PERPETUAL

ENERGY

2013

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S REPORT

The consolidated financial statements of Perpetual Energy Inc. ("Perpetual" or "the Corporation") are the responsibility of Management and have been approved by the Board of Directors of Perpetual. These consolidated financial statements have been prepared by Management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and the Interpretations of the IFRS Interpretations Committee.

The consolidated financial statements are audited and have been prepared using accounting policies in accordance with IFRS. The preparation of Management's Discussion and Analysis is based on Perpetual's financial results which have been prepared in accordance with IFRS. It compares Perpetual's financial performance in 2013 to 2012 and should be read in conjunction with the consolidated financial statements and accompanying notes.

Management is responsible for establishing and maintaining adequate internal control over Perpetual's financial reporting. Management believes that the system of internal controls that have been designed and maintained at Perpetual provide reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements. The internal accounting control process includes Management's communication to employees of policies which govern ethical business conduct.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Board of Directors has appointed an Audit Committee consisting of unrelated, non-management directors which meets at least four times during the year with Management and independently with the external auditors and as a group to review any significant accounting, internal control and auditing matters in accordance with the terms of the charter of the Audit Committee as set out in the Annual Information Form. The Audit Committee reviews the consolidated financial statements and Management's Discussion and Analysis before the consolidated financial statements are submitted to the Board of Directors for approval. The external auditors have free access to the Audit Committee without obtaining prior Management approval.

With respect to the external auditors, the Audit Committee approves the terms of engagement and reviews the annual audit plan, the Auditors' Report and results of the audit. It also recommends to the Board of Directors the firm of external auditors to be appointed by the shareholders.

The independent external auditors, KPMG LLP, have been appointed by the Board of Directors on behalf of the shareholders to express an opinion as to whether the consolidated financial statements present fairly, in all material respects, Perpetual's financial position, results of operations and cash flows in accordance with IFRS. The report of KPMG LLP outlines the scope of their examination and their opinion on the consolidated financial statements.

/s/ Susan L. Riddell Rose	*/s/ Cameron R. Sebastian*
Susan L. Riddell Rose	**Cameron R. Sebastian**
President & Chief Executive Officer	Vice President, Finance & Chief Financial Officer

March 5, 2014

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Perpetual Energy Inc.

We have audited the accompanying consolidated financial statements of Perpetual Energy Inc., which comprise the consolidated statements of financial position as at December 31, 2013, December 31, 2012 and January 1, 2012, the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years ended December 31, 2013 and December 31, 2012, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Perpetual Energy Inc. as at December 31, 2013, December 31, 2012 and January 1, 2012, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2013 and December 31, 2012, in accordance with International Financial Reporting Standards.

Comparative Information

Without modifying our opinion, we draw attention to note 2 to the consolidated financial statements which indicates that the comparative information presented as at and for the year ended December 31, 2012, has been restated and that the comparative information presented as at January 1, 2012, has been derived from the consolidated financial statements as at and for the year ended December 31, 2011.

KPMG LLP

Chartered Accountants

Calgary, Canada
March 5, 2014

PERPETUAL ENERGY INC.
Consolidated Statements of Financial Position

As at	**December 31, 2013**	December 31, 2012	January 1, 2012
(Cdn$ thousands)		Restated (note 2)	Restated (note 2)
Assets			
Current assets			
Accounts receivable	**$ 36,099**	$ 33,787	$ 34,209
Prepaid expenses and deposits	**1,369**	2,928	3,891
Marketable securities	**-**	1,963	3,282
Derivatives (note 18)	**326**	3,703	12,604
Assets held for sale (note 5)	**-**	22,321	20,325
	37,794	64,702	74,311
Long term Crown receivable (note 9)	**10,997**	8,784	9,059
Derivatives (note 18)	**19**	-	7,692
Property, plant and equipment (note 7)	**576,954**	570,415	827,928
Exploration and evaluation (note 8)	**88,177**	80,494	106,763
Equity-method investment (note 6)	**28,347**	5,493	-
	704,494	665,186	951,442
Total assets	**$ 742,288**	$ 729,888	$ 1,025,753
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	**$ 45,048**	$ 47,315	$ 53,316
Derivatives (note 18)	**6,468**	1,452	6,841
Share based payment liability	**11**	24	664
Convertible debentures (note 12)	**-**	-	74,250
Bank indebtedness (note 10)	**70,618**	-	-
Liabilities associated with assets held for sale (note 5)	**-**	93	4,843
	122,145	48,884	139,914
Derivatives (note 18)	**2,778**	8,402	10,865
Bank indebtedness (note 10)	**-**	77,974	130,062
Senior notes (note 11)	**147,719**	147,177	146,634
Convertible debentures (note 12)	**154,496**	151,673	149,020
Gas storage obligation	**-**	-	41,630
Gas over bitumen obligation (note 13)	**2,948**	2,737	3,356
Decommissioning obligation (note 13)	**213,906**	206,379	242,860
Deferred tax liability (note 21)	**-**	-	3,753
	521,847	594,342	728,180
Total liabilities	**643,992**	643,226	868,094
Equity			
Share capital (note 14)	**1,257,315**	1,255,450	1,254,273
Equity component of convertible debentures	**13,971**	13,988	13,988
Contributed surplus	**21,474**	19,308	15,496
Deficit	**(1,194,464)**	(1,202,084)	(1,126,098)
Total equity	**98,296**	86,662	157,659
Total liabilities and equity	**$ 742,288**	$ 729,888	$ 1,025,753

See accompanying notes. The notes are an integral part of the Corporation's annual consolidated financial statements.

/s/ Robert A. Maitland

Robert A. Maitland
Director

/s/ Geoffrey C. Merritt

Geoffrey C. Merritt
Director

PERPETUAL ENERGY INC.
Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

	Year Ended December 31	
	2013	2012
(Cdn$ thousands, except per share amounts)		Restated (note 2)
Revenue		
Oil and natural gas	**$ 201,294**	$ 176,137
Royalties	**(19,042)**	(12,665)
	182,252	163,472
Change in fair value of commodity price derivatives (note 18)	**8,058**	26,811
Gas over bitumen (note 4h)	**8,905**	6,768
	199,215	197,051
Expenses		
Production and operating	**75,414**	81,740
Transportation	**10,163**	8,773
Exploration and evaluation (note 8)	**7,263**	9,282
General and administrative	**28,483**	31,473
Gain on dispositions (notes 5 and 7)	**(52,143)**	(48,990)
Depletion and depreciation (note 7)	**92,877**	105,667
Impairment (reversals) losses (note 7)	**(5,171)**	54,313
Income (loss) from operating activities	**42,329**	(45,207)
Finance expenses (note 16)	**(38,498)**	(33,960)
Share of net income (loss) of equity-method investment (note 6)	**3,789**	(572)
Income (loss) before tax	**7,620**	(79,739)
Deferred income tax benefit (note 21)	**-**	3,753
Net income (loss) and comprehensive income (loss)	**$ 7,620**	$ (75,986)
Income (loss) per share (note 14)		
Basic and diluted	**$ 0.05**	$ (0.52)

See accompanying notes. The notes are an integral part of the Corporation's annual consolidated financial statements.

PERPETUAL ENERGY INC.
Consolidated Statements of Changes in Equity

(Cdn$ thousands)	Share capital	Equity component of convertible debentures	Contributed surplus	Deficit Restated (note 2)	Total equity
Balance at December 31, 2012	$ 1,255,450	$ 13,988	$ 19,308	$ (1,202,084)	$ 86,662
Net income	-	-	-	7,620	7,620
Common shares issued pursuant to share based compensation plans	1,865	-	(1,838)	-	27
Share based compensation expense	-	-	3,974	-	3,974
Share based payment liability	-	-	13	-	13
Redemption of convertible debentures	-	(17)	17	-	-
Balance at December 31, 2013	**$ 1,257,315**	**$ 13,971**	**$ 21,474**	**$ (1,194,464)**	**$ 98,296**

(Cdn$ thousands)	Share capital	Equity component of convertible debentures	Contributed surplus	Deficit Restated (note 2)	Total equity
Balance at January 1, 2012	$ 1,254,273	$ 13,988	$ 15,496	$ (1,126,098)	$ 157,659
Net loss	-	-	-	(75,986)	(75,986)
Common shares issued pursuant to share based compensation plans	1,177	-	(1,177)	-	-
Share based compensation expense	-	-	4,349	-	4,349
Share based payment liability	-	-	640	-	640
Balance at December 31, 2012	$ 1,255,450	$ 13,988	$ 19,308	$ (1,202,084)	$ 86,662

See accompanying notes. The notes are an integral part of the Corporation's annual consolidated financial statements.

PERPETUAL ENERGY INC.
Consolidated Statements of Cash Flows

(Cdn$ thousands)	Year Ended December 31 2013	2012 Restated (note 2)
Cash flows from operating activities		
Net income (loss)	**$ 7,620**	$ (75,986)
Adjustments to add (deduct) non-cash items:		
Depletion and depreciation	**92,877**	105,667
Exploration and evaluation	**2,715**	5,758
Share based compensation expense	**3,974**	4,349
Change in fair value of commodity price derivatives	**(1,783)**	2,224
Finance expenses	**9,566**	1,477
Share of net (income) loss of equity-method investment	**(3,789)**	572
Deferred income tax benefit	**-**	(3,753)
Gain on dispositions	**(52,143)**	(48,990)
Impairment (reversals) losses	**(5,171)**	54,313
Share of dividends from equity-method investment (note 6)	**2,370**	910
Call option premiums received	**953**	2,446
Long-term Crown receivable adjustments	**(2,213)**	275
Expenditures on decommissioning obligations	**(2,497)**	(1,825)
Change in non-cash working capital (note 17)	**(146)**	1,162
Net cash from operating activities	**52,333**	48,599
Cash flows used in financing activities		
Change in bank indebtedness	**(7,356)**	(52,844)
Repayment of convertible debentures	**(187)**	(74,925)
Common shares issued net of issue fees	**27**	-
Change in non-cash working capital (note 17)	**(20)**	33
Net cash used in financing activities	**(7,536)**	(127,736)
Cash flows from (used in) investing activities		
Acquisitions	**(8,255)**	(2,627)
Capital expenditures	**(95,405)**	(79,675)
Proceeds on dispositions	**78,975**	167,170
Proceeds on sale of marketable securities	**1,871**	2,120
Increased interest in equity-method investment	**(19,129)**	-
Change in non-cash working capital (note 17)	**(2,854)**	(7,851)
Net cash from (used in) investing activities	**(44,797)**	79,137
Change in cash	**-**	-
Cash, beginning of year	**-**	-
Cash, end of year	**$ -**	$ -
Interest paid	**$ 29,220**	$ 32,468

See accompanying notes. The notes are an integral part of the Corporation's annual consolidated financial statements.

(All tabular amounts are in Cdn$ thousands, except where otherwise noted)

1. REPORTING ENTITY

Perpetual Energy Inc. ("Perpetual" or the "Corporation") is a Canadian corporation engaged in the exploration, development, and marketing of oil and gas based energy in Alberta, Canada. The Corporation operates a diversified asset portfolio that includes conventional heavy oil, resource-style tight gas, liquids rich gas in the Alberta deep basin, and several long-term bitumen resource properties.

The address of the Corporation's registered office is 3200, 605 – 5 Avenue S.W., Calgary, Alberta, T2P 3H5.

The consolidated financial statements of the Corporation are comprised of the accounts of Perpetual and its wholly owned subsidiaries, Perpetual Energy Operating Corp. and Perpetual Operating Trust, which are incorporated in Canada.

2. RESTATEMENT OF PRIOR PERIOD AMOUNTS

During preparation of the consolidated financial statements for the year ended December 31, 2013, Perpetual determined that:

i) The gas over bitumen obligation (see notes 4(h) and 13) as at January 1 and December 31, 2012 was overstated when compared to the present value of expected repayments of the gas over bitumen royalty adjustments received by the Corporation under the Natural Gas Royalty Regulation (2002) with respect to foregone production from gas wells shut-in for the benefit of bitumen producers in the Athabasca oil sands area. Previously, the Corporation recognized the undiscounted amount of the gas over bitumen royalty adjustment, net of any amounts receivable, as gas over bitumen obligation.

ii) As a result of recording the gas over bitumen royalty adjustments received or due as an obligation, the gas over bitumen revenue was understated for the year ended December 31, 2012 and prior years. Previously, no gas over bitumen revenue was recognized unless it related to shut-in wells that had been sold, where entitlement to the royalty adjustment was retained but the obligation for repayment had been transferred to the purchaser.

The effect of the restatement on the consolidated statement of financial position as at January 1 and December 31, 2012 is as follows:

			January 1, 2012			December 31, 2012
	As reported	Adjustments	Restated	As reported	Adjustments	Restated
Long-term Crown receivable (note 9)	-	9,059	9,059	-	8,784	8,784
Gas over bitumen obligation (note 13)	74,705	(71,349)	3,356	44,553	(41,816)	2,737
Deficit	(1,206,506)	80,408	(1,126,098)	(1,252,684)	50,600	(1,202,084)

The effect of the restatement on the consolidated statement of loss and comprehensive loss for the year ended December 31, 2012 is as follows:

		Year ended December 31, 2012	
	As reported	Adjustments	Restated
Gas over bitumen revenue	37,195	(30,427)	6,768
Finance expense (note 16)	(34,579)	619	(33,960)
Net loss	(46,178)	(29,808)	(75,986)
Net loss per share – basic and diluted	(0.31)	(0.21)	(0.52)

3. BASIS OF PREPARATION

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

The consolidated financial statements of the Corporation were approved and authorized for issue by the Board of Directors on March 5, 2014.

The consolidated financial statements have been prepared on a historical cost basis except for marketable securities and derivative financial instruments that have been measured at fair value. The consolidated financial statements are presented in Canadian dollars which is the functional currency of the Corporation and its subsidiaries.

Critical accounting judgments and significant estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, revenue and expenses. These judgments, estimates, and assumptions are continuously evaluated and are based on management's experience and all relevant information available to the Corporation at the time of financial statement preparation. As the effect of future events cannot be determined with certainty the actual results may differ from estimates. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about the critical judgments and significant estimates made by management are described below and also in the relevant notes to the financial statements.

Critical accounting judgments:

The following are the critical judgments that management has made in the process of applying the Corporation's accounting policies. These judgments have the most significant effect on the amounts reported in the consolidated financial statements.

i) Cash-generating units

The Corporation allocates its oil and natural gas properties to cash generating units ("CGUs") identified as the smallest group of assets that generate cash flows independent of the cash flows of other assets or groups of assets. Determination of the CGUs is subject to management's judgement and is based on geographical proximity, shared infrastructure, and similar exposure to market risk.

ii) Componentization

For the purposes of depletion the Corporation allocates its oil and natural assets to components with similar useful lives and depletion methods. The grouping of assets is subject to management's judgement and is performed on the basis of geographical proximity and similar reserve life. The Corporation's oil and gas assets are depleted on a unit of production basis.

iii) Exploration and evaluation expenditures

Costs associated with acquiring oil and natural gas licenses and exploratory drilling are accumulated as exploration and evaluation ("E&E") assets pending determination of technical feasibility and commercial viability. Establishment of technical feasibility and commercial viability is subject to judgement and involves management's review of project economics, resource quantities, expected production techniques, production costs and required capital expenditures to confirm continued intent to develop and extract the underlying resources. Management uses the establishment of commercial reserves within the exploration area as the basis for determining technical feasibility and commercial viability. Upon determination of commercial reserves, E&E assets attributable to those reserves are tested for impairment and reclassified from E&E assets to a separate category within tangible assets referred to as oil and natural gas properties.

iv) Joint arrangements

Judgement is required to determine when the Corporation has joint control over an arrangement. In establishing joint control the Corporation considers whether unanimous consent is required to direct the activities that significantly affect the returns of the arrangement, such as the capital and operating activities of the arrangement.

Once joint control has been established judgement is also required to classify a joint arrangement. The type of joint arrangement is determined through analysis of the rights and obligations arising from the arrangement by considering its structure, legal form, and terms agreed upon by the parties sharing control. An arrangement where the controlling parties have rights to the assets and revenues, and obligations for the liabilities and expenses, is classified as a joint operation. Arrangements where the controlling parties have rights to the net assets of the arrangement are classified as joint ventures.

Significant estimates:

The following assumptions represent the key sources of estimation uncertainty at the end of the reporting period. As future confirming events occur the actual results may differ from estimated amounts.

i) Reserves

The Corporation uses estimates of natural gas, oil, and liquids reserves in the calculation of depletion and also for value in use and fair value less costs to sell ("FVLCS") calculations of non-financial assets. Estimates of economically recoverable natural gas, oil, and liquids reserves and their future net cash flows are based upon a number of variable factors and assumptions, such as geological, geophysical, and engineering assessments of hydrocarbons in place on the Corporation's lands, historical production from the properties, production rates, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and natural gas, royalty rates, the assumed effects of regulation by government agencies and future operating costs. The geological, economic and technical factors used to estimate reserves may change from period to period. Changes in the reported reserves could have a material impact on the carrying values of the Corporation's oil and natural gas properties, the calculation of depletion and depreciation and the timing of decommissioning cash flows.

Reserve engineers are engaged at least annually to independently evaluate the recoverable quantities and estimated future cash flows from the Corporation's interest in petroleum and natural gas properties. This evaluation of proved and proved plus probable reserves is prepared in accordance with the reserve definitions contained in National Instrument 51-101 and the COGE Handbook.

ii) Provisions for decommissioning obligations

Decommissioning, abandonment, and site reclamation expenditures for production facilities, wells and pipelines are expected to be incurred by the Corporation over many years into the future. Amounts recorded for decommissioning obligations and the associated accretion are calculated based on estimates of the extent and timing of decommissioning activities, future site remediation regulations and technologies, inflation and liability specific discount rates, and the related cash flows. The provision represents management's best estimate of the present value of the future abandonment and reclamation costs required. Actual abandonment and reclamation costs could be materially different from estimated amounts.

iii) Derivative financial instruments

Derivatives are measured at fair value on each reporting date. Fair value is the price that would be received or paid to exit the position as of the measurement date. The Corporation uses estimated external forward market price curves available at period end and the contracted volumes over the contracted term to determine the fair value of each contract. Changes in market pricing between period end and settlement of the derivative contracts could have a material impact on financial results related to the derivatives.

4. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these annual consolidated financial statements, and have been applied consistently by the Corporation, its subsidiaries, and its equity method investee.

a) Basis of consolidation

i) 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 are currently exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

ii) Business combinations

The acquisition 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 acquisition of control. Identifiable assets acquired and liabilities assumed in a business combination are measured at their recognized amounts (generally fair value) at the acquisition date. The excess of the cost of acquisition over the recognized amounts of the identifiable assets acquired and liabilities assumed is recorded as goodwill. If the cost of acquisition is less than the recognized amount of the net assets acquired, the difference is recognized as a bargain purchase gain in net income or loss.

iii) Joint venture

The Corporation's investment in Warwick Gas Storage Limited Partnership ("WGS LP") is accounted for as an investment in a jointly controlled entity using the equity-method of accounting.

On initial recognition of the investment, any excess of the Corporation's share of the fair value of WGS LP's net assets over the cost of the investment is included as income in the determination of the Corporation's share of WGS LP's profit or losses. The Corporation's share of WGS LP's profits or losses is recognized in net income or loss. Appropriate adjustments to the Corporation's share of WGS LP profits or losses are also made to account for depreciation of assets based on their fair values at the date of initial recognition. Dividends receivable are recognized as a reduction to the carrying amount of the investment and are included in cash flows from operating activities.

When the Corporation's cumulative share of losses equals or exceeds the Corporation's carrying amount of the investment, the Corporation does not recognize further losses unless the Corporation has incurred obligations or made payments on behalf of WGS LP.

After application of the equity-method, the Corporation determines whether it is necessary to recognize an impairment loss. Any loss recognized is recorded to net income or loss.

iv) Joint operations

Many of the Corporation's oil and natural gas activities involve jointly controlled assets. The consolidated financial statements include the Corporation's proportionate share of these jointly controlled assets, liabilities, revenue and expenses.

v) Transactions eliminated on consolidation

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

b) Financial instruments

Financial instruments are initially recognized at fair value on the statement of financial position. Subsequent measurement of financial instruments is based on their initial classification into one of the following categories: financial assets and liabilities measured at fair value through profit or loss, loans and receivables, held to maturity investments, available-for-sale financial assets, or other financial liabilities.

i) Non-derivative financial assets

Financial Instrument	**Category**	**Subsequent Measurement**
Accounts receivable	Loans and receivables	Amortized cost
Long term Crown receivable	Loans and receivables	Amortized cost
Marketable securities	Fair value through profit or loss	Fair value

The Corporation's accounts receivable and long term Crown receivable are initially recognized on the date they originate and are measured at amortized cost using the effective interest method, less any impairment losses.

Marketable securities are classified at fair value through profit or loss as the Corporation manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Corporation's risk management or investment strategy. Upon initial recognition, all transaction costs are recognized in net income or loss when incurred. At the period end date, marketable securities are measured at fair value derived from exchange traded values in active markets; any changes in the fair value are recognized in net income or loss.

ii) Derivative assets and liabilities

The Corporation has entered into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices and currency rates. The Corporation has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Corporation considers all commodity and currency contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and recorded as derivatives on the statement of financial position at fair value. Changes in the fair value of the commodity price and currency rate derivatives are recognized in net income or loss.

The Corporation has accounted for its forward physical delivery fixed-price sales contracts as derivative financial instruments. Accordingly, such forward physical delivery fixed-price sales contracts are classified as fair value through profit or loss and recorded as derivatives on the statement of financial position at fair value.

Transaction costs on derivatives are recognized in net income or loss when incurred.

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. Changes in the fair value of separable embedded derivatives are recognized immediately in net income or loss.

iii) Non-derivative financial liabilities

Financial Instrument	**Category**	**Subsequent Measurement**
Accounts payable and accrued liabilities	Financial liabilities	Amortized cost
Long term bank debt	Financial liabilities	Amortized cost
Senior notes	Financial liabilities	Amortized cost
Convertible debentures	Financial liabilities	Amortized cost

Accounts payable and accrued liabilities, long term bank debt and senior notes are recognized initially at fair value and are subsequently measured at amortized cost using the effective interest method.

The Corporation's convertible debentures are classified as debt with a portion of the proceeds allocated to equity representing the conversion feature. If the debentures are converted, a portion of debt and conversion feature components are transferred to share capital. The debt component associated with the convertible debentures accretes over time to the amount owing on maturity and such increases in the debt component are reflected as non-cash interest expense in net income or loss. The convertible debentures are carried net of issue costs on the statement of financial position. The issue costs are amortized to net income or loss using the effective interest rate method.

iv) Share capital

Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

c) Property, plant and equipment

i) Production and development costs

Items of property, plant and equipment, which include oil and natural gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. There are no significant parts of an item of property, plant and equipment, including oil and natural gas properties, that have different useful lives from the life of the area or facility in general, that had to be accounted for as separate items.

Gains and losses on disposition of an item of property, plant and equipment, including oil and natural gas properties, are determined by comparing the proceeds from disposition with the carrying amount of property, plant and equipment and are recognized in net income or loss. The carrying amount of any replaced or disposed item of property, plant and equipment is derecognized.

ii) 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 property, plant and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in net income or loss as incurred. Such capitalized property, plant and equipment 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 costs of the day-to-day servicing of property, plant and equipment are recognized in net income or loss as incurred.

iii) Depletion and depreciation

The net carrying amount of development or production assets is depleted using the unit of production method by reference to the ratio of production in the period to the related proved and probable reserves, taking into account estimated future development and decommissioning costs necessary to bring those reserves into production. Future development and decommissioning costs are estimated taking into account the level of development required to produce the reserves. The future development cost estimates are reviewed by independent reserve engineers at least annually.

Costs associated with office furniture, information technology, and leasehold improvements are carried at cost and are depreciated on a straight line basis over a period ranging from one to three years.

Depreciation methods, useful lives and residual values are reviewed at each period end date for all classes of property, plant, and equipment.

d) Exploration and evaluation expenditures

Pre-license costs, geological and geophysical costs and lease rentals of undeveloped properties are recognized in net income or loss as incurred.

E&E costs, consisting of the costs of acquiring oil and natural gas licenses, are capitalized initially as E&E assets according to the nature of the assets acquired. Costs associated with drilling exploratory wells in an undeveloped area will be capitalized. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability. When technical feasibility and commercial viability are determined, the relevant expenditure is transferred to oil and gas properties after impairment is assessed and any applicable impairment loss is recognized to net income or loss.

The Corporation's E&E assets consist solely of undeveloped land, exploratory drilling assets, and bitumen evaluation assets. Gains and losses on disposition of E&E assets are determined by comparing the proceeds from disposition with the carrying amount and are recognized in net income or loss.

e) Assets held for sale

Non-current assets, or disposal groups consisting of assets and liabilities ("disposal groups"), are classified as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. Assets and liabilities qualifying as held for sale must be available for immediate sale in their present condition subject to normal terms and conditions and their sale must be highly probable.

Non-current assets, or disposal groups, are measured at the lower of the carrying amount and fair value less costs to sell, with impairments recognized in net income or loss. Non-current assets or disposal groups held for sale are presented in current assets and liabilities within the statement of financial position. Assets held for sale are not subject to depletion and depreciation.

f) Impairment

i) Financial assets

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

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in net income or loss.

An impairment loss is reversed when there is objective evidence that the value of the financial asset has been partially or fully restored. For financial assets measured at amortized cost the reversal is recognized in net income or loss.

ii) Non-financial assets

The carrying amounts of the Corporation’s non-financial assets, other than E&E assets, are reviewed at each period end date to determine whether there is any indication of impairment. If any such indication exists, then the asset’s recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas properties, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together at a CGU level which is the smallest group of assets that generates cash inflows from continuing use and are largely independent of the cash inflows of other assets or groups of assets. The recoverable amount of an asset or a CGU is determined based on the higher of its FVLCS and its value in use. FVLCS is determined as the amount that would be obtained from the sale of a CGU in an arm’s length transaction between knowledgeable and willing parties. The FVLCS of oil and gas properties is generally determined as the net present value of estimated future cash flows expected to arise from the continued use of the CGU and its eventual disposition, using assumptions that an independent market participant may take into account. These cash flows are discounted by an appropriate discount rate which would be applied by such a market participant to arrive at a new present value of the CGU. In determining 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 determined by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

E&E assets are assessed for impairment both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to oil and natural gas properties in property, plant and equipment. If a test is required as a result of triggering facts and circumstances, the Corporation considers whether the combined recoverable amount of oil and natural gas properties and E&E assets is sufficient to cover the combined carrying value of E&E and oil and natural gas assets after a test at the CGU level has been performed. E&E assets are tested for impairment on reclassification to oil and natural gas properties.

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

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each period end date for any indication 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, if no impairment loss had been recognized.

g) Share based payments

Awards granted under share based payment plans and agreements are equity-settled and are measured at fair value. Fair values are determined by means of an option pricing model using the exercise price of the equity instrument granted, the share price at the grant date, the expected life of the grant based on the vesting date and expiry date, estimates of volatility and interest rates over its expected life. A forfeiture rate is estimated on the grant date and is subsequently adjusted to reflect the actual number of options that vest.

The costs of the equity-settled share based payments are recognized within general and administrative expenses with a corresponding increase in contributed surplus over the vesting period. Upon exercise or settlement of an equity-based instrument, consideration received and associated amounts previously recorded in contributed surplus are recorded to share capital.

h) Provisions

Provisions are recognized when the Corporation has a current legal or constructive obligation as a result of a past event, which can be reliably estimated, and will require the outflow of economic resources to settle the obligation. A provision is determined using the estimated future cash flows discounted at a rate that reflects current market conditions and liability specific risks.

Decommissioning obligations

The Corporation’s activities give rise to dismantling, decommissioning and site disturbance remediation activities. A 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 estimate of expenditures required to settle the present obligation at the statement of financial position date and using a risk free interest rate not adjusted for credit risk. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time, changes in the estimated future cash flows underlying the obligation and changes in the risk free rate. The accretion of the provision due to the passage of time is recognized in net income or loss whereas changes in the provision arising from the changes in estimated cash flows or changes in the risk free rate are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

Gas over bitumen obligation

The Corporation's entitlement to gas over bitumen royalty adjustments under the Natural Gas Royalty Regulation (2002) with respect to foregone production from gas wells shut-in (deemed production) for the benefit of bitumen producers in the Athabasca oil sands area is recognized as gas over bitumen revenue in the period that deemed production occurs.

The gas over bitumen royalty adjustment reduces the Corporation's gas Crown royalties ("royalty adjustments") otherwise payable. To the extent that royalty adjustments exceed gas Crown royalties payable in a given period, the amount is recorded as a receivable when there is reasonable assurance that it will be recovered and classified as current to the extent that the amounts are expected to be recovered within one year.

To the extent that these gas wells are allowed to return to production, the Corporation will be subject to gross overriding royalty of one percent for each year the gas over bitumen royalty adjustment was received to a maximum of 10 percent. The Corporation records a provision reflecting the present value of the expected repayments of the gas over bitumen royalty adjustments received by the Corporation under the Natural Gas Royalty Regulation (2002) should the related properties resume production. The expected repayments of the gas over bitumen royalty adjustments are estimated based on the present value of the expected gross overriding royalty on future revenues from the production of proved and probable reserves. Accretion of the provision due to the passage of time and change in estimated cash flows are recognized in net income or loss. Actual repayments, if any, will be charged against the provision as incurred.

i) Revenue

Revenue and royalty expense from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product are transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time product enters the pipeline.

Prior to the disposition of WGS LP on April 25, 2012, the Corporation recognized revenue for storage services, including gas injection, storage and withdrawal in accordance with the terms of the storage contracts. The Corporation does not hold title to third party storage gas and does not store proprietary gas.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

j) Income tax

Income tax expense comprises current and deferred components. Income tax expense is recognized in net income or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

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

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred 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 period end date. Deferred 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.

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

k) Income or loss per share amounts

Basic income or loss per share is calculated by dividing the net income or loss by the weighted average number of common shares outstanding during the period. For the dilutive net income or loss per share calculation, the weighted average number of shares outstanding is adjusted for the potential number of shares which may have a dilutive effect on net income or loss.

Diluted income or loss per share is calculated giving effect to the potential dilution that would occur if outstanding Share Options, Restricted Rights, Performance Share Units, or potential dilutive convertible debentures were exercised or converted into common shares. The weighted average number of diluted shares is calculated in accordance with the treasury stock method for Share Options, Restricted Rights and Performance Share Units and the if-converted method for potentially issuable common shares through the convertible debentures. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase common shares at the average market price. The if-converted method assumes conversion of convertible securities at the beginning of the reporting period**.**

l) Newly adopted accounting policies

Effective January 1, 2013, Perpetual has adopted the following new standards and amendments as issued by the IASB. Adoption of these new standards and amendments has had no measurement impact on the Corporation's consolidated financial statements. The enhanced disclosure requirements of IFRS 12, IFRS 13, and amended IFRS 7 have been reflected in these consolidated financial statements and notes.

i) IFRS 10, "Consolidated Financial Statements" replaces the guidance in IAS 27 "Consolidated and Separate Financial Statements". The new standard provides a single model to be applied in the control analysis for all investees, eliminating the current risk and rewards approach.

ii) IFRS 11, "Joint Arrangements" replaces the guidance in IAS 31, "Interests in Joint Ventures" and establishes criteria for classification of joint arrangements as either joint operations or joint ventures. The new standard mandates equity-method accounting for joint ventures; these entities no longer have a choice between proportionate consolidation and equity accounting. An entity's interest in a joint operation, where the parties have rights to the assets and obligations for the liabilities, is to be accounted for on the basis of the entity's interest in the assets, liabilities, revenues and expenses of the operation. The relationships are accounted for as joint operations similar to jointly controlled assets or operations under IAS 31.

iii) IFRS 12, "Disclosure of Interest in Other Entities" provides the required disclosures for entities that have interests in subsidiaries or joint arrangements. Disclosure requirements under the new standard aim to provide information that will assist financial statement users in their understanding of the nature, risks, and financial effects of an interest in other entities.

iv) IFRS 13, "Fair Value Measurement" provides a single source of fair value measurement guidance by replacing the guidance contained in other IFRSs. The new 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. IFRS 13 also establishes a framework for measurement of fair value and requires disclosures that allow users to evaluate fair value methodology and the inputs used.

v) IFRS 7, "Financial Instruments: Disclosures" was amended to provide additional guidance on disclosure of financial assets and financial liabilities in the statement of financial position.

m) Recent pronouncements issued

Perpetual will be required to adopt the following applicable new standards and amendments as issued by the IASB. The Corporation is currently evaluating the impact on the consolidated financial statements as discussed below.

i) IFRIC 21, "Levies" provides guidance on accounting for levies in accordance with the requirements of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.* The interpretation defines a levy as an outflow from an entity imposed by a government in accordance with legislation and states that levies do not arise from executory contracts or other contractual arrangements. The interpretation also confirms that an entity recognizes a liability for a levy only when the triggering event specified in the legislation occurs. This IFRIC is effective for annual periods commencing on or after January 1, 2014 and is to be applied retrospectively. The Corporation intends to adopt IFRIC 21 in its financial statements for the annual period beginning January 1, 2014.

ii) IFRS 9, “Financial Instruments” establishes principles for the disclosure of financial assets and financial liabilities that will present information that is useful for the assessment of the amounts, timing and uncertainty of an entity’s future cash flows. The IFRS is applicable to all items that fall within the scope of IAS 39, “Financial Instruments: Recognition and Measurement”. This IFRS is effective for annual periods commencing on or after January 1, 2018 and is to be applied retrospectively. The Corporation intends to adopt IFRS 9 in its financial statements for the annual period beginning January 1, 2018.

Perpetual has not applied any of these new standards as of December 31, 2013. The Corporation is currently evaluating the extent of the impact that adoption will have on the consolidated financial statements.

5. ASSETS HELD FOR SALE

As at		December 31, 2012
Assets held for sale		
Property, plant and equipment (note 7)	$	4,621
Exploration and evaluation (note 8)		17,700
	$	22,321
Liabilities associated with assets held for sale		
Decommissioning obligations (note 13)	$	93

During the first quarter of 2013, the Corporation closed the dispositions of all assets and associated liabilities presented as held for sale at December 31, 2012 for net cash proceeds of $76.8 million resulting in a gain on dispositions of $51.8 million. The dispositions consisted principally of the Elmworth property but also included non-core oil and natural gas properties in the Corporation’s West Central CGU.

6. EQUITY-METHOD INVESTMENT

Perpetual's equity-method investment consists of a 30 percent interest in WGS LP which operates a gas storage facility in Alberta, Canada.

Prior to April 25, 2012, WGS LP was a wholly owned subsidiary of Perpetual. On April 25, 2012, Perpetual sold a 90 percent interest in WGS LP for cash proceeds of $80.9 million. As part of the sale Perpetual continues to provide management and operational services to WGS LP for an annual fee. The Corporation also retained an option, exercisable within one year of closing, to buy back from the purchaser up to a 30 percent additional ownership interest in WGS LP at the same price as the initial sale plus working capital and other adjustments, less any dividends paid, for a final ownership interest post any exercise of the buy-back option of up to 40 percent ("WGS Call Option").

On April 25, 2013, Perpetual exercised the WGS Call Option to buy back an additional 20 percent interest in WGS LP for total consideration of $21.4 million comprised of $19.1 million in cash and $2.3 million related to the value of the option. The transaction closed on May 24, 2013 resulting in an increase in Perpetual's total ownership interest to 30 percent. The unexercised portion of the option has expired.

For the year ended December 31, 2013, the Corporation received dividends of $2.4 million (December 31, 2012 - $0.9 million) from WGS LP representing Perpetual's share of total dividends declared. Other transactions between Perpetual and WGS LP during the period totaled $2.0 million (December 31, 2012 - $1.3 million) consisting primarily of revenue earned related to the management services agreement.

Summary financial information for the Corporation's equity-method investment in WGS LP is as follows:

As at	**December 31, 2013**	December 31, 2012
Current assets	**$ 2,925**	$ 1,489
Non-current assets	**119,619**	85,551
Total assets	**122,544**	87,040
Current liabilities	**739**	3,768
Non-current liabilities[1]	**31,596**	48,677
Total liabilities	**32,335**	52,445
Net assets	**90,209**	34,595
Corporation's share of net assets	**27,063**	3,460
Adjustments on acquisition of interest in WGS LP	**1,284**	2,033
Equity-method investment	**$ 28,347**	$ 5,493

[1] Includes long term bank indebtedness of $7.9 million (December 31, 2012 – $3.8 million).

For the period ended	**December 31, 2013**	December 31, 2012
Revenue	**$ 16,864**	$ 10,533
Depreciation	**(3,564)**	(2,398)
Other expenses	**(2,609)**	(4,357)
Unrealized gain (loss) on gas storage obligation derivative	**4,920**	(8,786)
Net income (loss)	**15,611**	(5,008)
Share of net income (loss) of equity-method investment	**$ 3,789**	$ (572)

7. PROPERTY, PLANT AND EQUIPMENT

	Oil and Gas Properties	Corporate Assets	Total
Cost			
December 31, 2011	$ 2,640,472	$ 6,149	$ 2,646,621
Additions	76,136	221	76,357
Change in decommissioning obligations estimates (note 13)	(10,352)	–	(10,352)
Transferred from exploration and evaluation (note 8)	5,346	–	5,346
Acquisitions	1,113	–	1,113
Dispositions	(234,566)	(83)	(234,649)
Reclassification to assets held for sale (note 5)	(4,709)	–	(4,709)
December 31, 2012	2,473,440	6,287	2,479,727
Additions	93,180	120	93,300
Change in decommissioning obligations estimates (note 13)	2,182	-	2,182
Transferred from exploration and evaluation (note 8)	1,426	-	1,426
Acquisitions	808	-	808
Dispositions	(8,952)	-	(8,952)
Reclassification to assets held for sale	(1,581)	-	(1,581)
December 31, 2013	**$ 2,560,503**	**$ 6,407**	**$ 2,566,910**
Accumulated depletion, depreciation and impairment losses			
December 31, 2011	$ (1,813,881)	$ (4,812)	$ (1,818,693)
Depletion and depreciation	(104,964)	(703)	(105,667)
Dispositions	69,239	34	69,273
Impairment losses	(54,313)	–	(54,313)
Reclassification to assets held for sale (note 5)	88	–	88
December 31, 2012	(1,903,831)	(5,481)	(1,909,312)
Depletion and depreciation	(92,380)	(497)	(92,877)
Dispositions	7,062	-	7,062
Impairment reversal	5,171	-	5,171
December 31, 2013	**$ (1,983,978)**	**$ (5,978)**	**$ (1,989,956)**
Carrying amount			
December 31, 2012	$ 569,609	$ 806	$ 570,415
December 31, 2013	**$ 576,525**	**$ 429**	**$ 576,954**

At December 31, 2013, property, plant and equipment included $7.9 million (December 31, 2012 – $7.3 million) of costs currently not subject to depletion and $19.6 million (December 31, 2012 – $19.6 million) of costs related to shut-in gas over bitumen reserves which are not being depleted due to the non-producing status of the wells in the affected properties.

During the year ended December 31, 2013, the Corporation disposed of oil and natural gas properties, including those classified as held for sale as at December 31, 2012 (note 5), for cash proceeds of $79.0 million (2012 – $167.2 million). Gains on dispositions totaling $52.1 million (2012 – $49.0 million) were recorded in net income.

For the year ended December 31, 2013, the Corporation reversed a previous year impairment charge of $5.2 million on natural gas assets geographically located within the West Central CGU. The impairment was reversed as a result of positive reserve revisions related to the strong economic performance of Perpetual's wells in West Central.

For the year ended December 31, 2012, the Corporation recognized impairment losses of $54.3 million on natural gas assets geographically located within the Birchwavy West, Birchwavy East, and Other South CGUs. Impairments realized were a result of a decline in forecasted natural gas prices. The impairments recognized were based on the difference between the carrying amount of the CGU's (including decommissioning costs) and the value in use. In assessing value in use, the estimated future cash flows were discounted to their present value using pre-tax discount rates between 10.0 and 15.0 percent. The amount of value in use is computed by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

8. EXPLORATION AND EVALUATION

		2013		2012
Balance, beginning of year	**$**	**80,494**	$	106,763
Additions		**5,617**		4,765
Acquisitions		**7,400**		1,294
Dispositions		**-**		(3,524)
Transferred to property, plant and equipment		**(1,426)**		(5,346)
Non-cash exploration and evaluation expense		**(2,715)**		(5,758)
Reclassification to assets held for sale		**(1,193)**		(17,700)
Balance, end of year	**$**	**88,177**	$	80,494

During the year ended December 31, 2013, $4.5 million (2012 – $3.5 million) in costs were charged directly to E&E expense in net loss.

9. LONG TERM CROWN RECEIVABLE (restated note 2)

Perpetual is entitled to gas over bitumen royalty adjustments from the government (the Alberta "Crown") with respect to foregone production from gas wells that have been shut-in where they are deemed to be in communication with potentially recoverable bitumen. For operated facilities, the royalty adjustments are received by the Corporation as a reduction to the Corporation's Crown royalties payable. For non-operated facilities, Perpetual receives cash payments from joint venture partners. As at December 31, 2013, Perpetual had accumulated royalty adjustments on operated facilities in excess of the Corporation's accumulated Crown royalties payable totaling $18.1 million (December 31, 2012 - $17.7 million). Of this amount, $7.1 million (December 31, 2012 – $8.9 million) is included in current accounts receivable as the Corporation expects to recover this amount against Crown royalties otherwise payable in the next twelve months. The remaining $11.0 million (December 31, 2012 - $8.8 million) is recorded as long term Crown receivable as the Corporation expects to recover the amounts against Crown royalties payable over a period of time beyond the next year.

10. BANK INDEBTEDNESS

The Corporation's credit facility is with a syndicate of Canadian chartered banks. On April 26, 2013, the Corporation's lenders completed their semi-annual review of the borrowing base under the credit facility. The total availability under the facility was reduced to $125 million from $127.5 million which consists of a demand loan of $95 million; a working capital facility of $15 million, and a $15 million acquisition facility. Total availability under the facility was further reduced to $110 million with the maturity of the acquisition facility on July 31, 2013. On October 31, 2013, the Corporation's lenders completed their semi-annual review of the borrowing base under the credit facility and total availability was confirmed at $110 million. The revolving feature of the credit facility has been extended to October 30, 2014. The next semi-annual redetermination of the Corporation's borrowing base will occur on or before April 30, 2014.

The Corporation has covenants that require twelve month trailing income before interest, taxes and depletion and depreciation to consolidated debt and consolidated senior debt to be less than 4:0 to 1:0 and 3:0 to 1:0, respectively. Consolidated debt is defined as the sum of the Corporation's period end balance of the credit facility, senior notes and outstanding letters of credit ("Consolidated Debt"). Consolidated senior debt is defined as the sum of consolidated debt less the period end balance of the senior notes. The Corporation was in compliance with the lender's covenants at December 31, 2013. In addition to amounts outstanding under the credit facility, the Corporation has outstanding letters of credit in the amount of $5.9 million (December 31, 2012 – $7.6 million). Collateral for the credit facility is provided by a floating-charge debenture covering all existing and acquired property of the Corporation, as well as unconditional full liability guarantees from all subsidiaries in respect of amounts borrowed under the credit facility.

Advances under the credit facility are made in the form of Banker's Acceptances ("BA"), prime rate loans or letters of credit. In the case of BA advances, interest is a function of the BA rate plus a margin based on the Corporation's current ratio of debt to cash flow. In the case of prime rate loans, interest is charged at the lenders' prime rate plus margin. The effective interest rate on outstanding amounts at December 31, 2013 was 5.5 percent (December 31, 2012 – 5.5 percent).

11. SENIOR NOTES

On March 15, 2011, the Corporation issued $150.0 million in senior notes. The senior notes are direct senior unsecured obligations of Perpetual, ranking pari passu with all other present and future unsecured and unsubordinated indebtedness of the Corporation. The senior notes have a cross-default provision with the Corporation's credit facility. The Corporation was in compliance with the lenders' covenants at December 31, 2013. The senior notes mature on March 15, 2018 and bear interest at 8.75 percent, payable semi-annually on September 15 and March 15 of each year beginning on September 15, 2011. The Corporation can redeem at a premium to face value, with equity proceeds from common share offerings, up to 35 percent of the principal amount of the senior notes prior to March 15, 2015. The Corporation can repay the senior notes at any time on or after March 15, 2015 to maturity date at a premium to face value based on date of repayment. At December 31, 2013, the senior notes are presented net of $2.3 million in issue costs which are amortized using an effective interest rate of 9.1 percent.

12. CONVERTIBLE DEBENTURES

The Corporation's 6.50% convertible unsecured subordinated debentures ("6.50% Convertible Debentures") issued on June 20, 2007 and traded on the Toronto Stock Exchange ("TSX") under the symbol PMT.DB.C matured on June 30, 2012. They yielded interest at 6.50 percent per annum paid semi-annually on June 30 and December 31 of each year and were subordinated to substantially all other liabilities of the Corporation including the credit facility and senior notes. The 6.50% Convertible Debentures were convertible at the option of the holder into common shares at any time prior to the maturity date at a conversion price of $14.20 per common share. The Corporation's 6.50% Convertible Debentures were paid out in cash on June 30, 2012 at maturity.

The Corporation's 7.25% Convertible Debentures amended on December 17, 2009, which trade under the symbol PMT.DB.D, mature on January 31, 2015, bear interest at 7.25 percent per annum paid semi-annually on January 31 and July 31 of each year and are subordinated to substantially all other liabilities of the Corporation including the credit facility and senior notes. The 7.25% Convertible Debentures are convertible at the option of the holder into common shares at any time prior to the maturity date at a conversion price of $7.50 per common share.

The Corporation's 7.00% Convertible Debentures issued on May 26, 2010, which trade under the symbol PMT.DB.E, mature on December 31, 2015, bear interest at 7.00 percent per annum paid semi-annually on June 30 and December 31 of each year and are subordinated to substantially all other liabilities of the Corporation including the credit facility, senior notes and all other series of convertible debentures. The 7.00% Convertible Debentures are convertible at the option of the holder into common shares at any time prior to the maturity date at a conversion price of $7.00 per common share.

At the option of the Corporation, the repayment of the principal amount of the convertible debentures may be settled in common shares. The number of common shares to be issued upon redemption by the Corporation will be calculated by dividing the principal by 95 percent of the weighted average trading price for ten trading days prior to the date of redemption. The interest payable may also be settled with the issuance of sufficient common shares to satisfy the interest obligation.

Series	**6.50%**	**7.25%**	**7.00%**	**Total**
Trading symbol (TSX)	**PMT.DB.C**	**PMT.DB.D**	**PMT.DB.E**	
Carrying amount				
Balance, December 31, 2011	$ 74,250	$ 95,325	$ 53,695	$ 223,270
Accretion	316	890	892	2,098
Amortization of debenture issue fees	359	453	418	1,230
Repayment of principal on maturity	(74,925)	–	–	(74,925)
Balance, December 31, 2012	–	96,668	55,005	$ 151,673
Accretion	–	1,015	996	2,011
Amortization of debenture issue fees	–	493	500	993
Redemptions	–	(68)	(113)	(181)
Balance, December 31, 2013	$ –	**$ 98,108**	**$ 56,388**	**$ 154,496**
Market Value				
December 31, 2012	$ –	$ 94,723	$ 56,400	$ 151,123
December 31, 2013	**$ –**	**$ 97,903**	**$ 57,333**	**$ 155,236**
Principal amount outstanding				
December 31, 2012	**$ –**	$ 99,972	$ 60,000	$ 159,972
December 31, 2013	**$ –**	**$ 99,901**	**$ 59,878**	**$ 159,779**

13. PROVISIONS

A reconciliation of provisions is provided below:

	Gas over bitumen obligations		Decommissioning obligations	
	2013	2012 Restated (note 2)	**2013**	2012
Balance, beginning of year	**$ 2,737**	$ 3,356	**$ 206,379**	$ 242,860
Obligations acquired	**-**	-	**73**	45
Obligations incurred	**-**	-	**3,392**	1,308
Obligations disposed	**-**	-	**(62)**	(30,377)
Change in risk free rate	**-**	-	**(12,574)**	9,569
Change in estimates	**211**	(619)	**14,756**	(19,921)
Obligations settled	**-**	-	**(2,497)**	(1,825)
Accretion	**-**	-	**4,439**	4,813
Reclassification to liabilities associated with assets held for sale (note 5)	**-**	-	**-**	(93)
Balance, end of year	**$ 2,948**	$ 2,737	**$ 213,906**	$ 206,379

a) Decommissioning obligations

The total future decommissioning obligations are 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 periods.

The Corporation adjusts the decommissioning obligations on each period end date for changes in the risk free rate. Accretion is calculated on the adjusted balance after taking into account additions and dispositions to property, plant, and equipment. Decommissioning obligations are also adjusted annually for revisions to the future liability cost and the estimated timing of costs to be incurred in future years.

At December 31, 2013, the Corporation estimated the net present value of its total decommissioning obligations to be $213.9 million (December 31, 2012 – $206.4 million) based on an undiscounted total future liability of $236.8 (December 31, 2012 – $260.6 million). These payments are expected to be made over the next 25 years with the majority of costs incurred between 2020 and 2030. At December 31, 2013, the Corporation used a weighted average risk free rate of 2.41 percent (December 31, 2012 – 2.24 percent) to calculate the present value of the decommissioning obligation provisions.

b) Gas over bitumen obligation (restated note 2)

The gas over bitumen obligation represents the present value of expected repayments of the gas over bitumen royalty adjustments received or receivable by the Corporation under the Natural Gas Royalty Regulation (2002) in the event the shut-in gas over bitumen assets resume production. The cash flows are based on the estimated timing of future revenues and the related over-riding royalties that will be incurred in future periods. At December 31, 2013, the Corporation estimated the net present value of its total gas over bitumen obligation to be $2.9 million (December 31, 2012 - $2.7 million) based on undiscounted total future repayments of $10.8 million (December 31, 2012 - $11.6 million). The majority of these repayments are expected to occur between 2020 and 2032. At December 31, 2013, the Corporation used a liability specific discount rate of 15.0 percent (December 31, 2012 – 15.0 percent) to calculate the present value of the provision.

14. SHARE CAPITAL

a) Authorized

Authorized capital consists of an unlimited number of common shares.

b) Issued and outstanding

A reconciliation of share capital is provided below:

		2013		2012
	Shares	**Amount**	Shares	Amount
Balance, beginning of year	**147,455,167**	**$ 1,255,450**	146,966,260	$ 1,254,273
Common shares issued pursuant to:				
- Restricted Rights Plan	**894,553**	**1,501**	488,907	1,177
- Performance Share Units Plan	**90,349**	**334**	-	-
- Share Option Plan	**50,318**	**30**	-	-
Balance, end of year	**148,490,387**	**$ 1,257,315**	147,455,167	$ 1,255,450

c) Per share information

	Year ended December 31, **2013**	2012
(thousands, except per share amounts)		
Net income (loss) – basic	**$ 7,620**	$ (75,986)
Effect of dilutive securities	**-**	-
Net income (loss) – diluted	**$ 7,620**	$ (75,986)
Weighted average common shares outstanding – basic	**148,144**	147,085
Effective of dilutive securities	**2,098**	-
Weighted average common shares outstanding – diluted	**150,242**	147,085
Income (loss) per share - basic and diluted	**$ 0.05**	$ (0.52)

In computing per share amounts for the year ended December 31, 2012, 7,045,250 Share Options, 2,245,737 Restricted Rights, 1,328,360 Performance Share Rights, and 21,901,026 potentially issuable common shares through the convertible debentures were excluded as the Corporation had a net loss.

15. SHARE BASED PAYMENTS

a) Share Option Plan

The purpose of the Share Option Plan is to provide an effective long-term incentive to eligible participants and to reward them on the basis of the Corporation's long-term performance. The Board of Directors administers the Share Option Plan and determines participants, numbers of Share Options and terms of vesting. The exercise price of the Share Options granted shall not be less than the value of the weighted average trading price for Perpetual common shares for the five trading days immediately preceding the date of grant.

Participants in the Share Option Plan may offer to surrender their options to the Corporation in exchange for a cash payment not to exceed the in-the-money value of the Share Options. The Corporation has the right to accept or refuse such offers. For the year ended December 31, 2013, the Corporation recorded $1.8 million in share based payment expense related to Share Options (2012 – $2.7 million).

At December 31, 2013, the Corporation had 12.5 million Share Options and Restricted Rights (December 31, 2012 – 11.4 million) issued and outstanding relative to the 14.8 million (ten percent of total common shares outstanding) reserved under the Share Option and Restricted Rights Plans (December 31, 2012 – 14.7 million). As at December 31, 2013, 3.4 million Share Options granted under the Share Option Plan had vested but were unexercised (December 31, 2012 – 0.8 million).

The Corporation used the trinomial option pricing model to calculate the estimated fair value of the outstanding Share Options. During the year ended December 31, 2013, the Corporation granted 2.7 million Share Options under the Share Option Plan. The following assumptions were used to arrive at the estimate of fair value as at the date of grant:

Period of grant	**2013**	2012
Dividend yield (%)	**0.0**	0.0
Forfeiture rate (%)	**12.0**	8.0 – 12.0
Expected volatility (%)	**48.0 – 52.1**	44.1 – 50.8
Risk-free interest rate (%)	**1.1 – 1.6**	1.0 – 1.5
Expected life (years)	**2.5 – 3.5**	2.5 – 3.5
Vesting period (years)	**3.0**	3.0
Contractual life (years)	**4.0**	4.0
Weighted average grant date fair value	**$ 0.38**	$ 0.30

		2013		2012
	Average Exercise Price	**Share Options**	Average Exercise Price	Share Options
Balance, beginning of year	**$ 1.32**	**9,177,175**	$ 4.00	12,297,100
Granted	**1.12**	**2,665,000**	0.96	7,045,250
Exercised	**0.69**	**(104,439)**	4.55	(4,512,875)
Forfeited	**6.34**	**(170,500)**	4.12	(5,652,300)
Cancelled	**1.51**	**(366,209)**	-	-
Balance, end of year	**$ 1.20**	**11,201,027**	$ 1.32	9,177,175

The following table summarizes information about Share Options outstanding at December 31, 2013:

	Options Outstanding			**Options Exercisable**	
Range of Exercise Prices	**Number of Share Options**	**Average Contractual Life (years)**	**Weighted Average Exercise Price**	**Number of Share Options**	**Weighted Average Exercise Price**
$0.62 to $0.83	1,213,279	2.29	$ 0.62	348,484	$ 0.62
$0.84 to $1.07	5,085,448	2.56	1.03	1,682,556	1.03
$1.08 to $1.15	2,445,000	3.64	1.11	–	–
$1.16 to $5.03	2,457,300	2.23	1.92	1,365,701	1.99
Total	**11,201,027**	**2.70**	**$ 1.20**	**3,396,741**	**$ 1.38**

b) Restricted Rights Plan

The Corporation has a Restricted Rights Plan for certain officers, employees and direct and indirect service providers. Restricted Rights granted under the Restricted Rights Plan may be exercised during a period (the “Exercise Period”) not exceeding five years from the date upon which the Restricted Rights were granted. The Restricted Rights typically vest on a graded basis over two years. At the expiration of the Exercise Period, any Restricted Rights which have not been exercised shall expire and become null and void. Upon vesting, the plan participant is entitled to receive the vested common shares at no cost plus an additional number of common shares equal to the value of dividends on the Corporation’s shares as if the shares were invested in the Premium Dividend Reinvestment Plan accrued since the grant date.

For the year ended December 31, 2013, $0.6 million in share based payment expense was recorded in respect of Restricted Rights (2012 – $1.5 million).

The following table shows changes in the Restricted Rights outstanding under the Restricted Rights Plan:

	2013	2012
Balance, beginning of year	**2,245,737**	1,365,107
Granted	**200,432**	1,782,250
Exercised	**(988,028)**	(491,307)
Forfeited	**(127,058)**	(410,313)
Cancelled	**(20,510)**	-
Balance, end of year	**1,310,573**	2,245,737

c) Performance Share Rights Plan

The Corporation has a Performance Share Rights Plan for the Corporation's senior management team. Performance Share Rights granted under the Performance Share Rights Plan vest two years after the date upon which the Performance Share Rights were granted. The Performance Share Rights that vest and become redeemable are a multiple of the Performance Share Rights granted dependent upon the achievement of certain performance metrics over the vesting period. Vested Performance Share Rights can be settled in cash or Restricted Rights, at the discretion of the Board of Directors. Upon vesting, Performance Share Rights Plan participants are entitled to receive an additional number of Performance Share Rights equal to the value of dividends on the Corporation's shares as if the shares were invested in the Premium Dividend Reinvestment Plan accrued since the grant date. Should participants of the Performance Share Rights Plan leave the organization other than through retirement or termination without cause prior to the vesting date, the Performance Share Rights would be forfeited.

At December 31, 2013, the Corporation had 2,298,500 Performance Share Rights issued and outstanding under the Performance Share Rights Plan (December 31, 2012 – 1,328,360).

For the year ended December 31, 2013, $1.2 million in share based payment expense was recorded in respect of the Performance Share Rights granted (2012 – $0.3 million).

d) Compensation awards

The Corporation has agreements in place with certain employees whereby over a period of three years they may be entitled to receive shares of the Corporation purchased on the open market by an independent trustee if they remain employees of Perpetual during such time. This does not dilute equity or involve the issuance of shares from treasury.

At December 31, 2013, the Corporation had 1,212,000 of these awards and issued and outstanding (2012 – nil).

For the year ended December 31, 2013, $0.1 million in share based payment expense was recorded in respect of the awards (2012 – nil).

The Corporation also has agreements in place with directors and certain employees whereby, in the case of directors, upon retirement from the board of directors, or in the case of employees, over a period of two years if they remain employees of Perpetual during such time, may be entitled to receive, at the discretion of the Board, cash, a grant of restricted rights or shares of the Corporation purchased on the open market by an independent trustee.

At December 31, 2013, the Corporation had 1,810,000 of these awards issued and outstanding (2012 – nil).

For the year ended December 31, 2013, $0.3 million in share based payment expense was recorded in respect of the compensation awards granted (2012 – nil).

As at December 31, 2013, no shares have been purchased for the purpose of these agreements by the independent trustee (2012 – nil).

16. FINANCE EXPENSE

The components of finance expense are as follows:

	Year ended December 31	
	2013	2012
Interest	**$ (32,482)**	$ (36,354)
Accretion on decommissioning obligations (note 13)	**(4,439)**	(4,813)
(Loss) gain on marketable securities	**(92)**	801
(Loss) gain on call option	**(1,274)**	47
Change in estimate on gas over bitumen obligation (note 13)	**(211)**	619
Gain on retained investment in former subsidiary	**-**	2,104
Gain on gas storage obligation derivative	**-**	3,636
Finance expenses recognized in net income or loss	**$ (38,498)**	$ (33,960)

17. NON-CASH WORKING CAPITAL INFORMATION

	Year ended December 31, 2013	2012
Accounts receivable	**$ (2,312)**	$ (1,742)
Prepaid expenses and deposits	**1,559**	883
Accounts payable and accrued liabilities	**(2,267)**	(5,797)
Change in non-cash working capital(1)	**$ (3,020)**	$ (6,656)

(1) Includes working capital balances sold as part of the 2012 disposition of the Corporation's controlling interest in WGS LP.

The change in non-cash working capital has been allocated to the following activities:

	Year ended December 31, 2013	2012
Operating	**$ (146)**	$ 1,162
Financing	**(20)**	33
Investing	**(2,854)**	(7,851)
Change in non-cash working capital(1)	**$ (3,020)**	$ (6,656)

(1) Includes working capital balances sold as part of the 2012 disposition of the Corporation's controlling interest in WGS LP.

18. FINANCIAL RISK MANAGEMENT

The Corporation has exposure to credit risk, liquidity risk and market risk from its use of financial instruments.

This note presents information about the Corporation's exposure to each of the above risks, the Corporation's objectives, policies and processes for measuring and managing risk, and the Corporation's management of capital. Further quantitative disclosures are included throughout these annual consolidated financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk management framework. The Board of Directors has implemented and monitors compliance with risk management policies.

The Corporation's risk management policies are established to identify and analyze the risks faced by Perpetual, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation's activities.

a) Credit risk

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Corporation's receivables from joint venture partners, oil and natural gas marketers and derivative contract counterparties.

Receivables from oil and natural gas marketers are normally collected on the 25th day of the month following production. The Corporation's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large, well established purchasers. The Corporation historically has not experienced any significant collection issues with its oil and natural gas marketing receivables. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Corporation attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are generally from participants in the oil and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs, the risk of unsuccessful drilling and oil and gas production; in addition, further risk exists with joint venture partners as disagreements occasionally arise that increase the potential for non-collection. The Corporation does not typically obtain collateral from oil and natural gas marketers or joint venture partners, however, the Corporation does have the ability in some cases to withhold production or amounts payable to joint venture partners in the event of non-payment.

The Corporation manages the credit exposure related to marketable securities by monitoring the performance and financial strength of the investments and the liquidity of the securities being held.

The Corporation manages the credit exposure related to derivatives by engaging in economic hedging transactions with counterparties with investment grade credit ratings, and periodically monitoring the changes in such credit ratings.

During the year ended December 31, 2013, credit risk did not have any impact on the change in fair value of financial assets and liabilities classified as fair value through profit or loss.

The carrying amount of accounts receivable, marketable securities and fair value of derivatives represents the Corporation's maximum credit exposure. The Corporation's allowance for doubtful accounts as at December 31, 2013 is $0.6 million (December 31, 2012 – $0.8 million). The amount of the allowance was determined by assessing the probability of collection for each past due receivable. The Corporation is currently involved in negotiations with the joint venture partners involved to recover the full amount of the receivables in question. The total amount of accounts receivables 90 days past due amounted to $1.7 million as at December 31, 2013 (December 31, 2012 – $2.8 million).

b) Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking harm to the Corporation's reputation.

The Corporation anticipates that cash flows including cash flow from operating activities, proceeds from closed and potential future asset dispositions and available funds from the Corporation's credit facility will provide the required funds to discharge the Corporation's obligations, carry out exploration and development programs and fund ongoing operations for the foreseeable future.

The following are the contractual maturities of financial liabilities and associated interest payments as at December 31, 2013:

Contractual repayments of financial liabilities	**Total**	**2014**	**2015**	**2016-2018**
Accounts payable and accrued liabilities	**$ 45,048**	$ 45,048	$ –	$ –
Derivatives	**9,246**	6,468	2,778	–
Bank indebtedness – principal[1]	**70,618**	70,618	–	–
Senior notes – principal	**150,000**	–	–	150,000
Convertible debentures[2]	**159,779**	–	159,779	–
Total	**$ 434,691**	$ 122,134	$ 162,557	$ 150,000

[1] The revolving feature of the credit facility expires on October 30, 2014 if not extended. Upon expiry of the revolving feature of the credit facility, should it not be extended, amounts outstanding as of the expiry date will have a term to maturity date of one day.

[2] Assuming repayment of principal is not settled in common shares, at the option of the Corporation.

c) Market risk

Market risk is the risk that changes in market prices such as foreign exchange rates, equity prices, commodity prices and interest rates will affect the Corporation's net income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The Corporation utilizes both financial derivatives and fixed-price physical delivery sales contracts to manage market risks related to commodity prices and foreign currency rates. All such transactions are conducted in accordance with the Corporation's Hedging and Risk Management Policy, which has been approved by the Board of Directors.

i) Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows of the Corporation will fluctuate as a result of changes in foreign exchange rates. The majority of the Corporation's oil and natural gas sales are denominated in Canadian dollars. Due to the fact that the demand for oil and natural gas is substantially driven by the demand in the United States, the Corporation's exposure to US dollar foreign exchange risk is indirectly driven by the price of oil and natural gas. From time to time the Corporation also uses foreign exchange contracts to mitigate the effects of fluctuations in exchange rates on the Corporation's cash flows. The Corporation does not consider its direct exposure to foreign currency exchange rate risk to be significant.

ii) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by world economic events that dictate the levels of supply and demand. The Corporation has attempted to mitigate commodity price risk through the use of various financial derivatives and fixed-price physical delivery sales contracts.

The Corporation's policies as they relate to hedging and risk management are as follows:

Restrictive policy	Contract type	Hedging limit
Internal Hedging and Risk Management Policy [(1)]	Financial or forward physical oil or natural gas liquids-based hedge volumes	80 percent of the average forecast future oil and natural gas liquids production volume after royalties
Internal Hedging and Risk Management Policy [(1)]	Financial or forward physical natural gas-based hedge volumes	80 percent of the average forecast future natural gas production volumes after royalties plus 40 percent of the forecast future gas over bitumen deemed production volumes
Credit facility agreement	Financial or forward physical oil, condensate, or natural gas-based hedge volumes	60 percent of the trailing quarter's production including gas over bitumen deemed production

[(1)] For the purposes of these limitations, basis and differential volumes are counted at 25 percent and unexercised call or put options are counted at 50 percent of the contract volumes.

As at December 31, 2013, the Corporation has variable priced physical natural gas sales contracts based on future market prices. These contracts are not classified as non-financial derivatives due to the fact that the settlement price corresponds directly with fluctuations in natural gas prices.

Realized gains on commodity price derivatives recognized in net income for the year ended December 31, 2013 were $6.3 million (2012 – $29.0 million). The realized gains on commodity price derivatives for the year ended December 31, 2013, included $0.9 million in respect of settlement of contracts prior to maturity (2012 – $2.1 million).

Natural gas contracts

At December 31, 2013, the Corporation had entered into financial and forward natural gas sales arrangements at AECO as follows:

Type of Contract	Perpetual Sold/Bought	Volumes at AECO (GJ/d)	Price ($/GJ)	Term
Financial	sold	40,000	3.60	January 2014
Financial	bought	(10,000)	3.66	January 2014
Physical	sold	25,000	3.74	January 2014
Physical	bought	(10,000)	3.66	January 2014
Financial	sold	10,000	3.71	January 2014 – December 2014

At December 31, 2013, the Corporation had entered into the following financial call option gas sales arrangements, whereby the Corporation's counterparty has the right to settle the specified volumes of natural gas at the specified prices in the future periods. Any subsequent changes in the fair values of the call options will be included in change in fair values of commodity derivatives in net income or loss.

Type of Contract	Perpetual Sold/Bought	Volumes at AECO (GJ/d)	Price ($/GJ)	Term
Financial	sold	10,000	4.25	January 2014 – December 2014

At December 31, 2013, the Corporation had entered into financial natural gas sales arrangements to fix the basis differential between the New York Mercantile Exchange ("NYMEX") and AECO trading hubs. The price at which these contract settles is equal to the NYMEX index less a fixed basis amount.

Type of Contract	Perpetual Sold/Bought	Volumes at NYMEX-AECO (MMBtu/d)	Price ($USD/MMBtu)	Term
Financial	sold	2,500	(0.42)	January 2014 – March 2014
Financial	bought	(2,500)	(0.48)	January 2014 – March 2014
Financial	sold	10,000	(0.51)	April 2014 – October 2014

At December 31, 2013, the Corporation had entered into the following financial natural gas sales arrangements at NYMEX as follows:

Type of Contract	Perpetual Sold/Bought	Volumes at NYMEX (MMBtu/d)	Price ($USD/MMBtu)	Term
Financial	sold	20,000	4.48	February 2014 – March 2014
Financial	bought	(5,000)	4.39	February 2014 – March 2014
Financial	sold	2,500	4.25	April 2014 – October 2014
Financial	bought	(2,500)	4.16	April 2014 – October 2014

Oil contracts

At December 31, 2013, the Corporation had entered into financial and forward physical oil sales arrangements to fix the basis differential between the West Texas Intermediate ("WTI") and Western Canadian Select ("WCS") trading hubs. The price at which this contract settles is equal to the WTI index less a fixed basis amount.

Type of Contract	Perpetual Sold/Bought	Volumes at WTI-WCS (bbl/d)	Differential ($USD/bbl)	Term
Financial	sold	250	(23.40)	January 2014 – December 2014
Physical	sold	1,000	(22.63)	January 2014 – December 2014

At December 31, 2013 the Corporation had entered into the following costless collar oil sales arrangements:

Type of Contract	Volumes at WTI (bbls/d)	Floor Price ($USD/bbl)	Ceiling Price ($USD/bbl)	Term
Collar [(1)]	500	90.00	103.15	January 2014 – December 2014
Collar	500	85.00	91.10	January 2014 – December 2014
Collar	500	85.00	91.20	January 2014 – December 2014
Collar	500	87.50	95.25	January 2015 – December 2015
Collar	500	87.50	95.75	January 2015 – December 2015

(1) In this collar arrangement Perpetual received a ceiling price above the market price for such collars, and in exchange should the WTI index settle above $USD103.15 per bbl in any month during the contract period Perpetual will receive a price of $USD93.00 per bbl.

At December 31, 2013, the Corporation has entered into the following fixed price oil sales arrangements:

Type of Contract	Perpetual Sold/Bought	Volumes at WTI (bbl/d)	Price ($USD/bbl)	Term
Financial	sold	1,000	90.00	January 2014 – December 2014

At December 31, 2013, the Corporation had entered into the following financial call option oil sales arrangements, whereby the Corporation's counterparty has the right to settle specified volumes of oil at specified prices in the future periods. Any subsequent changes in the fair values of the call options are included in change in fair values of commodity derivatives in net income or loss.

Type of Contract	Perpetual Sold/Bought	Volumes at WTI (bbl/d)	Price ($USD/bbl)	Term
Financial [(1)]	sold	2,000	105.00	January 2014 – December 2014
Financial	sold	1,500	100.00	January 2015 – December 2015

(1) These oil call options are part of paired transactions in which the proceeds from the sale of the call options were used to fund the 2012 natural gas contract price.

Foreign exchange contracts

At December 31, 2013, the Corporation had entered into the following $USD forward sales arrangement:

Type of Contract	Perpetual Sold/Bought	Notional $USD/month	Exchange rate ($CAD/$USD)	Term
Financial [1]	sold	1,000,000	1.1000	January 2014 – June 2015

[1] The Corporation receives $1,000 each day during the month that the daily exchange rate is between $1.0000 and $1.1000. If the average monthly exchange rate is greater than $1.1000 the Corporation pays USD$1,000,000 multiplied by the difference between the average monthly exchange rate and $1.1000. No settlement occurs between the Corporation and the counterparty if the average monthly exchange rate settles below $1.0000.

At December 31, 2013, the Corporation had entered into the following $USD forward sales arrangement:

Type of Contract	Perpetual Sold/Bought	Notional Floor $USD/month	Notional Ceiling $USD/month	Exchange Rate Floor ($CAD/$USD)	Exchange Rate Ceiling ($CAD/$USD)	Term
Financial [1]	sold	2,500,000	5,000,000	1.0400	1.1410	July 2014 – December 2015

[1] If the average monthly exchange rate is greater than $1.1410 the Corporation pays $USD5,000,000 multiplied by the difference between the average monthly exchange rate and $1.1000. If the monthly average exchange rate settles below $1.0400 the Corporation receives $USD2,500,000 multiplied by the difference between the average monthly exchange rate and $1.0400.

The following table reconciles the Corporation's change in fair value of commodity derivatives:

	Year ended December 31, 2013	2012
Realized loss on financial oil contracts	**$ (2,596)**	$ (2,613)
Realized gain on financial natural gas contracts	**8,266**	30,051
Realized gain on forward foreign exchange contracts	**605**	1,597
Unrealized gain on financial oil contracts	**5,411**	10,507
Unrealized loss on physical oil contracts	**(519)**	-
Unrealized loss on financial natural gas contracts	**(2,447)**	(11,896)
Unrealized gain on physical natural gas contracts	**64**	-
Unrealized loss on forward foreign exchange contracts	**(726)**	(204)
Unrealized gain on power derivatives	**-**	(631)
Change in fair value of commodity price derivatives	**$ 8,058**	$ 26,811

Natural gas sensitivity analysis

As at December 31, 2013, if future natural gas prices changed by $0.25 per GJ with all other variables held constant, the fair value of commodity price derivatives and after tax net income for the period would change by $1.7 million. Fair value sensitivity was based on published forward AECO and NYMEX prices.

Oil sensitivity analysis

As at December 31, 2013, if future oil prices changed by $5.00 per boe with all other variables held constant, the fair value of commodity price derivative and after tax net income for the period would have changed by $0.6 million. Fair value sensitivity was based on published forward WTI and WCS prices.

iii) Interest rate risk

The Corporation utilizes a credit facility which bears a floating rate of interest and as such is subject to interest rate risk. Increased future interest rates will decrease future cash flows and net income or loss, thereby potentially affecting the Corporation's capital investments.

The Corporation's senior notes and convertible debentures were issued at a fixed interest rate and as such these securities are not materially impacted by market interest rate fluctuations. To ensure accounts payable and accrued liabilities are settled on a timely basis, the Corporation manages liquidity risk as previously outlined in this note, thus limiting exposure to interest rate fluctuations and other penalties potentially resulting from past due payables.

The Corporation had no interest rate swap or financial contracts in place as at or during the year ended December 31, 2013 (December 31, 2012 – nil).

Interest rate sensitivity analysis

For the year ended December 31, 2013, if interest rates changed by one percent with all other variables held constant, the impact on interest expense and net income would be $0.7 million.

The impact on net loss as a result of interest rate fluctuations is based on the assumption that the lender increases or decreases the fixed term BA rate consistently, based on a market interest rate change of one percent.

d) Fair value of financial assets and liabilities

Perpetual fair value measurements are classified as one of the following levels of the fair value hierarchy:

Level 1 – inputs represent unadjusted quoted prices in active markets for identical assets and liabilities. An active market is characterized by a high volume of transactions that provides pricing information on an ongoing basis.

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These valuations are based on inputs that can be observed or corroborated in the marketplace, such as market interest rates or forward prices for commodities.

Level 3 – inputs for the asset or liability are not based on observable market data.

The Corporation aims to maximize the use of highly observable inputs when preparing calculations of fair value. Classification of each measurement into the fair value hierarchy is based on the lowest level of input that is significant to the fair value calculation.

The fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity. The fair value of the long term Crown receivable approximates the carrying value as the Corporation expects to recover the full carrying amount by way of future gas Crown royalties. Bank debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying amount. The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels:

				Fair value	
As at December 31, 2013	**Gross**	**Netting[1]**	**Carrying Amount**	**Level 1**	**Level 2**
Financial assets					
Fair value through profit and loss					
Derivatives - current	**596**	**(270)**	**326**	**-**	**326**
Derivatives – non-current	**19**	**-**	**19**	**-**	**19**
Financial liabilities					
Financial liabilities at amortized cost					
Senior notes	**147,719**	**-**	**147,719**	**-**	**144,750**
Convertible debentures	**154,496**	**-**	**154,496**	**155,236**	**-**
Fair value through profit and loss					
Derivatives – current	**6,738**	**(270)**	**6,468**	**-**	**6,468**
Derivatives – non-current	**2,778**	**-**	**2,778**	**-**	**2,778**

(1) Derivative assets and liabilities presented in the statement of financial position are shown net of offsetting assets or liabilities where the arrangement provides or the legal right and intention for net settlement exists.

As at December 31, 2012	Gross	Netting[1]	Carrying Amount	Fair value Level 1	Level 2
Financial assets					
Fair value through profit and loss					
Marketable securities	1,963	-	1,963	1,963	-
Derivatives - current	9,144	(5,441)	3,703	-	3,703
Financial liabilities					
Financial liabilities at amortized cost					
Senior notes	147,177	-	147,177	-	144,000
Convertible debentures	151,673	-	151,673	151,123	-
Fair value through profit and loss					
Derivatives - current	6,893	(5,441)	1,452	-	1,452
Derivatives – non-current	8,402	-	8,402	-	8,402

(1) Derivative assets and liabilities presented in the statement of financial position are shown net of offsetting assets or liabilities where the arrangement provides or the legal right and intention for net settlement exists.

19. CAPITAL MANAGEMENT

The Corporation's policy is to maintain a strong capital base so as to retain investor, creditor and market confidence and to sustain the future development of the business. The Corporation manages its capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of its underlying oil and natural gas assets. The Corporation considers its capital structure to include share capital, bank debt, senior notes, convertible debentures and adjusted working capital. In order to maintain or adjust the capital structure, the Corporation may from time to time issue shares or debt securities and adjust its capital spending to manage current and projected debt levels.

The Corporation monitors capital based on the ratio of net debt to trailing twelve months cash flow from operations. As at December 31, 2013, the Corporation’s ratio of net debt to operating cash flow was 7.2 to 1 (December 31, 2012 – 8.0 to 1) reflecting changes in net debt and cash flow from operations. This ratio is monitored continuously by the Corporation, and the targeted range of net debt to cash flow varies based on such factors as acquisitions or dispositions, commodity prices, forecasts of future commodity prices, price management contracts, projected cash flows, dividends, capital expenditure programs and timing of such programs. As a part of the management of this ratio, the Corporation prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. Capital spending budgets are approved by the Board of Directors.

The Corporation’s 7.25% Convertible Debentures and 7.00% Convertible Debentures mature on January 31, 2015 and December 31, 2015 respectively. While the Corporation has the option to settle all or a portion of the outstanding 7.25% Convertible Debentures and 7.00% Convertible Debentures through the issuance of shares by giving notice of such intent to debenture holders not more than 60 and not less than 30 days prior to the maturity date, it is the intention of the Corporation to settle in cash. The banks for the Corporation’s revolving credit facility are awaiting more certainty on the Corporation’s plans to settle the debenture prior to extending the revolving credit facility which, if not renewed, comes due on October 31, 2013. The Corporation will apply to have the facility renewed prior to the next semi-annual review on April 30, 2014. In advance of the facility coming due, management plans include pursing alternative financing arrangements on the facility based on the Corporation’s increased year over year externally evaluated reserve values.

Management is pursuing repayment options for the 7.25% Convertible Debentures and 7.00% Convertible Debentures including asset dispositions, refinancing, or a combination thereof. There is no assurance that the Corporation will be able raise additional capital to settle all or a portion of the outstanding 7.25% Convertible Debentures and 7.00% Convertible Debentures in cash, in which case, the Corporation would have the option to settle all or a portion of the debentures.

20. COMMITMENTS

Perpetual has contractual agreements comprised of office lease costs and related sublease recoveries, as well as long-term commitments to pay for gas transportation on certain major pipeline systems in western Canada. As of December 31, 2013, the future minimum payments under these contractual agreements consisted of:

	Pipeline commitments	Operating lease commitments
2014	$ 4,599	$ 1,743
2015	1,682	1,678
2016	94	1,661
2017	34	1,598
2018	24	399
Total	**$ 6,433**	**$ 7,079**

21. DEFERRED INCOME TAXES

The provision for income taxes in the financial statements differs from the result that would have been obtained by applying the combined federal and provincial tax rate to the Corporation's loss before income tax. This difference results from the following items:

	Year ended December 31, **2013**	2012
Loss before income tax, including non-controlling interests	**$ 7,620**	$ (79,739)
Combined federal and provincial tax rate (%)	**25.0**	25.0
Computed income tax benefit	**1,905**	(19,935)
Increase (decrease) in income taxes resulting from:		
Non-deductible expenses	**994**	1,230
Non-taxable capital gain	**-**	(7,760)
Expired tax pools	**-**	10,793
Unrecognized tax asset	**(2,421)**	9,700
Other	**(478)**	2,219
Deferred income taxes	**$ -**	$ (3,753)

Income tax rates remained at 25.0 percent in 2013 and 2012 with no changes to federal statutory income tax rates.

The components of the Corporation's and its subsidiaries' deferred income tax liabilities are as follows:

	Year ended December 31, **2013**	2012
Property, plant and equipment	**$ 28,539**	$ 44,018
Other	**6,287**	3,303
Gas over bitumen royalty obligation	**(737)**	(684)
Decommissioning obligations	**(34,089)**	(46,637)
	$ –	$ -

The temporary deductible differences included in the Corporation's unrecognized deferred income tax assets are as follows:

	Year ended December 31, **2013**	2012
Non-capital losses	**$ 146,703**	$ 232,025
Capital losses	**160,969**	159,224
Decommissioning obligation	**77,551**	19,923
Other	**11,055**	-
	$ 396,278	$ 411,172

The tax losses expire between 2014 and 2032. The deductible temporary differences do not expire under current tax legislation. Deferred tax assets have not been recognized in respect of these temporary differences because it is not probable that future taxable profit will be available against which the Corporation can utilize the benefits. The petroleum and natural gas properties and facilities owned by the Corporation and its subsidiaries have an approximate tax basis of $551 million (December 31, 2012 – $490 million) available for future use as deductions from taxable income.

22. KEY MANAGEMENT PERSONNEL

The Corporation has defined key management personnel as executive officers and vice presidents, as well as the Board of Directors, as they have the collective authority and responsibility for planning, directing and controlling the activities of the Corporation. The following table outlines the total compensation expense for key management personnel:

	Year ended December 31,	
	2013	2012
Short-term fees and other short-term benefits	**$ 3,860**	$ 3,630
Share based compensation expense	**1,869**	2,001
	$ 5,729	$ 5,631

23. SUPPLEMENTAL DISCLOSURE

The Corporation's consolidated statements of loss and comprehensive loss are prepared primarily by nature of expense, with the exception of employee compensation costs which are included in both production and operating and general and administrative expenses.

The following table details the amount of total employee compensation costs included in production and operating and general and administrative expenses in the consolidated statements of loss and comprehensive loss.

	Year ended December 31,	
	2013	2012
Production and operating	**$ 9,279**	$ 10,107
General and administrative	**24,171**	25,564
	$ 33,450	$ 35,671

During the year ended December 31, 2013, total employee compensation costs included share based payment expense of $4.0 million (2012 – $4.3 million) with the remainder being short-term fees and other short-term benefits.