

Desmarais Energy Corporation

Management's Discussion and Analysis

Second Quarter 2011

This Management's Discussion and Analysis ("MD&A") of financial results and related data of Desmarais Energy Corporation ("Desmarais" or the "Company") is reported in Canadian dollars and has been prepared in accordance with International Financial Reporting Standard 1, "First-time Adoption of International Financial Reporting Standards", and with International Accounting Standard 34 "Interim Financial Reporting", as issued by the International Accounting Standards Board. Previously, the Company prepared its Interim and Annual Financial Statements in accordance with Canadian generally accepted accounting principles ("previous GAAP"). To the extent which may be appropriate, this MD&A should be read in conjunction with the audited financial statements for the year ended December 31, 2010 and the unaudited interim condensed financial statements for the three and six months ended June 30, 2011 and the three months ended March 31, 2011.

The commentary is as of August 29, 2011. The reader should be aware that historical results are not necessarily indicative of future performance.

In conformity with Canadian Securities Administrator's National Instrument ("NI") NI 51-101 "Standards of Disclosure for Oil and Gas Activities", natural gas volumes have been converted to equivalent barrels of oil ("BOE") using a conversion ratio of six thousand cubic feet ("mcf") of natural gas to one BOE. This ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Readers are cautioned that BOE may be misleading, particularly if used in isolation.

Forward Looking Statements

This MD&A contains forward-looking statements. Management's assessment of future plans and operations, capital expenditures, methods of financing capital expenditures and the ability to fund financial liabilities, expected commodity prices and the impact on Desmarais, future operating costs, future transportation costs, expected change in royalty rates, interest rates and the timing of and impact of adoption of IFRS and other accounting policies may constitute forward-looking statements under applicable securities laws and necessarily involve risks including, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, the inability to fully realize the benefits of the acquisitions, delays resulting from or inability to obtain required regulatory approvals, ability to access sufficient capital from internal and external sources, and litigation risks. As a consequence, the Company's actual results may differ materially from those expressed in, or implied by, the forward looking statements. Forward looking statements or information are based on a number of factors and assumptions which have been used to develop such statements and information but which may prove to be incorrect. Although Desmarais believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward looking statements because the Company can give no assurance that such expectations will prove to be correct. In addition to other factors and assumptions which may be identified in this document and other documents filed by the Company, assumptions have been made regarding, among other things: the impact of increasing competition; the ability of the Company to obtain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the operator of the projects which the Company has an interest in to operate the field in a safe, efficient and effective manner; Desmarais's ability to obtain financing on acceptable terms; field production rates and decline rates; the ability to reduce operating costs; the ability to replace and expand oil and natural gas reserves through acquisition, development or exploration; the timing and costs of pipeline, storage and facility construction and expansion; the ability of the Company to secure adequate product transportation; future oil and natural gas prices; currency, exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Company operates; and Desmarais's ability to successfully market its oil and natural gas products. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could affect the Company's operations and financial results are included in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com). Furthermore, the forward looking statements contained in this document are made as at the date of this document and the Company does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

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Non-IFRS Measurements

The MD&A contains the term cash flow from operations ("cash flow"), which should not be considered an alternative to or more meaningful than, "cash flow from operating activities" as determined in accordance with IFRS as an indicator of the Company's financial performance. Desmarais' determination of cash flow from operations may not be comparable to that reported by other companies. The reconciliation between net earnings and cash flow from operations can be found in the statements of cash flows in the financial statements. The Company evaluates its performance based on net income and cash flow from operations. The Company considers cash flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to repay debt and to fund future growth through capital investment. Cash flow from operations per share is calculated using the diluted weighted average number of shares for the period.

RESULTS OF OPERATIONS

| (\$, except boe/d) | Three months ended June 30 | | Six Months ended June 30 | |
|--|-------------------------------|-----------|-----------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Production | | | | |
| Oil and liquids | 8 | 9 | 8 | 10 |
| Natural gas | 187 | 135 | 174 | 151 |
| Boe/d (6:1) | 40 | 32 | 37 | 35 |
| Petroleum and natural gas sales | 131,746 | 95,195 | 248,436 | 236,040 |
| Royalties | (18,631) | (18,870) | (32,245) | (28,328) |
| Operating | (72,981) | (85,976) | (185,527) | (187,312) |
| Operating netback (loss) | 40,134 | (9,651) | 30,664 | 20,400 |
| Other income | 10,838 | 6,152 | 37,194 | 12,170 |
| General and administrative | (75,109) | (191,859) | (194,153) | (324,204) |
| Financing - interest paid | (42,433) | (25,912) | (67,134) | (71,518) |
| Cash flow used in operations | (66,570) | (221,270) | (193,429) | (363,152) |
| Depletion, depreciation and amortization | (51,508) | (164,717) | (102,135) | (255,213) |
| Stock-based compensation | - | (80,000) | - | (80,000) |
| Gain - debt settlements | - | 401,119 | 41,815 | 401,119 |
| Financing - accretion & unpaid interest | (26,589) | 34,142 | (99,724) | (78,230) |
| Net loss | (144,667) | (30,726) | (353,473) | (375,476) |

Production

An average of 40 BOE/d and 37 BOE/d was produced in the three and six month periods ended June 30, 2011, up from the 32 BOE/d and 35 BOE/d in the corresponding periods last year, primarily due to increased natural gas production in 2011.

Revenue

For the three and six months ended June 30, 2011 revenues were improved compared to the same periods in 2010 due primarily to lower natural gas sales prices and lower oil & natural gas liquids production offset by increased natural gas sales volumes and improved oil and natural gas liquids sales price.

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| (\$) | Three months ended June 30 | | Six Months ended June 30 | |
|--------------------------|-------------------------------|--------|-----------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenue | | | | |
| Oil and liquids | 67,430 | 56,631 | 130,498 | 128,859 |
| Natural gas | 64,316 | 38,564 | 117,938 | 107,182 |
| Total | 131,746 | 95,195 | 248,436 | 236,041 |
| Desmarais average prices | | | | |
| Oil and liquids (\$/bbl) | 88.21 | 63.37 | 87.68 | 69.94 |
| Natural gas (\$/mcf) | 3.77 | 3.29 | 3.74 | 3.90 |
| Oil equivalent (\$/boe) | 36.63 | 32.37 | 36.86 | 37.78 |

Royalties

| | Three months ended June 30 | | Six Months ended June 30 | |
|-----------------------|-------------------------------|-----------|-----------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Royalties | \$ 18,631 | \$ 18,870 | \$ 32,245 | \$ 28,329 |
| Per boe | \$ 5.18 | \$ 6.42 | \$ 4.78 | \$ 4.53 |
| Percentage of revenue | 16.0% | 19.8% | 13.0% | 12.0% |

Royalties on current production for the three and six month periods ended June 30, 2011 were higher primarily due to the higher oil and liquids selling prices, increased natural gas sales volumes partially offset by drilling credit recoveries in 2011.

Operating Costs

| (\$, except per boe) | Three months ended June 30 | | Six Months ended June 30 | |
|----------------------|-------------------------------|----------|-----------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Operating costs | 72,981 | 85,976 | 185,527 | 187,312 |
| Per boe | \$ 20.30 | \$ 29.24 | \$ 27.53 | \$ 29.98 |

The decrease in operating costs for the second quarter and first six months of 2011 reflects the reduced cost of natural gas processing achieved through the acquisition of the Barrhead area pipeline infrastructure. This allows Desmarais to utilize a lower cost production facility and continue profitable natural gas operations in the area.

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Other Income

Other income totaled \$10,838 for the second quarter of 2011 and \$37,194 for the first six months of 2011 as compared to \$6,152 and \$12,170 for the corresponding periods in 2010. In 2011, other income reflects increased third party recoveries for usage of Desmarais' Barrhead area pipeline infrastructure and equipment rental recoveries compared to the same periods in 2010.

Gain – Debt Settlements

A total of \$41,815 was recorded in the three and six months ended June 30, 2011 (\$401,119 for the three and six months ended June 30, 2010) as the result of ongoing settlement agreements and resolutions reached with trade creditors.

General and Administrative

| (\$, except per boe) | Three months ended June 30 | | Six Months ended June 30 | |
|----------------------------|-------------------------------|----------|-----------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| General and administrative | 75,109 | 191,859 | 194,153 | 404,204 |
| Per boe | \$ 20.89 | \$ 65.26 | \$ 28.81 | \$ 64.69 |

The expenditures for general and administrative expenses have decreased during the second quarter and first six months of 2011. Stock based compensation is \$nil for the three and six month periods ended June 30, 2011 as compared to \$80,000 for the corresponding periods in 2010.

The reduction in total expenditures reflects ongoing cost minimization efforts.

Financing Costs

| (\$) | Three months ended June 30 | | Six Months ended June 30 | |
|---|-------------------------------|----------|-----------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Interest | 64,092 | (18,160) | 157,298 | 121,518 |
| Accretion - decommissioning liabilities | 4,930 | 9,930 | 9,560 | 28,230 |
| Financing expenses (recoveries) | 69,022 | (8,230) | 166,858 | 149,748 |
| Interest paid | 42,433 | 25,912 | 67,134 | 71,518 |

Interest for the three and six months ended June 30, 2011 totaled \$64,092 and \$157,298 as compared to a recovery of \$(18,160) and \$121,518 in 2010. The six month period in 2011 includes an accrual of \$30,000 for anticipated interest due on outstanding accounts payable arrears. The second quarter of 2010 includes the reversal of the amount previously recorded in the first quarter of 2010 relating to interest on the ARTC audit assessment received in March 2010. This amount was reversed in June 2010 after an appeal by Desmarais.

Accretion of decommissioning liabilities is now classified as a financing cost. Accretion for the three months and six months ended June 30, 2011 totaled \$4,930 and \$9,560 as compared to \$9,930 and \$18,300 for the corresponding periods in 2010.

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Depletion, Depreciation and Amortization

| (\$, except per boe) | Three months ended June 30 | | Six Months ended June 30 | |
|--|-------------------------------|----------|-----------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Depletion, depreciation and amortization | 51,508 | 164,717 | 102,135 | 255,213 |
| Per BOE | \$ 14.32 | \$ 56.03 | \$ 15.15 | \$ 40.85 |

Depletion, depreciation and amortization during the three and six months ended June 30, 2011 were \$51,508 and \$102,135 respectively as compared to \$164,717 and \$255,213 for the corresponding 2010 periods. In 2011, lower total depletion provisions include recent reserve additions while the 2010 amounts include impairment provisions.

Taxes

No tax expense was recorded in either the second quarter or first six months of 2011 and 2010.

No tax asset has been recognized due to the uncertainty of future utilization.

Cash and Funds from Operations and Net Loss

| (\$, except per share amounts) | Three months ended June 30 | | Six Months ended June 30 | |
|---|-------------------------------|-----------|-----------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Funds from (used in) operating activities | 28,623 | (162,087) | (110,188) | (346,410) |
| Change in non-cash working capital | (95,193) | (59,183) | (83,241) | (16,742) |
| Cash flow used in operations | (66,570) | (221,270) | (193,429) | (363,152) |
| Per share - basic and diluted | \$ - | \$ (0.01) | \$ (0.01) | \$ (0.02) |
| Net loss | (144,667) | (30,726) | (353,473) | (375,476) |
| Per share - basic and diluted | \$ - | \$ - | \$ (0.01) | \$ (0.02) |

Capital Expenditures

Capital expenditures for the three and six months ended June 30, 2011 totaled \$26,535 and \$46,113 compared to \$1,210 and \$4,228 during the corresponding period in 2010. No amounts are included for non-productive lease rentals as all are included in operations expenses.

In the three and six month periods ended June 30, 2011, the Company minimized capital activity to conserve working capital. These expenditures were comprised of the acquisition of strategic development lands in the Barrhead area and necessary field and office equipment replacement.

Effective January 1, 2010, Desmarais acquired significant additional interests in wells and infrastructure in the Barrhead area in a non-cash exchange of assets. Desmarais assumed the current asset retirement obligations for these properties and exchanged the Company's rights to a gross overriding royalty. See also related party transactions.

Dispositions totaled \$nil for the second quarter and six months ended June 30, 2011 while \$12,060 was realized on a disposition in the corresponding periods of 2010.

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LIQUIDITY AND CAPITAL RESOURCES

Funding for the Company's capital expenditure program has come from joint venture partners and equity raised during the last year. The Company had negative cash flow from operations for the period and this trend is expected to continue until such time as the Company is able to establish a higher production base, which it hopes to achieve through a combination of drilling and strategic acquisitions. Desmarais currently does not have a credit facility with any commercial lending institution. Desmarais will require significant additional financing in order to execute its business plan.

Working Capital

As at June 30, 2011, the Company had a non-cash working capital deficiency, excluding the loan from a related party, of \$1,788,673 compared to \$1,744,310 at December 31, 2010. In addition, there was \$122,738 in the Company's bank accounts as at June 30, 2011 (\$48,136 as at December 31, 2010) and \$14,791 held in trust for joint venture partners at June 30, 2011 (\$nil – December 31, 2010).

Share Capital

As at the date of this report, 27,081,835 common shares of Desmarais are outstanding. (June 30, 2011 – 27,081,835).

There are no off-balance sheet financing arrangements.

RELATED PARTY TRANSACTIONS AND MANAGEMENT AND BOARD COMPENSATION

Except as disclosed elsewhere in these financial statements, the Company has undertaken transactions with entities which are considered related parties. Transactions in the normal course of operations are measured at the exchange amount equaling the consideration established and agreed to by the related parties.

The Corporate Secretary is a Partner in a legal firm. During the three months ending June 30, 2011, legal fees totalling \$2,500 (2010 - \$13,005) with this firm were recorded. At June 30, 2011, a balance of \$32,903 remains outstanding (December 31, 2010 - \$38,825).

A director has ownership in private companies that are sublease tenants of Desmarais. During the three months ending June 30, 2011, Desmarais received office space and related service fees of \$9,000 (2010 - \$9,000). At both June 30, 2011 and December 31, 2010 \$nil was due to Desmarais from these companies.

A director is the President of a company that advanced \$2,560,000 under a demand facility to Desmarais. At June 30, 2011, interest totaling \$126,948 (2010 - \$120,997) was recorded by Desmarais to this company. At June 30, 2011, \$137,499 (December 31, 2010 - \$58,298) relating to interest was due and payable to this company from Desmarais.

The President and Chief Executive Officer is an employee of the Company with an employment contract that provides for an annual salary of \$150,000 payable in semi-monthly instalments. By mutual agreement, he has agreed to defer a portion of these payments. As a result, the Company is in arrears a total of \$78,250 as at June 30, 2011 (December 31, 2010 - \$71,250).

The President and Chief Executive Officer has partial ownership in a company that exchanged assets with Desmarais in January 2010 and is an ongoing joint venture partner in the Barrhead area. At June 30, 2011, a total of \$6,540 is due to this company (December 31, 2010 - \$5,895).

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Desmarais has an arrangement to pay gross overriding royalties to a company controlled by a significant shareholder on properties developed as a direct result of their fund raising initiatives. For the six months ended June 30, 2011, the total of these royalties was \$2,761 (2010 - \$2,335) of which a balance of \$7,574 remained outstanding at June 30, 2011 (December 31, 2010 - \$5,841).

In 2010, Desmarais entered into joint venture agreements with companies controlled by a director. For the three months ended June 30, 2011, net amounts due from losses arising from these ventures totaled \$5,015, which remains outstanding at June 30, 2011. All amounts relating to capital activities were invoiced and paid in full as at June 30, 2011.

All related party transactions are in the normal course of business and have been measured at the agreed to exchange amounts, which are the amounts of consideration established and agreed to by the related parties and which are similar to those negotiated with third parties.

CONTINGENCIES AND COMMITMENTS

Claims and Litigation

The Company is involved in various claims and potential litigation arising during the normal course of business. The outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favour. If the outcome is unfavourable, it could have a materially adverse impact on the Company's financial position and/or results of operations.

Office Lease

Desmarais has a sublease for office premises with a term to September 30, 2011. The Company is committed to pay \$10,500 in 2011.

Employment Contract

Desmarais has an employment contract with the President and Chief Executive Officer that provides for payment of a lump sum payment of 2 years salary, currently \$150,000 per annum, and 20% in lieu of benefits along with any outstanding holiday pay in the event of a change in control or dismissal without cause.

The Company has guarantees and other commitments in the normal course of business which would not have a material adverse effect on the Company's liquidity, financial condition or results of operations.

OUTLOOK

The Company will shortly be completing its third well in a Barrhead drilling program which has resulted in two Banff oil discoveries and a potential gas well, the locations defined with Desmarais' proprietary 3-D seismic. Two vertical well locations and the Company's first horizontal well location have been selected for the next phase of drilling to follow up our recent successes. With a significant drill ready project inventory in a multi-zone environment, an enviable land position, and operatorship of more than 25 kilometers of pipeline infrastructure, Desmarais has positioned itself for a strong return to profitability via the drill bit.

Desmarais expects natural gas prices to remain in the range of \$3.50 to \$4.50 per MCF for the remainder of the year. No hedging contracts are in place or contemplated for the Company in the near future. Combined with the Company outlook for oil to remain strong at approximately \$85.00 per barrel (WTI), our plans to increase drilling activity in our West Central Alberta core area should yield the financial strength and flexibility to take advantage of new opportunities.

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ADDITIONAL DISCLOSURES

Risk Assessment

There are a number of risks facing participants in the Canadian oil and gas industry. Some risks are common to all businesses while others are specific to the Company. The following are a number of identifiable business risks faced by Desmarais which will evolve and additional risks will emerge periodically. The risks shown are those identified by management at the date of completion of this report and may not describe all of the risks faced by the Company.

Substantial Capital Requirements

The Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. As the Company's revenues may decline as a result of decreased commodity pricing, it may be required to reduce capital expenditures. In addition, uncertain levels of near term industry activity coupled with the present global credit crisis exposes the Company to additional financing risks. There can be no assurance that debt or equity financing, or funds generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's business financial condition, results of operations and prospects.

Third Party Credit Risk

The Company may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to the Company, such failures may have a material adverse effect on the Company's business, financial condition, results of operations and prospects. In addition, poor credit conditions in the industry and of joint venture partners may impact a joint venture partner's willingness to participate in the Company's ongoing capital program, potentially delaying the program and the results of such program until the Company finds a suitable alternative partner.

QUARTERLY RESULTS

| (\$, except per share amounts) | IFRS | | | | | | Canadian GAAP | |
|---|-----------|-----------|-----------|-----------|-----------|-----------|---------------|-----------|
| | Jun-11 | Mar-11 | Dec-10 | Sep-10 | Jun-10 | Mar-10 | Dec-09 | Sep-09 |
| Petroleum and natural gas sales | 131,746 | 116,690 | 109,970 | 138,745 | 95,195 | 140,845 | 139,671 | 113,573 |
| Cash flow used in operations | (66,570) | (126,859) | (221,313) | (91,596) | (173,036) | (102,158) | (515,001) | (456,471) |
| Funds from (used in) operating activities | 28,623 | (138,810) | (101,235) | (80,350) | (154,157) | (138,810) | 2,679 | (185,035) |
| Net loss | (144,667) | (208,806) | (325,065) | (198,265) | (30,726) | (344,750) | (884,674) | (421,708) |
| Per share - basic and diluted | - | (0.01) | (0.01) | (0.01) | - | (0.02) | (0.05) | (0.03) |
| Total assets | 4,146,730 | 4,589,396 | 4,028,428 | 4,718,442 | 3,917,126 | 4,123,524 | 4,189,605 | 4,669,598 |

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Desmarais' petroleum and natural gas sales, cash flow and funds from operating activities and net income are all impacted by production levels and volatile commodity pricing. From 2009 to 2011, these performance measures have fluctuated as a result of volatile commodity prices and escalating cost of royalties and operations.

Significant factors and trends that have impacted the Company's results during the above periods include:

- Revenue is directly impacted by the Company's ability to replace existing declining production and add incremental production through its on-going capital expenditure program
- Cash flow from operations over the past two years is a cumulative negative amount as production levels have not increased enough to support operating costs and the requisite staffing levels required to operate a publicly listed oil and gas company
- The working capital deficiency has increased due to a minimal amount of new equity
- Total assets have not grown materially due to capital expenditure activities being funded by joint venture partners

SIGNIFICANT ACCOUNTING POLICIES

Changes in accounting policies and practices

The following discussion explains the significant differences between Desmarais' previous GAAP accounting policies and those applied by the Company under International Financial Reporting Standards ("IFRS"). IFRS policies have been retrospectively and consistently applied except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS for first-time adopters.

The most significant changes to the Company's accounting policies relate to the accounting for exploration and evaluation costs and decommissioning liabilities. Refer to Note 16 of the June 30, 2011 Financial Statements as well as Notes 3 and 16 of the March 31, 2011 Financial Statements for additional disclosures and illustrative information for differences between IFRS and previously applied GAAP.

Recent accounting pronouncements

In May 2011, the IASB issued four new standards and two amendments. Five of these items related to consolidation, while the remaining one addresses fair value measurement. All of the new standards are effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted.

IFRS 11 "Joint Arrangements" replaces IAS 31, "Interests in Joint Ventures". IFRS 11 divides joint arrangements into two types, each having its own accounting model. A "joint operation" continues to be accounted for using proportionate consolidation, where a "joint venture" must be accounted for using equity accounting. This differs from IAS 31, where there was the choice to use proportionate consolidation or equity accounting for joint ventures. A "joint operation" is defined as the joint operators having rights to the assets, and obligations for the liabilities, relating to the arrangement. In a "joint venture", the joint ventures' have rights to the net assets of the arrangement, typically through their investment in a separate joint venture entity.

IFRS 12 "Disclosure of Interests in Other Entities" is a new standard, which combines all of the disclosure requirements for subsidiaries, associates and joint arrangements, as well as unconsolidated structured entities.

IFRS 13 "Fair Value Measurement" is a new standard meant to clarify the definition of fair value, provide guidance on measuring fair value and improve disclosure requirements related to fair value measurement.

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IAS 28 "Investments in Associates and Joint Ventures" has been amended as a result of the issuance of IFRS 11 and the withdrawal of IAS 31. The amended standard sets out the requirements for the application of the equity method when accounting for interest in joint ventures, in addition to interests in associates.

The IASB intends to replace IAS 39, "Financial Instruments: Recognition and Measurements" ("IAS39") with IFRS 9, "Financial Instruments" ("IFRS 9"). IFRS 9 will be published in three phases, of which the first phase has been published.

The first phase addresses the accounting for financial assets and financial liabilities. The second phase will address the impairment of financial instruments, and the third phase will address hedge accounting.

For financial assets, IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, and replaces the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. For financial liabilities, although the classification criteria for financial liabilities will not change under IFRS 9, the approach to the fair value option for financial liabilities may require different accounting for changes to the fair value of a financial liability as a result of changes to an entity's own credit risk. IFRS 9 is effective for annual periods beginning on or after January 1, 2013 with different transitional arrangements depending on the date of initial application.

The Company is currently evaluating the impact of adopting all of the newly issued and amended standards on our financial statements.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Desmarais' significant accounting policies are disclosed in Note 3 to the June 30, 2011 and March 31, 2011 financial statements.

Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These accounting policies are discussed below and are included to aid the reader in assessing the critical accounting policies and practices of the Company and the likelihood of materially different results being reported. Desmarais' management reviews its estimates regularly. The emergence of new information and changed circumstances may result in actual results or changes to estimate amounts that differ materially from current estimates.

The following assessment of significant accounting policies and associated estimates is not meant to be exhaustive. The Company might realize different results from the application of new accounting standards promulgated, from time to time, by various rule-making bodies.

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Exploration and Evaluation and Impairment Evaluation

Fair value of exploration and evaluation assets is determined based on market value to an arm's length buyer as described in property and equipment above. As E&E assets are not proven assets, they have uncertainties that make it difficult to assess future cash flows; as such market conditions and assessment by management are used to determine fair value.

Exploration and evaluation assets are assessed for impairment if:

- (i) sufficient data exists to determine technical feasibility and commercial viability, and
- (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units.

The technical feasibility and commercial viability of extracting an oil and gas resource is considered to be determinable when proven reserves are determined to exist. Upon determination of proven reserves, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within tangible assets referred to as oil and natural gas development and production assets.

Reserves

Estimation of reported recoverable quantities of proved and probable reserves include judgmental assumptions regarding production profile, commodity prices, exchange rates, remediation costs, timing and amount of future development costs, and production, transportation and marketing costs for future cash flows. It also requires interpretation of geological and geophysical models in order to make an assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economical, geological and technical factors used to estimate reserves may change from period to period. Changes in reported reserves can impact the carrying values of the Company's petroleum and natural gas properties and equipment, the calculation of depletion and depreciation, the provision for decommissioning obligations, and the recognition of deferred tax assets due to changes in expected future cash flows. The recoverable quantities of reserves and estimated cash flows from Desmarais' petroleum and natural interests are independently evaluated by reserve engineers at least annually.

The Company's petroleum and natural gas reserves represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be economically recoverable in future years from known reservoirs and which are considered commercially producible. Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon (i) a reasonable assessment of the future economics of such production; (ii) a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and (iii) evidence that the necessary production, transmission and transportation facilities are available or can be made available.

Reserves may only be considered proven and probable if productive capacity is supported by either production or conclusive formation tests. Desmarais' oil and gas reserves are determined pursuant to National Instrument 51-101, Standard of Disclosures for Oil and Gas Activities.

Decommissioning obligations

The Company estimates future remediation costs of production facilities, well sites and gathering systems at different stages of development and construction of assets or facilities. In most instances, removal of assets occurs many years into the future. This requires judgment regarding abandonment date, future environmental and regulatory legislation, the extent of reclamation activities, the engineering methodology for estimating cost, future removal technologies in determining the removal cost and liability-specific discount rates to determine the present value of these cash flows.

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Stock-based compensation

All share-based awards issued by the Company are fair valued using the Black-Scholes option-pricing model. In assessing the fair value of share-based compensation, estimates have to be made regarding the expected volatility in share price, option life, dividend yield, risk-free rate and estimated forfeitures at the initial grant date.

Impairment of assets

The impairment testing of PP&E is based on estimates of proved plus probable reserves, production rates, forecasted petroleum and natural gas prices, future costs and other relevant assumptions. Desmarais assets are aggregated into cash-generating units, for the purpose of calculating impairment, based on their ability to generate largely independent cash flows. By their nature, these estimates and assumptions are subject to measurement uncertainty and may impact the carrying value of the Company's assets in future periods.

Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment subsequent to the financial statement reporting period. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.