

## NOTES TO THE FINANCIAL STATEMENTS

30 JUNE 2009

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial report includes separate financial statements for Key Petroleum Limited as an individual entity and the consolidated entity consisting of Key Petroleum Limited and its subsidiaries. The financial report is presented in the Australian currency. Key Petroleum Limited is a company limited by shares, domiciled and incorporated in Australia. The financial report was authorised for issue by the directors on 30 September 2009. The directors have the power to amend and reissue the financial report.

**(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, Urgent Issues Group Interpretations and the Corporations Act 2001.

**Compliance with IFRS**

The financial report of Key Petroleum Limited also complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

**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) Principles of consolidation****(i) Subsidiaries**

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Key Petroleum Limited ("Company" or "parent entity") as at 30 June 2009 and the results of all subsidiaries for the year then ended. Key Petroleum Limited and its subsidiaries together are referred to in this financial report as the Group or the consolidated entity.

Subsidiaries are all of those entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group (refer note 1(h)).

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of identifiable net assets of the subsidiary.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Minority interests in the results and equity of subsidiaries are shown separately in the consolidated income statement and balance sheet respectively.

Investments in subsidiaries are accounted for at cost in the individual financial statements of Key Petroleum Limited.

**(ii) Associates**

Associates are all entities over which the Group 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 in the parent entity financial statements using the equity method of accounting, after initially being recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition (refer to note 26).

The Group'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 are recognised in the parent entity's income statement, whilst in the consolidated financial statements they reduce the carrying amount of the investment.

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

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group'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 Group.

**(iii) 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 headings. Details of the joint ventures are set out in note 27.

**(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) Foreign currency translation****(i) Functional and presentation currency**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Australian dollars, which is Key Petroleum Limited's functional and presentation currency.

**(ii) Transactions and balances**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when they are deferred in equity as qualifying cash flow hedges and qualifying net investment hedges or are attributable to part of the net investment in a foreign operation.

Translation differences on financial assets and liabilities carried at fair value are reported as part of the fair value gain or loss. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale financial assets are included in the fair value reserve in equity.

**(iii) Group companies**

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless that is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of any net investment in foreign entities, and of borrowings and other financial instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences are recognised in the income statement, as part of the gain or loss on sale where applicable.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entities and translated at the closing rate.

**(e) Revenue recognition**

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

**(f) Income tax**

The income tax expense or revenue for the year is the tax payable on the current year's taxable income based on the applicable 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 reporting 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)****(g) 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 22). 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.

**(h) Business combinations**

The purchase method of accounting is used to account for all business combinations, including business combinations involving entities or businesses under common control, regardless of whether equity instruments or other assets are acquired. Cost is measured as the fair value of the assets given, equity instruments issued or liabilities incurred or assumed at the date of exchange plus costs directly attributable to the acquisition. Where equity instruments are issued in an acquisition, the fair value of the instruments is their published market price as at the date of exchange unless, in rare circumstances, it can be demonstrated that the published price at the date of exchange is an unreliable indicator of fair value and that other evidence and valuation methods provide a more reliable measure of fair value. Transaction costs arising on the issue of equity instruments are recognised directly in equity.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill (refer to note 1(n)). If the cost of acquisition is less than the Group's share of the fair value of the identifiable net assets of the subsidiary acquired, the difference is recognised directly in the income statement, but only after a reassessment of the identification and measurement of the net assets acquired.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

**(i) 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.

**(j) 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.

**(k) 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.

**(l) 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 reporting 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 reporting date. Investments are designated available-for-sale if they do not have fixed maturities and fixed or determinable payments and management intends to hold them for the medium to long term.

**Financial assets - reclassification**

The Group may choose to reclassify a non-derivative trading financial asset out of the held-for-trading category if the financial asset is no longer held for the purpose of selling it in the near term. Financial assets other than loans and receivables are permitted to be reclassified out of the held-for-trading category only in rare circumstances arising from a single event that is unusual and highly unlikely to recur in the near term. In addition, the Group may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held-for-trading or available-for-sale categories if the Group has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates for financial assets reclassified to loans and receivables and held-to-maturity categories are determined at the reclassification date. Further increases in estimates of cash flows adjust effective interest rates prospectively.

**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.

Details on how the fair value of financial investments is determined are disclosed in note 2.

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

**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.

If there is evidence of impairment for any of the Group's financial assets carried at amortised cost, the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, excluding future credit losses that have not been incurred. The cash flows are discounted at the financial asset's original effective interest rate. The loss is recognised in the income statement.

**(m) 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 any component accounted for as a separate asset is derecognised when replaced. 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 or revalued amounts, net of their residual values, over their estimated useful lives or, in the case of leasehold improvements and certain leased plant and equipment, the shorter lease term. The rates vary between 20% and 40% per annum.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting 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(i)).

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.

**(n) Intangible assets****Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the consolidated entity's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is not amortised. Instead, goodwill is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, and is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Each of those cash-generating units represents the Group's investment in each country of operation (note 3).

**(o) 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 year the decision is made.

**(p) Trade and other payables**

These amounts represent liabilities for goods and services provided to the Company prior to the end of the financial year which are unpaid. The amounts are unsecured, non-interest bearing and are paid on normal commercial terms.

**(q) Employee benefits****(i) Wages and salaries and annual leave**

Liabilities for wages and salaries, including non-monetary benefits, and annual leave expected to be settled within 12 months of the reporting date are recognised in other payables in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

**(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.

**(r) 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.

**(s) 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 year, adjusted for bonus elements in ordinary shares issued during the year.

**(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.

**(t) 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 flows.

**(u) New accounting standards and interpretations**

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2009 reporting periods. The Group's and the parent entity's assessment of the impact of these new standards and interpretations is set out below.

**(i) AASB 8 Operating Segments and AASB 2007-3 Amendments to Australian Accounting Standards arising from AASB 8 (effective from 1 January 2009)**

AASB 8 will result in a significant change in the approach to segment reporting, as it requires adoption of a 'management approach' to reporting on financial performance. The information being reported will be based on what the key decision makers use internally for evaluating segment performance and deciding how to allocate resources to operating segments. The Group will adopt AASB 8 from 1 July 2009. Adoption of AASB 8 may result in different segments, segment results and different types of information being reported in the segment note of the financial report. However, at this stage, it is not expected to affect any of the amounts recognised in the financial statements.

**(ii) Revised AASB 101 Presentation of Financial Statements and AASB 2007-8 Amendments to Australian Accounting Standards arising from AASB 101 (effective from 1 January 2009)**

The September 2007 revised AASB 101 requires the presentation of a statement of comprehensive income and makes changes to the statement of changes in equity, but will not affect any of the amounts recognised in the financial statements. If an entity has made a prior period adjustment or has reclassified items in the financial statements, it will need to disclose a third balance sheet (statement of financial position), this one being as at the beginning of the comparative period. The Group intends to apply the revised standard from 1 July 2009.

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)****(iii) AASB 2008-1 Amendments to Australian Accounting Standard – Share-based Payments: Vesting Conditions and Cancellations (effective from 1 January 2009)**

AASB 2008-1 clarifies that vesting conditions are service conditions and performance conditions only and that the other features of a share-based payment are not vesting conditions. It also specifies that all cancellations, whether by the entity or other parties, should receive the same accounting treatment. The Group will apply the revised standard from 1 July 2009, but it is not expected to affect the accounting for the Group's share-based payments.

**(iv) Revised AASB 3 Business Combinations, AASB 127 Consolidated and Separate Financial Statements and AASB 2008-3 Amendments to Australian Accounting Standards arising from AASB 3 and AASB 127 (effective from 1 January 2009)**

The revised AASB 3 continues to apply the acquisition method to business combinations, but with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently remeasured through the income statement. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs must be expensed. This is different to the Group's current policy which is set out in note 1(h) above.

The revised AASB 127 requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses, see note 1(b)(i). The standard also specifies the accounting when control is lost. Any remaining interest in the entity is remeasured to fair value, and a gain or loss is recognised in profit or loss. This is consistent with the Group's current accounting policy if significant influence is not retained.

The Group will apply the revised standards prospectively to all business combinations and transactions with non-controlling interests from 1 July 2009.

**(v) AASB 2008-7 Amendments to Australian Accounting Standards – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (effective 1 July 2009)**

In July 2008, the AASB approved amendments to AASB 1 First-time Adoption of International Financial Reporting Standards and AASB 127 Consolidated and Separate Financial Statements. The Group will apply the revised rules prospectively from 1 July 2009. After that date, all dividends received from investments in subsidiaries, jointly controlled entities or associates will be recognised as revenue, even if they are paid out of pre-acquisition profits, but the investments may need to be tested for impairment as a result of the dividend

payment. Under the entity's current policy, these dividends are deducted from the cost of the investment. Furthermore, when a new intermediate parent entity is created in internal reorganisations it will measure its investment in subsidiaries at the carrying amounts of the net assets of the subsidiary rather than the subsidiary's fair value.

**(vi) AASB 2008-8 Amendment to IAS 39 Financial Instruments: Recognition and Measurement (effective 1 July 2009)**

AASB 2008-8 amends AASB 139 Financial Instruments: Recognition and Measurement and must be applied retrospectively in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors. The amendment makes two significant changes. It prohibits designating inflation as a hedgeable component of a fixed rate debt. It also prohibits including time value in the one-sided hedged risk when designating options as hedges. The Group will apply the amended standard from 1 July 2009. It is not expected to have a material impact on the Group's financial statements.

**(v) Critical accounting judgements, estimates and assumptions**

The preparation of these financial statements 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 reporting date reached a stage that permits reasonable assessment of the existence of economically recoverable reserves.

**Environmental Issues**

Balances disclosed in the financial statements and notes thereto are not adjusted for any pending or enacted environmental legislation, and the directors understanding thereof. At the current stage of the Group's development and its current environmental impact the directors believe such treatment is reasonable and appropriate.

**Taxation**

Balances disclosed in the financial statements and the notes thereto related to taxation are based on the best estimates of the directors. These estimates take into account both the financial performance and position of the Group as they pertain to current income taxation legislation, and the directors understanding thereof. No adjustment has been made for pending or future taxation legislation. The current income tax position represents that directors' best estimate, pending an assessment by the Australian Taxation Office.

## 2. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Group.

Risk management is carried out by the full Board of Directors as the Group believes that it is crucial for all board members to be involved in this process. The Managing Director, with the assistance of senior management as required, has responsibility for identifying, assessing, treating and monitoring risks and reporting to the board on risk management.

### (a) Market risk

#### (i) Foreign exchange risk

The Group and the parent entity operate internationally and are exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar.

Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities denominated in a currency that is not the entity's functional currency and net investments in foreign operations. The Group has not formalised a foreign currency risk management policy however, it monitors its foreign currency expenditure in light of exchange rate movements.

The Group's and the parent entity's exposure to foreign currency risk at the reporting date was as follows:

	Consolidated				Parent Entity	
	2009		2008		2009	2008
	USD	EUR	USD	EUR	USD	USD
Cash and cash equivalents	289,098	31,791	607,687	14,407	243,775	555,804
Trade and other receivables	42,537	28,956	59,418	12,308	81,156	96,318
Trade and other payables	(2,452)	(5,339)	-	(46,712)	-	-

#### Sensitivity analysis

Based on the financial instruments held at 30 June 2009, had the Australian dollar weakened/strengthened by 10% against the US dollar with all other variables held constant, there would have been nil impact on the Group's and the parent entity's post-tax losses for the year (2008: Nil) and immaterial movements to the Group's and parent entity's equity for both years presented.

#### (ii) Price risk

Given the current level of operations, neither the Group, nor the parent entity, are exposed to price risk.

#### (iii) Interest rate risk

The Group and the parent entity are exposed to movements in market interest rates on cash and cash equivalents. The Group policy is to monitor the interest rate yield curve out to six months to ensure a balance is maintained between the liquidity of cash assets and the interest rate return. The entire balance of cash and cash equivalents for the Group \$5,594,855 (2008: \$8,777,786) and the parent entity \$5,482,904 (2008: \$8,699,475) are subject to interest rate risk. The proportional mix of floating interest rates and fixed rates to a maximum of six months fluctuate during the year depending on current working capital requirements. The weighted average interest rate received on cash and cash equivalents by the Group was 4.2% (2008: 6.8%) and by the parent entity 4.2% (2008: 6.8%).

#### Sensitivity analysis

At 30 June 2009, if interest rates had changed by +/- 80 basis points from the weighted average rate for the year with all other variables held constant, post-tax loss for both the Group and the parent entity would have been \$62,000 lower/higher (2008: \$96,000 lower/higher) as a result of lower/higher interest income from cash and cash equivalents.

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

**2. FINANCIAL RISK MANAGEMENT (CONT'D)****(b) Credit risk**

Neither the Group, nor the parent entity, have any significant concentrations of credit risk. The maximum exposure to credit risk at balance date is the carrying amount (net of provision for impairment) of those assets as disclosed in the balance sheet and notes to the financial statements.

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

**(c) Liquidity risk**

The Group manages liquidity risk by continuously monitoring forecast and actual cash flows and ensuring sufficient cash and marketable securities are available to meet the current and future commitments of the Group. Due to the nature of the Group's activities, being oil and gas exploration, the Group does not have ready access to credit facilities, with the primary source of funding being equity raisings. The Board of Directors constantly monitor the state of equity markets in conjunction with the Group's current and future funding requirements, with a view to initiating appropriate capital raisings as required.

The financial liabilities of the Group and the parent entity are confined to trade and other payables as disclosed in the Balance Sheet. All trade and other payables are non-interest bearing and due within 12 months of the reporting date.

**(d) Fair value estimation**

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement or for disclosure purposes. All financial assets and financial liabilities of the Group and the parent entity at the balance date are recorded at amounts approximating their carrying amount.

The fair value of financial instruments traded in active markets is based on quoted market prices at the reporting date. The quoted market price used for financial assets held by the Group is the current bid 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.

### 3. SEGMENT INFORMATION

#### Description of segments

The Company's operations are in the petroleum industry. Geographically, the Company operates in three predominant segments, being Australia, Tanzania and Italy. The Company also has operations in other geographic areas, including Suriname, none 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		Italy		Consolidated	
	2009 \$	2008 \$	2009 \$	2008 \$	2009 \$	2008 \$	2009 \$	2008 \$
<b>Segment revenue</b>								
Other revenue	500,857	818,893	-	688	511	667	501,368	820,248
Total segment revenue	500,857	818,893	-	688	511	667	501,368	820,248
Intersegment elimination							-	-
Consolidated revenue							501,368	820,248
<b>Segment result</b>								
Segment result	(822,144)	(5,594,734)	(2,224,866)	688	(124,966)	(151,135)	(3,171,976)	(5,745,181)
Intersegment elimination							35,021	-
Loss before income tax							(3,136,955)	(5,745,181)
Income tax (expense)/benefit							-	-
Loss for the year							(3,136,955)	(5,745,181)
<b>Segment assets and liabilities</b>								
Segment assets	7,562,369	14,393,961	4,414,237	93,034	349,370	64,173	12,325,976	14,551,168
Intersegment elimination							(1,287,178)	(313,040)
Total assets							11,038,798	14,238,128
Segment liabilities	169,449	141,162	465,466	92,294	606,868	175,519	1,241,783	408,975
Intersegment elimination							(1,059,964)	(190,983)
Total liabilities							181,819	217,992
<b>Other segment information</b>								
Investment in associate	503,462	529,127	-	-	-	-	503,462	529,127
Share of net loss of associate	25,665	34,106	-	-	-	-	25,665	34,106
Acquisitions of property, plant and equipment, intangibles and other noncurrent segment assets	49,339	26,979	-	-	-	-	49,339	26,979
Depreciation expense	47,506	52,457	-	-	-	-	47,506	52,457

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>4. REVENUE</b>				
<b>From continuing operations</b>				
<b>Other revenue</b>				
Interest from financial institutions	322,464	819,877	321,953	818,893
Interest on loans to subsidiaries	-	-	35,021	-
Net foreign exchange gain	178,904	371	178,904	-
	<b>501,368</b>	<b>820,248</b>	<b>535,878</b>	<b>818,893</b>
<b>5. EXPENSES</b>				
<b>Loss before income tax includes the following specific expenses:</b>				
Minimum lease payments relating to operating leases	92,206	56,232	92,206	56,232
<b>6. INCOME TAX</b>				
<b>(a) Income tax expense</b>				
Current tax	-	-	-	-
Deferred tax	-	-	-	-
	-	-	-	-
<b>(b) Numerical reconciliation of income tax expense to prima facie tax payable</b>				
Loss from continuing operations before income tax expense	(3,136,955)	(5,745,181)	(2,910,204)	(5,560,628)
Prima facie tax benefit at the Australian tax rate of 30%	(941,086)	(1,723,554)	(873,061)	(1,668,188)
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:				
Share of associate loss	7,700	10,231	-	-
Exploration expenditure written off	655,130	1,365,747	655,130	1,365,747
Sundry items	(37,651)	98,672	(37,651)	88,440
	<b>(315,907)</b>	<b>(248,904)</b>	<b>(255,582)</b>	<b>(214,001)</b>
Movements in unrecognised temporary differences	(256,865)	(144,807)	(105,557)	(120,030)
Tax effect of current year tax losses for which no deferred tax asset has been recognised	572,772	393,711	361,139	334,031
Income tax expense	-	-	-	-
<b>(c) Unrecognised temporary differences</b>				
<b>Deferred Tax Assets (at 30%)</b>				
<i>On Income Tax Account</i>				
Employee entitlements	11,362	2,780	11,362	2,780
Capital raising costs and other section 40-880 deductions	225,568	338,351	225,568	338,351
Carry forward tax losses	1,129,337	556,565	858,024	496,886
	<b>1,366,267</b>	<b>897,696</b>	<b>1,094,954</b>	<b>838,017</b>
<b>Deferred Tax Liabilities (at 30%)</b>				
<i>On Income Tax Account</i>				
Accrued interest revenue	873	10,025	11,380	10,025
Capitalised exploration and evaluation costs	176,360	14,546	-	-
	<b>177,233</b>	<b>24,571</b>	<b>11,380</b>	<b>10,025</b>

Notes	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>7. CURRENT ASSETS - CASH AND CASH EQUIVALENTS</b>				
Cash at bank and in hand	772,379	131,853	671,778	64,233
Short-term deposits	4,822,476	8,645,933	4,811,126	8,635,242
Cash and cash equivalents as shown in the balance sheet and the statement of cash flows	5,594,855	8,777,786	5,482,904	8,699,475
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 Group, and earn interest at the respective short-term deposit rates.				
<b>8. CURRENT ASSETS - TRADE AND OTHER RECEIVABLES</b>				
Sundry receivables	115,182	152,369	108,208	173,812
Prepayments	35,154	36,877	35,154	36,877
	150,336	189,246	143,362	210,689
<b>9. NON-CURRENT ASSETS - RECEIVABLES</b>				
Bank guarantees	59,945	25,915	59,945	25,915
Loan to associate company	5,101	1,623	5,101	1,623
Loans to subsidiaries	-	-	1,103,994	160,484
	65,046	27,538	1,169,040	188,022
The recovery of the carrying value of loans to subsidiaries and loan to associate company is dependent on the successful development and commercial exploitation, or alternatively, sale of the respective exploration areas of interest.				
<b>10. NON-CURRENT ASSETS - INVESTMENT ACCOUNTED FOR USING THE EQUITY METHOD</b>				
Shares in associate company	26	503,462	529,127	600,000
			600,000	600,000
The recovery of the carrying value of the investment in associate company is dependent on the successful development and commercial exploitation, or alternatively, sale of the associate's exploration areas of interest.				
<b>11. NON-CURRENT ASSETS - OTHER FINANCIAL ASSETS</b>				
Shares in subsidiaries - at cost	25	-	-	32,721
				32,721
<b>12. NON-CURRENT ASSETS - PLANT AND EQUIPMENT</b>				
<b>Plant and equipment</b>				
Cost	237,389	188,050	237,389	188,050
Accumulated depreciation	(103,047)	(55,541)	(103,047)	(55,541)
Net book amount	134,342	132,509	134,342	132,509
<b>Plant and equipment</b>				
Opening net book amount	132,509	157,987	132,509	157,987
Additions	49,339	26,979	49,339	26,979
Depreciation charge	(47,506)	(52,457)	(47,506)	(52,457)
Closing net book amount	134,342	132,509	134,342	132,509
<b>13. NON-CURRENT ASSETS - INTANGIBLE ASSETS</b>				
<b>Goodwill</b>				
Cost	2,891	2,891	-	-
Accumulated impairment	-	-	-	-
Net book amount	2,891	2,891	-	-
<b>Goodwill</b>				
Opening net book amount	2,891	-	-	-
Additions - acquisition	-	2,891	-	-
Closing net book amount	2,891	2,891	-	-

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>14. NON-CURRENT ASSETS - PETROLEUM LICENCES AND CAPITALISED EXPLORATION COSTS</b>				
Exploration, evaluation and development costs carried forward in respect of petroleum areas of interest				
Preproduction				
Opening net book amount	4,579,031	3,724,891	4,530,545	3,724,891
Capitalised exploration and evaluation costs	2,192,602	5,435,729	1,653,222	5,387,243
Exploration and evaluation costs written off	(2,183,767)	(4,581,589)	(2,183,767)	(4,581,589)
Closing net book amount	4,587,866	4,579,031	4,000,000	4,530,545

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.

**15. CURRENT LIABILITIES - TRADE AND OTHER PAYABLES**

Trade payables	134,625	187,807	131,578	121,775
Other payables and accruals	47,194	30,185	37,871	19,387
	181,819	217,992	169,449	141,162

**16. ISSUED CAPITAL****(a) Share capital**

	Notes	2009		2008	
		Number of shares	\$	Number of shares	\$
Ordinary shares fully paid	16(b), 16(d)	86,000,005	19,868,699	86,000,005	19,868,699
Total issued capital		86,000,005	19,868,699	86,000,005	19,868,699

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

Beginning of the financial year	86,000,005	19,868,699	86,000,005	19,868,699
End of the financial year	86,000,005	19,868,699	86,000,005	19,868,699

**(c) Movements in options on issue**

	Number of options	
	2009	2008
Beginning of the financial year	44,225,002	-
Issued during the year:		
- Exercisable at 20 cents, on or before 30 November 2010	750,000	-
- Exercisable at 50 cents, on or before 30 November 2010	5,000,000	-
- Exercisable at 35 cents, on or before 31 March 2009 (listed)	-	44,000,002
- Exercisable at 35 cents, on or before 31 March 2009 (unlisted)	-	225,000
- Expired during the year		
- Exercisable at 35 cents, on or before 31 March 2009 (listed)	(44,000,002)	-
- Exercisable at 35 cents, on or before 31 March 2009 (unlisted)	(225,000)	-
End of the financial year	5,750,000	44,225,002

**(d) 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.

Ordinary shares have no par value and the Company does not have a limited amount of authorised capital.

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$

**16. ISSUED CAPITAL (CONT'D)****(e) Capital risk management**

The Group's and the parent entity's objectives when managing capital are to safeguard their ability to continue as a going concern, so that they may continue to provide returns for shareholders and benefits for other stakeholders.

Due to the nature of the Group's activities, being petroleum exploration, the Group does not have ready access to credit facilities, with the primary source of funding being equity raisings. Therefore, the focus of the Group's capital risk management is the current working capital position against the requirements of the Group to meet exploration programmes and corporate overheads. The Group's strategy is to ensure appropriate liquidity is maintained to meet anticipated operating requirements, with a view to initiating appropriate capital raisings as required. The working capital position of the Group and the parent entity at 30 June 2009 and 30 June 2008 are as follows:

Cash and cash equivalents	5,594,855	8,777,786	5,482,904	8,699,475
Trade and other receivables	150,336	189,246	143,362	210,689
Trade and other payables	(181,819)	(217,992)	(169,449)	(141,162)
Working capital position	5,563,372	8,749,040	5,456,817	8,769,002

**17. RESERVES AND ACCUMULATED LOSSES****(a) Reserves**

Foreign currency translation reserve	(87,870)	(11,343)	-	-
Share-based payments reserve	276,557	226,232	276,557	226,232
	188,687	214,889	276,557	226,232

**Movements:****Foreign currency translation reserve**

Balance at beginning of year	(11,343)	-	-	-
Currency translation differences arising during the year	(76,527)	(11,343)	-	-
Balance at end of year	(87,870)	(11,343)	-	-

**Share-based payments reserve**

Balance at beginning of year	226,232	-	226,232	-
Employees and contractors option expense	50,325	6,232	50,325	6,232
Amounts paid for listed options issued during the year	-	220,000	-	220,000
Balance at end of year	276,557	226,232	276,557	226,232

**(b) Accumulated losses**

Balance at beginning of year	(6,063,452)	(318,271)	(5,842,132)	(281,504)
Net loss for the year	(3,136,955)	(5,745,181)	(2,910,204)	(5,560,628)
Balance at end of year	(9,200,407)	(6,063,452)	(8,752,336)	(5,842,132)

**(c) Nature and purpose of reserves****(i) Foreign currency translation reserve**

Exchange differences arising on translation of the foreign controlled entities are taken to the foreign currency translation reserve, as described in note 1(d). The reserve is recognised in profit and loss when the net investment is disposed.

**(ii) Share-based payments reserve**

The share-based payments reserve is used to recognise the fair value of options issued.

**18. DIVIDENDS**

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

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

**19. KEY MANAGEMENT PERSONNEL DISCLOSURES****(a) Key management personnel compensation**

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$
Short-term benefits	627,101	832,716	627,101	832,716
Post employment benefits	7,393	22,038	7,393	22,038
Other long-term benefits	-	-	-	-
Termination benefits	-	-	-	-
Share-based payments	37,500	2,770	37,500	2,770
	<b>671,994</b>	<b>857,524</b>	<b>671,994</b>	<b>857,524</b>

Detailed remuneration disclosures are provided in sections A-C of the remuneration report on pages 21 to 23.

**(b) Equity instrument disclosures relating to key management personnel****(i) Options provided as remuneration and shares issued on exercise of such options**

Details of options provided as remuneration and shares issued on the exercise of such options, together with terms and conditions of the options, can be found in section D of the remuneration report on page 23.

**(ii) Option holdings**

The numbers of options over ordinary shares in the Company held during the financial year by each director of Key Petroleum Limited and other key management personnel of the Group, including their personally related parties, are set out below:

2009	Balance at start of the year	Granted as compensation	Exercised	Other changes	Balance at end of the year	Vested and exercisable	Unvested
<b>Directors of Key Petroleum Limited</b>							
Edward Ellyard	2,025,000	1,000,000	-	(2,025,000)	1,000,000	1,000,000	-
Kenneth Russell	2,782,500	2,000,000	-	(2,782,500)	2,000,000	2,000,000	-
Dennis Wilkins	500,000	750,000	-	(500,000)	750,000	750,000	-
Richard O'Shannassy	100,000	750,000	-	(100,000)	750,000	750,000	-
Terence Nilsen	500,000	-	-	(500,000)	-	-	-
<b>Other key management personnel of the Group</b>							
John Ribbons	400,002	500,000	-	(400,002)	500,000	500,000	-

All vested options are exercisable at the end of the year.

2008	Balance at start of the year	Granted as compensation	Exercised	Other changes	Balance at end of the year	Vested and exercisable	Unvested
<b>Directors of Key Petroleum Limited</b>							
Edward Ellyard	-	-	-	2,025,000	2,025,000	2,025,000	-
Kenneth Russell	-	-	-	2,782,500	2,782,500	2,782,500	-
Dennis Wilkins	-	-	-	500,000	500,000	500,000	-
Richard O'Shannassy	-	-	-	100,000	100,000	100,000	-
Terence Nilsen	-	-	-	500,000	500,000	500,000	-
<b>Other key management personnel of the Group</b>							
John Ribbons	-	100,000	-	300,002	400,002	400,002	-

**19. KEY MANAGEMENT PERSONNEL DISCLOSURES (cont'd)****(iii) Share holdings**

The numbers of shares in the Company held during the financial year 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.

2009	Balance at start of the year	Received during the year on the exercise of options	Other changes during the year	Balance at end of the year
<b>Directors of Key Petroleum Limited</b>				
<b>Ordinary shares</b>				
Edward Ellyard	4,050,000	-	400,000	4,450,000
Kenneth Russell	5,565,000	-	-	5,565,000
Dennis Wilkins	1,000,000	-	-	1,000,000
Richard O'Shannassy	200,000	-	-	200,000
Terence Nilsen	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

2008	Balance at start of the period	Received during the period on the exercise of options	Other changes during the period	Balance at end of the 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
Dennis Wilkins	1,000,000	-	-	1,000,000
Richard O'Shannassy	-	-	200,000	200,000
Terence Nilsen	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

**(c) Loans to key management personnel**

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

**(d) Other transactions with key management personnel**

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 Pty Ltd, a business of which Mr Wilkins is principal, provided company secretarial and other corporate services to Key Petroleum Limited during the year. The amounts paid were at arm's length and are included as part of Mr Wilkins' compensation.

Richard O'Shannassy & Co Pty Ltd, a business of which Mr O'Shannassy is principal, provided legal services to the Key Petroleum Group during the year. The amounts paid were at arm's length and are included as part of Mr O'Shannassy's compensation.

Under commercial terms, Richard O'Shannassy & Co Pty Ltd sublet premises from the Company from 1 July to 31 July 2008 to the value of \$2,944 (2008: \$32,290).

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$

**20. REMUNERATION OF AUDITORS**

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

Audit services				
Bentleys - audit of financial reports	27,700	23,300	27,700	23,300
Total remuneration for audit services	27,700	23,300	27,700	23,300

**21. CONTINGENCIES**

On 27 January 2009 a demand notice was issued by the Tanzanian Revenue Authority ("TRA") to Ndovu Resources Pty Ltd, the operator of the Nyuni Joint Venture, claiming a sum of Tshs 1,130,453,495.20 (approximately USD 851,500) due to the failure to re-export certain drilling equipment within 12 months of importation. Ndovu Resources Pty Ltd considers the matter has been resolved but if the TRA was to pursue the matter it could result in the Company, which has a 20% participating interest in the Nyuni JV, incurring a pro-rata liability if the relevant contractor, UPSL, will not fully satisfy the TRA claim.

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

**22. COMMITMENTS****(a) Exploration commitments**

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

within one year	932,250	750,000	-	-
later than one year but not later than five years	14,356,650	11,550,000	4,972,000	4,000,000
	15,288,900	12,300,000	4,972,000	4,000,000

**(b) Lease commitments: Group as lessee**

Operating leases (noncancellable):

Minimum lease payments				
within one year	88,520	47,325	88,520	47,325
later than one year but not later than five years	66,390	-	66,390	-
Aggregate lease expenditure contracted for at reporting date but not recognised as liabilities	154,910	47,325	154,910	47,325

The property lease is a non-cancellable lease currently in the first two-year renewal term, with an option to renew for another two-year term, 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 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 pages 6 and 7 that are not recognised as liabilities and are not included in the key management personnel compensation.

within one year	251,667	288,000	251,667	288,000
later than one year but not later than five years	-	231,667	-	231,667
	251,667	519,667	251,667	519,667

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$

### 23. RELATED PARTY TRANSACTIONS

#### (a) Parent entity

The ultimate parent entity within the Group is Key Petroleum Limited.

#### (b) Subsidiaries

Interests in subsidiaries are set out in note 25.

#### (c) Key management personnel

Disclosures relating to key management personnel are set out in note 19.

#### (d) Loans to related parties

##### Loans to subsidiaries

Beginning of the year	-	-	160,484	-
Loans advanced	-	-	908,489	160,484
Interest charges	-	-	35,021	-
End of year	-	-	1,103,994	160,484

Key Petroleum Limited has provided unsecured loans to its wholly owned subsidiaries Funguo Petroleum Pty Limited and Puma Petroleum S.r.L., with monthly interest charged at the BBSW rate plus 2%. Key Petroleum Limited has also provided an unsecured, interest free loan to its wholly owned subsidiary Key Petroleum (Tanzania) Pty Ltd. An impairment assessment is undertaken each financial year by examining the financial position of each subsidiary and the market in which the respective subsidiary operates to determine whether there is objective evidence that any of the subsidiaries are impaired. When such objective evidence exists, the Company recognises an allowance for the impairment loss.

##### Loan to associate

In addition to the above, Key Petroleum Limited has provided an unsecured, interest free loan to Portsea Oil & Gas Pty Ltd, a company the Group has accounted for as an associate. The balance of the loan at 30 June 2009 is \$5,101 (2008: \$1,623).

### 24. BUSINESS COMBINATIONS

#### Prior period

##### (a) Summary of acquisitions

On 13 August 2007 Key Petroleum (Tanzania) Pty Ltd was incorporated in Western Australia with Key Petroleum Limited as the sole shareholder.

On 24 October 2007 Funguo Petroleum Pty Limited was incorporated in Tanzania with Key Petroleum Limited as the sole beneficial shareholder.

On 1 July 2007 the parent entity acquired 100% of the issued share capital of Puma Petroleum Limited ("Puma"), a company registered in the British Virgin Islands. Post acquisition, the legal domicile of Puma has been changed to Italy.

The acquired business contributed \$667 revenue and a loss of \$151,135 to the Group for the period from 1 July 2007 to 30 June 2008. At the date of acquisition the acquired entity was involved in oil and gas exploration in Italy.

Details of the fair value of the assets and liabilities acquired and goodwill are as follows:

	\$
Purchase consideration (refer to (c) below):	
Issues of 2,000,000 ordinary shares(1)	-
Total purchase consideration	-
Fair value of net identifiable assets acquired (refer to (b) below)	(2,891)
Goodwill	2,891

(1) The consideration payable to the vendors is subject to various performance hurdles being met. As at the balance date none of these hurdles had been met and none of the ordinary shares had been issued per the acquisition agreement. The directors fully expect the performance conditions to be satisfied and the ordinary shares to be issued in future periods. Notwithstanding this, ownership has been completely transferred from the vendors to Key Petroleum Limited.

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

**24. BUSINESS COMBINATIONS (CONT'D)****(b) Assets and liabilities acquired**

The assets and liabilities arising from the acquisition are as follows:

	Acquiree's carrying amount \$	Fair value \$
Cash and cash equivalents	299	299
Payables	(3,190)	(3,190)
Net identifiable assets acquired	(2,891)	(2,891)

**(c) Purchase consideration**

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$
Outflow/(inflow) of cash to acquire Puma, net of cash acquired	-	(299)	-	-
Outflow of cash to acquire Key Petroleum (Tanzania) Pty Ltd	-	-	-	100
Post acquisition capital injection to Puma	-	-	-	32,621
Cash consideration and outflow/(inflow) of cash	-	(299)	-	32,721

**25. SUBSIDIARIES**

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in note 1(b):

Name	Country of Incorporation	Class of Shares	Equity Holding*	
			2009 %	2008 %
Puma Petroleum S.r.L.	Italy	Ordinary	100	100
Key Petroleum (Tanzania) Pty Ltd	Australia	Ordinary	100	100
Funguo Petroleum Pty Limited	Tanzania	Ordinary	100	100

\* The proportion of ownership interest is equal to the proportion of voting power held.

**26. INVESTMENT IN ASSOCIATE****(a) Carrying amount**

Information relating to the associate is set out below.

Name of Company	Principal Activity	Ownership Interest		Consolidated		Parent Entity	
		2009 %	2008 %	2009 \$	2008 \$	2009 \$	2008 \$
<b>Unlisted</b>							
Portsea Oil & Gas Pty Ltd	Oil and gas exploration	50	50	503,462	529,127	600,000	600,000

The above associates were incorporated in Australia.

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>(b) Movements in carrying amount</b>				
Carrying amount at the beginning of the year	529,127	563,233	600,000	600,000
Share of loss after income tax	(25,665)	(34,106)	-	-
Carrying amount at the end of the year	503,462	529,127	600,000	600,000

**26. INVESTMENT IN ASSOCIATE (cont'd)**

	Consolidated	
	2009 \$	2008 \$
<b>(c) Share of associate profit or loss</b>		
Loss before income tax	(25,665)	(34,106)
Income tax	-	-
Loss after income tax	(25,665)	(34,106)

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

	Gross Amount of:			
	Assets \$	Liabilities \$	Revenues \$	Loss \$
<b>2009</b>				
Portsea Oil & Gas Pty Ltd	5,008	198,080	137,127	(51,329)
<b>2008</b>				
Portsea Oil & Gas Pty Ltd	194,836	336,580	122,464	(68,212)

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

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

**(f) Contingent liabilities of associate**

Portsea Oil & Gas Pty Ltd does not have any contingent liabilities at 30 June 2009.

**27. INTERESTS IN JOINT VENTURES****Tanzanian Farmin Agreement - Nyuni**

During the year Key Petroleum Limited completed its obligations required 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.

**Tanzanian Bidding Agreement - West Songo Songo**

Pursuant to a Bidding Agreement with Ndovu the Company has, through its wholly owned subsidiary Funguo Petroleum Pty Ltd, entered into a new Production Sharing Contract with the Government of the Republic of Tanzania in respect of the West Songo Songo area, executed on 29 May 2008 and exploration licence subsequently issued on 18 July 2008.

**28. EVENTS OCCURRING AFTER THE BALANCE SHEET DATE**

During August 2009 the Company completed an entitlements offer that raised \$4,730,000 from the issue of 43,000,000 ordinary shares.

During June 2009 the Company announced that it had entered an agreement with Midmar Energy Limited, an unlisted United Kingdom company, to acquire its wholly-owned subsidiary Midmar Energy Onshore Limited, whose assets include 2 producing oilfields located in the south east of England for the sum of GBP 2 million. The acquisition is dependent on a number of conditions precedent.

No other matter or circumstance has arisen since 30 June 2009, 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

30 JUNE 2009

	Consolidated		Parent Entity	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>29. CASH FLOW STATEMENT</b>				
<b>Reconciliation of net loss after income tax to net cash outflow from operating activities</b>				
Net loss for the year	(3,136,955)	(5,745,181)	(2,910,204)	(5,560,628)
<b>NonCash Items</b>				
Depreciation of noncurrent assets	47,506	52,457	47,506	52,457
Employee and contractors options expense	50,325	6,232	50,325	6,232
Share of loss of associate	25,665	34,106	-	-
Net exchange differences	(93,142)	(11,343)	-	-
<b>Change in operating assets and liabilities, net of effects from purchase of controlled entity</b>				
Decrease/(increase) in trade and other receivables	37,847	(85,386)	29,995	(105,206)
(Increase)/decrease in petroleum permits and capitalised exploration costs	(764)	(854,140)	530,545	(805,654)
(Decrease)/increase in trade and other payables	(42,055)	139,498	27,142	65,858
Net cash outflow from operating activities	(3,111,573)	(6,463,757)	(2,224,691)	(6,346,941)

**30. LOSS PER SHARE**

	Consolidated	
	2009 \$	2008 \$
<b>(a) Reconciliation of earnings used in calculating loss per share</b>		
Loss attributable to the ordinary equity holders of the company used in calculating basic and diluted loss per share	(3,136,955)	(5,745,181)
	Number of shares	Number of shares
<b>(b) Weighted average number of shares used as the denominator</b>		
Weighted average number of ordinary shares used as the denominator in calculating basic and diluted loss per share	86,000,005	86,000,005

**(c) Information on the classification of options**

As the Group has made a loss for the year ended 30 June 2009, all options on issue are considered antidilutive and have not been included in the calculation of diluted earnings per share. These options could potentially dilute basic earnings per share in the future.

### 31. SHARE-BASED PAYMENTS

#### Employees and contractors options

The Group provides benefits to employees (including Directors) and contractors of the Group in the form of share-based payment transactions, whereby options to acquire ordinary shares are issued as an incentive to improve employee and shareholder goal congruence. The exercise prices of the options granted range from 20 cents to 50 cents with an expiry date of 30 November 2010.

Options granted carry no dividend or voting rights. When exercisable, each option is convertible into one ordinary share of the Company with full dividend and voting rights.

Set out below are summaries of the options granted:

	Consolidated and Parent Entity			
	2009		2008	
	Number of options	Weighted average exercise price cents	Number of options	Weighted average exercise price cents
Outstanding at the beginning of the year	225,000	35.0	-	-
Granted	5,750,000	46.1	225,000	35.0
Forfeited/cancelled	-	-	-	-
Exercised	-	-	-	-
Expired	225,000	35.0	-	-
Outstanding at year-end	5,750,000	46.1	225,000	35.0
Exercisable at year-end	5,750,000	46.1	225,000	35.0

The weighted average remaining contractual life of share options outstanding at the end of the financial year was 1.42 years (2008: 0.75), and the exercise prices range from 20 cents to 50 cents.

#### Expenses arising from share-based payment transactions

The weighted average fair value of the options granted during the year was 0.9 cents (2008: 2.8). The price was calculated by using the Black-Scholes European Option Pricing Model applying the following inputs:

	2009	2008
Weighted average exercise price (cents)	46.1	35.0
Weighted average life of the option (years)	2.00	1.25
Weighted average underlying share price (cents)	8.9	23.5
Expected share price volatility	80.85%	50%
Risk free interest rate	5.12%	6.75%

Historical volatility has been used as the basis for determining expected share price volatility as it assumed that this is indicative of future trends, which may not eventuate.

The life of the options is based on historical exercise patterns, which may not eventuate in the future.

Total expenses arising from share-based payment transactions recognised during the year were as follows:

	Consolidated		Parent Entity	
	2009	2008	2009	2008
	\$	\$	\$	\$
Options issued to employees and contractors	50,325	6,232	50,325	6,232