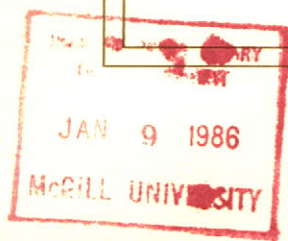


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# TEMAGAMI

Oil & Gas Ltd.

Annual Report  
1985



## **Officers and Directors**

Donald C. Campbell  
President, Chief Executive Officer and Director

R. Bruce Boyden  
Director

John S. Grant, Jr.  
Director

Carl R. Jonsson  
Secretary and Director

Frederick G. Roman  
Vice-President and Director

Irene Huntley  
Vice-President and Controller

## **Transfer Agent and Registrar**

Guaranty Trust Company of Canada  
88 University Avenue  
Toronto, Ontario  
M5J 1T8

## **General Council**

Tupper, Jonsson, Shroff & Zink  
Vancouver, British Columbia

## **Auditors**

Collins Barrow  
Calgary, Alberta

## **Bankers**

First Interstate Bank of California

## **Registered Office**

1710, 1177 West Hastings Street  
Vancouver, British Columbia  
V6E 2L3

## **Corporate Office**

2300, 300 - 5th Avenue S.W.  
Calgary, Alberta  
T2P 0L3

TEMAGAMI OIL & GAS LTD.

CONSOLIDATED STATEMENT OF DEFICIT

THREE MONTHS ENDED AUGUST 31

	<u>1985</u>	<u>1984</u>
Revenue		
Oil & gas sales	\$ 372,714	\$ 420,030
Other	-	20
Expenses		
Production and production tax	85,744	142,710
General and Administration	48,402	52,892
Interest on long-term debt	183,721	256,454
Depletion	122,364	189,950
Depreciation and amortization	6,118	87,639
	<u>446,349</u>	<u>729,645</u>
Loss before income taxes	73,635	309,595
Deferred income taxes (recovery)	-	(139,318)
Loss	73,635	170,277
Deficit, beginning of period	10,280,432	643,920
Deficit, end of period	<u>10,354,067</u>	<u>814,197</u>

TEMAGAMI OIL & GAS LTD.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

THREE MONTHS ENDED AUGUST 31

	<u>1985</u>	<u>1984</u>
Working capital provided from:		
Proceeds from sale of property & equipment	\$ -	\$ 16,340
Increase in long-term debt	-	-
Operations	54,847	-
	<u>54,847</u>	<u>16,340</u>
Working capital used for:		
Operations	-	31,762
Acquisitions of property and equipment	-	16,206
Reduction of long-term debt	35,125	33,652
Reclassification of long-term debt	-	182,000
	<u>35,125</u>	<u>263,620</u>
Increase in working capital	19,722	(247,280)
Working capital deficiency, beginning of period	1,911,238	1,236,268
Working capital deficiency, end of period	<u>1,891,516</u>	<u>1,483,548</u>





## To Our Shareholders:

Uncertainties in future crude price levels, a difficult gas marketing environment and high debt service requirements have all contributed to limiting your Company's activities during the year. We have continued to enjoy the cooperation and support of our bankers, First Interstate Bank of California, during this difficult period.

The Company's principal operations continue to be concentrated in Wyoming on the Hiland leases where there are eight producing wells. We have been successful in reducing operating costs on these wells to levels which are below those prevailing three years ago, while still maintaining production rates slightly higher than forecast. There are additional development sites, available on these leases but no schedule has yet been established for further drilling. Roman Corporation (U.S.) Inc. has the right to participate in such wells by paying 100 percent of the Company's costs to earn 75 percent of its working interest before payout and 40 percent thereafter.

Gas prices were falling sharply in Wyoming during the year and we were faced with very real problems of not being able to sell all of the gas we produced. As a result, we had an operating loss from our gas plant on the Hiland leases and, in addition, we were faced with the requirement to make a substantial investment in the plant to meet Wyoming's air quality standards. Consequently, we sold the gas plant at a loss near the end of 1984 and applied the proceeds toward reducing our long term bank debt. We have retained the right to a backin after payout and are now selling all of our raw gas production to the new owners.

In Texas, the Company continues to hold interests in two producing oil and gas wells in Burleson County, as well as four wells being operated by Martin Oil Company.

After evaluating the results of the unsuccessful exploration program on the Indiana leases carried out by the farmee at no cost to the Company, all participants decided not to proceed with any additional exploration activity. All lease interests were released. The Company also withdrew from its working interest position in the Michigan leases but continued to hold an overriding royalty.

In Canada, Temagami has net revenue interests in a number of leases in Alberta, British Columbia and the Northwest Territories. Negotiations are underway for the drilling of wells on several of these leases. These wells would be drilled at no cost to the Company. We anticipate that one or two of such wells will be drilled this year.

After a detailed analysis of the Company's properties and numerous discussions with our consultants and our auditors, we determined that it was prudent

to write down the value of our oil and gas properties and equipment. Since its formation, Temagami has capitalized all of its land acquisition costs, geological and geophysical expenditures, costs of drilling all productive and non-productive wells along with portions of its general administrative and interest costs.

In the past, we had determined that future net revenues, considering what we then thought was reasonable price escalation, plus the value of the undeveloped properties, were sufficient to support the amount carried on our books for these properties and equipment. However, crude prices are continuing to soften and it is very difficult to justify projections based on escalating prices for oil and gas over the next few years; gas revenues are down substantially both from an overall weakening of the gas market as well as from the change to selling raw gas rather than sweet gas; recovery from the sale of used equipment after depletion of the reserves has become quite hypothetical; and, in the current economic environment, it is difficult to reasonably evaluate undeveloped lands. Probable and possible reserves are difficult to take into account in evaluating undeveloped lands since projections of future crude price levels greatly affect whether or not it is feasible to drill the wells necessary to exploit such reserves.

Your Company has, therefore, taken a reasonably conservative approach in determining the amount of the writedown. We have attributed only nominal value to undeveloped lands; have assumed that oil and gas prices do not escalate from current levels over the life of the reserves; and do not give any salvage value to used equipment after completion of operations. Hopefully future events will prove that we have been overly pessimistic.

We still expect to further reduce our costs during the coming year, but we can not realistically expect any major change in your Company's fortunes without a significant improvement in the domestic and international oil and gas markets.

On Behalf of the Board,



Donald C. Campbell,  
President

December 10, 1985.





# Auditors' Report

To the Shareholders  
TEMAGAMI OIL & GAS LTD.

We have examined the consolidated balance sheet of Temagami Oil & Gas Ltd. as at May 31, 1985 and the consolidated statements of loss and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards in Canada, and accordingly included such tests and other procedures as we considered necessary in the circumstances, except as explained in the following paragraph.

We were unable to satisfy ourselves as to the propriety and status of the agreements related to the long-term account receivable as described in note 4 to the financial statements. Accordingly, we can not determine whether any adjustments might be necessary to long-term account receivable, accounts payable, property and equipment, depletion, depreciation, deferred income taxes, net loss and deficit.

In our opinion, except for the effect of adjustments, if any, which might have been determined to be necessary had we been able to satisfy ourselves with respect to the balance of the long-term account receivable described in the preceding paragraph, these consolidated financial statements present fairly the financial position of the company as at May 31, 1985 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles in Canada applied, after giving prospective effect to the change in the method of foreign currency translation as described in note 2(e) to the financial statements, on a basis consistent with that of the preceding year.

COLLINS BARROW  
Chartered Accountants

Calgary, Canada  
July 5th, 1985

## Comments on Difference in Canada - United States Reporting Standards For Auditors

In the United States, reporting standards for auditors require the expression of an opinion qualified as being subject to the outcome of significant uncertainties affecting the financial statements such as the uncertainties referred to in the attached balance sheet as at May 31, 1985 and as described in note 1 to the financial statements. The opinion in our above report is expressed in accordance with Canadian standards and is not qualified with respect to, and provides no reference to, these uncertainties since such an opinion would not be in accordance with Canadian reporting standards for auditors when the uncertainties are adequately disclosed in the financial statements.

COLLINS BARROW  
Chartered Accountants

Calgary, Canada  
July 5th, 1985

**TEMAGAMI OIL & GAS LTD.**

(Incorporated under the laws of British Columbia)

**Consolidated Balance Sheet****May 31, 1985**

	<u>May 31, 1985</u>	<u>May 31, 1984</u>
<b>Assets</b>		
Current assets		
Cash	\$ 78,972	\$ 44,199
Accounts receivable	210,329	233,356
Current portion of agreement receivable	31,171	—
Marketable securities	1,750	70,000
	<u>322,222</u>	<u>347,555</u>
Agreement receivable (note 3)	37,800	—
Long-term account receivable (note 4)	752,218	657,645
Property and equipment (note 5)	5,683,064	13,430,323
	<u>\$ 6,795,304</u>	<u>\$ 14,435,523</u>
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,355,584	\$ 1,118,915
Current portion of long-term debt	877,876	464,908
	<u>2,233,460</u>	<u>1,583,823</u>
Long-term debt (note 6)	6,340,523	6,302,110
Deferred income taxes	—	313,510
	<u>6,340,523</u>	<u>6,302,110</u>
<b>Shareholders' Equity (Deficiency)</b>		
Share capital (note 7)	6,880,000	6,880,000
Unrealized foreign exchange gain	1,621,753	—
Deficit	(10,280,432)	(643,920)
	<u>(1,778,679)</u>	<u>6,236,080</u>
	<u>\$ 6,795,304</u>	<u>\$ 14,435,523</u>

Approved on behalf of the Board,



, Director



, Director

**TEMAGAMI OIL & GAS LTD.**  
(Incorporated under the laws of British Columbia)

# **Consolidated Statement of Loss and Deficit**

year ended May 31, 1985

	<b>Year ended May 31, 1985</b>	<b>Year ended May 31, 1984</b>
Revenue		
Oil and gas sales	\$ 1,561,263	\$ 1,647,456
Gas processing income	88,777	167,682
Interest and other	79,914	66,535
	<u>1,729,954</u>	<u>1,881,673</u>
Expenses		
Production and production taxes	530,178	550,689
Gas processing	126,687	162,693
General and administrative	255,183	232,217
Interest on long-term debt	906,493	879,075
Depletion	495,000	789,000
Depreciation	143,547	345,844
	<u>2,457,088</u>	<u>2,959,518</u>
Loss from operations	727,134	1,077,845
Loss on disposal of gas plant	818,400	—
Provision for impairment in value of oil and gas properties and equipment	8,380,000	—
Write-down of marketable securities to estimated net realizable value	68,250	—
Gain on sale of property and equipment	—	37,629
Loss before income tax	9,993,784	1,040,216
Deferred income tax recovery	(357,272)	(410,100)
Net loss	9,636,512	630,116
Deficit, beginning of year	643,920	13,804
Deficit, end of year	<u>\$10,280,432</u>	<u>\$ 643,920</u>
Loss per share	<u>\$ 0.920</u>	<u>\$ 0.060</u>



**TEMAGAMI OIL & GAS LTD.**

(Incorporated under the laws of British Columbia)

**Consolidated Statement of Changes in Financial Position**  
**year ended May 31, 1985**

	<b>Year ended May 31, 1985</b>	<b>Year ended May 31, 1984</b>
Working capital was provided from		
Operations	\$ —	\$ 51,832
Proceeds on disposal of property and equipment	499,884	155,000
Decrease in long-term accounts receivable	—	150,394
	<u>499,884</u>	<u>357,226</u>
Working capital was used for		
Operations	156,837	—
Reduction of long-term debt	871,915	278,026
Foreign exchange loss on working capital	105,690	—
Acquisition of property and equipment	3,669	349,628
Increase in agreement receivable	36,743	—
	<u>1,174,854</u>	<u>627,654</u>
Decrease in working capital	674,970	270,428
Working capital deficiency, beginning of year	1,236,268	965,840
Working capital deficiency, end of year	<u>\$ 1,911,238</u>	<u>\$ 1,236,268</u>

## TEMAGAMI OIL & GAS LTD.

(Incorporated under the laws of British Columbia)

# Notes to the Consolidated Financial Statements

May 31, 1985

### 1. Going Concern

These financial statements are prepared on the basis that the company is a going concern. The company is dependent on the continued financial support of its banker and the ability to generate sufficient cash flow from its current operations to discharge its liabilities and meet its obligations under the terms of the bank loan agreement as described in note 6.

### 2. Significant accounting policies

The consolidated financial statements of the company have been prepared by management in accordance with accounting principles generally accepted in Canada, which, in the case of the company, conform in all material respects with International Accounting Standards. These financial statements have in management's opinion been properly prepared within reasonable limits of materiality and in light of information available up to July 5, 1985. The principal accounting policies are summarized as follows:

#### (a) Principles of consolidation

The consolidated financial statements include, in addition to the accounts of the company, the accounts of its wholly-owned subsidiary, Temagami Oil & Gas Inc.

#### (b) Exploration and development costs

The company follows the full cost method of accounting for exploration and development expenditures, wherein all costs related to the exploration for and the development of oil and gas reserves are initially capitalized. Costs capitalized include land acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties, costs of drilling productive and non-productive wells together with overhead and interest directly related to exploration and development activities. Proceeds on minor property sales are credited to the net book value of the property and equipment. Gains or losses on major property sales are normally recognized in the statement of loss. The company employs a ceiling test annually whereby capital costs are written off should they exceed the present value of future net revenues from estimated production of proven reserves together with undeveloped land at the lower of cost and net realizable value.

Exploration and development costs are allocated to one cost centre, namely, North America (Canada and the United States).

Costs capitalized in the cost centre are depleted on the composite unit-of-production method based on estimated proven oil and gas reserves as determined by independent and company engineers.

In calculating depletion, natural gas reserves and production are converted to equivalent barrels of oil based upon the relative energy content method.

#### (c) Depreciation

Depreciation of production equipment is provided for on the composite unit-of-production method. Depreciation of other equipment is computed on the declining balance method at rates varying from 20 to 30 percent per annum.

#### (d) Joint venture

Substantially all of the exploration and production activities of the company are conducted jointly with others and accordingly these financial statements reflect only the company's proportionate interest in such activities.

#### (e) Translation of foreign currencies

Effective June 1, 1984, the company implemented a change in its foreign currency translation policy in accordance with new recommendations of the Canadian Institute of Chartered Accountants. Prior years' results have not been restated to reflect the impact of this change.

Under the new policy, the U.S. operations are considered financially and operationally independent of the parent company and have been translated into Canadian dollars as follows: assets and liabilities at the rate of exchange at the balance sheet date, revenues and expenses at the average rate of exchange during the year. Gains or losses on translation are shown as a separate component in shareholders' equity. Previously, fixed assets, other non-current assets and liabilities and depreciation and depletion were translated at historic rates of exchange. Exchange gains and losses were included in income.



(f) **Marketable securities**

Marketable securities are carried at the lower of cost or estimated net realizable value.

(g) **Loss per share**

Net loss per share is based on the weighted average number of common shares outstanding during the year.

(h) **Accounting for changing prices**

No procedures have been adopted by the company to reflect the impact on the financial statements of specific price changes, changes in the general prices, or both.

**3. Agreement receivable**

The agreement receivable bears interest at 10¼% and is due in monthly installments of \$3,090 including interest.

	1985	1984
Balance, end of year	\$ 68,971	\$ —
Less: Current portion	31,171	—
	<u>\$ 37,800</u>	<u>\$ —</u>

**4. Long-term account receivable**

The long-term account receivable is due from a joint venture participant and relates to certain joint venture agreements which the company has entered into to develop oil and gas properties. The propriety and status of these joint venture agreements is uncertain, and in dispute. Management is of the opinion that any adjustments which may result upon resolution of the dispute can not be reasonably estimated at this time.

**5. Property and equipment**

	1985		1984
	Cost	Accumulated Depletion and Depreciation	Net
Oil and gas properties including exploration and development costs	\$ 10,257,713	\$ 4,864,599	\$ 5,393,114
Production equipment	736,869	470,075	266,794
Gas plant	—	—	—
Other equipment	153,946	130,790	23,156
	<u>\$ 11,148,528</u>	<u>\$ 5,465,464</u>	<u>\$ 5,683,064</u>

	1985	1984
	\$ 11,532,159	\$ 699,211
	1,146,674	52,279
	<u>\$ 13,430,323</u>	

**6. Long-term debt**

	1985	1984
Bank loan	\$ 6,335,033	\$ 6,295,060
Obligations under capital leases	5,490	7,050
	<u>\$ 6,340,523</u>	<u>\$ 6,302,110</u>

(a) **Bank loan**

The bank loan is secured by all assets of the company. The loan currently bears interest at a U.S. bank's prime rate plus ½% and is repayable in U.S. dollars.

The company may at any time elect to alter the interest terms as follows:

To December 31, 1985 at ½% in excess of Cost of Funds, as defined by loan agreement, for amounts not exceeding \$4,000,000 U.S. and at a U.S. bank's prime rate plus ½% on the balance;

From January 1, 1986 to December 31, 1986 at ½% in excess of Cost of Funds, as defined by loan agreement, for amounts not exceeding \$2,000,000 and at a U.S. bank's prime rate plus ½% on the balance;

From January 1, 1987, until principal and interest are paid in full, at a U.S. bank's prime rate plus ½%.

After January 1, 1985, the bank loan agreement requires that the company dedicate 95% to 100% of its "net cash flow" (as defined in the loan agreement) towards principal payments each month. If the total principal payment from "net cash flow" is less than \$103,000 in any calendar quarter in 1985 (\$165,000 in 1986 and



thereafter) then a supplementary payment is required on the last day of such calendar quarter to bring the total principal payment up to the required minimum payment. The company has been dedicating 95% to 100% of its "net cash flow" towards principal payments but such payments have been inadequate to meet the required minimum calendar quarter payment. The bank has however not demanded further payment in satisfaction of the deficiency.

	1985	1984
Bank loan (1985 - U.S. \$5,250,000; 1984 - U.S. \$5,650,000)	\$ 7,209,825	\$ 6,755,360
Less: Current portion	874,792	460,300
	<u>\$ 6,335,033</u>	<u>\$ 6,295,060</u>

Estimated minimum repayments (U.S. \$) required under the loan agreement in the next five years are as follows:

1986	\$ 645,000
1987	660,000
1988	660,000
1989	660,000
1990	660,000
subsequent years	1,965,000
	<u>\$ 5,250,000</u>

(b) Obligations under capital leases

The following is a schedule of future minimum lease payments under capital leases:

1986	\$ 4,608
1987	5,490
Total minimum lease payments	10,098
Less: Amount representing interest at 12.00%	1,524
Balance of obligations before current portion	8,574
Current portion	3,084
Balance of obligations	<u>\$ 5,490</u>

## 7. Share capital

Authorized and issued share capital consist of the following:

	1985	1984
Authorized		
100,000 Preferred Shares Series A with a par value of \$1 each		
100,000 Preferred Shares Series B with a par value of \$1 each		
100,000 Preferred shares Series C with a par value of \$1 each		
15,000,000 Common Shares without par value		
Issued		
10,470,000 Common Shares	<u>\$ 6,880,000</u>	<u>\$ 6,880,000</u>

## 8. Remuneration of directors and officers

The total remuneration paid to directors and officers of the company amounted to \$48,000 (1984 - \$40,589).

## 9. Related party transactions

Included in accounts payable is \$432,791 (1984 - \$398,214) interest payable to a related party which owns a significant interest in the company. The amount represents debenture interest accrued to November 15, 1981 (the date on which the debenture was converted to common shares) plus interest charged on the unpaid debenture interest at the rate of 1% over a Canadian bank's prime rate. During the year no payments on account were made. No fixed repayment terms have been determined.

Included in accounts payable is \$426,380 (1984 - \$207,836) of joint venture billings due to an affiliated company.

## 10. Segmented information

The company, which is engaged in only one industry, exploration for and development of oil and gas reserves, operates primarily in two geographic areas, Canada and the United States. The following is an analysis of certain financial information by geographic area:

	Canada	United States	Total
		1985	
Petroleum and natural gas sales	\$ —	\$ 1,561,263	\$ 1,561,263
Operating profit	\$ —	\$ 1,073,089	\$ 1,073,089
General and administrative expense			255,183
Interest on long-term debt			906,493
Depletion			495,000
Depreciation			143,547
Loss on disposal of gas plant			818,400
Provision for impairment in value of oil and gas properties			8,380,000
Write-down of marketable securities to estimated net realizable value			68,250
			11,066,873
Loss before income taxes			\$ 9,993,784
Identifiable assets	\$ 38,460	\$ 6,756,844	\$ 6,795,304
	Canada	United States	Total
		1984	
Petroleum and natural gas sales	\$ 1,642	\$ 1,645,814	\$ 1,647,456
Operating profit	\$ 1,429	\$ 1,166,862	\$ 1,168,291
General and administrative expense			232,217
Interest			879,075
Depletion			789,000
Depreciation			345,844
Gain on sale of property and equipment			(37,629)
			2,208,507
Loss before income taxes			\$ 1,040,216
Identifiable assets	\$ 824,351	\$ 13,611,172	\$ 14,435,523

## 11. Loss carryforwards

As at May 31, 1985, the company has non-capital losses for income tax purposes available to be carried forward and applied against taxable income of future years as follows:

	Year Incurred	Approximate Amount	Year of Expiry
<b>Canadian Operations</b>	1983	\$ 136,699	1988
	1984	138,196	1991
	1985	12,428	1992
		\$ 287,323	
<b>U.S. Operations</b>	1979	\$ 838,471 (U.S.)	1994
	1980	2,272,501 (U.S.)	1995
	1981	666,331 (U.S.)	1996
	1982	2,017,659 (U.S.)	1997
	1983	1,320,545 (U.S.)	1998
	1984	674,629 (U.S.)	1999
	1985	360,673 (U.S.)	2000
		\$ 8,150,809	

