MANAGEMENT'S REPORT TO SHAREHOLDERS

The accompanying consolidated financial statements of Orca Exploration Group Inc. are the responsibility of the Directors. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

The consolidated financial statements have been prepared by management, on behalf of the Board, in accordance with the accounting policies disclosed in the notes to the consolidated financial statements. Where necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality and are in accordance with International Financial Reporting Standards appropriate in the circumstances.

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures and has concluded that such disclosure controls and procedures are effective.

Management maintains appropriate systems of internal controls. Policies and procedures are designed to give reasonable assurance that transactions are properly authorised, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements. An independent firm of Chartered Accountants, as appointed by the Shareholders, audited the consolidated financial statements in accordance with the Canadian Generally Accepted Auditing Standards and International Auditing Standards to enable them to express an opinion on the fairness of the consolidated financial statements in accordance with International Financial Reporting Standards.

The Board of Directors carries out its responsibility for the financial reporting and internal controls of the Company principally through an Audit Committee. The committee has met with external auditors and Management in order to determine if Management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

W. David Lyons
Chairman and Chief Executive Officer
24 April 2014

Robert S. Wynne
Chief Financial Officer and Director
24 April 2014

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Orca Exploration Group Inc.

We have audited the accompanying consolidated financial statements of Orca Exploration Group Inc., which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012, the consolidated statements of comprehensive (loss)/income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Orca Exploration Group Inc. as at December 31, 2013 and December 31, 2012, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Emphasis of matter

Without modifying our opinion, we draw attention to Note 1 to the consolidated financial statements which describes that there is no certainty that the company will be able to collect its receivables to fund ongoing operations and exploration and development program. This condition set forth in Note 1, indicates the existences of a material uncertainty that may cast significant doubt about the company's ability to continue as a going concern.

KPMG LLP

Chartered Accountants

24 April 2014
Calgary, Canada

CONSOLIDATED STATEMENT OF COMPREHENSIVE (LOSS)/INCOME

US$'000s except per share amounts	*NOTE*	YEAR ENDED 31 DECEMBER 2013	2012
REVENUE	*6,7*	**54,718**	77,259
Cost of sales			
Production and distribution expenses		**(4,426)**	(5,953)
Depletion expense		**(12,166)**	(8,968)
		38,126	62,338
General and administrative expenses		**(15,428)**	(17,989)
Exploration asset impairment	*12*	**(158)**	(8,284)
Finance income	*9*	**2,646**	23
Finance costs	*9*	**(28,908)**	(634)
(Loss)/profit before tax		**(3,722)**	35,454
Income taxes	*10*	**(1,743)**	(17,125)
(Loss)/profit after tax		**(5,465)**	18,329
Foreign currency translation (loss)/gain from foreign operations		**(392)**	89
Total comprehensive (loss)/income for the period		**(5,857)**	18,418
(Loss)/earnings per share			
Basic *(US$)*	*17*	**(0.17)**	0.53
Diluted *(US$)*	*17*	**(0.17)**	0.52

See Going Concern (Note 1) and accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

US$'000s	*NOTE*	AS AT **31 Dec 2013**	AS AT 31 Dec 2012
ASSETS			
Current Assets			
Cash	*3*	**32,588**	16,047
Trade and other receivables	*11*	**37,215**	73,495
Tax receivable	*10*	**14,585**	14,692
Prepayments		**281**	246
		84,669	104,480
Non-Current Assets			
Long-term trade receivable	*11*	**29,911**	–
Exploration and evaluation assets	*12*	**5,564**	5,720
Property, plant and equipment	*13*	**90,832**	102,044
		126,307	107,764
Total Assets		**210,976**	212,244
EQUITY AND LIABILITIES			
Current Liabilities			
Trade and other payables	*14*	**53,296**	45,496
Bank loan	*15*	**1,659**	5,842
Tax payable		**1,958**	6,322
		56,913	57,660
Non-Current Liabilities			
Deferred income taxes	*10*	**12,132**	20,399
Deferred additional profits tax	*10*	**21,679**	8,250
		33,811	28,649
Total Liabilities		**90,724**	86,309
Equity			
Capital stock	*16*	**85,428**	84,983
Contributed surplus		**6,482**	6,753
Accumulated other comprehensive (loss)/income		**(303)**	89
Accumulated income		**28,645**	34,110
		120,252	125,935
Total Equity and Liabilities		**210,976**	212,244

See accompanying notes to the consolidated financial statements.
Going concern (Note 1)
Contractual obligations and committed capital investment (Note 19)
Contingencies (Note 20)

The consolidated financial statements were approved by the Board of Directors on 24 April 2014.

W H Smith

Director

Director

CONSOLIDATED STATEMENT OF CASH FLOWS

US$'000s	NOTE	YEAR ENDED 31 DECEMBER 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES			
(Loss)/Profit after tax		**(5,465)**	18,329
Adjustment for:			
Depletion and depreciation	13	**12,498**	9,281
Exploration asset impairment	12	**158**	8,284
Provision for doubtful debt	9	**10,531**	–
Discount on long-term receivable	9	**17,073**	–
Stock-based compensation	16	**(209)**	1,152
Deferred income taxes	10	**(8,267)**	5,205
Deferred additional profits tax	7, 10	**13,429**	3,463
Interest income	9	**–**	(23)
Interest expense	9	**678**	315
Unrealised loss on foreign exchange		**(586)**	258
Funds flow from operating activities		**39,840**	46,264
Decrease/(increase) in trade and other receivables		**25,845**	(33,133)
Decrease/(increase) in tax receivable		**107**	(8,812)
(Increase)/decrease in prepayments		**(35)**	56
Increase in trade and other payables		**8,082**	22,589
(Decrease)/increase in taxation payable		**(4,364)**	3,919
Increase in long-term receivable		**(46,984)**	–
Net cash flows from operating activities		**22,491**	30,883
CASH FLOWS USED IN INVESTING ACTIVITIES			
Exploration and evaluation expenditures	12	**(2)**	(11,083)
Property, plant and equipment expenditures	13	**(1,286)**	(43,612)
Interest received	9	**–**	23
Increase in trade and other payables		**–**	(716)
Net cash used in investing activities		**(1,288)**	(55,388)
CASH FLOWS (USED IN)/FROM FINANCING ACTIVITIES			
Normal course issuer bid	16	**–**	(12)
Bank loan proceeds	15	**4,000**	5,842
Bank loan repayments	15	**(8,183)**	–
Interest paid	9	**(678)**	(315)
Proceeds from exercise of options		**174**	150
Net cash flow (used in)/from financing activities		**(4,687)**	5,665
Increase/(decrease) in cash		**16,516**	(18,840)
Cash at the beginning of the year		**16,047**	34,680
Effect of change in foreign exchange on cash in hand		**25**	207
Cash at the end of the year		**32,588**	**16,047**

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

US$'000	Capital stock	Contributed surplus	Cumulative Translation adjustment	Accumulated Income	Total
Balance as at 1 January 2013	84,983	6,753	89	34,110	125,935
Options exercised	445	(271)	–	–	174
Foreign currency translation adjustment on foreign operations	–	–	(392)	–	(392)
Loss after tax for the period	–	–	–	(5,465)	(5,465)
Balance as at 31 Dec 2013	**85,428**	**6,482**	**(303)**	**28,645**	**120,252**

US$'000	Capital stock	Contributed surplus	Cumulative Translation adjustment	Accumulated Income	Total
Balance as at 1 January 2012	84,610	6,268	–	15,781	106,659
Stock based compensation	–	720	–	–	720
Options exercised	383	(233)	–	–	150
Normal course issuer bid	(10)	(2)	–	–	(12)
Foreign currency translation adjustment on foreign operations	–	–	89	–	89
Profit after tax for the period	–	–	–	18,329	18,329
Balance as at 31 Dec 2012	**84,983**	**6,753**	**89**	**34,110**	**125,935**

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

General Information

Orca Exploration Group Inc. was incorporated on 28 April 2004 under the laws of the British Virgin Islands. The Company produces and sells natural gas to the power and industrial sectors in Tanzania and has gas and oil exploration interests in Italy.

The consolidated financial statements of the Company as at and for the year ended 31 December 2013 comprise accounts of the Company and all its wholly owned subsidiaries (collectively, the "Company" or "Orca Exploration") and were authorised for issue in accordance with a resolution of the directors on 24 April 2014.

1 GOING CONCERN

These financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying amounts of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications.

The ability of the Company to continue as a going concern is dependent on the Company's ability to collect its receivables from Government entities to fund on-going operations and the exploration and development program. The continuing weakness in the financial position of the state utility, TANESCO, has created uncertainty as to whether the Company will be able to collect cash to continue operations and meet its commitments. The immediate need to collect from its debtors may create significant doubt about the Company's ability to continue as a going concern.

In the event that Company does not collect from TANESCO the balance of the outstanding receivables at 31st December 2013 and TANESCO continues to be unable to pay the Company for subsequent 2014 gas deliveries, the Company will need additional funding for its ongoing operations before the end of the current fiscal year. There are no guarantees that such additional funding will be available when needed, or will be available on suitable terms. The Company has served notice to TANESCO demanding payment in full and is reviewing legal options available to collect the arrears and mitigate a further increase in arrears, including but not limited to suspending gas deliveries to TANESCO.

The material uncertainties that may cast significant doubt on the Company's ability to continue as a going concern are set forth below. The Company generates in excess of 65% of its operating revenue from sales to the Power sector companies, Songas and TANESCO. The financial security of Songas is heavily reliant on the payment of capacity and energy charges by TANESCO, which in turn is dependent on the Government of Tanzania to subsidise a significant portion of TANESCO's operating budget. Prior to 2012, despite having a history of delayed payments, TANESCO had settled in full the outstanding balance subsequent to each quarter end.

At 31 December 2013, TANESCO owed the Company US$56.6 million gross prior to discount (including arrears of US$51.5 million) compared to US$33.3 million (including arrears of US$28.4 million) as at 31 December 2012. During the year the Company received a total of US$49.6 million (2012: US$16.4 million) from TANESCO and, subsequent to year-end, TANESCO paid the Company a further US$6.4 million. As of the date of this report, the outstanding balance is US$64.9 million of which US$60.2 million is in arrears.

At the end of Q1 2013, the World Bank approved a Tanzania First Power and Gas Development Policy Operation ("DPO") of US$100 million, the first in a programme of three contemplated operations. The objective of the program is to: (i) strengthen the Tanzania's ability to bridge the financial gap in its power sector; (ii) reduce the cost of power supply and promote private sector participation in the power sector; and (iii) strengthen the policy and institutional framework for the management of the country's natural gas resources. TANESCO made tangible progress in late 2013 towards sustainability in securing a 39% power tariff increase from the energy regulator, the Energy Water Utilities Regulatory Authority ("EWURA"). This was an important condition of the advancement of the Second US$100 million Power and Gas DPO, approved on 26 March 2014 and expected to be disbursed in Q2 2014. The Company received significant payments of approximately US$18.7 million in 2013 from TANESCO around the time of the disbursement of the First DPO and as at the date of this report has yet to be informed as to the quantum of payments if any which may be made as a result of the Second DPO.

Management continues to believe that TANESCO will ultimately settle its debts with the Company. As at the date of this report, however, there is no set schedule or repayment plan for TANESCO arrears proposed or agreed with the Company and payments have been irregular and unpredictable. Based on the actual repayment history as at 31 December 2013, US$9.6 million (2012: US$33.3 million) of the TANESCO receivable was classified as current and US$47.0 million (2012: nil) was classified as long-term. A discount of US$17.1 million has been taken against the TANESCO receivable to reflect the estimated finance cost of delay in collections. The trade receivable was discounted using a risk adjusted discount rate of 15% to reflect the cost of delayed timing of collections from TANESCO. The discount rate and the expected timing of the collections are reviewed at each period end with any adjustments recorded in the period that the estimates are changed.

As at 31 December 2013, Songas owed the Company US$24.8 million (2012: US$24.6 million), whilst the Company owed Songas US$16.9 million (2012: US$18.6 million). There is no contractual right to offset these amounts, although in practice the companies have set off receivables and payables. As at the year-end, Songas and the Company formally offset payable and receivable balances of US$17.5 million. Subsequent to the end of the year, the Company has neither received nor paid any amounts in settlement of these balances. Amounts due to Songas primarily relate to pipeline tariff charges of US$15.4 million (2012: US$17.5 million), whereas the amounts due to the Company are mainly for sales of gas of US$11.6 million (2012: US$14.3 million) and for the operation of the gas plant for US$13.3 million (2012: US$10.3 million). The operation of the gas plant is conducted at cost and the charges are billed to Songas on a flow through basis without profit margin. Due to the time for which the set off has been outstanding and the lack of evidence of cash payments from Songas, the Company was unable to recognize the net Songas receivable as at the end of the year and accordingly provided a provision against same (see Note 9). Management continues to negotiate with Songas to reach an offsetting agreement and if, and when, such agreement is reached, the related provision for bad debts will be reversed. Any amounts which are not agreed will be pursued by the Company through the dispute mechanisms provided in its agreements with Songas.

In 2012, to help alleviate the funding gap caused by the delays in TANESCO payments the Company entered into a US$10 million debt facility with a bank in Tanzania. By February 2013, the Company had drawn down the facility. Repayments commenced in March 2013 and the loan balance as at 31st December 2013 was US$1.7 million. By February 2014, the loan had been fully repaid.

2 BASIS OF PREPARATION

These consolidated financial statements have been prepared on a historical cost basis and have been prepared using the accrual basis of accounting. The consolidated financial statements are presented in US dollars.

A) Statement of Compliance

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

B) Basis of consolidation

i) Subsidiaries

The consolidated financial statements include the accounts of Orca Exploration Group Inc. and all its wholly owned subsidiaries (collectively, the "Company"). Subsidiaries are those enterprises controlled by the Company. The following companies have been consolidated within the Orca Exploration financial statements:

Subsidiary	Registered	Holding	Functional currency
Orca Exploration Group Inc.	British Virgin Islands	Parent Company	US dollar
Orca Exploration Italy Inc.	British Virgin Islands	100%	Euro
Orca Exploration Italy Onshore Inc.	British Virgin Islands	100%	Euro
PAE PanAfrican Energy Corporation	Mauritius	100%	US dollar
PanAfrican Energy Tanzania Limited	Jersey	100%	US dollar
Orca Exploration UK Services Limited	United Kingdom	100%	UK Pound Sterling

ii) Transactions eliminated upon consolidation

Inter-company balances and transactions, and any unrealised gains or losses arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

C) Foreign currency

i) Foreign currency transactions

Transactions in foreign currencies are recorded at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated at period-end rates. Non-monetary items are translated at historic rates, unless such items are carried at market value, in which case they are translated using the exchange rates that existed when the values were determined. Any resulting exchange rate differences are recognized in the profit and loss.

ii) Foreign currency translation

Orca Exploration Italy Inc. and Orca Exploration Italy Onshore Inc. use the Euro and Orca UK Services uses Pound Sterling as their functional currencies. The assets and liabilities of these companies are translated into US dollars at the period-end exchange rate. The income and expenses of the companies are translated into US dollars at the average exchange rate for the period. Translation gains and losses are included in other comprehensive income.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Company.

A) EXPLORATION AND EVALUATION ASSETS, PROPERTY, PLANT AND EQUIPMENT

i) Exploration and evaluation assets

Exploration and evaluation costs are capitalised as intangible assets. Intangible assets includes lease and license acquisition costs, geological and geophysical costs and other direct costs of exploration and evaluation which the directors consider to be unevaluated until reserves are appraised to be commercially viable and technologically feasible as commercial, at which time they are transferred to property, plant and equipment following an impairment review and depleted accordingly. Where properties are appraised to have no commercial value or are appraised at values less than book values, the associated costs are treated as an impairment loss in the period in which the determination is made.

ii) Property, plant and equipment

Property, plant and equipment comprises the Company's tangible natural gas assets, development wells, together with leasehold improvements, computer equipment, motor vehicles and fixtures and fittings and are carried at cost, less any accumulated depletion, depreciation and accumulated impairment losses. Cost includes purchase price and construction costs for qualifying assets. Depletion of these assets commences when the assets are ready for their intended use. Only costs that are directly related to the discovery and development of specific oil and gas reserves are capitalised. The cost associated with tangible natural gas assets are amortised on a field by field unit of production method based on commercial proven reserves. The calculation of the unit of production amortisation takes into account the estimated future development cost of the field.

iii) Impairment of exploration and evaluation assets, property, plant and equipment

At each balance sheet date, the Company reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. Individual assets are grouped together as a cash generating unit ("CGU") for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are independent from other group assets. In the case of exploration and evaluation assets, this will normally be at the CGU level. If any such indication of impairment exists, the Company makes an estimate of its recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down to its recoverable amount. In assessing the value in use, the estimated future cash flows are adjusted for the risks specific to the cash generating unit and are discounted to their present value with a pre-tax discount rate that reflects the current market indicators. The fair value less costs to sell is the amount that would be obtained from the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. Where an impairment loss subsequently reverses, the carrying amount of the asset CGU is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the CGU in prior years. A reversal of an impairment loss is recognised as income immediately.

B) OPERATORSHIP

The Company operates the Songo Songo gas field, flow lines and gas processing plant. The Songas wells, flowlines and gas plant are operated by the Company on behalf of Songas on a no cost no profit basis. The cost of operating and maintaining the wells and flow lines is paid for by the Company and Songas in proportion to the respective volumes of Protected Gas and Additional Gas sales. The costs of operating and maintaining the wells and flow lines are reflected in the accounts to the extent that the costs were incurred to accomplish Additional Gas sales. The cost of operating the gas processing plant and pipeline to Dar es Salaam is paid by Songas. When there are Additional Gas sales, a tariff is paid to Songas as compensation for using the gas processing plant and pipeline. This tariff is netted against revenue.

C) EMPLOYMENT BENEFITS

i) Pension

The Company does not operate a pension plan, but it does make defined contributions to the statutory pension fund for employees in Tanzania. Obligations for contributions to the statutory pension fund are recognised as an expense in the income statement as incurred.

ii) Stock options

The stock option plan provides for the granting of stock options to directors, Company officers, key personnel and employees to acquire shares at an exercise price determined by the market value at the date of grant. The exercise price of each stock option is determined at the closing market price of the Class B shares on the day prior to the day of grant. Each stock option granted permits the holder to purchase one Class B share at the stated exercise price. The Company records a charge to the profit and loss account using the Black-Scholes fair valuation option pricing model. The valuation is dependent on a number of estimates, including the risk free interest rate, the level of stock volatility, together with an estimate of the level of forfeiture. The level of stock volatility is calculated with reference to the historic traded daily closing share price at the date of issue.

iii) Stock appreciation rights

Stock appreciation rights are issued to certain key managers, officers, directors and employees. The fair value of stock appreciation rights is expensed in the profit and loss in accordance with the service period. The fair value of the stock appreciation rights is revalued every reporting date with the change in the value recognized in the income statement.

D) ASSET RETIREMENT OBLIGATIONS

No provision has been made for future site restoration costs in Tanzania because the Company currently has no legal or contractual or constructive obligation under the Songo Songo Production Sharing Agreement ("PSA") to restore the fields at the end of their commercial lives, should such occur within the term of the PSA. At such a time as the Company may be granted an extension of the term of the PSA, which encompasses the end of the field life, or other amendment to the PSA which requires the Company to do so, a provision will be made for future site restoration costs.

E) REVENUE RECOGNITION, PRODUCTION SHARING AGREEMENTS AND ROYALTIES

Pursuant to the terms of the PSA , the Company has exclusive rights to (i) to carry on Exploration Operations in the Songo Songo Gas Field; (ii) to carry on Development Operations in the Songo Songo Gas Field and (iii) jointly with Tanzania Petroleum Development Corporation ("TPDC"), a "parastatal entity" to sell or otherwise dispose of Additional Gas. Additional Gas is all the gas produced in excess of Protected Gas. Songas utilizes the Protected Gas (maximum 45.1 MMcfd on any given day, non-cumulative) as feedstock for its gas turbine electricity generators at Ubungo, for onward sale to the Wazo Hill cement plant and for electrification of certain villages along the pipeline route. The Company receives no revenue for the Protected Gas delivered to Songas.

The Company recognises revenue related to Additional Gas sales when title passes to a customer. Under the terms of the PSA, the Company pays both its share and the parastatal's share of operating, administrative and capital costs. The Company recovers all reasonably incurred operating, administrative and capital costs including the parastatal's share of these costs from future revenues over several years ("Cost Gas"). The parastatal's share of operating and administrative costs, are recorded in operating and general and administrative costs when incurred and capital costs are recorded in 'Property, plant and equipment'. All recoveries are recorded as Cost Gas in the year of recovery.

In any given year, the Company is entitled to recover as Cost Gas up to 75% of the net revenue (gross revenue less processing and pipeline tariffs). Any net revenue in excess of the Cost Gas ("Profit Gas") is shared between the Company and TPDC in accordance with the terms of the PSA. Revenue represents the Company's share of Cost Gas and Profit Gas during the period.

F) ADDITIONAL PROFITS TAX

Under the terms of the PSA, in the event that all costs have been recovered with an annual return from the PSA of 25% plus the percentage change in the United States Industrial Goods Producer Price Index, an additional profits tax ("APT") is payable to the Government of Tanzania. This tax is considered to be a royalty and is netted against revenue. Deferred APT is provided for by forecasting the total APT payable as a proportion of the forecast Profit Gas over the term of PSA license. The actual APT that will be paid is dependent on the achieved value of the Additional Gas sales and the quantum and timing of the operating costs and capital expenditure programme.

G) INCOME TAXES

Income tax on the profit for the year comprises current and deferred tax. The Company is liable for Tanzanian income tax, but this is recovered from TPDC through the Profit Gas sharing arrangement embedded in the PSA. Where current income tax is payable, the Company's revenue is adjusted for the amount of current tax payable and the income tax is shown as current tax. Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of carrying amounts of assets and liabilities using tax rates substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefits will be realised.

H) DEPRECIATION

Depreciation for non-natural gas properties is charged to the income statement on a straight line basis over the estimated useful economic lives of each class of asset. The estimated useful lives are as follows:

Leasehold improvement	Over remaining life of the lease
Computer equipment	3 years
Vehicles	3 years
Fixtures and fittings	3 years

I) FINANCIAL INSTRUMENTS

All financial instruments are initially recognized at fair value on the consolidated statement of financial position. The Company has classified each financial instrument into one of the following categories: (i) fair value through profit and loss, (ii) loans and receivables, and (iii) other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets and liabilities are offset and the net amount is reported on the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

Initial recognition

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit and loss:

A financial asset or liability classified in this category is recognized at each period at fair value with gains and losses from revaluation being recognized in net income. A financial asset or liability is classified in this category if acquired principally for the purpose of selling or re-purchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges.

(ii) Loans and receivables:

Loans and receivables are initially measured at fair value plus directly attributable transaction costs and are subsequently recorded at amortized cost using the effective interest method.

Long-term receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Long-term receivables are initially recognized at fair value based on the discounted cash flows. The discount rate is based on the credit quality and term of the financial instrument. The financial instrument is subsequently valued at amortized costs by accreting the instrument over the expected life of the assets. The accretion associated with instrument valued at amortized cost is reported on the statement of comprehensive loss each reporting period. The carrying amount of the long-term receivable less discounts represents the fair value of the receivable.

The fair value of the Company's trade and other receivables approximates their carrying values due to the short-term nature of these instruments.

(iii) Other financial liabilities:

Trade and other payables and the bank loan are classified as other financial liabilities and are initially measured at fair value less directly attributable transaction costs and are subsequently recorded at amortized cost using the effective interest method. The fair value of the other financial liabilities approximates the carrying amounts due to the short-term nature of these instruments.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, term deposits and short term highly liquid investments with the original term to maturity of three months or less, which are convertible to known amounts of cash and which, in the opinion of management, are subject to an insignificant risk of changes in value. The fair value of cash and cash equivalents approximates their carrying amount. As at 31 December 2013 US$9.8 million was held in Tanzania and there are no restrictions on the movement of funds out of Tanzania.

Impairment of financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

J) CONTRIBUTED SURPLUS

This is used to record two types of transactions:

(i) To recognise the fair value of equity settled stock based compensation expensed in the year.

(ii) To account for the difference between the aggregated book value of the shares purchased under the normal course issuer bid and the actual consideration.

K) EARNINGS OR LOSS PER SHARE (“EPS”)

Basic earnings or loss per share is calculated by dividing profit or loss attributable to owners of the Company (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period. The denominator is calculated by adjusting the shares outstanding at the beginning of the period by the number of shares bought back or issued during the period, multiplied by a time-weighting factor.

Diluted EPS is calculated by adjusting the earnings and number of shares for the effects of all dilutive potential ordinary shares deemed to have been converted at the beginning of the period or if later, the date of issuance. The effects of anti-dilutive potential ordinary shares are ignored in calculating diluted EPS. All options are considered anti-dilutive when the Company is in a loss position.

L) NEW ACCOUNTING STANDARDS AND INTERPRETATIONS

On 1st January 2013, the Company adopted new standards with respect to IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosures of Interests in Other Entities, as well as the consequential amendments to IAS 28 Investments in Associates and Joint Ventures (2011), IFRS 13 Fair Value Measurement and IFRS 7 Amendments to Financial Instrument Disclosures. The adoption of these standards had no impact on the amounts recorded in the financial statements.

M) RECENT ACCOUNTING PRONOUNCEMENTS

The following standards, amendments and interpretations applicable to the Company are in issue but not yet effective and have not been adopted in these consolidated financial statements. The Company has not yet determined the impact of the adoption of these amendments.

NEW AND AMENDED STANDARDS		Effective for annual periods beginning on or after
IAS 19 (amendments)	Employee Contributions	1 July 2014
IAS 32 (amendments)	Offsetting Financial Assets and Liabilities	1 January 2014
IFRIC 21	Liability for Levies	1 January 2014

4 USE OF ESTIMATES AND JUDGEMENTS

In applying the Company's accounting policies, which are described in Note 3, management makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, vary to the actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

I) RESERVES

There are numerous uncertainties inherent in estimating quantities of proved and probable reserves and cash flows to be derived therefrom, including many factors beyond the control of the Company. The reserve and cash flow information contained herein represents estimates only. The reserves and estimated future net cash flow from the Company's properties have been independently evaluated by McDaniel & Associates Consultants Ltd. ("McDaniel"), independent petroleum engineers. These evaluations include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, abandonment provisions, crude oil price differentials to benchmarks, future prices of oil and natural gas, operating costs, transportation costs, cost recovery provisions and royalties, TPDC "back-in" methodology and other government levies that may be imposed over the producing life of the reserves. These assumptions were based on price forecasts in use at the date of the relevant evaluations were prepared and many of these assumptions are subject to change and are beyond the control of the Company. For the purpose of the reserves certification as at 31 December 2013, based on an assumption of economically rational behaviour, it was assumed that TPDC will 'back-in' for 20% for all future new drilling activities as determined by the current development plan and this is reflected in the Company's net reserve position.

Reserves are integral to the amount of depletion charged to the profit or loss.

II) CARRYING VALUE OF EXPLORATION AND EVALUATION ASSETS AND PROPERTY, PLANT AND EQUIPMENT

Under the Company's accounting policy expenditures incurred on the exploration for, and evaluation of, reserves are capitalized as intangible assets. These intangibles assets are then assessed for impairment when circumstances suggest that the carrying amount may exceed its recoverable value. Such circumstances include but are not limited to:

- the period for which the Company has the right to explore in the specific area has expired during the period, or will expire in the near future, and is not expected to be renewed;
- no further expenditure on exploration and evaluation is budgeted or planned;
- no reserves have been encountered;
- the evaluation of seismic data indicates that the reserves are unlikely to be of a commercial quantity;
- the quantity of hydrocarbon reserves are deemed not to be of commercially viable quantities and the entity has decided to discontinue further activities; and
- sufficient data exists to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

The assessment for impairment involves estimates as to (i) the likely future commerciality of the asset and when such commerciality should be determined, (ii) future revenues and costs associated with the asset, and (iii) the discount rate to be applied to such revenues and costs for the purpose of deriving a recoverable value.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are grouped by concession.

The technical feasibility and commercial viability of extracting a resource is considered to be determinable based on several factors including the assignment of proven reserves. A review of each exploration license or field is carried out, at least annually, to ascertain whether the project is technically feasible and commercially viable. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to a separate category within property and equipment referred to as oil and natural gas interests.

Management performs impairment tests on the Company's property, plant and equipment assets if indicators of impairment are present. The assessment of impairment indicators is subjective and considers the various internal and external factors such as the financial performance of individual CGUs, market capitalization and industry trends. If impairment indictors are present an impairment test is required to be performed and the CGU is written down to its recoverable amount. Key assumptions to determine the recoverable amount relate to prices that are based on forward curves, long-term assumptions and discount rates that are risked to reflect conditions specific to individual assets.

III) FAIR VALUE OF STOCK BASED COMPENSATION

All stock options issued or stock appreciation rights granted by the Company are required to be valued at their fair value. In assessing the fair value of the equity based compensation, estimates have to be made as to (i) the volatility in share price, (ii) the risk free rate of interest, and (iii) the level of forfeiture. In the case of stock options, this fair value is estimated at the date of issue and is not revalued, whereas the fair value of stock appreciation rights is recalculated at each reporting period.

IV) COST RECOVERY

The Company is able to recover reasonable costs incurred on the development of the Songo Songo project out of 75% of the gross revenues less processing and pipeline tariffs ("Net Revenue"). There are inherent uncertainties in estimating when costs have been recovered as these costs are subject to government audit and in exceptional circumstances a potential reassessment after the elapse of a considerable period of time. Currently approximately US$34 million in cost recoveries for the period 2001 to 2009 have been denied by TPDC, which audit finding is now the subject of a Notice of Dispute by the Company.

V) COLLECTABILITY OF RECEIVABLES

The Company considers the Songas and TANESCO receivables to be collectable, despite being long overdue. Both Songas and the Company have been impacted by TANESCO's inability to pay. There have been acknowledgements by TANESCO and the Ministry of Energy and Minerals ("MEM") of the debt and the importance of addressing same. The recent Tanzania First and Second Power and Gas DPOs by the World Bank to ensure TANESCO's viability support management's view that the debts will be paid (see "Going Concern"). Given the irregularity and unpredictability of payments, the timing of repayment remains uncertain. Consequently management has reclassified an element of the TANESCO debt as long-term and has discounted the value of the receivable. The discount applied to the TANESCO receivable is based on a probabilistic assessment by management of a multi-scenario discounted cash flow model which incorporates a number of assumptions as to the timing and amount of cash receipts from TANESCO, timing of World Bank DPO disbursements to the Government of Tanzania, status of negotiations with the Government and/or World Bank for partial risk guarantees, expected operational start date for the NNGIP in Tanzania and the potential for an arbitration settlement. These assumptions are subject to change due to factors which are beyond the control of the Company. The Company has made a provision against the net Songas receivable, as ultimately the ability of Songas to pay is in turn dependent upon TANESCO settling is liabilities to Songas.

The Company has a substantial "Tax Receivable" balance. This arises from the revenue sharing mechanism within the PSA which entitles the Company to a share of revenue equivalent to its tax charge, grossed up at the prevailing rate. These amounts are collected by way of an offset against TPDC's share of revenue, as and when the Company pays its tax.

VI) TPDC BACK-IN

TPDC has previously indicated a wish to exercise its right under the PSA to 'back in' to the Songo Songo field development and a further wish to convert this into a carried interest in the PSA. The current terms of the PSA require TPDC to provide formal notice in a defined period and contribute a proportion of the costs of any development, sharing in the risks in return for an additional share of the gas. To date, TPDC has not contributed any costs. TPDC back-in rights and the potential conversion of these rights into a carried working interest were discussed with the GNT along with other issues, however conditions precedent to any potential change in the terms of the PSA as a result of the GNT were not met by the Government and as such the Company continues to stand behind the original terms of the PSA. The issue of any change to TPDC's back-in rights has therefore not been resolved. Should an amendment to the PSA be agreed in future relating to back-in rights, the impact on reserves and accounting estimates will be assessed at that time and reflected prospectively.

For the purpose of the reserves certification as at 31 December 2013, it was assumed that, on the basis of economically rational behavior, TPDC will elect to 'back-in' for 20% for all future new drilling activities with-in the prescribed period as determined by the current development plan and this is reflected in the Company's net reserve position.

VII) TPDC MARKETING COSTS

Under the Songo Songo PSA, all reasonable marketing costs including those incurred by TPDC, with the prior approval by the Company are recoverable. TPDC has to date attempted to claim US$3.6 million in marketing costs from the Company. Management reviewed the claims and can demonstrate that there was no prior approval for such costs, no supporting documentation provided evidencing the expenditure, and further believes the nature of the costs to be unreasonable and not related to marketing the downstream business. Accordingly the Company has rejected the claim by TPDC.

VIII) TAXATION

During 2013 the Company received a number of assessments for additional tax from the Tanzania Revenue Authority ("TRA"), which together with interest penalties total US$18.4 million. Management together with tax advisors have reviewed each of the assessments and believe them to be without merit. The Company has appealed against assessments for additional withholding tax and employment related taxes, and has filed formal objections against TRA's claims for additional corporation tax and VAT.

The Tax Revenue Appeals Board considered the Company's appeal against a withholding tax assessment of US$2.4 million in March 2013 and upheld the assessment. The Company then appealed to Tax Revenue Appeals Tribunal whose decision is awaited. Although a similar appeal to the Tribunal has been decided in favour of TRA, management continues to believe this assessment is flawed and, if necessary, will pursue the case in the Court of Appeal where a similar case is currently being heard.

The Company based on advice believes it has strong support, on the basis of tax legislation and the terms of the PSA, for its objection to the additional income tax assessment of US$7.8 million, including penalties. In the event that the Company's objection is overturned, any additional tax payable will be recoverable from TPDC under the terms the PSA.

The Company has filed an objection against a further assessment of VAT, which together with penalties totals US$7.5 million. Again, the Company based on advice believes that it has strong grounds for objecting to this assessment and accordingly has made no provision.

The Company has received an assessment of US$0.7 million in respect of employment related taxes which TRA believe to have been underpaid. The Company does not accept TRA's finding and has appealed.

Management continues to review the progress of the above appeals and objections and, as of the date of this report, does not believe any provision is required.

5 RISK MANAGEMENT

The Company, by its activities in oil and gas exploration, development and production, is exposed to the risk associated with the unpredictable nature of the financial markets as well as political risk associated with conducting operations in an emerging market. The Company seeks to manage its exposure to these risks wherever possible.

I) FOREIGN EXCHANGE RISK

Foreign exchange risk arises when transactions and recognised assets and liabilities of the Company are denominated in a currency that is not the US dollar functional currency.

The Company operates internationally and is exposed to foreign exchange risk arising from currency exposures to US dollars. The main currencies to which the Company has an exposure are: Tanzanian shillings, UK pounds sterling, Euros and Canadian dollars.

The majority of the expenditure associated with the operation of the gas distribution system is denominated in Tanzanian shillings. The majority of the consultants' contracts are denominated in UK pounds sterling. All of the capital stock, equity financing and any associated stock based compensation are denominated in Canadian dollars. All of the operational revenue and the majority of capital expenditure are denominated in US dollars.

There are no forward exchange rate contracts in place.

A 10% increase in the US dollar against the relevant foreign currency would result in an overall increase in working capital of US$0.6 million to US$28.3 million and a reduction in the loss before tax to US$3.1 million. The sensitivity includes only outstanding foreign currency denominated monetary items and adjusts their translation at period end for a 10% change in the foreign currency rates. A 10% sensitivity rate is used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonable possible change in foreign exchange rates.

The following balances are denominated in foreign currency (stated in US Dollars at period end exchange rates):

Balances as at December 31, 2013 *US$'000s*	Canadian Dollars	Tanzanian Shillings	Other currencies	Total
Cash	96	1,394	1,066	2,556
Trade and other receivables	–	19,506	400	19,906
Trade and other payables	(139)	(27,724)	(992)	(28,855)
	(44)	(6,824)	474	(6,393)

II) COMMODITY PRICE RISK

The Songo Songo gas field is the first gas field to be developed in East Africa. The Company has therefore been able to negotiate industrial gas sales contracts with gas prices that are at a discount to the lowest cost alternative fuels in Dar es Salaam, namely Heavy Fuel Oil ("HFO") and coal. The price of HFO is exposed to the volatility in the market price of crude oil.

III) INTEREST RATE RISK

The Company has a medium term loan which is repayable in twelve instalments, beginning in March 2013. The interest rate is defined in relation to LIBOR and the exposure to rate changes is considered minor. The final instalment of this loan was repaid in February 2014.

IV) CREDIT RISK

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from TANESCO and Songas. The carrying amount of accounts receivable and the long-term receivable represents the maximum credit exposure. As of December 31, 2013 and 2012, other than the discount applied to the TANESCO receivable, the provision against receivable from Songas whilst set off is being negotiated and interest accrued from TANESCO arrears, the Company does not have an allowance for doubtful accounts against any other receivables nor was it required to write-off any other receivables.

All of the Company's production is currently derived in Tanzania. The sales are made to the Power sector and the Industrial sector. In relation to sales to the Power sector, the Company has a contract with Songas for the supply of gas to the Ubungo power plant and a contract with TANESCO to supply approximately 37 MMcfd in 2013 to fire 147 MW of TANESCO power generation. The contracts with Songas and TANESCO accounted for 65% of the Company's operating revenue during 2013 and US$68 million[1] of the trade receivables at year-end. Songas itself is heavily reliant on the payment of capacity and energy charges by TANESCO for its liquidity.

1 *Includes long-term TANESCO receivable of US$47.0 million.*

Although TANESCO has a long history of delayed payments, it has prior to mid-2011, settled in full subsequent to the quarter end. However, during both 2012 and 2013, there has been a marked deterioration in the situation. Despite the Company receiving numerous assurances from TANESCO and the Government of Tanzania regarding payment, the outstanding balance has continued to grow. Since 31st December 2013, the Company has received US$6.4 million from TANESCO. As at the date of this report TANESCO owes the Company US$64.9 million. To reflect the uncertainly over timing of receipts the Company has discounted TANESCO receivables and reclassified a proportion as a long-term receivable.

Sales to the Industrial sector, currently 37 customers, are subject to an internal credit review to minimize the risk of non-payment. As of the date of this report, all amounts outstanding at the year end have been collected from Industrial customers.

The Company is currently in discussions with TPDC, acting in its proposed capacity as a gas aggregator, concerning the commercial terms for the sale of gas volumes associated with a planned expansion of Songo Songo production, the conditions for which are described under V) below. The Company has no history with TPDC as a debtor. Any contract with TPDC will expose the Company to additional credit risk with a parastatal entity in Tanzania. Management intends to manage such credit exposure by acquiring Partial Risk Guarantees against future payments under such contracts from the World Bank or other institutions.

The Company manages the credit exposure related to cash and cash equivalents by selecting counterparties based on credit ratings and monitoring all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

V) LIQUIDITY RISK

Liquidity risk is the risk that the Company will not have sufficient funds to meet its liabilities. Cash forecasts identifying liquidity requirements of the Company are produced on a regular basis. These are reviewed to ensure sufficient funds exist to finance the Company's current operational and investment cash flow requirements. The Company has US$53.3 million of financial liabilities with regards to trade and other payables identified in Note 14 of which US$45.9 million is due within one to three months, nil is due within three to six months, and US$7.4 million is due within six to twelve months. The Company has a current taxation liability of US$1.9 million payable within six months.

A significant proportion of the current liabilities relate to Songas and TPDC. Transactions between the Company and Songas currently show a net receivable from Songas. Management does not expect to fund settlement of the amount due in advance of collecting the receivable. The amounts due to TPDC represent a distribution of its share of Profit Gas; however given the difficulties in collecting from TANESCO, management expects to settle this liability on a pro rata basis in accordance with amounts received from TANESCO.

Management anticipates that unless regular payments are secured from TANESCO over coming months, it will have to seek other sources of finance in order to maintain operations, which financing may be expensive or unavailable. In order to achieve collection of the TANESCO receivable the Company may have to have to utilise dispute resolution mechanisms and other remedies within the PGSA, including but not limited to possible suspension of gas supplies. In March 2014, the Company served TANESCO with a Notice of Dispute regarding arrears as a first contractual step in the collection process.

The development of additional productive capacity at Songo Songo, through the drilling of the SS-12 development well and work-overs of SS-3, SS-4, SS-5 and SS-9, is dependent upon: (i) agreeing commercial terms with TPDC or other buyers regarding the sale of incremental gas volumes from Songo Songo; (ii) TANESCO receivables being brought up to date, guaranteed or other arrangements for payment satisfactory to the Company; (iii) the establishment of payment guarantees with the World Bank or other multi-lateral lending agencies to secure future receipts under any contracts with Government entities; and (iv) the arrangement of finance with the IFC or other lenders.

VI) CAPITAL RISK MANAGEMENT

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to achieve an optimal capital structure to reduce the cost of capital. The level of risk currently in Tanzania prohibits the optimisation of capital structure as many sources of traditional capital are unavailable. The Company had a medium-term loan facility of US$10 million with a local Tanzanian bank which was drawn down in 2012 and 2013. At the year end, US$1.7 million was still outstanding, and since the year end this has been fully repaid.

VII) COUNTRY RISK

In late 2011, there was resolution by Parliament advising the Government to terminate the Company's Songo Songo PSA on the gounds of an allegation by TPDC that the Company had over-recovered approximately US$21 million in Cost Gas revenue. Parliament itself does not have the authority to amend or terminate PSAs in Tanzania and in February 2012 on the recommendation of MEM, the Government announced that it was establishing a Government Negotiating Team ("GNT") to discuss a number of issues raised in parliament in relation to the Company's Songo Songo PSA. In Tanzania, government negotiating teams are a common mechanism to negotiate with business. The scope of the GNT was to discuss a number of issues that were raised by the Parliamentary Committee for Energy into the workings of the PSA. This included, but is not limited to, TPDC back in rights, profit sharing arrangements, the unbundling of the downstream assets, cost recovery and the Company's management of the upstream operations. After making submissions to the GNT, the Company commenced discussions in April 2012 and further in July 2012, at which time a conditional agreement in principle was reached on a number of major points to resolve the issues. The GNT completed its mandate, and the responsibility for finalisation, documentation and implementation moved back to MEM. The conditional agreement in principle contemplated completion this process by the end of 2012 as well as a number of undertakings from TPDC and the Government. As at the date of this report none of undertakings of the Government or TPDC have been met and, with the exception of the alleged US$21 million Cost Gas over recovery discussed below, none of the issues are resolved.

In response to a Notice of Dispute delivered by the Company, in March 2014, TPDC retracted its claim that the Company had over-recovered approximately US$21 million in Cost Gas, which in the opinion of management substantially exonerated the Company of allegations made by Parliament. Accordingly, the Company continues to rely upon its rights under the existing PSA and has initiated notices of dispute to resolve any remaining issues.

VIII) EVOLVING REGULATORY ENVIRONMENT

The fiscal and regulatory environment for oil & gas exploration and development in Tanzania is in its infancy. Following the discovery of significant offshore natural gas resources by international exploration and development companies, there was pressure on the Government to create a clear fiscal and regulatory framework for the industry. In October 2013, the Government of Tanzania introduced a National Natural Gas Policy. The policy contemplates, among other things, a restructuring of TPDC, increasing government ownership and control over infrastructure and resources, strategic involvement in the LNG value chain, the establishment of TPDC as monopoly gas aggregator in the country, and the establishment of Government controlled natural gas prices. The policy as contemplated conflicts in a number of areas with the rights of the Company under the PSA and has the potential, if implemented by law in its current form to materially affect the Company's business. The PSA has provisions to cause the parties to meet and agree changes in terms which would offset any changes in economic entitlement associated with a change in law.

IX) FINANCIAL INSTRUMENT CLASSIFICATION AND MEASUREMENT

The Company classifies the fair value of financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including expected interest rate, share prices, and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuation in this level are those with inputs for the asset or liabilities that are not based on observable market data.

The Company's long-term trade receivable is considered a Level 3 measurement.

6 SEGMENT INFORMATION

The Company has one reportable segment being international exploration, development and production of petroleum and natural gas. The Company currently has exploration and producing assets in Tanzania and exploration interests in Italy.

	2013			2012		
US$'000	Italy	Tanzania	Total	Italy	Tanzania	Total
External Revenue	**–**	**54,718**	**54,718**	–	77,259	77,259
(Loss)/profit after tax	**(676)**	**(4,789)**	**(5,465)**	(8,284)	26,613	18,329
Non-cash charge[1]	**–**	**27,604**	**27,604**	–	–	–
Total Assets	**257**	**210,719**	**210,976**	834	211,410	212,244
Total Liabilities	**221**	**90,503**	**90,724**	714	85,595	86,309
Capital Additions	**–**	**1,288**	**1,288**	7,531	47,164	54,695
Depletion & Depreciation	**–**	**12,498**	**12,498**	–	9,281	9,281
Exploration assets impairment	**158**	**–**	**158**	8,284	–	8,284

1 Material non-cash charges include a discount on long-term receivables of US$17.1 million and a provision of US$10.5 million for doubtful receivable accounts.

7 REVENUE

US$'000	YEARS ENDED 31 DECEMBER 2013	2012
Operating revenue	**53,855**	64,192
Current income tax adjustment	**14,292**	16,530
Deferred additional profits tax	**(13,429)**	(3,463)
Revenue	**54,718**	77,259

The Company's total revenues for the year amounted to US$54,718 after adjusting the Company's operating revenue of US$53,855 by:

i) adding US$14,292 for income tax for the current year. The Company is liable for income tax in Tanzania, but the income tax is recoverable out of TPDC's Profit Gas when tax is payable. To account for this, revenue is adjusted to reflect the current income tax charge, which represents a 30% gross up of the current tax for the year (Note 10); and,

ii) subtracting US$13,429 for the deferred effect of Additional Profits Tax – this tax is considered a royalty and is netted against revenue.

8 PERSONNEL EXPENSES

The average number of employees during the year was 91 (2012: 86). The costs are as follows:

US$'000	YEARS ENDED 31 DECEMBER 2013	2012
Wages and salaries	**5,113**	4,725
Social security costs	**1,021**	239
Other statutory costs	**158**	312
	6,285	5,276
Stock based compensation	**(209)**	1,152
	6,083	6,428

Stock based compensation is recorded under general and administrative expenses in the statement of comprehensive income. The balance of personnel expenses for 2013 of US$6.3 million (2012: US$5.3 million) is recorded in distribution and production expenses and general administrative expenses at US$0.2 million (2012: US$0.8 million) and US$6.1 million (2012: US$4.5 million) respectively.

9 NET FINANCE INCOME AND FINANCE COSTS

	YEARS ENDED 31 DECEMBER	
US$'000	**2013**	2012
Interest income	**–**	23
Interest charged on overdue trade receivables	**2,636**	–
Gain on disposal of motor vehicle	**10**	–
Finance income	**2,646**	23
Interest expense	**(678)**	(315)
Net foreign exchange loss	**(626)**	(319)
Provision for doubtful accounts	**(10,531)**	–
Discount of long-term receivable *(see Note 11)*	**(17,073)**	–
Finance costs	**(28,908)**	(634)
Net finance costs	**(26,262)**	(611)

Interest income of US$2.6 million is due from TANESCO, under the terms of the PGSA, for late payment of gas supplied. This forms part of the TANESCO account receivable balance and has been fully provided against to reflect the uncertainty over the timing of collection.

10 INCOME TAXES

Under the terms of the PSA the Company is liable to pay income tax at the corporate rate of 30% on profits generated in Tanzania. The amount paid is then recovered in full from TPDC by reducing its share of Profit Gas by the amount of current tax paid.

The tax charge is as follows:

	YEARS ENDED 31 DECEMBER	
US$'000	**2013**	2012
Current tax	**10,010**	11,920
Deferred tax	**(8,267)**	5,205
	1,743	17,125

Total taxes of US$14.4 million (2012: US$7.7 million) were paid during the year, including provisional tax payments relating to current year profits amounting to US$8.4 million (2012: US$4.5 million). These are presented as a reduction in Tax Payable on the balance sheet.

Tax Rate Reconciliation

US$'000	**2013**	2012
(Loss)/profit before taxation	**(3,722)**	35,454
Provision for income tax calculated at the statutory rate of 30%	**(1,117)**	10,636
Add the tax effect of non-deductible income tax items:		
Administrative and operating expenses	**2,697**	2,954
Financing charge	**(16)**	29
Stock-based compensation	**(104)**	346
Exploration asset impairment	**47**	2,485
Permanent differences	**236**	675
	1,743	17,125

As at 31 December 2013, there were temporary differences between the carrying amount of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Accordingly a deferred tax liability has been recognized for the year ended 31 December 2013.

A deferred tax asset of US$2.2 million (2012: US$2.2 million) in respect of the Longastrino Italy exploration costs has not been recognised because it is not probable that there will be future profits against which this can be utilised.

The deferred income tax liability includes the following temporary differences:

	AS AT 31 DECEMBER	
US$'000	**2013**	2012
Differences between tax base and carrying value of property, plant and equipment	**17,081**	16,341
Income tax recoverable	**10,182**	6,744
Discount on receivable & provision for doubtful debt	**(8,281)**	–
Other liabilities		
Employee bonuses, rent and insurance	**(341)**	(109)
TPDC additional Profit Gas	**–**	(102)
Deferred Additional Profits Tax	**(6,509)**	(2,475)
	12,132	20,399

Additional Profits Tax

Under the terms of the PSA, in the event that all costs have been recovered with an annual return from the PSA of 25% plus the percentage change in the United States Industrial Goods Producer Price Index ("PPI"), an Additional Profits Tax ("APT") is payable.

The Company provides for deferred APT by forecasting the total APT payable as a proportion of the forecast Profit Gas over the term of the PSA. The effective APT rate of 30.8% (2012: 32.3%) was applied to Profit Gas of US$43.6 million (2012: US$10.7 million), accordingly, US$13.4 million (2012: US$3.5 million) has been netted off revenue for the year ended 31 December 2013.

As a consequence of having to defer the development programme in 2012 all costs have now been recovered and at an operating level under the PSA the Company has earned a rate of return in excess 25%. Accordingly management estimates that APT of US$2.2 million will become payable in 2014 in accordance with the timing of the future development capital spending as set out in the independent engineering evaluation by McDaniel. The actual APT that will become payable over the life of the PSA will depend on the achieved value of the Additional Gas sales and the quantum and timing of the operating costs and capital expenditure program.

Tax Receivable

The Company has a "Tax Receivable" balance of US$14.6 million (2012: US$14.7 million). This arises from the revenue sharing mechanism within the PSA, which entitles the Company to a share of revenue equivalent to its tax charge, grossed up at the prevailing rate. This amount is collected by way of an offset against TPDC's share of revenue, as and when the Company pays its tax.

11 TRADE AND OTHER RECEIVABLES

Current Receivables	**AS AT 31 DECEMBER**	
US$'000	**2013**	2012
TANESCO	**9,624**	33,256
Songas	**11,560**	14,283
Other debtors	**10,874**	12,791
Trade receivables	**32,058**	60,330
Other receivables	**15,688**	13,165
Less provision for doubtful accounts	**(10,531)**	-
	37,215	73,495

In addition to the trade receivable from Songas of US$11.6 million, an additional US$13.3 million (2012: US$10.3 million) is due from Songas with respect to Gas Plant operations, which is included in Other Receivables. All receivable amounts from Songas have been included in the net Songas balance of US$7.9 million (see Note 14) and a provision for doubtful debts is recognised for the full net receivable amount (see Note 9).

Trade Receivables Age Analysis

As at 31 December, 2013	Current	>30 <60	>60 <90	>90	Total
TANESCO	5,071	4,553	–	–	**9,624**
Songas	1,076	1,016	927	8,541	**11,560**
Other debtors	3,663	2,822	1,661	2,728	**10,874**
Trade receivables	9,810	8,391	2,588	11,269	**32,058**

As at 31 December, 2012	Current	>30 <60	>60 <90	>90	Total
TANESCO	4,894	5,655	5,321	17,386	**33,256**
Songas	1,134	992	1,114	11,043	**14,283**
Other debtors	7,935	2,491	1,816	549	**12,791**
Trade receivables	13,963	9,138	8,251	28,978	**60,330**

Subsequent to 31 December 2013, US$6.4 million has been received from TANESCO, and US$10.9 million from other debtors. During the year, as a result of irregular and unpredictable payments by TANESCO, management reclassified the TANESCO balance more than 60 days as a long-term receivable and has discounted the value of the TANESCO receivable (see Note 1). The Songas trade receivable is less than equivalent trade payable and no contractual right of set off exists.

Long-Term Receivables

US$'000	As at 31 December 2013	2012
TANESCO receivable > 60 days	**46,984**	–
Discount on long-term receivable	**(17,073)**	–
Net long-term receivable	**29,911**	–

12 EXPLORATION AND EVALUATION ASSETS

US$'000	Italy	Tanzania	Total
Costs			
As at 1 January 2013	158	5,562	5,720
Additions	–	2	2
Impairment	(158)	–	(158)
As at 31 December 2013	**–**	**5,564**	**5,564**

US$'000	**Italy**	**Tanzania**	**Total**
Costs			
As at 1 January 2012	911	2,010	2,921
Additions	7,531	3,552	11,083
Impairment	(8,284)	–	(8,284)
As at 31 December 2012	**158**	**5,562**	**5,720**

TANZANIA

The exploration and evaluation asset represents site survey costs and materials purchased in preparation for the drilling of the first Songo Songo West well ("SSW-1"). SSW-1 is part of the initial evaluation of the Songo Songo West prospect which is required to determine the existence of proven and probable reserves.

Italy

Pursuant to the terms of the Company's Longastrino Block farm-in in the Po Valley Basin the Company spent a US$8.4 million related to the drilling of the La Tosca exploration well. The well was unsuccessful and in 2012 the Company treated US$8.3 million as impaired. The balance, relating to some residual materials has been treated as impaired in 2013.

13 PROPERTY, PLANT AND EQUIPMENT

US$'000	Oil and natural gas interests	Leasehold improvements	Computer equipment	Vehicles	Fixtures & Fittings	Total
Costs						
As at 1 January 2013	138,958	256	747	202	950	141,113
Additions	114	629	325	–	218	1,286
Disposals	–	–	–	(65)	–	(65)
As at 31 December 2013	**139,072**	**885**	**1,072**	**137**	**1,168**	**142,334**
Depletion and Depreciation						
As at 1 January 2013	37,801	219	649	194	206	39,069
Charge for period	12,166	26	112	8	186	12,498
Depreciation on disposals	–	–	–	(65)	–	(65)
As at 31 December 2013	**49,967**	**245**	**761**	**137**	**392**	**51,502**
Net Book Values						
As at 31 December 2013	**89,105**	**640**	**311**	**–**	**776**	**90,832**

US$'000	Oil and natural gas interests	Leasehold improvements	Computer equipment	Vehicles	Fixtures & Fittings	Total
Costs						
As at 1 January 2012	96,014	320	701	249	334	97,618
Additions	42,944	–	46	–	622	43,612
Disposals	–	(64)	–	(47)	(6)	(117)
As at 31 December 2012	**138,958**	**256**	**747**	**202**	**950**	**141,113**
Depletion and Depreciation						
As at 1 January 2013	28,833	271	520	196	85	29,905
Charge for period	8,968	12	129	45	127	9,281
Depreciation on disposals	–	(64)	–	(47)	(6)	(117)
As at 31 December 2012	**37,801**	**219**	**649**	**194**	**206**	**39,069**
Net Book Values						
As at 31 December 2012	**101,157**	**37**	**98**	**8**	**744**	**102,044**

In determining the depletion charge, it is estimated that future development costs of US$239 million (31 December 2012: US$107.1 million) will be required to bring the total proved reserves to production. During the year the Company recognized depreciation of US$0.3 million (2012: US$0.3 million) in General and Administrative expenses.

14 TRADE AND OTHER PAYABLES

US$'000	AS AT 31 DECEMBER 2013	2012
Songas	**15,355**	17,459
Other trade payables	**3,857**	4,458
Trade payables	**19,212**	21,917
TPDC	**20,644**	4,378
Accrued liabilities	**13,440**	19,030
Related party *(Note 18)*	**–**	171
	53,296	45,496

The balances payable to Songas are net of amounts receivable from Songas that have been agreed as fully settled. The following table shows the amounts considered to have been settled by offsetting during the year.

	1 January 2013	Transactions during the year	Gross balance	Set off	31 December 2013
Pipeline tariff - payable	(17,459)	(15,380)	(32,839)	17,485	(15,354)
Gas sales - receivable	14,283	11,607	25,890	(14,329)	11,561
Gas plant operation - receivable	10,287	6,208	16,495	(3,215)	13,280
Miscellaneous payable	(1,140)	(465)	(1,605)	59	(1,546)
Net balances	**5,971**	**1,970**	**7,941**	**–**	**7,941**

15 BANK LOAN

In September 2012, the Company closed a US$10 million 18-month bridge loan facility with a Tanzanian bank to finance the Company's working capital requirements in Tanzania. The facility is secured by an assignment of accounts receivable and a fixed and floating charge on the assets of the Company. The Company drew the final US$4.0 million in February 2013. The principal drawn under the facility was repayable in 12 equal monthly instalments which commenced in March 2013. Interest was payable monthly at three-month US LIBOR plus 8%. An additional interest rate of 2% would have been applied for any period in which the TANESCO receivable was greater than 240-days. As at 31 December 2013, principal of US$1.7 million was outstanding under the loan, with the remaining balance fully paid by February 2014. Total payments of US$8.3 million were made during the year.

16 CAPITAL STOCK

a) Authorised

50,000,000	Class A Common Shares	No par value
100,000,000	Class B Subordinate Voting Shares	No par value
100,000,000	First Preference Shares	No par value

The Class A and Class B shares rank *pari passu* in respect of dividends and repayment of capital in the event of winding-up. Class A shares carry twenty (20) votes per share and Class B shares carry one vote per share. The Class A shares are convertible at the option of the holder at any time into Class B shares on a one-for-one basis. The Class B shares are convertible into Class A shares on a one-for-one basis in the event that a take-over bid is made to purchase Class A shares which must, by reason of a stock exchange or legal requirements, be made to all or substantially all of the holders of Class A shares and which is not concurrently made to holders of Class B shares.

b) Changes in the capital stock of the Company were as follows:

	2013			2012		
NUMBER OF SHARES	**Authorised**	**Issued**	**Amount**	**Authorised**	**Issued**	**Amount**
(000's)			*(US$'000)*			*(US$'000)*
Class A						
As at 1 January and 31 December	50,000	1,751	983	50,000	1,751	983
Class B						
As at 1 January	100,000	32,892	84,000	100,000	32,746	83,627
Stock options exercised	–	180	445	–	150	383
Normal course issuer bid	–	–	–	–	(4)	(10)
As at 31 December 2013	**100,000**	**33,072**	**84,445**	**100,000**	**32,892**	**84,000**
FIRST PREFERENCE						
As at 31 December	100,000	–	–	100,000	–	–
Total Class A, Class B and First Preference shares	**250,000**	**34,823**	**85,428**	**250,000**	**34,643**	**84,983**

All of the issued capital stock is fully paid.

Stock Options

	2013		2012	
Thousands of options or CDN$	Options	Exercise Price	Options	Exercise Price
Outstanding as at 1 January	**1,922**	**1.00 to 3.60**	3,057	1.00 to 13.55
Forfeited/Expired	**–**	**–**	(1,385)	4.75 to 13.55
Exercised	**(180)**	**1.00**	(150)	1.00
Issued	**–**	**–**	400	3.18
Outstanding as at 31 December	**1,742**	**1.00 to 3.60**	**1,922**	**1.00 to 3.60**

The weighted average remaining life and weighted average exercise prices of options at 31 December 2013 were as follows:

Exercise Price *(CDN$)*	**Number outstanding as at 31 Dec 2013** *('000)*	Weighted Average Remaining Contractual Life *(years)*	**Number Exercisable as at 31 Dec 2013** *('000)*	Weighted Average Exercise Price *(CDN$)*
1.00	**1,092**	0.67	**1,092**	1.00
3.18	**400**	4.00	**400**	3.18
3.60	**250**	2.75	**250**	3.60
	1,742		**1,742**	

Stock Appreciation Rights

Thousands of stock appreciation rights or CDN$	**SAR**	**Exercise Price**	SAR	Exercise Price
Outstanding as at 1 January 2013	**745**	**2.35 to 5.30**	1,005	4.20 to 13.55
Expired	**(15)**	**5.30**	(690)	8.70 to 13.55
Granted [i]	**300**	**2.12**	430	2.35 to 2.70
Outstanding as at 31 December 2013	**1,030**	**2.12 to 4.20**	745	2.35 to 5.30

[i] A total of 300,000 stock appreciation rights were issued in July 2013 with an exercise price of CDN$2.12. These rights have a term of five years and vest in three equal instalments, the first third vesting on the anniversary of the grant date. There is no maximum liability associated with these rights.

The Company records a charge to the income statement with respect to the stock appreciation rights using the Black-Scholes option pricing model every reporting period with a resulting liability being recognised in trade and other payables. In the valuation of stock appreciation rights at the reporting date, the following assumptions have been made: a risk free rate of interest of 1.25% stock volatility of 50% to 53%; 0% dividend yield; 0% forfeiture; and a closing price of CDN$2.35 per Class B share.

As at 31 December 2013, a total accrued liability of US$0.4 million (2012: US$0.6 million) has been recognised in relation to the stock appreciation rights in other payables. The liability decreased by US$0.2 million during the year compared to an increase of US$0.4 million in 2012, due to the decline in the weighted average remaining contractual life, a lower share price and a lower volatility of the underlying shares.

17 EARNINGS PER SHARE

Number of shares ('000)	AS AT 31 DECEMBER 2013	2012
Weighted average number of shares outstanding		
Class A and Class B shares	**34,719**	34,642
Convertible securities		
Stock options	–	811
Weighted average diluted Class A and Class B shares	**34,719**	**35,453**

The calculation of basic earnings per share is based on the comprehensive loss for the year of US$5.9 million (2012: income US$18.4 million) and a weighted average number of Class A and Class B shares outstanding during the period of 34,718,662 (2012: 34,641,593).

In computing the diluted earnings per share, the effect of stock options is added to the weighted average number of Class A and Class B outstanding during the year. For 2013 the effective number was nil (2012: 811,386) shares, resulting in a diluted weighted average number of Class A and Class B shares of 34,718,662 for the year ended 31 December 2013 (2012: 35,452,979). No adjustments were required to the reported earnings from operations in computing diluted per share amounts. A total of 617,444 options were excluded as a result of being anti-dilutive to earnings per share.

18 RELATED PARTY TRANSACTIONS

One of the non-executive Directors is a partner at a law firm. During the year, the Company incurred US$0.1 million (2012: US$0.4 million) to this firm for services provided. The transactions with this related party were made at the exchange amount. As at 31 December 2013 the Company has a total of US$ nil (2012:US$0.2 million) recorded in trade and other payables in relation to the related party. The Chief Financial Officer provided services to the Company through a consulting agreement with a personal services company. During the year the Company incurred fees and bonus compensation of US$0.6 million in respect of these services (2012: US$0.5 million). In 2012 the Chief Executive Officer also provided services to the Company through a consulting agreement and the Company incurred US$0.2 million in costs. The full Chief Executive Officer's remuneration is included in Directors' Emoluments (see Note 21).

19 CONTRACTUAL OBLIGATIONS AND COMMITTED CAPITAL INVESTMENTS

CONTRACTUAL OBLIGATIONS

Protected Gas

Under the terms of the original gas agreement for the Songo Songo project ("Gas Agreement"), in the event that there is a shortfall/insufficiency in Protected Gas as a consequence of the sale of Additional Gas, then the Company is liable to pay the difference between the price of Protected Gas (US$0.55/MMbtu escalated) and the price of an alternative feedstock multiplied by the volumes of Protected Gas up to a maximum of the volume of Additional Gas sold (108.3 Bcf as at 31 December 2013). The Company did not have a shortfall during the reporting period and does not anticipate a shortfall arising during the term of the Protected Gas delivery obligation to July 2024.

The Gas Agreement may be superseded by an initialed Amended and Restated Gas Agreement ("ARGA"). The ARGA provides clarification of the Protected Gas volumes and removes all terms dealing with the security of the Protected Gas and the consequences of any insufficiency to a new Insufficiency Agreement ("IA"). The IA specifies terms under which Songas may demand cash security in order to keep it whole in the event of a Protected Gas insufficiency. Should the IA be signed, it will govern the basis for determining security. Under the provisional terms of the IA, when it is calculated that funding is required, the Company is required to fund an escrow account at a rate of US$2.00/MMbtu on all Industrial Additional Gas sales out of its and TPDC's share of revenue, and TANESCO shall contribute the same amount on Additional Gas sales to the Power sector. The funds provide security for Songas in the event of an insufficiency of Protected Gas. The Company is actively monitoring the reservoir and, supported by the report of its independent engineers, does not anticipate that a liability will occur in this respect.

Re-rating Agreement

During Q2 2011, the Company signed a re-rating agreement with TANESCO and Songas (the "Re-Rating Agreement") to increase the gas processing capacity to a maximum of 110 MMcfd (the pipeline and pressure requirements at the Ubungo power plant restrict the infrastructure capacity to a maximum of 102 MMcfd). Under the terms of the Re-rating Agreement, the Company effectively pays an additional tariff of US$0.30/mcf for sales between 70 MMcfd and 90 MMcfd and US$0.40/mcf for volumes above 90 MMcfd in addition to the tariff of US$0.59/mcf payable to Songas as set by the energy regulator, EWURA.

Under the terms of this agreement, the Company agreed to indemnify Songas for damage to its facilities caused by the re-rating, up to a maximum of US$15 million, but only to the extent that this was not already covered by indemnities from TANESCO or Songas' insurance policies. The Re-rating Agreement expired on 31st December 2012 and in September was extended by Songas to 31 December 2013. At this time, the Company knows of no reason to de-rate the Songas plant. Since 31 December 2013 production has continued at the higher rated limit and, given the Government's interest in pursuing further development and increasing gas production, the Company expects this to continue. However there are no assurances that this will occur.

Portfolio Gas Supply Agreement

On 17 June 2011, a long term (to June 2023) PGSA was signed between the Company, TPDC and TANESCO. Under the PGSA, the seller is obligated, subject to infrastructure capacity, to sell a maximum of approximately 37 MMcfd for use in any of TANESCO's current power plants except those operated by Songas at Ubungo. Under the agreement, the current basic wellhead is approximately US$2.88/mcf on 1 July 2014 this will increase to US$2.94/mcf. Any volumes of gas delivered under the PGSA in excess of 36 MMcfd are subject to a 150% increase in the basic wellhead gas price.

Operating leases

The Company has two office rental agreements, one in Dar es Salaam, Tanzania and one in Winchester, United Kingdom. The agreement in Dar es Salaam was entered into on 1 November 2013 and expires on 31 October 2015 at an annual rent of US$401 thousand. The agreement in Winchester expires on 25 September 2022 and is at an annual rental of GBP35 thousand (US$58 thousand) per annum during 2012 and 2013 and GBP71 thousand (US$115 thousand) per annum thereafter. The costs of these leases are recognised in the General and Administrative expenses.

CAPITAL COMMITMENTS

Italy

On 31 May 2010, the Company signed an agreement with Petroceltic International plc ("Petroceltic") to farm in on Petroceltic's Central Adriatic B.R268.RG Permit offshore Italy. The farm-in commits the Company to fund 30% of the Elsa-2 appraisal well up to a maximum of US$11.5 million to earn a 15% working interest in the permit. Thereafter, the Company will fund all future costs relating to the well and the permit in proportion to its participating interest. The Company has also agreed to pay Petroceltic fifteen per cent (15%) of the back costs in relation to the well up to a maximum of US$0.5 million.

No activity has occurred on the Adriatic Sea block during 2013. In 2012, a new law modified restrictions on offshore oil and gas exploration and production originally introduced by DLGS 128/2010 in August 2010. The Elsa-2 appraisal well is now expected to be drilled in 2015 following finalisation of an environmental impact study. The Company will not be liable for any costs associated with the drilling of Elsa-2 until a rig contract is signed.

There are no further capital commitments in Italy at this time.

Songo Songo

Significant additional capital expenditure will be required to enable the Songo Songo field to produce 190 MMcfd in line with the anticipated infrastructure expansion. There are no contractual commitments either in the PSA or otherwise agreed for capital expenditure at Songo Songo. Any significant additional capital expenditure in Tanzania is discretionary and remains dependent on: (i) agreeing commercial terms with TPDC or other buyers regarding the sale of incremental gas volumes from Songo Songo; (ii) TANESCO receivables being brought up to date, guaranteed or other arrangements for payment satisfactory to the Company, (iii) the establishment of payment guarantees with the World Bank or other multi-lateral lending agencies to secure future receipts under any contracts with Government entities; and (iv) the arrangement of finance with the IFC or other lenders.

The Company currently plans to finance Songo Songo development with a combination of cash, collection of TANESCO and Songas receivables, funds flow from operations, bank debt and financing to be arranged by IFC. There are no assurances that financing will be available or on reasonable terms to fund all or a portion of the Songo Songo development programme. The Company does not currently have any off-balance sheet financing arrangements.

20 CONTINGENCIES

Downstream unbundling

The separation or unbundling of the downstream assets currently in the PSA has been an objective of TPDC and MEM for some time. Unbundling was an issue raised by TPDC in the 2012 GNT negotiations and in the recently issued National Natural Gas Policy which contemplates TPDC as a monopoly aggregator and distributor of gas. In the context of the gas policy, TPDC and MEM have indicated that they wish Orca Exploration to unbundle the downstream distribution business in Tanzania. The methodology for this has been discussed with TPDC in the course of GNT negotiations. During the year, the Company tabled a proposal with alternative mechanisms to unbundle the downstream from the PSA which were economically neutral to the parties. TPDC did not respond to the proposal and it was later withdrawn by the Company in connection with the termination of negotiations arising from the GNT and TPDC was advised that the downstream would remain in the PSA until mutually agreed otherwise.

TPDC Back-in

TPDC has previously indicated a wish to exercise its right under the PSA to 'back in' to the Songo Songo field development and a further wish to convert this into a carried interest in the PSA. The current terms of the PSA require TPDC to provide formal notice in a defined period and contribute a proportion of the costs of any development, sharing in the risks in return for an additional share of the gas. To date, TPDC has not contributed any costs. TPDC back-in rights and the potential conversion of these rights into a carried working interest were discussed with the GNT along with other issues, however conditions precedent to any potential change in the terms of the PSA as a result of the GNT were not met by the Government and as such the Company continues to stand behind the original terms of the PSA. The issue of any change to TPDC's back-in rights has therefore not been resolved. Should an amendment to the PSA be agreed in future relating to back-in rights, the impact on reserves and accounting estimates will be assessed at that time and reflected prospectively.

For the purpose of the reserves certification as at 31 December 2013, it was assumed that, on the basis of economically rational behavior, TPDC will elect to 'back-in' for 20% for all future new drilling activities with-in the prescribed period as determined by the current development plan and this is reflected in the Company's net reserve position.

Cost recovery

The Company's Cost Pool in Tanzania has been fully recovered resulting in a reduction in the percentage of net revenue attributable to the Company.

TPDC conducted an audit of the historic Cost Pool and in 2011 disputed approximately US$34 million of costs that had been recovered from the Cost Pool from 2002 through to 2009. The Company has contended that the disputed costs were appropriately incurred on the Songo Songo project in accordance with the terms of the PSA. Undertakings to resolve this matter were an outcome of GNT negotiations and the matter was referred to the Controller and Auditor General ("CAG"), head of the National Audit Office of Tanzania. With no progress on resolving the matter, the Company served a Notice of Dispute on TPDC to put the matter to a definitive timeline for resolution, following which the CAG appointed an international independent audit firm to review the disputed costs; this team commenced work in March 2014 and has yet to report. If the matter is not resolved to the Company's satisfaction, it intends to proceed to ICSID arbitration pursuant to the terms of the PSA. This matter has had no impact on the results for the period.

TPDC marketing costs

Under the Songo Songo PSA, all reasonable marketing costs including those incurred by TPDC, with the prior approval by the Company are recoverable. TPDC has to date attempted to claim US$3.6 million in marketing costs from the Company. Management reviewed the claims and can demonstrate that there was no prior approval for such costs, no supporting documentation provided evidencing the expenditure, and further believes the nature of the costs to be unreasonable and not related to marketing the downstream business. Accordingly the Company has rejected the claim by TPDC.

Taxation

During 2013 the Company received a number of assessments for additional tax from the Tanzania Revenue Authority ("TRA"), which together with interest penalties total US$18.4 million at 31 December 2013. Management, together with tax advisors, have reviewed each of the assessments and believe them to be without merit. The Company has appealed against assessments for additional withholding tax and employment related taxes, and has filed formal objections against TRA's claims for additional corporation tax and VAT.

The Tax Revenue Appeals Board considered the Company's appeal against a withholding tax assessment of US$2.4 million in March 2013 and upheld the assessment. The Company then appealed to Tax Revenue Appeals Tribunal whose decision is awaited. Although a similar appeal to the Tribunal has been decided in favour of TRA, management continues to believe this assessment is flawed and, if necessary, will pursue the case in the Court of Appeal where a similar case is currently being heard.

The Company, based on legal counsel's advice, believes it has strong support, on the basis of tax legislation and the terms of the PSA, for its objection to the additional income tax assessment of US$7.8 million, including penalties. In the event that the Company's objection is overturned, any additional tax payable will be recoverable from TPDC under the terms the PSA.

The Company has filed an objection against a further assessment of VAT, which together with penalties totals US$7.5 million. Again, the Company, based on legal counsel's advice, believes that it has strong grounds for objecting to this assessment and accordingly has made no provision.

The Company has received an assessment of US$0.7 million in respect of employment related taxes which TRA believe to have been underpaid. The Company does not accept TRA's finding and has appealed.

Management continues to review the progress of the above appeals and objections and, as of the date of this report, does not believe any provision is required.

21 DIRECTORS AND OFFICERS EMOLUMENTS

US$'000	Year	Base	Bonus	Share based Compensation Expense	Total
Directors	**2013**	**1,454**	**335**	**–**	**1,789**
Directors	2012	1,655	510	402	2,567
Officers	**2013**	**1,227**	**175**	**–**	**1,402**
Officers	2012	2,060	470	750	3,280

The table above provides information on compensation relating to the Company's officers and directors. Five officers and two non-executive directors comprised the key management personnel during the year ended 31 December 2013 (2012: six officers and four non-executive directors). Two of the officers are also directors and as such their remuneration has been included under directors emoluments in the table above.

CORPORATE INFORMATION

BOARD OF DIRECTORS

W. David Lyons
Chairman and
Chief Executive Officer
Winchester
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William H. Smith
Non-Executive Director
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Canada

David W. Ross
Non-Executive Director
Calgary, Alberta
Canada

Robert S. Wynne
Chief Financial Officer
Calgary, Alberta
Canada

OFFICERS

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Chairman and
Chief Executive Officer
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Calgary, Canada

TRANSFER AGENT

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