

**FRONT STREET CANADIAN ENERGY RESOURCE FUND**

**FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

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## **INDEPENDENT AUDITOR'S REPORT**

### **To the Trustee and Unitholders of Front Street Canadian Energy Resource Fund**

#### **Report on the Financial Statements**

We have audited the accompanying financial statements of Front Street Canadian Energy Resource Fund which comprise the statements of net assets as at December 31, 2012 and 2011, the statements of operations and the statements of changes in net assets for the years then ended, the statement of investment portfolio as at December 31, 2012, and a summary of significant accounting policies and other explanatory information.

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

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement.



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An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 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 financial statements present fairly, in all material respects, the financial position of Front Street Canadian Energy Resource Fund as at December 31, 2012 and 2011 and its operations and changes in net assets for the years then ended in accordance with Canadian generally accepted accounting principles.

*Segal LLP*

Chartered Accountants  
Licensed Public Accountants

Toronto, Ontario  
March 27, 2013

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## STATEMENTS OF NET ASSETS AS AT DECEMBER 31, 2012 AND 2011

	2012	2011
<b>ASSETS</b>		
Investments, at fair value (cost - \$24,416,566; 2011 - \$40,348,629)	\$ 20,302,109	\$ 33,999,393
Amounts receivable relating to accrued income	5,750	1,121
Accounts receivable relating to units issued	<u>-</u>	<u>136,245</u>
	<u>\$ 20,307,859</u>	<u>\$ 34,136,759</u>
<b>LIABILITIES</b>		
Bank indebtedness	\$ 1,309,018	\$ 4,087,885
Accounts payable relating to units redeemed	310,868	623,348
Accounts payable and accrued liabilities	<u>113,295</u>	<u>143,066</u>
	<u>1,733,181</u>	<u>4,854,299</u>
<b>Net assets representing unitholders' equity</b>	<u>\$ 18,574,678</u>	<u>\$ 29,282,460</u>
<b>Net assets applicable to outstanding units allocated as follows:</b>		
Net assets, Series B, note 3	\$ 17,398,830	\$ 28,450,412
Units outstanding, Series B, note 3	1,298,179	1,475,630
Net assets per unit, Series B	<u>\$ 13.40</u>	<u>\$ 19.28</u>
Net assets, Series F, note 3	\$ 1,175,848	\$ 832,048
Units outstanding, Series F, note 3	89,806	44,098
Net assets per unit, Series F	<u>\$ 13.09</u>	<u>\$ 18.87</u>

Approved on behalf of Front Street Capital 2004, The Manager:



Gary P. Selke  
Management Committee Member



Normand A. Lamarche  
Management Committee Member

See accompanying notes to the financial statements

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
<b>Investment income</b>		
Interest	\$ 144	\$ -
Dividends	<u>5,750</u>	<u>-</u>
	<u>5,894</u>	<u>-</u>
<b>Expenses</b>		
Management fees, note 4 and 6	517,952	984,306
Operating costs	138,210	190,703
Interest expense and bank charges	48,368	117,421
Audit fees	30,500	39,500
Trustees' fees	15,456	12,760
Legal fees	<u>2,228</u>	<u>2,539</u>
	<u>752,714</u>	<u>1,347,229</u>
<b>Net investment loss</b>	<u>(746,820)</u>	<u>(1,347,229)</u>
<b>Realized and unrealized gains (losses) on investments</b>		
Net realized gain (loss) on the sale of investments	(10,370,057)	8,605,454
Transaction costs, note 5 and 6	(88,210)	(167,371)
Change in the unrealized appreciation (depreciation) of the value of investments	<u>2,224,914</u>	<u>(28,059,811)</u>
<b>Net loss on investments for the year</b>	<u>(8,233,353)</u>	<u>(19,621,728)</u>
<b>Net decrease in net assets from operations for the year</b>	<u>\$ (8,980,173)</u>	<u>\$ (20,968,957)</u>
Decrease in net assets from operations applicable to outstanding units allocated as follows:		
Decrease in net assets from operations, Series B	<u>\$ (8,517,499)</u>	<u>\$ (20,674,787)</u>
Decrease in net assets from operations per unit, Series B	<u>\$ (6.08)</u>	<u>\$ (13.09)</u>
Decrease in net assets from operations, Series F	<u>\$ (462,674)</u>	<u>\$ (294,170)</u>
Decrease in net assets from operations per unit, Series F	<u>\$ (5.69)</u>	<u>\$ (13.63)</u>

See accompanying notes to the financial statements

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### STATEMENTS OF CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
<b>Series B</b>		
Net assets, beginning of year	\$ <u>28,450,412</u>	\$ <u>54,347,910</u>
Net decrease in net assets from operations	<u>(8,517,499)</u>	<u>(20,674,787)</u>
<b>Unitholder transactions</b>		
Capital contributions	21,930	1,187,482
Redemptions	<u>(2,556,013)</u>	<u>(6,410,193)</u>
	<u>(2,534,083)</u>	<u>(5,222,711)</u>
Net decrease in net assets for the year	<u>(11,051,582)</u>	<u>(25,897,498)</u>
Net assets, end of year	<u>\$ 17,398,830</u>	<u>\$ 28,450,412</u>
<b>Series F</b>		
Net assets, beginning of year	\$ <u>832,048</u>	\$ <u>276,778</u>
Net decrease in net assets from operations	<u>(462,674)</u>	<u>(294,170)</u>
<b>Unitholder transactions</b>		
Capital contributions	1,143,889	849,440
Redemptions	<u>(337,415)</u>	<u>-</u>
	<u>806,474</u>	<u>849,440</u>
Net increase in net assets for the year	<u>343,800</u>	<u>555,270</u>
Net assets, end of year	<u>\$ 1,175,848</u>	<u>\$ 832,048</u>
<b>Total</b>		
Net assets, beginning of year	\$ <u>29,282,460</u>	\$ <u>54,624,688</u>
Net decrease in net assets from operations	<u>(8,980,173)</u>	<u>(20,968,957)</u>
<b>Unitholder transactions</b>		
Capital contributions	1,165,819	2,036,922
Redemptions	<u>(2,893,428)</u>	<u>(6,410,193)</u>
	<u>(1,727,609)</u>	<u>(4,373,271)</u>
Net decrease in net assets for the year	<u>(10,707,782)</u>	<u>(25,342,228)</u>
Net assets, end of year	<u>\$ 18,574,678</u>	<u>\$ 29,282,460</u>

See accompanying notes to the financial statements

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### STATEMENT OF INVESTMENT PORTFOLIO AS AT DECEMBER 31, 2012

	Number of Shares / Units	Cost \$	Fair Value \$
<b>Long positions (109.2%)</b>			
<b>Domestic (94.3%)</b>			
<b>Energy (54.5%)</b>			
Anatolia Energy Corp Warrants February 15, 2013	220,625	\$ -	\$ -
C&C Energia Limited	121,431	909,953	1,141,451
Canadian International Oil Corporation Warrants August 25, 2015	202,781	-	152,086
Crocotta Energy Inc.	401,867	919,138	1,197,564
Crown Point Energy Inc.	169,574	262,840	73,765
Cub Energy Inc.	4,200,000	1,680,000	1,512,000
Lipari Energy Inc. Warrants March 11, 2014	348,793	-	1,744
Madalena Ventures Inc.	2,546,011	542,424	967,484
P1 Energy Corporation	727,591	2,000,875	400,175
Petroamerica Oil Corporation Warrants November 4, 2014	2,000,000	-	50,378
Renegade Petroleum Limited	300,000	1,200,000	732,000
Royal Coal Corporation Warrants February 23, 2013	4,750,000	950	23,750
Sintana Energy Inc.	7,488,750	1,914,000	1,273,088
Spartan Oil Corporation	424,072	1,064,107	2,222,138
Xtreme Drilling and Coil Services Corporation	234,419	<u>844,494</u>	<u>382,103</u>
		<u>\$ 11,338,781</u>	<u>\$ 10,129,726</u>

See accompanying notes to the financial statements

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### STATEMENT OF INVESTMENT PORTFOLIO AS AT DECEMBER 31, 2012

	Number of Shares / Units	Cost \$	Fair Value \$
<b>Long positions (109.2%)</b>			
<b>Domestic (94.3%) (Continued...)</b>			
<b>Industrials (1.8%)</b>			
ENTREC Corporation	221,485	\$ 329,618	\$ 338,872
<b>Materials (38.0%)</b>			
Augusta Resource Corporation	559,881	\$ 733,444	\$ 1,338,116
Billabong Gold Restricted	1,250,000	500,000	187,500
Calston Exploration Inc. Restricted	1,739,232	434,808	400,023
Calston Exploration Inc. Warrants June 17, 2013	869,616	-	1
Dalradian Resources Inc.	752,948	232,074	1,152,010
Edgewater Exploration Limited Warrants September 21, 2013	500,000	-	1
Entree Gold Inc.	389,300	863,768	171,292
Guatavita Gold Corporation Restricted	1,000,000	250,000	130,000
Lithium Americas Corporation	398,500	737,225	346,695
Plata Latina Minerals Corporation	771,500	311,089	231,450
PMI Gold Corporation	986,200	1,232,750	798,822
Riva Gold Corporation	857,150	173,573	154,287
Rubicon Minerals Corporation	259,031	901,827	655,348
Tolima Gold Inc.	1,800,000	724,500	270,000
Wildcat Silver Corporation	1,531,529	911,582	1,225,223
		<u>\$ 8,006,640</u>	<u>\$ 7,060,768</u>
<b>Total domestic</b>		<u>\$ 19,675,039</u>	<u>\$ 17,529,366</u>

See accompanying notes to the financial statements



## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### STATEMENT OF INVESTMENT PORTFOLIO AS AT DECEMBER 31, 2012

	Number of units / Units	Cost \$	Fair Value \$
<b>Foreign (14.9%)</b>			
<b>Australia (7.8%)</b>			
Mirabela Nickel Limited	1,314,364	\$ 2,214,619	\$ 644,038
Perseus Mining Limited	376,054	<u>876,638</u>	<u>812,277</u>
		<u>\$ 3,091,257</u>	<u>\$ 1,456,315</u>
<b>U.S. Equities (4.8%)</b>			
Business Bridge Corporation Private Placement	10	<u>\$ 1,047,954</u>	<u>\$ 895,228</u>
<b>Cayman Islands (2.3%)</b>			
Greenfields Petroleum Corporation	105,300	<u>\$ 602,316</u>	<u>\$ 421,200</u>
<b>Total foreign (14.9%)</b>		<u>\$ 4,741,527</u>	<u>\$ 2,772,743</u>
<b>Total long positions (109.2%)</b>		<u>\$ 24,416,566</u>	<u>\$ 20,302,109</u>
<b>Transaction costs, note 2</b>		<u>(42,977)</u>	-
<b>Total investments (109.2%)</b>		<u>\$ 24,373,589</u>	20,302,109
<b>Bank indebtedness (-7.0%)</b>			(1,309,018)
<b>Other assets less liabilities (-2.2%)</b>			<u>(418,413)</u>
<b>Net assets (100.0%)</b>			<u>\$ 18,574,678</u>

See accompanying notes to the financial statements

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 1. THE FUND

Front Street Canadian Energy Resource Fund (Formerly Front Street Canadian Energy Fund) (the "Fund") is a mutual fund trust created under the laws of the Province of Ontario pursuant to a trust agreement dated January 3, 2005 (the "Trust Agreement") as amended and restated as of May 1, 2009. The business of the Fund is to invest in equity, debt and derivative securities. Effective May 1, 2009, the Trust Agreement was amended to change the name of the Fund from "Front Street Mining Opportunities Fund" to "Front Street Canadian Energy Fund", redesignate the units of the Fund as B Units, authorize the Fund to issue F Units and amend the investment objective, investment strategies and investment restrictions of the Fund. Effective December 15, 2009, Valiant Trust Company replaced HSBC Trust Company (Canada) as the trustee of the Fund (the "Trustee"). Pursuant to the Amended and Restated Trust Agreement dated February 15, 2010, the name of the Fund has been changed to Front Street Canadian Energy Resource Fund.

As of December 31, 2012, Series B and Series F units have been issued. Series F commenced operations on June 1, 2010.

Front Street Capital 2004 is the Manager of the Fund (the "Manager"). Front Street Investment Management Inc. (the "Investment Advisor") has been retained by the Manager, on behalf of the Fund, to provide investment advisory and portfolio management services to the Fund. RBC Dominion Securities Inc. is the custodian. Citigroup Fund Services Canada, Inc. provides fund accounting and unitholder record keeping services.

The Fund's investment objective is to achieve maximum capital appreciation by investing primarily in a diversified portfolio (the "portfolio") consisting primarily of equity and equity-related securities of small and medium-sized business entities in a range of energy-related industries, including oil and gas exploration and production, servicing and drilling, the power generation market, including coal, liquefied natural gas, nuclear and electricity, and alternative energy-related projects, including fuel cell, power generation and wind power projects, as well as other related natural resource sector industries including mineral resource mining and exploration, forestry and water resource projects.

The Fund is not a mutual fund for securities law purposes. As a result, certain of the protections provided to investors in mutual funds under such laws are not available to investors in the units.

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The following is a summary of the significant accounting policies followed by the Fund:

a) Financial instruments

Investments, at fair value, have been classified as held for trading. Amounts receivable relating to accrued income have been classified as loans and receivables and accounts receivable relating to units issued. Bank indebtedness, accounts payable relating to units redeemed and accounts payable and accrued liabilities have been classified as other financial liabilities.

The Canadian Securities Administrators adopted changes to National Instrument 81-106 on Investment Fund Continuous Disclosure. The changes are essentially aimed at modifying the requirements pertaining to the calculation of the unit value due to the inclusion of Section 3855, Financial Instruments - Recognition and Measurement of the CICA Handbook. These changes allow the Fund to report two distinct net asset values: one for the financial statements, which is calculated in accordance with Canadian GAAP (called "net assets") and another for all other purposes, such as unit pricing (called "net asset value"). A reconciliation between the net assets per unit and the net asset value per unit is required (see note 9) as well as description of the differences between the valuation principles and practices used by the Manager to calculate the net asset value and those prescribed by Canadian GAAP.

b) Valuation of investments

i) Investments listed on an exchange are valued at the last bid price reported by the principal securities exchange on which the issue is traded on the financial statement date. The difference between this amount and cost is shown as the change in the unrealized appreciation (depreciation) of the value of investments. For investments that are not traded in an active market, Section 3855 requires the use of specific valuation techniques to be used in the determination of fair value. When current market prices or quotations are not readily available, valuations are established using specific procedures in order to estimate what the fair value would be, in an arms length transaction, motivated by normal business considerations. Valuation techniques principally include the use of the last publicly traded price, the issuance price of the securities at the date of the most recent financing of the entity or a price established by the Manager in accordance with its fair value policy.

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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#### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

##### b) Valuation of investments (continued...)

- ii) Investments which are restricted as to transferability are valued at the fair value of the unrestricted investment as provided in paragraphs (i) above less a discount of 2% per month up to four months.

The process of valuing investments for which no published market exists is inevitably based on inherent uncertainties and the resulting values may differ from values that would have been established had a ready market existed for these investments.

- iii) Trust units are valued at the last bid price reported by the principal securities exchange on which the issue is traded on the financial statement date. The cost of the trust units is reduced on an annual basis by distributions from the trust and increased by the annual income allocated to the units by the trust.

- iv) Investments in mutual funds or pooled funds are valued based on the net asset value per unit at the close of the trading on the financial statement date.

- v) The Fund values its investments in limited partnerships at the last bid price reported by the principal securities exchange on which the issue is traded on the financial statement date. The Fund calculates the cost value of its investment in limited partnerships using the equity method. Under this method, the limited partnership investments are recorded at cost plus the Fund's pro rata unit in undistributed earnings since acquisition.

- vi) The Fund may make short sales whereby a security that it does not own is sold in anticipation of a decline in the fair value of the security. Securities which are sold short are valued at the last ask price reported by the principal securities exchange on which the issue is traded on the financial statement date. To enter a short sale, the Fund may need to borrow the security for delivery to the buyer.

While the transaction is open, the Fund will also incur a liability for any paid dividends or interest which are due to the lender of the security.

- vii) The Fund invests in derivatives which represent financial instruments which may require little or no initial investment and which are settled in the future. These investments are commonly referred to as options, forwards or futures contracts. Futures contracts listed upon a principal exchange are valued at their last bid price (for long contracts) and last ask price (for short contracts) at the financial statement date. Contracts with no available bid and ask prices are valued at the fair value as determined by the Manager.

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

#### c) Financial instruments disclosure and presentation and fair value measurements

The Fund adopted CICA Handbook Sections 3862, Financial Instruments - Disclosures and 3863, Financial Instruments - Presentation. These standards place increased emphasis on disclosures with respect to the nature and extent of risks arising from financial instruments and how the Fund has managed those risks. See note 10 for additional details.

The Fund adopted the amendments to CICA 3862, Financial Instruments - Disclosures. CICA 3862 establishes a three-tier hierarchy as a framework for disclosing fair value based on the inputs used to value the Fund's investments. The hierarchy of inputs is summarized below:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices) (Level 2); and
- Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

See note 12 for additional details.

#### d) Transaction costs

Portfolio transaction costs are expensed and are included in "Transaction costs" in the Statement of Operations. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of an investment, which include fees and commissions paid to agents, advisors, brokers and dealers, levies by regulatory agencies and securities exchanges. The individual security's cost shown on the Statement of Investment Portfolio includes only those transaction costs incurred on the acquisition of portfolio investments.

#### e) Cash and cash equivalents

Cash and cash equivalents consist of cash balances with banks and highly liquid short-term investments with original terms to maturity of less than three months.

#### f) Bank indebtedness

Bank indebtedness is the balance of a margin account representing cash loans with the brokers which are secured by the underlying investments owned by the Fund. Bank indebtedness is shown net of cash and cash equivalents since both the margin account and cash and cash equivalents accounts are maintained with the same custodian.

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

g) Investment transactions and income recognition

Investment transactions are accounted for on a trade date basis. Gains and losses from such transactions are calculated using the weighted average cost of the securities on disposition.

Interest income is recorded on an accrual basis. Dividend income is recorded on the ex-dividend date.

h) Income taxes

The Fund presently qualifies as a mutual fund trust under the Income Tax Act (Canada) and, accordingly, is not taxed on that portion of its taxable income that is paid or allocated to unitholders. The Fund allocates to its unitholders sufficient net income and net realized gains so that it will not be subject to income taxes. Foreign income is subject to foreign withholding taxes.

i) Foreign currency translation

Income, expenses and investment transactions in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the dates of such transactions. Assets and liabilities in foreign currencies are translated into Canadian dollars at the closing exchange rates on each valuation day.

j) Net increase (decrease) in net assets from operations per unit

Net increase (decrease) in net assets from operations per unit are based on the increase (decrease) in net assets from operations attributable to each series of units divided by the average number of units outstanding of that series during the year.

k) Net assets per unit

The net assets per unit are calculated by dividing the net assets of a series of units by the total number of units of the series outstanding at the end of the year.

l) Capital disclosures

The Fund has adopted CICA Handbook Section 1535, Capital Disclosures, which requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. See note 11 for additional details.

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

#### m) General standards on financial statement presentation

CICA Handbook Section 1400, General Standards on Financial Statement Presentation, includes requirements to assess and disclose an entity's ability to continue as a going concern. The Manager of the Fund has made this assessment and concluded that there are currently no material uncertainties that cast doubt on the Fund's ability to continue as a going concern.

#### n) Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires the Manager to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of financial statements, and the reported amounts of revenues and expenses during the reporting year. Significant estimates include the fair value of the Fund's investments in private companies and the fair value of the Fund's investments in corporate warrants which are not traded in active markets. Actual results may differ from those estimates.

#### o) Future accounting pronouncements

Recent accounting pronouncements that have been issued but are not yet effective, which have potential implications for the Fund, are as follows:

##### International financial reporting standards ("IFRS")

Effective for its fiscal year commencing January 1, 2014, the Fund must adopt IFRS. In preparation thereof, the Manager continues to monitor and implement the Fund's changeover plan and will continue to assess the impact on the implementation as new IFRS guidance become available from the International Accounting Standards Board ("IASB").

The Manager has reviewed the current IFRS against the Fund's current accounting policies and financial statement presentation under Canadian generally accepted accounting principles ("Canadian GAAP"), and the following areas of differences have been identified:

- (a) IAS 32, Financial Instruments: Disclosure and Presentation, requires unitholders' equity to be classified as liability unless certain criteria are met.
- (b) IFRS 13, Fair Value Measurements, that was released in May 2011 provides guidance on the fair value measurements and allows for the possible use of closing prices to value investments.

The Manager is monitoring these developments and will assess the impact of any changes in accounting policies or financial statement presentation as necessary to determine an appropriate approach.

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 2. SIGNIFICANT ACCOUNTING POLICIES (Continued...)

#### o) Future accounting pronouncements (Continued...)

The anticipated impact of IFRS on accounting policies and implementation decisions will be on the financial statement presentation and note disclosures in the Fund's financial statements. In particular, the Fund will be required to present a statement of unitholders' equity and a statement of cash flows, and will be required to include certain additional and enhanced disclosures.

The Fund's changeover plan includes key activities in (a) preparation of financial statements, (b) information processing and record-keeping, (c) business policy assessment and (d) systems and controls. Based on the Manager's current analysis, the Manager believes the changeover to IFRS will not materially affect the Fund's existing business arrangements.

### 3. UNITS ISSUED AND OUTSTANDING

The Fund is authorized to issue an unlimited number of units in one or more series. Initially, B units and F units have been authorized. Each unit of a series represents an undivided interest in the net assets of the Fund applicable to that series. Each unit has equal rights with respect to voting, liquidation and other events in respect of the Fund.

Subject to the Fund's right to suspend redemptions, units that have been held by a Unitholder for a minimum of six months may be surrendered at least 30 days prior to the last business day of each month (each, a "Redemption Date") for redemption on such Redemption Date. Units so surrendered for redemption by a Unitholder will be redeemed on such Redemption Date for a redemption price equal to the applicable Series Net Asset Value per Unit on such Redemption Date.

The following unitholder transactions took place during the year:

	2012	2011
Units outstanding, beginning of the year		
Series B	1,475,630	1,671,138
Series F	44,098	8,767
Units issued during the year		
Series B	1,771	37,808
Series F	71,603	35,331
Units redeemed during the year		
Series B	179,222	233,316
Series F	25,895	-
Units outstanding, end of year		
Series B	1,298,179	1,475,630
Series F	89,806	44,098



## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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#### 4. MANAGEMENT AND PERFORMANCE FEES

The Fund pays a monthly management fee, within 10 business days after the end of each month, equal to 1/12 of 2% of the Series B net asset value and a monthly management fee equal to 1/12 of 1% of the Series F net asset value, calculated based on the weekly net asset value calculation during the month and paid at the end of each month in arrears for each series. The Manager will pay any fees owing to the Investment Advisor out of the management fee.

The Fund is responsible for payment of all operating and administrative expenses of the Fund. The main components of these expenses are legal and accounting fees, printing expenses, reporting issuer filing and sustaining fees, custodial fees, trustees' fees, fees payable to, and expenses incurred by, the Fund's Independent Review Committee and expenses making distributions to unitholders. As the Fund has more than one series of units, the unitholders of each series, bear their pro rata unit of those expenses which are common to the operation of all series, as well as those expenses which are attributable solely to that series.

The Manager may, at its discretion add a service charge of up to 15% of the costs incurred for any operating and administrative costs charged to the Fund other than management services which are already included in the management fee rate which the Manager receives from the Fund.

The Fund pays a performance fee per unit of each series equal to 20% of the amount by which the aggregate of:

- (a) the Series Net Asset Value per unit for the relevant series at the end of such fiscal year (without regard to any accrual of the Performance Bonus), and
- (b) Any distribution per unit of such series declared during such year;

exceeds the series Net Asset Value per unit for such series at the beginning of such fiscal year, provided that the Fund generates an annual return on investment of at least 6%.

#### 5. TRANSACTION COSTS

The total brokerage commissions paid by the Fund with respect to security transactions for the year ended December 31, 2012 was \$88,210 (2011 - \$167,371).

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 6. RELATED PARTY TRANSACTIONS

During the years ended December 31, 2012 and 2011, fees paid to the Manager were as follows:

	2012	2011
Management fees, note 4	<u>\$ 517,952</u>	<u>\$ 984,306</u>

Included in accrued expenses are amounts payable to the Manager as follows:

	2012	2011
Management fees payable	<u>\$ 36,388</u>	<u>\$ 55,175</u>

The following shares are held by the related parties of the Fund:

	2012	2011
Series B units held by Partners of the Manager	449,728.77	461,798.50
Percentage of Series B units held by Partners of the Manager	34.64%	31.30%
Series B units held by relatives of Partners of the Manager	102,310.74	102,310.74
Percentage of Series B units held by relatives of Partners of the Manager	7.88%	6.93%

The Fund may place a portion of its portfolio transactions with brokerage firms which are affiliates of the Manager provided it determines that these affiliates' trade execution abilities and costs are comparable to those non affiliated, qualified brokerage firms, on an execution only basis. During the year ended December 31, 2012, Tuscarora Capital Inc, a company under common control to the Manager, received \$433 (2011 - \$175) in commissions on portfolio transactions for the Fund.

Management fees and performance fees are measured at the exchange amount of consideration prescribed by the offering documents of the Fund. When related parties enter unitholder transactions with the Fund, the exchange amount of consideration is the transactional NAV available to all other unitholders on the trade date. In the case of brokerage commissions, the exchange amount of consideration is that which is negotiated by the related parties.

### 7. DISTRIBUTION POLICY

The Fund intends to distribute all of its income for purposes of the Income Tax Act, including sufficient net realized capital gains (less applicable losses), on an annual basis, so that the Fund will not be liable for income tax. Distributions over the life of the Fund will be derived primarily from net realized capital gains and income from the Portfolio.

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

#### 8. INDEMNIFICATION OF THE MANAGER

The Fund, pursuant to the Trust Agreement, will indemnify the Manager, its partners, directors, officers, employees and agents out of the Trust Property from all claims that may arise in connection with the exercise of its duties as Manager if they do not result from the Manager's willful misconduct, bad faith, gross negligence or reckless disregard of its duties, or breach of its obligations as manager under the Trust Agreement.

#### 9. RECONCILIATION OF NET ASSET VALUE TO NET ASSETS FOR FINANCIAL STATEMENTS

In accordance with the decision made by the Canadian securities regulatory authorities, a reconciliation between the transactional net asset value ("NAV") and net assets calculated using Canadian generally accepted accounting principles ("GAAP NA") of an investment fund is required. For investments that are traded in an active market where quoted prices are readily and regularly available, Section 3855 requires bid prices (for investments held) and ask prices (for investments sold) to be used in the fair valuation of investments, rather than the use of closing trade prices currently used for the purpose of determining transactional NAV. For investments that are not traded in an active market, Section 3855 requires the use of specific valuation techniques (see note 2) rather than the use of valuation techniques in general practice in the investment funds industry.

These changes account for the difference between transactional NAV and GAAP NA. The impact of the adoption of Section 3855 on the net asset value of the Fund is as follows:

As at December 31, 2012

	Transactional NAV	Section 3855 Adjustment	GAAP NA	Transactional NAV per Unit	GAAP NA per Unit
Series B	\$ 17,794,147	\$ (395,317)	\$ 17,398,830	\$ 13.71	\$ 13.40
Series F	<u>1,206,613</u>	<u>(30,765)</u>	<u>1,175,848</u>	13.44	13.09
	<u>\$ 19,000,760</u>	<u>\$ (426,082)</u>	<u>\$ 18,574,678</u>		

As at December 31, 2011

	Transactional NAV	Section 3855 Adjustment	GAAP NA	Transactional NAV per Unit	GAAP NA per Unit
Series B	\$ 29,276,448	\$ (826,036)	\$ 28,450,412	\$ 19.84	\$ 19.28
Series F	<u>852,293</u>	<u>(20,245)</u>	<u>832,048</u>	19.33	18.87
	<u>\$ 30,128,741</u>	<u>\$ (846,281)</u>	<u>\$ 29,282,460</u>		

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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#### 10. FINANCIAL INSTRUMENTS

The Fund's assets and liabilities classified in accordance with CICA Handbook Section 3855 are as follows:

As at December 31,

	2012	2011
<b>Assets</b>		
Held for trading	\$ 20,302,109	\$ 33,999,393
Loans and receivables	<u>5,750</u>	<u>137,366</u>
Total Assets	<u>\$ 20,307,859</u>	<u>\$ 34,136,759</u>
<b>Liabilities</b>		
Held for trading	\$ -	\$ -
Other financial liabilities at amortized cost	<u>1,733,181</u>	<u>4,854,299</u>
Total liabilities	<u>1,733,181</u>	<u>4,854,299</u>
Net Assets	<u>\$ 18,574,678</u>	<u>\$ 29,282,460</u>

The Fund's financial instruments consist of investments at fair value, amounts receivable relating to accrued income, accounts receivable relating to units issued, bank indebtedness, accounts payable relating to units redeemed, accounts payable and accrued liabilities. It is the Manager's opinion that due to the short term nature of these financial instruments, the Fund is not exposed to significant market price, currency, interest rate, liquidity, cash flow and credit risks arising from these financial instruments except as described below. The fair value of these financial instruments approximate their carrying values, unless otherwise noted.

#### Risk management

The Investment Advisor seeks to minimize potential adverse effects of risks on the Fund's performance by employing professional, experienced portfolio advisors, by daily monitoring of the Fund's positions and market events, and by diversifying the investment portfolio within the constraints of the investment objective. To assist in managing risk, the Manager also maintains a governance structure that oversees the Fund's investment activities and monitors compliance with the Fund's stated investment strategy and securities regulations.

The Fund's investment activities expose it to various types of risk that are associated with the financial instruments and markets in which it invests. The Statement of Investment Portfolio presents the securities held by the Fund as at December 31, 2012, and groups the securities by asset type, sector and/or market segment. Significant risks that are relevant to the Fund are discussed below.

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 10. FINANCIAL INSTRUMENTS (Continued...)

#### i) Market price risk

Market price risk, is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting similar financial instruments traded in the market.

The Fund is exposed to market price risk arising from its investments in securities. The Investment Advisor manages the Fund's market price risk on a daily basis in accordance with the Fund's investment objective and policies.

#### ii) Currency risk

The Fund may invest in financial instruments denominated in currencies other than its measurement currency. Consequently, the Fund is exposed to risks that the exchange rate of its currency relative to other currencies may change in a manner that has an adverse effect on the value of the portion of the Fund's assets or liabilities denominated in currencies other than Canadian dollars, absent any changes in market prices or investment specific events.

Included in the undernoted accounts are the following foreign currency balances:

Currency	Investments, at fair value	Bank indebtedness	Total	Percentage of GAAP NA
Australian Dollar	\$ 1,456,315	\$ -	\$ 1,456,315	7.8%
United States Dollar	<u>895,228</u>	<u>(126)</u>	<u>895,102</u>	<u>4.8%</u>
	<u>\$ 2,351,543</u>	<u>\$ (126)</u>	<u>\$ 2,351,417</u>	<u>12.6%</u>

# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 10. FINANCIAL INSTRUMENTS (Continued...)

#### iii) Interest rate risk

The Fund may invest in fixed and floating rate securities. The income of the Fund may be affected by changes to interest rates relevant to particular securities or as a result of management being unable to secure similar returns on the expiry of contracts or sale of securities. The value of fixed interest securities may be affected by interest rate movements or the expectation of such movement in the future. Interest payable on bank overdraft or broker margin account positions will be affected by fluctuations in interest rates.

Financial assets	Floating Rate Financial Assets	Fixed Rate Financial Assets	Non-interest bearing	Total
Held for trading	\$ -	\$ -	\$ 20,302,109	\$ 20,302,109
Other receivables	<u>-</u>	<u>-</u>	<u>5,750</u>	<u>5,750</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,307,859</u>	<u>\$ 20,307,859</u>
Financial liabilities				
Other financial liabilities	<u>\$ 1,309,018</u>	<u>\$ -</u>	<u>\$ 424,163</u>	<u>\$ 1,733,181</u>
GAAP NA				<u>\$ 18,574,678</u>

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

#### 10. FINANCIAL INSTRUMENTS (Continued...)

##### iv) Liquidity risk

Liquidity risk is the risk the Fund will encounter difficulty in meeting obligations associated with financial liabilities. Unitholder redemption requests are the main liquidity risk for the Fund.

The Fund maintains sufficient cash and marketable securities, and manages liquidity risk through its ability to close out market positions.

Financial assets	0-12 months	1 - 3 years	3 - 5 years	Beyond 5 years	Indefinite maturity	Total
Held for Trading	\$ 23,752	\$ 204,208	\$ -	\$ -	\$ 20,074,149	\$ 20,302,109
Other receivables	<u>5,750</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,750</u>
Total	<u>\$ 29,502</u>	<u>\$ 204,208</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,074,149</u>	<u>\$ 20,307,859</u>
Financial liabilities						
Other financial liabilities	<u>\$ 1,733,181</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,733,181</u>
GAAP NA						<u>\$ 18,574,678</u>

Certain of the Fund's investments are in private securities which are thinly traded. As at December 31, 2012 the fair value of such assets was 11.8% (2011 - 17.3%) of the total net assets.

##### v) Cash flow risk

The risk that future cash flows associated with a monetary financial instrument will fluctuate in amount. In the case of a floating rate debt instrument, for example, such fluctuations could result from a change in the effective interest rate of the financial instrument, usually without a corresponding change in its fair value.

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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#### 10. FINANCIAL INSTRUMENTS (Continued...)

##### vi) Credit risk

The Fund is exposed to credit risk arising from its transactions with its counterparties and brokers, related to securities purchases and sales. Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Financial assets which potentially expose the Fund to credit risk consist principally of investments in bonds and amounts due from brokers. The Fund seeks to mitigate its exposure to credit risk by placing its cash, and transacting its securities activity with large financial institutions. The Fund may also invest in corporate bonds. Until the bonds are sold or mature, the Fund is exposed to credit risk relating to whether the bond issuer will meet its obligations when they come due. The extent of the Fund's exposure to credit risk in respect of these financial assets is reflected in their carrying value as recorded in the Fund's Statement of Net Assets.

As at December 31, 2012, the Fund had no significant investments in long term debt instruments.

#### 11. CAPITAL MANAGEMENT

The Manager considers the Fund's capital to consist of the issued units and the net assets attributable to participating unitholders.

The Manager manages the capital of the Fund in accordance with the Fund's investment objectives, policies and restrictions, as outlined in the Fund's prospectus, while maintaining sufficient liquidity to meet participating unitholder redemptions. The Fund's overall strategy for managing capital remains unchanged from 2011.

The Fund does not have any externally imposed capital requirements.



# FRONT STREET CANADIAN ENERGY RESOURCE FUND

## NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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### 12. FAIR VALUE HIERARCHY

The following is a summary of the inputs used as of December 31, 2012 in valuing the Fund's investments and derivatives carried at fair values as discussed in note 2(c):

Assets at fair value as at December 31, 2012	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total
	Level 1	Level 2	Level 3	
Investments, at fair value	<u>\$ 18,061,223</u>	<u>\$ 52,123</u>	<u>\$ 2,188,763</u>	<u>\$ 20,302,109</u>

During the year ended December 31, 2012 reconciliation of investments measured at fair value using unobservable inputs (Level 3) is presented as follows:

	Investments, at Fair value
Balance at December 31, 2011	\$ 5,060,049
Transfers out	(1,664,050)
Loss Unrealized	<u>(1,207,236)</u>
Balance at December 31, 2012	<u>\$ 2,188,763</u>

## FRONT STREET CANADIAN ENERGY RESOURCE FUND

### NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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#### 13. INCOME TAX LOSSES CARRYFORWARD

The Fund has \$1,809,175 in non-capital losses available to be applied against taxable income of future years which will expire as follows:

2029	\$ 82,638
2030	973,966
2032	<u>752,571</u>
	<u>\$ 1,809,175</u>

The Fund has \$5,083,572 in net capital losses available to be applied against capital gains of future years. These losses do not expire.

#### 14. EXEMPTION FROM REGULATORY FILING REQUIREMENTS

The Fund is not a reporting issuer and is exempt from the financial statement filing requirements of Sections 2.1 and 2.3 of National Instrument 81-106 for the year ended December 31, 2012 and following financial periods. The Fund has prepared its financial statements under National Instrument 81-106 and has advised the Ontario Securities Commission that it is relying on the exemption not to file its financial statements according to Sections 2.1 and 2.3.