

# **CANACOL ENERGY LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2014**



## MANAGEMENT'S REPORT

Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements of Canacol Energy Ltd. (the "Corporation") within reasonable limits of materiality. The accompanying consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgements. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Corporation's financial position, financial performance and cash flows, within International Financial Reporting Standards. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The Corporation's external auditors, Deloitte LLP, have audited the consolidated financial statements. Their audit provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported financial results and the financial performance of the Corporation.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.

*(signed) "Charle Gamba"*

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Charle Gamba  
President and Chief Executive Officer

September 22, 2014

*(signed) "George Gramatke"*

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George Gramatke  
Chief Financial Officer

## INDEPENDENT AUDITOR'S REPORT

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To the Shareholders of Canacol Energy Ltd.

We have audited the accompanying consolidated financial statements of Canacol Energy Ltd., which comprise the consolidated statements of financial position as at June 30, 2014, June 30, 2013 and July 1, 2012, and the consolidated statements of operations and comprehensive income (loss), consolidated statements of changes in equity and consolidated statements of cash flows for the years ended June 30, 2014 and June 30, 2013, and a summary of significant accounting policies and other explanatory information.

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

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

### **Auditor's Responsibility**

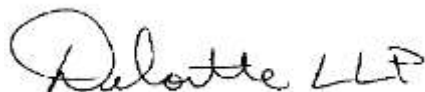
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain 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 the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers 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 financial position of Canacol Energy Ltd. as at June 30, 2014, June 30, 2013 and July 1, 2012, and its financial performance and its cash flows for the years ended June 30, 2014 and June 30, 2013 in accordance with International Financial Reporting Standards.



Chartered Accountants  
September 22, 2014  
Calgary, Alberta

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands of United States dollars)

As at	Note	June 30, 2014	June 30, 2013	July 1, 2012
			(restated) (note 26)	(restated) (note 26)
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		\$ 163,729	\$ 52,290	\$ 30,789
Restricted cash	7	7,379	7,127	6,072
Trade and other receivables		60,981	38,141	31,810
Prepaid expenses and deposits		12,405	11,331	4,630
Investments	8	5,254	-	-
Embedded derivatives asset	20	-	1,875	3,156
Crude oil inventory		1,936	3,261	8,136
		251,684	114,025	84,593
<b>Non-current assets</b>				
Restricted cash	7	59,448	19,267	483
Embedded derivatives asset	20	-	839	3,942
Exploration and evaluation assets	5	133,510	92,753	126,295
Property, plant and equipment	6	301,398	238,278	183,838
Investment in joint venture	25	8,046	1,963	4,361
Investments	8	2,501	2,467	2,690
Deferred tax assets	15	-	-	626
		504,903	355,567	322,235
<b>Total assets</b>		\$ 756,587	\$ 469,592	\$ 406,828
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Bank debt	9	\$ 44,000	\$ -	\$ 12,000
Trade and other payables		75,814	37,219	47,602
Commodity contracts	19	38	280	303
Warrants	19	2,121	37	-
Convertible debentures	11	25,395	-	-
Restricted share units	19	202	3,914	-
Equity tax payable	22	582	1,294	1,236
Taxes payable		15,969	575	3,893
		164,121	43,319	65,034
<b>Non-current liabilities</b>				
Bank debt	9	166,688	134,316	15,986
Deferred income	21	3,731	3,731	-
Commodity contracts	19	-	-	124
Convertible debentures	11	-	22,091	25,381
Decommissioning obligations	10	10,518	7,995	6,642
Restricted share units	19	202	-	-
Warrants	19	2,210	1,834	896
Phantom warrants	19	7,557	1,866	-
Equity tax payable	22	-	512	1,671
Other long term obligations	23	219	10,764	-
Deferred tax liabilities	15	1,054	3,861	-
<b>Total liabilities</b>		356,300	230,289	115,734
<b>Equity</b>				
Share capital	12	551,049	408,770	340,775
Other reserves		48,842	40,074	32,053
Accumulated other comprehensive loss		347	347	347
Deficit		(199,951)	(209,888)	(82,081)
<b>Total equity</b>		400,287	239,303	291,094
<b>Total liabilities and equity</b>		\$ 756,587	\$ 469,592	\$ 406,828

See accompanying notes to consolidated financial statements.

### Approved by the Board of Directors

(signed) "Jason Bednar"  
Director

(signed) "Michael Hibberd"  
Director

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(in thousands of United States dollars, except per share amounts)

Year ended June 30	Note	2014	2013 (restated) (note 26)
<b>Revenues</b>			
Petroleum and natural gas revenues, net of royalties	17	\$ 207,787	\$ 141,354
Share of joint venture profit (loss)	25	3,532	(2,421)
<b>Expenses</b>			
Production and transportation expenses		67,559	75,628
Pre-license and exploration costs	5	1,163	50,798
General and administrative		27,045	22,236
Stock-based compensation and restricted share units	12,19	7,290	8,041
Depletion and depreciation	6	38,740	46,910
Foreign exchange (gain) loss and other		(2,057)	524
Loss on derivatives and financial instruments	17	26,584	2,818
Change in provision and other settlements	23	(7,182)	-
Impairment on development assets	6	10,577	106,755
Gain on sale of assets		(9)	(1,654)
Gain on business acquisition	4	-	(18,759)
		169,710	293,297
Net finance expense	13	9,656	15,550
<b>Income (loss) before income taxes</b>		<b>31,953</b>	<b>(169,914)</b>
<b>Income taxes (recovery)</b>			
Current	15	24,823	2,033
Deferred	15	(2,807)	(44,140)
		22,016	(42,107)
<b>Net income (loss) and comprehensive income (loss)</b>		<b>\$ 9,937</b>	<b>\$ (127,807)</b>
<b>Earnings (loss) per share</b>			
Basic and diluted	14	\$ 0.11	\$ (1.71)

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(in thousands of United States dollars, number of shares in thousands)

	Number of Common Shares	Share Capital	Other Reserves	Accumulated Other Comprehensive Income	Deficit	Total Equity
Balance at July 1, 2012	61,898	\$ 340,775	\$ 32,053	\$ 347	\$ (82,081)	\$ 291,094
Issue of common shares, net of costs	24,601	67,985	-	-	-	67,985
Stock options exercised	7	10	(3)	-	-	7
Stock-based compensation	-	-	8,024	-	-	8,024
Net loss for the year (restated) (note 26)	-	-	-	-	(127,807)	(127,807)
Balance at June 30, 2013 (restated) (note 26)	86,506	\$ 408,770	\$ 40,074	\$ 347	\$ (209,888)	\$ 239,303
Issue of common shares, net of costs	18,277	124,527	-	-	-	124,527
Stock options and warrants exercised	2,953	17,752	(1,577)	-	-	16,175
Stock-based compensation	-	-	10,345	-	-	10,345
Net income for the year	-	-	-	-	9,937	9,937
<b>Balance at June 30, 2014</b>	<b>107,736</b>	<b>\$ 551,049</b>	<b>\$ 48,842</b>	<b>\$ 347</b>	<b>\$ (199,951)</b>	<b>\$ 400,287</b>

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of United States dollars)

Year ended June 30	Note	2014	2013
			(restated) (note 26)
<b>Operating activities</b>			
Net income (loss) for the year		\$ 9,937	\$ (127,807)
Adjustments for non-cash items:			
Net financing expense	13	9,656	15,550
Share of joint venture (profit) loss	25	(3,532)	2,421
Stock-based compensation and restricted share units	12,19	7,290	8,041
Depletion and depreciation	6	38,740	46,910
Unrealized loss on derivatives and financial instruments	19	24,288	1,184
Unrealized foreign exchange (gain) loss and other		(959)	390
Deferred income		-	3,731
Settlement of restricted share units liability		(7,232)	-
Deferred income tax	15	(2,807)	(44,140)
Exploration costs	5	386	50,252
Change in provision	23	(10,545)	-
Impairment on development assets		10,577	106,755
Loss on sale of assets		-	313
Gain on business acquisition	4	-	(18,759)
Changes in non-cash working capital	17	2,145	(18,786)
		77,944	26,055
<b>Investing activities</b>			
Expenditures on exploration and evaluation assets		(25,358)	(24,813)
Expenditures on property, plant and equipment		(107,523)	(31,999)
Disposition of exploration and evaluation assets	5	-	5,443
Investments		(8,314)	(22)
Cash paid for business acquisition	4	-	(40,224)
Cash acquired in business acquisition	4	-	8,300
Change in restricted cash	7	(40,433)	(17,577)
Changes in non-cash working capital	17	27,352	2,862
		(154,276)	(98,030)
<b>Financing activities</b>			
Net financing expense paid		(6,679)	(8,213)
Issue of common shares	12	126,167	7
Share issuance costs	12	(5,762)	(361)
Draw on bank debt		74,045	210,840
Repayment of bank debt		-	(108,797)
		187,771	93,476
Change in cash and cash equivalents		111,439	21,501
Cash and cash equivalents, beginning of year		52,290	30,789
<b>Cash and cash equivalents, end of year</b>		\$ 163,729	\$ 52,290
<b>Cash and cash equivalents consists of:</b>			
Cash		\$ 163,709	\$ 52,270
Cash equivalents		20	20
<b>Cash and cash equivalents, end of year</b>		\$ 163,729	\$ 52,290

See accompanying notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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### NOTE 1 - GENERAL INFORMATION

Canacol Energy Ltd. and its subsidiaries (“Canacol” or the “Corporation”) are primarily engaged in petroleum and natural gas exploration and development activities in Colombia and Ecuador, with non-core activities in Brazil and Peru. The Corporation’s head office is located at 4500, 525 - 8<sup>th</sup> Avenue SW, Calgary, Alberta, T2P 1G1, Canada. The Corporation’s shares are traded on the Toronto Stock Exchange under the symbol CNE, the OTCQX in the United States of America under the symbol CNNEF, and the Bolsa de Valores de Colombia under the symbol CNEC.

The Board of Directors approved these consolidated financial statements (the “financial statements”) for issuance on September 22, 2014.

### NOTE 2 - BASIS OF PREPARATION

The financial statements have been prepared by management in accordance with International Financial Reporting Standards (“IFRS”).

#### Basis of Measurement

These financial statements have been prepared on a historical cost basis, except for commodity contracts, convertible debentures, embedded derivatives, investments, warrants, phantom warrants, restricted share units and overlifted volumes payable, which are measured at fair value with changes in fair value recorded in profit or loss (“fair value through profit or loss”) and bank debt, which is measured at amortized cost.

These financial statements have been prepared on a going concern basis.

#### Functional and Presentation Currency

These financial statements are presented in United States dollars, which is both the functional and presentation currency.

#### Significant Estimates and Management Judgements

The timely preparation of financial statements in accordance with IFRS requires that management make estimates and assumptions and use judgement regarding the measured amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Such estimates relate primarily to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

The Corporation holds 25% of the voting rights of its joint arrangement. The Corporation has joint control over this arrangement as under the contractual agreements, unanimous consent is required from all parties to the agreements for all relevant activities. The Corporation’s joint arrangement is structured in a jointly-controlled entity and provides the Corporation and the parties to the agreements with rights to the net assets of the jointly-controlled entity under the arrangements. Therefore, this arrangement is classified as a joint venture.

Amounts recorded for depletion, depreciation, amortization, accretion, provisions for decommissioning obligations, the valuation of convertible debentures, the valuation of warrants, the valuation of phantom warrants, the valuation of embedded derivatives, the valuation of investments, the valuation of restricted share units and the valuation of stock options are based on their expected lives and other relevant assumptions.

Significant management judgement is required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Corporation has not recognized a benefit for the net deferred tax asset created from Canadian, Peruvian and Brazilian non-capital losses carried forward due to the uncertainty of realization of such amounts.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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The calculation of stock-based compensation expense is subject to uncertainty as it reflects the Corporation's best estimate of whether or not performance will be achieved and obligations incurred. In addition, the assumptions used for stock-based compensation calculation are based on estimated volatility and estimated forfeiture rates for stock options that will not vest.

Petroleum and natural gas assets are grouped into cash generating units ("CGUs") identified as having largely independent cash flows and are geographically integrated. The determination of the CGUs was based on management's interpretation and judgement.

The recoverability of development and production asset carrying values is assessed at the CGU level. Determination of what constitutes a CGU is subject to management judgement. The asset composition of a CGU can directly impact the recoverability of the assets included therein. In assessing the recoverability of oil and gas properties, each CGU's carrying value is compared to its recoverable amount, defined as the greater of its fair value less cost to sell and value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

Key input estimates used in the determination of future cash flows from oil and gas reserves include the following:

- a) Reserves – Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs or recovery rates may change the economic status of reserves and may ultimately result in reserves being restated.
- b) Petroleum and natural gas prices – Forward price estimates of the petroleum and natural gas prices are used in the cash flow model. Commodity prices have fluctuated in recent years due to global and regional factors including supply and demand fundamentals, inventory levels, exchange rates, weather, economic and geopolitical factors.
- c) Discount rate – The discount rate used to calculate the net present value of cash flows is based on estimates of an approximate industry peer group weighted average cost of capital. Changes in the general economic environment could result in significant changes to this estimate.

### NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

#### Application of New and Revised International Financial Reporting Standards ("IFRS")

The International Accounting Standards Board released the following new standards: IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements", IFRS 12 "Disclosures of Interests in Other Entities" and IFRS 13 "Fair Value Measurement". These standards have been adopted in the financial statements for the fiscal period beginning July 1, 2013. There have also been revisions made to the following existing standards: IFRS 9 "Financial Instruments", IFRS 7 "Financial Instruments: Disclosures", IAS 39 "Financial Instruments: Recognition and Measurement", IAS 19 "Employee Benefits", IAS 16 "Property, Plant and Equipment", IAS 36 "Impairment of Assets" and IAS 27 "Separate Financial Statements". The following describes the impact as a result of the application of the new and revised standards.

(i) Consolidated Financial Statements

IFRS 10 "Consolidated Financial Statements" supersedes IAS 27 "Consolidation and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities". This standard provides a single model to be applied in control analysis for all investees, including special purpose entities.

The adoption of this standard had no impact on the financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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### (ii) Joint Arrangements

IFRS 11 “Joint Arrangements” divides joint arrangements into two types, joint operations and joint ventures, each with their own accounting model. All joint arrangements are required to be reassessed on transition to IFRS 11 to determine their type to apply the appropriate accounting.

Upon the adoption of IFRS 11, the Corporation reviewed and assessed the legal form and terms of the contractual arrangements in relation to the Corporation’s investments in joint arrangements. The adoption of IFRS 11 resulted in a change in the method of accounting for the Corporation’s interest in the incremental production contract for the Libertador and Atacapi fields in Ecuador (the “Ecuador IPC”) from a jointly-controlled entity named Servicios Libertador S.L., using the proportionate consolidation method, to being accounted for using the equity method. This change in accounting for the Corporation’s investment in the Ecuador IPC has been applied in accordance with the relevant IFRS transitional provisions. The initial investment in the Ecuador IPC as at July 1, 2012 for the purposes of applying the equity method was measured as the aggregate of the carrying amounts of the assets and liabilities that the Corporation had previously proportionately consolidated. The change in accounting method has affected the amounts previously reported in the financial statements (see note 26).

### (iii) Disclosure of Interests in Other Entities

IFRS 12 “Disclosure of Interests in Other Entities” combines in a single standard the disclosure requirements for subsidiaries, associates and joint arrangements as well as unconsolidated structured entities.

Other than as disclosed in note 26, the adoption of this standard had no impact on the financial statements.

### (iv) Fair Value Measurement

IFRS 13 “Fair Value Measurement” defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The adoption of this standard had no impact on the financial statements.

### (v) Revised Standards

The revisions to existing standards mostly involve amendments to the definitions provided by the standards. Introduction of the new standard, IFRS 13 “Fair Value Measurement”, impacts the following standards for the revised definition of fair value: IAS 39 “Financial Instruments: Recognition and Measurement”, IAS 19 “Employee Benefits”, IAS 16 “Property, Plant and Equipment” and IAS 36 “Impairment of Assets”. IFRS 9 “Financial instruments” and IFRS 7 “Financial instruments: Disclosures” have been amended for the Mandatory Effective Date and Transition Disclosures definitions. IAS 27 “Separate Financial Statements” has been revised to reflect new standards, IFRS 10 “Consolidated Financial Statements” and IFRS 12 “Disclosure of Interests in Other Entities”, in determining to disclose separate financial statements for an investment entity.

The revisions to these standards have no impact on the financial statements.

## Principles of Consolidation

**Subsidiaries** – Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the financial statements from the date that control commences until the date that control ceases.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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The purchase method of accounting is used to account for acquisitions of subsidiaries and assets that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of the acquisition over the fair value of the identifiable assets acquired and liabilities and contingent liabilities assumed is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in profit or loss as a gain on acquisition. Acquisition related costs, other than share issue costs, are expensed as period costs in the consolidated statements of operations.

**Jointly-controlled operations and jointly-controlled assets** – Many of the Corporation's petroleum and natural gas activities involve jointly-controlled assets. The financial statements include the Corporation's share of these jointly-controlled assets and a proportionate share of the relevant revenue and related operating costs.

**Joint ventures** – The Corporation's investment in the Ecuador IPC is accounted for using the equity method whereby the Corporation's share of the Ecuador IPC's net income is included in the consolidated statements of operations.

**Transactions eliminated on consolidation** – Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated on consolidation.

### Foreign Currency

The United States dollar is the functional currency of the Corporation and its significant subsidiaries. Monetary assets and liabilities denominated in foreign currencies are translated to United States dollars at the period-end exchange rate. Non-monetary assets, liabilities, revenues and expenses are translated at exchange rates at the transaction date. Exchange gains or losses are included in the determination of profit or loss in the statements of operations.

### Financial Instruments

**Non-derivative financial instruments** – Non-derivative financial instruments include cash and cash equivalents, restricted cash, trade and other receivables, bank debt, investments, restricted share units, trade and other payables and other long-term obligations. Non-derivative financial instruments are initially recognized at fair value plus any directly attributable transaction costs, except for financial assets and liabilities at fair value through profit or loss whereby any directly attributable transaction costs are expensed as incurred. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

**Cash and cash equivalents** – Cash and cash equivalents comprise cash on deposit with banks and short-term investments with original maturities of three months or less and is measured similar to other non-derivative financial instruments. Subsequent to initial recognition, this financial instrument is measured at fair value and changes therein are recognized in the consolidated statements of operations.

**Restricted cash** – Restricted cash relates to cash placed in trust to ensure the payment of its obligations pursuant to exploration and credit agreements. Subsequent to initial recognition, this financial instrument is measured at fair value and changes therein are recognized in the consolidated statements of operations.

**Investments** – Investments are recorded at fair value through profit or loss. Subsequent to initial recognition, this financial instrument is measured at fair value and changes therein are recognized in the consolidated statements of operations.

**Restricted share units** – Restricted share units are recorded at fair value through profit or loss. Subsequent to initial recognition, this financial instrument is measured at fair value and changes therein are recognized in the consolidated statements of operations.

**Bank debt** – Bank debt is recorded at amortized cost, net of directly attributable transaction costs. Subsequent to initial recognition, the directly attributable transaction costs are amortized into the carrying value using the effective interest method over the term of the facility through the consolidated statements of operations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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*Overlift volumes payable* – Overlift volumes payable are recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in the consolidated statements of operations.

*Other* – Other non-derivative financial instruments, such as trade and other receivables, trade and other payables and other long-term obligations are measured at amortized cost, less any impairment losses.

**Derivative financial instruments** – The Corporation has entered into certain financial derivative contracts to manage its exposure to market risks associated with fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Corporation has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting. As a result, all commodity derivative contracts are classified as fair value through profit or loss and are recorded on the consolidated statements of financial position at fair value. Transaction costs are expensed when incurred in the consolidated statements of operations.

*Convertible debentures* – Convertible debentures are recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in the consolidated statements of operations.

*Embedded derivatives* – Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Embedded derivatives are classified as fair value through profit or loss and are recorded on the consolidated statements of financial position at fair value. Changes in the fair value of separable embedded derivatives are recognized immediately in the consolidated statements of operations.

*Warrants and phantom warrants* – Warrants and phantom warrants are recorded at fair value through profit and loss. Subsequent to initial recognition, they are measured at fair value and changes therein are recognized in the consolidated statements of operations.

### Property, Plant and Equipment and Exploration and Evaluation Assets

#### Recognition and measurement

*Exploration and evaluation (“E&E”) assets* – Pre-license costs incurred prior to obtaining the rights to explore lands are recognized in the consolidated statements of operations as incurred.

E&E costs, including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized either as tangible or intangible E&E assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

When E&E assets are determined to be technically feasible and commercially viable, the accumulated costs are transferred to property, plant and equipment. When E&E assets are determined not to be technically feasible and commercially viable or the Corporation decides not to continue with its activity, the unrecoverable costs are charged to the consolidated statements of operations as exploration and evaluation expense.

E&E assets are allocated into CGUs and assessed for impairment when they are transferred to property, plant and equipment or in any circumstances where sufficient data exists to determine technical feasibility and commercial viability, and facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

*Development and production costs* – Items of property, plant and equipment, which include petroleum and natural gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production (“D&P”) assets are grouped into CGUs for impairment testing.

When significant parts of an item of property, plant and equipment, including petroleum and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

Gains and losses on disposal of an item of property, plant and equipment, including petroleum and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized net within the consolidated statements of operations.

**Subsequent costs** – Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as petroleum and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in the consolidated statements of operations as incurred. Such capitalized petroleum and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in the consolidated statements of operations as incurred.

**Depletion and depreciation** – The net carrying value of development or production assets is depleted using the units-of-production method by reference to the ratio of production in the period to the related proved plus probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated by taking into account the level of development required to produce the reserves.

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible.

Reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected petroleum and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Corporation will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives for other assets for the current and comparative years are as follows:

Equipment and other	2 - 5 years
Leasehold improvements	Over the term of the leasing agreement

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

### Leased Assets

Leases where the Corporation assumes substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are recognized as assets at the lower of the fair value of the leased property, or the present value of the minimum lease payments as determined at the inception of the lease. Any initial direct costs are added to the amount recognized as an asset. Finance leases are amortized over the lease term.

Other leases are operating leases, which are not recognized on the consolidated statements of financial position. Payments made under operating leases are recognized in the consolidated statements of operations on a straight-line basis over the term of the lease.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Impairment

**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. Remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in the consolidated statements of operations.

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 the consolidated statements of operations.

**Non-financial assets** – The carrying amounts of the Corporation's non-financial assets, other than E&E assets and deferred income tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of the asset is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment as petroleum and natural gas interests, and also if facts and circumstances suggest that their carrying amount exceeds the recoverable amount. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (CGU). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

Impairment tests were carried out at June 30, 2014 and were based on value in use calculations, using a pre-tax discount rate of 10% and the following forward commodity price estimates:

Year	WTI Oil (US\$/bbl)	Guajira Gas (US\$/MMBTU) (Nelson Field)	Guajira Gas (US\$/MMBTU) (Non-Nelson Field)
2014 (6 months)	100.00	3.79	-
2015	97.92	4.73	4.70
2016	97.80	5.15	4.79
2017	97.63	5.27	4.89
2018	97.42	5.40	4.99
2019	99.37	5.56	5.09
2020	101.35	5.65	5.19
2021	103.38	5.31	5.29
2022	105.45	5.42	5.40
2023	107.56	5.53	5.51
2024	109.71	5.64	5.62
Remainder	+2.0% per year	+2.0% per year	+2.0% per year

E&E assets are allocated to related CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (petroleum and natural gas interests in property, plant and equipment).

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the consolidated statements of operations. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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In respect of assets other than goodwill, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

### Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

**Decommissioning obligations** – The Corporation's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the period-end date. Subsequent to initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

### Inventory

Inventory consists of crude oil in transit or in storage tanks at the reporting date, and is valued at the lower of cost, using the weighted-average cost method, or net realizable value. Costs include direct and indirect expenditures incurred in bringing the crude oil to its existing condition and location.

### Revenue

The Corporation's revenues are primarily derived from the production of petroleum and natural gas.

Revenue from the sale of petroleum and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer, which is usually when legal title passes to an external party.

Revenue is recorded net of any royalties.

### Stock-Based Compensation

The grant date fair value of stock options granted to officers, employees and directors is recognized as stock-based compensation expense with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of awards that vest.

### Restricted Share Units

The grant date fair value of restricted share units granted to officers, employees and directors is recognized as restricted share units expense with a corresponding increase in restricted share units liability. Subsequent to initial recognition, the restricted share units liability is measured at fair value and changes therein are recognized in the consolidated statements of operations.

### Finance Income and Expenses

Net finance income or expense is comprised of interest income, interest expense on borrowings, amortization of upfront fees, fair value adjustments on equity tax and accretion of the discount on decommissioning liabilities.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method.

### Income Taxes

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

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

Deferred income tax is recognized using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred income tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred income tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred income tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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

### Earnings per Share

Basic earnings (loss) per share is calculated by dividing the profit or loss attributable to common shareholders of the Corporation by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the net income attributable to common shareholders and the weighted-average number of common shares outstanding for the effects of dilutive instruments such as stock options, warrants and convertible debentures.

### Recent Accounting Pronouncements

The following are new IFRS pronouncements that have been issued, although not yet effective and have not been early adopted, and may have an impact on the Corporation in the future as discussed below.

On July 1, 2014, the Corporation will be required to adopt IFRIC 21 “Levies”. It is applicable for all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 Income Taxes) and fines or other penalties for breaches of legislation. The interpretation clarifies that an entity recognizes a liability for a levy no earlier than when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, no liability is recognized before the specified minimum threshold is reached. The adoption of IFRIC 21 is not expected to have a significant impact on the financial statements.

On January 1, 2017, the Corporation will be required to adopt IFRS 15, “Revenue from Contracts with Customers”. IFRS 15 was issued in May 2014 and will replace IAS 11, “Construction Contracts,” IAS 18, “Revenue Recognition,” IFRIC 13, “Customer Loyalty Programmes,” IFRIC 15, “Agreements for the Construction of Real Estate,” IFRIC 18, “Transfers of Assets from Customers,” and SIC-31, “Revenue – Barter Transactions Involving Advertising Services.” IFRS 15 provides a single, principle-based five-step model that will apply to all contracts with customers with limited exceptions, including, but not limited to, leases within the scope of IAS 17 and financial instruments and other contractual rights or obligations within the scope of IFRS 9 “Financial Instruments,” IFRS 10, “Consolidated Financial



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Statements” and IFRS 11, “Joint Arrangements.” In addition to the five-step model, the standard specifies how to account for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. The standard’s requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity’s ordinary activities. The Corporation is in the process of assessing the impact of IFRS 15 on its financial statements.

On January 1, 2018, the Corporation will be required to adopt IFRS 9 “Financial Instruments”, which is the result of the first phase of the International Accounting Standards Board (“IASB”) project to replace IAS 39 “Financial Instruments: Recognition and Measurement”. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. Portions of the standard remain in development and the full impact of the standard on the financial statements will not be known until the project is complete.

### NOTE 4 – BUSINESS ACQUISITION

On October 15, 2012, the Corporation entered into an agreement (the “Arrangement Agreement”) whereby the Corporation agreed to acquire 100% of the issued and outstanding class “A” common shares (“Shona Common Shares”) and series “A” preferred shares (“Shona Preferred Shares”) of Shona Energy Company, Inc. (“Shona”), in exchange for common shares of the Corporation (“Canacol Shares”) and cash, by way of a statutory plan of arrangement (the “Arrangement”). On December 21, 2012, the closing date of the transaction, the Corporation acquired 100% of the issued and outstanding Shona Common Shares in exchange for 0.10573 Canacol Shares and C\$0.0896 cash for each Shona Common Share (the “Consideration”) and 100% of the issued and outstanding Shona Preferred Shares in exchange for \$100.00 cash for each Shona Preferred Share. Canacol issued an aggregate of 24,600,758 Canacol Shares to Shona Common Shareholders in connection with the Arrangement.

Under the terms of the Arrangement Agreement, all of Shona’s outstanding options were surrendered and terminated prior to closing of the Arrangement. In addition, all holders of Shona warrants were entitled to receive, in lieu of the number of Shona Common Shares otherwise issuable upon the exercise thereof, the number of Canacol Shares adjusted for an exchange ratio of 0.12587 of a Canacol Share per Shona Share and the exercise price of the warrants was reduced with respect to the exchange ratio of 0.12587 such that the warrants maintained their economic equivalency.

Acquisition related costs, other than share issue costs, of approximately \$0.6 million have been expensed as period costs in the consolidated statements of operations for the year ended June 30, 2013.

From the period of December 21, 2012 to June 30, 2013, the acquired business contributed revenues, net of royalties, of \$15.2 million and operating income of \$12.5 million to Canacol’s operations. If the acquisition had occurred on July 1, 2012, management estimates its pro forma revenues, net of royalties and operating income, would have been approximately \$29.0 million and \$16.1 million for Shona, respectively, for the year ended June 30, 2013. Operating income includes \$4.9 million of transaction and other costs related to the acquisition by Canacol. It is impracticable to derive all amounts necessary to determine contributed net income from the acquired business as operations were immediately merged with Canacol’s operations to realize synergies.

The acquisition has been accounted for using the purchase method with the results of Shona’s operations included in the Corporation’s financial and operating results commencing December 21, 2012.

The allocation of the purchase price of the business acquisition was as follows:

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<b>Consideration:</b>		
Issue of common shares, net of costs	\$	68,346
Issue of warrants		2,231
Cash paid to common and preferred shareholders		40,224
	<b>\$</b>	<b>110,801</b>
<b>Net assets acquired:</b>		
Cash	\$	8,300
Restricted cash		2,262
Trade and other receivables		4,883
Other current assets		1,632
Exploration and evaluation assets		6,523
Property, plant and equipment		162,063
Trade and other payables		(3,915)
Other current liabilities		(670)
Decommissioning obligations		(2,628)
Deferred tax liability		(48,629)
Other long term liabilities		(261)
		129,560
Gain on business acquisition		(18,759)
	<b>\$</b>	<b>110,801</b>

The gain on business acquisition was recognized as a result of the change in the Corporation's share price between when the Arrangement Agreement with Shona was signed and the closing of the acquisition.

### NOTE 5 – EXPLORATION AND EVALUATION ASSETS

Balance at July 1, 2012	\$	126,295
Acquisition of Shona		6,523
Additions		24,813
Dispositions		(6,249)
Transferred to D&P assets (Note 6)		(8,377)
Transferred to exploration expense		(50,252)
Balance at June 30, 2013		92,753
Additions		27,108
Property acquisitions		15,000
Transferred to D&P assets (Note 6)		(965)
Transferred to exploration expense		(386)
<b>Balance at June 30, 2014</b>	<b>\$</b>	<b>133,510</b>

On January 31, 2014, the Corporation acquired a right to an 80% interest in each of the COR 4 and COR 12 Exploration and Production contracts located in the Upper Magdalena Basin of Colombia for a total payment of \$15 million (\$7.5 million for each block) payable entirely in newly issued common shares of the Corporation. The Corporation issued 2,454,590 common shares in satisfaction of the share consideration.

During the year ended June 30, 2014, the Corporation made two light oil discoveries on its LLA-23 and Santa Isabel blocks and, consequently, \$1.0 million of development costs associated with these blocks have been transferred to D&P assets.

During the year ended June 30, 2013, the Corporation made two light oil discoveries on its LLA-23 and VMM-2 blocks and, consequently, \$8.4 million of development costs associated with these blocks have been transferred to D&P assets.

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During the year ended June 30, 2014, the Corporation assessed its exploration blocks for impairment and, as the result of relinquishment or planned relinquishment of certain blocks, all costs and capitalized interests associated with such blocks have been transferred to exploration expense. In addition to the \$0.4 million (2013 – \$50.3 million) of costs transferred to exploration expense, \$0.8 million (2013 – \$0.5 million) of pre-license costs were also included in pre-license and exploration costs for the year ended June 30, 2014.

### NOTE 6 – PROPERTY, PLANT AND EQUIPMENT

	Petroleum and Natural Gas Assets		Corporate and Other Assets		Total
<b>Cost</b>					
Balance at July 1, 2012 (restated – note 26)	\$	269,957	\$	5,456	\$ 275,413
Acquisition of Shona (note 4)		162,063		-	162,063
Net additions		30,704		1,272	31,976
Transferred from E&E assets (note 5)		8,377		-	8,377
Reclassifications		1,896		-	1,896
Balance at June 30, 2013 (restated – note 26)		472,997		6,728	479,725
Additions		69,402		1,655	71,057
Property acquisition		40,000		-	40,000
Transferred from E&E assets (note 5)		965		-	965
Reclassifications		(321)		321	-
<b>Balance at June 30, 2014</b>	<b>\$</b>	<b>583,043</b>	<b>\$</b>	<b>8,704</b>	<b>\$ 591,747</b>
Balance at July 1, 2012 (restated – note 26)	\$	(88,932)	\$	(2,643)	\$ (91,575)
Depletion and depreciation		(45,399)		(1,511)	(46,910)
Impairment		(106,755)		-	(106,755)
Reclassifications		(1,893)		-	(1,893)
Derecognition and inventory adjustments		5,663		23	5,686
Balance at June 30, 2013 (restated – note 26)		(237,316)		(4,131)	(241,447)
Depletion and depreciation		(38,224)		(516)	(38,740)
Impairment		(10,577)		-	(10,577)
Derecognition and inventory adjustments		388		27	415
<b>Balance at June 30, 2014</b>	<b>\$</b>	<b>(285,729)</b>	<b>\$</b>	<b>(4,620)</b>	<b>\$ (290,349)</b>
<b>Carrying amounts</b>					
At July 1, 2012 (restated – note 26)	\$	181,025	\$	2,813	\$ 183,838
At June 30, 2013 (restated – note 26)	\$	235,681	\$	2,597	\$ 238,278
<b>At June 30, 2014</b>	<b>\$</b>	<b>297,314</b>	<b>\$</b>	<b>4,084</b>	<b>\$ 301,398</b>

At June 30, 2014, a write down of \$10.6 million (2013 – \$106.8 million) was recorded based on the estimated recoverable amount of the Rancho Hermoso CGU, representing the value in use using a 10% (2013 – 25%) discounted cash flows of reserves as determined by the Corporation's external reserve evaluators and the then current forecast prices for crude oil.

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### NOTE 7 – RESTRICTED CASH

	June 30, 2014	June 30, 2013	July 1, 2012
		(restated) (note 26)	
Restricted cash – current	\$ 7,379	\$ 7,127	\$ 6,072
Restricted cash – long term	59,448	19,267	483
	\$ 66,827	\$ 26,394	\$ 6,555

At June 30, 2014, restricted cash consisted of \$47.4 million of term deposits used as collateral to secure the Ecuador IPC's borrowings, \$9.3 million for work commitments and other capital commitments, and \$10.1 million held in a debt reserve account as required under the Corporation's senior secured term loan.

### NOTE 8 – INVESTMENTS

Balance at July 1, 2012	\$ 2,690
Unrealized loss	(58)
Foreign exchange loss	(165)
Balance at June 30, 2013	2,467
Additions	5,821
Unrealized loss	(508)
Foreign exchange loss	(25)
<b>Balance at June 30, 2014</b>	<b>\$ 7,755</b>

The Corporation owns a 0.5% interest in Oleoducto Bicentenario de Colombia ("OBC"), which owns a pipeline system that will link Llanos basin oil production to the Cano Limon oil pipeline system. Under the terms of the OBC agreement, the Corporation may be required to provide financial support or guarantees for its proportionate equity interest in any future debt financings undertaken by OBC. The Corporation will be eligible to receive any dividends on the project. The Corporation is required to enter into ship-or-pay arrangements with OBC to guarantee pipeline revenues.

During the year ended June 30, 2014, the Corporation invested \$5 million in the securities of a company involved in the exploration and development of oil and gas in Latin America. An officer of the Corporation is also a director of such company.

### NOTE 9 – BANK DEBT

#### Senior Secured Term Loan

On April 3, 2013, the Corporation entered into a credit agreement for a \$140 million senior secured term loan with a syndicate of banks. The Senior Secured Term Loan was for a five-year term, with interest payable quarterly and principal repayable in 15 equal quarterly instalments starting in October 2014, following an initial 18 month grace period. The Senior Secured Term Loan carried interest at LIBOR plus 4.50% and was secured by all of the material assets of the Corporation.

On April 24, 2014, the Corporation completed an upsizing of its existing Senior Secured Term Loan, from \$140 million to \$220 million, with no changes to the terms of the Senior Secured Term Loan or the repayment schedule. The revised term loan carries interest at LIBOR plus 4.50-5.00%, depending on agreed leverage ratios, and is secured by all of the material assets of the Corporation. The carrying value of the Senior Secured Term Loan included \$9.3 million of transaction costs netted against the principal amount as at June 30, 2014.

The Senior Secured Term Loan includes various non-financial covenants relating to future acquisitions, indebtedness, operations, investments, capital expenditures and other standard operating business covenants. The Senior Secured Term Loan also includes various financial covenants, including a maximum consolidated leverage ratio ("Consolidated Leverage Ratio"), a minimum consolidated interest coverage ratio ("Consolidated Interest Coverage Ratio"), a

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minimum debt service coverage ratio ("Debt Service Coverage Ratio"), a minimum consolidated current assets to consolidated current liabilities ratio ("Consolidated Current Assets to Consolidated Current Liabilities Ratio") and other standard financial covenants.

The Consolidated Leverage Ratio is calculated on a quarterly basis as consolidated total debt ("Consolidated Total Debt") divided by consolidated EBITDAX ("Consolidated EBITDAX"). Consolidated EBITDAX is calculated on a rolling 12-month basis and is defined as consolidated net income adjusted for interest, income taxes, depreciation, depletion, amortization, exploration expenses, share of joint venture profit/loss and other similar non-recurring or non-cash charges. Consolidated EBITDAX is further adjusted for the contribution to adjusted funds from operations, before taxes, of the results of the Ecuador IPC. The purpose of including this last amount is to capture the funds from operations of the Corporation's joint venture in Ecuador into the calculation as it is accounted for on an equity basis in the financial statements. The maximum allowable Consolidated Leverage Ratio is 2.75:1.00. Consolidated Total Debt includes the principal amount of all indebtedness, which currently includes bank debt, office lease commitments, and net hedging liabilities, if any, and specifically excludes amounts with respect to the Corporation's convertible debentures or warrants; additionally, restricted cash maintained in the debt service reserve account related to the Senior Secured Term Loan is deductible against Consolidated Total Debt.

The Consolidated Interest Coverage Ratio is calculated on a quarterly basis as Consolidated EBITDAX divided by consolidated interest expense ("Consolidated Interest Expense"). The minimum Consolidated Interest Coverage Ratio required is 3.50:1.00. Consolidated EBITDAX is calculated on a rolling 12-month basis as described in the above paragraph. Consolidated Interest Expense is calculated on a rolling 12-month basis and includes interest expense, amortization of upfront fees, and capitalized interest.

The Debt Service Coverage Ratio is calculated on a quarterly basis as actual cash collections deposited by customers in the Corporation's collection accounts divided by the debt service amount ("Debt Service Amount"). The minimum Debt Service Coverage Ratio required is 1.50:1.00. The Debt Service Amount is defined as the sum of all amounts in respect of principal, interest, and fees payable on the interest payment date succeeding the date of the calculation.

The Consolidated Current Assets to Consolidated Current Liabilities Ratio is calculated on a quarterly basis as consolidated current assets divided by consolidated current liabilities, excluding the current portion of any long-term indebtedness. The minimum Consolidated Current Assets to Consolidated Current Liabilities Ratio required is 1.00:1.00.

The Corporation was in compliance with its financial covenants as at June 30, 2014.

### **Syndicated Credit Facility**

During the year ended June 30, 2013, the Corporation, through its wholly-owned subsidiary Canacol Energy Colombia S.A., had in place a \$200 million syndicated credit facility with an approved borrowing base of \$33.0 million. The credit facility consisted of a reserve-based revolving facility and an amortized term facility.

The revolving facility had a three-year term maturing on June 29, 2015 and was subject to re-determination of the borrowing base semi-annually on April 1 and October 1 each year. The borrowing base was determined based on, among other things, the Corporation's reserve report, results of operations, the lender's view of the current and forecasted commodity prices and the current economic environment. Advances under the revolving facility bore interest at rates ranging from LIBOR plus 2.50% to 3.25% per annum, depending on utilization. Undrawn amounts under the revolving facility bore a commitment fee of 0.50% per annum.

The term facility bore interest at LIBOR plus 2.50% and was repayable in ten equal principal instalments of \$3.0 million plus accrued interest due at the end of each three month period starting on September 1, 2012. Repayments under the term facility resulted in a corresponding increase in the amounts available under the revolving facility such that the total amount available always equaled the approved borrowing base.

The combined credit facility was secured by certain of the Corporation's oil and gas assets and reserves.

On April 3, 2013, the Corporation cancelled and repaid all amounts outstanding under the Syndicated Credit Facility with proceeds from the Senior Secured Term Loan described above. All transaction costs that were netted against the principal amount of the syndicated credit facility were fully expensed upon repayment of the combined facility.

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### Shona Term Loan

In connection with the closing of the Shona business acquisition on December 21, 2012, the Corporation entered into a senior secured credit agreement for \$45.0 million. This credit facility carried a term of one year, was repayable in full upon maturity, bore interest at 15% per annum, payable quarterly, and was secured by the assets of Shona.

On April 3, 2013, the Corporation cancelled and repaid all amounts outstanding under the Shona Term Loan with proceeds from the Senior Secured Term Loan described above. All remaining unamortized transaction costs that were netted against the principal amount of the Shona Term Loan were fully expensed upon repayment of the loan.

### Other Colombian Credit Facilities

The Corporation has revolving lines of credit in place in Colombia with an aggregate borrowing base of \$37.4 million (COP\$ 70.4 billion). These lines of credit have interest rates ranging from 6% to 9% and are unsecured. The facilities were undrawn as at and during the year ended June 30, 2014.

### Letters of Credit

At June 30, 2014, the Corporation had letters of credit outstanding totaling \$32.8 million to guarantee work commitments on exploration blocks and to guarantee other contractual commitments. The total of these letters of credit, net of amounts counter-guaranteed by other financial institutions, reduce the amounts available under the Colombian revolving lines of credit by \$15.8 million.

## NOTE 10 – DECOMMISSIONING OBLIGATIONS

Balance at July 1, 2012	\$	6,642
Accretion		353
Additions		800
Dispositions		(821)
Acquisition of Shona (note 4)		2,628
Change in estimate		(1,607)
<hr/>		
Balance at June 30, 2013		7,995
Accretion		540
Additions		1,860
Dispositions		(25)
Change in estimate		148
<hr/>		
<b>Balance at June 30, 2014</b>	<b>\$</b>	<b>10,518</b>

The Corporation's decommissioning obligations result from its ownership interests in petroleum and natural gas assets, including well sites, facilities, and gathering systems. The total decommissioning obligation is estimated based on the Corporation's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities, and the estimated timing of the costs to be incurred in future years. The Corporation has estimated the net present value of the decommissioning obligations to be \$10.5 million at June 30, 2014 (2013 - \$8.0 million) based on an undiscounted total future liability of \$18.0 million (2013 - \$14.5 million). These payments are expected to be made over the next 17 years with the majority of costs to be incurred between 2015 and 2030. The average discount factor, being the risk-free rate related to the liability, is 6.3% (2013 - 6.8%) and the average inflation rate is 3.0% (2013 - 3.2%).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 11 – CONVERTIBLE DEBENTURES

On July 16, 2010, the Corporation closed a Canadian dollar denominated convertible unsecured debenture financing for aggregate gross proceeds of \$39.4 million (C\$41.5 million). The convertible debentures bear interest at 8% per annum, payable semi-annually on the last day of June and December commencing on December 31, 2010. The convertible debentures mature on June 30, 2015 and are convertible at the holder's option into common shares of the Corporation at any time prior to the earlier of either the maturity date or the business day immediately preceding the date fixed by the Corporation for redemption at a conversion price of C\$10.526 per common share, being the ratio of 95 common shares per C\$1,000 principal amount of the convertible debentures. The convertible debentures were not redeemable prior to June 30, 2013. Transaction costs in connection with the financing were \$1.9 million and were recognized in profit or loss.

The convertible debentures were recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss. A reconciliation of the convertible debentures is provided below.

Balance at July 1, 2012	\$	25,381
Unrealized gain		(2,614)
Foreign exchange gain		(676)
Balance at June 30, 2013		22,091
Unrealized loss		3,699
Foreign exchange gain		(395)
<b>Balance at June 30, 2014</b>	<b>\$</b>	<b>25,395</b>

### NOTE 12 – SHARE CAPITAL

#### Authorized

The Corporation is authorized to issue an unlimited number of common shares.

#### Issued and Outstanding

	Number (000s)		Amount
Balance at July 1, 2012	61,898	\$	340,775
Issued on Shona acquisition (note 4)	24,601		68,346
Issued on exercise of stock options	7		7
Transfer from other reserves for stock options exercised	-		3
Share issuance costs	-		(361)
Balance at June 30, 2013	86,506		408,770
Issued on equity offering	15,823		115,289
Issued on property acquisitions (Note 5)	2,454		15,000
Issued on exercise of stock options and warrants	2,953		10,878
Transfer from other reserves and warrants for stock options and warrants exercised	-		6,874
Share issuance costs	-		(5,762)
<b>Balance at June 30, 2014</b>	<b>107,736</b>	<b>\$</b>	<b>551,049</b>

On May 27, 2014, the Corporation closed a bought deal equity financing announced on May 6, 2014. The Corporation issued 15,823,000 common shares at a price of C\$7.90 per common share for gross proceeds of \$115,289,000 (C\$125,001,700).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Stock Options

The number and weighted-average exercise prices of stock options are as follows:

	Number (000s)	Weighted-Average Exercise Price (C\$)
Balance at July 1, 2012	5,498	7.92
Granted	2,267	3.58
Exercised	(7)	1.00
Forfeited and cancelled	(307)	7.74
Balance at June 30, 2013	7,451	6.61
Granted	3,983	6.90
Exercised	(1,177)	2.84
Forfeited and cancelled	(568)	8.99
<b>Balance at June 30, 2014</b>	<b>9,689</b>	<b>7.05</b>

Information with respect to stock options outstanding at June 30, 2014 is presented below.

Stock Options Outstanding				Stock Options Exercisable	
Range of Exercise Prices (C\$)	Number of Stock Options (000s)	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price (C\$)	Number of Stock Options (000s)	Weighted-Average Exercise Price (C\$)
\$1.00 to \$3.50	1,608	2.84	3.41	1,184	3.42
\$3.60 to \$7.00	3,073	3.37	6.02	2,028	5.92
\$7.10 to \$10.50	4,346	1.90	8.01	3,167	8.27
\$10.60 to \$14.00	132	1.68	12.10	132	12.10
\$14.10 and higher	530	1.57	14.90	530	14.90
	<b>9,689</b>	<b>2.50</b>	<b>7.05</b>	<b>7,041</b>	<b>7.35</b>

The fair value of the stock options granted was estimated using the Black-Scholes option pricing model with the following weighted-average inputs:

Year ended June 30	2014	2013
Weighted-average fair value at grant date (C\$)	4.84	4.47
Share price (C\$)	3.38 - 15.00	3.38 - 15.00
Exercise price (C\$)	3.38 - 15.00	3.38 - 15.00
Volatility	72% - 126%	90% - 126%
Option life	5 years	5 years
Dividends	Nil	Nil
Risk-free interest rate	1.17% - 2.78%	1.17% - 2.78%

A forfeiture rate of 5% (2013 - 5%) was used when recording stock-based compensation for year ended June 30, 2014. Stock-based compensation expense of \$6.9 million (2013 - \$4.4 million) was expensed and \$3.4 million (2013 - \$3.6 million) was capitalized during the year ended June 30, 2014.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 13 – FINANCE INCOME AND EXPENSE

Year ended June 30	2014	2013
		(restated) (note 26)
<b>Finance income</b>		
Interest and other income	\$ (2,241)	\$ (2,383)
<b>Finance expense</b>		
Fair value adjustment on equity tax payable	55	116
Accretion on decommissioning obligations	540	353
Amortization of upfront fees	2,383	4,962
Phantom warrants issued on closing of term loan	-	1,906
Interest and other expense	8,919	10,596
	<b>11,897</b>	<b>17,933</b>
<b>Net finance expense</b>	<b>\$ 9,656</b>	<b>\$ 15,550</b>

### NOTE 14 – EARNINGS (LOSS) PER SHARE

Basic and diluted earnings (loss) per share were calculated as follows:

Year ended June 30	2014	2013
		(restated) (note 26)
<b>Net income (loss), basic and diluted</b>	<b>\$ 9,937</b>	<b>\$ (127,807)</b>
<b>Weighted-average common share adjustments</b>		
Weighted-average common shares outstanding, basic	89,836	74,839
Effect of warrants	79	-
Effect of stock options	456	-
<b>Weighted-average common shares outstanding, diluted</b>	<b>90,371</b>	<b>74,839</b>

For the years ended June 30, 2014 and 2013, the effect of the convertible debentures was anti-dilutive. For the year ended June 30, 2013, all items were anti-dilutive due to the net loss.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 15 – INCOME TAXES

The following table reconciles income taxes calculated at the Colombian Statutory rate with actual income taxes:

Year ended Jun 30	2014	2013
		(restated) (note 26)
Net income (loss) before taxes	\$ 31,953	\$ (169,914)
Statutory rates	25.00%	25.00%
Expected income taxes	\$ 7,988	\$ (42,479)
Effect on taxes resulting from:		
Non-deductible share-based payments and other permanent differences	860	1,112
Tax differential on foreign jurisdictions	5,968	(15,251)
Change in unrecognized tax benefit, foreign exchange and other	7,200	14,511
<b>Provision for income taxes</b>	<b>22,016</b>	<b>(42,107)</b>
Current	24,823	2,033
Deferred	(2,807)	(44,140)
	<b>22,016</b>	<b>(42,107)</b>

The net deferred tax asset is comprised of:

	June 30, 2014	June 30, 2013
		(restated) (note 26)
Net book value of property, plant and equipment in excess of asset tax base	\$ (5,493)	\$ (9,005)
Non-capital losses carried forward	27,154	28,325
Decommissioning liabilities	3,576	2,718
Timing differences on revenue and expense recognition and other	2,546	(1,995)
<b>Deferred tax asset</b>	<b>27,783</b>	<b>20,043</b>
Deferred tax asset not recognized	(28,837)	(23,904)
<b>Net deferred tax (liability) asset</b>	<b>(1,054)</b>	<b>(3,861)</b>

At June 30, 2014, the Corporation had non-capital losses carried forward of approximately \$11.3 million (2013 - \$16.6 million) available to reduce future years taxable income. At June 30, 2014, the Corporation had available deferred income tax assets of \$34.5 million (2013 - \$30.8 million) related to income tax pools in Canada, Brazil and Peru that were not recognized in the financial statements due to uncertainties associated with its ability to utilize these balances in the future.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 16 – KEY MANAGEMENT PERSONNEL COMPENSATION

The Corporation has determined that the key management personnel of the Corporation consists of its executive management and its Board of Directors. In addition to the salaries and fees paid to key management, the Corporation also provides compensation to both groups under its stock-based compensation and restricted share unit plans. Compensation expenses paid to key management personnel were as follows:

Year ended June 30	2014		2013	
Salaries and director fees	\$	4,159	\$	2,966
Termination benefits		38		75
Stock-based compensation		7,016		2,724
Restricted share units		-		3,219
<b>Key management personnel compensation</b>	<b>\$</b>	<b>11,213</b>	<b>\$</b>	<b>8,984</b>

### NOTE 17 – SUPPLEMENTAL INFORMATION

The Corporation records petroleum and natural gas sales net of royalties. Royalties incurred were as follows:

Year ended June 30	2014		2013	
Petroleum and natural gas royalties	\$	21,287	\$	12,488

Income taxes and interest paid were as follows:

Year ended June 30	2014		2013	
Income taxes paid	\$	5,252	\$	4,292
Interest paid	\$	10,613	\$	5,157

Loss (gain) on derivatives and financial instruments:

Year ended June 30	2014		2013	
Embedded derivatives	\$	2,714	\$	4,384
Convertible debentures – unrealized		3,699		(2,614)
Warrants – unrealized		8,746		(1,085)
Warrants – realized		(611)		-
Phantom warrants – unrealized		5,827		120
Restricted share units – unrealized		3,647		468
Restricted share units – realized		1,864		-
Share investments – unrealized		508		58
Commodity contracts – unrealized		(242)		(147)
Commodity contracts – realized		432		1,634
	<b>\$</b>	<b>26,584</b>	<b>\$</b>	<b>2,818</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

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Changes in non-cash working capital were comprised of:

Year ended June 30	2014	2013
<b>Change in:</b>		
Trade and other receivables	\$ (21,321)	\$ (1,969)
Prepaid expenses and deposits	(1,074)	(5,070)
Crude oil inventory	979	1,650
Trade and other payables	36,798	(4,392)
Equity tax payable	(1,279)	(1,857)
Taxes payable	15,394	(4,286)
	<b>29,497</b>	<b>(15,924)</b>
<b>Attributable to:</b>		
Operating activities	2,145	(18,786)
Investing activities	27,352	2,862
	<b>\$ 29,497</b>	<b>\$ (15,924)</b>

### NOTE 18 – SEGMENTED INFORMATION

The Corporation's only reportable segment is "Colombia" (previously "Colombia" and "Ecuador"). As a result of the adoption of IFRS 11, "Ecuador" no longer meets the definition of a reportable segment under IFRS 8. Consequently, "Ecuador" has been removed from the composition of the Corporation's reportable segments during the year ended June 30, 2014.

The Corporation's investment and its share of profit in the Ecuador IPC (the unconsolidated joint venture that was previously proportionately consolidated as "Ecuador") have been added to "Other Segments". The main purpose of "Other Segments" is to reconcile the reportable segment to the Corporation's combined results. "Other Segments" is not a reportable segment. The Corporation's chief operating decision maker is its executive officers.

The following tables show information regarding the Corporation's segments.

	Colombia (reportable)	Other Segments (non-reportable)	Total
<b>Year ended June 30, 2014</b>			
Revenues	\$ 207,787	\$ -	\$ 207,787
Share of joint venture profits	-	3,532	3,532
Expenses, excluding income taxes	(145,778)	(33,588)	(179,366)
Net income (loss) before taxes	62,009	(30,056)	31,953
Income taxes	22,016	-	22,016
Net income (loss)	\$ 39,993	\$ (30,056)	\$ 9,937
Capital expenditures, net	\$ 147,353	\$ 5,812	\$ 153,165
<b>Year ended June 30, 2013</b> (restated – note 26)			
Revenues	\$ 141,354	\$ -	\$ 141,354
Share of joint venture loss	-	(2,421)	(2,421)
Expenses, excluding income taxes	(266,516)	(42,331)	(308,847)
Net income (loss) before taxes	(125,162)	(44,752)	(169,914)
Income taxes (recovery)	(43,164)	1,057	(42,107)
Net income (loss)	\$ (81,998)	\$ (45,809)	\$ (127,807)
Capital expenditures, net	\$ 45,254	\$ 5,286	\$ 50,540

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

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	Colombia		Other Segments		Total
	(reportable)		(non-reportable)		
<b>As at June 30, 2014</b>					
Total assets	\$	529,705	\$	226,882	\$ 756,587
Total liabilities	\$	192,923	\$	163,377	\$ 356,300
<b>As at June 30, 2013</b> (restated - note 26)					
Total assets	\$	383,651	\$	85,941	\$ 469,592
Total liabilities	\$	123,625	\$	106,664	\$ 230,289
<b>As at July 1, 2012</b>					
Total assets	\$	314,394	\$	92,434	\$ 406,828
Total liabilities	\$	64,658	\$	51,076	\$ 115,734

Major customers are customers which represent more than 10% of total revenue for a given period. For the year ended June 30, 2014, five major customers represented 30%, 20%, 12%, 11% and 11% of total revenue, respectively. For the year ended June 30, 2013, three major customers represented 54%, 23% and 10% of total revenue, respectively.

### NOTE 19 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

#### Fair Value of Financial Instruments

The carrying values and respective fair values of financial assets and liabilities at June 30, 2014 are summarized as follows:

	Carrying Value		Fair Value	
<b>Fair value through profit or loss</b>				
Cash and cash equivalents	\$	163,729	\$	163,729
Restricted cash		66,827		66,827
Convertible debentures		25,395		25,395
Commodity contracts liabilities		38		38
Phantom warrants		7,557		7,557
Warrants		4,331		4,331
Restricted share units		404		404
Investments		7,755		7,755
<b>Loans and receivables</b>				
Bank debt		210,688		220,000
Trade and other receivables		60,981		60,981
<b>Other liabilities</b>				
Trade and other payables		75,814		75,814
Equity tax payable		582		582
Other long term obligations		219		219
Deferred income		3,731		3,731

The Corporation classifies the fair value of financial instruments measured at fair value 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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- 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 quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Corporation's financial instruments have been assessed on the fair value hierarchy described above. Cash and cash equivalents, restricted cash, restricted share units and convertible debentures are classified as Level 1. Commodity contracts liabilities and investments are classified as Level 2. Warrants and phantom warrants are classified as Level 3. There has been no reclassification of financial instruments into or out of each fair value hierarchy during the year ended June 30, 2014. Assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the placement within the fair value hierarchy level.

### Warrants

On December 21, 2012, upon closing of the Shona acquisition, the Corporation issued 5,053,216 warrants in exchange for Shona warrants at an exchange ratio of 0.12587 of a Canacol warrant per Shona warrant and the exercise price of the warrants was reduced with respect to the exchange ratio of 0.12587 such that the warrants maintained their economic equivalency (note 4).

	Number (000s)		Amount
Balance at July 1, 2012	329	\$	896
Issued on Shona acquisition (note 4)	5,053		2,231
Unrealized gain	-		(1,085)
Foreign exchange gain	-		(171)
Balance at June 30, 2013	5,382		1,871
Exercised	(1,776)		(5,329)
Expired	(1,114)		(650)
Unrealized loss	-		8,746
Foreign exchange gain	-		(307)
<b>Balance at June 30, 2014</b>	<b>2,492</b>	<b>\$</b>	<b>4,331</b>

Information with respect to warrants outstanding at June 30, 2014 is presented below.

Expiry date	Number of warrants (000s)	Exercise Price (C\$)
January 26, 2015	495	5.96
February 1, 2015	1,218	5.96
September 2, 2015	515	3.97
February 9, 2016	264	5.20
	<b>2,492</b>	<b>5.47</b>

### Restricted Share Units

On May 2, 2013, the Corporation granted 1,404,138 restricted share units ("RSUs") to certain directors, officers and employees, with a reference price of C\$2.58 per share. The RSUs vested as to one-third in three months and two-thirds in twelve months from the grant date, and were settled in cash.

During the year ended June 30, 2014, the Corporation granted 62,082 RSUs to certain employees with a weighted-average reference price of C\$6.35 per share. The RSUs vest as to one-half in one year and one-half in two years from the grant date, and are settled in cash.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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	Number (000s)	Amount
Balance at July 1, 2012	-	\$ -
Granted	1,404	3,592
Unrealized loss	-	468
Foreign exchange gain	-	(146)
Balance at June 30, 2013	1,404	3,914
Granted	62	366
Settled	(1,404)	(7,232)
Unrealized loss	-	3,647
Foreign exchange gain	-	(291)
<b>Balance at June 30, 2014</b>	<b>62</b>	<b>\$ 404</b>

### Phantom Warrants

In connection with the closing of the Shona business acquisition on December 21, 2012, the Corporation entered into a credit agreement for \$45.0 million, which has since been replaced by the Senior Secured Term Loan. In consideration for entering into the credit agreement, the Corporation agreed to a “phantom warrant payment” arrangement such that the Corporation would pay an amount (in cash or Canacol Shares, at the election of the Corporation) equal to the in-the-money amount of 2,697,292 common share purchase warrants of the Corporation at an exercise price of C\$4.50 per Canacol Share. The phantom warrant payment may be demanded partially or in full at any time for a period of three years.

	Number (000s)	Amount
Balance at July 1, 2012	-	\$ -
Issued	2,697	1,906
Unrealized loss	-	120
Foreign exchange gain	-	(160)
Balance at June 30, 2013	2,697	1,866
Unrealized loss	-	5,827
Foreign exchange gain	-	(136)
<b>Balance at June 30, 2014</b>	<b>2,697</b>	<b>\$ 7,557</b>

The fair value of the phantom warrants was estimated using the Black-Scholes option pricing model with the following inputs:

	June 30, 2014	June 30, 2013
Fair value at reporting date (C\$)	3.00	0.73
Share price (C\$)	6.95	2.93
Exercise price (C\$)	4.50	4.50
Volatility	51.84%	60.76%
Remaining warrant life	1.5 years	2.5 years
Dividends	Nil	Nil
Risk-free interest rate	1.01%	1.22%

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Market Risk

Market risk is the risk that changes in market factors, such as commodity prices, foreign exchange rates, and interest rates will affect the Corporation's cash flows, net income (loss), liquidity or the value of financial instruments. The objective of market risk management is to mitigate market risk exposures where considered appropriate and maximize returns.

#### (i) Commodity Price Risk

Commodity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in commodity prices. Lower commodity prices can also impact the Corporation's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. From time to time the Corporation may attempt to mitigate commodity price risk through the use of financial derivatives. The Corporation's policy is to only enter into commodity contracts considered appropriate to a maximum of 50% of forecasted production volumes.

At June 30, 2014, the Corporation had one financial oil collar outstanding under the following terms:

Period	Volume	Type	Price Range
Jan 2014 – Dec 2014	500 bbls/day	Financial Brent Oil Collar	\$75.00 – \$123.50

For the year ended June 30, 2014, a \$1.00/boe increase/decrease in the price of a barrel of oil equivalent is estimated to increase/decrease the Corporation's earnings by \$1,987,000 (2013 - \$1,228,000) assuming all other variables are held constant.

#### (ii) Foreign Currency Risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. The Corporation is exposed to foreign currency fluctuations as certain expenditures are denominated in Colombian pesos and Canadian dollars, and to a lesser extent, Brazilian reais and Peruvian sol.

The Corporation had no forward exchange rate contracts in place as at or during the year ended June 30, 2014.

For the year ended June 30, 2014, a 1% increase/decrease in the US dollar vis-à-vis the Colombian peso and Canadian dollar is estimated to increase/decrease the Corporation's earnings by \$417,000 and \$622,000 (2013 - \$464,000 and \$81,000), respectively, assuming all other variables are held constant.

The Corporation's sensitivity to Brazilian reais and Peruvian sol in the years ended June 30, 2014 and 2013 was immaterial.

#### (iii) Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate risk on certain variable interest rate debt instruments, to the extent they are drawn. The remainder of the Corporation's financial assets and liabilities are not exposed to interest rate risk. The Corporation had no interest rate swap or financial contracts in place as at or during the year ended June 30, 2014.

For the year ended June 30, 2014, a 1% increase/decrease in interest rate is estimated to increase/decrease the Corporation's earnings by \$990,000 (2013 - \$389,000), assuming all other variables are held constant.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. The Corporation's approach to managing liquidity is to ensure, within reasonable means, sufficient liquidity to meet its liabilities when due, under both normal and unusual conditions, without incurring unacceptable losses or jeopardizing the Corporation's business objectives. The Corporation prepares annual capital expenditure budgets which are monitored regularly and updated as considered necessary. Petroleum and natural gas production is monitored daily to provide current cash flow estimates and the Corporation utilizes authorizations for expenditures on projects to manage capital expenditures.

The following table outlines the contractual maturities of the Corporation's financial liabilities at June 30, 2014:

	Less than 1 year	1-2 years	Thereafter	Total
Bank debt – principal	44,000	58,667	117,333	220,000
Trade and other payables	75,814	-	-	75,814
Deferred income	-	3,731	-	3,731
Equity tax payable – undiscounted	587	-	-	587
Other long term obligations	-	-	219	219
Convertible debentures – principal	23,904	-	-	23,904
Commodity contracts	38	-	-	38
Phantom warrants	-	7,557	-	7,557
Warrants	2,121	2,210	-	4,331
Restricted share units	202	202	-	404
	146,666	72,367	117,552	336,585

In addition to the above, the Corporation has issued letters of credit totalling \$32.8 million to guarantee certain obligations under its exploration contracts and to guarantee other contractual commitments. Such amounts only become payable should the Corporation not meet those obligations.

### Credit Risk

Credit risk reflects the risk of loss if counterparties do not fulfill their contractual obligations. The majority of the Corporation's trade receivable balances relate to petroleum and natural gas sales. The Corporation's policy is to enter into agreements with well established customers in a good financial position such that the level of risk is mitigated. To date, the Corporation has not experienced any material credit losses in the collection of its trade receivables. In Colombia, a significant portion of crude oil sales are with customers that are directly or indirectly controlled by the government. The Corporation has also entered into sales agreements with certain Colombian private sector companies.

The Corporation's trade receivables primarily relate to sales of petroleum and natural gas, which are normally collected within 45 days of the month of production. The Corporation has historically not experienced any collection issues with its customers.

### Capital Management

The Corporation's policy is to maintain a strong capital base in order to provide flexibility in the future development of the business and maintain investor, creditor and market confidence. The Corporation manages its capital structure and makes adjustments in response to changes in economic conditions and the risk characteristics of the underlying assets. The Corporation considers its capital structure to include common share capital, convertible debentures, bank debt and working capital, defined as current assets less current liabilities, excluding non-cash items such as the current portion of commodity contracts, current portion of warrants, current portion of convertible debentures and any embedded derivatives asset/liability. In order to maintain or adjust the capital structure, from time to time the Corporation may issue common shares or other securities, sell assets or adjust its capital spending to manage current and projected debt levels.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

The Corporation monitors leverage and adjusts its capital structure based on the ratio of net debt to funds from operations. This ratio is calculated as net debt, defined as the principal amount of its outstanding bank debt plus the principal amount of its convertible debentures, unless the debentures are in-the-money or may otherwise be settled in common shares at the option of the Corporation, less working capital, as defined above and less the current portion of bank debt and convertible debentures included above, divided by adjusted funds from operations, defined as cash flows from operating activities, excluding changes in non-cash working capital, and adjusted for the Corporation's share of operating funds flows under the Ecuador IPC, which was previously proportionately consolidated and is now accounted for under the equity method (see note 26). The Corporation uses the ratio of net debt to adjusted funds from operations as a key indicator of the Corporation's leverage and to monitor the strength of its financial position.

In order to facilitate the management of this ratio, the Corporation prepares annual budgets, which are updated as necessary depending on varying factors including current and forecast crude oil prices, changes in capital structure, execution of the Corporation's business plan and general industry conditions. The annual budget is approved by the Board of Directors and updates are prepared and reviewed as required.

	June 30, 2014
Bank debt (current and long-term) – principal	\$ 220,000
Working capital surplus, excluding the current portion of bank debt, convertible debentures, warrants, and derivatives	(159,117)
Net debt	\$ 60,883
Adjusted funds from operations <sup>(1)</sup>	\$ 95,522
Net debt to adjusted funds from operations	0.6

(1) Adjusted funds from operations for the year ended June 30, 2014 inclusive of amounts related to the Ecuador IPC.

### NOTE 20 – COMMITMENTS AND CONTINGENCIES

Presented below are the Corporation's contractual commitments at June 30, 2014:

	Less than 1 year		1-3 years		Thereafter		Total
Exploration and production contracts	\$	22,053	\$	26,842	\$	-	\$ 48,895
Office lease		1,045		1,748		3,852	6,645

#### Trucking Contract

During the year ended June 30, 2012, the Corporation has signed an agreement with a Colombian trucking company for the exclusive use of 100 trucks for transportation of crude oil from the Corporation's operations in Colombia for a period of three years. The Corporation will pay transportation fees plus an additional 7.5% for administrative costs. Any excess or shortage of the fees charged over the actual operating costs will be shared equally between the Corporation and the trucking company at the end of each year. The Corporation has the option to purchase up to 50 trucks at the end of the three year agreement.

As at June 30, 2013, the Corporation's share of estimated excess fees charged over the term of the contract was discounted and recognized as an embedded derivatives asset of \$2.7 million (2012 – \$7.1 million).

During the year ended June 30, 2014, the Corporation amended its trucking contract whereby i) the Corporation no longer has the option to purchase up to 50 trucks at the end of the contract and ii) any excess or shortage of the fees charged over the actual operating costs will no longer be shared between the Corporation and the trucking company. Consequently, the embedded derivatives asset was de-recognized during the year, resulting in a loss on embedded derivatives of \$2.7 million for the year ended June 30, 2014. The amended trucking contract will expire in June 2016.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

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### Ecuador Incremental Production Contract

In addition to the commitments described above, the Corporation has a non-operated 25% equity participation interest (27.9% capital participation interest) in a joint-venture consortium which in 2012 was awarded an incremental production contract for the Libertador and Atacapi mature oil fields in Ecuador. The consortium is committed to incur project expenditures for a total of \$334 million (\$93.3 million net to the Corporation) over the 15 year term of the contract. As at June 30, 2014, the Corporation had incurred \$55.6 million of expenditures in connection with its Ecuador IPC commitment.

### OBC Pipeline

The Corporation owns a 0.5% interest in OBC, which owns a pipeline system that will link Llanos basin oil production to the Cano Limon oil pipeline system. Under the terms of the OBC agreement, the Corporation may be required to provide financial support or guarantees for its proportionate equity interest in any future debt financings undertaken by OBC. The Corporation is also required to enter into ship-or-pay arrangements with OBC to guarantee pipeline revenues.

### Contingencies

In the normal course of operations, the Corporation has disputes with industry participants for which it currently cannot determine the ultimate results. The Corporation has a policy to record contingent liabilities as they become determinable and the probability of loss is more likely than not.

## NOTE 21 – DEFERRED INCOME

Pacific Rubiales Energy Corp. (“Pacific Rubiales”) has executed an agreement with the Corporation whereby, among other things, the Corporation has agreed to transfer operatorship of the Portofino Exploration and Production contract (the “Contract”) to Pacific Rubiales subject to ANH approval. Under the terms of the agreement, Pacific Rubiales will operate any commercial discoveries made on the contract. In consideration for the transfer of operatorship, Pacific Rubiales has agreed to pay the Corporation the sum of \$3,731,000 (the “Consideration”) and has agreed to provide the Corporation with the option to participate pro-rata in its interest in the Contract, as well as in all pipelines and transportation infrastructure projects in which Pacific Rubiales participates in respect of the evacuation of crude from the area. As at June 30, 2014, the consideration was received and recognized as deferred income.

## NOTE 22 – EQUITY TAX

Equity tax represents a tax on the capital of Colombian corporations and branches of foreign corporations. The tax was approved by the Colombian government in December 2010 and was assessed for the calendar years 2011-2014 based on 6% of the net equity of the Corporation’s Colombian entities as at January 1, 2011. The assessed amount of \$5.2 million is payable in semi-annual instalments over the four-year period. The net present value of the assessed amount, being \$4.7 million, was expensed on January 1, 2011 and was classified as an operating expense in the statements of operations since it is not based on income. The Corporation has estimated the net present value of the equity tax payable to be \$0.6 million at June 30, 2014 (2013 - \$1.8 million) based on an undiscounted total future liability of \$0.6 million (2013 - \$1.9 million).

## NOTE 23 – PROVISIONS

There is an ongoing disagreement between the Corporation and another Colombian entity (the “Counterparty”) over the payment of certain operating costs relating to crude oil production. The Counterparty has asserted that Canacol is liable for certain operating costs incurred by the Counterparty. Canacol disagrees with this assertion because it believes the Counterparty has not met the terms of the contract governing these operating costs. The ultimate result of this disagreement cannot be determined at June 30, 2014.

At June 30, 2013, the Corporation believed that the disagreement may result in a cash settlement and had recorded a provision of \$10.5 million based on management’s estimate. At June 30, 2014, the Corporation believes that the

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

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possibility of an outflow of resources embodying economic benefits to settle this disagreement is remote and has consequently reversed such provision during the year ended June 30, 2014 in accordance with IAS 37.

Detailed information of the estimated provision and the reversal thereof was not disclosed as it may prejudice seriously the position of the Corporation in the disagreement with the Counterparty.

### NOTE 24 – SIGNIFICANT SUBSIDIARIES

The Corporation has the following significant subsidiaries:

	Country of Incorporation	Fiscal year end	Ownership Interest	
			June 30, 2014	June 30, 2013
Canacol Energy Inc.	Canada	December 31	100%	100%
Canacol Energy Colombia S.A.	Colombia	December 31	100%	100%
Canacol Energy Inc. (Sucursal Colombia)	Colombia	December 31	100%	100%
CNE Oil and Gas SAS	Colombia	December 31	100%	-
Carrao Energy Ltd.	Canada	December 31	100%	100%
Brazalta Brazil Norte Ltda.	Brazil	December 31	100%	100%
Ice Peak Investments S.L.	Spain	December 31	100%	100%
Shona Energy (Colombia) Ltd.	British Virgin Islands	December 31	100%	100%
Geoproduction Oil and Gas Company, LLC	United States of America	December 31	100%	100%

### NOTE 25 – INVESTMENT IN JOINT VENTURE

The Corporation conducts its operations in Ecuador through a 25% equity interest (27.9% capital participation interest) in the Ecuador IPC, which is reported in these financial statements using the equity method of accounting. Prior to the adoption of IFRS 11, the Ecuador IPC was accounted for using the proportionate consolidation method of accounting. Details of the Ecuador IPC's net assets, revenues and net income (loss) are shown below with comparative information due to the adoption of IFRS 11.

As at	June 30, 2014	June 30, 2013	July 1, 2012
Total Ecuador IPC assets (gross)	\$ 250,255	\$ 94,878	\$ 21,154
Total Ecuador IPC liabilities (gross)	231,607	105,334	21,926
Ecuador IPC Equity (gross)	18,648	(10,456)	(772)
Investment in joint venture	8,046	1,963	4,361

During the year ended June 30, 2014, the Corporation contributed \$2.6 million (2013 - \$nil) into the Ecuador IPC.

Year ended June 30	2014	2013
Joint venture net income (loss)	\$ 14,128	\$ (9,684)
Corporation's share of joint venture profit (loss)	\$ 3,532	\$ (2,421)

### NOTE 26 – EFFECT OF IFRS 11 ADOPTION

The adoption of IFRS 11 affected the Corporation's previously reported Consolidated Statements of Financial Position, Consolidated Statements of Operations and Comprehensive Income (Loss), and Consolidated Statements of Cash Flows as at and for the year ended June 30, 2013. Prior to the adoption of IFRS 11, the Ecuador IPC was accounted for using the proportionate consolidation method and is now being accounted for using the equity method of accounting.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended June 30, 2014 and 2013

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

### Impact on Consolidated Statements of Financial Position

As at July 1, 2012	As Previously Reported	Effect of IFRS 11 Adoption	Restated
Trade and other receivables	\$ 32,801	\$ (991)	\$ 31,810
Property, plant and equipment	187,208	(3,370)	183,838
Investment in joint venture	-	4,361	4,361

As at June 30, 2013	As Previously Reported	Effect of IFRS 11 Adoption	Restated
Trade and other receivables	\$ 41,957	\$ (3,816)	\$ 38,141
Restricted cash – non-current	4,849	14,418	19,267
Property, plant and equipment	257,586	(19,308)	238,278
Investment in joint venture	-	1,963	1,963
Deferred tax liabilities	3,409	452	3,861
Deficit	(202,693)	(7,195)	(209,888)

### Impact on Consolidated Statements of Operations and Comprehensive Income (Loss)

For the year ended June 30, 2013	As Previously Reported	Effect of IFRS 11 Adoption	Restated
Petroleum and natural gas revenue, net of royalties	\$ 147,666	\$ (6,312)	\$ 141,354
Share of joint venture loss	-	(2,421)	(2,421)
Depreciation and depreciation	48,240	(1,330)	46,910
Net finance expense	16,211	(661)	15,550
Deferred tax recovery	(44,592)	452	(44,140)
Net income and comprehensive income	(120,612)	(7,195)	(127,807)
Earnings per share – basic and diluted	(1.61)	(0.10)	(1.71)

### Impact on Consolidated Statements of Cash Flows

For the year ended June 30, 2013	As Previously Reported	Effect of IFRS 11 Adoption	Restated
Cash flows from operating activities	\$ 29,545	\$ (3,490)	\$ 26,055
Cash flows from investing activities	(100,859)	2,829	(98,030)
Cash flows from financing activities	92,815	661	93,476
Change in cash and cash equivalents	\$ 21,501	\$ -	\$ 21,501