(10,931)
Amended returns and pool balances	4,946	-
Change in valuation allowance	(12,692)	-
Non-deductible expenses	(3,499)	(2,409)
Other	(2,561)	(212)
Non-taxable portion of capital loss	-	2,483
Income tax recovery	\$ (29,827)	\$ (65,309)

The change in the applicable tax rate for the year ended December 31, 2011 from the previous year is due to a reduction in the federal component of the tax rate.

Movements in the DIT asset (liability) are as follows:

	PP&E	Decommissioning liabilities	Non-capital tax losses	Other	Total deferred asset (Liability)
At January 1, 2010	\$ (574,644)	\$ 144,867	\$ 289,647	\$(1,975)	\$(142,105)
Recognized in profit or loss	23,205	23,615	13,469	4,808	65,097
Acquired in business combination	(5,032)	-	-	-	(5,032)
Recognized in other comprehensive loss	-	-	-	2,530	2,530
At December 31, 2010	\$ (556,471)	\$ 168,482	\$ 303,116	\$ 5,363	\$(79,510) <sup>(1)</sup>
Recognized in profit or loss	(48,823)	3,898	71,921	2,884	29,880
Recognized in other comprehensive loss	-	-	-	(5,277)	(5,277)
<b>At December 31, 2011</b>	<b>\$ (605,294)</b>	<b>\$ 172,380</b>	<b>\$ 375,037</b>	<b>\$ 2,970</b>	<b>\$ (54,907)</b>

(1) The net DIT liability at December 31, 2010 consists of a \$1.6 million DIT asset and an \$81.1 million DIT liability.

DIT assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax losses can be utilized. As at December 31, 2011, Harvest had approximately \$1.6 billion of carry-forward tax losses that would be available to offset against future taxable profit. A DIT asset has been recognized in respect of all of these losses, and is included in the net DIT liability of \$54.9 million. The DIT asset related to the carry-forward losses has been recorded despite the fact that the Company has incurred losses before income tax in 2010 and 2011. The Company has tax planning opportunities available that could support full recognition of these losses as a DIT asset.

## 21. Post-Employment Benefits

The measurement of the accrued benefit obligation and annual expense for the defined benefit plans requires actuarial calculations and the following key assumptions.

	December 31, 2011		December 31, 2010		January 1, 2010	
	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Discount rate	5.0%	5.0%	5.25%	5.25%	5.5%	5.5%
Expected long-term rate of return on plan assets	7.0%	—	7.0%	—	7.0%	—
Rate of compensation increase	3.5%	—	3.5%	—	3.5%	—
Employee contribution of pensionable income	6.0%	—	6.0%	—	6.0%	—
Annual rate of increase in covered health care benefits	—	8%	—	8%	-	9%

The defined benefit pension plan asset mix is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Bonds/fixed income securities	30%	32%	31%
Equity securities	70%	68%	69%

Total cash payments for employee future benefits, consisting of cash contributed by Harvest to the pension plans and other benefit plans was \$3.6 million for the year ended December 31, 2011 (2010 - \$3.9 million); the expected contribution for the pension plans and other benefit plans in 2012 is \$5.3 million.

The expected long-term rates of return are estimated based on many factors, including the expected forecast for inflation, risk premiums for each class of asset, and current and future financial market conditions.

The defined benefit plans were subject to an actuarial valuation on December 31, 2011, and the next valuation report is due December 31, 2012.

	December 31, 2011			December 31, 2010		
	Pension Plans	Other Benefit Plans	Total	Pension Plans	Other Benefit Plans	Total
Employee benefit obligation, beginning of period	\$ 63,791	\$ 7,901	\$ 71,692	\$ 56,476	\$ 7,047	\$ 63,523
Current service costs	2,466	285	2,751	2,189	291	2,480
Interest costs	3,507	423	3,930	3,258	397	3,655
Employee contributions	1,606	202	1,808	1,526	170	1,696
Actuarial gain (loss)	1,572	(137)	1,435	2,250	423	2,673
Benefits paid	(2,123)	(481)	(2,604)	(1,908)	(427)	(2,335)
Employee benefit obligation, end of period	\$ 70,819	\$ 8,193	\$ 79,012	\$ 63,791	\$ 7,901	\$ 71,692
Fair value of plan assets, beginning of period	\$ 51,327	\$ —	\$ 51,327	\$ 46,070	\$ —	\$ 46,070
Expected return on plan assets	3,623	—	3,623	3,277	—	3,277
Actuarial loss	(4,678)	—	(4,678)	(1,243)	—	(1,243)
Employer contributions	3,299	279	3,578	3,605	257	3,862
Employee contributions	1,606	202	1,808	1,526	170	1,696
Benefits paid	(2,123)	(481)	(2,604)	(1,908)	(427)	(2,335)
Fair value of plan assets, end of period	\$ 53,054	\$ —	\$ 53,054	\$ 51,327	\$ —	\$ 51,327
Funded status – deficit	\$ (17,765)	\$ (8,193)	\$ (25,958)	\$ (12,464)	\$ (7,901)	\$ (20,365)
Experience adjustments arising on plan assets	(8.8)%	—		(2.4)%	—	
Experience adjustments arising on plan liabilities	(2.2)%	1.7%		(3.5)%	(5.4)%	

The table below shows the components of the net benefit plan expense:

	Year Ended December 31					
	2011			2010		
	Pension Plans	Other Benefit Plans	Total	Pension Plans	Other Benefit Plans	Total
Current service cost	\$ 2,466	\$ 285	\$ 2,751	\$ 2,189	\$ 291	\$ 2,480
Interest costs	3,507	423	3,930	3,258	397	3,655
Expected return on assets	(3,623)	—	(3,623)	(3,277)	—	(3,277)
Net benefit plan expense	\$ 2,350	\$ 708	\$ 3,058	\$ 2,170	\$ 688	\$ 2,858

The actual loss on plan assets for the year ended December 31, 2011 was \$1.1 million (December 31, 2010 - a return of \$2.0 million).

For the year ended December 31, 2011 the net benefit plan expense of \$3.1 million (2010 - \$2.9 million) has been included in operating expenses in the statement of comprehensive loss. An actuarial loss of \$4.9 million, net of tax of \$1.2 million (2010 - \$3.2 million, net of tax of \$0.7 million) has been included in other comprehensive income. The cumulative amount of actuarial loss included in accumulated other comprehensive loss as at December 31, 2011 is \$8.1 million, net of tax of \$1.9 million.

Under the pension regulations, North Atlantic is required to fund its defined benefit pension plan obligation within 5 to 15 years. The funding requirements are included in note 25.

A 1 % change in the expected health care cost trend rate would have an immaterial annual impact on post-retirement benefit expense and projected benefit obligation as at December 31, 2011.

## 22. Accumulated Other Comprehensive Income (Loss)

	Foreign Currency Translation Adjustment	Gains (Losses) on Designated Cash Flow Hedges, Net of Tax	Actuarial Loss, Net of Tax	Total
Balance at January 1, 2010	\$ —	\$ —	\$ —	\$ —
Losses on derivatives designated as cash flow hedges	—	(5,020)	—	(5,020)
Actuarial loss	—	—	(3,217)	(3,217)
Losses on foreign currency translation	(45,920)	—	—	(45,920)
Balance at December 31, 2010	(45,920)	(5,020)	(3,217)	(54,157)
Reclassification to net income of losses on cash flow hedges	—	(7,050)	—	7,050
Gains on derivatives as designated cash flow hedges	—	26,471	—	12,371
Actuarial loss	—	—	(4,891)	(4,891)
Gains on foreign currency translation	21,480	—	—	21,480
<b>Balance at December 31, 2011</b>	<b>\$ (24,440)</b>	<b>\$ 14,401</b>	<b>\$ (8,108)</b>	<b>\$(18,147)</b>

The effective portion of the unrealized gain of \$26.5 million net of tax of \$8.9 million (2010 - \$5.0 million loss net of tax recovery of \$1.8 million) was included in other comprehensive loss for the year ended December 31, 2011. The amount removed from accumulated other comprehensive loss and included in petroleum, natural gas, and refined product sales was a loss of \$7.1 million, net of tax recovery of \$2.4 million for the year ended December 31, 2011 (2010 - \$nil).

The Company expects that \$14.4 million of gains reported in accumulated other comprehensive loss will be released to net income within the next 12 months.

**23. Financial Instruments**
**(a) Fair Values**

Financial instruments of Harvest consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, bank loan, risk management contracts, convertible debentures and senior notes.

The carrying value and fair value of these financial instruments are disclosed below by financial instrument category:

	December 31, 2011		December 31, 2010		January 1, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Assets</b>						
<u>Loans and Receivables</u>						
Accounts receivable	\$ 212,252	\$ 212,252	\$ 213,931	\$ 213,931	\$178,662	\$178,662
<u>Held for Trading</u>						
Cash and cash equivalents	6,607	6,607	18,906	18,906	-	-
Risk management contracts	20,162	20,162	1,007	1,007	-	-
<b>Total Financial Assets</b>	<b>\$ 239,021</b>	<b>\$ 239,021</b>	<b>\$ 233,844</b>	<b>\$ 233,844</b>	<b>\$178,662</b>	<b>\$178,662</b>
<b>Financial Liabilities</b>						
<u>Held for Trading</u>						
Risk management contracts	\$ -	\$ -	\$ 7,553	\$ 7,553	\$ 2,052	\$ 2,052
<u>Measured at Amortized Cost</u>						
Accounts payable and accrued liabilities	464,148	464,148	360,487	360,487	205,378	205,378
Bank loan	355,575	358,885	11,379	14,000	428,017	428,017
6 <sup>7/8</sup> % senior notes	495,674	523,119	482,389	507,246	-	-
7 <sup>7/8</sup> % senior notes	-	-	-	-	265,377	265,377
Convertible debentures	742,067	752,345	745,257	758,108	931,067	931,067
<b>Total Financial Liabilities</b>	<b>\$2,057,464</b>	<b>\$2,098,497</b>	<b>\$1,607,065</b>	<b>\$1,647,394</b>	<b>\$1,831,891</b>	<b>\$1,831,891</b>

Harvest enters into risk management contracts with various counterparties, principally financial institutions with investment grade credit ratings. Derivatives valued using valuation techniques with market observable inputs are mainly foreign exchange contracts and financial commodity contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, interest rate curves and forward rate curves of the underlying commodity.

The fair values of the risk management contracts are net of a credit valuation adjustment attributable to derivative counterparty default risk or the Company's own default risk. The changes in counterparty credit risk had no material effect on the hedge effectiveness assessment for derivatives designated in the hedging relationship and other financial instruments recognized at fair value.

The fair values of the convertible debentures and the senior notes are based on quoted market prices as at December 31, 2011. The fair value of the bank loan approximates the carrying value (excluding deferred financing charges) as the bank loan bears floating market rates. The carrying value of the bank loan includes \$3.3 million of deferred financing charges at December 31, 2011 (2010 - \$2.6 million). Due to the short term maturities of accounts receivable and accounts payable and accrued liabilities, their carrying values approximate their fair values.

Harvest's financial assets and liabilities recorded at fair value have been classified according to the following hierarchy based on the significance of observable inputs used to value the instrument:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

Harvest's cash and cash equivalents and risk management contracts have been assessed on the fair value hierarchy described above. Cash and cash equivalents are classified as Level 1 and risk management contracts as Level 2. During the year ended December 31, 2011, there were no transfers among Levels 1, 2 and 3.

**(b) Risk Management Contracts**

Harvest uses electricity price swap contracts to manage some of its price risk exposure. These swap contracts are not designated as hedges and are entered into for periods consistent with forecast electricity purchases.

The Company enters into crude oil and foreign exchange contracts to reduce the volatility of cash flows from some of its forecast sales. Harvest designates all of its crude oil derivative contracts and certain foreign exchange contracts as cash flow hedges. The effective portion of the unrealized gains and losses is included in other comprehensive income. The effective portion of the realized gains and losses is removed from accumulated other comprehensive income and included in petroleum, natural gas, and refined product sales (see note 22). The ineffective portion of the unrealized and realized gains and losses recognized in the consolidated income statement from these cash flow hedges is shown below for crude oil, together with the realized and unrealized (gains) losses on power and currency risk management contracts:

Year Ended December 31								
2011					2010			
	Power	Crude oil	Currency	Total	Power	Crude oil	Currency	Total
Realized (gains) losses	\$(7,730)	\$1,730	\$ –	\$(6,000)	\$1,808	\$ –	\$ –	\$1,808
Unrealized (gains) losses	1,008	(1,754)	–	(746)	(3,060)	702	–	(2,358)
	\$(6,722)	\$ (24)	\$ –	\$(6,746)	\$(1,252)	\$ 702	\$ –	\$(550)

The following is a summary of Harvest's risk management contracts outstanding at December 31, 2011:

**Contracts Designated as Hedges**

Contract Quantity	Type of Contract	Term	Contract Price	Fair Value
4,200 bbls/day	Crude oil price swap	2012	US \$111.37/bbl	\$ 19,718
US \$468/day	Foreign exchange swap	2012	\$1.0236 Cdn/US	444
				\$ 20,162

**(c) Risk Exposure**

Harvest is exposed to market risks resulting from fluctuations in commodity prices, currency exchange rates and interest rates in the normal course of operations. Harvest is also exposed, to a lesser extent, to credit risk on accounts receivable, counterparty risk from price risk management contracts and to liquidity risk relating to the Company's debt.

**(i.) Credit Risk**

Upstream Accounts Receivable

Accounts receivable in Harvest's Upstream operations are due from crude oil and natural gas purchasers as well as joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risks. Concentration of credit risk is mitigated by having a broad customer base, which includes a significant number of companies engaged in joint operations with Harvest. Harvest periodically assesses the financial strength of its crude oil and natural gas purchasers and will adjust its marketing plan to mitigate credit risks. This assessment involves a review of external credit ratings; however, if external ratings are not available, Harvest requests a guarantee from the parent company that does have a credit rating. If this is not possible, Harvest performs an internal credit review based on the purchaser's past financial performance. The credit risk associated with joint venture partners is mitigated by reviewing the credit history of partners and requiring some partners to provide cash prior to incurring significant capital costs on their behalf. Additionally, most agreements have a



provision enabling Harvest to use the proceeds from the sale of production that would otherwise be taken in kind by the partner to offset amounts owing from the partner that is in default. Generally, the only instances of impairment are when a purchaser or partner is facing bankruptcy or extreme financial distress.

#### Risk Management Contract Counterparties

Harvest is exposed to credit risk from the counterparties to its risk management contracts. This risk is managed by diversifying Harvest's risk management portfolio among a number of counterparties limited to lenders in its syndicated credit facilities; Harvest has no history of losses with these counterparties.

#### Downstream Accounts Receivable

The supply and off take agreement exposes Harvest to the credit risk of Macquarie Energy Canada Ltd. ("Macquarie") as all feedstock purchases and the majority of product sales are made with Macquarie. This credit risk is mitigated by the amounts owing to Macquarie for feedstock purchases that are offset against amounts receivable from Macquarie for product sales with the balance being net settled. The supply and off take agreement also requires both Harvest and Macquarie's parent, Macquarie Bank Ltd, to provide reciprocal guarantees of US\$75 million to each other in order to mitigate the risk of either counter party being unable to settle a net payable amount. At December 31, 2011, Harvest is in a net payable position with Macquarie and the outstanding balance is included in current trade accounts payable in the liability liquidity table.

Harvest's maximum exposure to credit risk relating to the above classes of financial assets at December 31, 2011 is the carrying value of accounts receivable. The table below provides an analysis of Harvest's current and past due but not impaired receivables.

	Current AR	≤ 30 days	Overdue AR		
			> 30 days, ≤ 60 days	> 60 days, ≤ 90 days	> 90 days
Upstream accounts receivable	\$ 146,164	\$ 1,286	\$ 556	\$ 1,168	\$ 4,000
Downstream accounts receivable	50,660	6,155	1,702	206	355
	<b>\$ 196,824</b>	<b>\$ 7,441</b>	<b>\$ 2,258</b>	<b>\$ 1,374</b>	<b>\$ 4,355<sup>(1)</sup></b>

(1) Net of \$3.3 million of allowance for doubtful accounts.

#### (ii.) Liquidity Risk

Harvest is exposed to liquidity risk due to the Company's borrowings under its credit facility, convertible debentures and 67/8% senior notes. This risk is mitigated by managing the maturity dates on the Company's obligations, complying with covenants and managing the Company's cash flow by entering into price risk management contracts. Additionally, when Harvest enters into price risk management contracts it selects counterparties that are also lenders in its syndicated credit facility thereby using the security provided in the credit agreement and eliminating the requirement for margin calls and the pledging of collateral.

In addition to the guarantee provided to Macquarie at December 31, 2011, Harvest has also provided guarantees of \$15.8 million for Downstream product purchases.

The following table provides an analysis of Harvest's financial liability maturities based on the remaining terms of its liabilities as at December 31, 2011 and includes the related interest charges:

	≤1 year	>1 year ≤3 years	>3 years ≤5 years	>5 years	Total
Accounts payable and accrued liabilities	\$464,148	\$ —	\$ —	\$ —	\$ 464,148
Bank loan and interest	5,643	11,287	360,756	—	377,686
Convertible debentures and interest	158,554	449,138	243,972	—	851,664
6 <sup>7/8</sup> % senior notes and interest	34,959	69,919	69,919	534,720	709,517
Guarantees <sup>(1)</sup>	47,004	—	—	—	47,004
	<b>\$710,308</b>	<b>\$ 530,344</b>	<b>\$674,647</b>	<b>\$534,720</b>	<b>\$2,450,019</b>

(1) Amounts are net of the related payables and receivables to and from counterparties.

(iii.) Market Risks and Sensitivity Analysis

Harvest is exposed to three types of market risks: interest rate risk, currency exchange rate risk and commodity price risk.

Harvest has performed sensitivity analysis on the three types of market risks identified, assuming that the volatility of the risks over the next year will be similar to that experienced in the past year. Harvest has determined that a reasonably possible price or rate variance over the next reporting period for a given risk variable can be estimated by calculating two standard deviations for each three month period in the last year for the relevant daily price/rate settings and using an average of the standard deviation as a reasonable estimate of the expected variance. This variance is then applied to the relevant period end rate or price to determine a reasonable percentage increase and decrease in the risk variable which can then be applied to the outstanding risk exposure at period end. Using twelve months of data, Harvest factors in the seasonality of the business and the price volatility therein.

Interest rate risk

Harvest is exposed to interest rate risk on its bank borrowings as interest rates are determined in relation to floating market rates plus an incremental charge based on the Company's secured debt to EBITDA. Harvest's convertible debentures and 67/8% senior notes have fixed interest rates and therefore do not have any additional interest rate risk. Harvest manages its interest rate risk by targeting appropriate levels of debt relative to its expected cash flow from operations.

If the interest rate applicable to Harvest's bank borrowings at December 31, 2011 increased or decreased by 25% with all other variables held constant, after-tax net income for the year would decrease by \$0.1 million and increase by \$0.9 million respectively as a result of change in interest expense on variable rate borrowing.

Currency exchange rate risk

Harvest is exposed to the risk of changes in the U.S. dollar exchange rate on its U.S. dollar denominated revenues as well as Canadian dollar revenues that are based on a U.S. dollar commodity price. In addition, Harvest's 67/8% senior notes are denominated in U.S. dollars (U.S.\$500 million) and interest on these notes is payable semi-annually in U.S. dollars and accordingly the principal and any interest payable at the balance sheet date are also subject to currency exchange rate risk. Harvest's Downstream operations operate with a U.S. dollar functional currency which gives rise to currency exchange rate risk on the Company's Canadian dollar denominated monetary assets and liabilities such as Canadian dollar bank accounts and accounts receivable and payable. Harvest is also exposed to currency exchange rate risk on its net investment in its Downstream operations. Harvest manages these exchange rate risks by occasionally entering into fixed rate currency exchange contracts on future U.S. dollar payments and U.S. dollar sales receipts.

At December 31, 2011, if the U.S. dollar strengthened or weakened by 10% relative to the Canadian dollar, the impact on net income and other comprehensive income due to the translation of monetary financial instruments would be as follows:

	<b>Increase (decrease) in Net Income</b>	<b>Increase (decrease) in Other Comprehensive Income</b>
U.S. Dollar Exchange Rate - 10% increase	\$ (19,870)	\$ (34,754)
U.S. Dollar Exchange Rate - 10% decrease	\$ 19,870	\$ 34,754

(1) The sensitivity to net income and other comprehensive income is done independently.

Commodity Price Risk

Harvest is exposed to electricity and crude oil price movements as part of its normal business operations. The Company uses price risk management contracts to protect a portion of the Company's future cash flows and net income against unfavorable movements in commodity prices. These contracts are recorded on the consolidated statement of financial position at their fair value as of the reporting date. Changes from the prior period's fair value for electricity contracts are reported in net income. The effective portion of the changes from the prior period's fair value for crude oil contracts are reported in other comprehensive income. These fair values are generally determined as the difference between the stated fixed price of the contract and an expected future price of power and oil. Variances in expected future prices expose Harvest to commodity price risk as changes will result in a gain or loss that Harvest will realize on settlement of these contracts. This risk is mitigated by continuously monitoring the effectiveness of these contracts.

If the following changes in expected forward prices were applied to the fair value of risk management contracts in place at December 31, 2011, the pre-tax impact would be as follows:

	Increase (decrease) in Net Income	Increase (decrease) in Other Comprehensive Income
Forward price of crude oil – 10% increase	\$ (1,020)	\$ (18,517)
Forward price of crude oil – 10% decrease	\$ 621	\$ 11,390

## 24. Segment Information

Harvest operates in Canada and has two reportable operating segments: Upstream and Downstream. Harvest's Upstream operations consist of development, production and subsequent sale of petroleum, natural gas and natural gas liquids, while its Downstream operations include the purchase of crude oil, the refining of crude oil, the sale of the refined products including a network of retail operations and the supply of refined products to commercial and wholesale customers.

	Year Ended December 31					
	Downstream		Upstream		Total	
	2011	2010	2011	2010	2011	2010
Petroleum, natural gas and refined products sales	\$3,239,455	\$3,105,957	\$1,286,866	\$1,007,004	\$4,526,321	\$4,112,961
Royalty	-	-	(195,452)	(154,757)	(195,452)	(154,757)
<b>Revenues</b>	<b>3,239,455</b>	<b>3,105,957</b>	<b>1,091,414</b>	<b>852,247</b>	<b>4,330,869</b>	<b>3,958,204</b>
<b>Expenses</b>						
Purchased products for resale and processing	3,055,236	2,893,805	-	-	3,055,236	2,893,805
Operating	225,675	215,640	350,456	265,593	576,131	481,233
Transportation and marketing	6,293	6,366	29,626	9,394	35,919	15,760
General and administrative	1,764	1,764	60,804	45,303	62,568	47,067
Exploration and evaluation	-	-	18,289	3,300	18,289	3,300
Depletion, depreciation and amortization	91,006	83,091	535,692	470,641	626,698	553,732
Gains on disposition of PP&E	-	-	(7,883)	(741)	(7,883)	(741)
Risk management contracts gains	-	-	(6,746)	(550)	(6,746)	(550)
Impairment on PP&E	-	-	-	13,661	-	13,661
	(140,519)	(94,709)	111,176	45,646	(29,343)	(49,063)
Finance costs					109,127	100,808
Foreign exchange gains					(3,986)	(3,399)
Loss before income tax					(134,484)	(146,472)
Income tax recovery					(29,827)	(65,309)
Net loss					\$ (104,657)	\$ (81,163)
<b>Capital Expenditures</b>						
Business acquisition	\$ -	\$ -	\$ 509,829	\$ 145,144	\$ 509,829	\$ 145,144
Additions to PP&E	284,244	71,234	682,497	356,851	966,741	428,085
Additions to E&E	-	-	50,883	46,997	50,883	46,997
Additions to other long term asset	-	-	7,413	-	7,413	-
Property acquisitions (dispositions), net	-	-	(4,474)	30,513	(4,474)	30,513
Total expenditures	\$ 284,244	\$ 71,234	\$1,246,148	\$ 579,505	\$1,530,392	\$ 650,739

(1) Of the total Downstream revenue, two customers represent sales of \$1.5 billion and \$586 million for the year ended December 31, 2011 (2010 - \$2 billion and \$145 million). No other single customer within either segment represents greater than 10% of Harvest's total revenue.

(2) There is no intersegment activity.

	Total Assets	PP&E	E&E	Other Long Term Assets	Goodwill
<b>December 31, 2011</b>					
Downstream	\$ 1,408,112	\$ 1,222,512	\$ –	\$ –	\$ –
Upstream	4,876,258	4,177,875	74,517	7,105	404,943
<b>Total</b>	<b>\$ 6,284,370</b>	<b>\$ 5,400,387</b>	<b>\$ 74,517</b>	<b>\$ 7,105</b>	<b>\$ 404,943</b>
<b>December 31, 2010</b>					
Downstream	\$ 1,211,367	\$ 1,003,384	\$ –	\$ –	\$ –
Upstream	4,177,373	3,479,852	59,554	–	404,943
<b>Total</b>	<b>\$ 5,388,740</b>	<b>\$ 4,483,236</b>	<b>\$ 59,554</b>	<b>\$ –</b>	<b>\$ 404,943</b>
<b>January 1, 2010</b>					
Downstream	\$ 1,273,882	\$ 1,113,742	\$ –	\$ –	\$ –
Upstream	3,504,923	2,940,877	36,034	–	404,943
<b>Total</b>	<b>\$ 4,778,805</b>	<b>\$ 4,054,619</b>	<b>\$ 36,034</b>	<b>\$ –</b>	<b>\$ 404,943</b>

## 25. Commitments and Contingencies

From time to time, Harvest is involved in litigation or has claims brought against it in the normal course of business operations. Management of Harvest is not currently aware of any claims or actions that would materially affect Harvest's reported financial position or results from operations. In the normal course of operations, management may also enter into certain types of contracts that require Harvest to indemnify parties against possible third party claims, particularly when these contracts relate to purchase and sale agreements. The terms of such contracts vary and generally a maximum is not explicitly stated; as such the overall maximum amount of the obligations cannot be reasonably estimated. Management does not believe payments, if any, related to such contracts would have a material effect on Harvest's reported financial position or results from operations.

The following are the significant commitments and contingencies at December 31, 2011:

Harvest entered into two contracts in relation to the engineering, procurement and construction ("EPC") of the production and processing facilities required for its BlackGold oil sands project in 2010 for a total contracted cost of \$311 million. Harvest provided a cash deposit of \$31.1 million in 2010, of which \$24.9 million (2010 - \$30.6 million) remains at December 31, 2011 to be applied to future payments. The remaining balances of the two contracts are included in the contractual obligation and commitment table below.

The Downstream operations have a supply and offtake agreement ("SOA") with Macquarie Energy Canada Ltd. ("Macquarie") for a primary term to October 31, 2012. This agreement provides that the ownership of substantially all crude oil feedstock and refined product inventory at the refinery be retained by Macquarie and that Macquarie has the right and obligation to provide crude oil feedstock for delivery to the refinery, as well as the right and obligation to purchase substantially all refined products produced by the refinery. As such, as at December 31, 2011, Downstream had commitments totaling approximately \$776 million in respect of future crude oil feedstock purchases from Macquarie.

The following is a summary of Harvest's contractual obligations and commitments as at December 31, 2011:

	Payments Due by Period				
	1 year	2-3 years	4-5 years	After 5 years	Total
Debt repayments <sup>(1)</sup>	\$ 106,796	\$ 390,598	\$ 595,464	\$ 508,500	\$ 1,601,358
Debt interest payments <sup>(1)</sup>	92,360	139,745	79,182	26,220	337,507
Purchase commitments <sup>(2)</sup>	207,207	48,409	1,143	–	256,759
Operating leases	9,368	15,267	2,187	564	27,386
Transportation agreements <sup>(3)</sup>	13,936	22,606	9,680	317	46,539
Feedstock and other purchase commitments <sup>(4)</sup>	776,092	–	–	–	776,092
Employee benefits <sup>(5)</sup>	4,534	7,828	4,944	3,837	21,143
Decommissioning liabilities <sup>(6)</sup>	12,782	58,989	33,805	1,343,584	1,449,160
<b>Total</b>	<b>\$1,223,075</b>	<b>\$ 683,442</b>	<b>\$ 726,405</b>	<b>\$1,883,022</b>	<b>\$ 4,515,944</b>

(1) Assumes constant foreign exchange rate.

(2) Relates to drilling commitments, AFE commitments, BlackGold oil sands project commitment and Downstream capital commitments.

(3) Relates to firm transportation commitments.

(4) Includes commitments to purchase refinery crude stock and refined products for resale under the SOA with Macquarie.

(5) Relates to the expected contributions to employee benefit plans and long-term incentive plan payments.

(6) Represents the undiscounted obligation by period.

## 26. Related Party Transactions

Harvest's has a Global Technology and Research Centre ("GTRC"), is used as a training facility for KNOC personnel. For the year ended December 31, 2011, Harvest billed KNOC and certain subsidiaries for a total of \$1.6 million (2010 – \$0.2 million) primarily related to technical services provided by the GTRC. As at December 31, 2011, \$1.1 million (2010 - \$0.1 million) remained outstanding from KNOC in accounts receivable. KNOC billed Harvest \$0.6 million (2010 – \$ nil) for reimbursement to KNOC for secondee salaries paid by KNOC on behalf of Harvest for the year ended December 31, 2011. As at December 31, 2011, \$0.6 million (2010 - \$nil) remains outstanding in accounts payable.

As at September 30, 2011, North Atlantic had committed to purchase \$322.5 million of crude feedstock from KNOC, which Macquarie has taken over under the SOA.

On August 6, 2010, Harvest acquired the BlackGold oil sands project from KNOC for \$374.2 million, representing the fair value of the oil and gas assets acquired. The acquisition was paid with the issuance of shares to KNOC. The following amounts were added to Harvest's statement of financial position at August 6, 2010 as a result of this transaction:

Current assets	\$	500
Property, plant and equipment		374,182
Long-term liabilities		(10)
Decommissioning liabilities		(503)
Shareholder's capital	\$	(374,169)

### *Directors and Key Management Personnel Remuneration*

Key management personnel includes the Company's officers and other members of the executive management team. Included in the following table is remuneration to 5 (2010 – 9) independent directors and 15 (2010 – 14) key management personnel for the year ended December 31, 2011.

	Year Ended December 31	
	2011	2010
Salaries, wages and short-term employee benefits	\$ 4,630	\$ 5,248
Post-employment benefits	49	49
Other long-term benefits	961	989
	\$ 5,640	\$ 6,286

## 27. First Time Adoption of IFRS

IFRS 1 "First-time Adoption of International Financial Reporting Standards" establishes the transitional requirements for the preparation of financial statements upon first time adoption of IFRS. IFRS 1 generally requires an entity to comply with IFRS effective at the reporting date and to apply the standards retrospectively to the opening balance sheet, the comparative period and the reporting period. The standard allows certain optional exceptions from full retrospective application and other elections on transition, which the Company has applied as follows:

### **Business Combinations Exemption**

The Company has applied the business combinations exemption in IFRS 1. It has not restated business combinations that took place prior to the January 1, 2010 transition date ("Transition Date").

### **Deemed Cost Election for Oil and Gas Assets**

Under Canadian GAAP, the Company accounted for its oil and gas properties in one cost centre using full cost accounting. The Company elected to apply the exemption in IFRS 1 available to full cost oil and gas entities to its Upstream PP&E and measure its oil and gas properties at the Transition Date on the following basis:

- E&E assets at the amount determined under Canadian GAAP; and
- the remainder allocated to the underlying PP&E assets on a pro rata basis using proved and probable reserve values discounted at 10% at the Transition Date.

### **Fair Value as Deemed Cost Exemption**

The Company elected to use the fair value as deemed cost exemption on its Downstream PP&E at the Transition Date.

**Lease Exemption**

The Company has elected to carry forward assessments made under Canadian GAAP for arrangements containing leases. The assessment of arrangements containing leases results in the same outcome under IAS 17 and IFRIC 4 "Determining whether an Arrangement contains a Lease".

**Decommissioning Liabilities**

Harvest has applied the deemed cost election for oil and gas assets under IFRS 1 and as such decommissioning liabilities at the Transition Date have been measured in accordance with IAS 37, "Provisions, Contingent Liabilities and Contingent Assets". The Company recognized directly in retained earnings any difference between the re-measured amount and the carrying amount of those liabilities at the Transition Date.

For the Downstream decommissioning liabilities, Harvest applied the exemption from full retrospective application of IAS 37 under IFRS 1. As such, the Company measured the decommissioning liabilities at the Transition Date, and recognized the corresponding charge in retained earnings.

**Reconciliations of Canadian GAAP to IFRS**

This is the first year that the Company has presented financial statements under IFRS; as such, the following reconciliations between Canadian GAAP and IFRS are included to provide an understanding of the material adjustments to the financial statements. The transition from Canadian GAAP to IFRS had no material effect upon previously reported cash flows. The following represents the reconciliations from Canadian GAAP to IFRS for the respective periods for shareholder's equity, net loss, and comprehensive loss.

**Reconciliation of Shareholder's Equity**

	Note	December 31, 2010	January 1, 2010
Shareholder's equity under Canadian GAAP		\$ 3,250,943	\$ 2,422,688
Decommissioning liabilities	a	(270,142)	(272,258)
Exploration and evaluation expenses	b		
Impairment of exploration and evaluation asset		(2,858)	-
Pre-licensing costs		(442)	-
Impairment of PP&E	c	(13,661)	-
Depletion, depreciation and amortization	d	(47,792)	-
Dispositions	e	335	-
Acquisitions	f		
Acquisition costs		(329)	-
BlackGold asset transfer		8,467	-
Gain on acquisition		406	-
Post-employment benefits	g	(2,765)	-
Deferred income taxes	h	94,283	69,083
Cumulative translation adjustments	i	440	-
Shareholder's equity under IFRS		\$ 3,016,885	\$ 2,219,513



*Reconciliation of Net Loss*

	Note	Year Ended December 31, 2010
Net loss under Canadian GAAP		\$ (44,561)
Decommissioning liabilities	a	2,556
Exploration and evaluation expenses	b	
Unsuccessful exploration and evaluation costs		(2,858)
Pre-licensing costs		(442)
Impairment of PP&E	c	(13,661)
Depletion, depreciation and amortization	d	(47,792)
Dispositions	e	335
Acquisitions	f	
Acquisition costs		(329)
Gain on acquisition		406
Post-employment benefits	g	423
Deferred income taxes	h	25,200
Foreign currency translation	i	(440)
Total differences		(36,602)
Net loss under IFRS		\$ (81,163)

*Reconciliation of Other Comprehensive Loss*

	Note	Year Ended December 31, 2010
Other comprehensive loss under Canadian GAAP		\$ (51,380)
Post-employment benefits	g	(3,217)
Cumulative translation adjustments	i	440
Total differences		(2,777)
Other comprehensive loss under IFRS		(54,157)
Net loss under IFRS		(81,163)
Comprehensive loss under IFRS		\$ (135,320)

The following adjustments were made to the consolidated statement of cash flows for the year ended December 31, 2010.

		Cash used in Operating Activities	Cash used in Investing Activities
Exploration and evaluation expenses	b	\$ (442)	\$ 442
Acquisition cost	f	(329)	329

There was no difference between Canadian GAAP and IFRS related to cash from financing activities.

**(a) Decommissioning liabilities**

The Company elected to apply the IFRS 1 exemption relating to decommissioning liabilities and re-measured decommissioning liabilities as at January 1, 2010 using the relevant risk-free rate. The exemption resulted in an increase of \$272.3 million in decommissioning liabilities and a corresponding increase to deficit. This increase is mainly attributable to the change from the credit-adjusted risk-free rate to the risk-free rate of 4% for the Upstream decommissioning liabilities, resulting in an adjustment of \$264.6 million. The recognition standards are different between Canadian GAAP and IFRS, which resulted in the recognition of the Downstream decommissioning liabilities of \$7.7 million under IFRS on the Transition Date.

Under IFRS, the discount rate is adjusted each reporting period to reflect the current market risk-free rate. As at December 31, 2010, PP&E and the decommissioning liability were \$68.8 million higher under IFRS.

As the opening decommissioning liabilities and the discount rates are different under IFRS, the accretion expense decreased by \$2.6 million for the year ended December 31, 2010. There was minimal impact to the accretion due to the reduction of decommissioning liabilities resulting from the dispositions discussed under item (e).

(b) Exploration and evaluation costs*Unsuccessful exploration and evaluation costs*

Under IFRS, Harvest capitalizes costs relating to exploration and evaluation activities until a project is determined to be successful or otherwise. If a project is deemed to be successful because it is technically feasible and commercially viable, then the costs are tested for impairment and transferred to property, plant and equipment. If a project is deemed to be unsuccessful, the associated costs are charged to the consolidated statement of income in the period as exploration and evaluation expense. During the year ended December 31, 2010, the Company recognized \$2.9 million of exploration and evaluation expenses on certain unsuccessful E&E projects.

*Pre-licensing costs*

Under IFRS, costs incurred prior to obtaining the legal right to explore for oil and gas must be expensed while under Canadian GAAP these costs were capitalized in PP&E under one full-cost centre. For the year ended December 31, 2010, \$0.4 million of pre-licensing costs were charged to the consolidated statement of income as exploration and evaluation expense. The accounting policy difference has resulted in a decrease in cash from operating activities and an increase in cash from investing activities by \$0.4 million for the year ended December 31, 2010.

(c) CGU impairment

Under IFRS, impairment testing is performed at a lower level of asset aggregation than under Canadian GAAP. During the fourth quarter of 2010, Harvest recorded a \$13.7 million before tax impairment related to certain properties in South Alberta to reflect declining forecasted gas prices which resulted in lower estimated future cash flows. The recoverable amount was based on the assets' value-in-use, estimated using the net present value of the expected future cash flows.

(d) Depletion, depreciation and amortization

Under IFRS, Harvest aggregates its PP&E into major components for depletion, depreciation and amortization. For the Upstream PP&E, costs accumulated within each component are depleted using the unit-of-production method based on estimated proved developed reserves, whereas under Canadian GAAP, estimated proved reserves were used. The carrying value of PP&E under IFRS differs from that under Canadian GAAP as a result of changes in the accounting of decommissioning liabilities and dispositions of PP&E as discussed in items (a) and (e). Among these changes, the componentization of PP&E and the use of proved developed reserves for depletion primarily attributed to the recognition of additional \$47.8 million of depletion, depreciation and amortization expense for the year ended December 31, 2010.

(e) Dispositions

Under Canadian GAAP, proceeds on the dispositions of PP&E were credited to the full cost pool and no gain or loss was recognized unless the effect of the sale would have changed the DD&A rate by 20% or more. Under IFRS, all gains and losses are recognized on oil and gas property divestitures and calculated as the difference between net proceeds and the carrying value of the net assets disposed. Accordingly, Harvest recognized a gain on PP&E disposal of \$1.3 million for the year ended December 31, 2010 under IFRS. During the year ended December 31, 2010, Harvest also recognized a loss of \$1.0 million relating to disposition of certain E&E assets.

(f) Acquisition*Acquisition costs*

Under IFRS, acquisition costs relating to a business combination are expensed. As such, \$0.3 million of acquisition costs were expensed for the year ended December 31, 2010. Under Canadian GAAP, such costs were capitalized as part of PP&E.

*BlackGold asset transfer*

Under IFRS, the transfer of BlackGold oil sand assets from KNOC in August 2010 is measured at the fair value of the assets and liabilities. Under Canadian GAAP, the assets and liabilities were transferred at the carrying value. The difference in the accounting treatment results in a reversal of an \$8.5 million loss that was previously recognized in retained earnings and an increase of \$8.5 million in PP&E.

*Gain on acquisition*

On September 30, 2010, Harvest purchased the remaining 40% of the Redearth Partnership ("Partnership") as well as additional petroleum and natural gas rights, tangible assets, seismic data and other miscellaneous interests and associated production. Under IFRS, the acquirer is required to re-measure its previously held equity interest in the acquired (the Partnership) at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss; as such a gain of \$0.4 million was recognized in the income statement relating to the 60% previously held interest in the Partnership for the year end December 31, 2010. Canadian GAAP did not require such re-measurement. See note 3 for other information on this asset acquisition.

(g) Post-employment benefits

Under Canadian GAAP, the Company amortized actuarial gains and losses to income over the estimated average remaining service life, with disclosure of the unrecognized amount in the notes to the consolidated financial statements. Under IFRS, actuarial gains and losses are recognized directly in other comprehensive income in the period in which they occur. For the year ended December 31, 2010, actuarial losses amortization of \$0.4 million were reclassified to other comprehensive income from the net income. Together with the recognition of the unamortized actuarial losses, other comprehensive income was reduced by \$3.2 million (net of deferred tax asset of \$0.7 million) under IFRS.

(h) Deferred income taxes ("DIT")

IFRS requires recognition of the DIT asset or liability that arises on the difference between historical and current exchange rates on the translation of non-monetary assets, whereas Canadian GAAP did not. This difference, however, does not impact the DIT liability balance on transition date as the cumulative translation adjustments balance at transition date is \$nil as a result of the KNOC acquisition. For the year ended December 31, 2010, the DIT expense decreased by \$10.9 million.

As a result of the increase in the net book value of the decommissioning liabilities, the DIT effect has been adjusted. This resulted in a corresponding increase in retained earnings of \$69.1 million on January 1, 2010.

The DIT expense decreased by \$14.3 million for the year ended December 31, 2010, resulting from the increase in decommissioning liabilities and PP&E.

(i) Currency translation

Harvest's Downstream functional currency is U.S. dollars. As a result of the addition of the Downstream decommissioning liabilities in accordance with IAS 37, a currency exchange loss resulted from the revaluation of the liabilities at the end of each reporting period. For the year ended December 31, 2010 the amount of foreign exchange loss recognized was \$0.4 million, which increased net loss and decreased other comprehensive loss.

***Reclassifications***E&E and PP&E

Under Canadian GAAP, the Company had accounted for E&E and PP&E amounts under the full-cost method where these costs were included in PP&E. IFRS requires E&E costs to be segregated from PP&E.

As a result of the application of IFRS, the Company has separately classified E&E expenditures of \$36.0 million from PP&E at the Transition Date. At December 31, 2010, \$47.0 million were reclassified. Note 6 discloses a reconciliation of E&E assets from the Transition Date to December 31, 2011.

Accretion of decommissioning liabilities

Accretion expense under Canadian GAAP has been reclassified from depreciation, depletion, amortization and accretion expense to finance costs under IFRS. The amount that was reclassified was \$25.2 million for the year ended December 31, 2010.

Downstream loyalty program

Under Canadian GAAP, the Company had accounted for loyalty program costs by recording an expense. Under IFRS, the fair value of the consideration received or receivable in respect of the initial sale should be allocated between the award credits. As such, the Company has allocated the fair value of the consideration received from the sales to the award credits. This resulted in reclassifying \$1.3 million of petroleum, natural gas, and refined product sales to Downstream operating expenses for the year ended December 31, 2010.