

# **Key Petroleum Limited**

**ABN 50 120 580 618**

## **Annual Financial Report**

**for the period ended 30 June 2007**

## Corporate Information

**ABN 50 120 580 618**

### **Directors**

Edward Ellyard (Non Executive Chairman)  
Kenneth Russell (Managing Director)  
Terence Nilsen (Technical Director)  
Dennis Wilkins (Finance Director)  
Richard O'Shannassy (Non Executive Director)

### **Company Secretary**

John Ribbons

### **Registered Office**

Level 1, 14 Outram Street  
WEST PERTH WA 6005  
Telephone: +61 8 9327 3500  
Facsimile: +61 8 9327 3510

### **Postal Address**

PO Box 1242  
WEST PERTH WA 6872

### **Solicitors**

Richard O'Shannassy & Co Pty Ltd  
Level 1, 14 Outram Street  
WEST PERTH WA 6005

### **Bankers**

National Australia Bank Limited  
1232 Hay Street  
WEST PERTH WA 6005

### **Share Register**

Computershare Investor Services Pty Ltd  
Level 2, Reserve Bank Building  
45 St George's Terrace  
PERTH WA 6000

### **Auditors**

Rix Levy Fowler  
Level 1, 12 Kings Park Road  
WEST PERTH WA 6005

### **Internet Address**

[www.keypetroleum.com](http://www.keypetroleum.com)

### **Email Address**

[info@keypetroleum.com](mailto:info@keypetroleum.com)

### **Stock Exchange Listings**

Key Petroleum Limited shares and the 35 cent options expiring on 31 March 2009 are listed on the Australian Stock Exchange.

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## Directors' Report

Your directors submit their report for the period ended 30 June 2007.

### DIRECTORS

The names and details of the company's directors in office during the period and until the date of this report are as follows. Where applicable, all current and former directorships held in listed public companies over the last three years have been detailed below. Directors were in office for this entire period unless otherwise stated.

#### Names, qualifications, experience and special responsibilities

##### **Edward Ellyard**, B.Sc.(Geology), Grad.Dip, MAusIMM, MAAPG (Chairman)

Ted Ellyard is a geologist with over 30 years experience in petroleum and petroleum exploration, development and production. Mr Ellyard graduated from Curtin University, Perth in 1974 and has worked for several major Australian and international resource companies. More recently, Mr Ellyard was Managing Director and CEO of Hardman Resources Ltd from 1996 to late 2004. In that role he oversaw the international expansion of Hardman into the Mauritanian oil/gas discoveries and its dramatic market capitalization growth from less than \$5 million to over \$1.5 billion.

Mr Ellyard has been involved at board level in the management of listed Australian resource companies for the past 20 years and has been a founding director of several companies. Currently, Mr Ellyard is a director of Bonaparte Diamond Mines NL and Minemakers Limited. Mr Ellyard has been a former director of Hardman Resources Limited within the last 3 years.

Mr Ellyard was appointed a director on 5 July 2006.

##### **Kenneth Russell** (Managing Director)

Mr Russell is a petroleum engineering and production technology specialist with over 30 years experience in the international oil and gas industry. He commenced his career in the oil producing offshore fields of West Africa with Gulf Oil Limited in Angola and later worked for Flopetrol Schlumberger Limited, involved in well testing, wireline services and production and worked in areas such as Australia, Asia and various parts of Africa and Europe.

In 1984 he established a petroleum engineering and production technology consultancy business which has participated in the development to production of a large number of the oil and gas fields in Australia and also in parts of South East Asia, Brazil, and Russia. His client list included companies such as Royal Dutch Shell plc (Shell), Enterprise Oil plc, Chevron Limited, BHP Billiton Limited and Hardman as well as a number of smaller entities.

Mr Russell has held a number of managerial roles and directorships in the oil and gas industry throughout his career and was a founding Director of the ASX listed Bounty Oil and Gas NL. He has considerable experience, developed over the last 20 years, in international business and has practical operating experience operating in the areas of Key Petroleum's exploration permits. Mr Russell has not held any former directorships in the last 3 years.

Mr Russell was appointed a director on 5 July 2006.

##### **Terence Nilsen**, B.Sc. Hons (Geology) (Technical Director)

Mr Nilsen is a petroleum geologist with 20 years experience. Graduating in 1985 from the University of Western Australia, he has worked as a geologist and interpretive geophysicist at senior levels for Cultus Petroleum NL, Stirling Resources NL, Santos Limited (Santos), Arc Energy Limited and Hardman.

Whilst at Santos, Mr Nilsen made a significant contribution to the most successful onshore gas exploration programme undertaken by Santos in the last 25 years. More recently, Mr Nilsen worked for Hardman from 2000 to 2005, where he was the Exploration Supervisor, which at that time was the most senior technical position in the company. In that position he played a guiding role in Hardman's international exploration effort, including several oil and gas discoveries in Mauritania. Mr Nilsen is a member of the Petroleum Exploration Society of Australia, Australian Society of Exploration Geophysicists and the Southeast Asia Petroleum Exploration Society. Mr Nilsen has not held any former directorships in the last 3 years.

Mr Nilsen was appointed a director on 31 January 2007.

##### **Dennis Wilkins**, B.Bus, AICD, ACIS (Finance Director)

Mr Wilkins is an accountant who has been a director, company secretary or acted in a corporate advisory capacity to listed resource companies for over 20 years.

Mr Wilkins previously served as the Finance Director and Company Secretary for a mid tier gold producer and also spent five years working for a leading merchant bank in the United Kingdom. Resource postings to Indonesia, South Africa and New Zealand in managerial roles has broadened his international experience.

Mr Wilkins has extensive experience in capital raising specifically for the resources industry and is the principal of DWCorporate which provides advisory, funding and administrative management services to the resource sector. Mr Wilkins is a director of Bonaparte Diamond Mines NL, Marengo Mining Limited, Minemakers Limited and South Boulder Mines Limited. Mr Wilkins has not held any former directorships in the last 3 years.

Mr Wilkins was appointed a director on 5 July 2006.

## Directors' Report continued

### Richard O'Shannassy, B.Juris.; LL.B. (Hons) (Non Executive Director)

Mr O'Shannassy is a commercial lawyer with over 25 years' experience in the mining and energy sectors. He has experienced private legal practice, including conducting his own practice in Perth for over 13 years, as well as in-house roles - most recently, he was General Counsel & Company Secretary for Hardman Resources Limited until it was acquired by Tullow Oil plc under a Scheme of Arrangement in late 2006. He has served upon mining industry committees over a number of years and is a member of Australian Mining & Petroleum Law Association Inc. Currently Mr O'Shannassy is a director of Minemakers Limited and Hardman Resources Pty Ltd (formerly ASX listed company Hardman Resources Limited). Mr O'Shannassy has not held any former directorships in the last 3 years.

Mr O'Shannassy was appointed a director on 1 July 2007.

**John Ribbons** was appointed a director at incorporation on 5 July 2006 and resigned on the same date.

### COMPANY SECRETARY

#### John Ribbons, B.Bus., CPA, ACIS

Mr Ribbons is an accountant who has worked within the resources industry for over fourteen years in the capacity of company accountant, group financial controller or company secretary.

Mr Ribbons has extensive knowledge and experience with ASX listed production and exploration companies. He has considerable site based experience with operating mines and has also been involved with the listing of several exploration companies on ASX. Mr Ribbons has experience in capital raising, ASX compliance and regulatory requirements.

Mr Ribbons was appointed company secretary on 5 July 2006.

### Interests in the shares and options of the company and related bodies corporate

As at the date of this report, the interests of the directors in the shares and options of Key Petroleum Limited were:

|                     | Ordinary<br>Shares | Options over<br>Ordinary<br>Shares |
|---------------------|--------------------|------------------------------------|
| Edward Ellyard      | 4,050,000          | 2,025,000                          |
| Kenneth Russell     | 5,565,000          | 2,782,500                          |
| Terence Nilsen      | 1,000,000          | 500,000                            |
| Dennis Wilkins      | 1,000,000          | 500,000                            |
| Richard O'Shannassy | 200,000            | 100,000                            |

### PRINCIPAL ACTIVITIES

The principal activities of the Company during the period were the acquisition of petroleum permits, and the exploration of these permits with the objective of identifying economic oil and gas deposits.

### DIVIDENDS

No dividends were paid or declared during the period. No recommendation for payment of dividends has been made.

### OPERATING AND FINANCIAL REVIEW

#### Finance Review

Key Petroleum Limited was incorporated as a private company on 5 July 2006 and converted to a public company on 16 February 2007. The Company raised \$19.2 million through the issue of 64 million ordinary shares at initial public offer and was admitted to the official list of Australian Stock Exchange Limited on 24 April 2007. Funds raised are being used to actively pursue the Company's international projects.

The Company has recorded an operating loss after income tax for the period ended 30 June 2007 of \$318,271.

At 30 June 2007 surplus funds available totalled \$15,055,731.

## Directors' Report continued

### Operating Results for the Period

Summarised operating results are as follows:

|                                                                      | 2007     |           |
|----------------------------------------------------------------------|----------|-----------|
|                                                                      | Revenues | Results   |
|                                                                      | \$       | \$        |
| <i>Geographic segments</i>                                           |          |           |
| Australia                                                            | 199,787  | (318,271) |
| Tanzania                                                             | -        | -         |
| Revenues and loss from ordinary activities before income tax expense | 199,787  | (318,271) |

### Shareholder Returns

|                              | 2007  |
|------------------------------|-------|
| Basic loss per share (cents) | (1.6) |

### Risk Management

The board is responsible for ensuring that risks, and also opportunities, are identified on a timely basis and that activities are aligned with the risks and opportunities identified by the board.

The company believes that it is crucial for all board members to be a part of this process, and as such the board has not established a separate risk management committee.

The board has a number of mechanisms in place to ensure that management's objectives and activities are aligned with the risks identified by the board. These include the following:

- Board approval of a strategic plan, which encompasses strategy statements designed to meet stakeholders needs and manage business risk.
- Implementation of board approved operating plans and budgets and board monitoring of progress against these budgets.

### SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

Key Petroleum Limited was incorporated as a private company on 5 July 2006 and converted to a public company on 16 February 2007. The Company raised \$19.2 million through the issue of 64 million ordinary shares at initial public offer and was admitted to the official list of Australian Stock Exchange Limited on 24 April 2007. Funds raised are being used to actively pursue the Company's international projects.

### SIGNIFICANT EVENTS AFTER THE BALANCE DATE

No matters or circumstances, besides those disclosed at note 23, have arisen since the end of the financial period which significantly affected or may significantly affect the operations of the Company, the results of those operations, or the state of affairs of the Company in future financial years.

### LIKELY DEVELOPMENTS AND EXPECTED RESULTS

The Company expects to maintain the present status and level of operations and hence there are no likely developments in the entity's operations.

### ENVIRONMENTAL REGULATION AND PERFORMANCE

The Company is subject to significant environmental regulation in respect to its exploration activities.

The Company aims to ensure the appropriate standard of environmental care is achieved, and in doing so, that it is aware of and is in compliance with all environmental legislation. The directors of the Company are not aware of any breach of environmental legislation for the period under review.

## Directors' Report continued

### REMUNERATION REPORT

The remuneration report is set out under the following main headings:

- A Principles used to determine the nature and amount of remuneration
- B Details of remuneration
- C Service agreements
- D Share-based compensation
- E Additional information

The information provided under headings A-D includes remuneration disclosures that are required under Accounting Standard AASB 1024 *Related Party Disclosures*. These disclosures have been transferred from the financial report and have been audited. The disclosures in Section E are additional disclosures required by the Corporations Act 2001 and the Corporations Regulations 2001 which have not been audited.

#### **A Principles used to determine the nature and amount of remuneration (audited)**

##### ***Remuneration Policy***

The remuneration policy of Key Petroleum Limited has been designed to align director and executive objectives with shareholder and business objectives by providing a fixed remuneration component and offering specific long-term incentives based on key performance areas affecting the Company's financial results. The board of Key Petroleum Limited believes the remuneration policy to be appropriate and effective in its ability to attract and retain the best executives and directors to run and manage the Company.

The board's policy for determining the nature and amount of remuneration for board members and senior executives of the Company is as follows:

The remuneration policy, setting the terms and conditions for the executive directors and other senior executives, was developed by the board. All executives receive a base salary (which is based on factors such as length of service and experience) and superannuation. The board reviews executive packages annually by reference to the Company's performance, executive performance and comparable information from industry sectors and other listed companies in similar industries.

The board may exercise discretion in relation to approving incentives, bonuses and options. The policy is designed to attract and retain the highest calibre of executives and reward them for performance that results in long-term growth in shareholder wealth.

Executives are also entitled to participate in the employee share and option arrangements.

The executive directors and executives receive a superannuation guarantee contribution required by the government, which is currently 9%, and do not receive any other retirement benefits.

All remuneration paid to directors and executives is valued at the cost to the company and expensed. Options are valued using the Black-Scholes methodology.

The board policy is to remunerate non-executive directors at market rates for comparable companies for time, commitment and responsibilities. The board determines payments to the non-executive directors and reviews their remuneration annually, based on market practice, duties and accountability. Independent external advice is sought when required. The maximum aggregate amount of fees that can be paid to non-executive directors is subject to approval by shareholders at the Annual General Meeting (currently \$300,000). Fees for non-executive directors are not linked to the performance of the Company. However, to align directors' interests with shareholder interests, the directors are encouraged to hold shares in the company and are able to participate in the employee option plan.

##### ***Performance based remuneration***

The company currently has no performance based remuneration component built into director and executive remuneration packages.

##### ***Company performance, shareholder wealth and directors' and executives' remuneration***

The remuneration policy has been tailored to increase the direct positive relationship between shareholders investment objectives and directors and executives performance. The Company plans to facilitate this process by directors and executives participating in future option issues to encourage the alignment of personal and shareholder interests. The company believes this policy will be effective in increasing shareholder wealth. For details of directors and executives interests in options at period end, refer to note 17 of the financial statements.

## Directors' Report continued

### B Details of remuneration (audited)

Details of the remuneration of the directors and the key management personnel (as defined in AASB 124 *Related Party Disclosures*) of Key Petroleum Limited are set out in the following table.

The key management personnel of Key Petroleum Limited include the directors and company secretary as per pages 3 and 4 above.

Given the size and nature of operations of Key Petroleum Limited, there are no other employees who are required to have their remuneration disclosed in accordance with the Corporations Act 2001.

#### Key management personnel and other executives of Key Petroleum Limited

|                                                    | Short-Term    |              | Post Employment |                     | Share-based Payments  | Total   |
|----------------------------------------------------|---------------|--------------|-----------------|---------------------|-----------------------|---------|
|                                                    | Salary & Fees | Non Monetary | Superannuation  | Retirement benefits | Shares <sup>(1)</sup> |         |
|                                                    | \$            | \$           | \$              | \$                  | \$                    | \$      |
| <b>Directors</b>                                   |               |              |                 |                     |                       |         |
| Edward Ellyard                                     |               |              |                 |                     |                       |         |
| 2007                                               | 8,120         | -            | -               | -                   | 64,000                | 72,120  |
| Kenneth Russell                                    |               |              |                 |                     |                       |         |
| 2007                                               | 45,139        | -            | -               | -                   | 63,000                | 108,139 |
| Terence Nilsen                                     |               |              |                 |                     |                       |         |
| 2007                                               | 32,433        | -            | 2,919           | -                   | 60,000                | 95,352  |
| Dennis Wilkins <sup>(2)</sup>                      |               |              |                 |                     |                       |         |
| 2007                                               | 49,956        | -            | -               | -                   | 60,000                | 109,956 |
| <b>Other key management personnel</b>              |               |              |                 |                     |                       |         |
| John Ribbons                                       |               |              |                 |                     |                       |         |
| 2007                                               | -             | -            | -               | -                   | 60,000                | 60,000  |
| <b>Total key management personnel compensation</b> |               |              |                 |                     |                       |         |
| 2007                                               | 135,648       | -            | 2,919           | -                   | 307,000               | 445,567 |

(1) The share-based payments represent ordinary shares issued in satisfaction of services provided during the capital raising and ASX listing process. The shares were valued at the seed investor price of 12 cents per share. The costs associated with these services have been included as a transaction cost against Contributed Equity in the balance sheet.

(2) Mr Wilkins' remuneration includes payments made to DWCorporate Pty Ltd, a business of which Mr Wilkins is principal, for company secretarial, bookkeeping and other corporate services provided to Key Petroleum Limited during the period.

### C Service agreements (audited)

The details of service agreements of the key management personnel of Key Petroleum Limited are as follows:

Kenneth Russell, Managing Director:

- Term of agreement - 3 years commencing 24 April 2007.
- Annual consultancy fees of \$250,000 (plus GST) are paid to Russell Group Pty Ltd, a company of which Mr Russell is a director and shareholder.
- The agreement may be terminated by either party by giving 3 months written notice.

Terence Nilsen, Technical Director:

- Term of agreement - 2 years commencing 24 April 2007.
- Base salary, inclusive of statutory superannuation, of \$200,000 to be reviewed annually by the board.
- Payment of termination benefit on early termination by the employer, other than for gross misconduct, equal to the fee for the remaining term of the agreement plus any accrued long service leave and annual entitlements.

Dennis Wilkins, Finance Director:

- Term of agreement –commencing 1 March 2007, four months written notice of termination by either party.
- Mr Wilkins' firm, DWCorporate, is engaged to provide book-keeping, accounting and company secretarial services. The services are being billed at an hourly rate with the fee totalling \$40,881 for the period to 30 June 2007.

## Directors' Report continued

### D Share-based compensation (audited)

Ordinary shares were issued to directors and executives during the period in satisfaction of services provided during the capital raising and ASX listing process. The shares were valued at the seed investor price of 12 cents per share. The costs associated with these services have been included as a transaction cost against Contributed Equity in the balance sheet.

### E Additional information - unaudited

#### *Performance income as a proportion of total compensation*

No performance based bonuses have been paid to key management personnel during the financial period.

### DIRECTORS' MEETINGS

During the period the company held seven meetings of directors. The attendance of directors at meetings of the board were:

|                 | Directors Meetings |   |
|-----------------|--------------------|---|
|                 | A                  | B |
| Edward Ellyard  | 7                  | 7 |
| Kenneth Russell | 7                  | 7 |
| Terence Nilsen  | 6                  | 6 |
| Dennis Wilkins  | 7                  | 7 |

#### Notes

A - Number of meetings attended.

B - Number of meetings held during the time the director held office during the period.

### SHARES UNDER OPTION

At the date of this report there are 43,000,002 unissued ordinary shares in respect of which options are outstanding.

|                                                                                      | Number of options |
|--------------------------------------------------------------------------------------|-------------------|
| Balance at the beginning of the period                                               | -                 |
| <b>Total number of options outstanding as at 30 June 2007</b>                        | -                 |
| Issued subsequent to period end, exercisable at 35 cents, on or before 31 March 2009 | 43,000,002        |
| <b>Total number of options outstanding as at the date of this report</b>             | <b>43,000,002</b> |

The balance is comprised of the following:

| Expiry date                                                           | Exercise price (cents) | Number of options |
|-----------------------------------------------------------------------|------------------------|-------------------|
| 31 March 2009                                                         | 35                     | 43,000,002        |
| <b>Total number of options outstanding at the date of this report</b> |                        | <b>43,000,002</b> |

No person entitled to exercise any option referred to above has or had, by virtue of the option, a right to participate in any share issue of any other body corporate.

### INSURANCE OF DIRECTORS AND OFFICERS

During or since the financial period, the company has paid premiums insuring all the directors of Key Petroleum Limited against costs incurred in defending proceedings for conduct involving:

(a) a wilful breach of duty; or

(b) a contravention of sections 182 or 183 of the Corporations Act 2001, as permitted by section 199B of the Corporations Act 2001.

The total amount of insurance contract premiums paid is \$24,000.

## Directors' Report continued

### NON-AUDIT SERVICES

The following non-audit services were provided by the entity's auditor, Rix Levy Fowler or associated entities.

The directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

Rix Levy Fowler received or are due to receive the following amount for the provision of non-audit services:

|                                                          | 2007<br>\$ |
|----------------------------------------------------------|------------|
| Investigating accountants report for 2007 IPO prospectus | 13,000     |

### PROCEEDINGS ON BEHALF OF THE COMPANY

No person has applied to the Court under section 237 of the Corporations Act 2001 for leave to bring proceedings on behalf of the company, or to intervene in any proceedings to which the company is a party, for the purpose of taking responsibility on behalf of the company for all or any part of those proceedings.

No proceedings have been brought or intervened in on behalf of the company with leave of the Court under section 237 of the Corporations Act 2001.

### AUDITOR'S INDEPENDENCE DECLARATION

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 10.

Signed in accordance with a resolution of the directors.



Kenneth Russell  
Managing Director

Perth, 28 September 2007



To The Board of Directors

**Auditor's Independence Declaration  
under Section 307C of the Corporations Act 2001**

This declaration is made in connection with our audit of the financial report of Key Petroleum Ltd for the year ended 30 June 2007 and in accordance with the provisions of the Corporations Act 2001.

We declare that, to the best of our knowledge and belief, there have been:

- no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the audit;
- no contraventions of the Code of Professional Conduct of the Institute of Chartered Accountants in Australia in relation to the audit.

Yours faithfully

**RIX LEVY FOWLER**  
Audit & Corporate Pty Ltd

**RANKO MATIC**  
Director

DATED at PERTH this 28th day of September 2007

## Corporate Governance Statement

### *The Board of Directors*

The company's constitution provides that the number of directors shall not be less than three and not more than nine. There is no requirement for any share holding qualification.

As and if the company's activities increase in size, nature and scope the size of the board will be reviewed periodically, and as circumstances demand. The optimum number of directors required to supervise adequately the company's constitution will be determined within the limitations imposed by the constitution.

The membership of the board, its activities and composition, is subject to periodic review. The criteria for determining the identification and appointment of a suitable candidate for the board shall include quality of the individual, background of experience and achievement, compatibility with other board members, credibility within the company's scope of activities, intellectual ability to contribute to board's duties and physical ability to undertake board's duties and responsibilities.

Directors are initially appointed by the full board subject to election by shareholders at the next general meeting. Under the company's constitution the tenure of a director (other than managing director, and only one managing director where the position is jointly held) is subject to reappointment by shareholders not later than the third anniversary following his or her last appointment. Subject to the requirements of the Corporations Act 2001, the board does not subscribe to the principle of retirement age and there is no maximum period of service as a director. A managing director may be appointed for any period and on any terms the directors think fit and, subject to the terms of any agreement entered into, may revoke any appointment.

The board considers that the company is not currently of a size, nor are its affairs of such complexity to justify the formation of separate or special committees (other than an Audit Committee) at this time. The board as a whole is able to address the governance aspects of the full scope of the company's activities and to ensure that it adheres to appropriate ethical standards.

### *Role of the Board*

The board's primary role is the protection and enhancement of long-term shareholder value.

To fulfil this role, the board is responsible for oversight of management and the overall corporate governance of the company including its strategic direction, establishing goals for management and monitoring the achievement of these goals.

### *Appointments to Other Boards*

Directors are required to take into consideration any potential conflicts of interest when accepting appointments to other boards.

### *Independent Professional Advice*

The board has determined that individual directors have the right in connection with their duties and responsibilities as directors, to seek independent professional advice at the company's expense. With the exception of expenses for legal advice in relation to director's rights and duties, the engagement of an outside adviser is subject to prior approval of the Chairman and this will not be withheld unreasonably.

### *Continuous Review of Corporate Governance*

Directors consider, on an ongoing basis, how management information is presented to them and whether such information is sufficient to enable them to discharge their duties as directors of the company. Such information must be sufficient to enable the directors to determine appropriate operating and financial strategies from time to time in light of changing circumstances and economic conditions. The directors recognise that petroleum exploration is an inherently risky business and that operational strategies adopted should, notwithstanding, be directed towards improving or maintaining the net worth of the company.

### *ASX Principles of Good Corporate Governance*

The board has reviewed its current practices in light of the ASX Principles of Good Corporate Governance and Best Practice Guidelines with a view to making amendments where applicable after considering the company's size and the resources it has available.

As the company's activities develop in size, nature and scope, the size of the board and the implementation of any additional formal corporate governance committees will be given further consideration.

The following table sets out the company's present position with regard to adoption of these Principles.

## Corporate Governance Statement continued

|                     | ASX Principle                                                                                                                                                                    | Status                       | Reference/comment                                                                                                                                                                                                                                                                                                                                                                  |
|---------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Principle 1:</b> | <b>Lay solid foundations for management and oversight</b>                                                                                                                        |                              |                                                                                                                                                                                                                                                                                                                                                                                    |
| 1.1                 | Formalise and disclose the functions reserved to the board and those delegated to management                                                                                     | <b>A</b>                     | The company has adopted this recommendation to formalise and disclose the functions reserved to the board and those delegated to management.                                                                                                                                                                                                                                       |
| <b>Principle 2:</b> | <b>Structure the board to add value</b>                                                                                                                                          |                              |                                                                                                                                                                                                                                                                                                                                                                                    |
| 2.1                 | A majority of board members should be independent directors                                                                                                                      | <b>N/A</b>                   | Given the company's background, the nature and size of its business and the current stage of its development, the board comprises five directors, two of whom are non-executive (including the independent Chairman). The board believes that this is both appropriate and acceptable at this stage of the company's development.                                                  |
| 2.2                 | The chairperson should be an independent director                                                                                                                                | <b>A</b>                     |                                                                                                                                                                                                                                                                                                                                                                                    |
| 2.3                 | The roles of chairperson and chief executive officer should not be exercised by the same individual                                                                              | <b>A</b>                     | The positions of Chairman and Managing Director are held by separate persons.                                                                                                                                                                                                                                                                                                      |
| 2.4                 | The board should establish a nomination committee                                                                                                                                | <b>N/A</b>                   | The board has no formal nomination committee. Acting in its ordinary capacity from time to time as required, the board carries out the process of determining the need for, screening and appointing new directors. In view of the size and resources available to the company, it is not considered that a separate nomination committee would add any substance to this process. |
| 2.5                 | Provide the information indicated in Guide to reporting on Principle 2                                                                                                           | <b>A</b><br><b>(in part)</b> | The skills and experience of directors are set out in the company's Annual Report and on its website.                                                                                                                                                                                                                                                                              |
| <b>Principle 3:</b> | <b>Promote ethical and responsible decision-making</b>                                                                                                                           |                              |                                                                                                                                                                                                                                                                                                                                                                                    |
| 3.1                 | Establish a code of conduct to guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to: | <b>A</b>                     | The company has formulated a Code of Conduct which can be viewed on the company's website.                                                                                                                                                                                                                                                                                         |
|                     | 3.1.1 the practices necessary to maintain confidence in the company's integrity                                                                                                  |                              |                                                                                                                                                                                                                                                                                                                                                                                    |
|                     | 3.1.2 the responsibility and accountability of individuals for reporting or investigating reports of unethical practices                                                         |                              |                                                                                                                                                                                                                                                                                                                                                                                    |

A = Adopted

N/A = Not adopted

## Corporate Governance Statement continued

|                     | ASX Principle                                                                                                                                                                                                                                                                                                                                           | Status      | Reference/comment                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|---------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Principle 3:</b> | <b>Promote ethical and responsible decision-making</b>                                                                                                                                                                                                                                                                                                  |             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| (continued)         |                                                                                                                                                                                                                                                                                                                                                         |             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 3.2                 | Disclose the policy concerning trading in company securities by directors, officers and employees                                                                                                                                                                                                                                                       | A           | The company has formulated a securities trading policy which can be viewed on its website.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 3.3                 | Provide the information indicated in Guide to Reporting on Principle 3                                                                                                                                                                                                                                                                                  | A           | The company has established an audit committee which comprises of three members, two being non-executive directors. The charter for this committee is disclosed on the company's website. Sourcing alternative or additional directors to strictly comply with this Principle is considered expensive with costs outweighing potential benefits. In addition, the board as a whole addresses the governance aspects of the full scope of the company's activities to ensure that it adheres to appropriate ethical standards. All matters which might properly be dealt with by special committees are subject to regular scrutiny at full board Meetings. |
| <b>Principle 4:</b> | <b>Safeguard integrity in financial reporting</b>                                                                                                                                                                                                                                                                                                       |             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 4.1                 | Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards | A           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 4.2                 | The board should establish an audit committee                                                                                                                                                                                                                                                                                                           | A           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 4.3                 | Structure the audit committee so that it consists of:                                                                                                                                                                                                                                                                                                   | A (in part) |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|                     | • Only non-executive directors                                                                                                                                                                                                                                                                                                                          | ✗           | The company only has two non-executive directors.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|                     | • A majority of independent directors                                                                                                                                                                                                                                                                                                                   | ✓           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|                     | • An independent chairperson who is not the chairperson of the board                                                                                                                                                                                                                                                                                    | ✓           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|                     | • At least three members                                                                                                                                                                                                                                                                                                                                | ✓           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 4.4                 | The audit committee should have a formal charter                                                                                                                                                                                                                                                                                                        | A           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 4.5                 | Provide the information indicated in Guide to reporting on Principle 4                                                                                                                                                                                                                                                                                  | A           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| <b>Principle 5:</b> | <b>Make timely and balanced disclosure</b>                                                                                                                                                                                                                                                                                                              |             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 5.1                 | Establish written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior management level for that compliance                                                                                                                                                     | A           | The company has instigated internal procedures designed to provide reasonable assurance as to the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with relevant laws and regulations. The board is acutely aware of the continuous disclosure regime and there are strong informal systems in place to ensure compliance, underpinned by experience.                                                                                                                                                                                                                                                     |
| 5.2                 | Provide the information indicated in Guide to Reporting on Principle 5                                                                                                                                                                                                                                                                                  | A           | The board receives monthly reports on the status of the company's activities and any new or proposed activities. Disclosure is reviewed as a routine agenda item at each board meeting.                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| A = Adopted         |                                                                                                                                                                                                                                                                                                                                                         |             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| N/A = Not adopted   |                                                                                                                                                                                                                                                                                                                                                         |             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |

## Corporate Governance Statement continued

|                                  | ASX Principle                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Status | Reference/comment                                                                                                                                                                                                                                                                                                                                                                                                                    |
|----------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Principle 6:</b>              | <b>Respect the rights of shareholders</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |        |                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 6.1                              | Design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings                                                                                                                                                                                                                                                                                                                                                                                               | A      | In line with adherence to continuous disclosure requirements of ASX all shareholders are kept informed of major developments affecting the company. This disclosure is through regular shareholder communications including the Annual Report, Quarterly Reports, the company website and the distribution of specific releases covering major transactions or events.                                                               |
| 6.2                              | Request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the audit and the preparation and content of the auditor's report                                                                                                                                                                                                                                                                                                                                                                 | A      | Shareholders are encouraged to exercise their right to vote, either by attending meetings, or by lodging a proxy. The company's auditors attend all shareholders' meetings.                                                                                                                                                                                                                                                          |
| <b>Principle 7:</b>              | <b>Recognise and manage risk</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |        |                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 7.1                              | The board or appropriate board committee should establish policies on risk oversight and management                                                                                                                                                                                                                                                                                                                                                                                                                                                        | A      | While the company does not have formalised policies on risk management the board recognises its responsibility for identifying areas of significant business risk and for ensuring that arrangements are in place for adequately managing these risks. This issue is regularly reviewed at board meetings and risk management culture is encouraged amongst employees and contractors.                                               |
|                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |        | Determined areas of risk which are regularly considered include: <ul style="list-style-type: none"> <li>• performance and funding of exploration activities</li> <li>• budget control and asset protection</li> <li>• status of petroleum permits</li> <li>• compliance with government laws and regulations</li> <li>• safety and the environment</li> <li>• continuous disclosure obligations</li> <li>• sovereign risk</li> </ul> |
| 7.2                              | The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the Board in writing that:<br>7.2.1 the statement given in accordance with best practice recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board<br>7.2.2 the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects | A      |                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 7.3                              | Provide information indicated in Guide to Reporting on Principle 7                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | N/A    |                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| A = Adopted<br>N/A = Not adopted |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |        |                                                                                                                                                                                                                                                                                                                                                                                                                                      |

## Corporate Governance Statement continued

|                              | ASX Principle                                                                                                                                                                                                                                                                                          | Status         | Reference/comment                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Principle 8:</b><br>8.1   | <b>Encourage enhanced Performance</b><br>Disclose the process for performance evaluation of the board, its committees and individual directors, and key executives                                                                                                                                     | N/A            | <p>The company does not consider it appropriate to have a sub-committee of the board to consider remuneration matters.</p> <p>The remuneration of executive and non-executive directors is reviewed by the board with the exclusion of the director concerned. The remuneration of management and employees is reviewed by the board and approved by the chairman.</p> <p>Acting in its ordinary capacity, the board from time to time carries out the process of considering and determining performance issues including the identification of matters that may have a material effect on the price of the company's securities. Whenever relevant, any such matters are reported to ASX.</p> |
| <b>Principle 9:</b><br>9.1   | <b>Remunerate fairly and responsibly</b><br>Provide disclosure in relation to the company's remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives and corporate performance | A              | <p>The company discloses remuneration-related information in its Annual Report to shareholders in accordance with the Corporations Act 2001.</p> <p>Remuneration levels are determined by the board on an individual basis, the size of the company making individual assessment more appropriate than formal remuneration policies. In doing so, the board seeks to retain professional services as it requires, at reasonable market rates, and seeks external advice and market comparisons where necessary.</p>                                                                                                                                                                             |
| 9.2                          | The board should establish a remuneration committee                                                                                                                                                                                                                                                    | A              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 9.3                          | Clearly distinguish the structure of non-executive directors remuneration from that of executives                                                                                                                                                                                                      | A              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 9.4                          | Ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders                                                                                                                                                                 | A              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 9.5                          | Provide information indicated in ASX Guide to Reporting on Principle 9                                                                                                                                                                                                                                 | A<br>(in part) |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| <b>Principle 10:</b><br>10.1 | <b>Recognise legitimate interests of Stakeholders</b><br>Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders                                                                                                                      | A              | <p>The company's Code of Conduct is set out in the company's website.</p> <p>The board continues to review existing procedures over time to ensure adequate processes are in place.</p> <p>All directors, employees and contractors are expected to act with the utmost integrity and objectivity in their dealings with other parties, striving at all times to enhance the reputation and performance of the company.</p>                                                                                                                                                                                                                                                                     |

A = Adopted

N/A = Not adopted

## Income Statement

PERIOD ENDED 30 JUNE 2007

Notes

The Company  
2007  
\$

|                                                                                                                        |    |           |
|------------------------------------------------------------------------------------------------------------------------|----|-----------|
| REVENUE FROM CONTINUING OPERATIONS                                                                                     | 4  | 199,787   |
| <b>EXPENDITURE</b>                                                                                                     |    |           |
| Depreciation expense                                                                                                   | 5  | (3,084)   |
| Salaries and employee benefits expense                                                                                 |    | (101,325) |
| Corporate expenditure                                                                                                  |    | (139,122) |
| Administration costs                                                                                                   |    | (146,486) |
| Share of net loss of associate accounted for using the equity method                                                   |    | (36,767)  |
| Other expenses                                                                                                         | 5  | (91,274)  |
| <b>LOSS BEFORE INCOME TAX</b>                                                                                          |    | (318,271) |
| <b>INCOME TAX BENEFIT / (EXPENSE)</b>                                                                                  | 6  | -         |
| <b>LOSS FOR THE PERIOD</b>                                                                                             |    | (318,271) |
| Basic and diluted loss per share for loss attributable to the ordinary equity holders of the company (cents per share) | 25 | (1.6)     |

The above Income Statement should be read in conjunction with the Notes to the Financial Statements.

## Balance Sheet

AT 30 JUNE 2007

Notes

The Company  
2007  
\$

**CURRENT ASSETS**

|                             |   |                   |
|-----------------------------|---|-------------------|
| Cash and cash equivalents   | 7 | 15,055,731        |
| Trade and other receivables | 8 | 107,264           |
| <b>TOTAL CURRENT ASSETS</b> |   | <b>15,162,995</b> |

**NON-CURRENT ASSETS**

|                                                     |    |                  |
|-----------------------------------------------------|----|------------------|
| Receivables                                         | 9  | 24,135           |
| Investment accounted for using the equity method    | 10 | 563,233          |
| Plant and equipment                                 | 11 | 157,987          |
| Petroleum permits and capitalised exploration costs | 12 | 3,724,891        |
| <b>TOTAL NON-CURRENT ASSETS</b>                     |    | <b>4,470,246</b> |

**TOTAL ASSETS****19,633,241****CURRENT LIABILITIES**

|                                  |    |               |
|----------------------------------|----|---------------|
| Trade and other payables         | 13 | 82,813        |
| <b>TOTAL CURRENT LIABILITIES</b> |    | <b>82,813</b> |

**TOTAL LIABILITIES****82,813****NET ASSETS****19,550,428****EQUITY**

|                    |    |            |
|--------------------|----|------------|
| Issued capital     | 14 | 19,868,699 |
| Accumulated losses | 15 | (318,271)  |

**TOTAL EQUITY****19,550,428**

The above Balance Sheet should be read in conjunction with the Notes to the Financial Statements.

## Statement of Changes in Equity

PERIOD ENDED 30 JUNE 2007

Notes

The Company  
2007  
\$

TOTAL EQUITY AT THE BEGINNING OF THE PERIOD

-

LOSS FOR THE PERIOD

(318,271)

TOTAL RECOGNISED INCOME AND EXPENSE FOR THE PERIOD  
ATTRIBUTABLE TO MEMBERS OF KEY PETROLEUM LIMITED

(318,271)

Transactions with equity holders in their capacity as equity holders:

Shares issued during the period

14

21,680,001

Transaction costs

14

(1,811,302)

19,868,699

TOTAL EQUITY AT THE END OF THE PERIOD

19,550,428

The above Statement of Changes in Equity should be read in conjunction with the Notes to the Financial Statements.

## Cash Flow Statement

| PERIOD ENDED 30 JUNE 2007                                     | Notes | The Company<br>2007<br>\$ |
|---------------------------------------------------------------|-------|---------------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                   |       |                           |
| Payments to suppliers and employees                           |       | (376,983)                 |
| Interest received                                             |       | 152,863                   |
| Expenditure on petroleum interests                            |       | (3,119,876)               |
| NET CASH (OUTFLOW) FROM OPERATING ACTIVITIES                  | 24(a) | (3,343,996)               |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                   |       |                           |
| Payments for plant and equipment                              |       | (153,563)                 |
| Payment for lease guarantee                                   |       | (24,135)                  |
| NET CASH (OUTFLOW) FROM INVESTING ACTIVITIES                  |       | (177,698)                 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                   |       |                           |
| Proceeds from issues of ordinary shares                       |       | 20,114,001                |
| Payment of share issue costs                                  |       | (1,445,302)               |
| NET CASH INFLOW FROM FINANCING ACTIVITIES                     |       | 18,668,699                |
| NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS          |       | 15,147,005                |
| Effects of exchange rate changes on cash and cash equivalents |       | (91,274)                  |
| CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD            | 7     | 15,055,731                |

The above Cash Flow Statement should be read in conjunction with the Notes to the Financial Statements.

## Notes to the Financial Statements

30 JUNE 2007

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial report are set out below. The financial report includes financial statements for Key Petroleum Limited as an individual entity.

#### (a) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Australian Interpretations and the Corporations Act 2001.

##### *Compliance with IFRS*

Australian Accounting Standards include Australian equivalents to International Financial Reporting Standards (AIFRS). Compliance with AIFRS ensures that the financial statements and notes of Key Petroleum Limited comply with International Financial Reporting Standards (IFRS).

##### *Historical cost convention*

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and liabilities (including derivative instruments) at fair value through profit or loss, certain classes of property, plant and equipment and investment property.

#### (b) Associates and joint ventures

##### *(i) Associates*

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting, after initially being recognised at cost. The Company's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition (refer to note 21).

The Company's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Dividends receivable from associates reduce the carrying amount of the investment.

When the Company's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured long-term receivables, the Company does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company.

##### *(ii) Joint ventures*

##### *Jointly controlled assets*

The proportionate interests in the assets, liabilities and expenses of joint venture activities have been incorporated in the financial statements under the appropriate heading. Details of the joint ventures are set out in note 22.

#### (c) Segment reporting

A business segment is identified for a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different to those of other business segments. A geographical segment is identified when products or services are provided within a particular economic environment subject to risks and returns that are different from those of segments operating in other economic environments.

#### (d) Revenue recognition

Interest revenue is recognised on a time proportionate basis that takes into account the effective yield on the financial assets.

## Notes to the Financial Statements continued

30 JUNE 2007

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (e) Income tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the national income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

#### (f) Leases

Leases of property, plant and equipment where the Company, as lessee, has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short-term and long-term payables. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the asset's useful life and the lease term.

Leases where a significant portion of the risks and rewards of ownership are not transferred to the Company as lessee are classified as operating leases (note 20). Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

#### (g) Impairment of assets

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

#### (h) Cash and cash equivalents

For cash flow statement presentation purposes, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

#### (i) Trade and other receivables

Receivables are recognised and carried at original invoice amount less a provision for any uncollectible debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written-off as incurred.

## Notes to the Financial Statements continued

30 JUNE 2007

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (j) Investments and other financial assets

##### **Classification**

The Company classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and, in the case of assets classified as held-to-maturity, re-evaluates this designation at each reporting date.

##### *(i) Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

##### *(ii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the balance sheet date which are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet.

##### *(iii) Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. If the Company were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available-for-sale. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the reporting date, which are classified as current assets.

##### *(iv) Available-for-sale financial assets*

Available-for-sale financial assets, comprising principally marketable equity securities, are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

##### **Recognition and derecognition**

Regular purchases and sales of financial assets are recognised on trade-date – the date on which the Company commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed to the income statement. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

When securities classified as available-for-sale are sold, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities.

##### **Subsequent measurement**

Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Gains or losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are presented in the income statement within other income or other expenses in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the income statement as part of revenue from continuing operations when the Company's right to receive payments is established.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Changes in the fair value of other monetary and non-monetary securities classified as available-for-sale are recognised in equity.

##### **Fair value**

The fair values of quoted investments are based on last trade prices. If the market for a financial asset is not active (and for unlisted securities), the Company establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models making maximum use of market inputs and relying as little as possible on entity-specific inputs.

## Notes to the Financial Statements continued

30 JUNE 2007

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### **Impairment**

The Company assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of a security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments classified as available-for-sale are not reversed through the income statement.

#### **(k) Fair value estimation**

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement or for disclosure purposes.

The fair value of financial instruments traded in active markets (such as publicly traded derivatives, and trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Company is the last trade price.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values due to their short-term nature.

#### **(l) Plant and equipment**

All plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the reporting period in which they are incurred.

Depreciation of plant and equipment is calculated using the reducing balance method to allocate their cost, net of their residual values, over their estimated useful lives. The rates vary between 20% and 40% per annum.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 1(g)).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement. When revalued assets are sold, it is Company policy to transfer the amounts included in other reserves in respect of those assets to retained earnings.

#### **(m) Exploration and evaluation costs**

Exploration, evaluation and development costs incurred are accumulated in respect of each identifiable area of interest.

These costs are carried forward only if they relate to an area of interest for which rights of tenure are current and in respect of which: (i) such costs are expected to be recouped through successful development and exploitation or from sale of area; or (ii) exploration and evaluation activities in the area have not yet reached a stage that permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active operations in, or relating to, the area are continuing.

When an area of interest is abandoned or the directors decide that it is not commercial, any accumulated costs in respect of that area are written off in the financial period the decision is made.

#### **(n) Trade and other payables**

These amounts represent liabilities for goods and services provided to the Company prior to the end of the financial period which are unpaid. The amounts are unsecured and are paid on normal commercial terms.

## Notes to the Financial Statements continued

30 JUNE 2007

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (o) Employee benefits

##### (i) Wages and salaries, annual leave and other employee benefits

Provision is made for employee benefits accumulated as a result of employees rendering services up to the reporting date. These benefits include wages and salaries, annual leave, and long service leave.

Liabilities arising in respect of wages and salaries, annual leave and any other employee benefits expected to be settled within twelve months of the reporting date are measured at their nominal amounts based on remuneration rates which are expected to be paid when the liability is settled. All other employee benefit liabilities are measured at the present value of the estimated future cash outflow to be made in respect of services provided by employees up to the reporting date. In determining the present value of future cash outflows, the market yield as at the reporting date on national government bonds, which have terms to maturity approximating the terms of the related liability, are used.

##### (ii) Share-based payments

The Company provides benefits to employees (including directors) of the Company in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ('equity-settled transactions').

The cost of these equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by an internal valuation using a Black-Scholes option pricing model.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('vesting date').

The cumulative expense recognised for equity-settled transactions at each reporting date until vesting date reflects (i) the extent to which the vesting period has expired and (ii) the number of options that, in the opinion of the directors of the Company, will ultimately vest. This opinion is formed based on the best available information at balance date. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new award are treated as if they were a modification of the original award.

#### (p) Issued capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options for the acquisition of a business are not included in the cost of the acquisition as part of the purchase consideration.

#### (q) Earnings per share

##### (i) Basic earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial period, adjusted for bonus elements in ordinary shares issued during the period.

##### (ii) Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

## Notes to the Financial Statements continued

30 JUNE 2007

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### (r) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the taxation authority. In this case it is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net amount of GST recoverable from, or payable to, the taxation authority is included with other receivables or payables in the balance sheet.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flow.

#### (s) Comparative figures

Key Petroleum Limited was incorporated as a private company on 5 July 2006 and converted to a public company on 16 February 2007. These are the first financial statements prepared by the Company, hence there is no comparative information included in these statements.

#### (t) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2007 reporting periods. The Company's assessment of the impact of these new standards and interpretations is set out below.

(i) *AASB 7 Financial Instruments: Disclosures and AASB 2005-10 Amendments to Australian Accounting Standards [AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 & AASB 1038]*

AASB 7 and AASB 2005-10 are applicable to annual reporting periods beginning on or after 1 January 2007. The Company has not adopted the standards early. Application of the standards will not affect any of the amounts recognised in the financial statements, but will impact the type of information disclosed in relation to the Company's financial instruments.

(ii) *AASB-I 10 Interim Financial Reporting and Impairment*

AASB-I 10 is applicable to reporting periods commencing on or after 1 November 2006. The Company has not recognised an impairment loss in relation to goodwill, investments in equity instruments or financial assets carried at cost in an interim reporting period but subsequently reversed the impairment loss in the annual report. Application of the interpretation will therefore have no impact on the Company's financial statements.

#### (u) Critical accounting judgements, estimates and assumptions

The preparation of financial statements in conformity with AIFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are:

##### *Exploration and evaluation costs*

Exploration and evaluation costs are accumulated in respect of each identifiable area of interest where right of tenure is current.

These costs are carried forward in respect of an area that has not at balance sheet date reached a stage that permits reasonable assessment of the existence of economically recoverable reserves.

## Notes to the Financial Statements continued

30 JUNE 2007

### 2. SEGMENT INFORMATION

#### Description of segments

The Company's operations are in the petroleum industry. Geographically, the Company operates in two predominant segments, being Australia and Tanzania. The Company also has operations in other geographic areas including Italy and Suriname, neither of which constitutes a separately reportable segment. The head office and investment activities of the Company take place in Australia.

#### Primary reporting format – geographical segments

|                                                                                                 | Australia  | Tanzania  | The Company |
|-------------------------------------------------------------------------------------------------|------------|-----------|-------------|
|                                                                                                 | 2007       | 2007      | 2007        |
|                                                                                                 | \$         | \$        | \$          |
| <b>Segment revenue</b>                                                                          |            |           |             |
| Other revenue                                                                                   | 199,787    | -         | 199,787     |
| Total segment revenue                                                                           | 199,787    | -         | 199,787     |
| Intersegment elimination                                                                        |            |           | -           |
| Consolidated revenue                                                                            |            |           | 199,787     |
| <b>Segment result</b>                                                                           |            |           |             |
| Segment result                                                                                  | (318,271)  | -         | (318,271)   |
| Intersegment elimination                                                                        |            |           | -           |
| Loss before income tax                                                                          |            |           | (318,271)   |
| Income tax expense                                                                              |            |           | -           |
| Loss for the period                                                                             |            |           | (318,271)   |
| <b>Segment assets and liabilities</b>                                                           |            |           |             |
| Segment assets                                                                                  | 15,908,350 | 3,724,891 | 19,633,241  |
| Intersegment elimination                                                                        |            |           | -           |
| Total assets                                                                                    |            |           | 19,633,241  |
| Segment liabilities                                                                             | 82,813     | -         | 82,813      |
| Intersegment elimination                                                                        |            |           | -           |
| Total liabilities                                                                               |            |           | 82,813      |
| <b>Other segment information</b>                                                                |            |           |             |
| Investment in associate                                                                         | 563,233    | -         | 563,233     |
| Share of net loss of associate                                                                  | 36,767     | -         | 36,767      |
| Acquisitions of property, plant and equipment, intangibles and other non-current segment assets | 161,071    | -         | 161,071     |
| Depreciation expense                                                                            | 3,084      | -         | 3,084       |

## Notes to the Financial Statements continued

30 JUNE 2007

### 3. FINANCIAL RISK MANAGEMENT

#### (a) Interest rate risk

The Company is exposed to movements in market interest rates on short-term deposits. The policy is to monitor the interest rate yield curve out to 120 days to ensure a balance is maintained between the liquidity of cash assets and the interest rate return.

The Company's exposure to interest rate risks and the effective interest rates of financial assets and financial liabilities, both recognised and unrecognised at the balance date, are as follows:

| 2007                         |         | Fixed interest rate maturing in: |                |              | Non interest bearing | Total carrying amount as per the balance sheet | Weighted average effective interest rate |
|------------------------------|---------|----------------------------------|----------------|--------------|----------------------|------------------------------------------------|------------------------------------------|
|                              |         | Floating interest rate           | 1 year or less | 1 to 5 years | More than 5 years    |                                                |                                          |
| Financial instrument         | \$      | \$                               | \$             | \$           | \$                   | \$                                             | %                                        |
| <i>Financial assets</i>      |         |                                  |                |              |                      |                                                |                                          |
| Cash and cash equivalents    | 119,384 | 14,936,347                       | -              | -            | -                    | 15,055,731                                     | 5.6                                      |
| Trade and other receivables  | -       | 24,135                           | -              | -            | 107,264              | 131,399                                        | -                                        |
| Total financial assets       | 119,384 | 14,960,482                       | -              | -            | 107,264              | 15,187,130                                     |                                          |
| <i>Financial liabilities</i> |         |                                  |                |              |                      |                                                |                                          |
| Trade creditors              | -       | -                                | -              | -            | (34,089)             | (34,089)                                       | -                                        |
| Other creditors and accruals | -       | -                                | -              | -            | (48,724)             | (48,724)                                       | -                                        |
| Total financial liabilities  | -       | -                                | -              | -            | (82,813)             | (82,813)                                       |                                          |

#### (b) Net fair values

All financial assets and liabilities have been recognised at the balance date at amounts approximating their carrying value.

#### (c) Credit risk exposures

The Company has no significant concentrations of credit risk. The maximum exposure to credit risk at balance date is the carrying amount (net of provision of doubtful debts) of those assets as disclosed in the balance sheet and notes to the financial statements.

As the Company does not presently have any debtors, lending, significant stock levels or any other credit risk, a formal credit risk management policy is not maintained.

#### (d) Foreign currency risk

The Company is exposed to fluctuations in foreign currencies arising from exploration commitments in currencies other than the Company's measurement currency.

The Company operates internationally and is exposed to foreign exchange risk arising from currency exposures to the United States Dollar.

The Company has not formalised a foreign currency risk management policy, however it monitors its foreign currency expenditure in light of exchange rate movements.

The Company  
2007  
\$

### 4. REVENUE

#### From continuing operations

Other revenue

Interest

199,787

## Notes to the Financial Statements continued

30 JUNE 2007

The Company  
2007  
\$

### 5. EXPENSES

Loss before income tax includes the following specific expenses:

|                                     |        |
|-------------------------------------|--------|
| Depreciation of plant and equipment | 3,084  |
| Net foreign exchange losses         | 91,274 |

### 6. INCOME TAX

#### (a) Income tax expense

|              |   |
|--------------|---|
| Current tax  | - |
| Deferred tax | - |
|              | - |

#### (b) Numerical reconciliation of income tax expense to prima facie tax payable

|                                                           |           |
|-----------------------------------------------------------|-----------|
| Loss from continuing operations before income tax expense | (318,271) |
|-----------------------------------------------------------|-----------|

|                                                           |          |
|-----------------------------------------------------------|----------|
| Prima facie tax benefit at the Australian tax rate of 30% | (95,481) |
|-----------------------------------------------------------|----------|

Tax effect of amounts which are not deductible (taxable) in calculating taxable income:

|                         |          |
|-------------------------|----------|
| Share of associate loss | 11,030   |
| Sundry items            | 489      |
|                         | (83,962) |

|                                                 |             |
|-------------------------------------------------|-------------|
| Movements in unrecognised temporary differences | (1,221,645) |
|-------------------------------------------------|-------------|

Tax effect of current period tax losses for which no deferred tax asset has been recognised

|                    |           |
|--------------------|-----------|
|                    | 1,305,607 |
| Income tax expense | -         |

#### (c) Unrecognised temporary differences

##### Deferred Tax Assets (at 30%)

On Income Tax Account

|                          |           |
|--------------------------|-----------|
| Capital raising costs    | 434,712   |
| Other                    | 4,500     |
| Carry forward tax losses | 1,305,607 |
|                          | 1,744,819 |

##### Deferred Tax Liabilities (at 30%)

|                                                       |           |
|-------------------------------------------------------|-----------|
| Petroleum licenses and capitalised explorations costs | 1,117,467 |
|-------------------------------------------------------|-----------|

### 7. CURRENT ASSETS - CASH AND CASH EQUIVALENTS

|                                                                                         |            |
|-----------------------------------------------------------------------------------------|------------|
| Cash at bank and in hand                                                                | 119,384    |
| Short-term deposits                                                                     | 14,936,347 |
| Cash and cash equivalents as shown in the balance sheet and the statement of cash flows | 15,055,731 |

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates.

Short-term deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Company, and earn interest at the respective short-term deposit rates.

## Notes to the Financial Statements continued

30 JUNE 2007

Note

The Company  
2007  
\$

### 8. CURRENT ASSETS - TRADE AND OTHER RECEIVABLES

|                    |  |                |
|--------------------|--|----------------|
| Sundry receivables |  | 82,046         |
| Prepayments        |  | 25,218         |
|                    |  | <u>107,264</u> |

### 9. NON-CURRENT ASSETS - RECEIVABLES

|                 |  |               |
|-----------------|--|---------------|
| Lease guarantee |  | <u>24,135</u> |
|-----------------|--|---------------|

### 10. NON-CURRENT ASSETS - INVESTMENT ACCOUNTED FOR USING THE EQUITY METHOD

|                     |    |                |
|---------------------|----|----------------|
| Shares in associate | 21 | <u>563,233</u> |
|---------------------|----|----------------|

### 11. NON-CURRENT ASSETS - PLANT AND EQUIPMENT

#### Plant and equipment

|                          |  |                |
|--------------------------|--|----------------|
| Cost                     |  | 161,071        |
| Accumulated depreciation |  | (3,084)        |
| Net book amount          |  | <u>157,987</u> |

#### Plant and equipment

|                         |  |                |
|-------------------------|--|----------------|
| Opening net book amount |  | -              |
| Additions               |  | 161,071        |
| Depreciation charge     |  | (3,084)        |
| Closing net book amount |  | <u>157,987</u> |

### 12. NON-CURRENT ASSETS - PETROLEUM LICENCES AND CAPITALISED EXPLORATION COSTS

Exploration, evaluation and development costs carried forward in respect of petroleum areas of interest

Pre-production

|                                               |  |                  |
|-----------------------------------------------|--|------------------|
| – Tenement acquisition costs                  |  | 704,560          |
| – Joint venture contributions for exploration |  | 3,020,331        |
|                                               |  | <u>3,724,891</u> |

The ultimate recoupment of costs carried forward for exploration and evaluation phases is dependent on the successful development and commercial exploitation or sale of the respective petroleum interests.

### 13. CURRENT LIABILITIES - TRADE AND OTHER PAYABLES

|                             |  |               |
|-----------------------------|--|---------------|
| Trade payables              |  | 34,089        |
| Other payables and accruals |  | 48,724        |
|                             |  | <u>82,813</u> |

### 14. ISSUED CAPITAL

#### (a) Share capital

|                            |              | 2007              |                   |
|----------------------------|--------------|-------------------|-------------------|
|                            |              | Number of shares  | \$                |
| Ordinary shares fully paid | 14(b), 14(c) | 86,000,005        | 19,868,699        |
| Total contributed equity   |              | <u>86,000,005</u> | <u>19,868,699</u> |

## Notes to the Financial Statements continued

30 JUNE 2007

### 14. ISSUED CAPITAL (cont'd)

#### (b) Movements in ordinary share capital

|                                                                                                            | 2007             |             |
|------------------------------------------------------------------------------------------------------------|------------------|-------------|
|                                                                                                            | Number of shares | \$          |
| Beginning of the period                                                                                    | -                | -           |
| Issued during the period:                                                                                  |                  |             |
| – Issued for cash at incorporation at 20 cents per share                                                   | 5                | 1           |
| – Issued for cash at 1 cent per share                                                                      | 8,000,000        | 80,000      |
| – Issued for cash at 12 cents per share                                                                    | 7,000,000        | 840,000     |
| – Issued as consideration for services at 12 cents per share                                               | 3,000,000        | 360,000     |
| – Issued as consideration for the acquisition of an associate at 30 cents per share                        | 2,000,000        | 600,000     |
| – Issued as part consideration for the acquisition of an interest in a joint venture at 30 cents per share | 2,000,000        | 600,000     |
| – Issued on Initial Public Offering at 30 cents per share                                                  | 64,000,000       | 19,200,000  |
| Less: Transaction costs                                                                                    | -                | (1,811,302) |
| End of the period                                                                                          | 86,000,005       | 19,868,699  |

#### (c) Ordinary shares

Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of and amounts paid on the shares held.

On a show of hands every holder of ordinary shares present at a meeting in person or by proxy, is entitled to one vote, and upon a poll each share is entitled to one vote.

The Company  
2007  
\$

### 15. ACCUMULATED LOSSES

#### Accumulated losses

|                                |           |
|--------------------------------|-----------|
| Balance at beginning of period | -         |
| Net loss for the period        | (318,271) |
| Balance at end of period       | (318,271) |

### 16. DIVIDENDS

No dividends were paid during the financial period. No recommendation for payment of dividends has been made.

30 JUNE 2007

### 17. KEY MANAGEMENT PERSONNEL DISCLOSURES

#### (a) Details of key management personnel

##### (i) Directors

The following persons were directors of Key Petroleum Limited during the financial period:

|                 |                        |                                    |
|-----------------|------------------------|------------------------------------|
| Edward Ellyard  | Chairman               | Appointed 5 July 2006              |
| Kenneth Russell | Managing Director      | Appointed 5 July 2006              |
| Terence Nilsen  | Technical Director     | Appointed 31 January 2007          |
| Dennis Wilkins  | Finance Director       | Appointed 5 July 2006              |
| John Ribbons    | Non Executive Director | Appointed and resigned 5 July 2006 |

##### (ii) Other Key Management Personnel

The following person also had authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, during the financial period:

|              |                   |                       |
|--------------|-------------------|-----------------------|
| John Ribbons | Company Secretary | Appointed 5 July 2006 |
|--------------|-------------------|-----------------------|

## Notes to the Financial Statements continued

30 JUNE 2007

### 17. KEY MANAGEMENT PERSONNEL DISCLOSURES (cont'd)

#### (b) Key management personnel compensation

|                          | The Company<br>2007<br>\$ |
|--------------------------|---------------------------|
| Short-term benefits      | 135,648                   |
| Post employment benefits | 2,919                     |
| Other long-term benefits | -                         |
| Termination benefits     | -                         |
| Share-based payments     | 307,000                   |
|                          | <u>445,567</u>            |

The company has taken advantage of the relief provided by Corporations Regulation 2M.6.04 and has transferred the detailed remuneration disclosures to the directors' report. The relevant information can be found in sections A-C of the remuneration report on pages 6 and 7.

#### (c) Equity instrument disclosures relating to key management personnel

##### (i) Options provided as remuneration and shares issued on exercise of such options

There have been no options provided as remuneration to key management personnel.

##### (ii) Share holdings

The numbers of shares in the company held during the financial period by each director of Key Petroleum Limited and other key management personnel of the Company, including their personally related parties, are set out below. There were no shares granted during the reporting period as compensation.

2007

|                                                      | Balance at<br>start of the<br>period | Received<br>during the<br>period on the<br>exercise of<br>options | Other<br>changes<br>during the<br>period | Balance at<br>end of the<br>period |
|------------------------------------------------------|--------------------------------------|-------------------------------------------------------------------|------------------------------------------|------------------------------------|
| <b>Directors of Key Petroleum Limited</b>            |                                      |                                                                   |                                          |                                    |
| <b>Ordinary shares</b>                               |                                      |                                                                   |                                          |                                    |
| Edward Ellyard                                       | -                                    | -                                                                 | 4,050,000                                | 4,050,000                          |
| Kenneth Russell                                      | -                                    | -                                                                 | 5,565,000                                | 5,565,000                          |
| Terence Nilsen                                       | -                                    | -                                                                 | 1,000,000                                | 1,000,000                          |
| Dennis Wilkins                                       | -                                    | -                                                                 | 1,000,000                                | 1,000,000                          |
| <b>Other key management personnel of the Company</b> |                                      |                                                                   |                                          |                                    |
| <b>Ordinary shares</b>                               |                                      |                                                                   |                                          |                                    |
| John Ribbons                                         | -                                    | -                                                                 | 600,005                                  | 600,005                            |

#### (d) Loans to key management personnel

There were no loans to key management personnel during the period.

#### (e) Other transactions with key management personnel

##### Services

The services of Mr Ken Russell as Managing Director of Key Petroleum Limited are provided by Russell Group Holdings Pty Ltd, a company of which Mr Russell is a director and shareholder. The amounts are included as part of Mr Russell's compensation.

DWCorporate, a business of which Mr Wilkins is principal, provided company secretarial and other corporate services to Key Petroleum Limited during the period. The amounts paid were at arms length and are included as part of Mr Wilkins compensation.

## Notes to the Financial Statements continued

30 JUNE 2007

The Company  
2007  
\$

### 18. REMUNERATION OF AUDITORS

During the period the following fees were paid or payable for services provided by the auditor of the Company, its related practices and non-related audit firms:

#### (a) Audit services

Rix Levy Fowler - audit and review of financial reports

10,000

Total remuneration for audit services

10,000

#### (b) Non-audit services

Rix Levy Fowler – independent accountants report for 2007 IPO prospectus

13,000

Total remuneration for other services

13,000

### 19. CONTINGENCIES

There are no material contingent liabilities or contingent assets of the Company at balance date.

### 20. COMMITMENTS

#### (a) Exploration commitments

The company has certain commitments to meet minimum expenditure requirements on the petroleum exploration assets it has an interest in. Outstanding exploration commitments are as follows:

within one year

6,003,726

later than one year but not later than five years

3,004,920

9,008,646

#### (b) Lease commitments: Company as lessee

*Operating leases (non-cancellable):*

Minimum lease payments

within one year

63,769

later than one year but not later than five years

49,331

Aggregate lease expenditure contracted for at reporting date but not recognised as liabilities

113,100

The property lease is a non-cancellable lease with a two-year term, and two renewal option terms of two years each, with rent payable monthly in advance. Contingent rental provisions within the lease agreement require the minimum lease payments shall be subject to a CPI review every two years, and a market rent review in 2009 and 2011 if applicable. The lease allows for subletting of all lease areas.

#### (c) Remuneration commitments

Amounts disclosed as remuneration commitments include commitments arising from the service contracts of key management personnel referred to in section C of the remuneration report on page 7 that are not recognised as liabilities and are not included in the key management personnel compensation.

within one year

456,000

later than one year but not later than five years

625,000

1,081,000

## Notes to the Financial Statements continued

30 JUNE 2007

### 21. INVESTMENT IN ASSOCIATE

#### (a) Carrying amount

Information relating to the associate is set out below.

| Name of Company      | Principal Activity      | Ownership Interest<br>2007<br>% | The Company<br>2007<br>\$ |
|----------------------|-------------------------|---------------------------------|---------------------------|
| <i>Unlisted</i>      |                         |                                 |                           |
| Portsea Oil & Gas NL | Oil and gas exploration | 50                              | 563,233                   |

The above associate is incorporated in Australia.

|                                                | The Company<br>2007<br>\$ |
|------------------------------------------------|---------------------------|
| <b>(b) Movements in carrying amount</b>        |                           |
| Carrying amount at the beginning of the period | -                         |
| Acquisition of associate                       | 600,000                   |
| Share of loss after income tax                 | (36,767)                  |
| Carrying amount at the end of the period       | 563,233                   |

#### (c) Share of associate profit or loss

|                        |          |
|------------------------|----------|
| Loss before income tax | (36,767) |
| Income tax             | -        |
| Loss after income tax  | (36,767) |

#### (d) Summarised financial information of associate

|                      | Assets<br>\$ | Liabilities<br>\$ | Company's share of:<br>Revenues<br>\$ | Loss<br>\$ |
|----------------------|--------------|-------------------|---------------------------------------|------------|
| <b>2007</b>          |              |                   |                                       |            |
| Portsea Oil & Gas NL | 656,682      | 730,214           | 272,141                               | (73,534)   |

#### (e) Share of associate's expenditure commitments, other than for the supply of inventories

Portsea Oil & Gas NL does not have any expenditure commitments at balance date.

#### (f) Contingent liabilities of associate

Portsea Oil & Gas NL does not have any contingent liabilities at 30 June 2007.

### 22. INTERESTS IN JOINT VENTURES

#### Tanzanian Farmin Agreement

In February 2007 the company entered in to an agreement to earn a 20% interest in the Nyuni Production Sharing Agreement ("Nyuni PSA") and a 20% participating interest in the Joint Operating Agreement ("JOA") between Ndovu Resources Limited ("Ndovu"), a Tanzanian company, and Bounty Oil and Gas NL. The Nyuni PSA and the JOA are in relation to oil and gas exploration offshore Namibia in an area immediately adjacent to the producing Songo Songo gas field. All conditions precedent to the farmin agreement, including the admittance of the company to the official list of ASX and the issue of 2 million ordinary shares to Ndovu, have been met.

To earn the 20% interest in the joint venture the company is to contribute 30% of the cost of drilling the next two wells (Key Petroleum's contribution is capped at US\$4.62 million), 10% of the operating cost for seismic acquisition, and 20% of all other expenditure of the joint venture from the date of the company's admission to the official list of ASX.

## Notes to the Financial Statements continued

30 JUNE 2007

### 23. EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

Key Petroleum (Tanzania) Pty Ltd was incorporated in Western Australia on 20 August 2007 with Key Petroleum Limited the sole shareholder.

No other matter or circumstance has arisen since 30 June 2007, which has significantly affected, or may significantly affect the operations of the Company, the result of those operations, or the state of affairs of the Company in subsequent financial years.

The Company  
2007  
\$

### 24. CASH FLOW STATEMENT

#### (a) Reconciliation of net loss after income tax to net cash outflow from operating activities

|                         |           |
|-------------------------|-----------|
| Net loss for the period | (318,271) |
|-------------------------|-----------|

#### Non-Cash Items

|                                           |         |
|-------------------------------------------|---------|
| Depreciation of non-current assets        | 3,084   |
| Exploration expenditure - issue of shares | 600,000 |
| Share of loss of associate                | 36,767  |
| Net exchange differences                  | 91,274  |

#### Change in operating assets and liabilities, net of effects from purchase of controlled entity

|                                                                   |             |
|-------------------------------------------------------------------|-------------|
| (Increase) in trade and other receivables                         | (107,264)   |
| (Increase) in petroleum permits and capitalised exploration costs | (3,724,891) |
| Increase in trade and other payables                              | 75,305      |
| Net cash outflow from operating activities                        | (3,343,996) |

#### (b) Non-cash investing and financing activities

Two million ordinary shares with a deemed value of \$600,000 were issued to Ndovu Resources Limited as part consideration for the Tanzanian Farmin Agreement as shown in note 22. Additionally two million ordinary shares with a deemed value of \$600,000 were issued to Kenneth Russell as consideration for the acquisition of an associate as shown in note 21.

### 25. LOSS PER SHARE

The Company  
2007  
\$

#### (a) Reconciliation of earnings used in calculating loss per share

|                                                                                                                      |           |
|----------------------------------------------------------------------------------------------------------------------|-----------|
| Loss attributable to the ordinary equity holders of the company used in calculating basic and diluted loss per share | (318,271) |
|----------------------------------------------------------------------------------------------------------------------|-----------|

#### Number of shares

#### (b) Weighted average number of shares used as the denominator

|                                                                                                                    |            |
|--------------------------------------------------------------------------------------------------------------------|------------|
| Weighted average number of ordinary shares used as the denominator in calculating basic and diluted loss per share | 20,266,672 |
|--------------------------------------------------------------------------------------------------------------------|------------|

## Directors' Declaration

In the directors' opinion:

- (a) the financial statements and notes set out on pages 16 to 34 are in accordance with the Corporations Act 2001, including:
  - (i) complying with Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements; and
  - (ii) giving a true and fair view of the company's financial position as at 30 June 2007 and of its performance for the financial period ended on that date; and
- (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable; and
- (c) the audited remuneration disclosures set out on pages 6 to 8 of the directors' report comply with Accounting Standards AASB 124 *Related Party Disclosures* and the Corporations Regulations 2001.

The directors have been given the declarations by the chief executive officer and chief financial officer required by section 295A of the Corporations Act 2001.

This declaration is made in accordance with a resolution of the directors.

A handwritten signature in black ink, appearing to read 'K. Russell', with a large, stylized loop at the top.

Kenneth Russell  
Managing Director

Perth, 28 September 2007



## Independent Audit Report

### To the Members of Key Petroleum Ltd

We have audited the accompanying financial report of Key Petroleum Ltd (the company), which comprises the balance sheet as at 30 June 2007, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies and other explanatory notes and the directors' declaration of the company at the year's end or from time to time during the financial year.

As permitted by the Corporations Regulations 2001, the company has disclosed information about the remuneration of directors and executives (remuneration disclosures), required by Accounting Standard AASB 124: Related Party Disclosures, under the heading "Remuneration Report" in pages 6 to 8 of the directors' report and not in the financial report.

#### Directors Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standards AASB 101: Presentation of Financial Statements, that compliance with the Australian equivalents to International Financial Reporting Standards (IFRS) ensures that the financial report, comprising the financial statements and notes, complies with IFRS.

The directors also are responsible for preparation and presentation of the remuneration disclosures contained in the directors' report in accordance with the Corporations Regulations 2001.

#### Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement and that the remuneration disclosures in the directors' report comply with Accounting Standard AASB 124.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report 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 the directors, as well as evaluating the overall presentation of the financial report and the remuneration disclosures in the directors' report.

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

## ***Independent Auditor's Report***

To the Members of Key Petroleum Ltd (Continued)

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### **Independence**

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

### **Auditor's Opinion**

In our opinion:

- a. The financial report of Key Petroleum Ltd is in accordance with the Corporations Act 2001, including:
  - i. giving a true and fair view of the company's financial position as at 30 June 2007 and of their performance for the year ended on that date; and
  - ii. complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001;
- b. The financial report also complies with International Financial Reporting Standards as disclosed in Note 1; and
- c. The remuneration disclosures that are contained in pages 6 to 8 of the directors' report comply with Accounting Standard AASB 124.



**RIX LEVY FOWLER**  
Audit & Corporate Pty Ltd



**RANKO MATIĆ**  
Director

DATED at PERTH this 28th day of September 2007

## ASX Additional Information

Additional information required by Australian Stock Exchange Ltd and not shown elsewhere in this report is as follows. The information is current as at 27 September 2007.

### (a) Distribution of equity securities

Analysis of numbers of equity security holders by size of holding:

|                                                                                                |           | Ordinary shares   |                   | Options           |                   |
|------------------------------------------------------------------------------------------------|-----------|-------------------|-------------------|-------------------|-------------------|
|                                                                                                |           | Number of holders | Number of shares  | Number of holders | Number of options |
| 1                                                                                              | - 1,000   | 1                 | 1                 | 12                | 11,454            |
| 1,001                                                                                          | - 5,000   | 74                | 256,730           | 203               | 894,346           |
| 5,001                                                                                          | - 10,000  | 286               | 2,751,777         | 167               | 1,458,553         |
| 10,001                                                                                         | - 100,000 | 718               | 27,725,071        | 319               | 11,167,681        |
| 100,001                                                                                        | and over  | 137               | 55,266,426        | 53                | 29,467,968        |
|                                                                                                |           | <b>1,216</b>      | <b>86,000,005</b> | <b>754</b>        | <b>43,000,002</b> |
| The number of equity security holders holding less than a marketable parcel of securities are: |           | <b>28</b>         | <b>54,128</b>     | <b>299</b>        | <b>1,534,353</b>  |

### (b) Twenty largest shareholders

The names of the twenty largest holders of quoted ordinary shares are:

|    |                                                                                                       | Listed ordinary shares |                               |
|----|-------------------------------------------------------------------------------------------------------|------------------------|-------------------------------|
|    |                                                                                                       | Number of shares       | Percentage of ordinary shares |
| 1  | Mr Kenneth Russell                                                                                    | 5,040,000              | 5.86                          |
| 2  | Cogent Nominees Pty Ltd                                                                               | 3,393,322              | 3.95                          |
| 3  | Jerele Mining Pty Ltd <Ellyard Super Fund A/C>                                                        | 3,000,000              | 3.49                          |
| 4  | Aminex plc                                                                                            | 2,000,000              | 2.33                          |
| 5  | Dreamaster Pty Ltd <Carlyon Super Fund A/C>                                                           | 2,000,000              | 2.33                          |
| 6  | Wadham Nominees Pty Ltd                                                                               | 2,000,000              | 2.33                          |
| 7  | Professional Trust Company Limited                                                                    | 1,660,000              | 1.93                          |
| 8  | Mr Terence Percival Nilsen                                                                            | 1,000,000              | 1.16                          |
| 9  | Ms Natalie Michelle Garbutt-Wilkins                                                                   | 1,000,000              | 1.16                          |
| 10 | Bond Street Custodians Limited <MXR – WN0125 A/C>                                                     | 950,000                | 1.10                          |
| 11 | Bond Street Custodians Limited <Western Pacific Concentrated Fund Account>                            | 918,678                | 1.07                          |
| 12 | Mr Andrew Christopher Mays & Miss Carolyn Law & Mr Herbert Archie Mayes <The Andrew Mayes Family A/C> | 900,000                | 1.05                          |
| 13 | Leet Investments Pty Ltd <Superannuation Fund>                                                        | 850,000                | 0.99                          |
| 14 | Equity Trustees Limited <SGH Micro Cap Trust A/C>                                                     | 833,333                | 0.97                          |
| 15 | ANZ Nominees Limited <Cash Income A/C>                                                                | 824,281                | 0.96                          |
| 16 | Mr Andrew Donnelly <Donnelly Super Fund A/C>                                                          | 664,335                | 0.77                          |
| 17 | Arrow Clocktower Global Fund                                                                          | 657,500                | 0.76                          |
| 18 | Pavilion Drive Pty Ltd                                                                                | 650,000                | 0.76                          |
| 19 | Russell Group Pty Ltd                                                                                 | 525,000                | 0.61                          |
| 20 | F H Nominees Pty Ltd                                                                                  | 500,000                | 0.58                          |
|    |                                                                                                       | <b>29,366,449</b>      | <b>34.16</b>                  |

## ASX Additional Information continued

### (c) Twenty largest option holders

The names of the twenty largest holders of quoted options are:

|    |                                                                            | Listed options    |                             |
|----|----------------------------------------------------------------------------|-------------------|-----------------------------|
|    |                                                                            | Number of options | Percentage of total options |
| 1  | Custodial Services Pty Ltd                                                 | 10,378,909        | 24.14                       |
| 2  | Mr Kenneth Russell                                                         | 2,520,000         | 5.86                        |
| 3  | Cogent Nominees Pty Ltd                                                    | 1,696,661         | 3.95                        |
| 4  | Jerele Mining Pty Ltd <Ellyard Super Fund A/C>                             | 1,500,000         | 3.49                        |
| 5  | Mr Geoffrey Godden                                                         | 1,150,000         | 2.67                        |
| 6  | Aminex plc                                                                 | 1,000,000         | 2.33                        |
| 7  | Wadham Nominees Pty Ltd                                                    | 1,000,000         | 2.33                        |
| 8  | Professional Trust Company Limited                                         | 830,000           | 1.93                        |
| 9  | Mr Terence Percival Nilsen                                                 | 500,000           | 1.16                        |
| 10 | Ms Natalie Michelle Garbutt-Wilkins                                        | 500,000           | 1.16                        |
| 11 | Bond Street Custodians Limited <Western Pacific Concentrated Fund Account> | 459,339           | 1.07                        |
| 12 | Mr Andrew Donnelly <Donnelly Super Fund A/C>                               | 332,167           | 0.77                        |
| 13 | Pavilion Drive Pty Ltd                                                     | 325,000           | 0.76                        |
| 14 | ANZ Nominees Limited <Cash Income A/C>                                     | 315,890           | 0.73                        |
| 15 | Ms Antoinette Janet Ribbons                                                | 300,002           | 0.70                        |
| 16 | Russell Group Pty Ltd                                                      | 262,500           | 0.61                        |
| 17 | Howba Pty Ltd                                                              | 250,000           | 0.58                        |
| 18 | Jerele Mining Pty Ltd <Ellyard Super Fund A/C>                             | 250,000           | 0.58                        |
| 19 | Key International Pty Ltd                                                  | 250,000           | 0.58                        |
| 20 | Leet Investments Pty Ltd <Superannuation Fund>                             | 250,000           | 0.58                        |
|    |                                                                            | 24,070,468        | 55.98                       |

### (d) Substantial shareholders

The names of substantial shareholders who have notified the Company in accordance with section 671B of the Corporations Act 2001 are:

|                    | Number of Shares |
|--------------------|------------------|
| Mr Kenneth Russell | 5,040,000        |

### (e) Voting rights

All ordinary shares (whether fully paid or not) carry one vote per share without restriction.

### (f) Schedule of interests in petroleum blocks

| Location            | Block            | Percentage held / earning |
|---------------------|------------------|---------------------------|
| Tanzania – Offshore | Nyuni            | 20                        |
| Suriname – Offshore | Uitjik           | 1.75                      |
| Suriname – Offshore | Coronie          | 1.75                      |
| Italy – Offshore    | Lampedusa        | 100                       |
| Italy – Offshore    | Western Sardinia | 100                       |
| Italy – Offshore    | Elba South       | 100                       |
| Italy – Po Valley   | Borsano          | 100                       |