Key Petroleum Ltd
ACN 120 580 618

Annual Report 2010

BUILDING ON
OPPORTUNITY

Our Business Highlights

AUSTRALIA

Highlights of 2009 › 2010

++ EP437 Joint Venture

++ Potential for 400 bopd production

++ Two well drilling programme

++ Drilling rig sourced

++ Earning 45% interest in block by funding 60% capped at $1.35 Million Dollars

++ Drilling planned to take place Q4 2010

ENGLAND

Highlights of 2009 › 2010

++ Completed purchase of 100% of MEOL

++ Sales revenue from day one

++ Operator status in UK

++ Lidsey #2 well planning with potential for additional 200-400 bopd oil production

++ Well workover and oilfield optimisation

++ Experienced worst winter in UK for 30 years

ITALY

Highlights of 2009 › 2010

++ West Sardinia:
Granted exploration status

++ Lampedusa:
Completed work required for exploration status prior to Ministry sign off

++ Elba:
Application for exploration status progressing

TANZANIA

Highlights of 2009 › 2010

++ Kiliwani North Contingent Resouce declared of 44BcF (Pmean)

++ Additional Kiliwani Seismic completed

++ New drilling being planned to take place Q1 2011

++ Expansion of Songo Songo plant now expected following announcements

Corporate Directory

Key Petroleum Ltd
ACN 120 580 618

Directors

Dennis Wilkins
Non Executive Chairman

Kenneth Russell
Managing Director/CEO

John Sheppard
Non Executive Director *(appointed 31 August 2010)*

Edward (Ted) Ellyard
Non Executive Chairman *(resigned 31 August 2010)*

Richard O'Shannassy
Non Executive Director *(resigned 31 August 2010)*

Company Secretary

John Ribbons

Registered Office

23 Altona Street, West Perth WA 6005

Principal Place of Business

Level 1, 14 Outram Street, West Perth WA 6005
Ph +61 8 9327 3500
Fx +61 8 9327 3510

Postal Address

PO Box 1622, West Perth WA 6872

Solicitors

Richard O'Shannassy & Co Pty Ltd
Level 3, 46 Ord 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

Bentleys
Level 1, 12 Kings Park Road, West Perth WA 6005

Internet Address

www.keypetroleum.com

Email Address

info@keypetroleum.com

Stock Exchange Listings

Key Petroleum Limited shares (Code: **KEY**) are listed on the Australian Securities Exchange.

Contents

ECF ELEMENTAL CHLORINE FREE · RECYCLED CONTENT · FOREST MANAGEMENT · EMS ENVIRONMENTAL MANAGEMENT SYSTEMS · GREEN STAMP CERTIFIED PRINTERS

The cover and inside pages of this annual report were printed on environmentally sound paper and printed by a Green Stamp certified printer.

Chairman's Letter

I am pleased to present to you the 2010 Annual Report for Key Petroleum.

The 2010 financial year has been another very active and challenging period, highlighting the tenacity required to build a successful business in the oil and gas industry. As the world started to emerge from one of the most difficult periods in economic history Key continued to improve its production profile, critically assess its exploration interests and deal with changing environmental hurdles associated with its Italian offshore interests.

The management team, led by Ken Russell, have tirelessly reviewed opportunities for growth as well as maintained a very vigilant watch on Key's UK production assets. As you would have read about during the year, and will find succinctly summarised in the CEO's Review, our continuous search for additional assets resulted in an exciting opportunity being acquired in the North Perth Basin. As this Annual Report goes to press we are in the depths of preparation for the drilling of the two wells in the new joint venture. I hope to be able to bring more news on this project in the very near future.

In addition, some difficult decisions have been taken. The possible divestment of our Tanzanian asset is regrettable but will assist with the acceleration of the drilling necessary to increase oil flows of our UK production assets. While we would ideally prefer to retain both assets choices have to be made and, after weighing up the possible outcomes, we firmly believe the path we have set Key on will lead to faster growth with increased financial security.

Progress was made during the year in Italy but then snatched away from us. World oil drilling disasters, well outside our control, have increased the frustration surrounding our Italian asset permitting and exploration activities but have not dampened our enthusiasm. We will continue our efforts to put Key in a position where it is able to test the potential of these assets as soon as we can.

Shortly after the end of the year, Ted Ellyard and Richard O'Shannassy retired from the board following a period of challenge. In the end the challenge was resolved amicably but resulted in the departure of these two experienced board members. I would like to acknowledge and thank them both for their fantastic contribution and guidance from Key's inception right up until the date of their departure. Fortunately, we have secured the services of a highly regarded industry professional in Mr John Sheppard and I look forward to his contribution over the coming years.

Our small but highly skilled technical team and administration staff continue to provide the professionalism and sophistication necessary to engage Key at all levels in the industry and to seek out opportunities for growth. I am very grateful to them as they have not faltered in their efforts to secure a bright future for Key.

I would also like to thank our long standing shareholders for their patience and continuing support. I assure you we are focussed on rewarding all shareholders and will continue to strive to do so. The year ahead promises to be another active period and I think it will be a pivotal year in Key's history.

I look forward to addressing you at the forthcoming annual general meeting and hope you will be able to join us on the day to learn more of our efforts and plans.

Dennis Wilkins
Non Executive Chairman

Chief Executive's Review

As I look back over the period since the Company's last Annual Report and contemplate what the Company has actually been involved in, I can see that we have achieved a considerable amount, in a relatively short time frame, with a limited number of full time staff, with changes in our Company's board composition and against the background of an unsettled business and financial market place.

Our priorities as management, as clearly defined to us by the board of directors of the Company, are to maximise production sales revenue from our oil producing assets whilst maintaining our safety, environmental and corporate and social philosophy. While doing this, we have to minimise costs associated with acquiring that revenue by way of application of technology and creative engineering with the lowest impact on people and surrounding areas.

On top of all that, we are also attempting to secure additional assets that can provide the Company with sustained cash flow which will translate into an improving share price and return for shareholders.

Since our last Annual Report we have reviewed a number of opportunities, both large and small, that we felt initially could have a beneficial impact on Key Petroleum. The reality however, is that as we further investigate many of these opportunities we find that there are problems associated with them. It maybe the quality of the reservoirs making recovery expensive or difficult to finance, it may be overriding royalties that are left over from previous mergers or acquisitions which then impact on the bottom line of the deal. In fact, any number of things can cause the project to fail our internal investment criteria. So when we look at an acquisition such as our two producing oil fields in the UK they should be viewed as opportunities being taken by management after considerable review and analysis.

EUROPE
Oil Production UK

At the end of September 2009 we completed the acquisition of 100% of the England-based business, Midmar Onshore Energy Limited and changed the company name to Key Petroleum (Weald Basin) Ltd. Completing that acquisition moved the Company from being solely exploration focused into both an exploration and an oil production company. It has also given us Operator status in the United Kingdom. Importantly though, it also provided us with cash revenues from oil sales from day one of the assumption of control. Since that time, we have undertaken a number of operational changes and performed a workover operation (remedial work) on one of our major wells and now we are aiming to drill the Lidsey #2 horizontal well that we announced not long after acquiring the business. This well, from our technical evaluation, has the potential to add in the region of 200 – 400 barrels of oil per day to Key Petroleum's total oil production sales. Drilling tenders for this well have been issued and awarded and various required approvals are almost complete.

EUROPE
Italy

The Company regards Italy as a long term company building exercise due to the size of its surrounding market place for oil and gas and the history of the surrounding countries' close links with it. Recently however, following the Gulf of Mexico environmental disaster we have seen the growth in lobbying against drilling activity offshore and we, like a number of companies with offshore assets in Italy, are concerned by this lack of understanding as to the need for oil production and await government responses and possible action in relation to just how the drilling industry can operate in Italy.

Progress is based on maximising the benefit of current assets and finding and acquiring new oil and gas opportunities. Such opportunities are getting harder to find for the right price.

Looking Ahead

Progress is based on maximising the benefit of current assets and finding and acquiring new oil and gas opportunities. Such opportunities are getting harder to find for the right price. But we do not shy away from the task at hand. We will persist and remain confident that we can succeed in attaining our objectives.

Our vision remains unchanged – 'To build Key Petroleum Ltd into a mid size oil and gas exploration and production company which provides a good return for shareholders". We will do this by;

1. Acquiring additional oil producing assets
2. Improving those assets we already have
3. Focusing on specific areas and countries that can provide growth opportunities
4. Always remembering that we are working for the benefit of all shareholders as we make our decisions

Ken Russell, Key's CEO provides a review of the past year and some insights into the next twelve months of opportunities for the Company.

EAST AFRICA

Tanzania

Progress has been slower than we would have liked in Tanzania, but we can now see the approvals process for expansion of the Songo Songo gas plant gathering pace, which is something that will greatly assist in the development of the Kiliwani North Gas Field and provide impetus for the area. The Company is currently reviewing a draft proposed field development plan.

However, the Company has taken a very difficult step in making the decision to divest this interest if, and only if, suitable offers can be secured. This divestment process has been ongoing for a number of months. The Board's decision to divest the Tanzanian assets can hopefully take advantage of the increasing interest being observed in the East Coast of Africa by the oil and gas majors.

AUSTRALIA

Perth Basin - EP 437

Building on the experience gained from the UK acquisition, the Company made the decision to investigate low cost oil potential in Australia and entered into a joint venture with CalEnergy Resources Ltd, a US company that is part of the well-known Berkshire Hathaway conglomerate and who is the Operator for the project. Two low cost, relatively shallow wells are close to being drilled during 2010 with the potential to add to Key's oil production and revenue. The Perth Basin is well known for its hydrocarbon reserves of both oil and gas. Our geological team continues to review the potential of the EP 437 permit area and has identified some interesting further leads which bodes well for the future activity in the permit area.

Health and Safety

As we grow the Company, the number of people involved in its daily activities increases and although we do not have a large workforce we are mindful of our obligations to ensure that those working with us, whether our own personnel or outside personnel who interact with us, are protected and able to work in safe conditions. It is the number one focus we have and will always continue to be.

I express my thanks to the staff of the Company for their dedication and commitment to the Company over a difficult period. I am confident that better times are ahead for the Company and its shareholders.

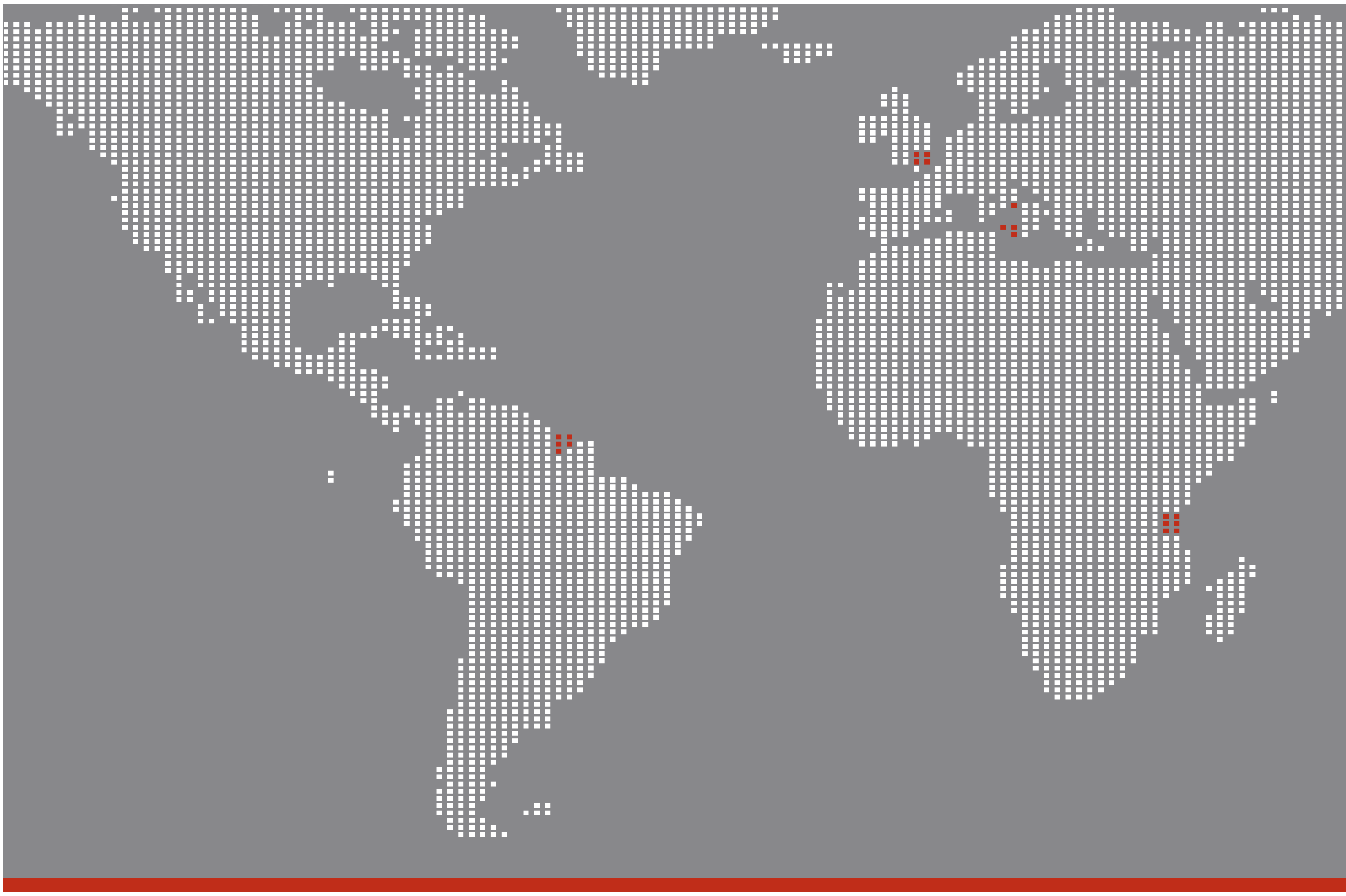
I also express my appreciation for the continuing support shown by the overwhelming majority of shareholders.

I invite you to carefully review the following pages that will provide you with a more detailed understanding of our assets and projects and what we have undertaken over the past 12 months or so.

Strategic Progress

The oil and gas business is costly in all its forms. It is a risk based business. However, the rewards can be considerable for those willing to partake in it and the focus of management is built on that premise. Our business model is to continue with our major objective of increasing shareholder value through the discovery and development of commercial deposits of oil and gas. We are looking to acquire and enhance cash generative assets thereby enabling us to support further growth. Strict financial discipline is always maintained by the Company and during the year we have raised capital to allow the Company to continue with its expansion plans, be they the improvement and optimisation of our UK oil fields, the exploration drilling in our new Australian assets or the acquisition of other interests. We all know however, that there are various work related commitments that the Company has to undertake which will require future funding. The oil and gas industry is one that is constantly full of challenges. We have to overcome those challenges and take advantage of the opportunities that arise. Key's management will be working to that belief as we progress through the remainder of 2010 and into 2011.

From the outside looking in, it is sometimes difficult for shareholders to identify and understand what is taking place within a company. But shareholders may be assured that what goes on behind the scenes is a team of capable people working diligently to find or develop that "company maker" project.



Offshore Tanzania Nyuni Block KEY INTEREST 20%	**Onshore Weald Basin UK** PEDL235 - Brockham Oil Field KEY INTEREST 100%	**Onshore Italy** Borsano Permit KEY INTEREST 100%	**Offshore Italy - Lampedusa** d 342 C.R–.PU Application KEY INTEREST 100%
Offshore Tanzania West Songo Songo KEY INTEREST/ OPERATOR 50%	**Onshore Weald Basin UK** PEDL241 - Lidsey Oil Field KEY INTEREST 100%	**Offshore Italy - Lampedusa** d 341 C.R-.PU Application KEY INTEREST 100%	**Offshore Italy - West Sardinia** E.R54.PU Exploration KEY INTEREST 100%
			Offshore Italy - Elba d 91 E.R–.PU Application KEY INTEREST 100%

Our Projects Review

Offshore East Africa

Key Petroleum had early success in its drilling activities in East Africa with the discovery of gas in the Kiliwani North #1 well, adjacent to the producing Songo Songo Gas Field, off the coast of Tanzania in 2008. This discovery identified a new gas field for the area. The Nyuni Joint Venture is now in the process of commercialising this discovery and at the end of the year a gas field development licence application was being prepared. Appraisal seismic was also recorded over the discovery area during July 2009 to assist in delineating the size of the field and this has greatly assisted in establishing a resource range of P90-PMean-P10 gas in place of 24-45-70 Bcf in the proven Neocomian reservoir. This is the same reservoir that has been producing gas at the Songo Songo Gas Field since 2004 and has an estimated life of 25 years.

Reservoir engineering simulation studies of field performance have confirmed that the Kiliwani North field will have a high recovery factor. It is currently envisaged that the most economic method of producing and processing the gas would be through the existing Songas facilities on Songo Songo Island before transportation via the pipeline network to customers in the Dar es Salaam area and elsewhere in East Africa. Feasibility studies for extension and expansion of the main pipeline from Songo Songo island are underway at this time. One issue for the Joint Venture to contend with in the development timetable for Kiliwani gas has been the ability to get any produced gas to market, however, with recent approvals for the expansion of the Songo Songo Island processing facilities having been announced this is viewed as an encouraging sign as is the increasing demand for gas and market expansion in the region.

There is renewed focus on the East Coast of Africa and significant activity is anticipated in the near term in Tanzanian deepwater blocks held by major companies such as Petrobras, Shell, Statoil and Ophir. The latter has commenced a 3-well deepwater drilling campaign east of Songo Songo Island. In the last year, Anadarko has made three deep water discoveries off Northern Mozambique, whose border is with Tanzania, and one of these wells, Ironclad #1, represents the first deepwater oil discovered off the coast of East Africa. The latter is reported to have been in an Upper Cretaceous turbidite reservoir and may be an analog for the seismic amplitude-supported fairway in Key's West Songo Songo PSA area.

Onshore Suriname
Uitkijk and Coronie Blocks

KEY INTEREST 1.75%

Onshore Australia
EP437 – North Perth Basin

KEY INTEREST 45%

Offshore Tanzania

	KEY
Nyuni Block	20%

As part of the ongoing commitments attached to the permits the Nyuni Joint Venture is preparing to drill a deviated well from Nyuni Island in late 2010 or early 2011. This will be by use of a large land rig that would have capacity to reach targets at a deeper location and a considerable distance from the island. The first well drilled from the island, Nyuni #1, was drilled in 2003-04. This well discovered a 15m thick gas reservoir in Albian-Aptian sandstones, above the Neocomian reservoir sequence and provided strong oil shows in the Upper Jurassic section. Other evidence of oil generation in the region is the presence of a documented oil seep on Nyuni Island.

Operational reasons prevented testing the gas zone in the Nyuni #1 well where no hydrocarbon / water contact was observed. The objective of the new well will be to crestally test both objective horizons in this large anticline. The Operator's probabilistic mean resource volumes are 207 Bcf in the Albian-Aptian sandstones and over 1 Trillion Cubic Feet of gas in the Neocomian unit.

	KEY
West Songo Songo	50%
	+Operator

The West Songo Songo block is located between Songo Songo Island and the Tanzanian coastline. Key is the designated Operator of the block, participating in a 50/50 joint venture with Aminex PLC.

Over the last year, the work on the licence area has comprised a review of gas marketing opportunities in East Africa, geological and geophysical interpretation and the reprocessing of seismic data. The licence area is undrilled and contains a number of prospective structural leads at the proven Neocomian reservoir level and shallower stratigraphic leads within the Campanian section that are supported by strong seismic amplitudes.

The combined unrisked potential volumetrics for all leads in the licence area exceeds 1 Trillion Cubic Feet of gas.

Onshore Weald Basin UK

	KEY
PEDL 235 **Brockham Oil Field**	100%
PEDL 241 **Lidsey Oil Field**	100%

Since Key's ownership of these fields commenced on 30 September 2009, the Company's net production to 30 June 2010 amounted to 15,088 barrels of oil. Production operations were hindered by an intensely cold winter, the worst in the UK for 30 years, and the requirement for a workover operation on the highest producing well. Key has implemented a number of changes to field operations which have arrested the previous decline trend.

The fields are only partially developed and Key has received most of the approvals required for the drilling of its first operated well which will be a horizontal development well in the Lidsey field. It is planned that the well will be drilled in late 2010 and should access around 300m of reservoir section, as opposed to 57m with a vertical well. Reservoir models indicate that base case incremental production for the asset area should initially be around 200 to 400 Bopd.

Onshore Italy

	KEY
Borsano Permit	100%

The exploration licence lies in a heavily urbanised portion of the Northern Po Valley and the proposed drilling location lies in a built-up industrial/residential area. The Po Valley Basin contains many producing fields, some along trend with the Borsano Permit but the permit area is difficult due to site availability. The Company has sought an extension of the permit life because of this.

Offshore Italy

	KEY
Application Areas	100%

Lampedusa d 341 C.R–.PU Application
Lampedusa d 342 C.R–.PU Application
West Sardinia E.R54.PU (formerly d 90 E.R-.PU Application)
Elba d 91 E.R–.PU Application

Key's evaluation of the prospectivity of E.R54.PU commenced immediately after the area was granted exploration status on 21 April 2010. Though the area has not been actively explored for some years and currently has sparse seismic coverage, it can be shown to be prospective for deep gas and shallow oil and gas plays.

Shortly after the award of E.R54.PU, and as a precaution following BP's Macondo oil discharge in the Gulf of Mexico, the Italian Government temporarily halted offshore drilling in its territorial waters and proposed the enactment of drilling exclusion zones close to environmentally sensitive areas. At the same time, the Government suspended the awarding of new acreage, including Key's long-standing application areas. The enactment of the exclusion zones is pending and in response the Company has sought a suspension of the work commitment for E.R54.PU until exclusion zones are ratified and effects to Company acreage can be determined.

The application areas are an important part of Key's portfolio and the areas south of Lampedusa are highly regarded by the industry as they have not been actively explored since the mid 1980's and lie on an extension of productive of basins further south in Tunisian waters. Combined unrisked resources for the leads inventory in the Lampedusa areas exceed 1 Billion barrels of oil.

Onshore Suriname

	KEY
Uitkijk and Coronie Blocks	1.75%

The Company is participating in a multi-well drilling programme in Suriname, through its 50% shareholding in Portsea Oil & Gas Pty Ltd. Key has a 1.75% free carried underlying interest through an agreement with Hardman Oil and Gas Pty Ltd, a Company now owned by Tullow Oil plc. Both areas are located adjacent to Suriname's main producing oil fields, Tambaredjo and Calcutta, During the year, Portsea's interest was being registered onto the permit title, rather than as underlying interest held by Hardman Oil and Gas Pty Ltd.

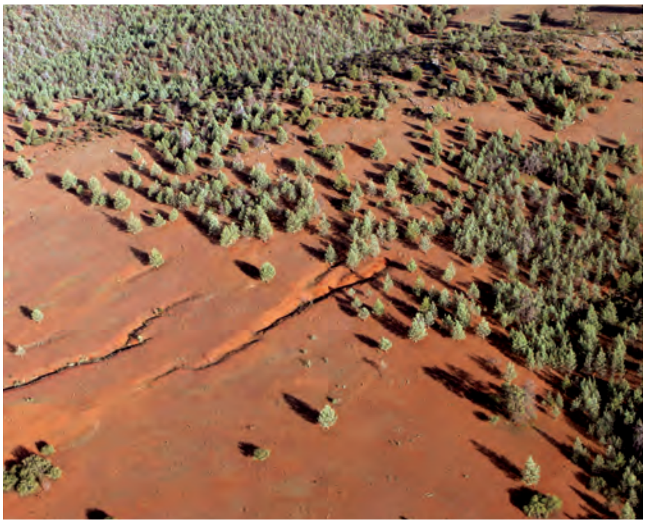
The first drilling in the Coronie Block is now scheduled for the December Quarter of 2010 with five wells planned. If these prove successful and additional 10 wells could be drilled.

The first two phases of exploration drilling under Tullow's farmin program has led to some success with 10 wells being drilled in the Uitkijk Block. A potentially economic resource has been discovered straddling the Tambaredjo block and is still undergoing evaluation but the Operator has estimated that it may have a P90 recoverable volume of 6.75 million barrels.

Onshore Australia

EP437 North Perth Basin	KEY 45%

Key's entry to this Australian venture is a departure from its previous international operations. The Company entered this permit area on very favourable terms and the area lies in an established producing region with low operating costs. Commercial discoveries in this area have the ability to deliver satisfactory returns, even from smallish fields and oil discoveries made since 2000 have created significant industry interest and company growth for participating companies. Preparations are being finalised for the drilling of two shallow farmin wells, Dunnart #1 and Dibbler #1 during October-November 2010. CalEnergy operates EP437 and the prospects lie 7 and 14km respectively north of the Dongara oil and gas field, the largest field in the basin. The Operator's unrisked P50 oil resource volume for each prospect is around 1.5 MMbo and potential payout could be achieved in around 1 ½ years.



For a more detail assessment of all our ongoing projects, please view our website: ***www.keypetroleum.com***.

Corporate Social Responsibility Report

Corporate social responsibility (CSR) is a phrase that's used a lot these days. The World Business Council for Sustainable Development has defined CSR as "the continuing commitment by companies to behave ethically and to contribute to economic development, while improving the quality of life of the workforce and their families, as well as the local community and society at large". It is not a legal requirement in some countries but at Key Petroleum we have made a conscious decision to adopt and implement this philosophy.

Being a good corporate citizen is about making a lasting commitment to giving something back to the community in which a company operates. It recognises that members of its workforce come from that local community and its potential employees may also originate from that community.

These days, a company is required to look out for more than just the interests of its shareholders; it must look after the interests of all persons who either affect, or are affected by, the business. This includes employees, customers, suppliers, community organisations and local neighbourhoods. To ensure that the Company can fulfill its commitment to be a good corporate citizen, CSR has to be interwoven into the Company's day to day operations and decision-making.

How Does The Company Do This ?

The Company needs to monitor three main areas on a regular basis. These are:

++ Social and Ethical Policy and practices.

++ Health and Safety policy and practices and

++ The Environment

Continue to Put Something Back

With the Company's move into the United Kingdom during this past year, it was decided to provide some assistance in the surrounding area of its operations. After looking for a suitable charity that could benefit from some assistance, the Company identified CLIC Sargent, a charity that had a slogan of "Answering real needs" and had a simple aim: to ease the burden of childhood cancer on children, young people and their families. The Company has focused on young person's initiatives throughout the year in its CSR activities and has also provided financial assistance to local organizations such as the Blue Light Discos and Rotary sponsored functions.

Safe and Healthy Environment

The Company has been working closely with various Environmental agencies, such as in the United Kingdom, as part of its operational requirements for its production operations and for the planning of its Lidsey drilling programme. It also works with Safety uppermost in its operations. Today, in the oil and gas industry the safety and environment are always considered before any actions are undertaken. At Key we have ongoing targets of zero LTI's (lost time incidents) in our oilfields and on any project we're involved with. We are also conscious of the need to have no material environmental impact and allow all to enjoy and live in a safe and healthy community.

Being a good corporate citizen is about making a lasting commitment to giving something back to the community in which a company operates.

Contents to the Accounts

Directors' Report

Your directors submit their report on the consolidated entity (referred to hereafter as the Group) consisting of Key Petroleum Limited and the entities it controlled at the end of, or during, the year ended 30 June 2010.

DIRECTORS

The names and details of the Company's directors in office during the year 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

Dennis Wilkins, *B.Bus, AICD, ACIS (Non Executive Chairman)*

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 22 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 Pty Ltd which provides advisory, funding and administrative management services to the resource sector. Mr Wilkins is a director of Minemakers Limited. Mr Wilkins is a former director of Marengo Mining Limited and South Boulder Mines Limited within the last 3 years.

Kenneth Russell *(Managing Director)*

Mr Russell is a petroleum engineering and production technology specialist with over 32 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 participated in the development 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 Resources Limited 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 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.

John Sheppard, *MBA, B. Eng, Met Cert, M Aus IMM, GAICD*
(Non Executive Director - appointed 31 August 2010)

Mr Sheppard is a senior executive with oil and gas, finance and business development skills. He has extensive experience in corporate governance, strategic planning, business development, mergers and acquisitions, capital development and project financing nationally and internationally in the resources and finance areas which has been built up over 42 years.

Edward Ellyard, *B.Sc.(Geology), Grad.Dip, MAusIMM, MAAPG*
(Director from 1 July 2009 until 31 August 2010.)

Mr 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 capitalisation growth from less that $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 Minemakers Limited. Mr Ellyard has not held any former directorships in the last 3 years.

Richard O'Shannassy, *B.Juris.; LL.B. (Hons)*
(Director from 1 July 2009 until 31 August 2010.)

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.

Directors' Report (cont'd)

COMPANY SECRETARY

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

Mr Ribbons is an accountant who has worked within the resources industry for over 16 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.

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 Shares	Options over Ordinary Shares
Dennis Wilkins	1,000,000	750,000
Kenneth Russell	5,815,000	2,000,000
John Sheppard	35,000	-
Edward Ellyard	6,675,000	1,000,000
Richard O'Shannassy	300,000	750,000

PRINCIPAL ACTIVITIES

The principal activities of the Group during the year 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 year. No recommendation for payment of dividends has been made.

OPERATING AND FINANCIAL REVIEW

Finance Review

The Group has recorded an operating loss after income tax for the year ended 30 June 2010 of $6,072,006 (2009: $3,136,955).

At 30 June 2010 funds available totalled $2,902,916.

Operating Results for the Year

Summarised operating results are as follows:

	2010	
	Revenues $	Results $
Geographic segments		
Australia	153,040	(3,777,287)
United Kingdom	1,090,538	(1,791,259)
Tanzania	(32)	(43,365)
Italy	427	(460,095)
Consolidated entity revenues and loss	1,243,973	(6,072,006)

Shareholder Returns

	2010	2009
Basic loss per share (cents)	(4.9)	(3.6)

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

During the year under review Key Petroleum Limited moved from being an exploration company to an oil producer after it acquired Midmar Energy Onshore Limited, a UK company which has three producing oil wells located in the UK. Subsequent to this acquisition the company was renamed Key Petroleum Weald Basin Limited.

SIGNIFICANT EVENTS AFTER THE BALANCE DATE

No matters or circumstances, besides those disclosed at note 28, have arisen since the end of the financial year which significantly affected or may significantly affect the operations of the Group, the results of those operations, or the state of affairs of the Group in future financial years.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

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

ENVIRONMENTAL REGULATION AND PERFORMANCE

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

The Group 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 year under review.

The Group is in compliance with the various environmental legislation and regulations that govern its activities in the jurisdictions in which it operates.

REMUNERATION REPORT

The information provided in this remuneration report has been audited as required by section 308(3C) of the *Corporations Act 2001*.

Principles used to determine the nature and amount of remuneration

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 Group.

The board's policy for determining the nature and amount of remuneration for board members and senior executives of the Group 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 or an agreed fee (which is based on factors such as length of service and experience) and superannuation or GST. The board reviews executive packages annually by reference to the Group'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 eligible to participate in the employee share and option arrangements.

The 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 Group. Based on each individual's timesheet, costs are allocated to exploration projects and treated in accordance with the accounting policy described at note 1(p), or expensed where the time is not allocated directly to a project. 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 Group. However, to align directors' interests with shareholder interests, the directors are encouraged to hold shares in the Company and are eligible to participate in the employee option plan.

Performance based remuneration

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

Group 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 year end, refer to note 19 of the financial statements.

Details of remuneration

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

The key management personnel of Key Petroleum Limited include the directors and company secretary as per pages 13 and 14 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*.

Directors' Report (cont'd)

Key management personnel and other executives of Key Petroleum Limited

	Short Term Benefits				Post-employment Benefits	
	Salary & Fees $	Profit Share & Bonuses $	Non Monetary $	Other $	Pension & Superannuation $	Other $
Directors						
Dennis Wilkins[1]						
2010	30,000	-	-	-	-	-
2009	30,000	-	-	-	-	-
Kenneth Russell						
2010	302,500	-	-	-	-	-
2009	284,002	-	-	-	-	-
Edward Ellyard (Resigned 31 August 2010)						
2010	46,840	-	-	-	4,126	-
2009	43,680	-	-	-	3,931	-
Richard O'Shannassy[2] (Resigned 31 August 2010)						
2010	33,750	-	-	-	-	-
2009	25,000	-	-	-	-	-
Terence Nilsen (Resigned 8 July 2008)						
2010	-	-	-	-	-	-
2009	38,470	-	-	-	3,462	-
Other key management personnel						
John Ribbons[3]						
2010	-	-	-	-	-	-
2009	-	-	-	-	-	-
Total key management personnel						
2010	413,090	-	-	-	4,126	-
2009	421,152	-	-	-	7,393	-

Long-Term Benefits		Equity-Settled Share-Based Payments				
Incentive Plans $	LSL $	Shares/ Units $	Options/ Rights $	Cash-Settled Share Based Payments $	Termination Benefits $	Total $
-	-	-	-	-	-	30,000
-	-	-	5,625	-	-	35,625
-	-	-	-	-	-	302,500
-	-	-	15,000	-	-	299,002
-	-	-	-	-	-	50,966
-	-	-	7,500	-	-	55,111
-	-	-	-	-	-	33,750
-	-	-	5,625	-	-	30,625
-	-	-	-	-	-	-
-	-	-	-	-	-	41,932
-	-	-	-	-	-	-
-	-	-	3,750	-	-	3.750
-	-	-	-	-	-	417,216
			37,500			466,045

(1) In addition to the above remuneration a total of $132,026 (2009: $116,049) was paid to DWCorporate Pty Ltd, a business of which Mr Wilkins is principal. DWCorporate Pty Ltd provided company secretarial, bookkeeping and other corporate services to the Key Group during the year. The amounts paid were at usual commercial rates with fees charged on an hourly basis.

(2) In addition to the above remuneration a total of $69,050 (2009: $54,500) was paid to Richard O'Shannassy & Co Pty Ltd, a business of which Mr O'Shannassy is principal. Richard O'Shannassy & Co Pty Ltd provided legal services. The amounts paid were at usual commercial rates.

(3) Mr Ribbons is a full-time employee of DWCorporate Pty Ltd.

Directors' Report (cont'd)

SERVICE AGREEMENTS

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

Kenneth Russell, Managing Director:

- Term of agreement – 1 year commencing 24 April 2010.
- Annual consultancy fees of $315,000 (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.

Dennis Wilkins, Finance Director:

- Term of agreement – four months written notice of termination by either party.
- Mr Wilkins' firm, DWCorporate Pty Ltd, is engaged to provide book keeping, accounting and company secretarial services. A fixed fee of $1,500 per month is payable and additional services are charged on an hourly basis. This engagement is subject to four months notification of termination.

Richard O'Shannassy, Non Executive Director:

- Mr O'Shannassy's firm, Richard O'Shannassy & Co Pty Ltd, is engaged to provide legal services. Fees are charged on an hourly basis with a minimum monthly retainer of $4,000. The agreement has no fixed term, however, one month notification of termination is required.

Share-based compensation

No shares or options were issued to directors and executives as part of their remuneration during the year.

There were no ordinary shares issued upon exercise of remuneration options to directors or other key management personnel of Key Petroleum Limited during the year. Refer to note 31 for model inputs for the options granted.

DIRECTORS' MEETINGS

During the year the Company held 13 meetings of directors. The attendance of directors at meetings of the board were:

	Directors Meetings		Meetings of Committees			
			Audit		Remuneration	
	A	B	A	B	A	B
Dennis Wilkins	13	13	2	2	1	1
Kenneth Russell	12	13	*	*	*	*
Edward Ellyard	13	13	2	2	1	1
Richard O'Shannassy	13	13	2	2	1	1

Notes

A Number of meetings attended.

B Number of meetings held during the time the director held office during the year.

* Not a member of the relevant committee.

SHARES UNDER OPTION

At the date of this report there are 5,950,000 unissued ordinary shares in respect of which options are outstanding.

	Number of options
Balance at the beginning of the year	5,750,000
Movements of share options during the year	
Issued, exercisable at 20 cents, on or before 30 November 2010	200,000
Issued, exercisable at 30 cents, on or before 30 November 2011	250,000
Cancelled, exercisable at 20 cents, on or before 30 November 2010	(250,000)
Total number of options outstanding as at 30 June 2010	5,950,000
Movements subsequent to year end:	-
Total number of options outstanding as at the date of this report	5,950,000

The balance is comprised of the following:

Expiry date	Exercise price (cents)	Number of options
30 November 2010	20	700,000
30 November 2011	30	250,000
30 November 2010	50	5,000,000
Total number of options outstanding at the date of this report		5,950,000

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 year, the Group 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 $31,208.

NON AUDIT SERVICES

The following fees were paid or payable to Mazars LLP for non audit services provided during the year ended 30th June 2010.

	Number of options
Preparation of financial statements for UK entities	8,696
Lodgement of accounts at Companies house	260
	8,956

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 Group, or to intervene in any proceedings to which the Group is a party, for the purpose of taking responsibility on behalf of the Group for all or any part of those proceedings.

No proceedings have been brought or intervened in on behalf of the Group 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 20.

Signed in accordance with a resolution of the directors.

Ken Russell
Managing Director

Perth, 30 September 2010

Audit Independence Declaration

Bentleys
Thinking ahead

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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 Limited and Controlled Entities for the year ended 30 June 2010 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

BENTLEYS	CHRIS WATTS CA
Chartered Accountants	Director

DATED at PERTH this 30th day of September 2010

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 Group 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 Group'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 Group 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 Group'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 Group.

ASX Principles of Good Corporate Governance

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

As the Group'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 board has adopted the revised Recommendations and the following table sets out the Company's present position in relation to each of the revised Principles.

Corporate Governance Statement (cont'd)

	ASX Principle	Status	Reference/comment
Principle 1:	**Lay solid foundations for management and oversight**		
1.1	Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions	A	Matters reserved for the board are included on the Company's website.
1.2	Companies should disclose the process for evaluating the performance of senior executives	N/A	Acting in its ordinary capacity, the board from time to time carries out the process of considering and determining performance issues. The remuneration of executive and non executive Directors is reviewed by the board with the exclusion of the Director concerned. The remuneration of executive management is reviewed and approved by the Board.
1.3	Companies should provide the information indicated in the Guide to reporting on Principle 1	A (in part)	
Principle 2:	**Structure the board to add value**		
2.1	A majority of the board should be independent directors	N/A	Given the Company's background, the nature and size of its business and the current stage of its development the board compromises four 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 chair should be an independent director	A	
2.3	The roles of chair and chief executive officer should not be exercised by the same individual	A	The positions of Chairman and Managing Director are held by separate persons.
2.4	The board should establish a nomination committee	N/A	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 the process.
2.5	Companies should disclose the process for evaluating the performance of the board, its committees and individual directors	N/A	Given the size of the Company, formal procedures for evaluating the performance of the board, committees and individual directors have not been developed. The Company conducts these aspects on an ongoing basis and takes action to correct any abnormalities.
2.6	Companies should provide the information indicated in the Guide to reporting on Principle 2	A (in part)	The skills and experience of Directors are set out in the Company's Annual Report and on its website.
Principle 3:	**Promote ethical and responsible decision making**		
3.1	Companies should establish a code of conduct and disclose the code or a summary of the code as to: • the practices necessary to maintain confidence in the company's integrity • the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders • the responsibility and accountability of individuals for reporting and investigating reports of unethical practices	A	The Company has formulated a Code of Conduct which can be viewed on the Company's website.

A = Adopted \| N/A = Not adopted

	ASX Principle	Status	Reference/comment
3.2	Companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy	A	The Company has formulated a securities trading policy, which can be viewed on its website.
3.3	Companies should provide the information indicated in the Guide to reporting on Principle 3	A	
Principle 4:	**Safeguard integrity in financial reporting**		
4.1	The board should establish an audit committee	A	The Company has established an audit committee which compromises three members, two being non executive independent 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 the potential benefits. In addition, the board as a whole addresses the governance aspects to 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.
4.2	The audit committee should be structured so that it:	A	
	• consists only of non executive directors	N/A	The Company only has two non executive directors.
	• consists of a majority of independent directors	A	
	• is chaired by an independent chair, who is not chair of the board	A	
	• has at least three members	A	
4.3	The audit committee should have a formal charter	A	
4.4	Companies should provide the information indicated in the Guide to reporting on Principle 4	A	
Principle 5:	**Make timely and balanced disclosure**		
5.1	Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies	A	The Company has instigated internal procedures designed to provide reasonable assurance 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 informational systems in place to ensure compliance, underpinned by experience.
5.2	Companies should provide the information indicated in the Guide to reporting on Principle 5	A	The Board receives monthly updates 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.
Principle 6:	**Respect the rights of shareholders**		
6.1	Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy	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 Reports, Half Yearly Reports, Quarterly Reports, the Company Website and the distribution of specific releases covering major transactions and events or other price sensitive information.
6.2	Companies should provide the information indicated in the Guide to reporting on Principle 6	A	The Company has formulated a Communication Policy which can be viewed on the Company website.

A = Adopted | N/A = Not adopted

Corporate Governance Statement (cont'd)

	ASX Principle	Status	Reference/comment
Principle 7:	**Recognise and manage risk**		
7.1	Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies	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: • performance and funding of exploration activities • budget control and asset protection • status of mineral tenements • land access and native title considerations • compliance with government laws and regulations • safety and the environment • continuous disclosure obligations • share market conditions • sovereign risk
7.2	The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the Company's management of its material business risks	N/A	While the Company does not have formalised policies on risk management it 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.
7.3	The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks	A	
7.4	Companies should provide the information indicated in the Guide to reporting on Principle 7	N/A	
Principle 8:	**Remunerate fairly and responsibly**		
8.1	The board should establish a remuneration committee	A	For information on the Company's Remuneration Committee refer to its website.
8.2	Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives	A	
8.3	Companies should provide the information indicated in the Guide to reporting on Principle 8	A	Refer to the Remuneration Report in the Company's Annual Report.

A = Adopted | N/A = Not adopted

Consolidated Statement of Comprehensive Income

YEAR ENDED 30 JUNE 2010

	Notes	2010 $	2009 $
REVENUE AND OTHER INCOME	2	1,243,973	501,368
EXPENDITURE			
Cost of Goods Sold		(974,903)	-
Depreciation expense		(1,211,997)	(47,506)
Salaries and employee benefits expense		(246,611)	(144,978)
Corporate expenditure		(930,102)	(179,963)
Administration costs		(1,478,604)	(1,006,119)
Exploration costs written off		(1,934,789)	(2,183,767)
Impairment expense		(503,779)	-
Share based expense	31	(32,620)	(50,325)
Share of net loss of associate accounted for using the equity method	26(c)	(2,574)	(25,665)
LOSS BEFORE INCOME TAX	3	(6,072,006)	(3,136,955)
INCOME TAX BENEFIT / (EXPENSE)	4	-	-
LOSS FOR THE YEAR		(6,072,006)	(3,136,955)
OTHER COMPREHENSIVE INCOME			
Exchange differences on translation of foreign operations		(692,476)	(76,527)
Other comprehensive income for the year, net of tax		(692,476)	(76,527)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR ATTRIBUTABLE TO MEMBERS OF KEY PETROLEUM LIMITED		(6,764,482)	(3,213,482)
Basic loss per share for loss attributable to the ordinary equity holders of the company (cents per share)	30	(4.87)	(3.60)

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

Consolidated Statement of Financial Position

AT 30 JUNE 2010

	Notes	2010 $	2009 $
CURRENT ASSETS			
Cash and cash equivalents	5	2,902,916	5,594,855
Trade and other receivables	6	594,536	150,336
Inventories	7	47,237	-
TOTAL CURRENT ASSETS		3,544,689	5,745,191
NON CURRENT ASSETS			
Receivables	8	75,254	65,046
Investment accounted for using the equity method	9	-	503,462
Plant and equipment	10	145,305	134,342
Intangible assets	11	-	2,891
Petroleum assets	12	2,787,049	-
Capitalised exploration costs	13	3,546,076	4,587,866
TOTAL NON CURRENT ASSETS		6,553,684	5,293,607
TOTAL ASSETS		10,098,373	11,038,798
CURRENT LIABILITIES			
Trade and other payables	14	667,192	181,819
TOTAL CURRENT LIABILITIES		667,192	181,819
NON CURRENT LIABILITIES			
Provisions	15	575,707	-
TOTAL NON CURRENT LIABILITIES		575,707	-
TOTAL LIABILITIES		1,242,899	181,819
NET ASSETS		8,855,474	10,856,979
EQUITY			
Issued capital	16	24,599,056	19,868,699
Reserves	17(a)	(471,169)	188,687
Accumulated losses		(15,272,413)	(9,200,407)
TOTAL EQUITY		8,855,474	10,856,979

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

Consolidated Statement of Changes in Equity

YEAR ENDED 30 JUNE 2010

	Issued Capital $	Options Reserve $	Foreign Currency Translation Reserve $	Accumulated Losses $	Total $
BALANCE AT 1 JULY 2008	19,868,699	226,232	(11,343)	(6,063,452)	14,020,136
Loss for the year	-	-	-	(3,136,955)	(3,136,955)
OTHER COMPREHENSIVE INCOME					
Exchange differences on translation of foreign operations	-	-	(76,527)	-	(76,527)
TOTAL COMPREHENSIVE INCOME	-	-	(76,527)	(3,136,955)	(3,213,482)
TRANSACTIONS WITH OWNERS IN THEIR CAPACITY AS OWNERS					
Employee options	-	50,325	-	-	50,325
BALANCE AT 30 JUNE 2009	19,868,699	276,557	(87,870)	(9,200,407)	10,856,979
Loss for the year	-	-	-	(6,072,006)	(6,072,006)
OTHER COMPREHENSIVE INCOME					
Exchange differences on translation of foreign operations	-	-	(692,476)	-	(692,476)
TOTAL COMPREHENSIVE INCOME	-	-	(692,476)	(6,072,006)	(6,764,482)
TRANSACTIONS WITH OWNERS IN THEIR CAPACITY AS OWNERS					
Employee options	-	32,620	-	-	32,620
Shares issued during the year	4,730,357	-	-	-	4,730,357
BALANCE AT 30 JUNE 2010	24,599,056	309,177	(780,346)	(15,272,413)	8,855,474

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

Consolidated Statement of Cash Flows

YEAR ENDED 30 JUNE 2010

	Notes	2010 $	2009 $
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from customers		912,215	-
Payments to suppliers and employees		(3,234,574)	(1,336,928)
Interest received		153,862	350,699
Other revenue		-	178,904
Expenditure on petroleum interests		(915,423)	(2,304,248)
NET CASH (OUTFLOW) FROM OPERATING ACTIVITIES	29	(3,083,920)	(3,111,573)
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for plant and equipment		(25,733)	(48,194)
Payments for subsidiaries, net of cash acquired	24(c)	(202,384)	-
Loan to associate company		-	(3,478)
Payment for bank guarantee		-	(31,719)
NET CASH (OUTFLOW) FROM INVESTING ACTIVITIES		(228,117)	(83,391)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issues of ordinary shares and options		4,635,357	-
Repayment of borrowings		(4,001,662)	-
NET CASH INFLOW FROM FINANCING ACTIVITIES		633,695	-
NET (DECREASE) IN CASH AND CASH EQUIVALENTS		(2,678,342)	(3,194,964)
Cash and cash equivalents at the beginning of the financial year		5,594,855	8,777,786
Effects of exchange rate changes on cash and cash equivalents		(13,597)	12,033
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	5	2,902,916	5,594,855

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

Notes to the Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial statements are for the consolidated entity consisting of Key Petroleum Limited and its subsidiaries. The financial statements are presented in the Australian currency. Key Petroleum Limited is a company limited by shares, domiciled and incorporated in Australia. The financial statements were authorised for issue by the directors on 30 September 2010. The directors have the power to amend and reissue the financial statements.

(a) Basis of preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Australian Accounting Interpretations and the *Corporations Act 2001*.

Compliance with IFRS

The consolidated financial statements of the Key Petroleum Limited Group comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

Accruals basis

These financial statements have been prepared on an accruals basis and are based on historical costs, modified, where applicable, by the measurement at fair value of selected non-current assets, financial assets and financial liabilities.

Financial statement presentation

The Group has applied the revised AASB 101 Presentation of Financial Statements which became effective on 1 January 2009. The revised standard requires the separate presentation of a statement of comprehensive income and a statement of changes in equity. All non-owner changes in equity must now be presented in the statement of comprehensive income. As a consequence, the Group had to change the presentation of its financial statements. Comparative information has been re-presented so that it is also in conformity with the revised standard.

Going concern

The accounts have been prepared on the going concern basis, which contemplates continuity of normal activities and the realisation of assets and settlement of liabilities in the ordinary course of business. The Group incurred a loss from general business activities of $6,072,006 for the year ended 30 June 2010 (2009: $3,136,955 loss). Included within this loss was the write off of exploration expenditure of $1,934,789 (2009: $2,183,767).

The net working capital position of the Group at 30 June 2010 was $2,857,649 (2009: $5,563,372) and the net decrease in cash held during the year was $2,830,260 (2009: $3,182,931). Since the end of the financial year the Company has raised $1,033,600 through a share placement and plans to undertake further capital raisings in the near future.

The Group has expenditure commitments relating to work programme obligations of their assets of $20,045,000 which potentially could fall due in the twelve months to 30 June, 2011. $9,300,000 of these commitments relate to the drilling of two wells in the Tanzanian Nyuni block where the Kiliwani North gas discovery has been made and plans for development of that gas field are progressing. The Group believes that at this stage it is likely that only one of these two wells will be drilled before 30 June 2011.

The Group is undertaking a process to divest its interests in these Tanzanian assets to take advantage of the increased focus by the larger oil and gas companies on the east coast of Africa that is being seen. A successful divestment would reduce the Group's commitment obligations by $15,100,000, should they fall due before 30 June 2011. The Group is currently in talks with several interested parties who are evaluating these assets however there can be no guarantee that divestment will occur.

If the divestment process is unsuccessful it is the Group's intention to raise capital in the next three months to meet the commitments related to this first Nyuni well. A requirement to drill a well in the Tanzanian West Songo Songo block in the first half of 2011 also exists however, drill rig availabilities may limit the Group's ability to drill within this timeframe. Expenditure commitments in Italy are in question at this time due to uncertainties relating to changes in environmental laws and drilling exclusion zones that are being proposed. The Group has made applications to suspend work programme requirements and obligations on its Italian permits until these uncertainties have been clarified by the Italian government and the Ministry of Economics. The Group believes the suspension approval will be granted shortly by the Ministry of Economics.

Commitments related to the drilling of the two wells, Dunnart and Dibbler that are currently expected to commence during October 2010 in the North Perth Basin are fully funded.

The ability of the Group to continue to pay its debts as and when they fall due is dependent upon the Company successfully raising additional share capital, continuing to enhance and develop its oil producing assets, possibly divesting some assets and ultimately developing its other assets.

Should the Group not be successful in its planned capital raisings, it may be necessary to sell some of its assets, farm out exploration projects and/or reduce exploration expenditure by various methods including surrendering or withdrawing from less prospective tenements. Should the Company be unable to raise the funds to meet its commitments in Tanzania, it is possible that the Group would default on one or both of its joint venture obligations. There is also a possibility that the Group could then be subjected to claims by its joint venture partners for failing to meet its financial obligations and damages for losses which may arise.

Although the Directors believe that they will be successful in these measures, if they are not, the Group may be unable to continue as a going concern and therefore may be unable to realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial statements. The Directors also recognise, that should the Group fail to secure the required funding to maintain its assets in good standing then the Directors would then be in

Notes to the Financial Statements (cont'd)

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

a position whereby they could not commit to further capital expenditure on them. The consequences of this eventuating are that some of the Group's asset values could be severely impaired or even lost.

However, whilst bearing all of the above comments in mind, in light of the Group's current exploration and development projects , the Directors believe it is appropriate to prepare these accounts on a going concern basis because they have an ongoing and appropriate business plan which includes raising additional funds as and when required.

(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 2010 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 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 acquisition method of accounting is used to account for business combinations by the Group (refer note 1(h)).

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.

Non-controlling interests in the results and equity of subsidiaries are shown separately in the consolidated statement of comprehensive income, statement of changes in equity and statement of financial position respectively.

Investments in subsidiaries are accounted for at cost in the separate 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 statement of comprehensive income, 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 statement of comprehensive income, 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.

(iv) Changes in ownership interests

The Group treats transactions with non-controlling interests that do not result in a loss of control as transactions with equity owners of the Group. A change in ownership interest results in an adjustment between the carrying amounts of the controlling and non-controlling interests to reflect their relative interests in the subsidiary. Any difference between the amount of the adjustment to non-controlling interests and any consideration paid or received is recognised in a separate reserve within equity attributable to owners of Key Petroleum Limited.

When the Group ceases to have control, joint control or significant influence, any retained interest in the entity is remeasured to its fair value with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, jointly controlled entity or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

If the ownership interest in a jointly controlled entity or associate is reduced but joint control or significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

(v) Changes in accounting policy

The Group has changed its accounting policy for transactions with non-controlling interests and the accounting for loss of control, joint control or significant influence from 1 July 2009 when a revised AASB 127 Consolidated and Separate Financial Statements became operative. The revisions to AASB 127 contained consequential amendments to AASB 128 Investments in Associates and AASB 131 Interests in Joint Ventures.

Previously transactions with non-controlling interests were treated as transactions with parties external to the Group. Disposals therefore resulted in gains or losses in profit or loss and purchases resulted in the recognition of goodwill. On disposal or partial disposal, a proportionate interest in reserves attributable to the subsidiary was reclassified to profit or loss or directly to retained earnings.

Previously when the Group ceased to have control, joint control or significant influence over an entity, the carrying amount of the investment at the date control, joint control or significant influence ceased became its cost for the purposes of subsequently accounting for the retained interests as associates, jointly controlled entity of financial assets.

The Group has applied the new policy prospectively to transactions occurring on or after 1 July 2009. As a consequence, no adjustments were necessary to any of the amounts previously recognised in the financial statements.

(c) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the full Board of Directors.

Change in accounting policy

The Group has adopted AASB 8 Operating Segments from 1 July 2009. AASB 8 replaces AASB 114 Segment Reporting. The new standard requires a 'management approach', under which segment information is presented on the same basis as that used for internal reporting purposes. There has been no change to the reportable segments required to meet the new standard.

(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 profit or loss, 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 statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- income and expenses for each statement of comprehensive income 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 in other comprehensive income.

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 recognised in other comprehensive income. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences is reclassified to profit or loss, 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

The consolidated entity's revenue is derived primarily from oil sales. Sales revenue is recognised when the physical product and associated risks and rewards of ownership pass to the purchaser. This is generally at the time of delivery to the purchaser's premises. 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 (cont'd)

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

(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.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Company's subsidiaries and associated operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

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 is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

(g) Leases

Leases of property, plant and equipment where the Group, 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 profit or loss 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 Group 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 profit or loss 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 statement of comprehensive income, 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 statement of cash flows 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 statement of financial position.

(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 Group 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 statement of financial position.

(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 Group 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.

Notes to the Financial Statements (cont'd)

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

Recognition and derecognition

Regular purchases and sales of financial assets are recognised on trade-date – the date on which the Group 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 statement of comprehensive income. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group 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 statement of comprehensive income 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 statement of comprehensive income 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 statement of comprehensive income as part of revenue from continuing operations when the Group'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 are determined are disclosed in note 33.

Impairment

The Group 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 statement of comprehensive income. Impairment losses recognised in the statement of comprehensive income on equity instruments classified as available-for-sale are not reversed through the statement of comprehensive income.

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 statement of comprehensive income.

(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 Group 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 statement of comprehensive income 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 statement of comprehensive income. When revalued assets are sold, it is Group 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 34).

(o) Petroleum assets

Petroleum assets are measured on the cost basis less amortisation and impairment losses. The carrying amount of petroleum assets is reviewed bi-annually by Directors to ensure that it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows that will be received from the assets employment and subsequent disposal. The expected net cash flows have been discounted to their present values in determining recoverable amounts.

Amortisation

Amortisation of petroleum and gas licences, production facilities, field equipment and buildings are determined based on the proven and probable hydrocarbon reserves.

(p) 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.

(q) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(r) Trade and other payables

These amounts represent liabilities for goods and services provided to the Group 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.

(s) 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 Group 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.

(t) Provisions

Provisions are recognised when the Group has a legal or constructive obligation, as a result of past events, for which it is probable that an outflow of economic benefits will result and that outflow can be reliably measured.

(u) 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.

(v) Earnings per share

(i) Basic earnings per share

Basic earnings per share is calculated by dividing the profit attributable to owners 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.

(w) 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 statement of financial position.

Notes to the Financial Statements (cont'd)

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

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.

(x) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2010 reporting periods. The Group's assessment of the impact of these new standards and interpretations is set out below.

AASB 2009-8 Amendments to Australian Accounting Standards – Group Cash-Settled Share-based Payment Transactions [AASB 2] (effective from 1 January 2010)

The amendments made by the AASB to AASB 2 confirm that an entity receiving goods or services in a Group share-based payment arrangement must recognise or expense for those goods or services regardless of which entity in the Group settles the transaction or whether the transaction is settled in shares or cash. They also clarify how the Group share-based payment arrangement should be measured, that is, whether it is measured as an equity or a cash-settled transaction. The Group will apply these amendments retrospectively for the financial reporting period commencing on 1 July 2010. There will be no impact on the Group's financial statements.

AASB 2009-10 Amendments to Australian Accounting Standards – Classification of Rights Issues [AASB 132] (effective from 1 February 2010)

In October 2009 the AASB issued an amendment to AASB 132 Financial Instruments: Presentation which addresses the accounting for addresses for rights issues that are denominated in a currency other than the functional currency of the issuer. Provided certain conditions are met, such rights issues are now classified as equity regardless of the currency in which the exercise price is denominated. Previously, these issues had to be accounted for as derivative liabilities. The amendment must be applied retrospectively in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors. The Group will apply the amended standard from 1 July 2010. As the Group has not made any such rights issues, the amendment will not have any effect on the Group's financial statements.

AASB 9 Financial Instruments and AASB 2009-11 Amendments to Australian Accounting Standards arising from AASB 9 (effective from 1 January 2013)

AASB 9 Financial Instruments addresses the classification and measurement of financial assets and is likely to affect the Group's accounting for its financial assets. The standard is not applicable until1 January 2013 but is available for early adoption. The group is yet to assess its full impact. The Group has not yet decided when to adopt AASB 9.

Revised AASB 124 Related Party Disclosures and AASB 2009-12 Amendments to Australian Accounting Standards (effective from 1 January 2011)

In December 2009 the AASB issued a revised AASB 124 Related Party Disclosures. It is effective for accounting periods beginning on or after 1 January 2011 and must be applied retrospectively. The amendment removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities and clarifies and simplifies the definition of a related party. The Group will apply the amended standard from 1 July 2011. The amendments are not expected to have a significant impact on the financial statements of the Group.

AASB Interpretation 19 Extinguishing financial liabilities with equity instruments and AASB 2009-13 Amendments to Australian Accounting Standards arising from Interpretation 19 (effective from 1 July 2010)

AASB Interpretation 19 clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the entity issuing its own equity instruments to the creditor (debt for equity swap). It requires a gain or loss to be recognised in profit or loss which is measured as the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued. The Group will apply the interpretation from 1 July 2010, with retrospective application required. The Group has not yet determined the potential effect of the interpretation.

(y) 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 Group'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.

Share-based payments

Share-based payment transactions, in the form of options to acquire ordinary shares, are valued using the Black-Scholes option pricing model. This model uses assumptions and estimates as inputs.

2. REVENUE AND OTHER INCOME

	Notes	2010 $	2009 $
From continuing operations			
Sales revenue			
Oil Sales		1,090,538	-
Other revenue			
Interest from financial institutions		153,435	322,464
Other income			
Net foreign exchange gain		-	178,904
		1,243,973	501,368

3. EXPENSES

	Notes	2010 $	2009 $
Loss before income tax includes the following specific expenses:			
Defined contribution superannuation expense		50,776	62,539
Impairment of Goodwill		2,891	-
Impairment of Investment		500,888	-
Minimum lease payments relating to operating leases		112,185	92,206

4. INCOME TAX

	Notes	2010 $	2009 $
(a) Income tax expense			
Current tax		-	-
Deferred tax		-	-
		-	-

(b) Reconciliation of income tax expense to prima facie tax payable

The prima facie tax payable on profit from ordinary activities before income tax is reconciled to the income tax expense as follows:

	2010 $	2009 $
Loss from continuing operations before income tax expense	(6,072,006)	(3,136,955)
Prima facie tax benefit at the Australian tax rate of 30%	(1,821,602)	(941,086)
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Share of associate loss	772	7,700
Exploration expenditure written off	580,437	655,130
Impairment of Investments	150,266	-
Impairment of Goodwill	867	-
Sundry items	206,831	(37,651)
	(882,429)	(315,907)
Movements in unrecognised temporary differences	(1,050)	(256,865)
Tax effect of current year tax losses for which no deferred tax asset has been recognised	883,479	572,772
Income tax expense	-	-

Notes to the Financial Statements (cont'd)

4. INCOME TAX (cont'd)

	Notes	2010 $	2009 $
(c) Deferred Tax Assets			
Employee entitlements		17,362	11,362
Capital raising costs and other section 40-880 deductions		140,132	165,871
Tax losses		130,498	-
		287,992	177,233
Set off deferred tax liabilities	4(d)	(287,992)	(177,233)
Net deferred tax assets		-	-
(d) Deferred Tax Liabilities			
Accrued interest revenue		20,092	873
Capitalised exploration and evaluation costs		267,900	176,360
		287,992	177,233
Set-off deferred tax assets	4(c)	(287,992)	(177,233)
Net deferred tax liabilities		-	-
(e) Tax Losses			
Unused tax losses and deferred tax asset for which no deferred tax asset has been recognised		6,540,207	1,189,034
		6,540,207	1,189,034

Potential deferred tax assets attributable to tax losses and exploration expenditure carried forward have not been brought to account at 30 June 2010 because the directors do not believe it is appropriate to regard realisation of the deferred tax assets as probable at this point in time. These benefits will only be obtained if:

i. the Group derives future assessable income of a nature and of an amount sufficient to enable the benefit from the deductions for the loss and exploration expenditure to be realised;

ii. the Group continues to comply with conditions for deductibility imposed by law; and

iii. no changes in tax legislation adversely affect the Group in realising the benefit from the deductions for the loss and exploration expenditure.

5. CURRENT ASSETS - CASH AND CASH EQUIVALENTS

	Notes	2010 $	2009 $
Cash at bank and in hand		602,916	772,379
Short-term deposits		2,300,000	4,822,476
Cash and cash equivalents as shown in the statement of financial position and the statement of cash flows		2,902,916	5,594,855

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.

6. CURRENT ASSETS - TRADE AND OTHER RECEIVABLES

	Notes	2010 $	2009 $
Trade receivables		378,236	115,182
Other receivables		216,300	35,154
		594,536	150,336

Credit Risk – Trade and Other Receivables

The Group has a no significant concentration of credit risk with respect to any single counter party or group of counterparties other than those receivables specifically provided for and mentioned within Note 33. The class of assets described as Trade and Other Receivables is considered to be the main source of credit risk related to the group.

On a geographical basis, the Group has credit risk exposures in Australia and the United Kingdom given the operations in those regions. The Group's exposure to credit risk for receivables at the end of the reporting period in those regions is as follows:

AUD

Australia	143,757	143,362
United Kingdom	430,842	-
	574,599	143,362

The following table details the Group's trade and other receivables exposed to credit risk with ageing analysis and impairment provided for thereon. Amounts are considered to be 'past due' when the debt has not been settled, with the terms and conditions agreed between the Group and the customer or counterparty to the transaction. Receivables that are past due are assessed for impairment by ascertaining solvency of the debtors and are provided for where there are specific circumstances indicating that the debt may not be fully repaid to the Group.

The balances of receivables that remain within initial trade terms (as detailed in the table) are considered to be of high credit quality.

	Gross Amount	Past due and impaired	Past due but not impaired (days overdue)				Within initial trade terms
			< 30	31 - 60	61 - 90	> 90	
	$	$	$	$	$	$	$
2010							
Trade receivables	378,236	-	-	-	-	-	378,236
Other receivables	216,300	-	-	-	-	-	216,300
Total	594,536	-	-	-	-	-	594,536
2009							
Trade receivables	115,182	-	-	-	-	-	115,182
Other receivables	35,154	-	-	-	-	-	35,154
Total	150,336	-	-	-	-	-	150,336

7. CURRENT ASSETS - INVENTORY

	Notes	2010 $	2009 $
Petroleum products at cost		13,786	-
Chemical stocks at cost		33,451	-
		47,237	-

Notes to the Financial Statements (cont'd)

8. NON-CURRENT ASSETS – RECEIVABLES

	Notes	2010 $	2009 $
Bank guarantees		62,275	59,945
Loan to associate company		8,101	5,101
Other non-current receivables		4,878	-
		75,254	65,046

The recovery of the carrying value of loans to subsidiaries (refer note 32) and loan to associate company is dependent on the successful development and commercial exploitation, or alternatively, sale of the respective exploration areas of interest. 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.

9. NON-CURRENT ASSETS – INVESTMENT ACCOUNTED FOR USING THE EQUITY METHOD

	Notes	2010 $	2009 $
Shares in associate company	26	-	503,462

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.

10. NON-CURRENT ASSETS - PLANT AND EQUIPMENT

	Notes	2010 $	2009 $
Plant and equipment			
Cost		539,317	237,389
Accumulated depreciation		(394,012)	(103,047)
Net book amount		145,305	134,342
Plant and equipment			
Opening net book amount		134,342	132,509
Additions		63,569	49,339
Depreciation charge		(52,606)	(47,506)
Closing net book amount		145,305	134,342

11. NON-CURRENT ASSETS – INTANGIBLE ASSETS

	Notes	2010 $	2009 $
Goodwill			
Cost		2,891	2,891
Accumulated impairment		(2,891)	-
Net book amount		-	2,891
Goodwill			
Opening net book amount		2,891	-
Additions - acquisition		-	2,891
Impairment		(2,891)	-
Closing net book amount		-	2,891

12. NON CURRENT ASSETS – PETROLEUM ASSETS

	Notes	2010 $	2009 $
Petroleum assets at cost		3,944,042	-
Less accumulated amortisation		(1,156,993)	-
Total petroleum assets		2,787,049	-
Reconciliation of movement in petroleum assets			
Opening net book amount		-	-
Additions		13,806	-
Acquisitions		3,930,236	-
Amortisation expense		(1,156,993)	-
Closing net book amount		2,787,049	-

13. NON-CURRENT ASSETS –CAPITALISED EXPLORATION COSTS

	Notes	2010 $	2009 $
Exploration, evaluation and development costs carried forward in respect of areas of interest			
Pre production			
Opening net book amount		4,587,866	4,579,031
Capitalised exploration and evaluation costs		892,999	2,192,602
Exploration and evaluation costs written off		(1,934,789)	(2,183,767)
Closing net book amount		3,546,076	4,587,866

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.

14. CURRENT LIABILITIES - TRADE AND OTHER PAYABLES

	Notes	2010 $	2009 $
Trade payables		549,144	134,625
Other payables and accruals		118,048	47,194
		667,192	181,819

15. NON CURRENT LIABILITIES - PROVISIONS

	Notes	2010 $	2009 $
Site Restoration Provision			
Opening balance		-	-
Purchase of controlled entity		555,986	-
Unwind discount		19,721	-
Amount capitalised		-	-
Closing balance		575,707	-

Provision for Site Restoration

A provision has been recognised for the costs to be incurred for the restoration of the oil well sites in the United Kingdom. It is anticipated that the sites will require restoration within the next five years if no further discoveries are made.

Notes to the Financial Statements (cont'd)

16. ISSUED CAPITAL

	Notes	2010 Number of shares	2010 $	2009 Number of shares	2009 $
(a) Share capital					
Ordinary shares fully paid	16(b), 16(d)	130,175,518	24,599,056	86,000,005	19,868,699
Total issued capital		130,175,518	24,599,056	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
– Rights issue at 11 cents per share		43,175,513	4,749,307	-	-
– New shares issued		1,000,000	95,000	-	-
– Share issue transaction costs		-	(113,950)	-	-
End of the financial year		130,175,518	24,599,056	86,000,005	19,868,699

(c) Movements in options on issue

	Number of options 2010	Number of options 2009
Beginning of the financial year	5,750,000	44,225,002
Issued during the year:		
– Exercisable at 20 cents, on or before 30 November 2010	200,000	750,000
– Exercisable at 30 cents, on or before 30 November 2011	250,000	-
– Exercisable at 50 cents, on or before 30 November 2010	-	5,000,000
Expired/cancelled during the year		
– Exercisable at 20 cents, on or before 30 November 2010	(250,000)	-
– Exercisable at 35 cents, on or before 31 March 2010 (listed)	-	(44,000,002)
– Exercisable at 35 cents, on or before 31 March 2010 (unlisted)	-	(225,000)
End of the financial year	5,950,000	5,750,000

(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.

(e) Capital risk management

The Group'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.

Refer to Note 1 for managements plans to remain a going concern. The working capital position of the Group at 30 June 2010 and 30 June 2009 are as follows:

	Notes	2010 $	2009 $
Cash and cash equivalents		2,902,916	5,594,855
Trade and other receivables		594,536	150,336
Trade and other payables		(667,192)	(181,819)
Working capital position		2,830,260	5,563,372

17. RESERVES

	Notes	2010 $	2009 $
(a) Reserves			
Foreign currency translation reserve		(780,346)	(87,870)
Share-based payments reserve		309,177	276,557
		(471,169)	188,687
Movements:			
Foreign currency translation reserve			
Balance at beginning of year		(87,870)	(11,343)
Currency translation differences arising during the year		(692,476)	(76,527)
Balance at end of year		(780,346)	(87,870)
Share-based payments reserve			
Balance at beginning of year		276,557	226,232
Employees and contractors option expense		32,620	50,325
Amounts paid for listed options issued during the year		-	-
Balance at end of year		309,177	276,557

(b) 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)

19. KEY MANAGEMENT PERSONNEL DISCLOSURES

(a) Key management personnel compensation

	Notes	2010 $	2009 $
Short-term benefits		413,090	421,152
Post employment benefits		4,126	7,393
Other long-term benefits		-	-
Termination benefits		-	-
Share-based payments		-	37,500
		417,216	466,045

Detailed remuneration disclosures are provided in the remuneration report on pages 15 to 17.

(b) Equity instrument disclosures relating to key management personnel

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

No options were provided as remuneration to key management personnel in 2010.

(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:

	Balance at start of the year	Granted as compensation	Exercised	Other changes	Balance at end of the year	Vested and exercisable	Unvested
2010							
Directors of Key Petroleum Limited							
Dennis Wilkins	750,000	-	-	-	750,000	750,000	-
Kenneth Russell	2,000,000	-	-	-	2,000,000	2,000,000	-
Edward Ellyard (Resigned 31 August 2010)	1,000,000	-	-	-	1,000,000	1,000,000	-
Richard O'Shannassy (Resigned 31 August 2010)	750,000	-	-	-	750,000	750,000	-
Other key management personnel of the Group							
John Ribbons	500,000	-	-	-	500,000	500,000	-

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

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

(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 Group, including their personally related parties, are set out below. There were no shares granted during the reporting period as compensation.

	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
2010				
Directors of Key Petroleum Limited				
Ordinary shares				
Dennis Wilkins	1,000,000	-	-	1,000,000
Kenneth Russell	5,565,000	-	250,000	5,815,000
Edward Ellyard (Resigned 31 August 2010)	4,450,000	-	2,225,000	6,675,000
Richard O'Shannassy (Resigned 31 August 2010)	200,000	-	100,000	300,000
Other key management personnel of the Group				
Ordinary shares				
John Ribbons	600,005	-	-	600,005

	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
2009				
Directors of Key Petroleum Limited				
Ordinary shares				
Dennis Wilkins	1,000,000	-	-	1,000,000
Kenneth Russell	5,565,000	-	-	5,565,000
Edward Ellyard	4,050,000	-	400,000	4,450,000
Richard O'Shannassy	200,000	-	-	200,000
Terence Nilsen	1,000,000	-	(1,000,000)	-
Other key management personnel of the Group				
Ordinary shares				
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.

A total of $132,026 (2009: $116,049) was paid to DWCorporate Pty Ltd, a business of which Mr Wilkins is principal. DWCorporate Pty Ltd provided company secretarial, bookkeeping and other corporate services to the Key Group during the year. The amounts paid were at usual commercial rates with fees charged on an hourly basis.

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.

Notes to the Financial Statements (cont'd)

20. REMUNERATION OF AUDITORS

	Notes	2010 $	2009 $
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		31,450	27,700
Mazars – audit of UK financial reports		10,435	-
Total remuneration for audit services		41,885	27,700
Non audit services			
Mazars		8,956	-
Total remuneration for non audit services		8,956	-

21. CONTINGENCIES

A contingent liability exists in relation to the purchase of Puma Petroleum S.r.l which occurred in 2007. Key Petroleum Limited will issue:

- 400,000 Key shares upon the granting of an Exploration Permit for the second Offshore Block.
- 200,000 Key shares upon the granting of an Exploration Permit for the third Offshore Block
- 400,000 Key shares upon the granting of an extension of permission to drill on the Borsano Permit.

In relation to the Group's interest in the West Songo Songo joint venture correspondence has been received from its joint venture participant's legal representative notifying the Company of its obligations under the West Songo Songo Production Sharing Agreement. The Company's response has been that it is fully aware of its obligations as Operator and of its work commitments. The directors believe the issues raised in the correspondence will be able to be satisfactorily resolved.

There are no material contingent assets of the Group 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:

	Notes	2010 $	2009 $
within one year		20,045,000	932,250
later than one year but not later than five years		5,956,000	14,356,650
		26,001,000	15,288,900

(b) Lease commitments: Group as lessee

Operating leases (non cancellable):		
Minimum lease payments		
within one year	113,241	88,520
later than one year but not later than five years	84,931	66,390
Aggregate lease expenditure contracted for at reporting date but not recognised as liabilities	198,172	154,910

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 the remuneration report on pages 15 to 17 that are not recognised as liabilities and are not included in the key management personnel compensation.

	Notes	2010 $	2009 $
within one year		88,750	251,667
later than one year but not later than five years		-	-
		88,750	251,667

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

Loan to associate

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 2010 is $8,101 (2009: $5,101).

24. BUSINESS COMBINATIONS

Current period

(a) Summary of acquisitions

Key Petroleum (UK) Limited, a United Kingdom registered private company, was incorporated on 28 July 2009 with Key Petroleum Limited being the sole shareholder.

On 30 September 2009 Key Petroleum (UK) Limited acquired 100% of the issued share capital of Midmar Energy Onshore Limited, a company registered in the United Kingdom. Subsequently the name of the acquired entity has been changed to Key Petroleum Weald Basin Limited.

As part of the acquisition the Company acquired third party borrowings of $3,648,800. These were repaid on the day of the acquisition.

The acquired business contributed $1,090,538 revenue and a loss of $1,529,893 to the Group for the period from 30 September 2009 to 30 June 2010. If the acquisition had occurred on 1 July 2009, consolidated revenue and consolidated loss for the year ended 30 June 2010 would have been $2,102,628 and $6,148,328 respectively.

At the date of acquisition, the acquired entity was involved in oil production in England.

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

	$
Purchase consideration (refer to (c) page 48):	
Cash paid	297,494
Total purchase consideration	297,494
Fair value of net identifiable assets acquired (refer to (b) page 48)	297,494
Goodwill	-

Notes to the Financial Statements (cont'd)

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	95,110	95,110
Trade and other receivables	258,300	258,300
Inventory	65,810	65,810
Plant and equipment	37,834	37,834
Petroleum permits and capitalised exploration costs	6,624,359	4,164,434
Trade and other payables	(119,208)	(119,208)
Borrowings	(3,648,800)	(3,648,800)
Provisions	(555,986)	(555,986)
Net identifiable assets acquired	2,757,419	297,494

(c) Purchase consideration

	Notes	2010 $	2009 $
Outflow of cash to acquire business, net of cash acquired			
Cash consideration		297,494	-
Less: Balances acquired			
Cash and cash equivalents		(95,110)	-
Outflow of cash		202,384	-

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*	
			2010 %	2009 %
Puma Petroleum S.r.l.	Italy	Ordinary	100	100
Key Petroleum (Australia) Pty Ltd	Australia	Ordinary	100	100
Funguo Petroleum Pty Limited	Tanzania	Ordinary	100	100
Key Petroleum (UK) Limited	England	Ordinary	100	-
Key Petroleum Weald Basin Limited	England	Ordinary	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 2010 %	Ownership Interest 2009 %	Consolidated 2010 $	Consolidated 2009 $
Unlisted					
Portsea Oil & Gas Pty Ltd	Oil and gas exploration	50	50	-	503,462

The above associate was incorporated in Australia.

(b) Movements in carrying amount

	2010 $	2009 $
Carrying amount at the beginning of the year	503,462	529,127
Share of loss after income tax	(2,574)	(25,665)
Impairment of Investment	(500,888)	-
Carrying amount at the end of the year	-	503,462

(c) Share of associate profit or loss

	2010 $	2009 $
Loss before income tax	(2,574)	(25,665)
Income tax	-	-
Loss after income tax	(2,574)	(25,665)

(d) Summarised financial information of associate

	Gross Amount of: Assets $	Liabilities $	Revenues $	Loss $
2010				
Portsea Oil & Gas Pty Ltd	5,695	203,917	1	(5,150)
2009				
Portsea Oil & Gas Pty Ltd	5,008	198,080	137,127	(51,329)

(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 2010.

27. INTERESTS IN JOINT VENTURES

Tanzanian Agreement - Nyuni

Key Petroleum Limited owns 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 Agreement – West Songo Songo

Key Petroleum Limited, through its wholly owned subsidiary Funguo Petroleum Pty Ltd, owns a 50% interest in a Production Sharing Contract with the Government of the Republic of Tanzania in respect of the West Songo Songo area.

Notes to the Financial Statements (cont'd)

28. EVENTS OCCURRING AFTER THE STATEMENT OF FINANCIAL POSITION DATE

1. In the 23rd July, 2010 the Company issued 19,501,887 ordinary shares at 5.3 cents. The proceeds will be used to drill two oil wells in the North Perth Basin and for working capital purposes. This issue was approved and ratified at a shareholder meeting held on the 31st August 2010.
2. On the 8th September, the Company allotted 8,200,000 unlisted options in the Company on a 1 for 2 basis, with an exercise price of $0.075 per option to those investors who subscribed to 4 million shares or more. Expiry of the options will be on 30th November 2011. The grant of these options were approved at a shareholder meeting held on the 31st August 2010.
3. On the 30th August, 2010 the Company announced that it had finalised a Farm-In and Joint Venture Agreement with CalEnergy Resources (Australia) Limited for its interest in the North Perth Basin exploration permit EP 437. Key will earn a 45% interest in the EP 437 permit by agreeing to pay 60% of drilling costs with those drilling costs being capped at $2.25 million, thereafter Key's contribution will decrease to 45%. Drilling will commence in October 2010 subject to rig availability.
4. On the 31st August 2010, Mr John Sheppard was appointed to the Board as a Non-Executive Director. Mr Sheppard is a senior executive with oil and gas, finance and business development skills. He has extensive experience in corporate governance, strategic planning, business development, mergers and acquisitions, capital development and project financing nationally and internationally in the resources and finance areas which has been built up over 42 years.
5. On the 31st August 2010, Mr Edward Ellyard and Mr Richard O'Shannassy resigned from the Board.

29. STATEMENT OF CASH FLOWS

	Notes	2010 $	2009 $
(a) Reconciliation of net loss after income tax to net cash outflow from operating activities			
Net loss for the year		(6,072,006)	(3,136,955)
Non Cash Items			
Depreciation of non current assets		1,211,997	47,506
Employee and contractors options expense		32,620	50,325
Share of loss of associate		2,574	25,665
Impairment expense		503,779	-
Net exchange differences		(3,013)	(93,142)
Change in operating assets and liabilities, net of effects from purchase of controlled entity			
Decrease/(increase) in trade and other receivables		(205,240)	37,847
(Increase)/decrease in inventories		16,246	-
(Decrease)/increase in provisions		39,378	-
(Increase)/decrease in petroleum permits and capitalised exploration costs		1,019,366	(764)
(Decrease)/increase in trade and other payables		370,379	(42,055)
Net cash outflow from operating activities		(3,083,920)	(3,111,573)

(b) Non-cash financing and investing activites

(i) Share issue

1,000,000 ordinary shares were issued at 30 cents as a result of the granting of the Exploration Permit for West Sardinia as part of the consideration for the purchase of Puma Petroleum S.r.L.

30. LOSS PER SHARE

	Notes	2010 $	2009 $
(a) Reconciliation of earnings used in calculating loss per share			
Loss attributable to the owners of the Company used in calculating basic and diluted loss per share		(6,072,006)	(3,136,955)

	Number of shares	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	124,670,935	86,000,005

(c) Information on the classification of options

As the Group has made a loss for the year ended 30 June 2010, all options on issue are considered anti-dilutive 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 and the 30 November 2011.

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:

	2010		2009	
	Number of options	Weighted average exercise price cents	Number of options	Weighted average exercise price cents
Outstanding at the beginning of the year	5,750,000	46.1	225,000	35.0
Granted	450,000	25.6	5,750,000	46.1
Forfeited/cancelled	(250,000)	20.0	-	-
Exercised	-	-	-	-
Expired	-	-	(225,000)	35.0
Outstanding at year-end	5,950,000	45.6	5,750,000	46.1
Exercisable at year-end	5,950,000	45.6	5,750,000	46.1

The weighted average remaining contractual life of share options outstanding at the end of the financial year was 0.46 years (2009: 1.42), and the exercise prices range from 20 cents to 50 cents.

Notes to the Financial Statements (cont'd)

31. SHARE-BASED PAYMENTS (cont'd)

Expenses arising from share-based payment transactions

The weighted average fair value of the options granted during the year was 7.25 cents (2009: 0.9 cents). The price was calculated by using the Black-Scholes European Option Pricing Model applying the following inputs:

	Notes	2010	2009
Weighted average exercise price (cents)		25.6	46.1
Weighted average life of the option (years)		1.46	2.00
Weighted average underlying share price (cents)		14.0	8.9
Expected share price volatility		148.44%	80.85%
Risk free interest rate		3.75%	5.12%

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:

	Notes	2010 $	2009 $
Options issued to employees and contractors		32,620	50,325

32. PARENT ENTITY INFORMATION

The following information relates to the parent entity, Key Petroleum Limited, at 30 June 2010. The information presented here has been prepared using accounting policies consistent with those presented in Note 1.

	Notes	2010 $	2009 $
Current assets		2,793,707	5,626,266
Non-current assets		7,116,800	5,936,103
Total assets		9,910,507	11,562,369
Current liabilities		239,980	169,449
Total liabilities		239,980	169,449
Issued capital		24,599,055	19,868,699
Share-based payments reserve		309,177	276,557
Accumulated losses		(15,237,705)	(8,752,336)
Total equity		9,670,527	11,392,920
Loss for the year		(6,485,369)	(2,910,204)
Total comprehensive loss for the year		(6,485,369)	(2,910,204)

The parent entity is responsible for the contingent liabilities outlined in note 21.

The parent entity is responsible for the commitments outlined in note 22.

Interests in subsidiaries are set out in note 25.

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

Loans to related parties

Loans to subsidiaries

	Key Petroleum (UK) Ltd		Other subsidiaries		Total	
	2010 $	2009 $	2010 $	2009 $	2010 $	2009 $
Beginning of the year	-	-	453,081	59,048	453,081	59,048
Loans advanced	4,911,872	-	50,963	379,511	4,962,835	379,511
Interest charged	268,254	-	29,915	14,522	298,169	14,522
Impairments	(1,834,072)	-	(160,454)	-	(1,994,526)	-
Closing balance	3,346,054	-	373,505	453,081	3,719,559	453,081

Key Petroleum Limited has provided unsecured loans to its wholly owned subsidiaries Key Petroleum (UK) Ltd and Funguo Petroleum Pty Limited 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 (Australia) 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 Group recognises an allowance for the impairment loss.

33. FINANCIAL RISK MANAGEMENT

The Group's financial instruments consist mainly of deposits with banks and accounts receivable and payable.

The totals for each category of financial instruments, measured in accordance with AASB 139 as detailed in the accounting policies to these financial statements, are as follows:

	Notes	2010 $	2009 $
Financial Assets			
Cash and cash equivalents		2,902,916	5,594,855
Loans and Receivables		669,790	215,382
Total Financial Assets		3,572,706	5,810,237
Financial Liabilities			
Trade and other payables		667,191	181,819
Total Financial Liabilities		667,191	181,819

Specific Financial Risk Exposures and 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.

Notes to the Financial Statements (cont'd)

33. FINANCIAL RISK MANAGEMENT (cont'd)

(a) Market risk

(i) Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures.

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 exposure to foreign currency risk at the reporting date was as follows:

	2010			2009		
	GBP	USD	EUR	GBP	USD	EUR
Cash and cash equivalents	110,207	12,782	29,097	-	289,098	31,791
Trade and other receivables	42,488	64,735	46,828	-	42,537	28,956
Trade and other payables	(204,201)	(37,506)	(25,793)	-	(2,452)	(5,339)

Sensitivity analysis

Based on the financial instruments held at 30 June 2010, had the Australian dollar weakened/strengthened by 10% against the US dollar, the Euro or the British pound with all other variables held constant, there would have been an immaterial impact on the Group's post-tax losses for the year (2009: Nil) and immaterial movements to the Group's equity for both years presented.

(ii) Price risk

The Group is exposed to movements in the world oil price as its revenues are generated through the sale of crude oil.

Sensitivity analysis

At 30 June, 2010 if the oil price had changed by -/+ 5% from the weighted average rate for the year with all other variables held constant, the post-tax loss for the Group would have been $54,500 higher/lower (2009: $0) as a result of lower/higher oil sales revenue.

(iii) Interest rate risk

The Group is 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 $2,902,916 (2009: $5,594,855) is 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 4.4% (2009: 4.2%).

Sensitivity analysis

At 30 June 2010, 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 the Group would have been $28,000 lower/higher (2009: $62,000 lower/higher) as a result of lower/higher interest income from cash and cash equivalents.

(b) Credit risk

Exposure to credit risk relating to financial assets arises from the potential non-performance by counterparties of contract obligations that could lead to a financial loss to the Group.

Credit risk is minimised by investing surplus funds in financial institutions that maintain AAA credit ratings and by ensuring customers and counterparties to transactions are of sound credit worthiness.

Credit Risk Exposures

The maximum exposure to credit risk by class of recognised financial assets at balance date is equivalent to the carrying value and classification of those financial assets (net of any provisions) as presented in the statement of financial position.

The Group has a concentration of credit risk relating to sales of oil in the UK which are to only one customer (BP Exploration Operating Company Ltd). There was an outstanding balance for this debtor at 30 June 2010 of $178,322.

All cash holdings within the Group are currently held with AAA rated financial institutions.

(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. Refer to Note 1 for managements plans to remain a going concern.

The tables below reflect an undiscounted contractual maturity analysis for financial liabilities. Cash flows realised from financial assets reflect management's expectation as to the timing of realisation. Actual timing may therefore differ from that disclosed. The timing of cash flows presented in the table to settle financial liabilities reflects the earliest contractual settlement dates.

Financial Liability and Financial Asset Maturity Analysis

	Within One Year		1 to 5 Years		Total	
	2010 $	2009 $	2010 $	2009 $	2010 $	2009 $
Financial liabilities due for payment						
Trade and other payables (excluding estimated annual leave)	609,318	143,947	-	-	609,318	143,947
Operating lease liabilities	113,241	88,520	84,931	66,390	198,172	154,910
Exploration commitments	20,045,000	932,250	5,956,000	14,356,650	26,001,000	15,288,900
Total contractual outflows	20,767,559	1,164,717	6,040,931	14,423,040	26,808,490	15,587,757
Financial assets – cash flows realisable						
Cash and cash equivalents	2,902,916	5,594,855	-	-	2,902,916	5,594,855
Trade and loan receivables	669,790	215,382	-	-	669,790	215,382
Total anticipated inflows	3,572,706	5,810,237	-	-	3,572,706	5,810,237
Net (outflow)/inflow on financial instruments	(17,194,853)	4,645,520	(6,040,931)	(14,423,040)	(23,235,784)	(9,777,520)

(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 at the balance date are recorded at amounts approximating their fair value.

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.

As disclosed in note 1 should the Company not continue as a going concern then the fair value of financial assets and financial liabilities may not reflect the true fair value of financial assets and financial liabilities on a liquidation basis.

Notes to the Financial Statements (cont'd)

34. SEGMENT INFORMATION

Identification of reportable segments

The Group has identified its operating segments based on the internal reports that are reviewed and used by the board of directors (chief operating decision makers) in assessing performance and determining the allocation of resources.

The Group is managed primarily on the basis of geographic location of assets given that the type of work done in each location is of a similar nature. Operating segments are therefore determined on this basis.

Types of activites by segment

United Kingdom

The United Kingdom segment produces oil for sale and conducts exploration on the Company's licenses.

Tanzania

The Tanzanian segment is engaged in exploration for oil and gas in the Company's interests in Tanzania.

Italy

The Italian segment is engaged in exploration for oil and gas in the Company's interests in Italy.

Basis of accounting for purposes of reporting by operating segments

Accounting policies adopted

Unless stated otherwise, all amounts reported to the Board of Directors as the chief decision maker with respect to operating segments are determined in accordance with accounting policies that are consistent to those adopted in the annual financial statements of the Group.

Inter-segment transactions

An internally determined transfer price is set for all inter-entity sales. This price is re-set quarterly and is based on what would be realised in the event the sale was made to an external party at arm's-length. All such transactions are eliminated on consolidation for the Group's financial statements.

Inter-segment loans payable and receivable are initially recognised at the consideration received net of transaction costs. If inter-segment loans receivable and payable are not on commercial terms, these are not adjusted to fair value based on market interest rates. This policy represents a departure from that applied to the statutory financial statements.

Segment assets

Where an asset is used across multiple segments, the asset is allocated to the segment that receives the majority of economic value from the asset. In the majority of instances, segment assets are clearly identifiable on the basis of their nature and physical location.

Unless indicated otherwise in the segment assets note, investments in financial assets, deferred tax assets and intangible assets have not been allocated to operating segments.

Segment liabilities

Liabilities are allocated to segments where there is direct nexus between the incurrence of the liability and the operations of the segment. Borrowings and tax liabilities are generally considered to relate to the Group as a whole and are not allocated. Segment liabilities include trade and other payables and certain direct borrowings.

Unallocated items

The following items of revenue, expenses, assets and liabilities are not allocated to operating segments as they are not considered part of the core operations of any segment:

- Interest income
- Administration expenses
- Corporate expenses
- Equity accounted profits and losses of associates
- Impairment of investment in associates
- Corporate liabilities
- Cash

Major Customers

Details of major customers are disclosed in note 33 (b).

Comparative information

This is the first reporting period in which AASB 8 Operating Segments has been adopted. Comparative information has been restated to conform to the requirements of the Standard.

	United Kingdom		Tanzania		Italy		Total	
	2010 $	2009 $	2010 $	2009 $	2010 $	2009 $	2010 $	2009 $
Segment revenue								
External sales	1,090,538	-	-	-	-	-	1,090,538	-
Interest revenue	-	-	-	-	427	511	427	511
Total segment revenue	1,090,538	-	-	-	427	511	1,090,965	511
Reconciliation of segment revenue to Group revenue								
Intersegment elimination							-	-
Total Group revenue							1,243,973	501,368
Segment result								
Segment result before income tax	(349,564)	-	(14,219)	(41,099)	(203,509)	(124,965)	(567,292)	(166,064)
Reconciliation of segment result to Group loss before tax								
Amounts not included in the segment result but reviewed by the Board:								
Depreciation and amortisation	(1,175,480)	-	-	-	-	-	(1,175,480)	-
Impairment of capitalised exploration costs			(1,695,896)	(2,183,767)	(253,695)	-	(1,949,591)	(2,183,767)
Equity accounted profits of associates and JVs							(2,574)	(25,665)
Impairment of goodwill					(2,891)	-	(2,891)	-
Impairment of investment							(500,888)	-
Interest revenue							153,435	322,464
Administration charges							(1,215,738)	(839,544)
Corporate charges							(692,046)	(179,963)
Unallocated items:								
Depreciation and amortisation							(36,516)	(47,506)
Other							(82,425)	(16,910)
Loss for the year							(6,072,006)	(3,136,955)
Segment assets	3,757,518	-	3,280,197	4,414,237	117,846	349,370	7,155,561	4,763,607
Reconciliation of segment assets to Group assets								
Intersegment elimination	-	-	-	-	-	-	-	-
Unallocated items:								
Corporate assets							2,942,812	5,771,729
Equity accounted associates and joint ventures							-	503,462
Total Group assets from continuing operations							10,098,373	11,038,798
Segment asset increases for the year								
Capital expenditure	271,846	-	565,195	-	-	52,541	837,041	52,541
Acquisitions	4,202,268	-		-	-	-	4,202,268	-
	4,474,114	-	565,195	-	-	52,541	5,039,309	52,541
Segment liabilities	5,662,001	-	509,671	450,944	36,773	586,369	6,208,445	1,037,313
Reconciliation of segment liabilities to Group liabilities								
Intersegment elimination							(5,205,524)	(1,024,943)
Unallocated items:								
Corporate liabilities							239,978	169,449
Total Group liabilities from continuing operations							1,242,899	181,819

Notes to the Financial Statements (cont'd)

35. COMPANY DETAILS

The registered office of the company is:

Key Petroleum Limited

23 Altona Street
WEST PERTH WA 6005

The principal place of business is:

Key Petroleum Limited

Level 1, 14 Outram Street
WEST PERTH WA 6005

Directors' Declaration

In the directors' opinion:

(a) the financial statements and notes set out on pages 25 to 58 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 2010 and of its performance for the financial year ended on that date;

(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) a statement that the attached financial statements are in compliance with International Financial Reporting Standards has been included in the notes to the financial statements.

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.

Ken Russell
Managing Director

Perth, 30 September 2010

Independent Auditor's Report

To the Members of Key Petroleum Limited

Bentleys
Thinking ahead

RLF Bentleys
Audit & Corporate Pty Ltd
ABN 33 121 222 802

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We have audited the accompanying financial report of Key Petroleum Limited ("the Company") and Controlled Entities ("the Consolidated Entity"), which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a statement of accounting policies, other selected explanatory notes and the directors' declaration of the Consolidated Entity, comprising the Company and the entities it controlled at the year's end or from time to time during the financial year.

Directors Responsibility for the Financial Report

The directors of Key Petroleum Limited 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.

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.

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.

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

Independence

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

BASIS FOR QUALIFIED AUDITOR'S OPINION

Going Concern

As disclosed in Note 1 to the financial statements, the accounts have been prepared on the going concern basis, which contemplates continuity of normal activities and the realisation of assets and settlement of liabilities in the ordinary course of business. The Consolidated Entity incurred a loss from general business activities of $6,072,006 for the year ended 30 June 2010. Included within this loss was the write-off of exploration expenditure of $1,934,789.

The net working capital position of the Consolidated Entity at 30 June 2010 was $2,857,649 and the net decrease in cash held during the year was $2,830,260. Since the end of the financial year the Company has raised $1,033,600 through a share placement and plans to undertake further capital raisings in the near future.

The Consolidated Entity has expenditure commitments relating to work programme obligations of their assets amounting to $20,045,000, which potentially could fall due within the twelve months to 30 June 2011. Of these commitments, $9,300,000 relate to the drilling of two wells in the Tanzanian Nyuni block where the Kilwani

Independent Auditor's Report

To the Members of Key Petroleum Limited (cont'd)

North gas discovery has been made and plans for development of that gas field are progressing. The Company believes that at this stage it is likely that only one of these two wells will be drilled before 30 June 2011.

The Board is undertaking a process to divest the Consolidated Entity's interests in these Tanzanian assets to take advantage of the increased focus by the larger oil and gas companies on the east coast of Africa that is being seen. A successful divestment would reduce the Consolidated Entity's commitment obligations by $15,100,000, should they fall due before 30 June 2011. The Board is currently in talks with several interested parties who are evaluating these assets, however there can be no guarantee that divestment will occur.

If the divestment process is unsuccessful it is the Company's intention to raise capital in the next three months to meet the commitments related to this first Nyuni well. A requirement to drill a well in the Tanzanian West Songo Songo block in the first half of 2011 also exists. However, drill rig availabilities may limit the Company's ability to drill within this timeframe. Expenditure commitments in Italy are in question at this time due to uncertainties relating to changes in environmental laws and drilling exclusion zones that are being proposed. The Company has made applications to suspend work programme requirements and obligations on its Italian permits until these uncertainties have been clarified by the Italian government and the Ministry of Economics. The Company believes the suspension approval will be granted shortly by the Ministry of Economics.

Commitments related to the drilling of the two wells, Dunnart and Dibbler that are currently expected to commence during October 2010 in the North Perth Basin are fully funded.

The ability of the Consolidated Entity to continue to pay its debts as and when they fall due is dependent upon the Company successfully raising additional share capital, continuing to enhance and develop its oil producing assets, possibly divesting some assets and ultimately developing its other assets.

Should the Company not be successful in its planned capital raisings, it may be necessary to sell some of its assets, farm out exploration projects and/or reduce exploration expenditure by various methods including surrendering or withdrawing from less prospective tenements. Should the Company be unable to raise the funds to meet its commitments in Tanzania, it is possible that the Company would default on one or both of its joint venture obligations. There is also a possibility that the Company could then be subjected to claims by its joint venture partners for failing to meet its financial obligations and damages for losses which may arise.

As a result of these matters, a material uncertainty exists which may cast significant doubt on the Consolidated Entity's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. The financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the Consolidated Entity not continue as a going concern.

Qualified Auditor's Opinion

In our opinion, except for the matter included in the preceding paragraph:

a. The financial report of Key Petroleum Limited and Controlled Entities is in accordance with the *Corporations Act 2001*, including:
    i. giving a true and fair view of the Company and the Consolidated Entity's financial position as at 30 June 2010 and of its 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.

Report on the Remuneration Report

We have audited the Remuneration Report included within the report of the directors for the year ended 30 June 2010. The directors of Key Petroleum Limited are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's Opinion

In our opinion the Remuneration Report of Key Petroleum Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.

Bentleys

BENTLEYS
Chartered Accountants

CHRIS WATTS CA
Director

DATED at PERTH this 30th day of September 2010

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 2010.

(a) Distribution of equity securities

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

	Ordinary shares	
	Number of holders	Number of shares
1 - 1,000	32	5,516
1,001 - 5,000	133	470,031
5,001 - 10,000	236	2,060,778
10,001 - 100,000	742	28,071,284
100,001 and over	221	119,069,796
	1,381	149,677,405
The number of equity security holders holding less than a marketable parcel of securities are:	404	2,567,320

(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	HSBC Custody Nominees (Australia) Limited <EY A/C>	6,500,000	4.34%
2	Mr Kenneth Russell	5,290,000	3.53%
3	Jerele Mining Pty Ltd <Ellyard Super Fund A/C>	5,250,000	3.51%
4	HSBC Custody Nominees (Australia) Limited	4,714,090	3.15%
5	UBS Wealth Management Australia Nominees Pty Ltd	4,251,035	2.84%
6	Australian Global Capital P/L	3,970,000	2.65%
7	Leet Investments Pty Ltd	2,862,172	1.91%
8	Campestre Enterprises Pty Ltd	2,800,000	1.87%
9	Woolsthorpe Investments Limited	2,256,746	1.51%
10	Citicorp Nominees Pty Limited	2,053,789	1.37%
11	Mr Stephen Cansdell Hirst	2,000,000	1.34%
12	Mr Allen King & Mrs Jolanka King & Mr John King <A J & J King S/F A/C>	1,800,000	1.20%
13	Dreamaster Pty Ltd <Carlyon Super Fund A/C>	1,665,000	1.11%
14	Leet Investments Pty Limited <Superannuation Fund>	1,650,000	1.10%
15	Fiske Nominees Ltd <Edgew0001 A/C>	1,500,000	1.00%
16	Minsk Pty Ltd	1,398,365	0.93%
17	Key International Pty Ltd	1,350,000	0.90%
18	Mr David Alan Dyer & Mrs Angela Mary Dyer	1,250,000	0.84%
19	ANZ Nominees Limited <Cash Income A/C>	1,125,000	0.75%
20	Mr Peter Taylor	1,125,000	0.75%
		54,811,197	36.60%

(c) Voting rights

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

(d) Schedule of interests in petroleum blocks

Location	Block	Percentage held / earning
Tanzania – Offshore	Nyuni	20
Tanzania – Offshore	West Songo Songo	50
Suriname – Onshore	Uitjik	1.75 (indirect)
Suriname – Onshore	Coronie	1.75 (indirect)
Italy – Offshore	West Sardinia	100
Italy – Offshore (Application)	Lampedusa	100
Italy – Offshore (Application)	Elba South	100
Italy – Po Valley	Borsano	100
Australia – Onshore	EP 437	45

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