



**Interim Condensed Consolidated Financial Statements  
(Unaudited)**

**For the three and six months ending June 30, 2014 and 2013**

PACIFIC RUBIALES ENERGY CORP.  
**Interim Condensed Consolidated Statements of Income**

(In thousands of U.S. Dollars, except per share information; unaudited)	Notes	Three months ended June 30		Six months ended June 30	
		2014	2013*	2014	2013*
<b>Oil and gas sales</b>	4	\$ 1,344,666	\$ 1,055,573	\$ 2,628,119	\$ 2,314,335
<b>Cost of operations</b>					
Production and operating costs	5	508,210	374,863	979,381	866,574
Fees paid on suspended pipeline capacity	6	24,794	-	53,704	-
Depletion, depreciation and amortization		382,703	332,486	758,345	665,009
General and administrative		90,090	76,275	165,304	148,264
Share-based compensation	22	1,364	405	3,091	35,937
<b>Earnings from operations</b>		337,505	271,544	668,294	598,551
Finance costs		(64,655)	(37,076)	(126,150)	(84,653)
Share of (loss) gain of equity-accounted investees	15	(1,660)	(187)	15,403	(1,819)
Foreign exchange		13,644	(6,535)	11,869	8,436
(Loss) gain on risk management	24d	(2,530)	(537)	1,325	(6,188)
Other expenses		(14,681)	(24,282)	(35,150)	(20,560)
<b>Net earnings before income tax</b>		267,623	202,927	535,591	493,767
Income tax expense	7	(39,397)	(132,996)	(188,855)	(297,614)
<b>Net earnings for the period</b>		\$ 228,226	\$ 69,931	\$ 346,736	\$ 196,153
Attributable to:					
Equity holders of the parent		228,527	74,279	347,767	201,657
Non-controlling interests		(301)	(4,348)	(1,031)	(5,504)
		\$ 228,226	\$ 69,931	\$ 346,736	\$ 196,153
Basic earnings per share attributable to equity holders of the parent	8	\$ 0.73	\$ 0.23	\$ 1.10	\$ 0.63
Diluted earnings per share attributable to equity holders of the parent	8	\$ 0.72	\$ 0.23	\$ 1.10	\$ 0.62

\*Certain amounts have been restated upon the first-time adoption of IFRS 9 (Note 27) and finalization of the purchase price allocation of the C&C acquisition (Note 3).

See accompanying notes to the Interim Condensed Consolidated Financial Statements

PACIFIC RUBIALES ENERGY CORP.

**Interim Condensed Consolidated Statements of Comprehensive Income**

(In thousands of U.S. Dollars; unaudited)	Notes	Three months ended June 30		Six months ended June 30	
		2014	2013 *	2014	2013*
<b>Net earnings for the period</b>		\$ 228,226	\$ 69,931	\$ 346,736	\$ 196,153
<b>Other comprehensive income (loss) to be reclassified to net earnings in subsequent periods (nil tax effect)</b>					
Foreign currency translation		25,211	(22,372)	9,122	(36,834)
Fair value adjustments on available-for-sale financial assets		(494)	-	301	-
Unrealized gain (loss) on cash flow hedges	24d	5,620	(11,122)	1,415	(24,714)
Unrealized (loss) gain on the time value of cash flow hedges		(958)	(8,547)	(1,958)	(5,683)
Realized (loss) gain on cash flow hedges transferred to earnings	24d	(1,113)	(399)	675	(4,950)
		28,266	(42,440)	9,555	(72,181)
<b>Total comprehensive income</b>		\$ 256,492	\$ 27,491	\$ 356,291	\$ 123,972
Attributable to:					
Equity holders of the parent		\$ 256,793	\$ 31,839	\$ 357,322	\$ 129,476
Non-controlling interests		(301)	(4,348)	(1,031)	(5,504)
		\$ 256,492	\$ 27,491	\$ 356,291	\$ 123,972

*\*Certain amounts have been restated upon the first-time adoption of IFRS 9 (Note 27) and finalization of the purchase price allocation of the C&C acquisition (Note 3).*

*See accompanying notes to the Interim Condensed Consolidated Financial Statements*

PACIFIC RUBIALES ENERGY CORP.

**Interim Condensed Consolidated Statements of Financial Position**

(In thousands of U.S. Dollars; unaudited)	Notes	As at June 30 2014	As at December 31 2013*
<b>ASSETS</b>			
Current			
Cash and cash equivalents		\$ 396,413	\$ 632,503
Restricted cash		31,400	16,980
Accounts receivables	24b	1,117,110	1,038,162
Inventories	10	77,650	59,526
Income tax receivable		82,404	132,226
Prepaid expenses		1,444	2,760
Assets held for sale	17	-	377,544
Risk management assets	24d	6,298	2,148
		1,712,719	2,261,849
Non-current			
Oil and gas properties	11	5,551,636	5,483,011
Exploration and evaluation assets	12	2,194,826	2,014,804
Intangible assets	14	90,441	105,813
Plant and equipment	13	136,081	125,600
Investments in associates	15	704,721	659,111
Other assets	16	177,591	55,990
Goodwill		501,249	501,249
		\$ 11,069,264	\$ 11,207,427
<b>LIABILITIES</b>			
Current			
Accounts payable and accrued liabilities		\$ 1,651,921	\$ 1,683,179
Risk management liability	24d	8,927	6,910
Income tax payable		43,789	106,250
Current portion of long-term debt	18	437,757	553,571
Current portion of obligations under finance lease	20	17,418	17,807
		2,159,812	2,367,717
Non-current			
Long-term debt	18	3,812,526	3,818,240
Obligations under finance lease	20	41,125	47,980
Deferred tax liability	7	473,551	544,981
Asset retirement obligation	19	225,907	201,576
		6,712,921	6,980,494
<b>EQUITY</b>			
Common shares	22a	2,609,302	2,667,820
Contributed surplus		93,231	157,810
Other reserves		(12,785)	(22,340)
Retained earnings		1,636,260	1,392,284
Equity attributable to equity holders of the parent		4,326,008	4,195,574
Non-controlling interests		30,335	31,359
Total equity		4,356,343	4,226,933
		\$ 11,069,264	\$ 11,207,427

\*Certain amounts have been restated upon the first-time adoption of IFRS 9 (Note 27).

See accompanying notes to the Interim Condensed Consolidated Financial Statements

PACIFIC RUBIALES ENERGY CORP.

**Interim Condensed Consolidated Statements of Changes in Equity**

For the six months ending June 30, 2014

(In thousands of U.S. Dollars; unaudited)	Note	Attributable to equity holders of parent							Total	Non-controlling interests	Total Equity
		Common Shares	Contributed Surplus	Retained Earnings	Cash flow hedge	Time Value Reserves	Foreign currency translation	Fair value Investment			
As at December 31, 2013		\$ 2,667,820	\$ 157,810	\$ 1,392,284	\$ 1,093	\$ (3,092)	\$ (17,083)	\$ (3,258)	\$ 4,195,574	\$ 31,359	\$ 4,226,933
Net earnings for the period		-	-	119,240	-	-	-	-	119,240	(730)	118,510
Other comprehensive income		-	-	-	(2,417)	(1,000)	(16,089)	795	(18,711)	-	(18,711)
Total comprehensive income		-	-	119,240	(2,417)	(1,000)	(16,089)	795	100,529	(730)	99,799
Share-based compensation		-	-	-	-	-	-	-	-	4	4
Dividends paid	9	-	-	(51,933)	-	-	-	-	(51,933)	-	(51,933)
Repurchase of shares	22	(75,281)	(58,895)	-	-	-	-	-	(134,176)	-	(134,176)
As at March 31, 2014		2,592,539	98,915	1,459,591	(1,324)	(4,092)	(33,172)	(2,463)	4,109,994	30,633	4,140,627
Net earnings for the period		-	-	228,527	-	-	-	-	228,527	-	228,527
Other comprehensive income		-	-	-	4,507	(958)	25,211	(494)	28,266	(301)	27,965
Total comprehensive income		-	-	228,527	4,507	(958)	25,211	(494)	256,793	(301)	256,492
Exercise of options	22	16,763	(5,684)	-	-	-	-	-	11,079	-	11,079
Share-based compensation		-	-	-	-	-	-	-	-	3	3
Dividends paid	9	-	-	(51,858)	-	-	-	-	(51,858)	-	(51,858)
As at June 30, 2014		\$ 2,609,302	\$ 93,231	\$ 1,636,260	\$ 3,183	\$ (5,050)	\$ (7,961)	\$ (2,957)	\$ 4,326,008	\$ 30,335	\$ 4,356,343

For the six months ending June 30, 2013

(In thousands of U.S. Dollars; unaudited)	Note	Attributable to equity holders of parent							Total	Non-controlling interests	Total Equity
		Common Shares	Contributed Surplus	Retained Earnings	Cash flow hedge	Time Value Reserves	Foreign currency translation				
As at December 31, 2012		\$ 2,623,993	\$ 157,159	\$ 1,161,962	\$ 27,505	\$ (7,415)	\$ 10,394	\$ 3,973,598	\$ -	\$ 3,973,598	
Net earnings for the period		-	-	127,378	-	-	-	127,378	(1,156)	126,222	
Other comprehensive income		-	-	-	(18,143)	2,864	(12,824)	(28,103)	(1,638)	(29,741)	
Total comprehensive income		-	-	127,378	(18,143)	2,864	(12,824)	99,275	(2,794)	96,481	
Issued on exercise of options		43,576	(12,752)	-	-	-	-	30,824	-	30,824	
Issued on conversion of convertible debentures		7	-	-	-	-	-	7	-	7	
Share-based compensation		-	34,849	-	-	-	-	34,849	-	34,849	
Dividends paid	9	-	-	(35,458)	-	-	-	(35,458)	-	(35,458)	
Acquisition of subsidiary	3	-	-	-	-	-	-	-	135,592	135,592	
As at March 31, 2013		\$ 2,667,576	\$ 179,256	\$ 1,253,882	\$ 9,362	\$ (4,551)	\$ (2,430)	\$ 4,103,095	\$ 132,798	\$ 4,235,893	
Net earnings for the period		-	-	74,279	-	-	-	74,279	(4,348)	69,931	
Other comprehensive income		-	-	-	(11,521)	(8,547)	(19,289)	(39,357)	(3,083)	(42,440)	
Total comprehensive income		-	-	74,279	(11,521)	(8,547)	(19,289)	34,922	(7,431)	27,491	
Issued on exercise of options		7,110	(1,894)	-	-	-	-	5,216	-	5,216	
Share-based compensation		-	6	-	-	-	-	6	-	6	
Dividends paid		-	-	(53,363)	-	-	-	(53,363)	-	(53,363)	
Acquisition of subsidiary		-	-	-	-	-	-	-	32,400	32,400	
Transaction with non-controlling interest		-	-	-	-	-	-	-	(2,361)	(2,361)	
As at June 30, 2013		2,674,686	177,368	1,274,798	(2,159)	(13,098)	(21,719)	4,089,876	155,406	4,245,282	

See accompanying notes to the Interim Condensed Consolidated Financial Statements

\*Certain amounts have been restated upon the first-time adoption of IFRS 9 (Note 27) and finalization of the purchase price allocation of the C&C acquisition (Note 3)

PACIFIC RUBIALES ENERGY CORP.  
**Interim Condensed Consolidated Statements of Cash Flows**

(In thousands of U.S. Dollars; unaudited)	Notes	Three months ended June 30		Six months ended June 30	
		2014	2013*	2014	2013*
<b>OPERATING ACTIVITIES</b>					
Net earnings for the period		\$ 228,226	\$ 69,931	\$ 346,736	\$ 196,153
Items not affecting cash:					
Depletion, depreciation and amortization		382,703	332,486	758,345	665,009
Accretion expense		11,088	4,971	14,983	10,837
Unrealized loss on risk management contracts	24d	3,322	537	9,148	6,188
Share-based compensation		1,364	6	1,368	34,855
Gain (loss) on cash flow hedges included in operating expense	24d	(1,113)	(399)	675	(4,950)
Deferred income tax (recovery) expense	7	(69,788)	31,652	(71,380)	34,950
Unrealized foreign exchange gain (loss)		(25,813)	33,684	(39,214)	46,625
Share of (gain) loss of equity-accounted investees	15	1,660	187	(15,403)	1,819
Loss (gain) on acquisition of control		-	1,946	-	(10,325)
Changes in non-cash working capital	25	(20,763)	(365,821)	(109,685)	(249,448)
Net cash provided by operating activities		510,886	109,180	895,573	731,713
<b>INVESTING ACTIVITIES</b>					
Additions to oil and gas properties and plant and equipment		(358,564)	(379,333)	(669,230)	(705,956)
Additions to exploration and evaluation assets		(156,655)	(78,121)	(319,563)	(186,067)
Additions to intangible assets		-	-	-	(3,911)
Investment in associates and other assets		(6,567)	(122,898)	(27,627)	(263,079)
Proceeds from sale of assets held for sale		-	-	267,544	-
(Increased) decrease in restricted cash		(13,829)	(9,614)	(14,009)	(6,795)
Business acquisitions net cash outflow		-	1,638	-	9,108
Net cash used in investing activities		(535,615)	(588,328)	(762,885)	(1,156,700)
<b>FINANCING ACTIVITIES</b>					
Advances from debt and Senior Notes	18	606,011	113,572	660,750	1,484,343
Repayment of debt		(455,899)	(672,145)	(805,447)	(777,606)
Transaction costs		-	-	-	(28,662)
Proceeds from the exercise of warrants and options	22	11,079	5,216	11,079	36,047
Dividends paid	9	(51,858)	(53,363)	(103,791)	(88,821)
Repurchase of common shares	22	-	-	(134,176)	-
Net cash provided (used) by financing activities		109,333	(606,720)	(371,585)	625,301
Effect of exchange rate changes on cash and cash equivalents		5,390	(7,812)	2,807	(5,230)
Change in cash and cash equivalents during the period		89,994	(1,093,680)	(236,090)	195,084
Cash and cash equivalents, beginning of the period		306,419	1,532,454	632,503	243,690
Cash and cash equivalents, end of the period		\$ 396,413	\$ 438,774	\$ 396,413	\$ 438,774
Cash		\$ 374,837	\$ 426,171	\$ 374,837	\$ 426,171
Short-term money market instruments		21,576	12,603	21,576	12,603
		\$ 396,413	\$ 438,774	\$ 396,413	\$ 438,774

\*Certain amounts have been restated upon the first-time adoption of IFRS 9 (Note 27) and finalization of the purchase price allocation of the C&C acquisition (Note 3).

See accompanying notes to the Interim Condensed Consolidated Financial Statements

# **Notes to the Interim Condensed Consolidated Financial Statements**

***(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)***

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## **1. Corporate Information**

Pacific Rubiales Energy Corp. (the "Company") is an oil and gas company incorporated in Canada and engaged in the exploration, development and production of crude oil and natural gas in Colombia, Peru, Brazil, Guatemala, Papua New Guinea, Guyana and Belize. The Company's common shares are listed and publicly traded on the Toronto Stock Exchange and the Bolsa de Valores de Colombia (or the Colombian Stock Exchange). The Brazilian Depository Receipts representing the Company's common shares ("BDRs") are traded on Bolsa de Valores Mercadorias e Futuros (or the Brazilian Stock Exchange). The Company's registered office is located at Suite 650 – 1188 West Georgia Street, Vancouver, British Columbia, V6E 4A2, Canada and it also has corporate offices in Toronto, Canada and Bogota, Colombia.

These Interim Condensed Consolidated Financial Statements of the Company were authorized for issuance by the Audit Committee of the Board of Directors on August 12, 2014.

## **2. Basis of Preparation and Significant Accounting Policies**

The Interim Condensed Consolidated Financial Statements for the three and six months ending June 30, 2014 have been prepared in accordance with IAS 34 *Interim Financial Reporting*.

The Interim Condensed Consolidated Financial Statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Company's annual financial statements as at December 31, 2013.

### **New Standards, Interpretations and Amendments Adopted by the Company**

The accounting policies used in the preparation of the Interim Condensed Consolidated Financial Statements are consistent with those followed in the preparation of the Company's Annual Consolidated Financial Statements for the year that ended December 31, 2013, except for the adoption of new standards and interpretations effective as of January 1, 2014, as described below.

#### **IFRIC 21 Levies**

IFRIC 21 is effective for annual periods beginning on or after January 1, 2014 and is applied retrospectively. It is applicable for all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 *Income Taxes*) and fines or other penalties for breaches of legislation.

The interpretation clarifies that an entity recognizes a liability for a levy no earlier than when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, no liability is recognized before the specified minimum threshold is reached. The interpretation requires these same principles to be applied in the interim financial statements. The adoption of IFRIC 21 did not have any material impact on the Company's Interim Condensed Consolidated Financial Statements.

#### **IFRS 9 Financial Instrument**

As of January 1, 2014, the Company early adopted IFRS 9 (2013) - Financial Instruments ("IFRS 9 (2013)") as issued by the International Accounting Standards Board ("IASB") in November 2013. IFRS 9 (2013) replaces International Accounting Standard 39 – Financial Instruments: Recognition and Measurement ("IAS 39") and addresses the accounting for financial instruments including hedge accounting. Upon adoption of IFRS 9 (2013) certain comparative figures were restated and the impact of such restatement on the financial position of the Company and results of operations are disclosed in Note 27.

These are the Company's second interim condensed consolidated financial statements prepared in accordance with IFRS 9 (2013), which the Company expects to adopt in its annual consolidated financial statements for the year ending December 31, 2014. The transition to IFRS 9 (2013) resulted in changes to some of the Company's previous accounting policies as applied and disclosed in the consolidated financial statements for the year ended December 31, 2013. The revised accounting policies affected by the early adoption of IFRS 9 (2013) have been included in Note 27.

## **Notes to the Interim Condensed Consolidated Financial Statements** *(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

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### **Financial Instruments**

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial instruments classified as amortized costs are included with the carrying value of such instruments. Transaction costs directly attributable to the acquisition of financial instruments classified as fair value through profit or loss are recognized immediately in earnings.

#### *Financial Assets*

All recognized financial assets are subsequently measured in their entirety at either amortized cost or fair value, depending on this classification.

Financial assets that meet the following conditions are subsequently measured at amortized cost less impairment loss:

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
- The asset was not acquired principally for the purpose of selling in the near term or management for short-term profit taking (held for trading).

All other financial assets except equity investments as described below are subsequently measured at fair value (classified as fair value through profit and loss (“**FVTPL**”). The gains or losses arising on re-measurement are recognized in earnings and included in the other line item (Note 24) in the Interim Condensed Consolidated Statements of Income.

On the day of acquisition of an equity instrument, the Company can make an irrevocable election (on an instrument-by-instrument basis) to designate investments in equity instruments as at fair value through other comprehensive income (“**FVTOCI**”). Designation at FVTOCI is not permitted if the equity investment is held for trading. Investments in equity instruments at FVTOCI are initially measured at fair value plus transaction costs. Subsequently they are measured at fair value, with gains and losses arising from changes in fair value recognized in other comprehensive income and accumulated in the fair value instrument. The cumulative gain or loss will not be reclassified to profit or loss on disposal of the investments. The Company has designated all investments in equity instruments as FVTOCI on initial application of IFRS 9 (see Note 24).

#### *Financial Liabilities*

Financial liabilities are classified as at FVTPL when the financial liability is either held for trading or is designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value. Any gains or losses arising on re-measurement of held-for-trading financial liabilities are recognized in earnings. Such gains or losses recognized in profit or loss incorporate any interest paid on the financial liabilities.

Financial liabilities that are not held for trading and are not designated as at FVTPL are measured at amortized cost at the end of subsequent accounting periods. The carrying amounts of financial liabilities that are subsequently measured at amortized cost are determined based on the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the expected life of the financial liability.

### **Derivative Financial Instruments**

The Company enters into a variety of derivative financial instruments to manage its exposure to foreign exchange rate risks and commodity price risks, including collars and forwards.

Derivatives are initially recognized at fair value at the date the derivative contracts are entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is immediately



## **Notes to the Interim Condensed Consolidated Financial Statements** *(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

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recognized in earnings unless the derivative is designated and effective as a hedging instrument (further explained below under "Hedge Accounting"), in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

### *Embedded Derivatives*

Derivatives embedded in non-derivative host contracts that are not financial assets within the scope of IFRS 9 (e.g. financial liabilities) are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at FVTPL. Fair value is determined in the manner described in Note 24.

### **Hedge Accounting**

The Company designates certain hedging instruments, in respect of foreign currency risk and commodity price risk, as cash flow hedges.

At the inception of the hedge relationship, the Company documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Company documents whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows of the hedged item attributable to the hedged risk.

### *Cash Flow Hedges*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income and accumulated under the heading of cash flow hedge reserve. The gain or loss relating to the ineffective portion is recognized immediately in profit or loss, and is included in the foreign exchange gain or loss line item of the interim statements of income for foreign currency hedging instruments and the risk management gain or loss line item for commodity hedging instruments.

Amounts previously recognized in other comprehensive income and accumulated in equity are reclassified to earnings in the periods when the hedged item is recognized in earnings, within the same line of the Interim Condensed Consolidated Statements of Income as the recognized hedged item. However, when the hedged forecast transaction results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously recognized in other comprehensive income and accumulated in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

If, upon the designation of option instruments as hedging instruments, the intrinsic and time value components are separated, with only the intrinsic component designated as the hedging instrument, the aligned time value component will be deferred in OCI as a cost of hedging.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or when it no longer meets the criteria for hedge accounting. Any gain or loss recognized in other comprehensive income and accumulated in equity at that time remains in equity and is recognized when the forecast transaction is ultimately recognized in profit or loss. When a forecast transaction is no longer expected to occur, the gain or loss accumulated in equity is recognized immediately in profit or loss.

### **Standards Issued but Not Yet Effective**

#### **IFRS 15 Revenue from Contracts with Customers**

IFRS 15, "Revenue from Contracts with Customers" ("**IFRS 15**"), was issued in May 2014 and will replace IAS 11, "Construction Contracts," IAS 18, "Revenue Recognition," IFRIC 13, "Customer Loyalty Programmes," IFRIC 15, "Agreements for the Construction of Real Estate," IFRIC 18, "Transfers of Assets from Customers," and SIC-31, "Revenue – Barter Transactions Involving Advertising Services." IFRS 15 provides a single, principle-based five-step model that will apply to all contracts with customers with limited exceptions, including, but not limited to, leases within the scope of IAS 17 and financial instruments and other contractual rights or obligations within the scope of IFRS 9 "Financial Instruments," IFRS 10, "Consolidated Financial Statements" and IFRS 11, "Joint Arrangements." In addition to the five-step model, the standard specifies how to account for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity's ordinary

## Notes to the Interim Condensed Consolidated Financial Statements

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activities. IFRS 15 is required for annual periods beginning on or after January 1, 2017; earlier adoption is permitted. The Company is in the process of assessing the impact of IFRS 15 on its consolidated financial statements.

### IFRS 9 (2014)

On July 24, 2014 the IASB issued the final version of IFRS 9 Financial Instruments ("IFRS 9 (2014)"), bringing together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard is effective for annual periods beginning on or after January 1 2018, with early application permitted. Retrospective application will be required, however, transition reliefs are provided (including no restatement of comparative period information). The Company is in the process of assessing the impact of IFRS 9 (2014) on its consolidated financial statements.

### 3. Business Acquisitions

#### Information on Prior-Year Acquisitions

*Pacific Infrastructure Venture Inc. ("PII", previously Pacific Infrastructure Inc.)*

On February 8, 2013 the Company acquired control of PII by purchasing an additional 2.3 million common shares for \$2.2 million in cash and increasing its interest to 50.2%; prior to this date the Company held a 49.38% interest and recognized the investment as an equity interest. Upon acquiring control, a gain of \$12.3 million was recognized in other income on the consolidated financial statements.

On October 4, 2013 the Company determined that it no longer held control over PII as a result of the International Finance Corporation's investment, which reduced the Company's interest in PII to 41.65%. Upon loss of control the Company de-consolidated PII and subsequently accounted for the investment as an associate using the equity method.

PII is an unlisted company established in the British Virgin Islands for the purpose of developing an export terminal, an industrial park, and a free trade zone in Cartagena, Colombia.

*CGX Energy Inc. ("CGX")*

On April 26, 2013 the Company acquired control of CGX by purchasing 350 million common shares for C\$35 million and increasing its interest to 63.2%; prior to this date the Company held a 36% interest and recognized the investment as an equity interest. CGX is a company listed on the TSX Venture Exchange and is involved in the exploration and development of petroleum and natural gas in Guyana.

*Petrominerales Ltd. ("PMG")*

On November 28, 2013 the Company completed the acquisition of Petrominerales Ltd ("PMG") by acquiring all of its issued and outstanding shares for approximately \$1,000 million, the assumption of net debt of approximately \$753 million and the transfer of approximately \$86 million of seed capital to a newly formed exploration and production company consisting of PMG's Brazilian assets. PMG was an international oil and gas company involved in the exploration, development and production of crude oil in Colombia, Peru and Brazil.

During the six months ending June 30, 2014 the fair value of the assets held for sale (the OCENSA pipeline interest), was finalized. The finalization of the fair value resulted in the following changes to the preliminary purchase price allocation: a decrease in assets held for sale by \$7.1 million, an increase to goodwill by \$4.6 million, and a decrease to deferred tax liabilities by \$2.5 million. The Company is still in the process of finalizing the fair value of the oil and gas assets and property, and the equipment acquired.

*Sabanero Block ("Sabanero")*

Sabanero was a producing block owned by Maurel & Prom Colombia B.V. ("M&P Colombia") of which the Company had a 49.9% interest and Maurel and Prom S.A. ("M&P S.A.") had 50.1%. On September 1, 2013, the Company entered into an agreement with M&P Colombia whereby it would effectively pay \$10 million in cash for the remaining 50.1% interest in the Sabanero block. The transaction was completed in December 2013 upon approval by the Colombian regulator.

## Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)

C&C Energia Ltd. ("C&C")

On December 31, 2012 the Company completed the acquisition of C&C, an oil and gas company engaged in the exploration and development of oil resources in Colombia. On December 31, 2013 the Company finalized the fair values of the assets acquired, resulting in an adjustment to the preliminary purchase price allocation. The effect of the adjustment for the three and six months ending June 30, 2013 was a decrease of \$12.4 and \$24.9 million respectively to the previously reported depreciation, depletion, and amortization, and an increase of \$4.2 and \$8.5 million respectively to deferred income tax expense.

#### 4. Segmented Information

The Company is organized into business units based on the main types of activities and has one reportable segment as at June 30, 2014: the exploration, development, and production of heavy crude oil and gas in Colombia. The Company's assets in other countries are still in the early stages of development and are not significant: therefore, they are not considered a reportable segment as at June 30, 2014. The Company manages its operations to reflect differences in the regulatory environments and risk factors of each country.

As at June 30, 2014, all of the Company's assets are located in Colombia except for \$17 million (December 31, 2013: \$328 million) in cash and cash equivalents held in Canada and the United States; \$885 million (December 31, 2013: \$776 million) of non-current assets in Peru; \$144 million (December 31, 2013: \$127 million) of non-current assets in Papua New Guinea; \$48 million (December 31, 2013: \$35 million) of non-current assets in Guatemala; \$315 million (December 31, 2013: \$291 million) of non-current assets in Brazil; and \$46 million of non-current assets in Guyana (December 31, 2013: \$44 million).

The Company's revenue, based on the geographic location of customers, is as follows:

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Asia	\$ 811,553	\$ 284,587	\$ 1,466,213	\$ 600,147
North and Central America	220,795	592,042	647,040	1,331,169
Europe	245,557	115,503	393,240	245,265
Colombia	42,191	51,028	75,847	111,373
Peru	24,570	12,413	45,779	26,381
	\$ 1,344,666	\$ 1,055,573	\$ 2,628,119	\$ 2,314,335

#### 5. Production and Operating Costs

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Oil and gas operating costs	\$ 520,875	\$ 411,484	\$ 1,040,906	\$ 900,926
Underlift (overlift)	(12,665)	(36,621)	(61,525)	(34,352)
Total	\$ 508,210	\$ 374,863	\$ 979,381	\$ 866,574

#### 6. Fees Paid on Suspended Pipeline

Beginning in mid-February 2014, the Bicentenario pipeline (Note 15) has experienced periodic suspensions following security-related disruptions. Under the take-or-pay agreement between the Company and Bicentenario, the Company has recognized a net expense of \$24.8 million and \$53.7 million in take-or-pay fees to Bicentenario during the three and six months ending June 30, 2014 for the disrupted pipeline capacity.

**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

**7. Income Tax**

A reconciliation between income tax expense and the product of accounting profit multiplied by the Company's domestic tax rate is provided below:

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Net earnings before income taxes	\$ 267,623	\$ 202,927	\$ 535,591	\$ 493,767
Canadian statutory income tax rate	26.50%	26.50%	26.50%	26.50%
Income tax expense at statutory rate	70,920	53,776	141,932	130,849
Increase (decrease) in income tax provision resulting from:				
Other (non-taxable) non-deductible expenses	(60,905)	52,427	(16,251)	88,129
Share-based compensation	360	106	817	9,522
Risk management gain (loss)	704	(900)	(148)	(296)
Differences in tax rates in foreign jurisdictions	28,897	18,364	48,943	46,687
Losses for which no tax benefit is recorded	(579)	9,223	13,562	22,723
Income tax expense	\$ 39,397	\$ 132,996	\$ 188,855	\$ 297,614
Current income tax expense	109,185	101,344	260,235	262,664
Deferred income tax (recovery) expense :				
Relating to origination and reversal of temporary differences	(69,788)	31,652	(71,380)	34,950
Income tax expense	\$ 39,397	\$ 132,996	\$ 188,855	\$ 297,614

The Company's deferred tax relates to the following:

	As at June 30	As at December 31
	2014	2013
Tax loss carry forwards	\$ 23,259	16,477
Oil and gas properties and equipment	(570,089)	(656,678)
Other	73,279	95,220
Deferred tax liability	\$ (473,551)	\$ (544,981)

The Canadian statutory combined income tax rate was 26.5% as at June 30, 2014 and for 2013. The Peruvian statutory income tax rate was 30% as at June 30, 2014 and for 2013. The Peruvian income tax rate for Block Z-1 was 22% as at June 30, 2014 and for 2013.

The Colombian statutory tax rate as at June 30, 2014 was 34%. The Colombian Congress approved a new tax law in December 2012, which came into effect on January 1, 2013, whereby the general income tax rate was reduced from 33% to 25%. In addition, the law introduced a fairness tax ("CREE") at the rate of 9% to substitute for the elimination of certain payroll taxes primarily related to low-income salaries, which effectively increased the income tax rate to 34%.

The temporary differences associated with investments in subsidiaries and joint ventures, for which a deferred tax liability has not been recognized, amounted to approximately \$2 billion as at June 30, 2014 (December 31, 2013: \$2 billion).

**8. Earnings Per Share**

Earnings per share amounts are calculated by dividing the net earnings for the period attributable to shareholders of the Company by the weighted average number of shares outstanding during the period.

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Net earnings attributable to equity holders of the parent	\$ 228,527	\$ 74,279	\$ 347,767	\$ 201,657
Basic weighted average number of shares	313,581,537	323,000,819	315,696,856	322,177,235
Effects of dilution	1,867,625	3,125,096	1,295,867	3,537,253
Diluted weighted average number of shares	315,449,162	326,125,915	316,992,723	325,714,488
Basic earnings per share attributable to equity holders of the parent	\$ 0.73	\$ 0.23	\$ 1.10	\$ 0.63
Diluted earnings per share attributable to equity holders of the parent	\$ 0.72	\$ 0.23	\$ 1.10	\$ 0.62

All options that are anti-dilutive have been excluded from the diluted weighted average number of common shares.

**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

**9. Dividends Paid**

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Declared and paid	\$ 51,858	\$ 53,363	\$ 103,791	\$ 88,821
Dividend per common share	\$ 0.17	\$ 0.17	\$ 0.33	\$ 0.28

**10. Inventories**

	As at June 30		As at December 31	
	2014	2013	2013	2012
Crude oil and gas	\$ 49,530	\$ 42,272		
Materials and supplies	28,120	17,254		
	\$ 77,650	\$ 59,526		

**11. Oil and Gas Properties**

<b>Cost</b>			
Cost as at December 31, 2013		\$	8,553,964
Additions			327,807
Transfer from exploration and evaluation assets (Note 12)			127,817
Disposals			(27,861)
Currency translation adjustment			(9,111)
Change in asset retirement obligation (Note 19)			(4,530)
Cost as at March 31, 2014			8,968,086
Additions			340,473
Transfer from exploration and evaluation assets (Note 12)			9,661
Currency translation adjustment			6,775
Change in asset retirement obligation (Note 19)			24,675
Cost as at June 30, 2014		\$	9,349,670
<b>Accumulated depletion</b>			
Accumulated depletion as at December 31, 2013		\$	3,070,953
Disposals			(1,890)
Charge for the period			359,795
Accumulated depletion as at March 31, 2014		\$	3,428,858
Charge for the period			369,176
Accumulated depletion as at June 30, 2014		\$	3,798,034
<b>Net book value</b>			
As at December 31, 2013		\$	5,483,011
As at March 31, 2014			5,539,228
As at June 30, 2014			5,551,636

**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

**12. Exploration and Evaluation Assets**

As at December 31, 2013	\$	2,014,804
Additions		169,478
Disposal		(6,570)
Transfer to oil and gas properties (Note 11)		(127,817)
As at March 31, 2014	\$	2,049,895
Additions		156,655
Impairment		(2,063)
Transfer to oil and gas properties (Note 11)		(9,661)
As at June 30, 2014	\$	2,194,826

**13. Plant and Equipment**

Cost	Land & buildings	Assets under construction	Other plant & equipment	Total
Cost as at December 31, 2013	\$ 57,991	\$ 6,977	\$ 134,346	\$ 199,314
Additions	-	88	7,910	7,998
Cost as at March 31, 2014	\$ 57,991	\$ 7,065	\$ 142,256	\$ 207,312
Additions	-	-	18,520	18,520
Cost as at June 30, 2014	\$ 57,991	\$ 7,065	\$ 160,776	\$ 225,832
<b>Accumulated depreciation</b>				
Accumulated depreciation as at December 31, 2013	\$ 25,814	\$ -	\$ 47,900	\$ 73,714
Charge for the period	3,062	-	4,480	7,542
Accumulated depreciation as at March 31, 2014	\$ 28,876	\$ -	\$ 52,380	\$ 81,256
Charge for the period	1,833	-	6,662	8,495
Accumulated depreciation as at June 30, 2014	\$ 30,709	\$ -	\$ 59,042	\$ 89,751
<b>Net book value</b>				
As at December 31, 2013	\$ 32,177	\$ 6,977	\$ 86,446	\$ 125,600
As at March 31, 2014	29,115	7,065	89,876	126,056
As at June 30, 2014	27,282	7,065	101,734	136,081

**14. Intangible Assets**

Cost	Capacity Rights
Cost as at December 31, 2013, March 31 and June 30, 2014	\$ 202,919
<b>Accumulated amortization</b>	
Accumulated amortization as at December 31, 2013	\$ 97,106
Charge for the period	7,626
Accumulated amortization as at March 31, 2014	\$ 104,732
Charge for the period	7,746
Accumulated amortization as at June 30, 2014	\$ 112,478
<b>Net book value</b>	
As at December 31, 2013	\$ 105,813
As at March 31, 2014	98,187
As at June 30, 2014	90,441

**Notes to the Interim Condensed Consolidated Financial Statements**  
**(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)**

Capacity rights are comprised of the rights to the available capacity of the OCENSA pipeline system in Colombia, and the right to available capacity at the crude blending station. The OCENSA right is amortized based on the usage of the 160 million barrel capacity over the term of the agreement.

**15. Investments in Associates**

	ODL	Bicentenario	PII	Pacific Power	Pacific Coal	Total
As at December 31, 2013	\$ 191,413	\$ 216,598	\$ 219,417	\$ 22,228	\$ 9,455	\$ 659,111
Investment	-	8,550	-	-	-	8,550
Income (loss) from equity investments	14,572	3,960	(1,431)	50	(88)	17,063
Foreign currency translation	(4,022)	(2,555)	(2,034)	-	-	(8,611)
As at March 31, 2014	\$ 201,963	\$ 226,553	\$ 215,952	\$ 22,278	\$ 9,367	\$ 676,113
Investment	-	8,636	-	-	-	8,636
Income (loss) from equity investments	5,306	(7,213)	134	(50)	163	(1,660)
Foreign currency translation	9,493	7,186	4,953	-	-	21,632
As at June 30, 2014	\$ 216,762	\$ 235,162	\$ 221,039	\$ 22,228	\$ 9,530	\$ 704,721

Set out below are the investments in associates. Investments in associates are accounted for using the equity method, with the Company's proportionate share of the associates' net income or loss is recognized in the Interim Condensed Consolidated Statement of Income.

*ODL Finance S.A. ("ODL")*

The investment represents a 35% interest in ODL, a Panamanian company with a Colombian branch that has constructed an oil pipeline for the transportation of heavy crude oil produced from the Rubiales field. The remaining 65% interest is owned by Ecopetrol, S.A. ("**Ecopetrol**"), the national oil company of Colombia. ODL's functional currency is the Colombian peso and the currency translation adjustment upon conversion to U.S. dollars has been recorded in other comprehensive income.

The Company has take-or-pay contracts with ODL for the transportation of crude oil from the Rubiales field to Colombia's oil transportation system, for a total commitment of \$175 million from 2014 to 2020.

*Oleoducto Bicentenario de Colombia ("**Bicentenario**")*

Bicentenario is a corporation established and owned by a consortium of oil producers operating in Colombia, led by Ecopetrol, the Company owns 43%. Bicentenario operates a private-use oil pipeline in Colombia between Casanare and Coveñas. Bicentenario's functional currency is the Colombian peso and the currency translation adjustment upon conversion to U.S. dollars has been recorded in other comprehensive income.

The Company has ship-or-pay contracts with Bicentenario for the transportation of crude oil from the Rubiales field to Colombia's oil transportation system, for a total commitment of \$2.2 billion from 2014 to 2025. The Bicentenario pipeline has experienced ongoing periods of security-related disruptions since February 2014. During the three and six months ending June 30, 2014, the Company paid \$45 million and \$73.9 million respectively under the take or pay contract for which no transport service was received. During the three months ending June 30, 2014, the Company also accrued a receivable from Bicentenario in the amount of \$20 million, which represents the Company's share of the amount expected to be distributed to all shareholders of Bicentenario in respect to the disrupted pipeline service.

*Pacific Infrastructure Ventures Inc. ("**PII**")*

PII is a Panamanian company established for the purpose of developing an export terminal, an industrial park, and a free trade zone in Cartagena. The Company's interest in PII is 41.65% and it holds two board seats in PII. The functional currency of PII is the U.S. dollar.

*Pacific Power Generation Corp ("**Pacific Power**")*

The investment in Pacific Power represents a 24.9% indirect interest in Promotora de Energia Electrica de Cartagena & Cia, S.C.A. ESP ("**Proelectrica**"). Proelectrica is a private Company, Cartagena, Colombia-based 90 megawatt electrical utility peak demand supplier to the local Cartagena utility. The functional currency of Pacific Power is the U.S. dollar.

## Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)

### Pacific Coal Resources Ltd. ("Pacific Coal")

Pacific Coal is engaged in the acquisition and development of coal mining assets and related businesses in Colombia. The Company's interest is 14.35% and the functional currency of Pacific Power is the Canadian dollar.

The Company has determined that it holds significant influence but not control over Pacific Coal as a result of the Company's equity interests and a number of common directors.

The Company did not receive any cash dividends from its equity-accounted investments during the three and six months ending June 30, 2014 (2013: Nil).

### 16. Other Assets

	As at June 30 2014	As at December 31 2013
Bicentenario loan and prepayments	\$ 130,302	\$ 41,992
Financial assets	34,789	13,998
Farm-in interests	12,500	-
	\$ 177,591	\$ 55,990

#### Bicentenario Loan and Prepayments

During 2011 the Company, along with the other shareholders of Bicentenario, entered into certain subordinated loan agreements with Bicentenario. As at June 30, 2014, Bicentenario has the option to draw down an additional \$97.3 million (December 31, 2013: \$97.3 million) pursuant to these agreements. The principal of the subordinated loan will be repaid in 10 equal semi-annual installments starting in 2025 or earlier, after Bicentenario has repaid its bank loans in full. The loans carry an annual interest rate of 7.32%. As at June 30, 2014 the balance of loans outstanding to the Company under the agreement is \$42 million (December 31, 2013: \$42 million), representing the amounts advanced less repayments. Interest income of \$0.8 million and \$1.3 million was recognized during the three and six months ending June 30, 2014 (2013: \$0.5 million and \$1 million respectively).

As of June 30, 2014, the Company has \$110 million (December 31, 2013: \$90 million) in prepayments of transport tariffs to Bicentenario that will be used to offset against future volumes of crude oil transported. The amount was previously included in accounts receivable as of December 31, 2013, and was reclassified to other assets in the current period upon a change of plan to utilize the prepayment beyond a one-year period.

### 17. Assets Held for Sale

On December 23, 2013 the Company reached an agreement to sell its 5% interest and the associated transportation rights in Oleoducto Central S.A. ("OCENSA"), an oil pipeline in Colombia. The OCENSA equity and transportation rights were acquired by the Company as part of the Petrominerales acquisition in November 2013. The consideration consisted of cash consideration of \$360 million, dividends from OCENSA totalling approximately \$15 million, and a \$10 million receivable with annual interest of 15%, to be paid in five years. As of June 30, 2014, the \$10 million long-term receivable is included in other assets on the Interim Consolidated Statement of Financial Positions.



**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

**18. Interest-Bearing Loans and Borrowings**

	Maturity	Currency	Interest Rate	As at June 30 2014	As at December 31 2013
Senior Notes - 2011	2021	USD	7.25%	\$ 966,977	\$ 963,893
Senior Notes - March 2013	2023	USD	5.125%	990,108	989,730
Senior Notes - November 2013	2019	USD	5.375%	1,283,709	1,281,961
Revolving credit facility - US Dollar <sup>(1)</sup>	2015	USD	LIBOR + 2.75%	92,555	395,568
BOFA Loan - 2013	2016	USD	LIBOR + 1.5%	108,885	108,865
Bank loans <sup>(2)</sup>	2024	COP	DTF + 4.2%	85,761	78,794
Petrominerales debentures	2014	USD		-	283,000
Long-term debt	2017	USD	LIBOR+2.70% - 2.75%	322,288	-
Short-term working capital loans and facilities	2014	USD	LIBOR+0.95% - 1.5%	400,000	270,000
				\$ 4,250,283	\$ 4,371,811
Current portion				\$ 437,757	\$ 553,571
Non-current portion				3,812,526	3,818,240
				\$ 4,250,283	\$ 4,371,811

(1) The balance as at June 30, 2014 includes the unamortized deferred financing cost.

(2) Represents bank loans received for the construction of power transmission lines to supply additional electricity to two fields in Colombia. The loan amount is for up to \$112 million with an interest rate of 4.2% + DTF (90-day benchmark rate in Colombia).

*2011 Senior Notes*

The 2011 Senior Notes, due December 12, 2021, are direct, unsecured, unsubordinated obligations with interest payable in arrears at a rate of 7.25% on June 12 and December 12 of each year.

The 2011 Senior Notes are on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. Under the terms of the notes, the Company is required to maintain (1) an interest coverage ratio of greater than 2.5; and (2) a debt-to-EBITDA ratio of less than 3.5. The covenants do not apply during any period of time when the notes have an investment grade rating from at least two rating agencies. The Company was compliant with the covenants during the period.

The 2011 Senior Notes are carried at amortized cost using the effective interest rate method with note discount and transaction costs netted against the principal. The principal amount outstanding on the 2011 Senior Notes as at June 30, 2014 was \$1,012 million (December 2013: \$1,012 million). For the three and six months ending June 30, 2014, \$18 million and \$37.1 million respectively (2013: \$14.1 million and \$27.9 million) in interest expense related to the 2011 Senior Notes was recorded in the Interim Condensed Consolidated Statements of Income.

*March 2013 Senior Notes*

The March 2013 Senior Notes, due March 28, 2023, are direct, unsecured, subordinated obligations with interest payable in arrears at a rate of 5.125% on March 28 and September 28 of each year.

The March 2013 Senior Notes are listed on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. Under the terms of the notes, the Company is required to maintain: (1) an interest coverage ratio of greater than 2.5; and (2) a debt-to-EBITDA ratio of less than 3.5. The covenants do not apply during any period of time when the notes have an investment grade rating from at least two rating agencies. The Company was compliant with the covenants during the period.

The March 2013 Senior Notes are carried at amortized cost using the effective interest rate method with note discount and transaction costs netted against the principal. The principal amount outstanding on the March 2013 Senior Notes as at June 30, 2014 was \$1 billion (December 2013: \$1 billion). For the three and six months ending June 30, 2014, \$13 million and \$25.8 million respectively (2013: \$12.8 million and \$12.8 million respectively) in interest expense related to the March 2013 Senior Notes was recorded in the Interim Condensed Consolidated Statements of Income.

## **Notes to the Interim Condensed Consolidated Financial Statements** **(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)**

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### *November 2013 Senior Notes*

The November 2013 Senior notes, due November 26, 2019, are direct, unsecured, subordinated obligations with interest payable in arrears at a rate of 5.375% on January 26 and July 26 of each year.

The November 2013 Senior Notes are listed on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. Under the terms of the notes, the Company is required to maintain: (1) an interest coverage ratio of greater than 2.5; and (2) a debt-to-EBITDA ratio of less than 3.5. The covenants do not apply during any period of time when the notes have an investment grade rating from at least two rating agencies. The Company was compliant with the covenants during the period.

The November 2013 Senior Notes are carried at amortized cost using the effective interest rate method with note discount and transaction costs netted against the principal. The principal amount outstanding on the November 2013 Senior Notes as at June 30, 2014 was \$1.3 billion (December 2013: 1.3 billion). For the three and six months ending June 30, 2014, \$18.3 million and \$36.4 million respectively (2013: Nil) in interest expense related to the November 2013 Senior Notes was recorded in the Interim Condensed Consolidated Statement of Income.

### *Revolving Credit Facilities*

During April 2014 the Company entered into a new revolving credit facility of \$1 billion denominated in U.S. dollars with a syndicate of international and Colombian banks, and which is fully committed to its maturity in 2017. The \$400 million U.S. dollar credit facility and the \$300 million Peso facility that the Company had previously were duly cancelled. The new U.S. dollar revolving credit facility has an interest rate determined in accordance with the ratings assigned to the Company's senior notes; based on the credit rating as of June 30, 2014, the interest rate was LIBOR + 2.25%. In addition, the Company is required to pay commitment fees of 0.95% on the unutilized portion under the revolving credit facility. As of June 30, 2014 the Company has drawn down \$100 million on the revolving credit facility.

### *Long Term Debt*

In 2013, the Company borrowed \$109 million from Bank of American ("**2013 BOFA Loan**") which carries an interest rate of LIBOR +1.5% and matures on November 2016, with interest payments due biannually. As at June 30, 2014, the principal outstanding was \$109 million (December 31, 2013 \$109 million). The 2013 BOFA loan is subject to covenants that require the Company to maintain: (1) an interest coverage ratio of greater than 2.5; and (2) debt-to-EBITDA ratio of less than 3.5. The Company was compliant with the covenants during the period.

The Company also entered into two U.S. dollar-denominated long-term credit facilities that mature in 2017 with interest rates of LIBOR +2.70% and LIBOR +2.75%. The total balance outstanding on these credit facilities was \$322.3 million as at June 30, 2014 (December 31, 2013: Nil).

### *Short-term Working Capital Loans and Facilities*

The Company has several short-term loans and facilities that mature in 2014 to fund working capital needs. These working capital facilities are denominated in U.S. dollars with interest rates ranging from LIBOR +0.95% to LIBOR + 1.50%. The total balance outstanding on these working capital facilities was \$400 million as at June 30, 2014 (December 31, 2013: \$270 million).

### *Petrominerales Debentures*

As part of the acquisition of Petrominerales, the Company assumed two convertible debentures (the 2016 and 2017 debentures) totaling \$538 million. The Company provided notice to the holders of these convertible debentures for redemption at fair value plus accrued interest, as provided for in the indentures of the two debentures. As of December 31, 2013, the balance of debentures that had not yet been redeemed was \$283 million. The outstanding balance was repaid in full in January 2014.

**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

**19. Asset Retirement Obligation**

The Company makes full provision for the future cost of decommissioning oil production facilities on a discounted basis on the installation of those facilities.

As at December 31, 2013	\$	201,576
Arising during the period		(4,362)
Accretion expense		1,446
As at March 31, 2014	\$	198,660
Arising during the period		25,719
Accretion expense		1,528
As at June 30, 2014	\$	225,907

The asset retirement obligation represents the present value of decommissioning costs related to oil and gas properties, of which up to \$308 million are expected to be incurred (December 31, 2013: \$238 million). The future decommissioning costs are discounted using the risk free rate of between 2.96% and 3.67% (December 31, 2013: 3.57% and 4.38%) to arrive at the present value. Assumptions, based on the current economic environment, have been made which management believe are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to take into account any material changes to the assumptions. However, actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning expenditures and 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.

**20. Finance Leases**

The Company has entered into two power generation arrangements to supply electricity for three of its oil fields in Colombia until June 2016 and August 2021. In addition, the Company has lease and take or pay arrangements for airplanes, IT equipment and a gas facility that are accounted for as finance leases. These finance leases have an average effective interest rate of 12.85%. The Company's minimum lease payments are as follows:

	As at June 30		As at December 31	
	2014		2013	
Within 1 year	\$	24,751	\$	25,843
Year 2		20,344		20,447
Year 3		7,923		14,657
Year 4		6,778		6,793
Year 5		6,778		6,778
Thereafter		14,727		18,491
Total minimum lease payments		81,301		93,009
Amounts representing interest		(22,758)		(27,222)
Present value of net minimum lease payments	\$	58,543	\$	65,787
Current portion	\$	17,418	\$	17,807
Non-current portion		41,125		47,980
Total obligations under finance lease	\$	58,543	\$	65,787

For the three and six months ending June 30, 2014, interest expense of \$2.2 million and \$4.4 million respectively (2013: \$3.1 million and \$6.1 million) was incurred on these finance leases.

**Notes to the Interim Condensed Consolidated Financial Statements**  
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**21. Contingencies and Commitments**

A summary of the Company's commitments, undiscounted, by calendar year is presented below:

	2014	2015	2016	2017	2018	Subsequent to 2018	Total
LNG Project	\$ 59,088	\$ 59,088	\$ 59,088	\$ 59,088	\$ 59,088	\$ 590,877	886,317
Investment Acquisitions	57,891	25,357	-	-	-	-	83,248
ODL Take-or-Pay Agreement	18,605	30,513	42,420	23,815	23,815	35,722	174,890
Minimum work commitments	122,589	114,158	44,286	10,838	5,536	-	297,407
Bicentenario Take-or-Pay Agreement	80,122	159,806	160,244	159,806	159,806	1,052,530	1,772,314
Operating leases	428,571	429,434	240,353	111,550	111,320	900,420	2,221,648
Transportation and processing commitments	26,702	52,982	49,164	44,113	35,772	229,244	437,977
Transmission line project	1,693	-	-	-	-	-	1,693
Purchase Genser Power	41,591	38,105	23,750	9,394	9,394	45,405	167,639
Community obligations	18,888	-	-	-	-	-	18,888
	\$ 855,740	\$ 909,443	\$ 619,305	\$ 418,604	\$ 404,731	\$ 2,854,198	\$ 6,062,021

The Company has various guarantees in place in the normal course of business. As at June 30, 2014, the Company has issued letters of credit and guarantees for exploration and operational commitments for a total of \$443.8 million (December 31, 2013: \$368 million).

*Association Contracts*

Certain association contracts signed before 2003 with Ecopetrol include clauses in which Ecopetrol may commence participating in the operation of new discoveries made by the Company at any time, without prejudice to the Company's right to be reimbursed for the investments made on their sole account and risk (back-in right). The contract provides that if Ecopetrol decides to declare the commerciality of the field and participate in the commercial phase of the association contract, the Company shall have the right to be reimbursed for 200% of the total costs incurred during the exploration phase of the contract. Once the reimbursement has been made, Ecopetrol is entitled to acquire a 50% share of the oil production of the fields. No back-in rights were exercised as at June 30, 2014.

*Contingencies*

The Company is involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain, there can be no assurance that such matters will be resolved in the Company's favour. The Company does not currently believe that the outcome of adverse decisions in any pending or threatened proceedings related to these and other matters or any amount which it may be required to pay by reason thereof would have a material impact on its financial position, results of operations or cash flows.

*Tax Review in Colombia*

The Company currently has a number of tax filings under review by the Colombian tax authority ("**DIAN**").

The DIAN has officially reassessed several value-added tax ("**IVA**") tax declarations on the basis that the volume of oil produced and used for internal consumption at certain fields in Colombia should have been subjected to IVA. For second quarter of 2014, the new amount reassessed, including interest and penalties, is estimated at \$14.2 million. The Company disagrees with the DIAN's reassessment and official appeals had been initiated. Several other taxation periods back to 2011 in respect to IVA on field oil consumption are also currently under review by the DIAN. For the periods that are under review, if the DIAN's views were to prevail, the Company estimates that the IVA, including interest and penalties could range between \$12 million and \$50.3 million. The Company continues to utilize oil produced for internal consumption, which is an accepted practice for the oil industry in Colombia.

The DIAN is also reviewing certain income tax deductions in respect to the special tax benefit for qualifying petroleum assets as well as other exploration expenditures. As of the date of this report, the DIAN has reassessed \$77 million of tax owing, including estimated interest and penalties, with respect to the denied deductions.

As of June 30, 2014, the Company believes that the disagreements with the DIAN related to IVA and denied income tax deductions will be resolved in favour of the Company. As a result, no provision has been made in the financial statements.

*High-Price Royalty in Colombia*

The Company has certain exploration contracts acquired through business acquisitions where there existed outstanding disagreements with the Agencia Nacional de Hidrocarburos (National Hydrocarbon Agency or "**ANH**") of

## Notes to the Interim Condensed Consolidated Financial Statements

*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

Colombia) relating to the interpretation of the high-price participation clause. These contracts require high-price participation payments to be paid to the ANH once an exploitation area within a contracted area has cumulatively produced five million or more barrels of oil. The disagreement is around whether the exploitation areas under these contracts should be determined individually or combined with other exploration areas within the same contracted area, for the purpose of determining the five million barrel threshold. The ANH has interpreted that the high-price participation should be calculated on a combined basis.

The Company disagrees with the ANH's interpretation, and asserts that in accordance with the exploration contracts, the five million barrel threshold should be applied on each of the exploitation areas within a contracted area. The Company has several contracts that are subject to the ANH high-price participation. One of these contracts is the Corcel Block, which was acquired as part of the Petrominerales acquisition and which is the only one for which an arbitration process has been initiated. However, the arbitration process for Corcel was under suspension at the time the Company acquired Petrominerales. The amount under arbitration was approximately \$150 million plus related interest of \$70 million as of June 30, 2014. The Company also disagrees with the interest rate that the ANH has used in calculating the interest cost. The Company asserts that since the high-price participation is denominated in the U.S. dollar, the contract requires the interest rate to be three-month LIBOR +4%, whereas the ANH has applied the highest legally authorized interest rate on Colombian Peso liabilities, which was over 20%. The amount under discussion with the ANH for another contract is approximately \$90 million plus interest.

The Company and the ANH are currently in discussion to further understand the differences in interpretation of these exploration contracts, and expect to resolve these differences within one year. The Company believes that it has a strong position with respect to the high-price participation based on legal interpretation of the contracts and technical data available. However, in accordance with IFRS 3, to account for business acquisitions the Company is required to and has recorded a liability for such contingencies as of the date of acquisition, even though the Company believes the disagreement will be resolved in favour of the Company. The Company does not disclose the amount recognized as required by paragraphs 84 and 85 of IAS 37, on the grounds that this would be prejudicial to the outcome of the dispute resolution.

### *Natural Gas Supply Agreements*

Since the discovery at the La Creciente field in early 2007, the Company has focused on developing a commercial strategy to service the domestic market while concurrently exploring export opportunities. The Company has entered into take-or-pay contracts and interruptible contracts totaling 60MMBtu per day.

## 22. Issued Capital

### *(a) Authorized, Issued and Fully Paid Common Shares*

The Company has an unlimited number of common shares with no par value.

The continuity schedule of share capital is as follows:

	Number of Shares	Amount
As at December 31, 2013	322,503,758	\$ 2,667,820
Repurchase of shares	(9,056,800)	(75,281)
As at March 31, 2014	313,446,958	\$ 2,592,539
Issued on exercise of options	843,300	16,763
As at June 30, 2014	314,290,258	\$ 2,609,302

During the six months ending June 30, 2014, the Company repurchased from the open market approximately 9 million common shares under the previously announced share repurchase program. The total amount paid for the shares repurchased during the period was \$134.2 million, and this was recorded in the Interim Condensed Consolidated Financial Statements as a reduction to share capital of \$75.3 million and a reduction of \$58.9 million to contributed surplus.

### *(b) Stock Options*

The Company has established a "rolling" Stock Option Plan (the "Plan") in compliance with the applicable TSX policy for granting stock options. Under the Plan, the maximum number of shares reserved for issuance may not exceed 10%

**Notes to the Interim Condensed Consolidated Financial Statements**  
**(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)**

of the total number of issued and outstanding common shares. The exercise price of each option shall not be less than the market price (as defined under the TSX Company Manual) of the Company's stock at the date of grant.

A summary of the changes in stock options is presented below:

	Number of options outstanding	Weighted average exercise price (C\$)
Balance, December 31, 2013	25,917,692	\$ 21.01
Cancelled during the period	(5,000)	25.01
Balance, March 31, 2014	25,912,692	\$ 21.01
Exercised during the period	(843,300)	14.29
Cancelled during the period	(26,500)	26.69
Balance, June 30, 2014	25,042,892	\$ 21.23

The weighted average share price at the time when the stock options were exercised during the three and six months ending June 30, 2014 was C\$22.12 and C\$22.12 respectively (2013: C\$21.66 and C\$22.47).

The following table summarizes information about the stock options outstanding and exercisable:

Outstanding & exercisable	Exercise price (C\$)	Expiry date	Remaining contractual life (years)
116,667	\$ 6.30	July 10, 2017	3.0
10,000	10.86	July 30, 2014	0.1
1,776,400	13.09	October 12, 2014	0.3
3,656,500	14.08	February 9, 2015	0.6
3,000	19.00	March 16, 2015	0.7
2,708,875	20.56	April 23, 2015	0.8
10,000	20.09	May 18, 2015	0.9
5,000	24.41	June 23, 2015	1.0
37,000	27.58	September 29, 2015	1.2
250,000	34.43	February 2, 2016	1.6
3,755,250	25.76	March 16, 2016	1.7
53,000	28.01	May 3, 2016	1.8
12,000	25.59	May 26, 2016	1.9
160,000	22.05	September 27, 2016	2.2
11,000	24.68	October 24, 2016	2.3
5,289,700	22.75	January 18, 2017	2.6
69,000	29.10	March 30, 2017	2.8
6,212,000	23.26	January 28, 2018	3.6
757,000	24.32	February 8, 2018	3.6
150,500	19.21	November 15, 2018	4.4
25,042,892	\$ 21.23		2.1

**(c) Deferred Share Units**

The Company established the Deferred Share Unit Plan (the "DSU Plan") for its non-employee directors during 2012. Each DSU represents the right to receive a cash payment on retirement equal to the volume-weighted average market price of the Company's shares at the time of surrender. Cash dividends paid by the Company are credited as additional DSUs. As at June 30, 2014, 443,222 DSUs were outstanding with a fair value of \$9.6 million (December 31, 2013: 340,959 DSUs valued at \$6.3 million). The fair value of the DSUs granted and the changes in their fair value during the period was recognized as share-based compensation on the Interim Condensed Consolidated Statement of Income with a corresponding amount recorded in accounts payable and accrued liabilities on the Interim Consolidated Statement of Financial Position.

For the three and six months ending June 30, 2014, \$1.4 million and \$3.1 million were recorded as share-based compensation expense in respect of DSUs granted in the period and the change in fair value.

## Notes to the Interim Condensed Consolidated Financial Statements

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### 23. Related-Party Transactions

The following sets out the details of the Company's related party transactions

- a) During the three and six months ending June 30, 2014, the Company paid \$2.1 million and \$4.7 million (2013: \$10 million and \$22.8 million) to Transportadora Del Meta S.A.S. ("**Transmeta**") in crude oil transportation costs. In addition the Company has accounts receivable of \$1.4 million (December 31, 2013: \$1.5 million) from Transmeta and accounts payable of \$1.6 million (December 31, 2013: \$1.7 million) to Transmeta as at June 30, 2014. Transmeta is controlled by a director of the Company.
- b) As at June 30, 2014, the Company had trade accounts receivable of \$3.8 million (December 31, 2013: \$0.2 million) from Proelectrica de los Llanos ("**Proelectrica**"), in which the Company has a 24.9% indirect interest and which is 31.49% owned by Blue Pacific Assets Corp. ("**Blue Pacific**"). The Company's and Blue Pacific's indirect interests are held through Pacific Power. Revenue from Proelectrica in the normal course of the Company's business was \$4.4 million and \$6.9 million for the three and six months that ended June 30, 2014 (2013: \$10.7 and \$21.9 million respectively).
- c) In October 2012, the Company and Ecopetrol signed two Build, Own, Manage, and Transfer ("**BOMT**") agreements with Consorcio Genser Power-Proelectrica and its subsidiaries ("**Genser-Proelectrica**") to acquire certain power generation assets for the Rubiales field. Genser-Proelectrica is a joint venture between Promotora de Energia Electrica de Cartagena & Cia S.C.A.E.S.P ("**Proelectrica**") and Genser Power Inc. which is 51% owned by Pacific Power. Total commitment under the BOMT agreements is \$229.7 million over ten years. In April 2013 the Company and Ecopetrol entered into another agreement with Genser-Proelectrica to acquire additional assets for a total commitment of \$57 million over ten years. At the end of the Rubiales Association Contract in 2016, the Company's obligations along with the power generation assets will be transferred to Ecopetrol. During the three and six months ending June 30, 2014 those assets were under construction and the Company paid cash advances of \$9.7 million and \$9.7 million, which were recorded in other assets (2013: \$8.9 million and \$9.4 million). The Company has accounts payable of \$9.8 million (December 2013: \$0.4 million) due to Genser-Proelectrica. In addition, On May 5, 2014, a subsidiary of the Company provided a guarantee in favour of XM Compania de Expertos en Mercados S.A. on behalf of Proelectrica guaranteeing obligations pursuant to an energy supply agreement in the aggregate amount of approximately \$16.7 million. The Company has a 24.9% indirect interest in Proelectrica.
- d) In June 2007, the Company entered into a 5-year lease agreement with Blue Pacific for administrative office space in one of its Bogota, Colombia locations. Monthly rent expense of \$0.087 million was payable to Blue Pacific under this agreement. Three directors and officers of the Company control, or provide investment advice to the holders of, 78% of the shares of Blue Pacific. During 2011, the lease was amended to include additional space in Bogota for a 10-year term with a monthly rent of \$0.5 million and assignment of the lessor to an entity controlled by Blue Pacific. Effective January 1, 2014, Blue Pacific ceased to be a party to the lease agreements upon assigning the rights under these agreements to a third party that is not related to the Company.
- e) The Company has entered into aircraft transportation agreements with Helicopteros Nacionales de Colombia S.A.S. ("**Helicol**"), a company controlled by a director of the Company. During the three and six months ending June 30, 2014, the Company paid \$3.7 million and \$6.0 million (2013: \$2.5 million and \$6.9 million) in fees as set out under the transportation agreements. As at June 30, 2014, the Company had accounts payable of \$4.5 million to Helicopteros Nacionales de Colombia S.A.S. ("**Helicol**") (December 31, 2013: \$2.5 million).
- f) During the three and six months ending June 30, 2014, the Company paid \$34.6 million and \$63.2 million to ODL (2013: \$28.1 million and \$60.5 million), a pipeline company in which the Company has a 35% interest, for crude oil transport services under the pipeline take or pay agreement, and has accounts payable of \$20.1 million to ODL as at June 30, 2014 (December 31, 2013: \$7.4 million). The Company received \$0.9 million and \$1.0 million from ODL during the three and six months ending June 30, 2014 (2013: \$0.2 million and \$0.5 million) with respect to certain administrative services and rental equipment and machinery. The Company has accounts receivable from ODL as at June 30, 2014 of \$0.5 million (December 31, 2013: \$0.1 million).
- g) During the three and six months ending June 30, 2014, the Company paid \$45 million and \$73.9 million to Bicentenario (2013: Nil), a pipeline Company in which the Company has a 43% interest, for crude oil transport services under the pipeline take-or-pay agreement. As at Jun 30, 2014 the balance of loans outstanding to Bicentenario under the agreement in note 16 (other assets), is \$42 million (December 31, 2013: \$42 million). Interest income of \$0.65 million and \$1.3 million was recognized during the three and six months ended June 30, 2014 (2013: \$0.5 million and \$1.0 million). The Company has received Nil million and \$0.5 million during the three and six months ending June 30, 2014 (2013: \$0.3 million and \$0.7 million) with respect to certain

## Notes to the Interim Condensed Consolidated Financial Statements

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administrative services and rental equipment and machinery. The Company has accounts receivable from Bicentenario as at June 30, 2014 of \$42 million (December 31, 2013: \$42 million) and advanced \$110 million to Jun 30, 2014 (December 31, 2013: \$90 million) to Bicentenario as a prepayment of transport tariff, which is amortized against the barrels transported. As of June 30, 2014, the Company has a receivable from Bicentenario of \$20 million representing the return of a portion of the tariffs paid during the period of disrupted pipeline service.

- h) The Company has established one charitable foundation in Colombia, the Pacific Rubiales Foundation, with the objective of advancing social and community development projects in the country. During the three and six months ending June 30, 2014, the Company contributed \$13.9 million and \$20.9 million respectively to this foundation (2013: \$8.3 million and \$19.1 million) and advanced of \$8.7 million to June 30, 2014 (December 31, 2013: \$0.4 million).
- i) As at June 30, 2014, the Company has a demand loan receivable from PII in the amount of \$38 million. The loan is guaranteed by PII's pipeline project and bears interest at 7% per annum. The Company owns 41.65% of Pacific Infrastructure.

### 24. Financial Assets and Liabilities

#### Overview of Risk Management

The Company explores, develops and produces oil and gas and enters into contracts to sell its oil and gas production, and to manage its market risk associated to commodity markets, and notably its exposure to WTI pricing. The Company also enters into supply agreements and purchases goods and services denominated in non-functional currencies such as Colombia Pesos for its Colombian based activities. These activities expose the Company to market risk from changes in commodity prices, foreign exchange rates, interest rates, credit and liquidity risks that affect the Company's earnings and the value of associated financial instruments it holds.

The Company seeks to minimize the effects of these risks by using derivative financial instruments to hedge its risk exposures. The Company's strategy, policies and controls are designed to ensure that the risks it assumes comply with the Company's internal objectives and its risk tolerance. It is the Company's policy that no speculative trading in derivatives shall be undertaken.

When possible and cost effective, the Company applies hedge accounting. Hedging does not guard against all risks and is not always effective. The Company could recognize financial losses as a result of volatility in the market values of these contracts.

#### Risks Associated with Financial Assets and Liabilities

##### (a) Market Risks

###### *Commodity Price Risk*

Commodity price risk is the risk that the cash flows and operations of the Company will fluctuate as a result of changes in commodity prices associated with WTI pricing. Significant changes in commodity prices can also impact the Company's ability to raise capital or obtain additional debt financing. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. While the Company does not engage in speculative financial instrument trading, it may enter into various hedging strategies such as costless collars, swaps, and forwards to minimize its commodity price risk exposure to WTI pricing.

###### *Foreign Currency Risk*

Foreign exchange risk arises from changes in foreign exchange rates that may affect the fair value or future cash flows of the Company's financial assets or liabilities. As the Company operates primarily in Colombia, fluctuations in the exchange rate between the Colombian peso and the U.S. dollar can have a significant effect on the Company's reported results.

To mitigate the exposure to the fluctuating COP/USD exchange rate associated with operating and general and administrative expenses incurred in COP, the Company may enter into various hedging strategies, such as currency costless collars, swaps and forwards. In addition, the Company may also enter into currency derivatives to manage the foreign exchange risk on financial assets that are denominated in the Canadian dollar.



## Notes to the Interim Condensed Consolidated Financial Statements

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The Company's foreign exchange gain/loss primarily includes unrealized foreign exchange gains and losses on the translation of COP-denominated risk management assets and liabilities held in Colombia.

### Interest Rate Risk

The Company is exposed to interest rate risk on its outstanding variable-rate revolving credit borrowings due to fluctuations in market interest rates. The Company monitors its exposure to interest rates on an ongoing basis.

### Sensitivity Analysis on Market Risks

The detail below summarizes the sensitivities of the Company's risk management positions to fluctuations in the underlying benchmark prices, with all other variables held constant. Fluctuations in the underlying benchmarks could have resulted in unrealized gains or losses impacting pre-tax net earnings as follows:

- A \$1 change in the WTI price would have resulted in a \$24 million change in revenue as at June 30, 2014 (2013: \$22 million).
- A 10% change in the COP/USD exchange rate would have resulted in a \$1.2 million change in foreign exchange gain/loss as at June 30, 2014 (2013: \$0.8 million).
- A 1% (100 basis points) change in the interest rate would increase or decrease interest expense by \$2.5 million (2013: \$3.6 million).

### (b) Credit risk

Credit risk arises from the potential that the Company may incur a loss if a counterparty to a financial instrument fails to meet its obligations in accordance with agreed terms. The Company actively limits the total exposure to individual client counterparties and holds a trade credit insurance policy for indemnification for losses from non-collection of trade receivables.

	As at June 30 2014	As December 31 2013
Trade receivable	\$ 362,985	\$ 444,878
Advances / deposits	89,812	164,348
Recoverable VAT and Withholding Tax	192,627	140,889
Other receivables	157,790	52,255
Receivable from joint arrangements	314,954	236,761
Allowance for doubtful accounts	(1,058)	(969)
	\$ 1,117,110	\$ 1,038,162
Loan and advance to Bicentenario (non-current, Note 16)	130,302	41,992
	\$ 1,247,412	\$ 1,080,154

The Company actively limits the total exposure to individual client counterparties and holds a trade credit insurance policy for indemnification for losses from non-collection of trade receivables. As at June 30, 2014 three of the Company's customers had accounts receivable that were greater than 10% of total trade accounts receivable. The Company's credit exposure to these customers was \$97.7 million, \$82.7 million, and \$61.0 million, or 27%, 23% and 17% of trade accounts receivable, respectively (June 30, 2013: two customers at \$91 million and \$35 million or 40% and 16% of trade accounts receivable). Revenues from these customers for 2014 were \$291 million, \$79 million and \$82 million or 11%, 3% and 3% of revenue (June 30, 2013: \$104 million and \$118 million or 10% and 5% of revenue), respectively.

The majority of the recoverable VAT and Withholding Tax is due to the Colombian and Peruvian tax authority.

The majority of the receivables from joint arrangements are due from Ecopetrol.

Included in other receivables is a short-term loan receivable from PII of \$38 million. The loan is guaranteed by PII's pipeline project and bears interest at 7% per annum.

## Notes to the Interim Condensed Consolidated Financial Statements

(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)

The Company does not hold any collateral or other credit enhancements to cover its credit risks associated with its financial assets, except for the loan with PII.

### (c) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's process for managing liquidity risk includes ensuring, to the extent possible, that it will have sufficient liquidity to meet its liabilities when they become due. The Company prepares annual capital expenditure budgets which are monitored and updated as required. In addition, the Company requires authorizations for expenditures on projects to assist with the management of capital. As at June 30, 2014, the Company had available \$900 million of revolving credit. The following are the contractual maturities of non-derivative financial liabilities (undiscounted):

Financial liability due in	2014	2015	2016	2017	2018	Subsequent to 2018	Total
Accounts payable and accrued liabilities	\$ 1,651,921	\$ -	\$ -	\$ -	\$ -	\$ -	1,651,921
Long-term debt and bank indebtedness	437,500	-	109,000	312,500	75,000	3,394,106	4,328,106
Obligations under finance lease (Note 20)	24,751	20,344	7,923	6,778	6,778	14,727	81,301
<b>Total</b>	<b>\$ 2,114,172</b>	<b>\$ 20,344</b>	<b>\$ 116,923</b>	<b>\$ 319,278</b>	<b>\$ 81,778</b>	<b>\$ 3,408,833</b>	<b>\$ 6,061,328</b>

### d) Hedge Accounting and Risk Management Contracts

The terms and conditions of the hedging instruments and expected settlement periods are as follows for instruments outstanding as at:

June 30, 2014

Type of Instrument	Term	Notional Amount / Volume (bbl)	Floor/ Ceiling or strike price	Benchmark	Carrying amount	
					Assets	Liabilities
<b>Subject to Hedge Accounting:</b>						
<i>Foreign Currency Risk</i>						
Zero-cost collars	July 2014 to December 2014	150,000	1975-2075 COP/\$	COP/USD	\$ 3,832	\$ -
Zero-cost collars	July 2014 to December 2014	30,000	1850-2040 COP/\$	COP/USD	-	(85)
<i>Commodities Price Risk</i>						
Zero-cost collars	July 2014 to December 2015	6,750,000	80/114.50	WTI	-	(4,760)
<b>Total</b>					<b>\$ 3,832</b>	<b>\$ (4,845)</b>
<b>Not Subject to Hedge Accounting:</b>						
<i>Foreign Currency Risk</i>						
Zero - Cost Collar	July 2014 to December 2014	35,000	1925-2085 COP/\$	COP/USD	\$ 692	\$ -
<i>Commodities Price Risk</i>						
Zero-cost collars	July- December 2014	120,000	95 / 110	BRENT	-	(341)
Zero-cost collars	April - September 2014	1,000,000	80 / 108	WTI	-	(419)
Extendible zero-cost collars (counterparty option)	July-September 2014 Ext October-December 2014	300,000	80 / 108.15	WTI	-	(598)
Extendible zero-cost collars (counterparty option)	April- June 2014 Ext July - December 2014	2,700,000	80 / 109	WTI	-	(2,724)
Swap	June - July 2014	2,850,000	7.44-7.75	BRENT-WTI	1,774	-
<b>Total</b>					<b>\$ 2,466</b>	<b>\$ (4,082)</b>
<b>Total June 30, 2014</b>					<b>\$ 6,298</b>	<b>\$ (8,927)</b>

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December 31, 2013

Type of Instrument	Term	Notional Amount/ Volume (bbl)	Floor/ Ceiling or strike price	Benchmark	Carrying amount	
					Assets	Liabilities
<b>Subject to Hedge Accounting:</b>						
<i>Foreign Currency Risk</i>						
Zero-cost collars	January to December 2014	180,000	1920-2075 COP/\$	COP/USD	\$ 1,820	\$ -
Zero-cost collars	January to December 2014	300,000	1850-2085 COP/\$	COP/USD	-	(3,900)
<b>Total</b>					<b>\$ 1,820</b>	<b>\$ (3,900)</b>
<b>Not Subject to Hedge Accounting:</b>						
<i>Foreign Currency Risk</i>						
Zero-cost collars	January to May 2014	25,000	1900-1950 COP/\$	COP/USD	\$ 41	\$ -
Forwards	January to February 2014	35,000	1910 COP/\$	COP/USD	-	(339)
Zero-cost collars	January 2014	14,000,000	1.06 - 1.07 CAD/\$	COP/USD	-	(84)
<i>Commodities Price Risk</i>						
Zero-cost collars	January to September 2014	2,475,000	80/ 106-111	WTI	287	-
Zero-cost collars	January to December 2014	3,107,500	80/ 108-111	WTI	-	(868)
Extendible zero-cost collars (counterparty option)	January to June 2014	3,000,000	80/ 109-110	WTI	-	(1,719)
<b>Total</b>					<b>\$ 328</b>	<b>\$ (3,010)</b>
<b>Total December 31, 2013</b>					<b>\$ 2,148</b>	<b>\$ (6,910)</b>

**Instruments Subject to Hedge Accounting**

*Hedging Relationship*

The Company's hedging strategies for which hedge accounting is applied consists of the following:

- Foreign exchange: From its highly probable forecasted COP expenditures, the Company has identified the foreign exchange fluctuation risk as the hedged item. To mitigate the risk, currency collars were entered into and classified as hedging instruments. The collars used limit the risk of variability in cash flows arising from the fluctuations in the COP to USD exchange rates above and below the specified ranges.

To determine the effectiveness of the hedging relationship, the Company assesses the critical terms between the hedged item and hedging instruments on a qualitative basis. If mismatches in the terms are noted, a quantitative assessment is used to determine the impact of potential ineffectiveness.

The sources of ineffectiveness identified in the current foreign exchange hedging strategy relates to differing credit ratings of the counterparties, and the duration of the relationship. These sources of ineffectiveness were insignificant for the six months ending June 30, 2014.

- Commodity price: The Company's forecasted sales are subject to the benchmark price, quality differential, and location differential risk components. As part of the Company's risk management strategy, the benchmark price risk component is hedged, which has historically comprised approximately 94% of the hedged item as a whole. The basis and location risk components are not subject to hedge accounting, as it was not considered economical.

From its forecasted sales, the Company has identified its WTI price risk as the specific benchmark risk component to be hedged, consistent with the Company's risk management strategy and exposure. The Company utilized commodity price collars as designated hedging instruments to manage related fluctuations in cash flow above or below the specified ranges.

To determine the effectiveness of the hedging relationship, the Company assesses the critical terms between the hedged item and hedging instruments on a qualitative basis. If mismatches in the terms are noted, a quantitative assessment is used to determine the impact of potential ineffectiveness.

The sources of ineffectiveness identified in the current commodities hedging strategy relate to differing credit ratings of the counterparties. The sources of ineffectiveness were insignificant for the six months ending June 30, 2014 and 2013.

**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

The following table summarizes PRE's outstanding financial derivative positions subject to hedge accounting:

As at June 30, 2014:

	Hedging Instrument		Hedged Item	
	Line item in the statement of financial position where the hedging instrument is located	Changes in fair value used for calculating hedge ineffectiveness for 2014	Changes in fair value used for calculating hedge ineffectiveness for 2014	Cummulative Cash flow hedge reserve
<b>Cash flow hedges:</b>				
<b>Foreign Currency Risk</b>				
- Zero-cost collars	Risk Management Assets	\$ 3,919	\$ 3,919	\$ 3,258
- Zero-cost collars	Risk Management Liabilities	-	-	(158)
		\$ 3,919	\$ 3,919	\$ 3,100
<b>Commodities Price Risk</b>				
- Zero-cost collars (April-June)	Risk Management Liabilities	-	-	-
- Zero-cost collars (July - September)	Risk Management Liabilities	-	-	-
		-	-	-

*Impact of Hedging Relationship*

The Company excludes changes in fair value relating to the option time value from ineffectiveness assessments and records these amounts in other comprehensive income, as a cost of hedging.

Three months ending June 30, 2014:

	Change in the value of the hedging instrument recognized in OCI gain/(loss)	Hedge ineffectiveness recognized in profit or loss gain/(loss)	Line item in profit or loss (that includes hedge ineffectiveness)	Amount reclassified from the cash flow hedge reserve to profit or loss gain/(loss)	Line item affected in profit or loss because of the reclassification
<b>Foreign exchange risk</b>					
- Zero-cost collars	\$ 5,620	\$ (902)	Foreign exchange gain (loss)	\$ 1,113	Production and operating costs
<b>Commodities Price Risk</b>					
- Zero-cost collars	-	-	Risk management gain (loss)	-	Revenue

Six months ending June 30, 2014:

	Change in the value of the hedging instrument recognized in OCI gain/(loss)	Hedge ineffectiveness recognized in profit or loss gain/(loss)	Line item in profit or loss (that includes hedge ineffectiveness)	Amount reclassified from the cash flow hedge reserve to profit or loss gain/(loss)	Line item affected in profit or loss because of the reclassification
<b>Foreign exchange risk</b>					
- Zero-cost collars	\$ 1,415	\$ 460	Foreign exchange gain (loss)	\$ (675)	Production and operating costs
<b>Commodities Price Risk</b>					
- Zero-cost collars	-	-	Risk management gain (loss)	-	Revenue

## **Notes to the Interim Condensed Consolidated Financial Statements**

*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

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### **Instruments Not Subject to Hedge Accounting:**

As part of the Company's risk management strategy, derivative financial instruments are used to manage its exposure to its risks, in addition to those designated for hedge accounting.

As these instruments have not been designated as hedges, the change in fair value is recorded in profit or loss. For the three and six months ended June 30, 2014, the Company recorded a loss of \$2.5 million a gain of \$1.3 million respectively on commodity price risk management contracts as gain (loss) on risk management contracts in net earnings (2013: \$0.5 million and 6.2 million loss). Included in these amounts were \$3.1 million and nil unrealized loss respectively (2013: \$2.2 million and \$6.7 million unrealized loss) representing the change in the fair value of the derivatives, and realized gains of \$0.6 million and \$1.3 million (2013: Nil) respectively.

Also for the three and six months ended June 30, 2014, the Company recorded foreign exchange gains of \$0.6 million and \$1.1 million respectively in net earnings on foreign currency risk management contracts. These amounts consist of unrealized gains representing the change in the fair value of the derivatives.

### **Fair Value**

The Company's financial instruments are cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, risk management assets and liabilities, bank debt, finance lease obligation, debentures and available-for-sale investments on the statement of financial position. The carrying value and fair value of these financial instruments are disclosed below by financial instrument category.

**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

	June 30, 2014		December 31, 2013	
	Carrying value	Fair value	Carrying value	Fair value
<b>Financial Assets</b>				
<i>Financial assets measured at amortized cost</i>				
Cash and cash equivalents	\$ 396,413	\$ 396,413	\$ 632,503	\$ 632,503
Restricted cash	31,400	31,400	16,980	16,980
Accounts receivable	1,117,110	1,117,110	1,038,162	1,038,162
Bicentenario Loan and prepayments (Note 16)	130,302	130,302	41,992	41,992
Cash advance	9,649	9,649	-	-
Farm-in interests (Note 16)	12,500	12,500	-	-
Ocensa Receivable	10,375	10,375	-	-
	1,707,749	1,707,749	1,729,637	1,729,637
<i>Financial assets mandatorily measured at fair value through profit or loss (FVTPL)</i>				
Held-for-trading derivatives that are not designated in hedge accounting relationships (see Note 24)	2,466	2,466	328	328
	2,466	2,466	328	328
<i>Financial assets designated as measured at fair value through other comprehensive income (FVTOCI)</i>				
Investments in equity instruments	14,765	14,765	13,890	13,890
	14,765	14,765	13,890	13,890
<i>Derivative instruments in designated hedge accounting relationships (see Note 24)</i>				
	3,832	3,832	1,820	1,820
	3,832	3,832	1,820	1,820
	\$ 1,728,812	\$ 1,728,812	\$ 1,745,675	\$ 1,745,675
<b>Financial Liabilities</b>				
<i>Financial liabilities measured at amortized cost</i>				
Accounts payable and accrued liabilities	\$ (1,651,921)	\$ (1,651,921)	\$ (1,683,179)	\$ (1,683,179)
Long-term debt	(1,009,489)	(1,009,489)	(1,136,227)	(1,140,535)
Senior Notes (1)	(3,240,794)	(3,167,166)	(3,235,584)	(3,323,242)
Obligations under finance lease	(58,543)	(80,899)	(65,787)	(80,899)
	(5,960,747)	(5,909,475)	(6,120,777)	(6,227,855)
<i>Financial liabilities measured at fair value through profit or loss (FVTPL)</i>				
Held-for-trading derivatives that are not designated in hedge accounting relationships (see Note 24)	(4,082)	(4,082)	(3,010)	(3,010)
	(4,082)	(4,082)	(3,010)	(3,010)
<i>Derivative instruments in designated hedge accounting relationships (see Note 24)</i>				
	(4,845)	(4,845)	(3,900)	(3,900)
	(4,845)	(4,845)	(3,900)	(3,900)
	\$ (5,969,674)	\$ (5,918,402)	\$ (6,127,687)	\$ (6,234,765)

<sup>(1)</sup> Total fair value of the various Senior Notes is estimated using their last traded prices as at June 30, 2014.

When drawn, bank debt bears interest at a floating rate: accordingly, the fair value approximates the carrying value. Due to the short-term nature of cash and cash equivalents, accounts receivable and other current assets and accounts payable and accrued liabilities, their carrying values approximate their fair values.

The following table summarizes the Company's financial instruments that are carried or disclosed at fair value in accordance with the classification of fair value input hierarchy in *IFRS 7 Financial Instruments - Disclosures*.

**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

June 30, 2014

	Quoted prices in active markets	Significant Observable Inputs	Significant Unobservable Inputs	Total
	Level 1	Level 2	Level 3	
<b>Financial assets at Fair Value</b>				
Held for trading derivatives that are not designated in hedge accounting relationships	-	2,466	-	2,466
Derivative instruments in designated hedge accounting relationships	-	3,832	-	3,832
<b>Financial assets at FVTOCI</b>				
Investments in equity instruments	9,165	-	5,600	14,765
<b>Other Assets</b>				
Loan to Bicentenario	-	130,302	-	130,302
OCENSA receivable	-	10,375	-	10,375
<b>Financial liabilities at Fair Value</b>				
Held for trading derivatives that are not designated in hedge accounting relationships	-	(4,082)	-	(4,082)
Derivative instruments in designated hedge accounting relationships	-	(4,845)	-	(4,845)
<b>Other Liabilities</b>				
Long-term debt	-	(1,009,489)	-	(1,009,489)
Senior notes	(3,167,166)	-	-	(3,167,166)
Obligations under finance lease	-	(80,899)	-	(80,899)

December 31, 2013

	Quoted prices in active markets	Significant Observable Inputs	Significant Unobservable Inputs	Total
	Level 1	Level 2	Level 3	
<b>Financial assets at Fair Value</b>				
Held for trading derivatives that are not designated in hedge accounting relationships	-	328	-	328
Derivative instruments in designated hedge accounting relationships	-	1,820	-	1,820
<b>Financial assets at FVTOCI</b>				
Investments in equity instruments	1,966	-	11,924	13,890
<b>Other Assets</b>				
Loan to Bicentenario	-	41,992	-	41,992
<b>Financial liabilities at Fair Value</b>				
Held for trading derivatives that are not designated in hedge accounting relationships	-	(3,010)	-	(3,010)
Derivative instruments in designated hedge accounting relationships	-	(3,900)	-	(3,900)
<b>Other Liabilities</b>				
Long-term debt	-	(1,140,535)	-	(1,140,535)
Senior notes	(3,323,242)	-	-	(3,323,242)
Obligations under finance lease	-	(80,899)	-	(80,899)

The Company uses Level 1 inputs, being the last quoted price of the traded investments, to measure the fair value of its financial assets at FVTOCI.

## Notes to the Interim Condensed Consolidated Financial Statements

*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

The Company uses Level 2 inputs to measure the fair value of its risk management contracts. The fair values of these contracts are estimated using internal discounted cash flows based upon forward prices and quotes obtained from counterparties to the contracts, taking into account the credit worthiness of those counterparties or the Company's credit rating when applicable.

The Company uses Level 3 inputs to measure the fair value of certain investments that do not have an active market.

### Valuation Techniques

The foreign currency forward contracts are measured based on observable spot exchange rates, and the yield curves of the respective currencies, as well as the currency basis spreads between the respective currencies. The credit risks associated with the counterparties and the Company are estimated based on observable benchmark risk spreads.

Commodity risk management contracts are measured at observable spot and forward WTI prices.

Investment in unquoted ordinary shares which have no observable market data are valued at cost.

## 25. Supplemental Disclosure on Cash Flows

Changes in non-cash working capital are as follows:

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
(Increase) decrease in accounts receivable	\$ (34,677)	\$ 29,836	\$ (51,453)	\$ 118,467
(Increase) decrease in income taxes receivable	84,265	(92,567)	45,610	(82,916)
(Decrease) increase in accounts payable and accruals	46,818	(51,624)	(35,478)	(22,657)
(Increase) decrease in inventories	(5,685)	(16,165)	(13,026)	(7,267)
Increase (decrease) in income taxes payable	(111,770)	(236,676)	(56,654)	(253,568)
Decrease (increase) in prepaid expenses	286	1,375	1,316	(1,507)
	\$ (20,763)	\$ (365,821)	\$ (109,685)	\$ (249,448)
Other cash flow information:				
	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Cash income taxes paid	\$ 46,838	\$ 437,162	\$ 95,288	\$ 570,754
Cash interest paid	94,731	38,064	125,838	67,384
Cash interest received	788	769	1,684	1,507

## 26. Subsequent Events

Subsequent to June 30, 2014, the Company closed a transaction to purchase the approximately 40% interest in the Cubiro block in Colombia that was not already owned by the Company. The cash consideration for the purchase is \$228 million, and may be adjusted upon the certification of the proved and probable reserves from certain prospects located in the block at \$21.93 per barrel. In addition, the Company has granted the seller an exclusive two-year option over certain lead in the block, pursuant to which the seller may acquire a participating interest of between 50% to 100% in the lead, subject to a 100% carry obligation with respect to the next exploratory well to be drilled. The purchase will be accounted for as a business combination by the Company.

## 27. Adoption of IFRS 9

Effective January 1, 2014 the Company has early adopted IFRS 9 (2013) as described in Note 2. As a result, for all comparative periods up to and including the year ended December 31, 2013, the Company prepared its financial statements in accordance with IAS 39. The interim consolidated financial statements for the interim period June 30, 2014, are the first financial statements presented under IFRS 9 (2013). IAS 8 requires that comparative financial information be provided. The adoption of IFRS 9 (2013) includes full retrospective application, with the exception of hedge accounting and other sections identified for prospective application within the standard.



**Notes to the Interim Condensed Consolidated Financial Statements**  
*(Unaudited, U.S.\$ thousands, except share and per share amounts or unless otherwise stated)*

**Classification Effect:**

The adoption of IFRS 9 has had the following classification effects:

	<b>Original measurement category under IAS 39</b>	<b>New measurement category under IFRS 9</b>
Cash and cash equivalents, restricted cash, trade receivables, and other receivables	Loans and receivables	Financial assets at amortized cost
Loans and receivables (Loan to Bicentenario)	Loans and receivables	Financial assets at amortized cost
Investment in equity instruments	Available-for-sale investments	Financial assets at FVTOCI
Accounts payable and accrued liabilities, long-term debt, and finance lease obligation	Loans and receivables	Financial liability at amortized cost
Derivative contracts	Derivatives designated as hedging instruments	Fair value (designated as hedging instruments)
Derivative contracts	Derivatives designated as FVTPL	Derivatives designated as FVTPL

The classification requirements under IFRS 9 have not impacted the measurement or carrying amount.

**Effect of Adoption**

<b>Balance Sheet Line Item Impact</b>	<b>As at December 31, 2013</b>	<b>Effect of IFRS 9 Adoption</b>	<b>After Adoption As at December 31, 2013</b>	<b>As at January 1, 2013</b>	<b>Effect of IFRS 9 Adoption</b>	<b>After Adoption As at January 1, 2013</b>
<b>Equity</b>						
Time value for hedging instruments reserve	\$ -	\$ (3,092)	\$ (3,092)	\$ -	\$ (7,415)	\$ (7,415)
Retained earnings	1,389,192	3,092	1,392,284	1,154,547	7,415	1,161,962
<b>Comprehensive Income Line Item Impact</b>	<b>Three months ended June 30, 2013</b>	<b>Effect of IFRS 9 Adoption</b>	<b>After Adoption Three months ended June 30, 2013</b>	<b>Six months ended June 30, 2013</b>	<b>Effect of IFRS 9 Adoption</b>	<b>After Adoption Six months ended June 30, 2013</b>
<b>Statements of Income</b>						
Foreign exchange (loss) gain	\$ (15,082)	\$ 8,547	\$ (6,535)	\$ 2,753	\$ 5,683	\$ 8,436
<b>Statements of other comprehensive income</b>						
Unrealized gain (loss) on the time value of cash flow hedges	-	8,547	8,547	-	5,683	5,683
<b>EPS-Basic</b>	0.20	0.03	0.23	0.61	0.02	0.63
<b>EPS-Diluted</b>	0.20	0.03	0.23	0.60	0.02	0.62

**Explanation of IFRS 9 Adoption Adjustments**

*Time Value Reserve*

Under IAS 39, the time value component of option instruments was recognized in earnings at each date of the Interim Consolidated Statement of Financial Positions. Conversely, IFRS 9 requires the option time value of a hedging relationship to be deferred in other comprehensive income for the duration of the relationship. Retrospective adjustment for the time value of option is required.