



**CARNARVON**  
PETROLEUM LTD

2010  
Annual Report

For the financial year ended June 30, 2010  
ABN 60 002 688 851

## CONTENTS

Chairman's Review	1
Chief Executive's Review	2
Operating and Financial Review	3
Directors' Report	17
Independence Declaration	28
Consolidated Income Statement	29
Consolidated Statement of Comprehensive Income	30
Consolidated Statement of Financial Position	31
Consolidated Statement of Changes in Equity	32
Statement of Cash Flows	33
Notes to the Financial Statements	34
Directors' Declaration	71
Independent Audit Report	72
Corporate Governance Statement	74
Additional Shareholder Information	77

## CORPORATE DIRECTORY

### Directors

PJ Leonhardt (Chairman)  
EP Jacobson (Chief Executive Officer)  
NC Fearis (Non-Executive Director)  
KP Judge (Non-Executive Director) (retired 15 July 2010)  
W Foster (Non-Executive Director) (appointed 17 August 2010)

### Company Secretary

RA Anderson

### Auditors

WHK Horwath Perth Audit Partnership

### Bankers

Australia and New Zealand Banking Group Limited  
National Australia Bank Limited  
HSBC (Thailand)

### Registered Office

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Telephone: +61 8 9321 2665  
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Email: admin@cvn.com.au  
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### Share Registry

Computershare Investor Services Pty Limited  
Level 2, 45 St Georges Terrace  
Perth, WA 6000 Australia  
Investor Enquiries: 1300 557 010 (within Australia)  
Investor Enquiries: +61 3 9415 4000 (outside Australia)  
Facsimile: +61 8 9323 2033

### Stock Exchange Listing

Securities of Carnarvon Petroleum Limited are listed on ASX Limited.  
ASX Code: CVN - ordinary shares

**Last year we were pleased to report that Carnarvon had experienced a period of significant growth in operational and financial performance from its L44/43 Concession in Thailand. Last year was also a period of severe turbulence in economic conditions in the sense of the “Global Financial Crisis” or GFC. A year on and we find the Company in a very strong position. We have significantly upgraded our reserves, continued to produce oil from the L44/43 Concession in Thailand, and taken advantage of the difficulties of the GFC to position the business for future growth in new exploration acreage both within Thailand and in other regions.**

At a strategic level the Carnarvon Board, with support from its management, has carefully considered future growth plans that are most likely to realise material benefits for shareholders having regard to the risks and capital required to find and develop new reserves. We have articulated the Company's intention to focus on direct holdings in onshore and shallow offshore opportunities in the South East Asian and Australasian regions. In this context, during the year attractive new ventures were introduced into Carnarvon in Thailand, Indonesia, Australia and New Zealand. These are opportunities that are capable of providing material value to shareholders while containing government and other commitments to levels that are readily affordable by the Company without putting it under undue financial strain.

While the GFC may now be history, the Carnarvon Board remains wary of the risk of future adverse economic events that could materially affect business confidence and global liquidity. Accordingly, Carnarvon will continue to grow its business in a prudent manner and position itself to be capable of exploiting opportunities should they arise in any difficult economic times in the future.

Your directors are very conscious of the disappointing performance in the Company's share price over the past year. Certainly there have been a number of external factors affecting this, including the unrest in Bangkok earlier this year, the Australian Government's intention to introduce a super profits tax on the resources sector, and significant movements in oil prices and exchange rates. Fundamentally though, the key issue has been around the levels of production that we expected a year ago compared with those that were ultimately achieved. We acknowledge and thank Pan Orient Energy

Corp, the L44/43 Concession Operator, for its tremendous efforts during the year in managing a challenging reservoir. Despite a very effective drilling campaign, a number of the wells unfortunately failed to produce at the levels we had reasonably predicted. That said, we announced after the end of the financial year a series of well results that have significantly exceeded our expectations, including the WBEXT1a well that set a record for production rates onshore Thailand. I will leave further explanation of the production issues to be covered by Ted Jacobson in his Chief Executive's Review. Notwithstanding these issues, production from the L44/43 Concession continues to generate significant cash flows for investment in other growth opportunities for shareholders.

For Carnarvon's ongoing success we are aware of the need to work closely with all stakeholders, including joint venture partners, suppliers, our corporate advisers and shareholders. I would like to thank all those who have supported us during the year.

Carnarvon's people have again made outstanding contributions and the high calibre of our relatively small team is a key to our future growth. I believe it is also important to recognise the progress made in building the capabilities of our people. On behalf of the Carnarvon Board I congratulate our Chief Executive Officer Ted Jacobson and all of the staff. We all look forward to another exciting year in 2011 and beyond.

The Board was sorry to announce recently that Ken Judge had decided to retire from the Board. Ken joined the Board over 5 years ago and was an outstanding contributor to the Company's success over this period. His extensive experience and global insights will be greatly missed. So, thank you Ken and every best wish with your reduced international commitments. Bill Foster was subsequently appointed to the Board and brings to us extensive industry experience. We look forward to working with him in growing the Company in the future.



**Peter Leonhardt**  
Chairman

**Carnarvon posted a substantial 48% increase in audited oil reserves in its L44/43 Thailand concession as at 31 December 2009. Proven and probable recoverable oil reserves were calculated to be 24.5mmbbls net to Carnarvon. New oil pools were discovered and new production licences were approved over the Bo Rang, L44-W and NSE-F1 discoveries. This is an enviable position for our company to be in.**

Production declined over the year, partly the result of a focus on appraisal drilling to better define the limits of the oil reserves, but also due to natural decline of wells. However, recent drilling has significantly reversed this trend.

At the end of the financial year the L33-1 well, which was required to be drilled as part of the licence terms for the L33/43 concession, discovered a new pool of oil within fractured volcanic rock with substantial flow rates of 1,100 bopd. This new discovery was followed up after the financial year end with the drilling of L33-2 well which was flowed at 2,350 bopd. A production licence has now been applied for. Production will commence on approval of the production licence.

In addition, subsequent to year end, a new oil discovery was made in fractured volcanic rock within the Wichian Buri structure in the L44/43 concession, at WBEXT-1. A follow up well in the same structure, WBExt-1A, flowed a record 5,300 bopd on clean-up. Further drilling is ongoing within this structure.

Whilst production had declined at the end of the financial year, production at year end improved dramatically with the wells drilled in July and August 2010.

Elsewhere the Company has been very busy building on its assets. In Thailand, within the L20/50 permit, the seismic acquisition of 550 kms of seismic data was completed, processed and interpreted. Preparations are underway for one firm well and two contingent wells to be drilled late this calendar year, the timing being subject to weather conditions. In addition, the new L52/50 and L53/50 concessions were officially awarded and technical work has commenced.

Within Indonesia, Carnarvon acquired a 25 percent interest in the Rangkas permit, onshore Indonesia. Numerous oil

seeps and oil shows in previous wells have been reported in this permit and its close proximity to Jakarta and associated infrastructure makes this a desirable location. A total of 1,000 kms of existing seismic data has been re-processed by Carnarvon with modern computer routines, and a further 474 kms of new seismic acquisition is underway.

In Australia, Carnarvon was awarded a 50% interest in four permits covering the Phoenix gas discovery and surrounding area in the Bedout Sub-Basin offshore from Dampier in Western Australia. Carnarvon was later awarded a 100% interest in a further permit adjacent to the Phoenix permits, resulting in the Company having interests over a large area of 28,300 sq kms. These permits are in water depths of around 100metres being a mere 150 kms from the coast. Aeromagnetic data has been acquired by Carnarvon over these permits, and 1,100 sq kms of 3D seismic plus regional 2D seismic lines will be acquired later in 2010. The Phoenix structure already contains two wells which intersected large gas columns of approximately 700 metres which were not flow tested. Carnarvon plans to farm out a portion of its interest to fund the drilling of two appraisal wells. The timing of these wells will be late 2011 / early 2012.

The Company farmed into a new area offshore New Zealand for 10% of the drilling of a well at Tuatara-1. Although this well did not find commercial deposits of hydrocarbons, it did encounter gas and oil shows throughout the well which is encouraging for further exploration in the permit.

Carnarvon also farmed out a portion of the WA-399-P permit in the offshore Carnarvon Basin to Apache Energy and Jacka Resources in return for funding the recording and processing of new 3D seismic over the entire permit. Carnarvon retains a 13% interest in the permit. The farmout to Apache and Jacka allows the introduction of a strong joint venture partner and operator to facilitate the acquisition of 3D seismic at no cost to Carnarvon and rationalises Carnarvon's cash commitments enabling it to seek other attractive opportunities.

The Carnarvon team has worked hard during the year to grow the asset base of the Company. Reserves have been increased substantially, oil field production capacity has increased, and new opportunities have been acquired. I thank all our staff for the hard work, loyalty and dedication they have shown during the year and I look forward to another interesting year in building a strong company.



**Ted Jacobson**  
Chief Executive Officer



## OPERATING REVIEW

### Summary

During the financial year 2009/2010 Carnarvon produced nearly 900,000 bbls of oil in its Thailand concessions and achieved a significant 48% increase in reserves. In addition, the Company completed entry into two new countries, consolidated our acreage positions in Thailand and Australia and prepared for an onshore drilling campaign in L20/50.

Carnarvon participated in the drilling of 38 individual boreholes (including sidetracks) within the L33/43, L44/43 and SW1A group of permits, resulting in 23 completed wells and 16 wells testing at commercial rates.

Exploration and appraisal drilling over the year resulted in several new oil pools being discovered within the L44/43 exploration concession, leading to the application and approval of a new 20 year production license over the Bo Rang, L44-W and NSE-F1 reserve areas. As a result of the increase in audited oil reserves over the previous year in its Thailand concessions, as at 31 December 2009 proven and probable recoverable oil reserves were calculated to be 24.5mmbbls net to Carnarvon.

Elsewhere in Thailand, within the L20/50 permit, the acquisition of 550 kilometres of new 2D seismic data was completed. Planning has commenced on a multi-well program drilling campaign, with three prospects highgraded to drillable status.

Further in Thailand, the L52/50 and L53/50 concessions were officially awarded and technical work by the operator has commenced.

In Australia, Carnarvon concluded negotiations which resulted in the acquisition of a 50% interest in four permits covering the Phoenix gas discovery and surrounding area in the Bedout Sub-Basin offshore approximately 150 kilometres from Dampier in Western Australia. Subsequently, Carnarvon consolidated its position in the basin with the award of a 100% interest in a further permit adjacent to the Phoenix permits.

Also in Australia, Carnarvon farmed out a portion of the WA-399-P permit to Apache Energy in return for the recording and processing of new 3D seismic over the entire permit, and to Jacka Resources for a cash payment.

During the financial year 2009/2010 Carnarvon also acquired a 25 percent interest in the Rangkas permit, onshore Indonesia. Numerous oil seeps have previously been reported in this permit and its close proximity to Jakarta and associated infrastructure makes this a desirable location.

Subsequent to year end, the Company acquired a 10% interest in PEP 38524, a new area offshore New Zealand in return for contributing to the cost of drilling the Tuatara-1 exploration well. Although this well did not find commercial deposits of hydrocarbons, it did encounter gas and oil shows throughout the well which is encouraging for further exploration in the permit.

### Permits

Permit	Basin	Equity	Joint Venture Partner(s)	Partner Interest	Indicative Forward Program
<b>Thailand</b>					
SW1A	Phetchabun	40%	Pan Orient Energy *	60%	Production, Appraisal
L33/43	Phetchabun	40%	Pan Orient Energy *	60%	Development, Appraisal, Exploration
L44/43	Phetchabun	40%	Pan Orient Energy *	60%	Production, Appraisal, Exploration
L20/50	Phitsanulok	50%	Sun Resources	50%	Exploration
L52/50	Surat-Khiensa	50%	Pearl Oil Resources*	50%	Exploration
L53/50	Surat-Khiensa	50%	Pearl Oil Resources*	50%	Exploration
<b>Australia</b>					
WA-435-P	Roebuck	50%	Finder Exploration*	50%	Seismic Acquisition, Exploration
WA-436-P	Roebuck	50%	Finder Exploration*	50%	Seismic Acquisition, Exploration
WA-437-P	Roebuck	50%	Finder Exploration*	50%	Seismic Acquisition, Exploration
WA-438-P	Roebuck	50%	Finder Exploration*	50%	Seismic Acquisition, Exploration
WA-443-P	Roebuck	100%			Seismic Acquisition, Exploration
EP321	Perth	2.50% of 38.25% <sup>(i)</sup>			Appraisal
EP407	Perth	2.50% of 42.5% <sup>(i)</sup>			Appraisal
WA399P	Carnarvon	13%	Apache * Rialto Energy Jacka Resources	60% 12% 15%	Seismic Acquisition, Exploration
<b>Indonesia</b>					
Rangkas	West Java	25%	Lundin Petroleum * Tap Oil	50% 24%	Seismic Acquisition, Exploration
<b>New Zealand</b>					
PEP38524	Taranaki	10%	AWE* ROC Oil Kea Oil and Gas	60% 20% 10%	Seismic Acquisition, Exploration

Note: (\*) Denotes operator where Carnarvon is non-operator partner (i) Carnarvon has an overriding royalty interest in these assets

**Thailand**

*L44/43, L33/43 &, SW1A Phetchabun Basin ("SW1A") (Carnarvon Petroleum 40%, Pan Orient 60% operator)*  
 Carnarvon participated in the drilling of 38 individual boreholes (including sidetracks) within the L33/43, L44/43 and SW1A group of permits throughout the reporting period resulting in 23 completed wells and 16 wells testing at commercial rates. Post year end several new oil discoveries were made, including at WExt-1, WExt-1A and L33-1 & L33-2.

A production license and environmental approval were granted over the Bo Rang "A" and "B" and NSE-F oil reservoirs ("BRN") allowing field development drilling to commence. There are now a total of six production licenses with a further two to be applied for. The existing licences are Wichin Buri Licence I and II, Na Sanun, Si Thep, Na Sanun East and Bo Rang North. Applications will be submitted for licences to cover the recent discoveries at WExt-1, WExt-1A, L33-1 and L33-2.



Figure 1. Permit map of Thailand.

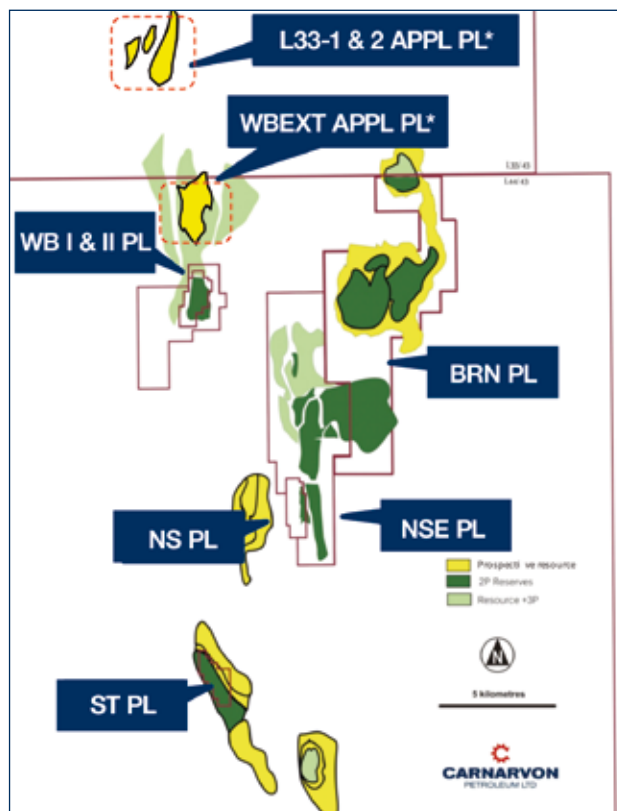


Figure 2. Location of oilfields and prospects within L44/43 & L33/43 Thailand – Phetchabun Basin.

\* Size and shape of PL application areas for illustrative purposes only



## Daily Production

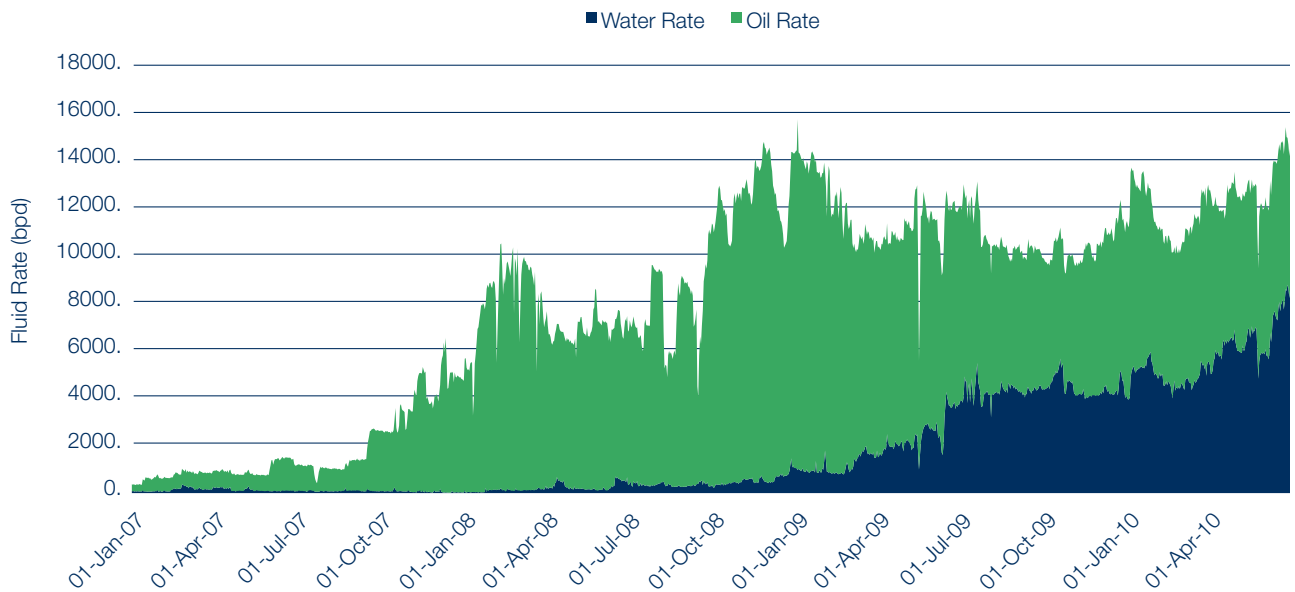


Figure 3. Daily production.

Total daily fluid production has remained relatively stable over the past 24 months, however water production has increased while oil production has decreased, as depicted on the graph above. Produced water is re-injected down non-producing wells and is moved between production wells and non-producing water re-injection wells by truck. Higher water handling volumes marginally increase operating costs and volumes are currently at levels considered normal in the oil and gas industry.

The majority of the production is from fractured reservoirs. The geological setting of these volcanic oil reservoirs is very complex, featuring rapid changes of lithofacies and thicknesses, distributions of fractures and pores/vugs, and different oil well productivities with neighbouring wells. The heterogenous nature of the fracturing leads to varying performance from individual wells, with initial rates ranging from 100 to 4,000 bopd and ultimate recovery per well estimated to be in the range of 100,000 bbls to 1.5 million bbls. This results in a varying production profile. Higher field rates are achievable with continued development drilling, although prediction of individual well performance is variable due to reasons outlined above.

However, fit for purpose operational procedures have resulted in world class low cost operations, with well costs in the order of US\$1 to US\$1.5 million per well and able to be drilled at a rate of 3 per month. Ongoing operational costs, including trucking, are in the order of US\$11 per bbl, with depreciation and amortization currently estimated at US\$7 / bbl. This results in high margin production with exploration

and appraisal upside, generating free cash that Carnarvon is able to use for growth in other regions.

It is anticipated that drilling will continue within the L33/43, L44/43 and SW1A group of fields in the near future to fully realize the value of the certified 2P reserves and unlock some of the value in the 3P reserves, contingent resources and prospective resources.



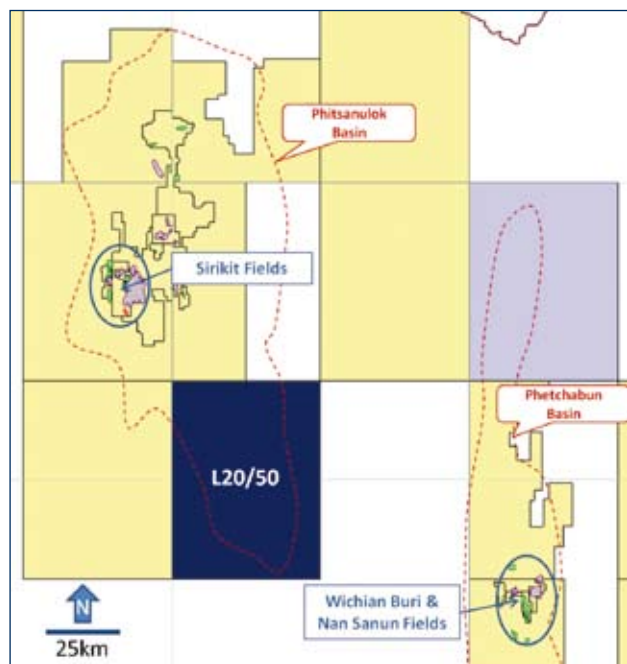


Figure 4. L20/50 Phitsanulok Basin outline.

**L20/50 Phitsanulok Basin**

*(Carnarvon Petroleum 50% Operator, Sun Resources 50%)*

Carnarvon, and partner Sun Resources, were granted the L20/50 exploration concession in January of 2007. The L20/50 concession is situated approximately 30 kms to the southeast and on trend with the largest onshore oil field in Thailand at Sirikit. The permit is around 60 km to the west of Carnarvon’s 40% owned Petchabun Basin producing assets. The concession covers around 4,000 km<sup>2</sup> and is lightly explored.

Previous drilling demonstrates that oil has been generated within the L20/50 concession. Prior to the recording of new seismic data, the only data available over the concession comprised approximately 1,000 km of 1980’s vintage 2D seismic data in paper format (now digitised) and six wells, also in paper format (three shallow at around 500m and three deeper).

Acquisition of 550 km of 2D seismic data by BGP was completed on time and on budget by the end of August 2009. This seismic acquisition exceeds the concession work commitment for L20/50 for the year. Processing of the new 2D seismic data was completed early in the December 2009 quarter.

Interpretation of all seismic data, combined with a geological assessment of the exploration concession, was completed in the March 2010 quarter. Significant sedimentary section and structuring are evident in the new data, and play types include Sirikit style fans, Wichian Buri style sandstones and Na Sanun style volcanics.

Three drillable prospects were identified from a seriatum of over 20 leads, and work has progressed on government, environmental and local permitting work. It is anticipated that a minimum of 1 well, and a maximum of 3 wells, will be drilled in the permit commencing late 2010 or early 2011.

**L52/50 and L53/50 Surat-Khiensa Basin**

*(Carnarvon Petroleum 50%, Pearl Oil 50% operator)*

The exploration concessions L52/50 and L53/50 onshore Thailand were officially awarded to Carnarvon and Pearl in the March 2010 quarter.

These blocks are situated in the Tertiary Surat-Khiensa Basin in the isthmus of southern Thailand adjacent to the NNE-oriented Ranong and Khlong Marui Fault Zones. The basin is of particular interest as it is on trend with the similar sized Chumphon Basin in the Gulf of Thailand to the immediate north. The Chumphon Basin has a proven oil kitchen and 4.3 MM bbls of oil was recovered from the Nang Nuan B well from 1994-1997 at rates up to 10,000 bopd. Numerous wells in the Chumphon Basin encountered oil shows.

Some leads have been identified on the limited 2D seismic available, but significant geologic risks remain on source presence, migration and seal.





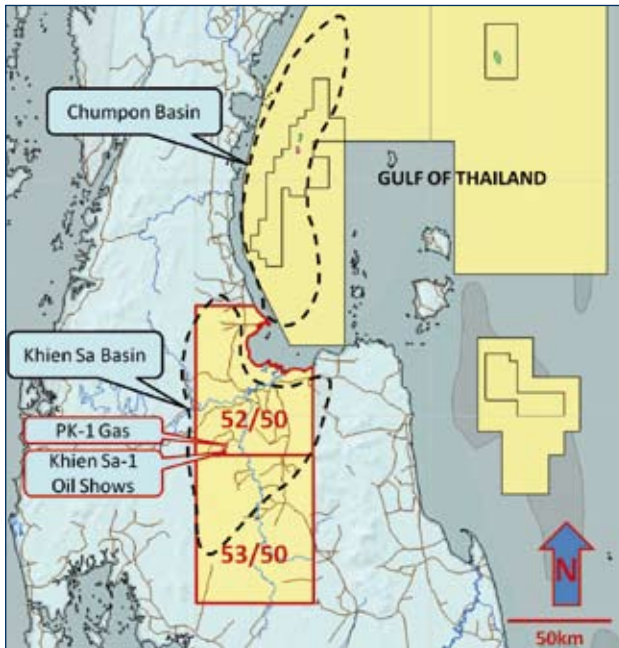


Figure 5. Basin location within Blocks L52/50 and L53/50.

Three oil and gas exploration wells have been drilled in Block L52/50 in addition to two very shallow coalbed methane wells. One well has been drilled in Block L53/50. One of the wells drilled in Block L52/50 (PK-1) is reported to have encountered gas.

L52 covers an area of 3,085 km<sup>2</sup> and L53 an area of 3,872 km<sup>2</sup>.

**Australia**

*WA-435-P, WA-436-P, WA-437-P & WA-438-P Offshore Northwest Shelf  
(Carnarvon Petroleum 50%, Finder Exploration 50% operator)*

Subsequent to being awarded 100% of exploration permit WA-435-P, Carnarvon completed an agreement with private exploration company Finder Exploration ("Finder") to exchange 50% of Carnarvon's WA-435-P for 50% of the three new adjacent Finder permits WA-436-P, WA-437-P and WA-438-P. Finder has assumed operatorship of all four permits.

The four permits are situated in the north-western part of the Bedout Sub-basin within the greater Roebuck Basin, offshore Western Australia. The blocks lie in an under-explored area that has received little recent attention, between the prolific Carnarvon Basin hydrocarbon province to the southwest and the Browse Basin to the northeast. The town of Port Hedland lies approximately 150 km to the south of the permits and Broome lies 250 km to the northeast. Water depths range from 35 to 265 metres and the permits cover a very large area of more than 21,000 km<sup>2</sup> (268 graticular blocks).

Only six wells have been drilled in the permits to date. The two wells, Phoenix-1 and Phoenix-2, drilled on the large Phoenix structure in WA-435-P both intersected extensive gas columns within lower-porosity, mid-Triassic reservoirs.

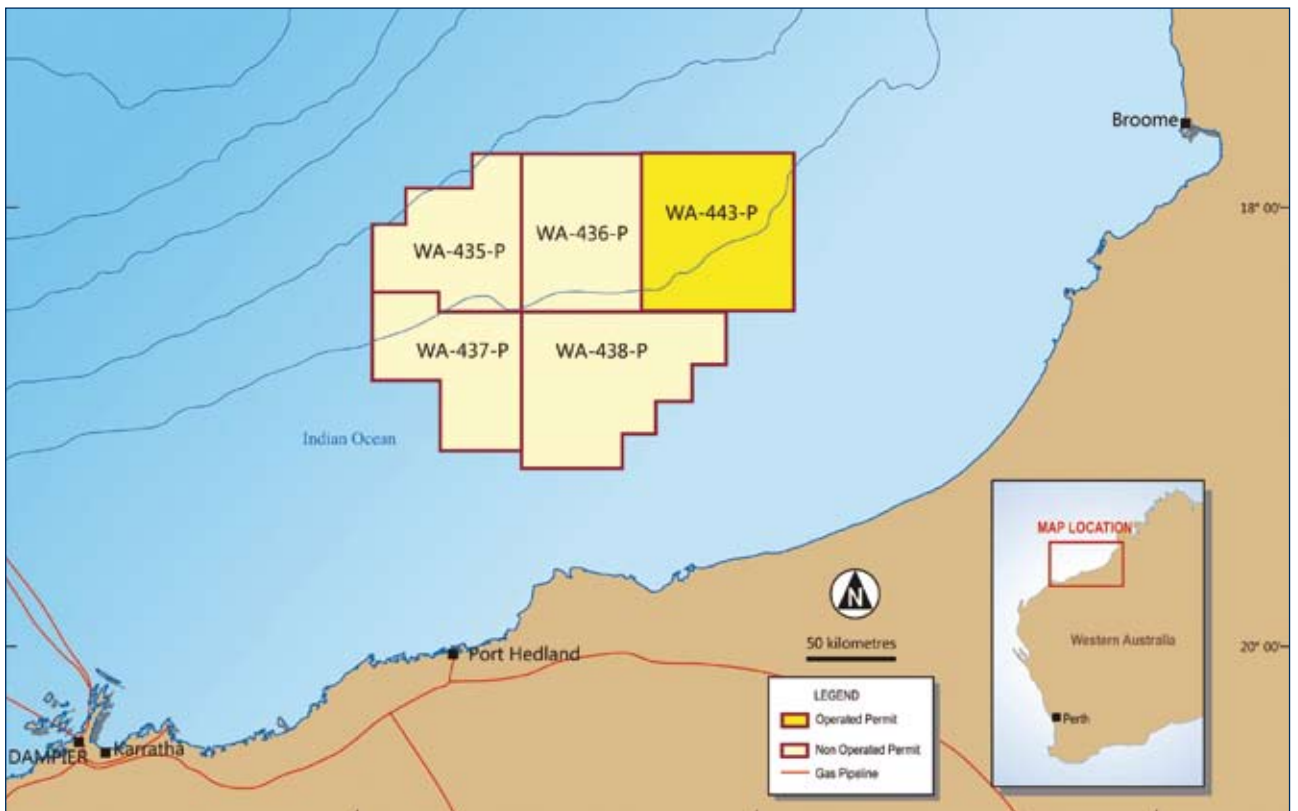


Figure 6. North West Shelf permit map.

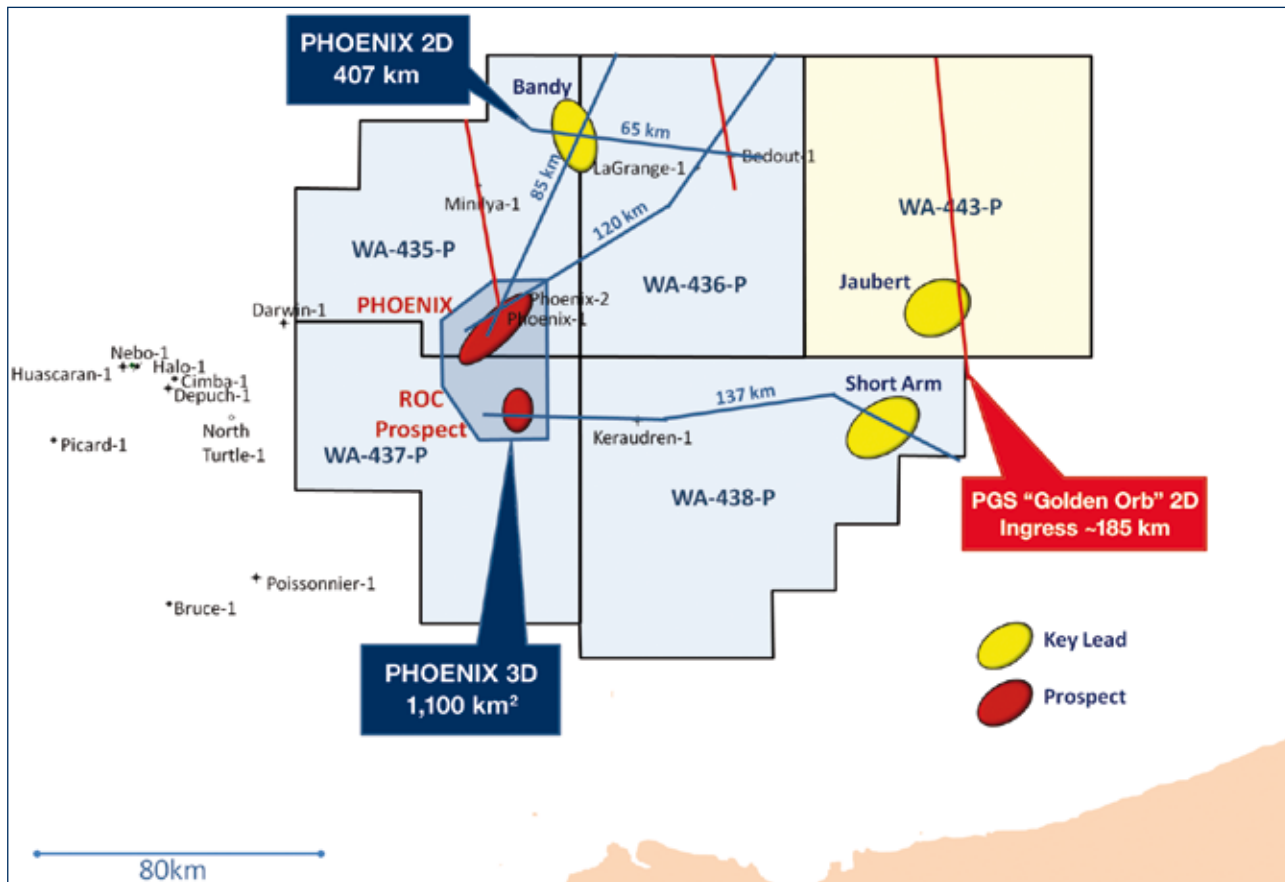


Figure 7. North West Shelf leads and prospects.

In particular, Phoenix-1 recorded 110 metres of net gas-bearing section. However, further work is required to determine whether the gas discovery at Phoenix could flow at commercial rates. A larger, untested structure in WA-435-P lies directly on trend with the Phoenix structure, 5 to 15 km to the southwest. Further to the southeast in WA-437-P lies yet another large, untested structure. Regional geology suggests that reservoir quality improves southward toward these prospects, but this model will need to be confirmed by drilling. These Triassic structures have significant potential, of the order of several Tcf's of recoverable gas, if exploration and appraisal drilling are successful.

Other viable plays are recognised in these blocks, including possible oil exploration potential at the shallower Cretaceous-aged levels. Carnarvon and FINDER intend to carry out a number of studies to evaluate this potential.

The Government-approved work programme for these permits, for the initial firm three-year term, comprises seismic reprocessing, the recording of an aeromagnetic survey, and technical studies, which will include a complete analysis of the gas intersections in the Phoenix-1 and Phoenix-2 wells.

15,847 km<sup>2</sup> of new aeromagnetic data has been acquired and over 400 km of regional 2D and 1,100 km<sup>3</sup> of detailed 3D is in the acquisition stage.

*WA-443-P Australia Offshore Northwest Shelf (Carnarvon Petroleum 100% Operator)*

In April 2010 Carnarvon was successful in its bid for 100% of a new permit gazetted by the Australian government, WA-443-P, offshore Western Australia. This new exploration permit is situated adjacent to Carnarvon's four existing permits WA-435-P, WA-436-P, WA-437-P and WA-438-P, in which it holds a 50% interest, within the Bedout Sub-Basin.

The block covers an area of approximate 7,300 km<sup>2</sup>.

No previous drilling has taken place in the WA-443-P block. The structural form and size of the prospect are comparable to the Phoenix group of potentially large gas accumulations. Carnarvon has secured this new permit with a firm programme over three years to reprocess and interpret 1,400 km of 2D seismic. Geological and geophysical studies will also be carried out in conjunction with similar work in the Phoenix permits.

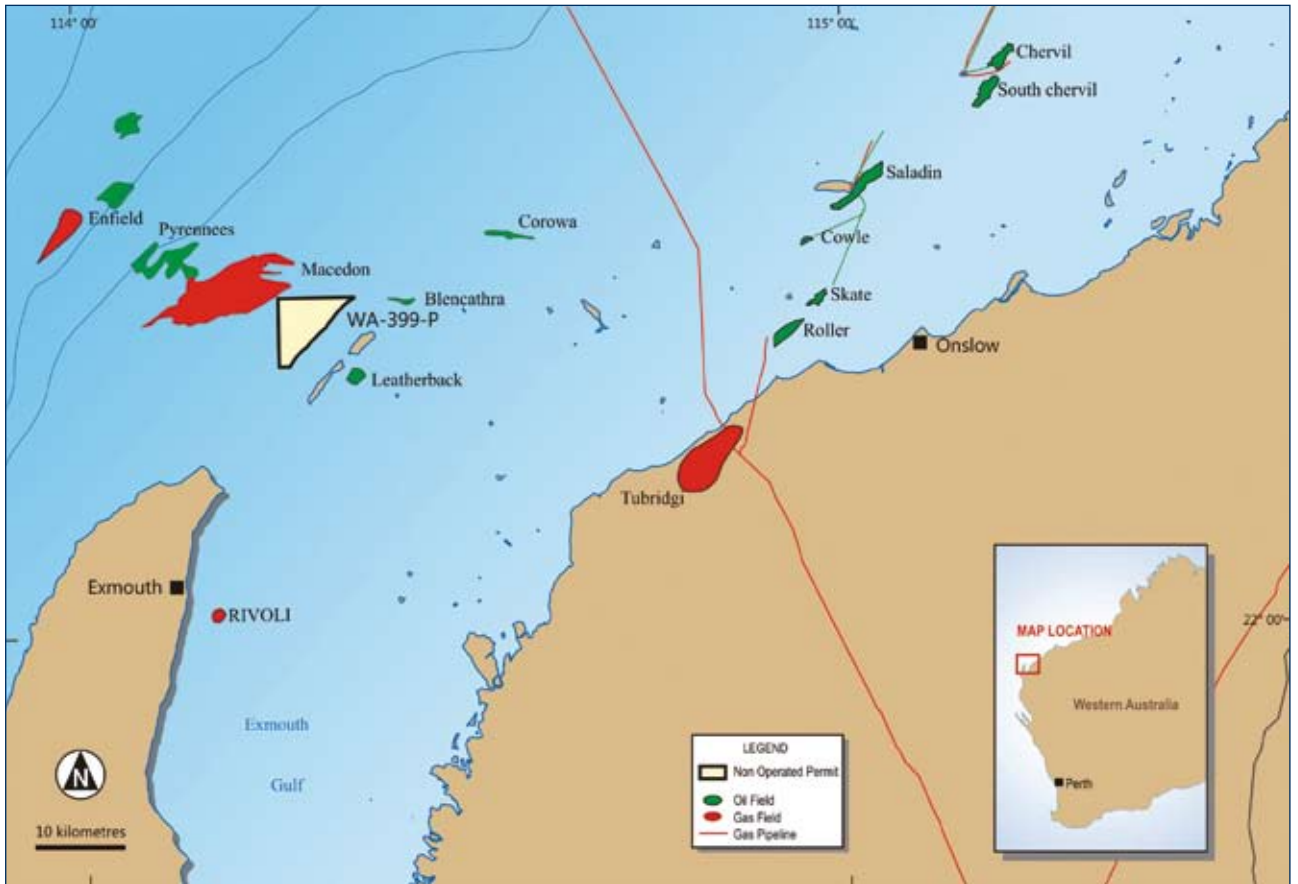


Figure 8. North West Shelf permit map.

*WA-399-P – Australia Offshore Northwest Shelf  
(Carnarvon Petroleum 13%, Apache Energy 60% and Operator, Jacka Resources 15% and Rialto Energy 12%)*

WA-399-P was awarded on 7 May 2007. The exploration permit covers an area of 50km<sup>2</sup> and is situated offshore Western Australia within the Exmouth Sub-basin. The block is adjacent to the Pyrenees Oil development, a Joint Venture between BHP Billiton and Apache, which commenced oil production in March 2010. Nearby, there are several producing oil fields including Enfield and Vincent/Van Gogh, as well as Macedon gas field and a number of other oil field discoveries as set out below.

During the June 2010 quarter, Carnarvon announced the farm out of a proportion of its interest in the permit to Apache Energy Limited (“Apache”) and Jacka Resources Limited (“Jacka”).

The farmout to Apache involves Apache undertaking, at its sole cost, a 3D seismic survey, which will fulfil the Years 2 and 3 work program obligations for the permit and in



consideration for which Apache will acquire a 60% working interest in the permit and Operatorship.

Following the farm out to Apache, Rialto and Jacka will complete their previously announced farm out. Carnarvon and Jacka have also exchanged a 7% working interest in consideration for Jacka making a cash payment to Carnarvon.

Apache plans to acquire the 3D seismic data over the permit in late 2010. The 3D seismic data acquisition will exceed the existing minimum exploration commitment obligation under the exploration permit's terms. The advanced acquisition and

processing of the new 3D seismic data will enable the Joint Venture to further de-risk a number of existing prospects that have already been mapped within the permit.

*EP 424 / EP 110 - Australia Offshore Northwest Shelf  
(Carnarvon Petroleum withdrawal)*

In light of Carnarvon's current exploration portfolio and commitment levels, it elected to withdraw from exploration permits EP 424 and EP 110. Whilst they provided attractive exploration prospects, the magnitude of any expected reward is no longer considered material to Carnarvon's operations.

## Indonesia

*Rangkas PSC Onshore Java  
(Carnarvon Petroleum 25%, Lundin Petroleum 51% and Operator, Tap Oil 24%)*

In September 2009, Carnarvon successfully entered into the Rangkas PSC onshore Indonesia. The proximity to Jakarta ensures that even minor oil and gas accumulations can be commercialized.

The exploration block covers an area of almost 4,000 km<sup>2</sup> and, while containing direct evidence of live oil from seeps

in the block, has limited recent exploration, with the most recent well drilled around 20 years ago.

The acquisition of around 500 km of new 2D seismic data is scheduled for late 2010, which will better delineate the 12 significant leads identified from the reprocessing of 1000 km of existing 2D data.

Following on from processing and interpretation of the new data, drilling is anticipated in 2011 to 2012.



Figure 9. West Java permit map.

**New Zealand**

*PEP38524 Offshore Taranaki  
(Carnarvon Petroleum 10%, AWE 60%  
and Operator, ROC Oil 20%, Kea Oil  
and Gas 10%)*

Post financial year end, Carnarvon successfully farmed into exploration block PEP 38254 offshore New Zealand in the southern Taranaki basin.

Subsequently the Tuatara-1 well was drilled, targeting a significant structure. While the well recorded strong gas and oil shows over an extensive interval, no zones of economic potential were identified.

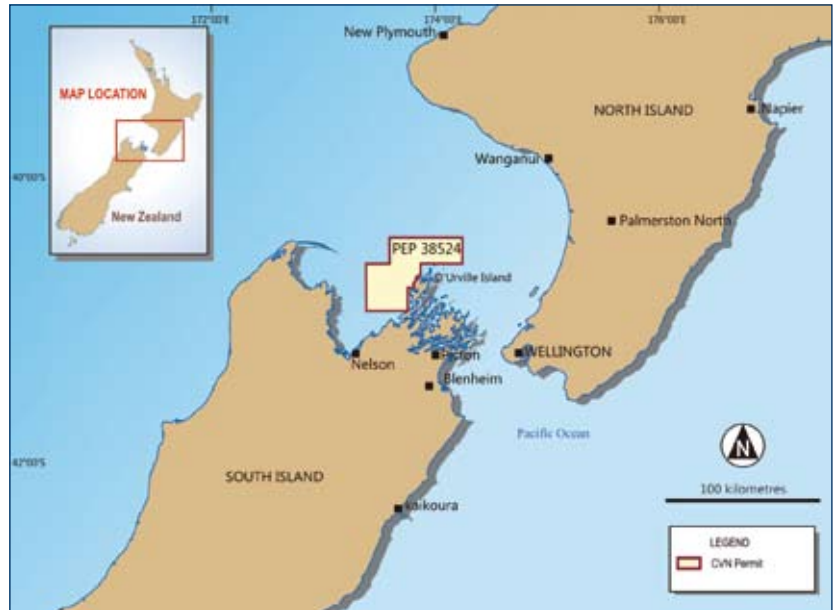


Figure 10. New Zealand permit map.



## RESERVE ASSESSMENT

### Petroleum Resource Classification, Categorisation and Definitions

Carnarvon calculates reserves and resources according to the SPE/WPC/AAPG/SPEE<sup>1</sup> Petroleum Resource Management System ("SPE-PRMS") definition of petroleum resources. This definition was first published in 1997 by the SPE, and in an effort to standardise reserves reporting, has been further clarified by the SPE-PRMS in 2007. Carnarvon reports reserves in line with ASX listing rules.

<sup>1</sup> Society of Petroleum Engineers ("SPE"); World Petroleum Council ("WPC"); American Association of Petroleum Geologists ("AAPG") & Society of Petroleum Evaluation Engineers ("SPEE")

### Proved and Probable (2P) Reserves Thailand

Carnarvon's reserves base has been certified by an independent reserves auditor. Over the last few years Gaffney, Cline and Associates ("GCA") has performed this service in line with end of calendar year requirements for the Department of Mineral Fuels ("DMF") in Thailand. GCA certified 24.5 million barrels of 2P oil reserves net to Carnarvon as at 31 December 2009.

This report is based on information which has been compiled by the Company's Chief Operating Officer, Mr Philip Huizenga, who is a full-time employee of the Company. Mr Huizenga is qualified in accordance with ASX Listing Rule 5.11 and has consented to the form and context in which this statement appears.

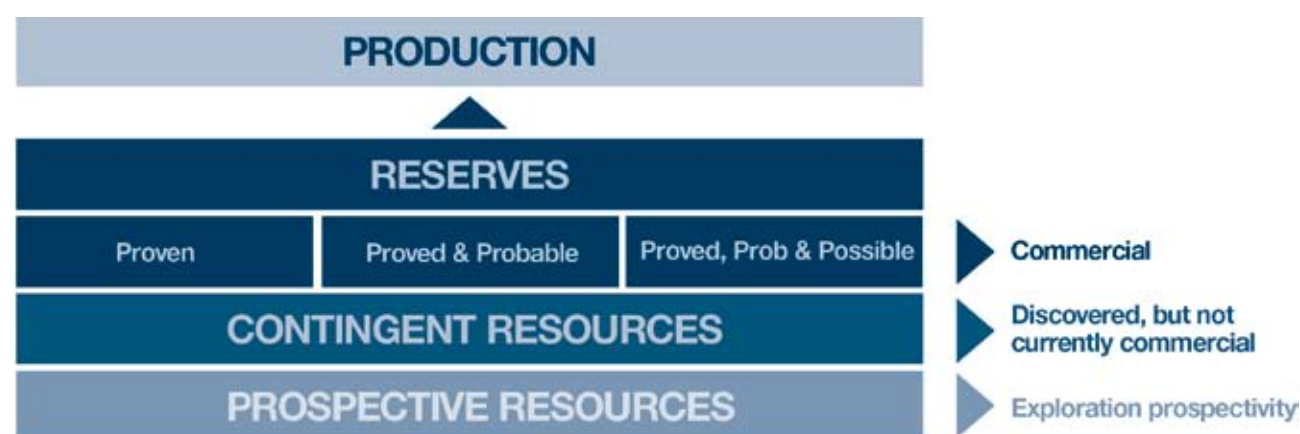


Figure 11.

	Net Carnarvon Reserves		
	Proved 1P (million bbls)	Proved + Probable 2P (million bbls)	Proved + Probable + Possible 3P (million bbls)
GCA 31 Dec 2009	6.4	24.5	57.0

Table 1.

31-Dec-09	Net Carnarvon Reserves	
	Proved + Probable 2P (million bbls)	Reservoir Type
NSE - Central	7.2	Volcanic
NSE-F	4.8	Volcanic
Bo Rang "B"	4.0	Volcanic
Bo Rang "A"	3.4	Volcanic
NSE-South	1.5	Volcanic
Wichian Buri	1.4	Sandstone
Minor Volcanics	1.5	Volcanic
Minor Sandstone	0.6	Volcanic
<b>Total</b>	<b>24.5</b>	

Table 2.

A breakdown of the major reservoirs net to Carnarvon is given in Table 2.

These reservoirs are schematically reproduced in Figure 11.

As discussed above, these reserves were certified by an independent auditor in GCA as at 31 December 2009. Since that time, several wells have been drilled into the NSE-F areas resulting in a reduced gross rock volume and hence likely negative impact on 2P and 3P reserves for that reservoir. Similarly recent production performance of the NSE-Central field has been below forecast for 2P reserves, which may result in a negative revision to the 2P estimate as given in Table 2.

**Contingent Resources Thailand**

In addition to its certified reserves, Carnarvon has a number of discovered oil and gas resources which currently do not classify as reserves. The most significant of these is the L33-1 and L33-2 discoveries in the L33/43 concession and the WBExt-1 and WBExt-1A discoveries in the L44/43 concession. These wells were drilled after the completion of the reporting period and as at the date of writing this report detailed assessment of the respective contingent resources has yet to be calculated. Due to this fact, Carnarvon will not list current contingent resources.

It is anticipated that the L33-1, L33-2, WBExt-1 and WBExt-1A discoveries will be evaluated as reserves or resources by year end 2010 and these reserve additions will offset the expected 2P negative revisions at NSE-Central and NSE-F.

**Prospective Resources**

Under the SPE-PRMS definitions prospective resources can also be classified as exploration resources.

Carnarvon has an increasing number of exploration licences. These exploration licences are evaluated using techniques like gravity and magnetic surveys, geochemical surveys, seismic surveys and basin analysis. This analysis results in a long list of leads and drillable prospects. Only drillable prospects which have been included on drilling schedules are categorised as prospective resources by Carnarvon. Leads are identified as potential hydrocarbon accumulations

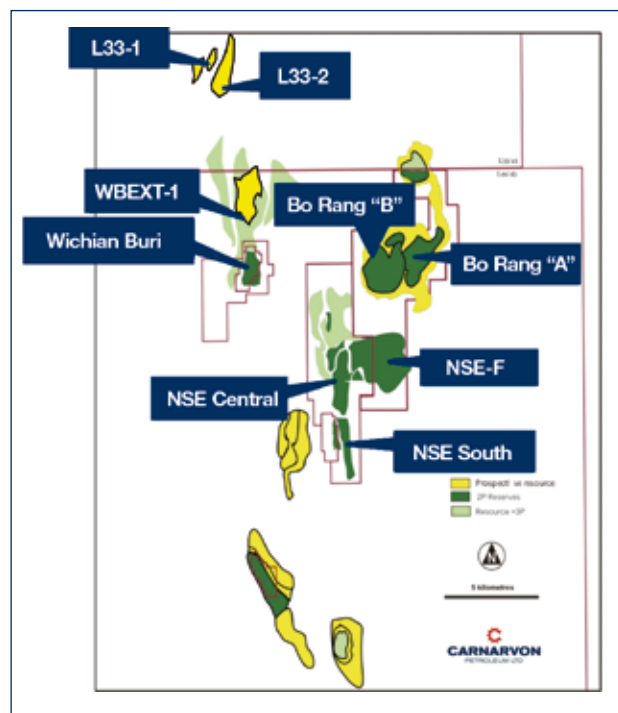


Figure 12. Map showing location of contingent resources.

that will require additional study before they are matured to prospects and appear in drilling plans. It is important to realise that prospects and leads carry exploration risks, which result in a chance of not finding commercial hydrocarbons. These risks are identified by Carnarvon and help management in ranking exploration priorities.

At the time of writing this report Carnarvon has a seriatim of leads in a number of exploration blocks, most notably in the L20/50, L33/43 and L44/43 concessions in Thailand. Those leads which have been upgraded to prospects and tentatively placed within a drilling program, and for which prospective (unrisked) volumes have been calculated, have been used to generate the table below. While Carnarvon continues to carry other leads with significant potential recoverable hydrocarbon volumes within the other exploration blocks in Thailand, Australia, Indonesia and New Zealand, none of those have immediate drilling programs. Carnarvon continues the process of undertaking additional work to progress those leads to drillable prospects.

**Net Carnarvon Prospective Resources  
Best Estimate Recoverable  
(million bbls)**

L44 Shallow Volcanics	14
L44 Mid Volcanics	13
L44 Deep Volcanics	13
L20/50	40
<b>Carnarvon 30 Jun 2010</b>	<b>79</b>

Table 3.

## GROWTH AND NEW VENTURES

Carnarvon has continued to achieve significant growth from its successful exploration and development efforts in the L44/43, L33/43 and SW1A concessions. These areas continue to be a primary focus for the Company and they are now delivering significant sustained oil production and revenues. Cash flow from these producing fields facilitates Carnarvon's pursuit of other new venture opportunities to grow the Company.

Through the year Carnarvon has added two new country entries via the Rangkas PSC onshore Indonesia and the PEP 38524 permit offshore New Zealand.

Carnarvon also completed the previously announced application of exploration concessions L52/50 and L53/50 in southern Thailand.

Finally, Carnarvon consolidated its position in the North West Shelf with the addition of the 100% held exploration permit WA-443-P.

Carnarvon continues to explore avenues of growth via organic growth, new venture asset acquisitions and corporate transactions.

## SUSTAINABILITY

Carnarvon is very aware of the effects of the oil and gas industry on the environment and its communities. Carnarvon takes all reasonable steps to mitigate any potential risk, as well as providing several benefits to the local communities that it operates in.

Carnarvon has recently developed an Integrated Safety Management System (IMS) that is designed to protect the environment, its communities and all staff and contractors that are directly or indirectly employed by Carnarvon. This safety management system has the full support and backing from all levels of management. All relevant projects are run and operated by Carnarvon and adhere to this safety system.

During the current financial year Carnarvon reported zero LTI's (Lost Time Incidents). Activities included the additional activity of shooting a 500km seismic survey onshore Thailand, with an additional staff of 387.

### Environment

Carnarvon has recently completed an Environmental Impact Assessment for an onshore drilling campaign in Thailand, this assessment covered all aspects of the environment, waste management through to local community involvement and opinion. On completion of the seismic survey a mitigation and monitoring report was submitted to the Thai authorities reporting zero incidents.





### Community

Carnarvon endeavors to ensure that everywhere we operate we are able to benefit the local community. Some examples of this are our insistence on hiring local labour and awarding contracts to local companies, where practical, to aid the local economy. We have recently set up several different schemes at local schools in Thailand. One such scheme “grow your own lunch” saw Carnarvon providing schools with the materials and skills to be able to grow their own produce of mushrooms, fish and bananas. This project gave the students the benefit of understanding the growing cycle from planting to harvesting and then being able to sell any remaining produce encouraging self sufficiency.

During any operational procedure we present the project to members of the local community and actively encourage questions and comments and ensure them that during the project we will action any of their concerns. Carnarvon is also a sponsor of the Curtin University Petroleum Engineering department.

### Health and Wellbeing

We value our staff as one of our greatest assets and have recently put into place an annual medical assessment. The nature of Carnarvon’s operations often requires staff to travel overseas and all staff are required to have a pre-travel medical for the specific region.

### Safety

All staff have recently undergone a CPR (DRABCD) course covered by the Australian Surf Lifesaving Academy. Further to this Carnarvon has had zero lost time incidents reported in the current financial year.

### Economic

Carnarvon increased its 2P reserves over the year to 31 December 2009 by 48% to 24.5 million barrels. Ongoing production of the L44/43 Concession in Thailand ensures the Company has a sustainable economic outlook.



Carnarvon endeavors to ensure that everywhere we operate we are able to benefit the local community

## FINANCIAL REVIEW

### Three consecutive profitable years

The Group has been profitable for three consecutive financial years. Profit after tax for the year ended 30 June 2010 was \$14,423,000. As development continues in the L44/43 Concession in Thailand, the Group is expected to remain profitable in the foreseeable future, with retained profits being made available for the exploration of new assets.

	2010	2009	Change
Production (bbls)	868,450	1,353,421	▼ 36%
Sales (\$'000)	65,230	100,758	▼ 35%
Cost of sales	21,473	27,847	▼ 23%

A decline in production is the main driver of the decrease in sales in the 30 June 2010 financial year. A portion of cost of sales is fixed and as a result, cost of sales did not decrease in line with sales.

### No debt

Strong operating cash flows have meant exploration and development activities have continued while the Group remains in a strong cash position with no debt.

### Significant expenditure on development and exploration

The increase in the value of Carnarvon's oil & gas assets to \$70,176,000 is a direct result of the development of the L44/43 Concession in Thailand. Development has continued on the L44/43 Concession and will commence on the L33/43 Concession in the 30 June 2011 financial year in order to access oil reserves in each Concession.

With the increase in development costs carried forward, there has been an increase in deferred tax liabilities recognised. These liabilities are due to temporary differences between income tax deductions and amortization with respect to the Company's oil and gas assets in Thailand. The deferred tax component of the income tax expense does not incur any cash obligation to the Thai tax authorities.

New venture costs of \$1,124,000 and exploration & evaluation expenditure of \$5,516,000 demonstrates Carnarvon's continued efforts to add producing assets to its portfolio. Further detail on Carnarvon's new ventures and exploration can be found in the operating review on page 3.

The directors present their report together with the financial report of the Group, being the Company, its controlled entities, and the Group's interest in jointly controlled assets, for the financial year ended 30 June 2010, and the auditor's report thereon.

Carnarvon Petroleum Limited is a listed public company incorporated and domiciled in Australia

### **Directors**

The names and details of the Company's directors in office at any time during or since the end of the financial year are as follows. Directors were in office for this entire period unless otherwise stated.

#### ***Peter J Leonhardt***

*Chairman*

FCA, FAICD (Life)

Appointed as a director on 17 March 2005 and appointed Chairman in April 2005.

Mr Leonhardt is an independent company director and adviser with extensive business, financial and corporate experience. He is a Chartered Accountant and a former Senior Partner with PricewaterhouseCoopers and Managing Partner of Coopers & Lybrand in Western Australia.

During the past three years Mr Leonhardt has served as a director of the following listed companies: CTI Logistics Limited (from August 1999); Centrepoint Alliance Limited (from May 2002 to June 2009). He is also a director of the Western Australian Institute for Medical Research.

Mr Leonhardt is a member of the Audit Committee and the Remuneration Committee.

#### ***Edward (Ted) P Jacobson***

*Chief Executive Officer*

B.Sc (Hons Geology)

Appointed as a director on 5 December 2005.

Mr Jacobson is a petroleum geophysicist with 38 years' experience in petroleum exploration principally in the European North Sea, South East Asia, South America and Australia. Within Australia he has been responsible for initiating a number of petroleum discoveries within the Cooper Basin, Barrow Sub Basin and Timor Sea. In 1986, Ted established the consulting company Exploration Study Projects Pty Ltd which advised companies on new venture opportunities in Australia and South East Asia and assisted in capital raisings and corporate activity. In 1991 Ted was co-founder of Discovery Petroleum NL and from 1996 co-founder and technical director of Tap Oil Ltd which grew to a market capitalisation of over \$400 million under his technical leadership. Ted retired from Tap in September 2005.

During the past three years Mr Jacobson has served as director of the following listed companies: Rialto Energy Limited (from July 2006 to November 2009). Mr Jacobson was also a director of Smart Rich Energy Finance (Holdings) Ltd (from January 2007 to November 2007), listed on the Hong Kong Stock Exchange.

## **Directors (continued)**

### **Neil C Fearis**

*Non-Executive Director*

LL.B (Hons), MAICD, F Fin

Appointed as a director on 30 November 1999.

Mr Fearis has over 32 years' experience as a commercial lawyer in the UK and Australia.

During the past three years Mr Fearis has served as a director of the following listed companies: Kresta Holdings Limited (from 1997 to December 2009); Perseus Mining Limited (from 2004); Liberty Resources Limited (from June 2007 to November 2008); Magma Metals Limited (from October 2009). Mr Fearis is also a member of several professional bodies associated with commerce and law.

Mr Fearis is Chairman of the Audit Committee and Chairman of the Remuneration Committee.

### **Kenneth P Judge**

*Non-Executive Director*

B.Com, B. Juris, LL.B

Appointed as a director on 1 April 2005 (Retired 15 July 2010)

Mr Judge has extensive legal and business management experience having held a number of public company directorships and has been engaged in the establishment or corporate restructure of technology, mining, and oil and gas companies in Australia, United Kingdom, USA, Brazil, Argentina, Mexico and the Philippines.

Mr. Judge is a director and Chairman of Brazilian Diamonds Limited (from February 2001), which is listed on both the Toronto Stock Exchange and the AIM market of the London Stock Exchange Plc. He is also Chairman of Hidefield Gold Plc (from October 2003) and a director of Gulfsands Petroleum Plc (from October 2006), both of which are listed on AIM.

He is also a director and Chairman of Alto Ventures Ltd (from April 2004) which is listed on the TSX Venture Exchange.

Mr Judge was a member of the Audit Committee and the Remuneration Committee.

Mr Judge retired from the Board of Directors, Audit Committee and Remuneration Committee on 15 July 2010.

### **William (Bill) A Foster**

*Non Executive Director*

BE (Chemical)

Appointed as a director on 17 August 2010.

Bill is an engineer with extensive technical, commercial and managerial experience in the energy industry over a 40 year period. He has been an advisor to a major Japanese trading company for the last 20 years in the development of their global E&P and LNG activities and has spent time prior to this working internationally in the development of a number of energy companies.

Bill was a former independent director of Tap Oil Ltd and of the E&P companies that were formed through his advisory services to the Japanese trading company.

Mr Foster is a member of the Audit Committee and the Remuneration Committee.

### Company Secretary

Mr Robert Anderson was appointed Company Secretary in November 2005. Mr Anderson is a Chartered Accountant who has previously held company secretarial positions in both ASX-listed companies and private entities.

### Directors' meetings

The number of directors' meetings held and attended by each of the directors during the reporting period was as follows:

	(a)	(b)
Peter Leonhardt	7	7
Ted Jacobson	7	7
Neil Fearis	7	7
Ken Judge	7	7

(a) Number of meetings held during period of office

(b) Number of meetings attended

### Audit Committee

Names and qualifications of Audit Committee members

The Committee is to include at least 3 members from 1 July 2009. Current members of the committee are Neil Fearis (Chairman of the Audit Committee), Peter Leonhardt, and Bill Foster. Mr Judge retired as a member on 15 July 2010 and Mr Foster was appointed on 17 August 2010. Qualifications of Audit Committee members are provided in the Directors section of this directors' report.

### Audit Committee meetings

The number of Audit Committee meetings held and attended by the members during the reporting period was as follows:

	(a)	(b)
Peter Leonhardt	2	2
Neil Fearis	2	2
Ken Judge	2	2

(a) Number of meetings held during period of office

(b) Number of meetings attended

## Remuneration Report (Audited)

### Remuneration Committee

The Remuneration Committee currently comprises Neil Fearis (Chairman), Peter Leonhardt, and Bill Foster. Mr Judge retired as a member on 15 July 2010 and Mr Foster was appointed on 17 August 2010.

Qualifications of Remuneration Committee members are provided in the Directors section of this directors' report.

#### Remuneration Committee meetings

The number of Remuneration Committee meetings and the number attended by each of the members during the reporting period were as follows:

	(a)	(b)
Neil Fearis (Chairman)	2	2
Peter Leonhardt	2	2
Ken Judge	2	2

(a) Number of meetings held during period of office

(b) Number of meetings attended

The Remuneration Committee is responsible for the compensation arrangements for directors and executives of the Company. The Remuneration Committee considers compensation packages and policies applicable to the executive directors, senior executives and non-executive directors fees. In certain circumstances these include incentive arrangements including employee share plans, incentive performance packages, and retirement and termination entitlements.

#### Principles of compensation

Total non-executive directors' fees are approved by shareholders and the Remuneration Committee is responsible for the allocation of those fees amongst the individual members of the Board.

The Remuneration Committee assesses the appropriateness of the nature and amount of compensation on an annual basis by reference to industry and market conditions, and with regard to individual performance and the Company's financial and operational results. Such assessments are also made after referring to the recommendations of specialist consultancy firms, industry groups, government and shareholder bodies. The Board obtains, when required, independent advice on the appropriateness of remuneration packages, given trends in comparative companies both locally and internationally.

The Remuneration Committee ultimately determines its compensation practices in terms of their effectiveness to attract, retain and incentivize appropriately qualified and experienced directors and senior executives.

Remuneration arrangements are made having regard to the number and composition of staff in the business and the stage of development of the Company. Remuneration arrangements include a mix of fixed and performance based remuneration. Performance based remuneration comprises short term and long term incentive schemes. Short term incentive arrangements are designed to incentivise superior individual achievement over a period of around twelve months and typically comprise cash payments. Long term incentive arrangements are share-based and designed to be simple, clear and strongly aligned between shareholder and executive interests over the medium to longer term.

Remuneration structures take into account the overall level of compensation for each director and executive, the capability and experience of the directors and senior executives, the executive's ability to control the financial performance of the relative business segment, the Group's performance (including earnings and share price), and the amount of any incentives within each executive's remuneration.

## Remuneration Report (Audited) (continued)

### *Principles of compensation (continued)*

On 1 August 2008 the Board adopted a policy that prohibits those that are issued share-based payments as part of their remuneration from entering into other arrangements that limit their exposure to losses that would result from share price decreases. The Company requires all executives and directors to sign annual statements of compliance with this policy throughout the preceding year.

In considering the Group's performance and impact on shareholder wealth, the Board has had regard to the following in respect of the current financial year and the previous four years. No dividends have been paid or declared during this period.

	30 June 2006	30 June 2007	30 June 2008	30 June 2009	30 June 2010
Share price as at 30 June each year	\$0.052	\$0.24	\$0.53	\$0.815	\$0.345
Year on year change in the share price	174%	362%	121%	54%	(58%)
Consolidated net profit / (loss) from continuing operations (\$000)	(\$1,246)	(\$1,542)	\$15,651	\$28,736	\$14,423
Cumulative net profit / (loss) from continuing operations (\$000)	(\$1,246)	(\$2,788)	\$12,863	\$41,599	\$56,022

### *Non-executive directors*

Total remuneration for all non-executive directors, last voted upon by shareholders at a General Meeting in November 2008, is not to exceed \$300,000 per annum.

With effect from 1 January 2010 a non-executive director's base fee is \$62,000 per annum and the Chairman receives \$105,000 per annum. These fees were reviewed on 18 June 2010 and were increased with effect from 1 January 2010 by a nominal \$1,500 per annum per director, broadly in line with inflation in the 2009 calendar year. Non-executive directors do not receive any performance-related remuneration. Directors' fees cover all main Board activities and membership of Board committees. The Company does not have any terms or schemes relating to incentives or retirement benefits for non-executive directors.

### *Fixed compensation*

Fixed compensation consists of base compensation as well as employer contributions to superannuation funds.

### *Short term incentive scheme*

Short term incentives are assessed by the Remuneration Committee at 31 December each year based on the individual performances of each employee. The Remuneration Committee has regard to the business's plans and targets set at the commencement of each calendar year and each individual's performance relative to those plans and targets. Short term incentive payments are granted at the discretion of the Remuneration Committee and are not contractual obligations. Accordingly, the Remuneration Committee is not obliged to make incentive payments regardless of changed circumstances. Non-executive directors are not entitled to participate in the short term incentive scheme.

All short term incentives awarded during the period are included in remuneration, as set out on page 14, and fully vested to each of the directors, named Company executives, and key management personnel during the period.

## Remuneration Report (Audited) (continued)

### *Long term incentive scheme - Employee Share Plan*

The Carnarvon Employee Share Plan ("ESP") was implemented following shareholder approval at the 1997 Annual General Meeting ("AGM") and was last ratified by shareholders at the AGM on 27 November 2009.

The purpose of the ESP is to attract, retain and motivate those who have been invited by the Board to participate in the ESP and align their interests with all other shareholders by encouraging performance that increases shareholder wealth through long term growth.

The principal provisions of the Plan include:

- the Plan is available to all directors, employees or consultants of the Company or any of its subsidiaries ("Eligible Person");
- the Company may at any time, in its absolute discretion, make an offer to an Eligible Person;
- the number of Plan Shares issued to any Eligible Person and the issue price is to be determined by the directors of the Company;
- the issue price is to be no less than the weighted average market price of the Company's shares on the 5 trading days prior to the proposed date of issue;
- the offer may be accepted by an Eligible Person or an associate of that Eligible Person, within the given acceptance period;
- the person accepting the offer ("Participant") will be taken to have agreed to borrow from the Company on the terms of the loan agreement referred to below an amount to fund the purchase of the Plan Shares;
- the Plan Shares will rank *pari passu* with all issued fully paid ordinary shares in respect of voting rights, dividends and entitlement to participate in any bonus or rights issues;
- Eligible Persons may not dispose of a third of their Plan Shares before the second year following their issue and may not dispose of a third of their Plan Shares before the third year following their issue. These restrictions do not apply in the event of redundancy or change of control.
- until the loan to the Participant is fully repaid, the Company has control over the disposal of the Plan Shares. Once the loan is repaid in full, the Participant may deal with the Plan Shares as he wishes;
- the aggregate number of Plan Shares and other shares and options issued in the previous 5 years under any other employee incentive scheme of the Company must not exceed 5% of the issued capital of the Company; and
- applications will be made as soon as practicable after the allotment of the Plan Shares for listing for quotation on ASX.

The principal provisions of the loan agreement include:

- the amount lent will be an advance equal to the issue price of the Plan Shares multiplied by the number of Plan Shares issued;
- the loan can be repaid at any time but the Participant must pay any amount outstanding to the Company within 30 days of termination of the Eligible Person's employment. All dividends declared and paid on the Plan Shares will be applied towards the repayment of the advance and there is no interest on the advance;
- the maximum liability in respect of the loan will be the value of the Plan Shares from time to time; and
- a holding lock will be placed on the Plan Shares until the loan is fully repaid.
- loans made under the ESP involve no cash outlay by the Company.

A complete copy of the rules of the ESP (which incorporates the terms of the loan agreement) is available for inspection by shareholders (free of charge) at the Company's Registered Office or, upon request, from the Company Secretary.

Plan Shares are approved by the Remuneration Committee based upon the assessed performance of each person against his job specifications and the recommendations of the Chief Executive Officer, and in the case of directors, with the approval of shareholders. In the last 4 years the Company has issued 11.47 million Plan Shares to employees, being 1.67% of the issued capital of the Company (compared to the Share Plan limit of 5%). In 2007 the Company also issued 12.0 million Plan Shares (being 1.75% of the issued capital of the Company) to directors of the Company. As noted in the Company's 2007 Annual



Report, the issue to the directors in 2007 was in recognition of the active day-to-day role of the Chairman over above the normal role of a non-executive Chairman and in recognition of the Chief Executive Officer's level of cash remuneration, which was significantly below market levels. There have been no ESP shares issued to directors during the last three years.

The Remuneration Committee, having regard to recent changes in the taxation of certain long term incentive schemes and current trends in structuring long term incentive plans, is of the view that the Company's ESP is effectively structured to meet its objectives in attracting, retaining and motivating appropriately qualified and experienced directors and senior executives.

During the current financial year the following Plan Shares were issued to Executive Officers of the Company:

<b>Executive Officers</b>	<b>Number of shares issued</b>	<b>Issue date</b>	<b>Issue price per share</b>	<b>Loan</b>
AC Cook	1,425,000	09/11/2009	\$0.526	\$750,000
PP Huizenga	200,000	23/12/2009	\$0.522	\$104,400

These share issues were made having regard to market advice on the relevant base packages of the recipients. The loan to Mr Cook was made upon his commencement with the Company in November 2009 and the associated shares are subject to the Share Plan restrictions outlined above. The issue price for each issue was calculated based on the 5 day weighted average closing price prior to the date of offer. The purchases were funded by interest-free loans with a limited recourse security over the Plan Shares and subject to the detailed rules of the ESP. The shares remain subject to the disposal restrictions contained in the Plan Rules summarized above.

#### *Directors' and executive officers' remuneration (Company and consolidated)*

Details of the nature and amount of each major element of the remuneration of each director of the Company and each of the named Company and Group executives receiving the highest remuneration are set out on the following page.

In order to determine the cost of Plan Shares issued in a period, the Company uses the Black-Scholes Option Pricing Model, calculated at the date of issue of the Plan Shares, assuming a 3 year life and nil cash consideration. Plan shares are treated as having vested immediately and the cost calculated under the Black-Scholes Option Pricing Model is recognised as an expense entirely in the current period, notwithstanding restrictions on their disposal and the period over which the benefits arise. The following factors and assumptions were used in determining the fair value of Plan Shares at grant date in the current reporting period:

<b>2010 Grant date</b>	<b>Assumed expiry date</b>	<b>Fair value per option</b>	<b>Exercise price</b>	<b>Price of shares at grant date</b>	<b>Expected volatility</b>	<b>Risk free interest rate</b>	<b>Dividend yield</b>
09/11/2009	08/11/2012	\$0.24	\$0.526	\$0.526	62.5%	3.25%	0%
23/12/2009	22/12/2012	\$0.24	\$0.522	\$0.522	62.5%	3.25%	0%

#### *Service contracts*

The contract duration, period of notice and termination conditions for key management personnel are as follows:

- (i) Ted Jacobson, Chief Executive Officer, is engaged through a rolling 12 month Employment Agreement. Termination by the Company is with 3 months' notice (or payment in lieu thereof) and payment of 9 months' remuneration. Termination by Mr Jacobson is with 3 months' notice.
- (ii) Philip Huizenga, General Manager (Operations), is engaged as an employee. Termination by the Company is with 3 months' notice (or payment in lieu thereof) and payment of 6 months' remuneration. Termination by Mr Huizenga is with 3 months' notice.
- (iii) Adrian Cook, General Manager (Corporate), is engaged as an employee. Termination by the Company is with 3 months' notice (or payment in lieu thereof) and payment of 6 months' remuneration. Termination by Mr Cook is with 3 months' notice.

## Remuneration Report (Audited) (continued)

### *Equity instruments*

#### (i) Shares

There were no shares in the Company issued as compensation to key management personnel during the reporting period, other than the ESP shares treated in principle as an option over the Company's shares as described under (ii) below.

#### (ii) Options

There were no options over shares or ESP shares in the Company issued as compensation to key management personnel during the reporting period. No options have been issued since the end of the financial year.

There were no shares issued in 2010 on the exercise of options. The following shares were issued in 2009 on the exercise of options issued as compensation in prior periods. These options were issued to Directors in 2006 at a time the Company had no full-time employees, very limited cash resources, and recognised the unusual contribution of the Directors.

### **2009**

<b>Directors</b>	<b>Number of shares</b>	<b>Amount paid per share</b>
EP Jacobson	4,000,000	\$0.10
PJ Leonhardt	3,000,000	\$0.10
NC Fearis	2,000,000	\$0.10
KP Judge	1,000,000	\$0.10

There are no amounts unpaid on shares issued as a result of the exercise of options. During the reporting period there was no forfeiture, lapsing or vesting of options issued in previous periods.

At the end of the reporting period, other than Plan Shares (treated in principle as options), there were no unvested options on issue.

**Remuneration Report (Audited) (continued)**

*Directors' and executive officers' remuneration, Company and consolidated (continued)*

Name	Short Term		Post Employment contributions (\$)	Share-based payments (\$)	Total (\$)	Proportion of remuneration related %	Value of shares as a % of remuneration
	Salary and fees (\$)	Short term cash bonus (\$)					
<b>Directors</b>							
<i>Non-Executive</i>							
Mr PJ Leonhardt (Chairman)							
2010	\$104,250	-	-	-	\$104,250	-	-
2009	\$96,750	-	-	-	\$96,750	-	-
Mr NC Fearis							
2010	\$61,250	-	-	-	\$61,250	-	-
2009	\$57,750	-	-	-	\$57,750	-	-
Mr KP Judge							
2010	\$61,250	-	-	-	\$61,250	-	-
2009	\$57,750	-	-	-	\$57,750	-	-
<i>Executive</i>							
Mr EP Jacobson (Chief Executive Officer)							
2010	\$424,656	\$80,500	\$38,219	-	\$543,375	14.8%	-
2009	\$345,183	\$35,000	\$31,066	-	\$411,249	8.5%	-
<b>Executives</b>							
Mr RA Anderson (CFO/Company Secretary)							
2010 (CFO Until 31 May 2010)	\$226,875	\$24,750	-	-	\$251,625	9.8%	-
2009	\$236,250	\$22,500	-	-	\$258,750	8.7%	-
Mr PP Huizenga (General Manager – Operations)							
2010	\$325,988	\$65,801	\$29,338	\$48,424	\$469,551	14.0%	10.3%
2009	\$276,120	\$29,910	\$37,931	-	\$343,961	8.7%	-
Mr AC Cook (General Manager – Corporate)							
2010 (from 2 November 2009)	\$223,065	-	\$20,076	\$338,747	\$561,888	-	58.2%
Total compensation: key management personnel (Company and consolidated)							
2010	\$1,427,334	\$171,051	\$87,633	\$387,171	\$2,073,189		
2009	\$1,069,803	\$87,410	\$68,997	-	\$1,226,210		

Directors' fees are paid or payable to the director or a director-related entity.

## Non-audit services

The auditors have not performed any non-audit services over and above their statutory duties during the current reporting period.

Details of the amounts paid or payable to the auditor of the Group for audit services provided during the year are set out below:

Audit Services	Consolidated 2010 (\$)
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*Auditors of the Company:*

Audit and review of financial reports	122,000
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## Directors' interests

At the date of this report, the relevant interests of the directors in securities of the Company are as follows:

Name	Ordinary Shares	Options over ordinary Shares
PJ Leonhardt	17,000,000	-
EP Jacobson	31,037,335	-
NC Fearis	8,400,000	-
WA Foster	-	-

Shares issued under the Company's ESP are included under the heading Ordinary Shares.

## Share options

Options issued to directors and executives of the Company

There were no options over shares issued as compensation to directors or named executives during or since the end of the financial year.

## Likely developments

The likely developments for the 2011 financial year are contained in the operating and financial review as set out on pages 3 to 15. The directors are of the opinion that further information as to the likely developments in the operations of the Group would prejudice the interests of the Company and the Group and it has accordingly not been included.

## Environmental regulation and performance

The Group's oil and gas exploration and development activities are concentrated in Thailand and Western Australia. Environmental obligations are regulated under both State and Federal Law in Western Australia and under the Department of Mineral Fuels regulations in Thailand. No significant environmental breaches have been notified by any government agency during the year ended 30 June 2010.

## Dividends

No dividends were paid during the year and the directors do not recommend payment of a dividend in respect of the current financial year.

## Auditor's independence declaration

The auditor's Independence Declaration under Section 307C of the Corporations Act is set out on page 28 and forms part of the directors' report for the financial year ended 30 June 2010.

## Principal activities

During the course of the 2010 financial year the Group's principal activities continued to be directed towards oil and gas exploration, development and production.

## Identification of independent directors

The independent directors are identified in the Corporate Governance Statement section of this Annual Report as set out on pages 74 to 76.

### Significant changes in state of affairs

In the opinion of the directors no significant changes in the state of affairs of the Group occurred during the current financial year other than as outlined in the operating and financial review as set out on pages 3 to 15.

### Indemnification and insurance of directors and officers

During the period the Company paid a premium to insure the directors and officers of the Company and its controlled entities. The policy prohibits the disclosure of the nature of the liabilities covered and the amount of the premium paid.

### Proceedings on behalf of the Company

No person has applied for leave of Court to bring proceedings on behalf of the Company or intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or any part of the proceedings. The Company was not a party to any such proceedings during the year.

### Operating and financial review

An operating and financial review of the Group for the financial year ended 30 June 2010 is set out on pages 3 to 15 and forms part of this report.

### Indemnity of directors and company secretary

Deeds of Access and Indemnity have been executed by the Company with each of the directors and Company Secretary. The deeds require the Company to indemnify each director and Company Secretary against any legal proceedings, to the extent permitted by law, made against, suffered, paid or incurred by the directors or Company Secretary pursuant to, or arising from or in any way connected with the director or Company Secretary being an officer of the Company.

### Events subsequent to reporting date

On July 5 2010 Carnarvon (NZ) Pty Limited, a wholly owned subsidiary of Carnarvon Petroleum Ltd, farmed into PEP38524, offshore Taranaki Basin in New Zealand. Carnarvon contributed towards the cost of the Tuatara-1 exploration well to earn a 10% participating equity interest from AWE New Zealand Pty Ltd.

On 14 July 2010 the Company farmed out a proportion of its interest in the WA-399-P exploration permit to Apache Energy Limited and Jacka Resources Limited. In consideration Apache will undertake at its sole cost, a 3D seismic survey, which will fulfil the Year 2 and 3 work program obligations. In consideration for the farmout to Jacka, Jacka paid Carnarvon \$350,000. Following completion of the respective farm in obligations, the Company will have a 13% interest in the permit.

No other matters or circumstance has arisen since 30 June 2010 that in the opinion of the directors has significantly affected, or may significantly affect in future financial years:

- (i) The Group's operations; or
- (ii) The results of those operations; or
- (iii) The Group's state of affairs

### Rounding off

The Company is an entity to which ASIC Class Order 98/100 dated 10 July 1998 applies. In accordance with that Class Order amounts in the financial report and directors' report have been rounded off to the nearest thousand dollars, unless otherwise stated.

Signed in accordance with a resolution of the directors.



### PJ Leonhardt

Director

Perth, 26 August 2010



## AUDITOR'S INDEPENDENCE DECLARATION

In accordance with the requirements of section 307C of the Corporations Act 2001, as lead auditor for the audit of Camarvon Petroleum Limited and its controlled entities (the consolidated entity) for the year ended 30 June 2010, I declare that, to the best of my knowledge and belief, there have been:

- (a) no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

WHK HORWATH PERTH AUDIT PARTNERSHIP

A handwritten signature in dark blue ink, appearing to read "Cyrus Patel".

CYRUS PATELL  
Partner

Perth, WA

Dated this 26<sup>th</sup> day of August 2010

### Total Financial Solutions



*Horwath refers to Horwath International Association, a Swiss entity, each member of the Association is a separate and independent legal entity.*

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A WHK Group firm

CONSOLIDATED INCOME STATEMENT  
For the year ended 30 June 2010

		Consolidated	
		2010 \$000	2009 \$000 (Restated)
	Notes		
<b>Oil Sales</b>		65,230	100,758
Other income	4	82	896
Cost of sales	5	(21,473)	(27,847)
Administrative expenses		(1,396)	(1,445)
Directors' fees		(227)	(212)
Employee benefits expense		(1,497)	(829)
Travel related costs		(392)	(424)
Unrealised foreign exchange (loss) / gain		(525)	2,305
New venture costs		(1,124)	(963)
Exploration expenditure written off	14	(384)	-
Share-based payments		(753)	(122)
Finance costs		(1)	(1)
<b>Profit before income tax</b>		37,540	72,116
Taxes			
Current income tax expense		10,616	16,357
Deferred income tax expense		8,790	13,462
	9	19,406	29,819
Special remuneratory benefit		3,711	13,561
Total taxes		23,117	43,380
<b>Profit for the year</b>		14,423	28,736
<b>Profit attributable to members of the Company</b>		14,423	28,736
Basic earnings per share from continuing operations (cents per share)	8	2.1	4.3
Diluted earnings per share from continuing operations (cents per share)	8	2.1	4.3

The above consolidated income statements should be read in conjunction with the accompanying notes to the financial statements.

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2010

	<b>Consolidated</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
		<b>(Restated)</b>
<b>Profit for the year</b>	14,423	28,736
<b>Other Comprehensive income</b>		
Exchange differences arising in translation of foreign operations	(1,482)	2,839
Exchange differences on change in functional currency	-	1,252
<b>Total Comprehensive income for the year</b>	12,941	32,827
<b>Total Comprehensive income attributable to members of the company</b>	12,941	32,827

*The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes to the financial statements.*



CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
As at 30 June 2010

	Notes	2010 \$000	Consolidated 2009 \$000 (Restated)	2008 \$000
<b>Current assets</b>				
Cash and cash equivalents	21(b)	30,255	31,099	28,281
Trade and other receivables	10	7,780	11,904	12,443
Inventories	12	4,090	3,865	1,586
Other assets	13	440	677	299
<b>Total current assets</b>		42,565	47,545	42,609
<b>Non-current assets</b>				
Property, plant and equipment	11	635	353	172
Exploration and evaluation	14	6,351	1,219	379
Oil and gas assets	15	70,176	49,701	22,078
<b>Total non-current assets</b>		77,162	51,273	22,629
<b>Total assets</b>		119,727	98,818	65,238
<b>Current liabilities</b>				
Trade and other payables	17	5,621	6,901	3,368
Employee benefits	24	91	49	13
Current tax		6,165	5,656	9,304
Provisions	18	2,172	3,122	14,848
<b>Total current liabilities</b>		14,049	15,728	27,533
<b>Non-current liabilities</b>				
Deferred tax	19	23,306	14,516	3,215
<b>Total non-current liabilities</b>		23,306	14,516	3,215
<b>Total liabilities</b>		37,355	30,244	30,748
<b>Net assets</b>		82,372	68,574	34,490
<b>Equity</b>				
Issued capital		68,240	68,090	66,738
Reserves		(2,990)	(2,215)	(6,211)
Retained earnings		17,122	2,699	(26,037)
<b>Total equity</b>		82,372	68,574	34,490

The above consolidated statement of financial position should be read in conjunction with the accompanying notes to the financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2010

	Issued capital \$000	Retained earnings \$000 (Restated)	Translation reserve \$000	Share-based payments reserve \$000	Total \$000
<b>Balance at 1 July 2008</b>	66,738	(26,037)	(7,437)	1,226	34,490
Shares issued net of transaction costs	996	-	-	-	996
Share based payments	356	-	-	(95)	261
Total comprehensive income	-	28,736	4,091	-	32,827
<b>Balance at 30 June 2009</b>	68,090	2,699	(3,346)	1,131	68,574
Shares issued net of transaction costs	104	-	-	-	104
Share based payments	46	-	-	707	753
Total comprehensive income	-	14,423	(1,482)	-	12,941
<b>Balance at 30 June 2010</b>	68,240	17,122	(4,828)	1,838	82,372

The above statements of changes in equity should be read in conjunction with the accompanying notes to the financial statements.

STATEMENT OF CASH FLOWS  
For the year ended 30 June 2010

	Notes	Consolidated	
		2010 \$000	2009 \$000
<b>Cash flows from operating activities</b>			
Receipts from customers and GST recovered		71,274	114,083
Payments to suppliers and employees		(23,775)	(34,238)
Income tax and special remuneratory benefit paid		(15,277)	(48,177)
Interest received		82	973
<b>Net cash flows generated from operating activities</b>	21(a)	32,304	32,596
<b>Cash flows from investing activities</b>			
Exploration and development expenditure		(34,488)	(35,550)
Joint venture cash assigned to subsidiary		-	-
Cash held as security		2,153	(429)
Acquisition of property, plant and equipment		(533)	(300)
<b>Net cash flows (used in) investing activities</b>		(32,868)	(36,279)
<b>Cash flows from financing activities</b>			
Proceeds from issue of share capital		-	1,000
Payment of share issue costs		(7)	(4)
Proceeds from repayment of Employee Share Plan loans		111	140
<b>Net cash flows from financing activities</b>		104	1,136
<b>Net (decrease) in cash and cash equivalents</b>		(460)	(2,547)
Cash and cash equivalents at the beginning of the financial year		31,099	28,281
Effect of exchange rate fluctuations on cash and cash equivalents		(384)	5,365
<b>Cash and cash equivalents at the end of the financial year</b>	21(b)	30,255	31,099

*The above consolidated statement of cash flows should be read in conjunction with the accompanying notes to the financial statements.*

## 1. Reporting entity

The consolidated financial report of Carnarvon Petroleum Limited ('Company') for the financial year ended 30 June 2010 comprises the Company and its controlled entities (the "Group") and the Group's interest in jointly controlled assets.

On 28 June 2010, the Government announced the passage of the Corporations Amendment (Corporate Reporting Reform) Bill 2010. The changes contained within the Bill have come into effect for the financial year ended 30 June 2010. A key change that impacted the financial report of Carnarvon Petroleum Limited is the abolition of the requirement to prepare parent company financial statements in addition to consolidated financial statements. As a result of this, the separate financial statements of the parent entity, Carnarvon Petroleum Limited have not been presented within this group financial report. Certain disclosures required by the Corporations Act 2001 in relation to the parent entity are detailed in Note 33 to the financial statements.

The financial report was authorised for issue by the directors on 26 August 2010.

## 2. Basis of preparation of the financial report

### Statement of compliance

The financial report is a general purpose financial report prepared in accordance with Australian Accounting Standards ("AASBs"), including Australian Accounting Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board ("AASB"), and the Corporations Act 2001.

Australian Accounting Standards set out accounting policies that the AASB has concluded would result in a financial report containing relevant and reliable information about transactions, events and conditions to which they apply. Compliance with Australian Accounting Standards ensures that the financial statements and notes also comply with International Financial Reporting Standards ("IFRSs"). Material accounting policies adopted in the preparation of this financial report are presented below. They have been consistently applied unless otherwise stated.

The Group has reviewed all new and revised accounting standards and interpretations issued by the Australian Accounting Standards Board ("AASB"). It has been concluded that the Presentation of Financial Statements (AASB 101) and Operating Segments (AASB 8) standards have had a disclosure impact on the financial report. However, there are no new and revised standards that are relevant to and effective for the current reporting period and accordingly there have been no changes to the Group's accounting policies.

### Basis of measurement

The financial report is prepared on a historical cost basis, except for available-for-sale financial assets and financial instruments at fair value through profit and loss which are measured at fair value.

### Functional and presentation currency

The consolidated financial statements are presented in Australian dollars, which is the Company's functional and presentation currency.

### Use of estimates and judgements

The preparation of the financial report requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

*Key estimate – impairment*

The Group assesses impairment at each reporting date by evaluating conditions specific to the group that may lead to the impairment of assets. Where an impairment trigger exists, the recoverable amount of the asset is determined. Value-in-use calculations performed in assessing recoverable amounts incorporate a number of key estimates.

There was not considered to be any impairment trigger over the carrying value of the Group's interest in exploration and evaluation or oil and gas assets at the date of this report.

*Key estimate – income and capital gains taxes*

Judgement is required in determining any provision for income and capital gains taxes. The Group recognizes liabilities of anticipated tax based on estimates of taxes due. Where the final tax outcome of these matters is different from the amounts that were initially recognised, such differences will impact the income tax and deferred tax expenses, assets or provisions in the year in which such determination is made.

*Key estimate – special remuneratory benefit and income tax*

The Group's Phetchabun Basin Joint Venture is subject to Thai income tax at 50% and a special remuneratory benefit ("SRB") tax on profits, at sliding scale rates (0% - 75% per concession).

The SRB, which is tax deductible in the calculation of Thai income taxes, involves a highly detailed calculation done on a concession by concession basis. The basis of the calculation is petroleum profits, adjusted for capital spent, being subjected to a sliding scale SRB rate such that profits are not taxed until all capital has been recovered. The sliding scale rate is principally driven by production and pricing but is subject to other adjustments such as changes in Thailand's consumer price index, wholesale price index, cumulative metres drilled on the concession, and, for certain concessions, changes in the exchange rate between the Thai Baht and the USD.

The SRB calculation is performed and paid annually for each concession at the calculated annual rate at the end of each calendar year. Judgement is required in determining provisions which are based on estimates of amounts due. Where the final outcome of those matters is different from the amounts that were originally recognised, such difference may impact those provisions in the period in which such a determination is made.

*Key estimate – functional currency*

The determination of the functional currency of the Company's controlled entities requires consideration of a number of factors. These factors include the currencies that primarily influence their sales and costs and the economic environment in which the entities operate.

*Key estimates – other*

Other areas of judgement are in the determination of oil reserves, rehabilitation provisions, capitalisation of exploration and evaluation costs, determination of areas of interest, and the units of production method of depreciation.

### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial report. The accounting policies have been applied consistently by all entities in the Group. Certain comparative amounts have been reclassified to conform to the current year's presentation.

#### (a) Basis of consolidation

##### *Controlled entities*

The consolidated financial report comprises the financial statements of the Company and its controlled entities. A controlled entity is any entity controlled by the Company whereby the Company has the power to control the financial and operating policies of an entity so as to obtain benefits from its activities. All inter-company balances and transactions between entities in the economic entity, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of controlled entities have been changed where necessary to ensure consistency with those applied by the Company.

Where controlled entities enter or leave the economic entity during the year, their operating results are included or excluded from the date control was obtained or until the date control ceased. Investments in controlled entities are carried at cost in the Company's financial statements.

##### *Jointly controlled assets*

The Group's share of the assets, liabilities, revenue and expenses of joint venture assets are included in the financial statements under the appropriate headings.

#### (b) Income tax and special remuneratory benefit

##### *Income tax (current tax & deferred tax)*

The charge for current income tax expense is based on the result for the year adjusted for any non-assessable or disallowed items. It is calculated using tax rates that have been enacted or are substantively enacted by balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is recognised in the income statement except where it relates to items recognised directly in equity, in which case it is recognised in equity. Deferred income 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 tax losses. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the company / group intends to settle its current tax assets and liabilities on a net basis.

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law. The carrying amount of deferred tax assets is reviewed at each balance date and only recognised to the extent that sufficient future assessable income is expected to be obtained.

##### *Special remuneratory benefit*

The Group's Phetchabun Basin Joint Venture is subject to a special remuneratory benefit ("SRB") tax on profits, at sliding scale rates (0% - 75% per concession).

The SRB, which is tax deductible in the calculation of Thai income taxes, involves a detailed calculation done on a concession by concession basis. The basis of the calculation is petroleum profits, adjusted for capital spent, being subjected to a sliding scale SRB rate such that profits are not taxed until all capital has been recovered. The sliding scale rate is principally driven by production and pricing but is subject to other adjustments such as changes in Thailand's consumer price index, wholesale price index, cumulative metres drilled on the concession, and, for certain concessions, changes in the exchange rate between the Thai Baht and the USD. The SRB calculation is performed quarterly for each concession at the calculated annual rate at the end of each quarter.

The SRB is considered, for accounting purposes, to be a tax on income.

#### *Tax consolidation*

Carnarvon Petroleum Limited and its wholly-owned Australian-resident controlled entities formed a tax-consolidated group with effect from 1 July 2003 and are therefore taxed as a single entity from that date. Carnarvon Petroleum Limited is the head entity of the tax-consolidated group. In future periods the members of the group will, if required, enter into a tax sharing agreement whereby each company in the group contributes to the income tax payable in proportion to their contribution to the net profit before tax of the tax consolidated group.

### **(c) Property, plant and equipment**

#### *Recognition and measurement*

All property, plant and equipment is stated at cost less accumulated depreciation and impairment losses. The cost of an item also includes the initial estimate of the costs of dismantling and removing an item and restoring the site on which it is located.

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. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

#### *Impairment*

The carrying amount of property, plant and equipment is reviewed at each balance date to determine whether there are any objective indicators of impairment that may indicate the carrying values may not be recoverable in whole or in part. Impairment testing is carried out in accordance with Note 3(f).

Where an asset does not generate cash flows that are largely independent it is assigned to a cash generating unit and the recoverable amount test applied to the cash generating unit as a whole.

If the carrying value of the asset is determined to be in excess of its recoverable amount, the asset or cash generating unit is written down to its recoverable amount.

#### *Depreciation*

Depreciation on property plant and equipment is calculated on a straight-line basis over expected useful life to the economic entity commencing from the time the asset is held ready for use. The major depreciation rates used for all classes of depreciable assets are:

Property, plant and equipment: 10% to 33%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at least annually.

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.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These gains and losses are included in the income statement.

### 3. Significant accounting policies (continued)

#### (d) Oil and gas assets

Oil and gas assets include costs transferred from exploration and evaluation once technical feasibility and commercial viability of an area of interest are demonstrable, together with subsequent costs to develop the asset to the production phase.

Where the directors decide that specific costs will not be recovered from future development, those costs are charged to the income statement during the financial period in which the decision is made.

Depreciation of oil and gas assets is calculated on a unit of production basis so as to write off costs, including an element of future costs, in proportion to the depletion of the estimated recoverable reserves.

#### (e) Exploration and evaluation

Exploration and evaluation expenditure incurred is accumulated in respect of each identifiable area of interest. These costs are only carried forward to the extent that the Group's rights of tenure to the area are current and that the costs are expected to be recouped through the successful development of the area, or where activities in the area have not yet reached a stage that permits reasonable assessment of the existence of economically recoverable reserves.

Each area of interest is assessed for impairment to determine the appropriateness of continuing to carry forward costs in relation to that area of interest. Impairment testing is carried out in accordance with Note 3(f).

Accumulated costs in relation to an abandoned area are written off in full against profit in the year in which the decision to abandon the area is made.

Once the technical feasibility and commercial viability of the extraction of mineral resources in an area of interest are demonstrable, exploration and evaluation costs attributable to that area of interest are first tested for impairment and then reclassified from exploration and evaluation to oil and gas assets.

#### (f) Recoverable amount of assets and impairment testing

Assets that have an indefinite useful life are not subject to depreciation and are tested annually for impairment by estimating their recoverable amount.

Assets that are subject to depreciation are reviewed annually to determine whether there is any indication of impairment. Where such an indicator exists, a formal assessment of recoverable amount is then made. Where this is less than carrying amount, the asset is written down to its recoverable amount.

Recoverable amount is the greater of fair value less costs to sell and value in use. Value in use is the present value of the future cash flows expected to be derived from the asset or cash generating unit. In estimating value in use, a pre-tax discount rate is used which reflects the current market assessments of the time value of money and the risks specific to the asset. Any resulting impairment loss is recognised immediately in the income statement.

For the purposes of impairment testing assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets.

#### (g) Trade receivables

Trade receivables are stated at fair value and subsequently measured at amortised cost, less impairment losses. Impairment testing is carried out in accordance with Note 3(f).



### 3. Significant accounting policies (continued)

#### (h) 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. Provisions are determined by discounting the expected future cash flows at a pre-tax discount rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

#### *Restoration costs*

Any provision for future restoration and rehabilitation costs is capitalised and depreciated in accordance with the policy set out in Note 3(c). The unwinding of the effect of discounting on the provision is recognised as a finance cost.

#### (i) Investments and other financial instruments

The Group determines the classification of its financial instruments at initial recognition and re-evaluates this designation at each reporting date.

Fair value is the measurement basis, with the exception of held-to-maturity investments and loans and receivables which are measured at amortised cost. Fair value is inclusive of transaction costs. Changes in fair value are either taken to the income statement or to an equity reserve (refer below). Amortised cost is the amount measured at initial recognition, less principal repayments, adjusted for the difference, if any, between initial measurement and the maturity amount calculated using the effective interest method, less any reduction for impairment. The effective interest method is the rate that discounts future expected cash flows through the expected life of the financial instrument to its net carrying amount. Revisions to expected cash flows will require an adjustment to the carrying value with a consequential recognition of an income or expense in profit and loss.

Fair value is determined based on current bid prices for all quoted investments. If there is not an active market for a financial asset fair value is measured using established valuation techniques.

The Group assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets are 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 in determining whether the security is impaired. If any such evidence exists the cumulative loss is removed from equity and recognised in the income statement.

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

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Realised and unrealised gains and losses arising from changes in the fair value of these assets are included in the income statement in the period in which they arise.

#### *(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 and are stated at amortised cost using the effective interest rate method, less any impairment losses.

#### *(iii) 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 included in any of the above categories. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity in an available-for-sale investments revaluation reserve. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains and losses from investment securities.

### 3. Significant accounting policies (continued)

#### (j) Segment reporting

The Group reports one segment, oil and gas exploration, development and production, to the chief operating decision maker, being the board of Carnarvon Petroleum Limited, in assessing performance and determining the allocation of resources. The financial information presented in the statement of cashflows is the same basis as that presented to chief operating decision maker.

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

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.

#### (k) Foreign currency

Functional and presentation currency

The functional currency of each of the group's entities is measured using the currency of the primary economic environment in which that entity operates (the "functional" currency). The consolidated financial statements are presented in Australian dollars which is the Company's functional and presentation currency.

##### *Transactions and balances*

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rate at balance sheet date. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction.

Exchange differences arising on the translation of monetary items are recognised in the income statement, except where deferred in equity as a qualifying cash flow or net investment hedge.

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

##### *Foreign operations*

The financial performance and position of foreign operations whose functional currency is different from the Group's presentation currency are translated as follows:

- assets and liabilities are translated at exchange rates prevailing at balance sheet date
- income and expenses are translated at average exchange rates for the period

Exchange differences arising on translation of foreign operations are transferred directly to the group's foreign currency translation reserve as a separate component of equity. These differences are recognised in the income statement upon disposal of the foreign operation.

### 3. Significant accounting policies (continued)

#### (l) Leases

Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and benefits incidental to ownership.

##### *Operating leases*

A lease where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments in relation to operating leases are charged to the income statement on a straight-line basis over the period of the lease.

#### (m) Share capital

Incremental costs directly attributable to an equity transaction are shown as a deduction from equity, net of any recognised income tax benefit.

#### (n) Inventories

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

Cost includes those costs incurred in bringing each component of inventory to its present location and condition.

#### (o) Employee benefits

##### *Wages and salaries, annual leave*

Provision is made for the Group's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits that are expected to be settled within one year have been measured at the amounts expected to be paid when the liability is settled, plus related on-costs.

##### *Share based payments – Employee Share Plan*

Share based compensation has been provided to eligible persons via the Carnarvon Employee Share Plan ("ESP"), financed by means of interest-free limited recourse loans. Under AASB 2 "Share-based Payments", the ESP shares are deemed to be equity settled, share-based remuneration.

For limited recourse loans issued to eligible persons on or after 1 January 2005, the Group is required to recognise within the income statement a remuneration expense measured at the fair value of the shares inherent in the issue to the eligible person, with a corresponding increase to a share-based payments reserve in equity. The fair value is measured at grant date and recognised when the eligible person become unconditionally entitled to the shares, effectively on grant. A loan receivable is not recognised.

The fair value at grant date is determined using a pricing model that factors in the share price at grant date, the expected price volatility of the underlying share, the expected dividend yield, and the risk free rate for the assumed term of the plan. Upon repayment of the ESP loans, the balance of the share-based payments reserve relating to the loan repaid is transferred to issued capital.

#### (p) Earnings per share

The Group presents basic and diluted earnings per share ("EPS") for its ordinary shares.

Basic EPS is calculated by dividing the profit attributable to equity holders of the Company by the weighted number of shares outstanding during the period.

Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all potential ordinary shares, which comprise share options issued.

### 3. Significant accounting policies (continued)

#### **(q) Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand, deposits held at call with banks, and other short-term highly liquid investments.

#### **(r) Revenue**

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable.

Revenue is recognised when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, and the amount of revenue can be measured reliably. For the sale of oil the transfer of risks and rewards occurs on delivery of oil to the refinery.

#### **(s) Goods and services tax**

Revenues, expenses and assets are recognised net of the amount of goods and services tax ("GST"), except where the amount of GST incurred is not recoverable from the Australian Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of the expense. Receivables and payables in the balance sheet are shown inclusive of GST.

Cash flows are presented in the cash flow statement on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

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

Trade and other payables are stated at amortised cost. The amounts are unsecured and usually paid within 60 days of recognition.

#### **(u) Finance income and expenses**

Interest revenue on funds invested is recognised as it accrues, using the effective interest rate method.

Finance expenses comprise interest expense on borrowings and the unwinding of the discount on provisions.

#### **(v) Royalties**

Royalties are treated as taxation arrangements when they have the characteristics of a tax. This is considered to be the case when they are imposed under government authority and the amount payable is calculated by reference to revenue derived (net of any allowable deductions) after adjustment for items comprising temporary differences. For such arrangements, current and deferred tax is provided on the same basis as described above for other forms of taxation.

Obligations arising from royalty arrangements that do not satisfy these criteria are recognised as current provisions and included in expenses.

#### **(w) Comparative figures**

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

### 3. Significant accounting policies (continued)

#### (x) New standards and interpretations not yet adopted

The following standards, amendments to standards and interpretations have been identified as those which may impact the entity in the period of initial application. They are available for early adoption at 30 June 2010, but have not been applied in preparing the financial report.

- i. AASB 9 *Financial Instruments* includes requirements for the classification and measurement of financial assets resulting from the first part of Phase 1 of the project to replace AASB 139 *Financial instruments: Recognition and measurement*. AASB 9 will become mandatory for the Group's 30 June 2014 financial statements. Retrospective application is generally required, although there are some exceptions, particularly if the entity adopts the standard for the year ended 30 June 2012 or earlier. The Group has not yet determined the potential affect of the standard.
- ii. AASB 124 *Related Party Disclosures* (revised December 2009) simplifies and clarifies the intended meaning of the definition of a related party and provides a partial exemption from the disclosure requirements for government-related entities. The amendments, which will become mandatory for the Group's 30 June 2012 financial statements, are not expected to have any impact on the financial statements.
- iii. AASB 2009-5 *Further Amendments to Australian Accounting Standards arising from the Annual Improvements Process* affect various AASBs resulting in minor changes for presentation, disclosure, recognition and measurement purposes. The amendments, which become mandatory for the Group's 30 June 2011 financial statements, are not expected to have a significant impact on the financial statements.
- iv. AASB 2009-8 *Amendments to Australian Accounting Standards – Group Cash – settled Share-based Payment Transactions* resolves diversity in practice regarding the attribution of cash-settled share-based payments between different entities within a group. As a result of the amendments AI 8 Scope of AASB 2 and AI 11 AASB 2 – *Group and Treasury Share Transactions* will be withdrawn from the application date. The amendments, which become mandatory for the Group's 30 June 2011 financial statements, are not expected to have a significant impact on the financial statements.
- v. AASB 2009-10 *Amendments to Australian Accounting Standards – Classification of Rights Issue* [AASB 132] (October 2010) clarify that rights, options or warrants to acquire a fixed number of an entity's own equity instruments for a fixed amount in any currency are equity instruments if the entity offers the rights, options or warrants pro-rata to all existing owners of the same class of its own non-derivative equity instruments. The amendments, which will become mandatory for the Group's 30 June 2011 financial statements, are not expected to have any impact on the financial statements.
- vi. IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. IFRIC 19 will become mandatory for the Group's 30 June 2011 financial statements, with retrospective application required. The Group has not yet determined the potential effect of the interpretation.

#### 4. Other income

	Consolidated	
	2010	2009
	\$000	\$000
Finance income on bank deposits	82	896
	82	896

#### 5. Cost of sales

Production expenses	(5,438)	(3,892)
Royalty and excise	(4,118)	(7,331)
Transportation	(2,283)	(3,827)
Depreciation - development costs and producing assets	(6,928)	(10,057)
Selling, general and administration	(2,706)	(2,740)
	(21,473)	(27,847)

#### 6. Other expenses

Depreciation – property, plant and equipment	(251)	(162)
Rental premises – operating leases	(204)	(234)
	(455)	(396)

#### 7. Auditors' remuneration

*Audit services:*

Auditors of the Company	122	108
	122	108

#### 8. Earnings per share

The calculation of basic and diluted earnings per share was based on a weighted average number of shares calculated as follows:

	2010	2009
	Number of shares	
Issued ordinary shares at 1 July	683,674,634	672,924,634
Effect of shares issued	1,723,233	583,699
Effect of share options exercised	-	2,493,151
Weighted average number of ordinary shares 30 June (basic)	685,397,867	676,001,484
Effect of share options on issue	-	-
Weighted average number of ordinary shares 30 June (diluted)	685,397,867	676,001,484
Profit used in calculating basic and diluted earnings per share from continuing operations	\$14,423,000	\$28,736,000

## 9. Income tax expense

	2010 \$000	2009 \$000 (Restated)
<i>Numerical reconciliation between pre-tax profit and income tax expense:</i>		
Prima facie income tax expense on pre-tax profit at 30% (2009: 30%)	11,262	21,634
Tax effect of:		
Special remuneratory benefit	(1,856)	(6,781)
Effect of higher overseas tax rate	6,843	12,988
Foreign exchange (gains) / losses	303	(3,220)
Non-deductible expenditure	581	350
Prior year losses recognised	-	(198)
Prior year temporary differences recognised	1,166	4,253
Current year tax benefit not brought to account	1,107	793
Income tax expense on pre tax profit	<u>19,406</u>	<u>29,819</u>
Current income tax	10,616	16,357
Deferred tax	8,790	13,462
	<u>19,406</u>	<u>29,819</u>

### *Tax Consolidation*

Effective 1 July 2003, for the purposes of Australian income taxation, Carnarvon and its 100%-owned controlled entities formed a tax consolidated group. The head entity of the tax consolidated group is Carnarvon.

The impact of consolidating for tax purposes is that Carnarvon's Australian controlled entities are treated as divisions of Carnarvon rather than as separate entities for tax purposes. The members of the group will, if required, enter into a tax sharing arrangement in order to allocate group tax related liabilities to contributing members on a reasonable basis. The agreement will provide for the allocation of income tax liabilities between entities should the head entity default on its tax payment obligations.

## 10. Trade and other receivables

	Consolidated		
	2010 \$000	2009 \$000	2008 \$000
<i>Current</i>			
Trade and other receivables	6,348	8,318	9,287
Cash held as security	1,432	3,586	3,156
	<u>7,780</u>	<u>11,904</u>	<u>12,443</u>

The Group's exposure to credit and currency risks is disclosed in Note 32.

**11. Property, plant and equipment**

	<b>Consolidated</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
<i>Plant and equipment</i>			
Cost:			
Balance at beginning of financial year	42	74	89
Additions	405	-	56
Transfers	-	(43)	-
Disposals	-	-	(63)
Effects of movements in foreign exchange	-	11	(8)
Balance at end of financial year	<u>447</u>	<u>42</u>	<u>74</u>
Depreciation and impairment losses:			
Balance at beginning of financial year	32	67	56
Disposals	-	-	(3)
Transfers	-	(43)	-
Depreciation charge for year	84	8	14
Balance at end of financial year	<u>116</u>	<u>32</u>	<u>67</u>
Carrying amount opening	<u>10</u>	<u>7</u>	<u>33</u>
Carrying amount closing	<u>331</u>	<u>10</u>	<u>7</u>
<i>Fixtures and fittings</i>			
Cost:			
Balance at beginning of financial year	626	319	204
Additions	96	271	121
Transfers	-	43	-
Disposals	-	(58)	-
Effects of movements in foreign exchange	(7)	51	(6)
Balance at end of financial year	<u>715</u>	<u>626</u>	<u>319</u>
Depreciation and impairment losses:			
Balance at beginning of financial year	334	191	133
Disposals	-	(41)	-
Transfers	-	43	-
Depreciation charge for year	147	141	58
Balance at end of financial year	<u>481</u>	<u>334</u>	<u>191</u>
Carrying amount opening	<u>292</u>	<u>128</u>	<u>71</u>
Carrying amount closing	<u>234</u>	<u>292</u>	<u>128</u>



**11. Property, plant and equipment (continued)**

	<b>2010</b>	<b>Consolidated</b>	<b>2008</b>
	<b>\$000</b>	<b>2009</b>	<b>\$000</b>
		<b>\$000</b>	<b>\$000</b>
<i>Land and buildings</i>			
Cost:			
Balance at beginning of financial year	65	38	-
Additions	38	21	38
Effects of movements in foreign exchange	-	6	-
Balance at end of financial year	103	65	38
Depreciation and impairment losses:			
Balance at beginning of financial year	14	1	-
Depreciation charge for year	19	13	1
Balance at end of financial year	33	14	1
Carrying amount opening	51	37	-
Carrying amount closing	70	51	37
<i>Total</i>			
Cost:			
Balance at beginning of financial year	733	431	293
Additions	540	292	215
Disposals	-	(58)	(63)
Effects of movements in foreign exchange	(7)	69	(14)
Balance at end of financial year	1,266	733	431
Depreciation and impairment losses:			
Balance at beginning of financial year	380	259	189
Disposals	-	(41)	(3)
Depreciation charge for year	251	162	73
Balance at end of financial year	631	380	259
Carrying amount opening	353	172	104
Carrying amount closing	635	353	172

## 12. Inventories

	Consolidated		
	2010	2009	2008
	\$000	\$000	\$000
<i>Current</i>			
Raw materials and consumables	4,090	3,865	1,586

## 13. Other assets

<i>Current</i>			
Deposits and prepayments	440	677	299

## 14. Exploration and evaluation

Cost:			
Balance at beginning of financial year	1,219	379	-
Additions	5,516	915	379
Exploration expenditure written off	(384)	-	-
Assignment of joint venture to subsidiary	-	(75)	-
Balance at end of financial year	6,351	1,219	379

## 15. Oil and gas assets

Cost:			
Balance at beginning of financial year	62,914	25,340	12,773
Additions	28,087	31,233	14,475
Effects of movements in foreign exchange	(874)	6,341	(1,908)
Balance at end of financial year	90,127	62,914	25,340
Depreciation and impairment losses:			
Balance at beginning of financial year	13,213	3,262	644
Depreciation charge for year	6,738	9,951	2,618
Balance at end of financial year	19,951	13,213	3,262
Carrying amount opening	49,701	22,078	12,129
Carrying amount closing	70,176	49,701	22,078

## 16. Joint ventures

The Group has the following interests in joint venture assets:

<i>Joint venture</i>	<i>Principal activities</i>	<i>Ownership interest %</i>	
		<b>2010</b>	<b>2009</b>
<i>Thailand</i>			
Phetchabun Basin Concession, Exploration Blocks L44/43 and L33/43 3/2546/60 and 5/2546/62 Concessions	Exploration, development and production of hydrocarbons	40%	40%
Exploration Block L20/50 7/2551/98 Concession	Exploration for hydrocarbons	50%	50%
Exploration Blocks L52/50 and L53/50 3/2553/105 concession	Exploration for hydrocarbons	50%	-
<i>Western Australia</i>			
WA-435-P, WA-436-P, WA-437-P, WA 438-P, Roebuck Basin	Exploration for hydrocarbons	50%	-
WA-443-P, Roebuck Basin	Exploration for hydrocarbons	100%	-
WA-399-P, Carnarvon Basin	Exploration for hydrocarbons	50%	50%
<i>Indonesia</i>			
Rangkas, West Java Basin	Exploration for hydrocarbons	25%	-

## 16. Joint ventures (continued)

Summary financial information for joint venture assets, as included in the consolidated statement of financial position and statement of comprehensive income, is shown below:

	<b>2010</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
		<b>Restated</b>
Current assets		
Cash and cash equivalents	7,497	27,758
Trade and other receivables	7,097	9,176
Inventories	4,090	3,865
Other assets	318	384
Total current assets	<u>19,002</u>	<u>41,183</u>
Non-current assets		
Property, plant and equipment	531	238
Exploration and evaluation	6,176	1,189
Oil and gas assets	70,176	50,401
Total non-current assets	<u>76,883</u>	<u>51,828</u>
Total assets	<u>95,885</u>	<u>93,011</u>
Current liabilities		
Trade and other payables	4,926	5,889
Provisions	8,338	6,643
Total current liabilities	<u>13,264</u>	<u>12,532</u>
Non-current liabilities		
Deferred tax	23,306	14,516
Total non-current liabilities	<u>23,306</u>	<u>14,516</u>
Total liabilities	<u>36,570</u>	<u>27,048</u>
Net assets	<u>59,315</u>	<u>65,963</u>
Income	65,275	100,758
Expenses	<u>(44,590)</u>	<u>(71,000)</u>
Net profit after tax	<u>20,685</u>	<u>29,758</u>

Capital commitments and contingent liabilities for the joint ventures are disclosed in Notes 22 and 23 respectively.

**17. Trade and other payables**

	<b>2010</b>	<b>Consolidated</b>	<b>2008</b>
	<b>\$000</b>	<b>2009</b>	<b>\$000</b>
		<b>\$000</b>	<b>\$000</b>
<i>Current</i>			
Trade payables	307	2,686	2,352
Non-trade payables and accrued expenses	5,298	4,163	948
Owing to related parties	16	52	68
	<u>5,621</u>	<u>6,901</u>	<u>3,368</u>

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in Note 32.

**18. Provisions**

	<b>2010</b>	<b>Consolidated</b>	<b>2008</b>
	<b>\$000</b>	<b>2009</b>	<b>\$000</b>
		<b>(Restated)</b>	<b>\$000</b>
<i>Current</i>			
Special Remuneratory Benefit - Thailand	2,172	3,122	14,848
	<u>2,172</u>	<u>3,122</u>	<u>14,848</u>

There are no restoration provisions required in respect of the Group's activities under current Thai Legislation.

**19. Deferred tax***Recognised deferred tax assets and liabilities*

The net deferred tax liability is attributable to the following:

Oil and gas assets	25,267	16,784	5,395
Tax value of losses carry forward	(1,960)	(2,268)	(2,180)
Net tax liability	<u>23,306</u>	<u>14,516</u>	<u>3,215</u>

The movement in the deferred tax liability during the reporting period has all been recognized in the income statement.

*Unrecognised deferred tax assets and liabilities*

Deferred tax assets have not been recognized in respect of the following items:

Deductible temporary differences	-	159	212
Australian tax losses	3,691	2,571	1,631
	<u>3,691</u>	<u>2,730</u>	<u>1,843</u>

The deductible temporary differences and tax losses do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available against which the Group can utilise the benefits.

## 20. Capital and reserves

	Company and consolidated		
	2010	2009	2008
	<b>Number of shares</b>		
<i>Issued capital</i>			
Balance at beginning of financial year	683,674,634	672,924,634	657,537,134
Employee Share Plan issues	3,085,000	750,000	387,500
Shares issued on exercise of share options	-	10,000,000	15,000,000
Balance at end of financial year	686,759,634	683,674,634	672,924,634

	Company and consolidated		
	2010	2009	2008
	<b>\$000</b>		
<i>Issued capital</i>			
Balance at beginning of financial year	68,090	66,738	65,041
Employee Share Plan related movements	46	216	380
Employee Share Plan loans repaid	111	140	90
Shares issued on exercise of share options	-	1,000	1,230
Share issue transaction costs	(7)	(4)	(3)
Balance at end of financial year	68,240	68,090	66,738

Ordinary shares have the right to one vote per share at meetings of the Company, to receive dividends as declared and, in the event of a winding-up of the Company, to participate in the proceeds from the sale of all surplus assets in proportion to the number of, and amounts paid up on, shares held.

### *Translation reserve*

Movements in the translation reserve are set out in the Statement of Changes in Equity on page 32.

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity.

### *Share based payments reserve*

Movements in the share based payments reserve are set out in the Statements of Changes in Equity on page 32.

This reserve represents the fair value of shares issued under the Company's ESP. This reserve is reversed against issued capital when shares are issued on exercise of option issued under the previous employee option plan or the loan is repaid under the current ESP.

**21. Reconciliation of cash flows from operating activities**

	<b>Consolidated</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
		<b>(Restated)</b>
<i>(a) Cash flows from operating activities</i>		
After tax profit for the period	14,423	28,736
<i>Adjustments for:</i>		
Equity settled share based payment expense	753	122
Deferred tax expense	8,790	11,301
Depreciation	6,930	10,114
Loss on disposal of property, plant and equipment	-	16
Foreign exchange (gains) / losses	525	(2,305)
Operating profit before changes in working capital and provisions:	31,421	47,984
Changes in assets and liabilities:		
Decrease in trade and other receivables	2,550	2,682
(Increase) in inventories	(225)	(1,972)
Decrease / (increase) in other assets	237	(185)
(Decrease) / increase in trade and other payables	(1,280)	150
(Decrease) in provisions and employee benefits	(399)	(16,063)
Net cash flows generated from operating activities	32,304	32,596
<i>(b) Reconciliation of cash and cash equivalents</i>		
Cash at bank and at call	30,255	31,099

The Group's exposure to interest rate risk and a sensitivity analysis for financial assets and liabilities is disclosed in Note 32.

Restricted cash of \$1,432,000 consolidated is included under trade and other receivables (2009: \$3,586,000 consolidated), see Notes 10 and 23.

## 22. Capital and other commitments

	Consolidated	
	2010 \$000	2009 \$000
<i>(a) Joint venture commitments</i>		
Share of capital commitments of joint venture assets:		
Within one year	1,572	1,189
Capital commitments of the Group to joint venture assets:		
Within one year	4,864	2,264

### *(b) Exploration expenditure commitments*

Due to the nature of the Group's operations in exploring and evaluating areas of interest it is necessary to incur expenditure in order to retain the Group's present permit interests. Expenditure commitments on exploration permits can be reduced by selective relinquishment of exploration tenure, by the renegotiation of expenditure commitments, or by farming out portions of the Group's equity.

Exploration expenditure commitments forecast but not provided for in the financial statements are as follows:

	Consolidated	
	2010 \$000	2009 \$000
Less than one year	5,500	4,100
Between one and five years	4,500	1,700
	10,000	5,800
<i>(c) Capital expenditure commitments</i>		
Data licence commitments	231	126

## 23. Contingencies

The directors are of the opinion that provisions are not required in respect of these matters as it is not probable that a future sacrifice of economic benefits will be required or the amount is not capable of reliable measurement.

### *Contingent liabilities not considered remote*

- a) Under the terms of an Investment Agreement the Group is required to pay a percentage of sales proceeds from specified zones within the Wichian Buri Production Licences I and II in Thailand to Gemini Oil and Gas Limited, an independent oil and natural gas investment fund. The current percentage is 7.5%.

The Group has expensed US\$61,000 in the current period (2009: US\$85,000). Cumulative amounts paid at balance date under the terms of this agreement are US\$966,000.

### *Contingent liabilities considered remote*

- a) The Phetchabun Basin Joint Venture operation, in which the Group has a 40% interest, has procured the issue of bank guarantees for an amount of 40 million Thai Baht as security in lieu of bonds.

The L20/50 Joint Venture, in which the Group has a 50% interest, has procured the issue of bank guarantees for an amount of 20 million Thai Baht as security in lieu of bonds.



## 23. Contingencies (continued)

The Company has provided a cash bond of US\$450,000 to the Department of Mineral Fuels in Thailand in respect of its obligations for its 50% interest in the L20/50 concession in Thailand. The bond is secured by a cash deposit of US\$450,000 held with Company's Australian bank. The Company and its joint venture partner, who has provided a similar guarantee to the Department of Mineral Fuels, have signed a Cross Deed of Indemnity in respect of their respective rights and interests.

The restricted cash held by the banks as security for these bonds and guarantees totaling \$1,432,000 (2009: \$3,586,000) is classified under "trade and other receivables".

b) In accordance with normal petroleum industry practice, the Group has entered into joint ventures and farmin agreements with other parties for the purpose of exploring and developing its petroleum permit interests. If a party to a joint venture defaults and does not contribute its share of joint venture obligations, then the other joint venturers are liable to meet those obligations. In this event, the interest in the permit held by the defaulting party may be redistributed to the remaining joint venturers.

## 24. Employee benefits

	<b>Consolidated</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
<i>Current:</i>			
Liability for annual leave	91	49	13

### *Share based payments - Employee Share Plan*

Under the terms of the Carnarvon Employee Share Plan ("ESP"), as approved by shareholders, the Company may, in its absolute discretion, make an offer of ordinary fully paid shares in the Company to any Eligible Person, to be funded by a limited recourse interest free loan granted by the Company.

The issue price is determined by the directors and is not to be less than the weighted average market price of the Company's shares on the five trading days prior to the date of offer. Eligible Persons use the above-mentioned loan to acquire plan shares.

The movements in the ESP during the financial year, including those held by Key Management Personnel, were as follows:

	<b>1 July 2009</b>	<b>Issued</b>	<b>Repaid</b>	<b>30 June 2010</b>
Number of shares	14,457,500	3,085,000	914,301	16,628,199
Loan	\$1,901,208	\$1,654,770	\$110,965	\$3,445,013
Average loan per share	\$0.13	\$0.54	\$0.12	\$0.21

## 24. Employee benefits (continued)

Shares issued under the ESP are accounted for in accordance with the AASB 2.

The fair value of shares issued under the ESP is measured by reference to their fair value using the Black-Scholes model, as set out below.

<b>Fair value of share options and related assumptions</b>	<b>Key management personnel 2010</b>	<b>Key management personnel 2009</b>	<b>Other employees 2010</b>	<b>Other employees 2009</b>
Fair value at measurement date (cents)	23.7 to 24.2	-	24.2 to 27.0	11.2 to 20.8
Share price at date of issue (cents)	54 to 66	-	54 to 60.7	26.1 to 48.5
Exercise price (cents)	54 to 55	-	54 to 60.7	26.1 to 48.5
Expected volatility	62.5%	-	62.5%	60%
Actual / assumed option life	3 years	-	3 years	3 years
Expected dividends	Nil	-	Nil	Nil
Risk-free interest rate	3.25%	-	3.25% to 3.75%	3.5%
Share-based expense recognised	\$387,171	-	\$365,997	\$122,208

The current year volatility is intended to reflect the movement of the Company's share price during the financial year.

Further details of shares and options issued to directors are set out in Note 28, and in the Remuneration Report set out on pages 9 to 14.

## 25. Related party disclosures

### *Ultimate parent*

Carnarvon Petroleum Limited is the ultimate parent company.

### *Wholly-owned group transactions*

During the reporting period there have been transactions between the Company and its controlled entities and joint ventures. The Company provided accounting and administrative services to its controlled entities for which it did not charge a management fee.

During the financial year ended 30 June 2010 net receipts from controlled entities totalled \$22,093,000 (2009: net repayment from controlled entities \$6,366,000).

The carrying value of loans to controlled entities at 30 June 2010 was \$8,420,000 (2009: \$10,273,000) after provisions of \$693,000 (2009: \$693,000). These loans are unsecured, non-interest bearing, and have no fixed terms of repayment.

### *Other related party balances*

At 30 June 2010 an amount of \$15,906 (2009: \$52,070) is included in Company and consolidated trade and other payables for outstanding director fees and expenses.

## 26. Operating leases

### *Leases as lessee*

Non-cancellable operating lease rentals are payable as follows:

	<b>Consolidated</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
Less than one year	245	231
Between one and five years	71	271
	316	502

During the reporting period \$325,000 was recognised as an expense in the consolidated income statement in respect of operating leases (2009: \$371,000).

## 27. Segment information

The Group reports one segment, oil and gas exploration, development and production, to the chief operating decision maker, being the board of Carnarvon Petroleum Limited, in assessing performance and determining the allocation of resources. The financial information presented in the statement of cash flows is the same basis as that presented to chief operating decision maker.

### *Basis of accounting for purposes of reporting by operating segments*

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

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.

### *Revenue by geographical region*

Revenue, including interest income, is disclosed below based on the location of the external customer:

	<b>2010</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
Thailand	65,275	101,440
Australia	37	214
	65,312	101,654

The Group derives 100% of its sales revenue from one customer in the oil and gas exploration, development and production segment.

### *Assets by geographical region*

The location of segment assets is disclosed below by geographical location of the assets:

	<b>2010</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
Thailand	94,488	91,985
Australia	23,792	6,833
Indonesia	1,447	-
	119,727	98,818

## 28. Key management personnel disclosures

### (a) Key management personnel compensation

Key management personnel compensation included in employee benefits expense, directors emoluments, share based payments and administration expenses are as follows:

	<b>Consolidated</b>	
	<b>2010 (\$)</b>	<b>2009 (\$)</b>
Short term employee benefits	1,598,385	1,157,213
Post-employment benefits	87,633	68,997
Share-based payments	387,171	-
	2,073,189	1,226,210

Information regarding individual directors and executives' compensation and some equity instruments disclosures, as permitted by Corporations Regulation 2M.3.03, are provided in the Remuneration Report section of the directors' report as set out on pages 20 to 25.

Apart from the details disclosed in this note, no director has entered into a material contract with the Company or the Group since the end of the previous financial year and there were no material contracts involving directors' interests existing at year end.

### (b) Options and rights over equity instruments

The movement during the reporting period in the number of options over ordinary shares in the Company held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

<b>Directors</b>	<b>Held at 1 July 2009</b>	<b>Exercised</b>	<b>Held at 30 June 2010</b>
PJ Leonhardt	-	-	-
EP Jacobson	-	-	-
NC Fearis	-	-	-
KP Judge	-	-	-

<b>Directors</b>	<b>Held at 1 July 2008</b>	<b>Exercised</b>	<b>Held at 30 June 2009</b>
PJ Leonhardt	3,000,000	(3,000,000)	-
EP Jacobson	4,000,000	(4,000,000)	-
NC Fearis	2,000,000	(2,000,000)	-
KP Judge	1,000,000	(1,000,000)	-

Options issued as compensation vest immediately. During the financial year there was no forfeiture or vesting of options issued in previous periods. There were no options on issue that were still to vest at the end of the reporting period.

## 28. Key management personnel disclosures (continued)

### (c) Loans to key management personnel and their related parties

Details of loans to key management personnel and their related parties, which are all interest free loans with limited recourse security over the plan shares provided in accordance with the Company's Employee Share Plan ("ESP"), are set out below. The loans to directors were made in 2006 in lieu of normal remuneration at a time the Company had no full time employees and limited cash resources.

	<b>Balance 1 July 2009 (\$)</b>	<b>Balance 30 June 2010 (\$)</b>	<b>Highest balance in period (\$)</b>	<b>Loaned in period (\$)</b>	<b>Repaid in period (\$)</b>
<i>Directors</i>					
PJ Leonhardt	270,000	270,000	270,000	-	-
EP Jacobson	540,000	540,000	540,000	-	-
<i>Executives</i>					
PP Huizenga	253,100	357,500	357,500	104,400	-
RA Anderson	81,065	70,100	81,065	-	10,965
AC Cook	-	750,000	750,000	750,000	-
	<b>Balance 1 July 2008 (\$)</b>	<b>Balance 30 June 2009 (\$)</b>	<b>Highest balance in period (\$)</b>	<b>Loaned in period (\$)</b>	<b>Repaid in period (\$)</b>
<i>Directors</i>					
PJ Leonhardt	270,000	270,000	270,000	-	-
EP Jacobson	540,000	540,000	540,000	-	-
<i>Executives</i>					
PP Huizenga	314,100	253,100	314,100	-	61,000
RA Anderson	81,065	81,065	81,065	-	-

Details regarding the aggregate of loans, all of which are interest-free, made by the Group to key management personnel and their related parties, and the number of individuals in each group, are as follows:

	<b>Opening balance (\$)</b>	<b>Closing balance (\$)</b>	<b>Number in group at 30 June</b>
2010	1,144,165	1,630,100	5
2009	1,205,165	1,144,165	4

Mr Cook joined the Company on 2 November 2009 and was classified as a key management person on that date. Mr Anderson is no longer is a key management personnel effective 31 May 2010.

### (d) Other key management personnel transactions

Amounts payable to key management personnel or their related parties at reporting date in respect of outstanding director and consulting fees and expenses are as follows:

	<b>Consolidated</b>	
	<b>2010 \$000</b>	<b>2009 \$000</b>
<i>Current</i>		
Trade and other payables	16	52

## 28. Key management personnel disclosures (continued)

### (e) Movements in shares

The movement during the reporting period in the number of ordinary shares in Carnarvon Petroleum Limited held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

	Held at 1 July 2009	Net acquired/ (sold)	Award under Employee Share Plan	Received on exercise of options	Held at 30 June 2010
<i>Directors</i>					
PJ Leonhardt	17,000,000	-	-	-	17,000,000
EP Jacobson	30,917,335	120,000	-	-	31,037,335
NC Fearis	8,400,000	-	-	-	8,400,000
KP Judge	10,932,855	(4,000,000)	-	-	6,932,855
<i>Executives</i>					
PP Huizenga	1,600,000	50,000	200,000	-	1,850,000
RA Anderson	1,485,000	(523,000)	-	-	962,000
AC Cook	-	169,839	1,425,000	-	1,594,839

	Held at 1 July 2008	Net acquired/ (sold)	Award under Employee Share Plan	Received on exercise of options	Held at 30 June 2009
<i>Directors</i>					
PJ Leonhardt	14,900,000	(900,000)	-	3,000,000	17,000,000
EP Jacobson	28,613,793	(1,696,458)	-	4,000,000	30,917,335
NC Fearis	6,316,186	83,814	-	2,000,000	8,400,000
KP Judge	15,568,596	(5,635,741)	-	1,000,000	10,932,855
<i>Executives</i>					
PP Huizenga	2,100,000	(500,000)	-	-	1,600,000
RA Anderson	3,104,441	(1,619,441)	-	-	1,485,000

Shares allotted under the ESP were funded by interest-free loans with a limited recourse security over the plan shares and subject to the detailed rules of the ESP.

In accordance with AASB 2 the issue of shares under the ESP is accounted for using the Black-Scholes model, and their valuation assumptions are set out in Note 24.

Information regarding individual directors' and executives' compensation, including company loans used to finance the purchase of the ESP shares, is provided in the Remuneration Report section of the directors' report as set out on pages 20 to 25.

## 29. Non-key management personnel disclosures

### *Identity of related parties*

The Group has a related party relationship with its controlled entities (see Note 30), joint venture assets (see Note 16), and with its key management personnel (see Note 28).

## 30. Consolidated entities

Name	Country of Incorporation	Ownership interest	
		2010	2009
<i>Company</i>			
Carnarvon Petroleum Ltd			
<i>Controlled entities</i>			
Carnarvon Thailand Ltd	British Virgin Islands	100%	100%
Lassoc Pty Ltd	Australia	100%	100%
SRL Exploration Pty Ltd	Australia	100%	100%
Carnarvon Petroleum (Indonesia) Pty Ltd	Australia	100%	100%
Carnarvon (NZ) Pty Ltd	New Zealand	100%	-

Investments in controlled entities are measured at cost in the financial statements of the Company.

## 31. Subsequent events

On July 5 2010 Carnarvon (NZ) Pty Limited, a wholly owned subsidiary of Carnarvon Petroleum Ltd, farmed into PEP38524, offshore Taranaki Basin in New Zealand. Carnarvon contributed towards the cost of the Tuatara-1 exploration well to earn a 10% participating equity interest from AWE New Zealand Pty Ltd.

On 14 July 2010 the Company farmed out a proportion of its interest in the WA-399-P exploration permit to Apache Energy Limited and Jacka Resources Limited. In consideration Apache will undertake at its sole cost, a 3D seismic survey, which will fulfil the Year 2 and 3 work program obligations. In consideration for the farmout to Jacka, Jacka paid Carnarvon \$350,000. Following completion of the respective farm in obligations, the Company will have a 13% interest in the permit.

No other matters or circumstance has arisen since 30 June 2010 that in the opinion of the directors has significantly affected, or may significantly affect in future financial years:

- (i) The Group's operations; or
- (ii) The results of those operations; or
- (iii) The Group's state of affairs

## 32. Financial risk management

The Group's activities expose it to market risk (including currency risk, commodity price risk and interest rate risk), credit risk and liquidity risk.

This note presents qualitative and quantitative information about the Group's exposure to each of the above risks, their objectives, policies and procedures for managing risk, and the management of capital. The Board of Directors has overall responsibility for the establishment and oversight of the risk management framework.

The Group's overall risk management approach focuses on the unpredictability of financial markets and seeks to minimize the potential adverse effects on the financial performance of the Group. The Group does not currently use derivative financial instruments to hedge financial risk exposures and therefore it is exposed to daily movements in the international oil prices, exchange rates, and interest rates.

The Group uses various methods to measure different types of risk to which it is exposed. These methods include sensitivity analysis in the case of interest rate, foreign exchange, and commodity price risk and ageing analysis for credit risk.

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor, and market confidence and to sustain future development of the business. Given the stage of the Group's development there are no formal targets set for return on capital. There were no changes to the Group's approach to capital management during the year. Neither the Company nor any of its controlled entities are subject to externally imposed capital requirements.

### (a) Commodity price risk

Commodity price risk is the risk of financial loss resulting from movements in the price of the Group's commodity output, being crude oil.

Revenues under the Group's contractual arrangements with its customer are denominated in US\$, linked to the US\$ prices of a basket of oil products, and paid in Thai Baht at the average monthly exchange rate. The Group does not currently use derivative financial instruments to hedge commodity price risk and therefore is exposed to daily movements in the prices of these oil products.

### Sensitivity analysis

An increase of 10% in the achieved monthly oil sale price would have increased equity and pre tax profit and loss by the amounts shown below. This analysis assumes that all other variables other than royalties, which are directly related to oil revenues, remain constant. The analysis is performed on the same basis for 2009:

	<b>Consolidated</b>	
	<b>Equity</b>	<b>Profit and loss</b>
	<b>\$000</b>	<b>\$000</b>
30 June 2010	6,177	6,177
30 June 2009	9,344	9,344

A decrease of 10% in the achieved monthly oil sale price would have decreased equity and pre tax profit and loss by the amounts shown below. This analysis assumes that all other variables other than royalties, which are directly related to oil revenues, remain constant. The analysis is performed on the same basis for 2009:



## 32. Financial risk management (continued)

	Consolidated	
	Equity \$000	Profit and loss \$000
30 June 2010	(6,177)	(6,177)
30 June 2009	(9,344)	(9,344)

### (b) Interest rate risk

The significance and management of the risks to the Group is dependent on a number of factors including:

- Interest rates (current and forward) and the currencies that are held;
- Level of cash and liquid investments and their term;
- Maturity dates of investments;
- Proportion of investments that are fixed rate or floating rate.

The Group manages the risk by maintaining an appropriate mix between fixed and floating rate investments.

At the reporting date the effective interest rates of variable rate interest bearing financial instruments of the Group were as follows. There were no interest-bearing financial liabilities.

	Consolidated	
	2010	2009
<i>Carrying amount (A\$000)</i>		
Financial assets – cash and cash equivalents	30,255	31,099
<i>Weighted average interest rate (%)</i>		
Financial assets – cash and cash equivalents	0.3%	0.4%

### *Sensitivity analysis*

All other financial assets are non interest bearing.

An increase in 50 basis points from the weighted average year-end interest rates at 30 June would have increased equity and profit and loss by the amounts shown below. This analysis assumes that all other variables remain constant. The analysis is performed on the same basis for 2009:

	Consolidated	
	Equity \$000	Profit and loss \$000
30 June 2010	188	188
30 June 2009	140	140

**32. Financial risk management (continued)**

A decrease in 50 basis points from the weighted average year-end interest rates at 30 June would have decreased equity and profit and loss by the amounts shown below. This analysis assumes that all other variables remain constant. The analysis is performed on the same basis for 2009:

	<b>Consolidated</b>	
	<b>Equity \$000</b>	<b>Profit and loss \$000</b>
30 June 2010	(43)	(43)
30 June 2009	(47)	47

*(c) Credit risk*

Credit risk refers to the risk that a counter party will default on its contractual obligations resulting in a financial loss to the Group, and arises principally from the Group's receivables from customers and cash deposits.

The Group's trade receivables at both June 2010 and June 2009 are all due from an entity located in Thailand and controlled by its government. This entity has an appropriate credit history with the Group. There were no receivables at 30 June 2010 or 30 June 2009 that were past due.

Cash transactions are limited to financial institutions considered to have a suitable credit rating.

Credit risk further arises in relation to financial guarantees given to certain parties, refer to Note 23.

Exposure to credit risk is considered minimal but is monitored on an ongoing basis. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

### 32. Financial risk management (continued)

The carrying amount of the Group's financial assets represents the maximum credit exposure. The Group's maximum exposure to credit risk at the reporting date was:

	<b>Consolidated</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>
<i>Carrying amount:</i>		
Cash and cash equivalents	30,255	31,099
Trade and other receivables	7,780	11,904
	38,035	43,003

The aging of the Group's trade receivables at reporting date was:

	<b>Gross</b>	<b>Impairment</b>	<b>Gross</b>	<b>Impairment</b>
	<b>2010</b>	<b>2010</b>	<b>2009</b>	<b>2009</b>
	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
Not past due	5,884	-	7,218	-
	5,884	-	7,218	-

Based on historical default rates, the Group believes that no impairment allowance is necessary in respect of trade receivables.

#### (d) Currency risk

Currency risk arises from sales, purchases, assets and liabilities that are denominated in a currency other than the functional currencies of the entities within the Group, being the A\$, THB and US\$.

The Group operates predominantly in Thailand and is exposed to currency risk arising from various foreign currency exposures, mainly with respect to the US\$ and Thai Baht ("THB"). The functional currency of its Thai operations changed from US\$ to THB from 1 January 2009, primarily because the trend in the source currency of the majority of its costs from US\$ to THB was not considered temporary.

Cash receipts from the Thai operations, which comprise 100% of the Group revenues, are received in Thai Baht. The majority of the Group's payments, including Thai SRB and income tax, are also payable in THB which effectively creates a natural hedge. The Company's foreign exchange risk predominantly resides in its US\$ loan to one of its controlled entities.

The Group does not currently use derivative financial instruments to hedge foreign currency risk and therefore is exposed to daily movements in exchange rates. However, the Group intends to maintain sufficient THB cash balances to meet its THB obligations, in particular its SRB and income tax liabilities.

## 32. Financial risk management (continued)

The Group's exposure to foreign currency risk at balance date was as follows, based on carrying amounts.

	<b>THB A\$000</b>	<b>USD A\$000</b>
<i>Consolidated 2010</i>		
Cash and cash equivalents	6,878	16,333
Trade and other receivables	5,884	-
Trade payables and accruals	(4,082)	(16)
SRB and income tax provisions	(8,337)	-
Gross balance sheet exposure	<u>343</u>	<u>16,317</u>
<i>Consolidated 2009</i>		
Cash and cash equivalents	27,405	48
Trade and other receivables	8,208	-
Trade payables and accruals	(5,304)	(754)
SRB and income tax provisions	(8,778)	-
Gross balance sheet exposure	<u>21,531</u>	<u>(706)</u>

The following significant exchange rates applied during the year:

AUD to:	<b>Average rate</b>		<b>Reporting date spot rate</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
1 Thai baht	0.034	0.040	0.036	0.037
1 USD	1.14	1.36	1.17	1.24

*(d) Currency risk (continued)*

Sensitivity analysis

A 10% strengthening of the AUD against the THB for the 12 months to 30 June 2010, and against the US\$ for the 6 months to 31 December 2008 and against the THB for the 6 months to 30 June 2009, reflecting the change in functional currency of the Phetchabun Basin Joint Venture from 1 January 2009, would have decreased equity and pre tax profit and loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates and the exchange rate between the Thai Baht and USD, remain constant:

	<b>Consolidated</b>	
	<b>Equity \$000</b>	<b>Profit and loss \$000</b>
<i>30 June 2010</i>		
THB	(10,389)	(3,167)
<i>30 June 2009</i>		
THB and USD	(7,752)	(5,077)

### 32. Financial risk management (continued)

A 10% weakening of the AUD against the THB for the 12 months to 30 June 2010, and against the US\$ for the 6 months to 31 December 2008 and against the THB for the 6 months to 30 June 2009, reflecting the change in functional currency of the Phetchabun Basin Joint Venture from 1 January 2009, would have increased equity and pre tax profit and loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates and the exchange rate between the Thai Baht and USD, remain constant:

	<b>Consolidated</b>	
	<b>Equity \$000</b>	<b>Profit and loss \$000</b>
<i>30 June 2010</i>		
THB	12,675	3,746
<i>30 June 2009</i>		
THB and USD	9,412	6,206

*(e) Fair values*

The fair values of financial assets and financial liabilities, together with their carrying amounts shown in the balance sheet, are as follows:

	<b>Carrying amount 2010 \$000</b>	<b>Fair Value 2010 \$000</b>	<b>Carrying amount 2009 \$000</b>	<b>Fair Value 2009 \$000</b>
<i>Consolidated</i>				
Loans and receivables	7,780	7,780	11,904	11,904
Cash and cash equivalents	30,255	30,255	31,099	31,099
Trade and other payables	(5,621)	(5,621)	(6,901)	(6,901)
	<u>32,414</u>	<u>32,414</u>	<u>36,102</u>	<u>36,102</u>

The basis for determining fair values is disclosed in Note 3(i).

*(f) Liquidity risk*

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as and when they fall due. The Group's approach to managing this risk is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due under a range of financial conditions. The net cashflows arising from its Thai assets are considered to generate sufficient working capital to adequately address this risk.

The Group currently does not have any available lines of credit.

### 32. Financial risk management (continued)

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of any netting agreements:

	Carrying amount \$000	Contractual cashflows \$000	6 months or less \$000	6 to 12 months \$000
<i>Consolidated 2010</i>				
<i>Non-derivative financial liabilities</i>				
Trade and other payables	5,621	5,621	5,621	-
SRB and income tax provisions	8,337	8,337	6,165	2,172
	13,958	13,958	11,786	2,172
<i>Consolidated 2009</i>				
<i>Non-derivative financial liabilities</i>				
Trade and other payables	6,901	6,901	6,901	-
SRB and income tax provisions	8,778	8,778	5,656	3,122
	15,679	15,679	12,557	3,122

### 33. Parent Information

The following information has been extracted from the books and records of the parent and has been prepared in accordance with the accounting standards:

	2010 \$000	2009 \$000
<b>Balance Sheet</b>		
Current Assets	23,717	6,525
Non-current assets	9,439	12,309
Total assets	33,156	18,834
Current liabilities	418	1,066
Non-current liabilities	-	-
Total liabilities	418	1,066
Equity		
Issued Capital	68,240	68,090
Accumulated losses	(37,340)	(51,453)
Reserves	1,838	1,131
Total equity	32,738	17,768
<b>Statement of comprehensive income</b>		
Total profit / (loss)	14,011	(1,023)
Total comprehensive income	14,011	(1,023)

### 33. Parent Information (continued)

#### Parent Contingencies

The Company has provided a cash bond of US\$450,000 to the Department of Mineral Fuels in Thailand in respect of its obligations for its 50% interest in the L20/50 concession in Thailand. The bond is secured by a cash deposit of US\$450,000 held with Company's Australian bank. The Company and its joint venture partner, who has provided a similar guarantee to the Department of Mineral Fuels, have signed a Cross Deed of Indemnity in respect of their respective rights and interests. This restricted cash held by the banks as security for these bonds and guarantees is classified under "trade and other receivables".

In accordance with normal petroleum industry practice, the Group has entered into joint ventures and farm in agreements with other parties for the purpose of exploring and developing its petroleum permit interests. If a party to a joint venture defaults and does not contribute its share of joint venture obligations, then the other joint venturers are liable to meet those obligations. In this event, the interest in the permit held by the defaulting party may be redistributed to the remaining joint venturers.

	Parent	
	2010	2009
	\$000	\$000

#### Parent capital and other commitments

##### (a) Joint venture commitments

Capital commitments of the Group to joint venture assets:

Within one year	4,864	2,264
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##### (b) Exploration expenditure commitments

Due to the nature of the Company's operations in exploring and evaluating areas of interest it is necessary to incur expenditure in order to retain the Company's present permit interests. Expenditure commitments on exploration permits can be reduced by selective relinquishment of exploration tenure, by the renegotiation of expenditure commitments, or by farming out portions of the Company's equity.

Exploration expenditure commitments forecast but not provided for in the financial statements are as follows:

Less than one year	5,500	4,100
Between one and five years	4,500	1,700
	10,000	5,800

##### (c) Capital expenditure commitments

Data licence commitments	230	126
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Non-cancellable operating lease rentals are payable as follows:

Less than one year	149	163
Between one and five years	14	-
	163	163

### 34. Prior period error

The year ended 30 June 2009 financial statements included a deferred tax liability of \$8,964,000 and current income tax liability of \$3,521,000 in respect of the Group's interest in the Phetchabun Basin Joint Venture ("Joint Venture") in Thailand, of which the Group is non-operator. The calculation of these liabilities include as an input the tax written down value of Joint Venture expenditure and associated tax depreciation.

In February 2010 the Company was advised by the Joint Venture operator that there was an error in the calculation of the tax written down value of Joint Venture expenditure and tax depreciation as at and for the 6 months ending 30 June 2009. As a result the consolidated financial statements for the year ended 30 June 2009 require restatement as follows:

		<b>\$000</b>
<i>Balance Sheet:</i>		
Income tax provision	Understated by	2,135
Current liabilities	Understated by	2,135
Deferred tax liability	Understated by	5,552
Total non-current liabilities	Understated by	5,552
Total liabilities	Understated by	7,687
Net assets	Overstated by	7,687
Accumulated profits	Overstated by	7,687
Total equity	Overstated by	7,687
<i>Statement of Comprehensive Income:</i>		
Income tax expense	Understated by	7,687
Net profit from continuing operations	Overstated by	7,687
Net profit attributable to members of the Company	Overstated by	7,687

	<b>Cents per share</b>	
	<b>Previously stated</b>	<b>Restated</b>
Basic and diluted earnings per share from continuing operations	5.4	4.3

The 30 June 2009 comparatives in these financial statements have been restated to reflect the above.



- (1) In the opinion of the directors of Carnarvon Petroleum Limited:
  - (a) the financial statements and notes of the Group set out on pages 29 to 70 are in accordance with the Corporations Act 2001, including:
    - (i) giving a true and fair view of the Group's financial position as at 30 June 2010 and of its performance, as represented by the results of its operations and its cash flows, for the financial year ended on that date; and
    - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and
  - (b) the financial statements comply with International Financial Reporting Standards as set out in Note 2; and
  - (c) the remuneration disclosures that are contained in the Remuneration Report in the Directors Report comply with Australian Accounting Standard AASB 124 Related Party Disclosures, the Corporations Act 2001 and the Corporations Regulations 2001; and
  - (d) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- (2) This declaration has been made after receiving the declarations required to be made to the directors in accordance with section 295A of the Corporations Act 2001 for the financial period ending 30 June 2010.

Signed in accordance with a resolution of the directors.



**PJ Leonhardt**

Director

Perth, 26 August 2010



## INDEPENDENT AUDIT REPORT TO THE MEMBERS OF CARNARVON PETROLEUM LIMITED

### Report on Financial Report

We have audited the accompanying financial report of Carnarvon Petroleum Limited and its controlled entities (the consolidated entity), which comprises the statement of financial position as at 30 June 2010, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies and other 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 the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard 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 have complied with the independence requirements of the Corporations Act 2001.

#### Total Financial Solutions



Horwath refers to Horwath International Association, a Swiss entity, each member of the Association is a separate and independent legal entity.

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**Auditor's Opinion**

In our opinion, the financial report of the consolidated entity is in accordance with the Corporations Act 2001 including:

- (a) (i) giving a true and fair view of 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 Australian Accounting Interpretations) and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 1 of the financial report.

**Report on the Remuneration Report**

We have audited the Remuneration Report included in pages 20 to 25 of the directors' report for the year ending 30 June 2010. The directors 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 for the year ended 30 June 2010, complies with section 300A of the Corporations Act 2001.

WHK HORWATH PERTH AUDIT PARTNERSHIP



CYRUS PATELL  
Partner

Perth, WA

Dated this 26<sup>th</sup> day of August 2010

## **Introduction**

The Company's directors are fully cognisant of the Corporate Governance Principles and Best Practice Recommendations published by the ASX Corporate Governance Council ("CGC") and have adopted those recommendations where they are appropriate to the Company's circumstances.

However, a number of those principles and recommendations are directed towards listed companies considerably larger than Carnarvon, whose circumstances and requirements accordingly differ markedly from the Company's. For example, the nature of the Company's operations and its low direct employee count mean that a number of the board committees and other governance structures recommended by the CGC are not only unnecessary in Carnarvon's case, but the effort and expense required to establish and maintain them would, in the directors' view, be an unjustified diversion of shareholders' funds.

Carnarvon's directors are aware that according to one school of thought listed companies will be rated by the investment community according to their compliance with the CGC's Best Practice Recommendations. However, in the directors' view that approach is not soundly based, particularly where unquestioning compliance with the recommendations would produce marginal or no benefit to shareholders.

In discharging its functions Carnarvon's board of directors receives competent legal and other professional advice. Based on that advice the board is satisfied that, notwithstanding non-compliance with the Best Practice Recommendations (to the extent noted below), the Company's governance structures are appropriate for its circumstances and the board acts at all times in the best interests of the Company and its shareholders.

The following additional information about the Company's corporate governance practices is set out on the Company's website at [www.carnarvon.com.au](http://www.carnarvon.com.au):

- Corporate governance disclosures and explanations;
- Statement of Board and management functions;
- Composition of the Board and new appointments;
- Committees of the Board;
- Summary of code of conduct for directors;
- Summary of policy on securities trading;
- Audit Committee Charter;
- Summary of policy and procedures for compliance with ASX Listing Rule disclosure requirements;
- Summary of arrangements regarding communication with and participation of shareholders;
- Summary of Company's risk management policy; and
- Corporate code of conduct.

## **Skills, experience, expertise and term of office of each director**

A profile of each director containing the applicable information is set out in the directors' report.

## **Statement concerning availability of independent professional advice**

If a director considers it necessary to obtain independent professional advice to properly discharge the responsibility of his/her office as a director then, provided the director first obtains approval for incurring such expense from the chairman, the Company will pay the reasonable expenses associated with obtaining such advice.

### Explanations for departures from best practice recommendations

From 1 July 2009 to 30 June 2010 (the "Reporting Period") the Company complied with each of the Essential Corporate Governance Principles (Note 1 below) and the corresponding Best Practice Recommendations (Note 2 below) as published by the ASX Corporate Governance Council ("ASX Principles and Recommendations"), other than in relation to the matters specified below:

Principle Reference	Recommendation Reference	Notification of Departure	Explanation for Departure
2	2.4	A separate Nomination Committee has not been formed.	The Board considers that the Company is not currently of a size to justify the formation of a Nomination Committee. The Board as a whole undertakes the process of reviewing the skills base and experience of existing directors to enable identification of attributes required in new directors. Where appropriate independent consultants are engaged to identify possible new candidates for the Board.

#### Notes

(1) A copy of the Ten Essential Corporate Governance Principles is set out on the Company's website under the section entitled "Corporate Governance". (2) A copy of the Best Practice Recommendations is set out on the Company's website under the section entitled "Corporate Governance".

### Existence and terms of any schemes for retirement benefits for non-executive directors

The Company does not have any terms or schemes relating to retirement benefits for non-executive directors.

### Company's remuneration policies

The Company's remuneration policies are set out in the Remuneration Report on pages 20 to 25.

The Company has separate remuneration policies for executive and non-executive directors. Non-executive directors receive a fixed fee and, when appropriate, share options or participation in the Employee Share Scheme.

Executive directors receive a salary or fee and, when appropriate, shares, share options, or participation in the Employee Share Scheme.

### Material business risks

Management has reported to the Board as to the effectiveness of the Company's management of its material business risks.

### Performance evaluation of the Board, its committees and senior executives

The Board reviews and evaluates the performance of the Board and its committees, which involves consideration of all the Board's key areas of responsibility.

A performance evaluation of senior executives was undertaken during the year, in the case of the Chief Executive by the Board, and in all other cases by the Chief Executive Officer and the Chairman.

## **Identification of independent directors**

The Company's independent directors are considered to be Peter Leonhardt, Neil Fearis, and Bill Foster.

Neither of these directors was considered to have a material relationship with the Company or another group member during the Reporting Period as professional advisor, consultant, supplier, customer, or through any other contractual relationship, nor did they have any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the Company.

The Board considers "material" in this context to be where any director-related business relationship represents the lesser of at least 5% of the Company's or the director-related business's revenue.

## **Number of Audit Committee meetings and names of attendees**

The number of Audit Committee meetings and names of attendees is set out in the directors' report.

## **Names and qualifications of Audit Committee members**

The names and qualifications of Audit Committee members are set out in the directors' report.

Additional information required by the ASX Limited ("ASX") Listing Rules and not disclosed elsewhere in this report is set out below.

**a) Shareholdings as at 24 August 2010**

*Substantial shareholders*

There are no substantial shareholder notices lodged with the Company.

*Voting Rights*

The voting rights attaching to Ordinary Shares are governed by the Constitution. On a show of hands every person present who is a member or representative of a member shall have one vote and on a poll, every member present in person or by proxy or by attorney or duly authorised representative shall have one vote for each share held. No options have any voting rights.

*Twenty Largest Shareholders*

<b>Name of Shareholder</b>	<b>Number of shares</b>	<b>% held</b>
J P Morgan Nominees Australia Limited	54,321,131	7.91
National Nominees Limited	36,507,339	5.32
HSBC Custody Nominees (Australia) Limited	30,143,692	4.39
ANZ Nominees Limited <Cash Income A/C>	19,073,702	2.78
AMP Life Limited	17,419,033	2.54
Mr Edward Patrick Jacobson	12,917,903	1.88
Citicorp Nominees Pty Limited	12,840,119	1.87
Macquarie Bank Limited (Metals & Energy Cap Div A/C)	11,294,046	1.64
Pendomer Investments Pty Ltd <Law Settlements Fund A/C>	8,400,000	1.22
Jacobson Geophysical Services Pty Ltd	8,000,000	1.16
Mr Peter James Leonhardt	7,700,000	1.12
Arne Investments Pty Ltd	6,710,493	0.98
Geolyn Pty Ltd	6,000,000	0.87
Mr Edward Patrick Jacobson	6,000,000	0.87
Mr Gregory John Munyard + Mrs Maria Ann Munyard + Miss Carmen Helene Munyard <Riviera Super Fund A/C>	5,750,000	0.84
Athol Steel Pty Ltd	5,200,000	0.76
Cogent Nominees Pty Ltd	5,032,092	0.73
Seawell Super Pty Ltd (Seawell S/F A/C)	4,120,000	0.60
Arne Investments Pty Ltd	3,991,906	0.58
Nefco Nominees Pty Ltd	3,733,000	0.54
	<b>265,154,456</b>	<b>38.61</b>

*Distribution of equity security holders*

<b>Size of Holding</b>	<b>Number of shareholders</b>	<b>Number of fully paid shares</b>
1 to 1,000	561	363,177
1,001 to 5,000	2,420	7,658,924
5,001 to 10,000	2,100	17,808,544
10,001 to 100,000	4,141	144,888,288
100,001 and over	655	516,040,701
	<b>9,877</b>	<b>686,759,634</b>

The number of shareholders holding less than a marketable parcel of ordinary shares is 704.

**b) Option holdings as at 24 August 2010**

There were no share options on issue.

**c) On-market buyback**

There is no current on-market buyback.

**d) Schedule of permits**

Permit	Basin/country	Joint Venture Partners	Equity %	Operator
SW1A	Phetchabun / Thailand	Carnarvon Pan Orient Energy	40% 60%	Pan Orient Energy
L33/43	Phetchabun / Thailand	Carnarvon Pan Orient Energy	40% 60%	Pan Orient Energy
L44/43	Phetchabun / Thailand	Carnarvon Pan Orient Energy	40% 60%	Pan Orient Energy
L20/50	Phitsanulok / Thailand	Carnarvon Sun Resources	50% 50%	Carnarvon
L52/50 & L53/50	Surat-Khiensa / Thailand	Carnarvon Pearl Oil	50% 50%	Pearl Oil
Rangkas PSC	West Java / Indonesia	Carnarvon Lundin Petroleum Tap Oil	25% 51% 24%	Lundin Petroleum
EP321 & EP407	Perth / Australia	Carnarvon	2.5% ORRI	Latent Petroleum
WA-399-P	Carnarvon / Australia	Carnarvon Apache Rialto Energy Jacka	13% 60% 12% 15%	Apache
WA-435-P, WA-436-P, WA-437-P, WA-438-P	Roebuck / Australia	Carnarvon Finder Exploration	50% 50%	Finder Exploration
WA-443-P	Roebuck / Australia	Carnarvon	100%	Carnarvon



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