
Cadogan Petroleum plc

Annual Financial Report

2009



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Principal Developments

Cadogan Petroleum plc is an independent oil and gas exploration, development and production company with onshore gas, condensate and oil assets in Ukraine.

Significant developments during 2009 included the following:

- > Fundamental management changes, including the appointment of Ian Baron as Chief Executive Officer
- > Full strategic and operational review of the Group's existing assets undertaken
- > Extension received on the Zagoryanska and Bityanska licences to 2014
- > Reduced operating expenses through temporarily suspending operations on major fields and lower headcount
- > Farm-out campaign being pursued to conserve existing cash and spread the risks associated with further exploration and development
- > An independent review of the Group's assets was received in March 2010 and resulted in downward reclassification of a large part of the Group's Reserves to the resource category
- > As a consequence of the downgrading of the Group's Reserves and Resources the Group's Ukrainian assets were impaired by £63.5 million (2008: £nil)
- > Commencement of litigation against certain former executives and suppliers with settlement reached with two third parties in 2009 and 2010
- > Continued vigorous defence of Pirkovskoe and Zagoryanska licences in Ukrainian Court
- > Total capital expenditure of £23.5 million (2008: £73.2 million) during the year
- > Net cash and cash equivalents at year end of £30.5 million (2008: £72.0 million)

Group Overview

Our Operations

The Group's assets are located in two of the three proven hydrocarbon basins in Ukraine, the Dnieper-Donets basin and the Carpathian basin.

Borynya and Bitlya fields

The Bitlyanska exploration and development licence covers an area of 390 square kilometres, tectonically belonging to the Krosno zone of the folded Carpathians and includes the

Bitlya, Borynya and Vovchenska fields. The Bitlya and Borynya fields are approximately 20 kilometres apart and both fields are close to the UkrTransGas pipeline at Turka.

Pokrovskoe field

The Pokrovskoe licence area covers 49.5 square kilometres and is located in the Dnieper-Donets basin. The Pokrovskoe field is approximately 10 kilometres from the UkrTransGas system.

Zagoryanska field

The Zagoryanska licence is adjacent to the Pirkovskoe licence and covers an area of 49.6 square kilometres. Four wells have been drilled to date in the field. The previous wells in the field have encountered gas in the Upper and Lower Visean and Tournaisian reservoirs and in one well, hydrocarbons have been encountered in the Devonian reservoir. Reservoir depths vary from 4,500 to 5,500 metres.

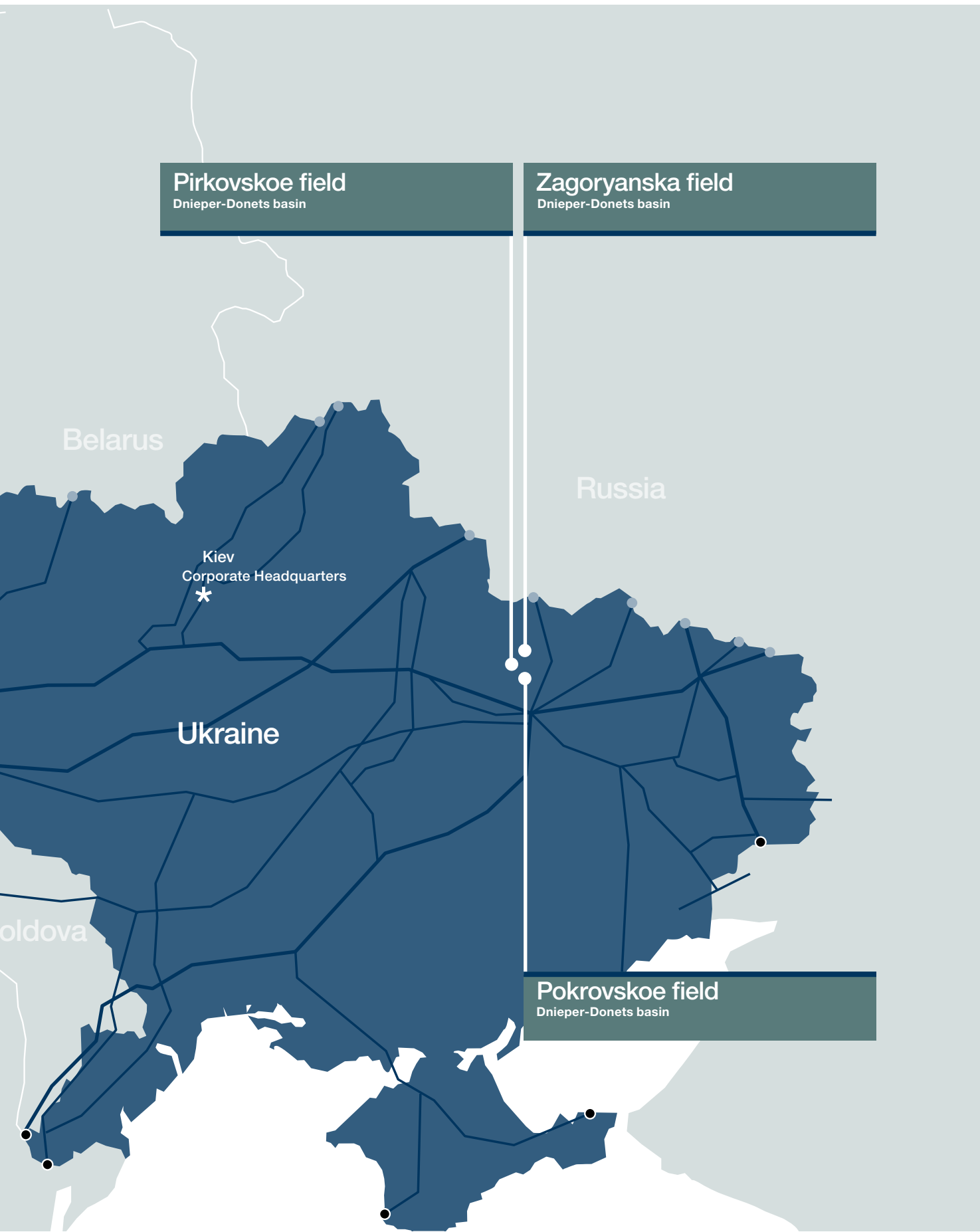
Pirkovskoe field

Pirkovskoe is located in the faulted transgression zone that forms the northern shoulder of the Dnieper-Donets Graben. The exploration and appraisal licence covers 71.6 square kilometres and holds 2.4 million barrels of oil equivalent ('mmboe') of proved and probable Reserves. Cadogan owns the Kraznozayarska gas treatment plant, on the Pirkovskoe licence area, which is connected to the UkrTransGas system.

Minor fields

Cadogan owns exploration, development and production licences either directly or through subsidiaries or joint ventures in several minor fields, of which two are currently in commercial production (Debeslavetska and Cheremkhivskoe).





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Chairman's Statement

Introduction and background

This statement and the accompanying Notice of Meeting and Resolutions present you with some clear alternatives and decisions about the future of your Company. You are invited to decide whether you want the Company to return capital or to build on the work undertaken by the new management team and retain capital to enable it to participate in the Ukrainian oil and gas sector. You are also invited to decide whether you want the current Board and management team to stay in place or whether you would prefer to elect a new Board comprising entirely of nominees of the Company's largest shareholder. The first sections of this statement review the events since the IPO. The last four sections – Board structure and governance, Control of the Company, Strategic alternatives and Outlook and recommendation – discuss the alternatives and provide you with additional material for your decisions.

The IPO of Cadogan in June 2008 was intended to be the beginning of a new and positive period in the Company's history. The Company had licences that contained promising prospects and seemed set for a period of successful development and good growth. Instead, the period since then has been one of great difficulty, challenge and disappointment for shareholders and employees alike. The problems began with the challenges to the Pirkovskoe and Zagoryanska licences in July 2008 and were compounded by poor operational performance and commercial judgement by the then management. Initially management seemed to be making good progress in resolving the licence challenges and, despite operational and commercial concerns, the Board felt it was in the best interests of shareholders to continue with the management team in place at least until the licence issues had been resolved. However, the reversal of a court judgment in February 2009, combined with continuing operational problems, caused the Board to lose its remaining confidence in management.

It appointed Ian Baron as Interim Chief Executive Officer in March 2009 to undertake both a strategic review of the Group's operations and an evaluation of the commercial viability of its assets. At around the same time, the Board launched an internal investigation into a number of commitments that had been entered into by the previous management. This investigation unexpectedly revealed serious procurement irregularities and in June 2009 the Company commenced litigation in the High Court in London against a number of parties, including its former Chief Executive Officer and Chief Operating Officer. Between March and June 2009 all the previous executive Directors departed, both as executives and as Directors of the Company.

Under the new management team operations were curtailed as quickly as was feasible given the constraints imposed by safety, environmental and technical considerations as well as the requirements of the Group's licence obligations. A major re-organisation was implemented and overheads reduced, thereby both cutting costs and increasing efficiency. The Group's headcount has been reduced by more than 70 per cent from over 500 employees at the start of 2009 to about 130 today and will remain appropriate for the level of ongoing activity. A revised business strategy was adopted to focus on operating at lower cost and reducing the overall risk profile of the Company's portfolio. By the end of 2009 the Company had significantly reduced the level of capital expenditure and had initiated a farm-out campaign on its four main licences.

Results of the strategic review

The key conclusions from the strategic review were as follows:

- Previous technical and operational analysis of the Group's assets had underestimated their risk profile.
- The high ownership levels the Group held in its major licences encumbered it with work obligations and financial commitments that were overdependent on major success in a short time frame.
- The drilling equipment and seismic acquisition systems in Ukraine were inadequate and hindered proper evaluation and development of the Group's assets.
- The disappointing test results from the Group's wells in east Ukraine were likely to have been a function of mechanical problems in the wells and operational practices, rather than poor reservoir characteristics as stated at the time.
- The Group lacked clear reporting lines, had too many people and offices in Ukraine and duplicated its efforts through unnecessary and inappropriate use of contractors.

As a result of this analysis, the Group curtailed all major operational expenditures, focused efforts on rigorously evaluating its assets, embarked on a programme to balance the risk profile of its portfolio and sought alternative ways to secure funding of its future work obligations.

By the end of the year the Group had reduced its asset base by three licences, having relinquished or allowed the expiration of licences that were considered unattractive. The evaluation of the four major assets (Bityanska, Pirkovskoe, Porkovskoe and Zagoryanska) was almost complete and a farm-out programme had been initiated with the aim of reducing our percentage ownership in these assets in return for funding of future work obligations. The minor fields and assets have been made profitable by streamlining the operations and the organisation.

As part of our financial reporting and to assist with the farm-out programme, a new Reserves and Resources Evaluation ('the Report') was commissioned at the end of 2009. This Report, an independent review of the Group's assets, was received in March 2010 and resulted in a downward reclassification of a large part of the Group's reserves to the resource category (refer to page 17 for the Statement of Reserves and Resources) and an impairment to the Group's net assets of £63.5 million. Notwithstanding this downgrade, the Report still recognises the merits of the assets and lists the Group's reserves and contingent resources as 110 million barrels of oil/condensate and 2.5 trillion cubic feet of gas. However, it remains to be demonstrated that the Group can economically develop the oil and gas believed to be present.

In order to expedite the marketing of the Group's major assets in the farm-out programme, the Board appointed IndigoPool, part of the Schlumberger Group and an industry leader in marketing oil and gas assets. Through the farm-out programme, Cadogan is seeking industry partners to take an equity interest in its major assets in return for contributing to the future work programme. This will improve the risk profile of the portfolio by reducing the Group's commitments whilst retaining sufficient equity to capture the potential upside in these assets. Several companies are actively evaluating the technical and commercial data on the assets under farm-out and the Company has requested that offers of interest are submitted by 31 May 2010.

In summary, having centralised all geological and geophysical evaluation work in Kiev, the Group has improved its knowledge of its asset base, disposed of non-strategic licences, curtailed

capital expenditures, reduced administrative and other costs and embarked on a farm-out programme.

Operations summary

During 2009, the new management team curtailed the Group's deep drilling programme in east Ukraine. All wells are currently suspended with the exception of Pirkovskoe 1 and Zagoryanska 3, where joint venture agreements were entered into with local companies to finance further testing of the wells. This resulted in the Pirkovskoe 1 well producing approximately 70 barrels of light oil per day from Upper Visean sands which is being recovered and sold. Testing on the Zagoryanska 3 well is currently underway.

In west Ukraine drilling of the Borynya 3 well on the Bitlyanska licence area was terminated at a drilling depth of 5,325 metres and the well was suspended for future evaluation. The well provided valuable data and demonstrated that an active hydrocarbon system is present over an extended interval. Several discrete gas bearing pressure regimes were penetrated and good quality logs and data were obtained. In June 2009, Borynya 3 tested gas from a secondary reservoir at an estimated maximum flow rate of 128,000 cubic metres of gas per day during a limited duration drill stem test.

During the year, oil and gas continued to be produced from certain of the Group's minor fields. Although modest, these fields now produce at economic rates, particularly since operating costs have been reduced. Other minor assets at the exploration stage were disposed of or allowed to expire. These include the Krasnoyilske licence, the Mizrichinska licence and the Monastryetska licence, and at the end of 2009 the Malynovetska licence was annulled by the Government.

Licence developments

During 2009, the Group continued to support its position in the courts of Ukraine against the indirect challenges to the Pirkovskoe and Zagoryanska special permits. Following an ambiguous but nevertheless disquieting announcement concerning five of Cadogan's licences on a Government website in September, the Company embarked on a series of negotiations with the Ministry for Protection of the Environment (the 'Ministry'). As a result, in October 2009 the Ministry confirmed that 'there are no grounds for invalidation or annulment or any doubts as to the validity of the Group's special permits and licence interests with respect to Pirkovskoe, Zagoryanska, Bitlyanska, Monastryetska and Krasnoyilske'. In light of this confirmation, the Group continues to seek resolution of the previously mentioned indirect legal challenges to the Pirkovskoe and Zagoryanska special permits. Following the recent election in Ukraine, the Company has received positive indications of support for its position from Government departments within an administration that has stated its support for foreign investment in the country.

Overview of financial position

At 27 April 2010 the Group had current cash and cash equivalents of approximately £29.3 million. The Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future.

Litigation

In June 2009, the Group commenced litigation in the High Court in London against the former Chief Executive Officer, Chief Operating Officer and certain third parties, including individuals and suppliers. This action was initiated to seek a return of funds to

the Company associated with the procurement of and payment for certain assets and services.

For the year ended 31 December 2009, the Group has incurred £4.1 million of fees associated with the investigation and litigation against these parties. As a result of the litigation, the Group has already entered into settlement agreements with two suppliers, Global Processing Systems LLC ('GPS') and Smith Eurasia. GPS has agreed to return up to US\$38.5 million and has also released the Group from GPS's US\$10.9 million contractual claim for what would have been the balance of the consideration for the two gas plants it was constructing. After the end of the year, the Group reached a settlement with Smith Eurasia whereby the Group has received US\$5.6 million, of which US\$1.1 million was for unused plant and equipment (included within inventories at 31 December 2009) which we have returned to Smith Eurasia. As part of the settlement, the Group from its side has paid its outstanding invoices to Smith Eurasia of US\$2.9 million (included within trade and other payables at 31 December 2009). The Board has been advised that it has a strong case against all the remaining parties to the litigation including, the former Chief Executive Officer and Chief Operating Officer and certain other individuals. Although the matter will not go to trial until February 2011 at the earliest, the Board fully expects that, with reduced legal spend, it will make recoveries from the defendants, including from those whose assets are presently secured by worldwide asset freezing orders.

Employees

The actions taken by the Board in early 2009 led to a complete reorganisation of the Group and the development of a new strategy, which in turn resulted in significant reductions in headcount. This inevitably caused significant uncertainty for the Group's employees, which was compounded by the global economic crisis which hit Ukraine particularly hard. Despite this, the Company's employees have remained committed to rebuilding a robust business for the Group in Ukraine and the Board would like to thank them for their commitment and hard work.

Board structure and governance

In view of the events at the Company since the IPO and the significant changes described above, the Board has implemented changes in its cost and governance in line with the changes in the rest of the Company. My fee as Chairman has been reduced from £125,000 to £40,000 and fees for the non-executive directors have been reduced from £40,000 to £25,000, all with effect from 1 April 2010. In addition, the Board will be reduced in size from seven to five with effect from the AGM. To this end, Jim Donaldson and Nick Corby, both of whom have served the Company since before the IPO, have suggested that they should resign after the forthcoming AGM. I would like to thank them both for the significant contributions they have made towards resolving the difficulties the Company has faced. The changes in fees and numbers will result in a reduction of more than 60 per cent in the cost of the Board.

In addition, the Board believes that shareholders should have the opportunity of choosing their Board both at this AGM and at all future annual meetings. It has therefore decided that all five remaining directors will put themselves forward for re-election at the AGM and, if re-elected, will stand for re-election every year as long as they remain on the Board. In putting itself forward for annual re-election, the Board is in effect giving shareholders the opportunity not just to comment but to vote each year on its performance in the most direct way possible.

Chairman's Statement continued

Control of the Company

During the year, Weiss Asset Management LP ('Weiss'), a fund management company based in the USA, became the Company's largest shareholder and currently owns 25.01 per cent of the Company's shares. Weiss has made a number of requests of the Company, including that the Board should be reduced in size from seven to three. They initially suggested that they should appoint two of the three members of the reduced Board and that I might remain as Chairman. However, since that would amount to giving Weiss control of the Company without their having to make an offer for the remaining shares in issue, the Board has informed Weiss that it is unwilling to agree to their proposals. Furthermore, since, as explained below in the section on Strategic alternatives, none of the existing Board believes that Weiss's plans are in the best interests of the Company or its shareholders as a whole, it would clearly not be right for any existing Director to remain on the Board should Weiss obtain control of it. Weiss subsequently proposed that they should nominate an entirely new Board of three directors. Their proposals and reasoning are set out in the accompanying letter from them to shareholders.

As described in the Introduction and background above, the Board has already made substantial progress towards achieving the objectives Weiss outline for the Company in their letter, including reducing headcount by over 70 per cent. Weiss refer to over £17 million of administrative expenses in the first half of 2009, which they characterise as excessive. If the actual cost of administering the Company during the period had been over £17 million, the Board would strongly agree with Weiss that it was excessive. However, the interim accounts for the period ending 30 June 2009 disclosed that the figure for administrative costs included approximately £13.5 million for a non-cash impairment of VAT. It is evident that Weiss has misunderstood the actual level of costs within the business and that costs are less than a quarter of what Weiss apparently believe them to be.

The Board has seen no supporting argument or evidence for Weiss's assertion that 'new board members will be better suited to facing the challenges posed by the Company's new landscape'. To the contrary, we believe appointment of their nominees and implementation of their plan will almost certainly eliminate any prospect that shareholders may have of recovering more than the current cash balances plus proceeds from the GPS settlement and ongoing litigation, less the legal and administrative costs needed to ensure the recoveries. As argued below, the Board believes that shareholders should be given the opportunity to accomplish much more than this.

Shareholders should also be aware that the cost of the Board will be higher if Weiss's proposals are approved. Setting aside Ian Baron, who, if he is re-elected at the AGM, will continue to be compensated as an executive rather than as a Director, the aggregate fees of the four non-executive directors (myself, Philip Dayer, Alan Cole and Nick Hooke) will be £115,000 per annum. Although not mentioned in their letter to you, in response to our queries Weiss have informed us that their nominated Directors will each be paid £40,000 per annum, for an aggregate of £120,000, plus 'an incentive arrangement based on cash distributed to shareholders'. They have not specified the quantum of the proposed incentive arrangement, but in earlier discussions they suggested that Ian Baron and Nick Corby could together be paid three to five per cent of the cash distributed to shareholders as an incentive. As explained below, Ian and Nick have declined this proposal as a matter of principle as they do not believe election of the Weiss nominees to be in the best interests of the Company or shareholders as a whole. However, if the three Weiss nominees

are paid anything even approaching their suggestion to Ian and Nick, the cost of their Directors will be substantially greater than the cost of the four non-executives proposed by the existing Board. Furthermore, shareholders should note that Weiss's proposals for an incentive scheme for non-executive directors would, according to the Combined Code, compromise their independence.

Although the Board does not agree that Weiss's proposals are in the best interests of the Company or its shareholders as a whole, it has no wish to obstruct a shareholder vote on them and has therefore cooperated with Weiss to enable them to put their proposals to you as shareholders. To that end, the Notice of Meeting contains a group of Resolutions (3, 4, 5 and 6) which, if passed, would give effect to the Weiss proposals on Board composition.

Strategic alternatives

The Board believes shareholders need to make the following key decisions:

- 1) Do you wish to build on the valuable work undertaken by the new management team in the past year and retain exposure to what could still be an interesting upside in the oil and gas sector in Ukraine, as recommended by the Board, or would you prefer the Company to return capital to shareholders?
- 2) Do you wish the Company to be managed by the current Board (other than Nick Corby and Jim Donaldson) or by the nominees proposed by Weiss?

Regarding the first decision, whilst fully acknowledging, and indeed sharing, the anger and dismay that shareholders must feel at events since the IPO, the Board nevertheless believes that, as a consequence of the actions taken by the new management team, there remains a significant opportunity for value to be created from the Company's sub-surface assets in Ukraine. This is where we disagree most strongly with Weiss. The independent report on Reserves and Resources prepared by Gaffney Cline & Associates as of 31 December 2009 states that the Group's assets contain reserves and contingent resources of approximately 110 million barrels of oil/condensate and 2.5 trillion cubic feet of gas. The Group is already producing oil and gas from three fields in west Ukraine and one field in east Ukraine and is currently testing a well that we expect to hook up for production in the coming weeks. The monthly net revenue from these wells alone will almost be sufficient to cover the Group's general and administrative expenses other than the ongoing cost of litigation.

Despite the challenges Ukraine presents, it is an environment with limited international competition, strong energy demand and attractive commercial terms in which a management team competent in oil and gas can make good returns on investment. Furthermore, the Board believes that many of the Company's problems were 'own goals' inflicted by the former management and that, with a different approach, many of those problems can be resolved. Since March 2009 the Group has moved forward swiftly. It has refined its portfolio by dropping assets considered unattractive and dramatically improved both its knowledge of its assets and the efficiency with which they are managed. We are also in the process of reducing risk by farming out expenditure obligations. We have opportunities to invest in increasing production from our existing assets and, now that we have 3D seismic interpretations on our east Ukraine assets, have identified targets that can be reached by deepening wells on one block. The 3D seismic has also identified "sweet spots" in some of the blocks we are seeking to farm-out. Having funds available to invest in these blocks if the farmed-out work proves successful could

generate significant value. In addition the management team has secured a five-year extension to the Group's Bitlyanska licence in west Ukraine.

Pursuing this alternative does not rule out returning capital at a later date if the farm-outs are not successful, but in the Board's view it does optimise the chances of creating much more value than could be generated by focusing narrowly on short-term asset realisation. If shareholders wish to pursue this alternative, it would be sensible to vote against Resolutions 3, 4, 5, 6 and 14.

A variation of the above would be to return almost all of the available cash to shareholders immediately while continuing to pursue the litigation against former management and their associates, ensuring maximum recovery from GPS and pursuing the farm-out plan. Based on our most recent analysis, the Board believes this could result in an immediate return of 10 pence per share, representing all the cash available today less an amount needed to operate the Group while pursuing the activities described above. Depending on the outcome of the litigation and the receipts from GPS and asset disposals, our analysis indicates that another 7-16 pence per share could be available for return over the next 12-18 months. The analysis also suggests that, by investing £1.2 million this year to increase production and by continuing to reduce costs, the Group could become cash-breakeven during 2010. This alternative could be characterised as 'return most of the available cash now while retaining optionality over future commercial success'. However, while this variation might seem superficially attractive, shareholders should not underestimate the consequences in Ukraine of being seen to return the bulk of available cash and the risks that such a step could pose to the Company's assets there. For this reason, as well as for the more positive reasons outlined above, this is not the Board's recommended alternative. However, if shareholders wish to pursue it, they can do so by voting against Resolutions 3, 4, 5 and 6 but for Resolution 14, in which case the current Directors other than Nick Corby and Jim Donaldson will remain in place to oversee the return of capital, the ongoing litigation and the farm-out process.

Regarding the decision about the composition of the Board, the current Board does not know exactly what Weiss will do if they assume control of the Company, but from our interactions with them we do not believe, whatever their intentions or statements, that they are likely to maximise value for shareholders. They have candidly stated that they do not follow the oil and gas sector and that they view Cadogan as merely 'a balance-sheet play'. From this and from our discussions with them we infer that their interest in Cadogan is based on the fact that the cost to them of acquiring their shares in the Company is below the value of the Company's cash and the expected proceeds from the GPS settlement and ongoing litigation. Their proposals for reconstructing the Board, besides potentially breaching the Combined Code, will undoubtedly increase its costs, perhaps substantially. We believe they have materially misunderstood and overstated the level of costs in the business and that there must be some risk that, in pursuit of cost savings that do not exist, they will damage the business and reduce the amount that could be returned to shareholders. Following extensive dialogue between management and Weiss, both in their office in Boston and on the telephone, the Board has concluded that allowing Weiss to take control of the Company would greatly reduce the probability of realising any value from the assets in Ukraine, whether through developing or disposing of them. Our best estimate is that under this scenario the return of capital is likely to be about the same amount (10 pence per share followed by 7-16 pence per share 12-18 months later), adjusted for any differences in

costs, as would be delivered under the 'variation' described above. The principal difference is likely to be the amount of any value realised from the Company's sub-surface assets in Ukraine, which could be considerable.

On any rational analysis the risk-adjusted expected value of Weiss's proposals is almost certainly lower than that of the alternatives presented by the Board and the cost of implementing them is almost certainly higher. If the culture in Weiss is cerebral, if they are analytically rigorous and if their investment decisions are based on economic analysis, all of which they claim on their website (www.weissasset.com), they should vote against their own proposals.

While the Board and management will cooperate with Weiss to ensure a smooth handover of control if shareholders vote for the Weiss nominees, none of the existing management team would be prepared to continue in post under those circumstances as they believe that Weiss is likely to liquidate the company and, in so doing, will not maximise value for shareholders. However, if shareholders seek that outcome under a Board comprising Weiss's nominees, they should vote for Resolutions 3, 4, 5, 6 and 14.

Outlook and recommendation

The Board believes that in practice the choices facing shareholders are as follows:

- 1) Reappoint four of the five current non-executive Directors plus Ian Baron and leave the cash within the Company to participate in the potential upside, which entails voting against Resolutions 3, 4, 5, 6 and 14.
- 2) Reappoint four of the five current non-executive Directors plus Ian Baron but require them to return almost all available cash now plus future surplus cash as it becomes available after participating in the potential upside from the farm-out programme, which entails voting against Resolutions 3, 4, 5 and 6 but for Resolution 14.
- 3) Elect the Weiss nominees, which the Board believes is tantamount to choosing to liquidate the Company and which entails voting for Resolutions 3, 4, 5, 6 and 14.

Despite the events that led to the change of management early in 2009, actions taken by the new management since then have greatly improved the Company's position and outlook. While understandable at a visceral level, it would seem non-commercial to call time on the Company's business and assets in Ukraine just when there is some prospect that the cloud over them might be lifting. With reserves and contingent resources of approximately 110 million barrels of oil/condensate and 2.5 trillion cubic feet of gas, the prospect of becoming cash breakeven during the current year and a management team that has the skills and experience to develop the Company's assets on your behalf, a rational choice for shareholders would be to retain their current level of investment in the Company as an option on the potential upside.

The Board therefore recommends that shareholders vote against Resolutions 3, 4, 5, 6 and 14. If you do so, we will continue to keep costs as low as possible while pursuing ways of realising value from our sub-surface assets in Ukraine. If at any time we conclude that these efforts are not being successful, we will revert to you with proposals for returning capital. In any event, all Directors will present themselves for re-election annually for as long as they remain on the Board.

Simon Duffy

Non-executive Chairman

Operations Review

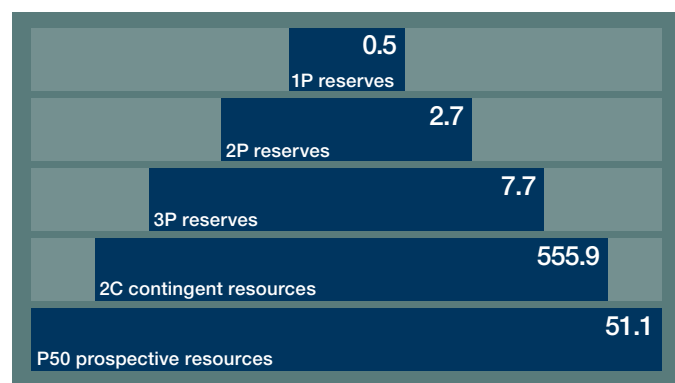
Following the management changes in March 2009, the capital intensive drilling operations of the Company were safely curtailed in a manner that would maintain the licences legally and leave maximum flexibility in the event further studies revealed scope for additional work on the wells. Greater effort was applied to developing and understanding the hydrocarbon potential and the risks on the Group's licences through work carried out by the Group's new subsurface team based in Kiev. Additionally the team focused on building the technical database and developing a farm-out programme designed to balance the risk profile of the asset base through finding partners to fund future work programmes, in return for part of Cadogan's equity in the licences.

At the beginning of 2009 the Group held working interests in eleven (2008: eleven) gas, condensate and oil exploration and production licences in the east and west of Ukraine. This was reduced to eight licences by the end of 2009 (the Krasnoil'ska and Monastryetska licences expired in December 2009 and the

Malynovetska licence was annulled by the Government in November 2009). All these assets are operated by the Group and are located in either the Carpathian basin or the Dnieper-Donets basin, in close proximity to the Ukrainian gas distribution infrastructure. The Group's primary focus is on the Bitlyanska licence, (Carpathian Basin, west Ukraine), Pokrovskoe, Zagoryanska and Pirkovskoe licences (Dnieper-Donets basin, east Ukraine) where the Group's main reserve and resource potential is located.

Reserves and resources

(mmbob)

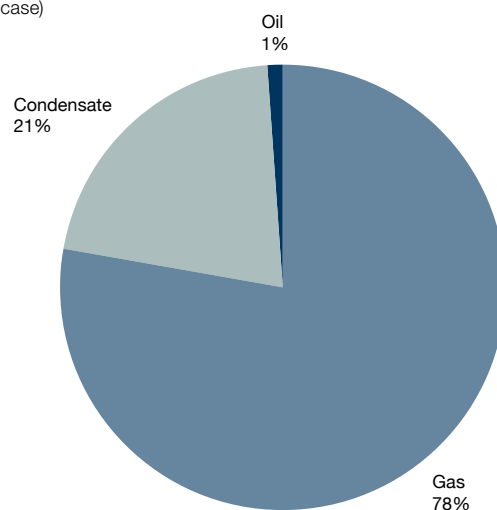


Notes:

The information shown above is based on the Reserves and Resources evaluation produced by an independent reservoir engineer Gaffney, Cline & Associates as at 31 December 2009. This is presented based on the Group's working interest share in the fields to which the Group has an interest. Conversion factor: bcf to mmbob at a factor 0.18.

Portfolio composition

(2P case)



Summary of the Group's licences held during the year

Working interest (%)	Licence	Expiry	Licence type ¹
Major licences			
96.5	Bitlyanska ⁽²⁾	December 2014	E&D
100.0	Pokrovskoe	August 2011	E&D
90.0	Zagoryanska	April 2014	E&D
97.0	Pirkovskoe	October 2010	E&D
Minor licences			
98.3	Debeslavtska	October 2026	Production
49.8	Cheremkhivska	May 2018	Production
100.0	Slobodo-Rungerska	April 2011	E&D
95.0	Monastryetska ⁽³⁾	December 2009	E&D
98.5	Krasnoil'ska ⁽³⁾	December 2009	E&D
40.0	Mizhrichenska	June 2011	E&D
79.9	Malynovetska ⁽⁴⁾	January 2012	E&D

(1) E&D = Exploration and Development.

(2) The working interest on the Bitlyanska licence declines on a stepped basis, every five years after the commencement of production on each well. The JAA also distinguishes working interests on new wells and work over wells with the former offering a higher share to the Group. Effective working interests are shown above.

(3) These licences expired in December 2009.

(4) This licence was annulled on 20 November 2009 (Order of Ministry of ecology #623).

Licences



Bittlyanska licence area

The Bittlyanska exploration and development licence covers an area of 390 square kilometres and the Group has a 96.5 per cent to 97.1 per cent working interest, varying with production. There are three hydrocarbon discoveries in this licence area: Bitlya, Borynya and Vovchenska. The Borynya and Bitlya fields hold 211.54 mmboe (2008: 188.6 mmboe) and 113.92 mmboe (2008: 114.0 mmboe) of Contingent Resources respectively, while no Reserves and Resources have been attributed to the Vovchenska field.

In December 2009, the Group received a five year extension for this licence until December 2014. The required work programme includes: (a) seismic surveying; (b) drilling of Bitlya 2, re-entering of Borynya 3 (testing and possible completion for production) and drilling of two additional wells; (c) commencement of a pilot commercial exploitation of Vovchenska 11 well; and (d) conducting geological and economic estimation work on the Vovchenska field.

In November 2009, drilling of the Borynya 3 well was terminated at a drilled depth of 5,325 metres and the well was suspended for future evaluation. Borynya 3 was a licence obligation well and confirmed that an active hydrocarbon system is present over an extended interval. Several discrete gas bearing pressure regimes were penetrated and good quality data were obtained from the well. In June 2009, Borynya 3 tested gas from a secondary reservoir at a maximum flow rate of 128,000 cubic metres per day during a limited duration drill stem test.

The Borynya 3 well was designed to test the potential of the Verchovinsky formation at a projected depth below 4,800 metres. According to Soviet era records, this interval in the Borynya 2 well tested 400,000 cubic metres of gas per day in an open-hole test before the test failed due to formation blocking the test tool. The possible extent of the Borynya structure is currently poorly defined as there is a lack of adequate seismic data due to the complex geology and the challenges of acquiring good seismic results in the terrain of the Borynya region.

Prior to changing strategy earlier in 2009, the Group had planned to drill the Bitlya 2 well following Borynya 3. This well has been postponed into the extension phase of the licence, pending a decision to commence exploratory drilling. Bitlya is a 3,000 metre normally pressured gas field which has already been drilled by the Bitlya 1 well. This well established the presence of hydrocarbons in a structure identified by Soviet era 2D seismic. This has been reprocessed and reinterpreted using modern geophysical techniques, including generation of a structurally balanced section to verify the tectonic activity in the area. Although the structure is confirmed by the interpretation the geometry and extent of the closure will need to be confirmed by a targeted seismic study planned for 2010.

Pokrovskoe licence

The Group has a 100 per cent working interest in the Pokrovskoe licence which holds 51.06 mmboe (2008: 58.6 mmboe) of Prospective Resources. The exploration licence covers 49.5 square kilometres and runs until August 2011. There is a four well drilling commitment (two of which have been drilled), 3D seismic work commitment as well as the construction of a gas treatment plant. Interpretation of the 3D seismic was completed in early 2010 and confirms the presence of a prospect with four-way closure at the Lower Visean level and potentially in the deeper Tournasian sediments beneath both the Pokrovskoe 1 and Pokrovskoe 2 well locations separated by a geological fault.

Pokrovskoe 2 was the first exploration well drilled on the Pokrovskoe structure and was spudded in late 2006. Drilling of the well was terminated at a drilling depth of 5,185 metres and the well was suspended for future evaluation. During drilling and coring operations across the Visean (V17 to V22) formations, there was strong gas influx into the well bore. The main objectives of this well are to determine the productivity of the Upper and Lower Visean formations and to convert potentially Prospective Resources to Reserves.

Pokrovskoe 1 is the second exploration well on the licence and was spudded in early 2008. The well was temporarily suspended at 4,988 metres pending evaluation of data obtained from the well so far.

The processing of the previously acquired 3D seismic data over the entire field is now complete and it is planned to deepen Pokrovskoe 1 and Pokrovskoe 2 to the lower target horizons and their commitment depths.

Zagoryanska licence

The Group has a 90 per cent working interest in the Zagoryanska licence area which is located immediately to the east of the Pirkovskoe licence. The Zagoryanska licences hold 96.4 mmboe of Contingent Resources (2008: 18.6 mmboe of Contingent Resources and 25.9 mmboe of Prospective Resources). The exploration and production licence covers 49.6 square kilometres and in January 2009 the Group received a five year extension for this licence which now expires in April 2014.

The required work programme includes: a 3D seismic survey (completed); testing of well Zagoryanska 3 (underway); workover of well Zagoryanska 2; the drilling of an appraisal well; and conducting geological and economic estimation of hydrocarbon Reserves, which are to be verified by the State of Reserves Commission.

The Zagoryanska 3 well has been drilled to a TD of 5,110 metres in the Lower Visean (V26) and was suspended in order to evaluate the data obtained from testing. Several potential gas bearing reservoirs were tested in the Carboniferous. In late 2009, additional testing of the well was farmed-out to a local company that is funding additional testing at their own expense in return for a share of any future production from the well. Following completion of this testing programme, management will consider the workover of two previously drilled wells (Zagoryanska 2 and 8).

Operations

Review continued

Pirkovskoe licence

The Group has a 97 per cent working interest in the Pirkovskoe licence which holds 2.4 mmboe (2008: 82.4 mmboe) of proved and probable Reserves, 5.0 mmboe (2008: 73.0 mmboe) of possible Reserves, 134.0 mmboe of Contingent Resources (2008: 10.4 mmboe of Contingent Resources and 180.3 mmboe of Prospective Resources). The exploration and appraisal licence covers 71.6 square kilometres and runs until October 2010.

The required work programme includes work-over of the Pirkovskoe 460 well, and the drilling of Pirkovskoe 1 and Pirkovskoe 2 wells and calculation of the potential hydrocarbon Reserves.

Pirkovskoe 1 was the first appraisal well drilled in the northern part of the Pirkovskoe licence. The well was terminated at a TD of 5,723 metres in the Devonian D3 and after testing the Devonian and lower Carboniferous, the well was temporarily suspended. The testing and subsequent completion of several shallower Carboniferous oil and gas bearing zones was farmed out to a local company at no cost to Cadogan, in return for a share of any future production. This interval is currently producing small volumes of oil and gas.

This Pirkovskoe 2 well was drilled to a depth of 4,580 metres, and has been suspended until the results of Pirkovskoe 1 have been reviewed.

Initial well testing of Pirkovskoe 460 was part of the Group's field development obligations and was completed in December 2007. Test results indicated that poor well integrity was causing water influx from behind casing. As a result, the well was producing at lower than anticipated gas rates and as the cost of remediation was prohibitive, the well has been plugged and abandoned.

The Group owns the Kraznozayarska gas treatment plant, on the Pirkovskoe licence area, which is connected to the UkrTransGas system. Its capacity was upgraded in July 2007 to 300,000 cubic metres per day of gas and 150 tonnes per day of condensate in anticipation of future production.

Minor fields

The Group has a number of minor fields located in western Ukraine. These include the following:

- **Debeslavtska licence area**

An exploration and development licence and production licence, containing 0.3 mmboe of proved, probable and possible Reserves (2008: 0.5 mmboe). This licence is currently producing 132.0 barrels of oil equivalent per day ('boepd') (2008: 168.8 boepd).

- **Cheremkhivska licence area**

A production licence containing 0.1 mmboe of proved, probable and possible Reserves (2008: 0.1 mmboe). This licence is currently producing 56.2 boepd (2008: 65.6 boepd).

- **Slobodo-Rungerska licence area**

An exploration and development licence, with no booked Reserves and Resources (2008: 20.0 mboe of proved, probable and possible Reserves and 10.3 mmboe Prospective Resources). This licence is currently producing 7.6 boepd (2008: 4.52 boepd).

- **Mizhrichenska licence area**

An exploration and development licence, with no booked Reserves or Resources (2008: nil).

During the year, oil and gas continued to be produced from certain of these fields and although modest, they are now producing at economic rates because of a considerable reduction in operating costs. Other minor non-strategic assets which were either sub-commercial or at the exploration stage were disposed of or allowed to expire. These include the Krasnoilska and Monastryetska licences which expired in December 2009 and the Malynovetska licence which was annulled by the Government in November 2009.

Some capital expenditure on certain minor fields is planned for 2010 to sustain production levels. In addition, subsurface analysis is planned to identify further potential on these licences as well as evaluation of other opportunities for diversifying risk and obtaining additional capital through potential farm-outs.

Financial Review

Impairment

IAS 36 *Impairment of Assets* and IFRS 6 *Exploration for and Evaluation of Mineral Resources* require that a review for impairment be carried out if events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. As a result of the significant downward revisions to the Group's Reserves and Resources estimates in the independent Reserves and Resources Evaluation (the 'Report') as outlined in the Statement of Reserves and Resources on page 17, poor test results on wells drilled to date and the Group's strategy of suspending operations on major licences, the Directors believed it appropriate to assess the carrying value of the Group's oil and gas assets including, goodwill, exploration and evaluation assets ('E&E') and property, plant and equipment ('PP&E') for impairment at 31 December 2009.

In order to assess the present value of the future cash flows attributable to the Group's goodwill, E&E and PP&E assets at 31 December 2009, reference was made to the Report.

For PP&E assets, the aggregate carrying value of each cash generating unit ('CGU') was compared against the expected recoverable amount of the related asset, by reference to the present value of the future cash flows expected to be derived from the production of commercial Reserves (2P Reserves) of that unit. An impairment loss of £4.9 million (2008: £nil) has been provided at 31 December 2009, reducing the carrying value of PP&E to £32.0 million (2008: £39.1 million).

As the Group applies the full cost method of accounting for E&E costs, the E&E assets are tested for impairment on a cost pool basis. At 31 December 2009, no commercial Reserves were assigned to the oil and gas licences within the Report, included within E&E assets, as insufficient work had been performed to determine the commerciality of the assigned Resources. Under the circumstances, a formal impairment test was triggered, however, as only the commercial Reserves (2P Reserves) assigned to the wider cost pool of Ukraine have been used to determine the present value of the future cash flows, the Contingent and Prospective Resources assigned to these licences are not, therefore, reflected in the recoverable amount. As a result the entire balance was provided for at 31 December 2009, resulting in the carrying value of £56.4 million being impaired in full.

The Group's goodwill was allocated to the wider cost pool of Ukraine and as such was assessed for impairment based on the present value of the future cash flows expected to be derived from production of commercial Reserves. The recoverable amount of the cash-generating unit to which goodwill was allocated was less than the carrying value of goodwill and as a result the entire balance was provided for at 31 December 2009, resulting in the carrying value of £2.3 million being impaired in full.

In addition to the impairment provided against the Group's goodwill, E&E and PP&E assets, further impairment charges against the carrying value of certain other assets have been provided. These are, a charge of £6.6 million (2008: £nil) to reduce the carrying value of the Group's inventory at 31 December 2009 to its net realisable value, a charge of £3.9 million (2008: £nil) to reduce the carrying value of other receivables in relation to the settlement agreement reached with Global Processing Systems LLC, and a charge of £13.2 million (2008: £0.8 million) against the carrying value of VAT receivable in Ukraine.

Total impairments charged to the Group's Consolidated Income Statement in 2009 were £87.3 million (2008: £0.8 million). Refer to note 7 to the Consolidated Financial Statements.

Income statement

In 2009, being in an exploration and development stage, the Group continued to operate at a loss, recognising a loss before tax of £107.2 million (2008: £24.4 million) of which £87.3 million (2008: £0.8 million) arose from the impairments discussed above. Revenue of £2.3 million (2008: £1.8 million) consisted of the sale of gas and oil from the producing wells in the Debeslavetska and Cheremkhivskoe fields and the sale of oil from test production on the Pirkovskoe licence. To the extent that revenue arises from test production during an evaluation programme, an amount is charged from evaluation costs to cost of sales, to reflect a zero margin. This has resulted in a gross profit from the Group's hydrocarbon sales of £0.3 million (2008: loss £0.2 million).

Other administrative expenses of £20.7 million (2008: £26.1 million) comprise staff costs, professional fees, Directors' remuneration, depreciation charges for the Group's property, plant and equipment and its other intangible assets and any currency effects from operating transactions or from the currency-related restatement of the value of monetary assets or liabilities. In addition to recurring administrative expenses, the following non-recurring items were included in administrative expenses during the year:

- £6.1 million (2008: £nil) recognised in relation to the investigation and litigation process of which £4.1 million (2008: £nil) was paid during 2009;
- £0.8 million (2008: £6.4 million) of consultancy fees incurred to defend the legal challenges indirectly associated with the Pirkovskoe and Zagoryanska licences;
- loss on the disposal of property, plant and equipment of £5.0 million (2008: £0.1 million);
- provision of £1.1 million (2008: £0.2 million) for doubtful assets to which recoverability is uncertain; and
- income of 0.8 million (2008: £0.2 million) relates to the reversal of equity-settled share-based payment transactions previously expensed due to certain options being forfeited.

The loss for the year includes £87.3 million (2008: £0.8 million) of impairment losses reducing the carrying value of goodwill, E&E assets, PP&E assets, prepayments, inventories and other receivables as at 31 December 2009. Refer to note 7 to the Consolidated Financial Statements.

Investment revenue decreased during the year to £0.4 million (2008: £2.9 million) due mainly to a reduction of interest rates and to the level of funds held.

Cash flow statement

The Consolidated Cash Flow Statement on page 42 shows expenditure of £15.9 million (2008: £38.3 million) on intangible E&E assets and £7.6 million (2008: £32.4 million) on PP&E. No acquisitions of subsidiaries were made in the year ended 31 December 2009 (2008: £2.4 million).

Balance sheet

As at 31 December 2009, the Group had net cash and cash equivalents of £30.5 million (2008: £72.0 million) with no external borrowings. The PP&E balance of £32.0 million at 31 December 2009 (2008: £39.1 million), relates primarily to the cost of developing fields with commercial Reserves and bringing them into production. Net assets have decreased by £119.8 million to

Financial Review continued

£83.6 million at 31 December 2009 from £203.4 million at 31 December 2008 which is principally due to the impairment losses provided at 31 December 2009 reducing the carrying value of the Group's goodwill, E&E assets, PP&E assets, prepayments, inventories and other receivables as discussed above.

Key performance indicators

The events and circumstances that took place during the year, as outlined in the Chairman's Statement on pages 4 to 7, have forced the Group to focus primarily on reducing costs and headcount, as a result of which the KPIs which it had used to monitor performance have been related to cash flow, cost reduction and numbers employed.

The average monthly cash outflow from operating and investing activities decreased by £5.9 million from £9.4 million in 2008 to £3.5 million in 2009. During the first three months of 2010 the average monthly cash outflow has been reduced to £0.9 million. The Group's headcount reduced substantially from 518 employees (including executive Directors) at 31 December 2008 to 153 at 31 December 2009.

The Group would normally monitor its performance in implementing its strategy with reference to clear targets set out for five key financial and one key non-financial performance indicators ('KPIs'):

- to increase oil, gas and condensate production measured on number of boepd;
- to increase the Group's oil and gas Reserves by de-risking possible Reserves and Contingent and Prospective Resources into proved plus probable Reserves ('2P'). This is measured in mmboe;
- to increase the realised price per 1,000 cubic metres;
- to decrease the cost per barrel for exploration and acquisition related expenditure;
- to increase the Group's basic and diluted earnings per share; and
- to reduce the number of lost time incidents.

These KPIs are applied across the Group. The Group's performance in 2009 against these targets is set out in the table below, together with the prior year performance data. No changes have been made to the source of data or calculation used in the year.

	Unit	2009	2008
Financial KPIs			
Average production (working interest basis) ⁽¹⁾	boepd	234	263
2P Reserves ⁽²⁾	mmboe	2.7	83.0
Finding and development cost per barrel ⁽³⁾	£	N/A⁽³⁾	15.79
Realised price per 1,000 cubic metres ⁽⁴⁾	£	188.5	104.1
Basic and diluted earnings per share ⁽⁵⁾	£	(0.46)	(0.17)
Non-financial KPIs			
Lost time incidents ⁽⁶⁾	Incidents	–	1

- (1) Average production is calculated as the average daily monthly production during the year.
- (2) Quantity of 2P Reserves as at 31 December 2009 and 2008 is based on Gaffney, Cline & Associates' independent report on the Group's Reserves and Resources dated February 2010 and 30 November 2008, respectively.
- (3) Calculated as exploration and acquisition expenditures paid during the year divided by 2P Reserves additions in the year. As a result of the significant downward revisions made to the Group's 2P Reserves (refer to Statement of Reserves and Resources on page 17), the finding and development cost per barrel for 2009 is not applicable.
- (4) This represents the average price received for gas sold during the year (excluding VAT).
- (5) Basic loss per Ordinary share is calculated by dividing the net loss for the year attributable to Ordinary equity holder of the parent by the weighted average number of Ordinary shares during the year. Dilutive loss per Ordinary share equals basic loss per Ordinary share, as due to the losses incurred in 2009 and 2008, there is no dilutive effect from the subsisting share warrants and share options. Refer to note 14 to the Consolidated Financial Statements.
- (6) Lost time incidents relate to injuries where an employee/contractor is injured and has time off work.

Related party transactions

Following the former Chief Executive Officer's resignation in March 2009, the Board initiated legal action against the former Chief Executive Officer and Chief Operating Officer, and certain third parties to obtain redress for the Company, arising from potential irregularities surrounding the procurement of and payment for certain assets and services by the Group. Some of these transactions may give rise to related party transactions that are not disclosed in the Consolidated Financial Statements.

Refer to note 30 of the Consolidated Financial Statements for a detailed discussion of related parties to the Group.

Treasury

The Group continually monitors its exposure to currency risk. It maintains a portfolio of cash and cash equivalent balances in both USD and GBP held primarily in the UK and holds these mostly in term deposits depending on the Group's operational requirements. Production revenues from the sale of hydrocarbons are received in the local currency in Ukraine ('UAH') and to date funds from such revenues have been held in Ukraine for further use in operations rather than being remitted to the UK. Funds are primarily converted to USD and transferred to the Company's subsidiaries to fund operations at which time the funds are converted to UAH. Some payments are made on behalf of the subsidiaries from the UK.

Risks and Uncertainties

There are a number of potential risks and uncertainties, which could have a material impact on the Group's long-term performance and could cause the actual results to differ materially from expected and historical results.

Financial risks

Issue	Risk	Mitigation
Validity of the Group's licences	There is a risk that licence obligations are not met or that the Group's title to its assets is not successfully upheld. This could impact the Group's working interests in its licences and future revenues, and trigger impairment charges and write-offs in the financial statements of future periods. Two of the Group's licences have been indirectly challenged to date (see note 4(c) to the Consolidated Financial Statements).	The Group's work programme has been designed to fulfil all of its licence obligations. If the work programme does not fulfil the various licence obligations, the Group will engage proactively with the government to renegotiate terms and to apply for an extension. The Group is taking all action to successfully defend its interests in the Pirkovskoe and Zagoryanska licences (see note 4(c)).
Recoverability of the Group's assets	There is a risk that the carrying value of the Group's assets will not be recovered through future revenues, leading to significant impairment losses. The recoverability of £22.9 million of other receivables is reliant upon a third party being able to sell the two gas plants within ten months and in the event that these gas plants are not sold there is an agreement that the third party will purchase the gas plants from the Group (refer to note 4(d) of the Consolidated Financial Statements).	The Group manages the recoverability of its assets and assesses the economic viability throughout the exploration, development and production phases. Significant impairment losses were recognised at 31 December 2009 to reduce the carrying amount of the Group's E&E and PP&E assets. The value attributable to the Group's E&E and PP&E assets is supported by the Reserves and Resources Evaluation received in March 2010. The Group ultimately retains title to the gas plants until such time as full settlement of agreed sums is achieved.
Liquidity risk management and going concern assumption	There is a risk that there will be insufficient funds to meet all corporate and development obligations and activities and continue as a going concern into the foreseeable future.	The Group manages liquidity risk by maintaining adequate cash reserves and by monitoring forecast and actual cash flow and there is an established framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. Management regularly reviews the Group's cash flow projections and forecasts. Refer to note 28 of the Consolidated Financial Statements.
Regulatory and tax compliance risk	There is a risk that the Group will fail to meet reporting, statutory and tax filing requirements.	The Group has an adequately trained and experienced financial department to ensure that all reporting, statutory and tax filing requirements are met.
Fraud risk	Following the departure of the former Chief Executive Officer and Chief Operating Officer, the Board launched an internal investigation into procurement procedures and potential irregularities. As a result, the Board initiated litigation in the High Court in London. There is a risk that further management or employee fraud will lead to misleading financial statements or financial loss to the Company.	Following the departure of the former Chief Executive Officer and Chief Operating Officer, the Board did the following: - assumed effective operational and financial control of the Group; - appointed Ian Baron as Chief Executive Officer; - completed an internal investigation into potential procurement irregularities and initiated litigation in the High Court in London; and - revised its cash management and the tendering and procurement process. Management and the Board will continue to strengthen controls within the Group to ensure that the opportunity to commit fraudulent acts is appropriately mitigated.
Litigation risk	There is a risk that the Group will be unsuccessful in the courts or that damages received do not cover the cost of litigation.	The Group has engaged highly experienced litigation lawyers to pursue claims against the former Chief Executive Officer, Chief Operating Officer and certain third parties associated with the alleged procurement irregularities. Management and the Company's lawyers are taking all measures to ensure that all actions made against the defendants are justified and are reasonably supported by evidence.

Risks and Uncertainties

continued

Financial risks continued

Issue	Risk	Mitigation
Budgeting risk	There is risk that the information on which planning documents and budgets are based may be inaccurate or incomplete resulting in management decisions that do not maximise the Group's resources.	The Group's annual budget based on the Group's work programme is updated and reviewed on a regular basis and is approved by the Board.
Procurement and commitment risk	There is a risk that unnecessary goods and services are procured, excessive prices are paid, substandard goods or services are accepted, erroneous payments occur or transactions are not appropriately recorded. In addition, there is a risk that information regarding contractual commitments is inaccurate or incomplete leading to incorrect decisions made on future commitments and/or inadequate accounting and disclosures being made in the Group's Consolidated financial statements.	The Group manages all contractual commitments through the budgeting process and updates the budget on a regular basis with all changes being approved by the Board.
Foreign exchange risk management	Funds are primarily maintained by the Group in GBP and USD. There is a risk that purchasing power in Ukraine is lost through foreign exchange translation.	The Group considers its foreign exchange risk to be a normal and acceptable business exposure and does not hedge against this risk. The Group monitors the foreign exchange movements of required currencies and maintains a minimum amount of funds in high risk currencies, such as the Ukrainian hryvnia ('UAH').
Inflation risk management	Inflation in Ukraine and in the international market for oil and gas may affect the Group's cost for acquiring equipment and supplies.	Management closely monitor Ukrainian inflation effects and adjust budgetary requirements as necessary. The Group's practice of raising funds in GBP and keeping deposits primarily in GBP accounts until funds are needed and selling its production in the spot market, coupled with the linkage of the currency in Ukraine to USD, should enable the Group to manage the risk of inflation.
Credit risk management	Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group.	The Group does not have any significant credit risk exposure as the normal terms for sales of gas and condensate to the Group's customers require prepayment before delivery. In the future, the Group could face issues with customers if curtailments of throughput in the gas transportation system delay deliveries to customers, but the Group has yet to experience such issues and transportation remains the responsibility of the customer once the Group has delivered product to the transportation system. The credit risk on liquid funds (cash and cash equivalents) is considered to be limited because counterparties are financial institutions with high and good credit ratings assigned by international credit-rating agencies in the UK and Ukraine, respectively.
Interest rate risk management	The Group has substantial cash and cash equivalents balances on which it earns deposit interest income. Other than placing sums on deposit at fixed rates for varying maturity periods, no financial instruments are used to manage the risk of interest rate volatility.	As the Group has no committed borrowings, the Group is not exposed to any significant risks associated with fluctuations in interest rates. Fluctuations in interest rates on cash balances held is mitigated by funds being spread over several banking institutions with varying interest rates offered. The Group considers this risk as a normal business exposure and does not hedge against this risk.
Commodity price risk management	The commodity price risk related to Ukrainian gas and condensate prices and, to a lesser extent, prices for crude oil.	The Group continues to seek to establish higher value wholesale and/or retail markets inside Ukraine.
Validity and appropriateness of accounting policies	Due to the procurement irregularities identified following the resignation of the former Chief Executive Officer and Chief Operating Officer, there are concerns over the validity and appropriateness of accounting treatments previously applied to expenditure incurred throughout the Group.	Management has taken action to ensure that all procurement irregularities and inappropriate accounting treatments are identified and corrected. An internal investigation into these irregularities has been completed and following the former executives' departure, legal actions have been initiated. A Reserves and Resources Evaluation was obtained to support the value attributable to the Group's exploration and evaluation ('E&E') assets and property, plant and equipment ('PP&E').

Non-financial risks

Issue	Risk	Mitigation
Operating environment	The stability of the Ukrainian economy is significantly impacted by the Ukrainian government's policies and actions in relation to supervisory, legal and economic reforms. As a result, the Group's ability to develop its oil and gas assets as well as sell hydrocarbon production within Ukraine will be driven by Ukrainian government policies towards the oil and gas sector generally and in particular pricing, taxation and licensing policies. A breach of Ukrainian regulation or procedure could put the Group's assets at risk.	The Group has established and maintains contacts across the political spectrum in Ukraine. The process of identifying political and state entity parties, who control decision making for the development of hydrocarbons and establishing contacts, is a continual process. The Group is actively maintaining communication with governmental agencies to ensure that the Group is not in breach of Ukrainian regulation or procedure. The Group also ensures that all activities undertaken comply with Ukrainian legislative requirements.
Regulatory and licence issues	The Ukrainian government authorises all exploration, development and production of hydrocarbons in Ukraine, and closely monitors compliance with hydrocarbon licence obligations. There is a risk that not all licence obligations are met and that the Group's licence interests may be lost as a result. Two of the Group's licences have been indirectly challenged to date.	If the work programme does not fulfil the various licence obligations, the Group will engage proactively with the government to renegotiate terms and to apply for an extension. Management seeks to minimise scope for legal challenges by maintaining up to date documentation and ensuring actions taken are in compliance with state regulations. The Group is currently taking all action to ensure a satisfactory conclusion to the legal issues faced on the Pirkovskoe and Zagoryanska licences. Refer to note 4(c) of the Consolidated Financial Statements for further comments.
Political risks	By operating in an emerging market (Ukraine), the Group is exposed to greater risks, including legal, regulatory, economic and political risks, than more developed markets. Emerging economies, such as Ukraine's, are generally subject to rapid change which could adversely impact the Group's ability to operate in this market.	The Group minimises this risk by maintaining the maximum amount of funds in international banks outside Ukraine and by continuously maintaining contacts across the political spectrum. The Group is also actively pursuing possible commercial relationships with oil and gas companies in order to develop its operations with Ukraine and to capitalise on opportunities that develop within the sector.
Economic environment	There is a risk that the Group's operations will become uneconomical due to the price of hydrocarbons in Ukraine being set below that of other European markets. There is a risk that fluctuations in the global economy may adversely affect the Ukrainian economy and the Group's business, results of operation or financial position.	Upon achieving commercial production from major fields in Ukraine, management will seek alternative markets in Ukraine, including vertical integration and will establish and build higher value wholesale and/or retail markets inside Ukraine.
Drilling and workover activities	Higher production volumes, and resulting revenues, operating profits and cash flows, are dependent on the effectiveness of the Group's drilling and workover activities on its existing and planned wells.	Management takes all actions necessary to ensure that wells are operating in accordance with international standards in order to minimise risk. Equipment is maintained to manufacturers' specifications and personnel are adequately trained. Future drilling activities will be performed and supervised by western trained personnel using western techniques and where possible, equipment. In addition, management is pursuing a farm-out campaign on the Group's major licences to spread the risk and alleviate the potential future capital required for drilling operations.
Reserves and Resources	Commercial Reserves are determined using estimates of oil and gas in place, recovery factors and future oil and gas prices. In addition, the geological conditions associated with our licence areas are complex which could impact on our ability to extract hydrocarbons from the various fields.	The Group relies upon a competent persons report provided by independent advisers for the determination of its oil and gas Reserves. Economic viability is confirmed before and during field investment and development. All measures are taken throughout the drilling and assessment phase of each well to determine commercial viability.

Risks and Uncertainties

continued

Non-financial risks continued

Issue	Risk	Mitigation
Information system integrity, access and availability risk	There is a risk that accounting systems and technical databases are not maintained appropriately or that IT security and back-up procedures fail and information is lost, stolen or corrupted.	The Group's IT department is managed by qualified IT experts, or where appropriate is outsourced to external consultants, who provide support, back-up and security.
Human resource risk	The loss of service of certain members of senior management or the departure of key members from the Group's team of technical engineers could have a material adverse effect on the business, results of operations or financial position of the Group. There is also a risk it will be difficult to attract, employ and retain the necessary skilled and experienced personnel.	During 2009, significant headcount reductions were made to reduce excessive staffing levels in Ukraine and to conserve cash flow. Senior management are primarily employed on a consultancy basis due to the uncertainties faced by the Group. A review of compensation and contractual terms for management and key employees is underway and will be agreed by the Remuneration Committee (bonus plan or long-term incentive plan will be considered).
Health, safety and environment ('HSE')	The Group's operations are such that minor and major injuries as well as fatalities could occur.	The Group ensures proper internal HSE supervision is in place (this includes appropriate supervision and training to avoid accidents, personal accident insurance, in-field medical facilities and access to hospitals) and compliance with local legislation and international standards. As part of our ongoing planning process prior to commencing any operation that carries HSE risk, HSE contingency plans are put in place. Refer to Corporate Responsibility on page 18 for further comments.
Social responsibilities	Failure to meet an aspect of the agreed social investment programme. There is also a risk that Ukraine backed insurance is not adequate or will fail to cover the Group in the case of an incident.	The Group ensures that Corporate, Social and Community Relation activities are planned and implemented. Refer to Corporate Responsibility on page 18 for further comments.

Statement of Reserves and Resources

As advised during 2009, the Board commissioned an independent Reserves and Resources Evaluation of the Group's assets in Ukraine, as at 31 December 2009 (the 'Report'). The Board received the report on 22 March 2010 and the results of the report are summarised in the tables below.

Summary of Reserves as of 31 December 2009

	Working interest basis		
	Gas (bcf)	Condensate (mmbbl)	Oil (mmbbl)
Proved and probable reserves			
At 1 January 2009	330.5	22.7	0.8
Revisions	(318.5)	(22.1)	(0.8)
Production	(0.5)	–	–
At 31 December 2009	11.5	0.6	–
Possible reserves			
At 1 January 2009	284.0	21.2	0.9
Revisions	(264.5)	(19.7)	(0.9)
At 31 December 2009	19.5	1.5	–

Summary of Contingent Resources as of 31 December 2009

	Working interest basis			
	Gas (bcf)	Condensate (mmbbl)	Oil (mmbbl)	Total mmboe
Contingent resources				
At 1 January 2009	1,583.2	48.0	1.5	334.4
Revisions	904.8	(60.1)	(1.5)	221.5
At 31 December 2009	2,488.0	108.1	–	555.9

The most significant change in the Group's Reserves and Resources, as compared to 1 January 2009, is the re-classification of most of the Reserves in the Pirkovskoe field as Contingent Resources. Additionally, best estimate Prospective Resources of 237 bcf gas and 8.4 mmbbl condensate are attributed to the Pokrovskoe prospect.

Despite the re-classification, the Group retains a significant level of Reserves and Contingent and Prospective Resources. Successful operations in the future (based on in-house studies underway or completed) should enable some of these Resources to be re-classified as Reserves.

The reason for this re-classification is the disappointing results of the drilling campaign conducted by the Group during 2008 and the first part of 2009, under the previous management. Although petrophysical analysis of the well log data provided very promising results, the test results failed to meet expectations. This could be a function of either reservoir characteristics or poor drilling and testing practices. At that time, the Group relied upon low-cost Ukrainian drilling rigs and testing technology, and as a result the wells drilled lack mechanical integrity. During testing, the procedures applied and tools utilised were frequently insufficient to perforate adequately and stimulate the reservoir intervals. This was a conclusion of the independent report on well testing commissioned by the new management team in 2009, which was critical of and questioned many of the previous well testing practices.

There have also been some revisions to the Resource volume estimates in Pirkovskoe and Zagoryanska based on a preliminary interpretation of the 3D seismic data. This interpretation was carried out by the local contractor, Ukrgeofizika, and was considered to be inaccurate, as it relied heavily on the structural model based on pre-conceived geological concepts. An in-house interpretation of the 3D seismic and well data is currently being prepared.

In the Report, Reserves are only assigned to the currently producing fields, specifically Pirkovskoe, Debeslavetska and Cheremkhivska. Slobodo-Rungurske field is excluded, as production is currently considered uneconomical, pending further analysis.

Contingent Resources are assigned to Pirkovskoe, Zagoryanska, Borynya and Bitlya fields, where development is contingent on further appraisal. The positive revision of 904.8 bcf in the Contingent Resources category comprises 585 bcf of re-classified 3P Reserves from Pirkovskoe field plus 321.8 bcf of additional Contingent Resources from the Borynya field and Zagoryanska field.

Prospective Resources are attributed to Pokrovskoe, where there has not yet been a production test.

Corporate Responsibility

The Group is aiming to build a sustainable business through developing its gas producing assets in Ukraine. Accordingly the Company will in time meet the expectations of what would be required of any company operating in the oil and gas sector anywhere in the world. The Board recognises that the key driver for its aim to become a sustainable business is the safety and development of its staff.

The business operates under a code of ethics, adopted at Board level, which has been disseminated to all management. A whistle-blowing procedure has been put in place, and all staff in both Ukraine and the United Kingdom have been made aware of it.

The Group Health, Safety and Environment Manager reports directly to the Chief Executive Officer. His role is to ensure that the Group has developed suitable procedures and that operational management have incorporated them into daily operations.

The Board believes that health and safety procedures and training across the Group should be to the standard expected in any company operating in the oil and gas sector. Accordingly, it has set up a Committee of the Board to review and agree health and safety initiatives and report back on progress. The monthly management report to the Board contains a full report on both health and safety, and environmental issues and key safety and environmental issues are discussed at the Executive Committee. The Health, Safety and Environment Committee report is on page 25.

Health and safety

A full Health and Safety Management System is in place. As part of a continuous improvement programme the Group is reviewing the existing system during a period of reduced operational activity, to develop a system that will ensure that a safety and environmental protection culture is embedded in the organisation. Incident reporting has been improved and covers performance statistics for exposure to safety, health and environmental hazards. A staff training programme is in place, which ensures all staff is aware of the policy, and onsite training is undertaken, which ranges from 'toolbox talks' on safety issues with site staff through to 'disaster' drills for major incidents.

The Board monitors lost time incidents as a key performance indicator of the business, to satisfy itself that the procedures in place are robust. The Board has benchmarked safety performance against the HSE performance index measured and published annually by the International Association of Oil & Gas Producers. In 2009, the Group has recorded a total of 1,018,265 man hours without a single lost time incident. The last lost time incident occurred in August 2008.

Employees

Certain of the Group's operations are undertaken by specialist sub-contractors who have the requisite technical knowledge required for complex drilling operations. Wherever possible local staff are recruited and procedures are in place to ensure that all recruitment is undertaken on a fair basis with no discrimination between applicants. Each operating company has its own Human Resources staff to ensure that the Group's employment policies are properly implemented. The Human Resources policy covers key areas such as equal opportunities, wages, overtime and discrimination. All staff are aware of the Group's grievance procedure. Sufficient levels of health insurance are provided by the Group to employees to ensure they have access to good medical facilities. Each employee's training needs are assessed on an individual basis to ensure that their skills are adequate to support the Group's operations, and to help them develop.

Environment

The Group's Environmental Action Plan (the 'Plan') was put in place following the recommendation of an independent auditor. All recommendations of the Plan have been implemented prior to the end of 2009. Going forward, environmental protection is being revised as part of the Group's evolving HSE management system.

Community

The Group's activities are carried out in rural areas of Ukraine and the Board is aware of its responsibilities to the local communities that the Group operates in and that some of the employees are recruited from. At current well sites, management work with the local councils to ensure that the impact of operations is minimised as far as is practical. Key projects undertaken include improving the road infrastructure in the area, so that sites are accessible which allow improved road communications in the local community. Specific charitable donations are made which directly benefit local schools and medical services, and other community focused facilities (refer to charitable donations made on page 29). Where appropriate, gas is provided to these organisations and the local villages near to our producing sites.

The Group's local companies see themselves as part of the community and are involved not only with financial assistance, but also with practical help. Wherever possible general site staff are recruited from the local area and given appropriate training, thereby providing income for areas that have been previously dependent on the agricultural sector.

Board of Directors

Simon Duffy, 60

Non-executive Chairman

Appointed to the Board on 9 May 2008, Mr Duffy has over 20 years experience as an executive director of a number of companies listed in the UK, Europe and the United States. These include, amongst others, Thorn EMI plc, Orange SA and most recently ntl Inc. He has served variously as chief financial officer, chief operating officer, chief executive officer, president and executive chairman. He also has 30 years experience as a non-executive director and non-executive chairman of a range of companies, including ten years with Imperial Tobacco Group plc.

Ian Baron, 53

Chief Executive Officer

Mr Baron was appointed to the Board as Chief Executive Officer on 19 March 2009. He has over 30 years of international experience in the upstream petroleum industry and has worked in several countries in the former Soviet Union. He is founding partner of Energy Services Group Ltd, a firm which provides project management and advisory services to the oil and gas industry. He was previously a non-executive Director of the Company until 19 April 2008. He is also a non-executive director of Petro Vista Energy Corporation.

Nicholas Corby, 49

Commercial Director

Mr Corby has over 20 years experience in investing in emerging markets. He is currently a partner and fund manager of Bridge Asset Management LLP, having previously been a director of Argo Capital Management. On 9 June 2009 Mr Corby ceased to be an independent non-executive director and was appointed Commercial Director on a part-time basis. Mr Corby joined the Board on 19 December 2006.

Philip Dayer, 59

Independent non-executive Director

Mr Dayer qualified as a chartered accountant with Peat, Marwick, Mitchell & Co and then pursued a corporate finance career in investment banking, specialising in advising small and mid-market UK companies. He was first appointed advisory director in 1983 at Barclays Merchant Bank Limited and since then he has held the position of corporate finance director with a number of banks. He retired from Hoare Govett Limited in 2004. Mr Dayer was a financial consultant to OJSC Rosneft Oil Company, the Russian state-owned oil and gas company, on its floatation in 2006. Mr Dayer is a non-executive director of Dana Petroleum plc, AVEVA Group plc and Navigators Underwriting Agency Ltd, senior independent director of Arden Partners plc, and chairman of IP Plus plc. Mr Dayer joined the Board on 9 May 2008. He is Chairman of the Remuneration and Audit Committees and Senior Independent Director.

Alan Cole, 68

Independent non-executive Director

Mr Cole is currently a non-executive chairman of several companies including JP Morgan Income Growth plc and NAAFI Pension Trustees. He is also a non-executive director of Hexadex Limited. Between 1990 and 1999, he was chief executive of Transport Development Group plc. Mr Cole was a non-executive director of Burren Energy plc when it was admitted to the Official List in 2003. Mr Cole joined the Board on 9 May 2008.

James Donaldson, 56

Independent non-executive Director

Mr Donaldson has been a non-executive Director since 5 March 2007. Since 1981, Mr Donaldson has worked with companies in exploration, development and production of hydrocarbons. Mr Donaldson is based in the United States and is involved in numerous domestic oil and gas projects, primarily in the US mid-continent. He was initially appointed to represent the European Bank of Reconstruction and Development (EBRD), one of the Company's major shareholders. He has, however, no contractual relationship with the EBRD.

Nick Hooke, 52

Independent non-executive Director

Mr Hooke is a chartered petroleum engineer and a fellow of the Energy Institute. He has over 25 years of oil and gas experience. Mr Hooke has worked in a variety of technical, commercial and management roles with Esso and Conoco and is currently an executive director of Challenge Energy, an oil and gas advisory company which he founded in 1997. Mr Hooke joined the Board on 9 May 2008.

Corporate Governance Statement

The Board of Cadogan Petroleum plc is committed to the highest standards of corporate governance and bases its actions on the principles set out in the June 2008 Combined Code on Corporate Governance (the 'Code') published by the Financial Reporting Council.

This statement describes how the Company applies the principles of the Code.

During the year under review, the Company has complied with the provisions set out in Section 1 of the Code with the following exceptions:

- Code provision A.6.1 – No formal performance evaluation of the Board, its Committees and its individual Directors has been undertaken.
- Code provision A.1.3 – The Senior Independent Director has not met with the non-executive Directors to review the performance of the Chairman, following a Board performance evaluation.

The reasons for both of these exceptions are set out on page 21 under the heading 'Performance evaluation 2009'.

Board

The Board provides leadership and stewardship. The Board comprises the Chairman, Chief Executive Officer, Commercial Director and four independent non-executive Directors. With the exception of the Chief Executive Officer, all Directors have served throughout the whole year. The membership of the Board and biographical details for all of the Directors are incorporated into this report by reference and appear on page 19.

The Board has a formal schedule of matters specifically reserved for it to decide, including approval of acquisitions and disposals, major capital projects, financial results, Board appointments, dividend recommendations, material contracts and Group strategy. The Board met ten times formally during 2009.

The Chairman, in conjunction with the Company Secretary, plans the programme for the Board during the year. The agenda for Board and Committee meetings is considered by the relevant Chairman and issued with supporting papers during the week preceding the meeting. For each Board meeting, the Directors receive a Board pack including detailed monthly management accounts, briefing papers on commercial and operational matters and major capital projects including acquisitions. The Board also receives briefings from key management on specific issues.

The attendance of those Directors in place at the year end at Board and Committee meetings during the year was as follows:

	Board	Audit Committee	Nomination Committee	Remuneration Committee
No. Held	10	7	2	3
No. Attended:				
SP Duffy	10	–	2	–
IR Baron ¹	7	–	–	–
PJ Dayer	9	7	–	3
AJ Cole	10	7	–	3
NC Corby ²	10	3	–	2
JC Donaldson	10	6	2	–
NJ Hooke	8	–	2	2

¹ There have only been eight Board meetings since Mr Baron's appointment to the Board on 19 March 2009.

² On 9 June 2009 Mr Corby became a part-time executive Director and, accordingly, stepped down as a member of the Audit and Remuneration Committee.

In addition to the formal Board meetings there have been numerous informal meetings and calls, most of them attended by the majority of Directors, to discuss the issues facing the Group. A procedure exists for the Directors, in the furtherance of their duties, to take independent professional advice if necessary, under the guidance of the Company Secretary and at the Company's expense. All Directors have access to the advice and services of the Company Secretary, who is responsible to the Chairman for ensuring that Board procedures are complied with and that applicable rules and regulations are followed.

Board independence

The roles and responsibilities of Chairman and Chief Executive Officer are separate. A formal division of each individual's responsibilities has been agreed and documented by the Board. Mr PJ Dayer is the Senior Independent Director.

The non-executive Directors bring an independent view to the Board's discussions and the development of its strategy. Their range of experience ensures that management's performance in achieving the business goals is challenged appropriately. All the non-executive Directors are considered by the Board, in accordance with the Code, to be independent. Notwithstanding Mr JC Donaldson's former association with the European Bank for Reconstruction and Development Limited (a major shareholder of the Company, who initially appointed him to represent them on the Board but with whom Mr Donaldson now has no contractual relationship), Mr Donaldson is considered to be independent in character and judgement.

The letters of appointment for non-executive Directors are available for review at the Registered Office and prior to the Annual General Meeting. For information regarding the Annual General Meeting please refer to the separate Notice of Meeting.

Performance evaluation 2009

As a consequence of the issues and challenges that the Board has had to face and discuss there has been no formal review of Board performance. Depending on the strategy pursued by the Group, the appropriateness of a review will be considered during 2010. Despite not having undertaken a formal review, the Chairman is satisfied that each of the non-executive Directors being put forward for re-election at the forthcoming Annual General Meeting continues to be effective and that their ongoing commitment to the role is undiminished.

Responsibilities and membership of Board committees

The Board has agreed written terms of reference for the Nomination Committee, Remuneration Committee and Audit Committee. The terms of reference for all three Board Committees are published on the Company's website, www.cadoganpetroleum.com, and are also available from the Company Secretary at the Registered Office. A review of the terms of reference, membership and activities of all Board Committees is detailed on pages 23 to 26 and page 30.

Internal control

The Directors are responsible for the Group's system of internal control and for maintaining and reviewing its effectiveness. The Board has delegated responsibility for the review of the Group's internal controls to the Audit Committee. The Group's systems and controls are designed to safeguard the Group's assets and to ensure the reliability of information used both within the business and for publication.

Due to the withholding of information and other alleged irregular behaviour by some of the former executive Directors of the Company, the internal control process for the Group was overridden in 2008 and the first half of 2009 (see note 3(b) of the Consolidated Financial Statements for further information). All senior management at Executive Committee level and above have, during 2009, resigned. The Board will continue to review the procedures and systems being implemented throughout the Group to ensure these are robust.

Systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

The key features of the internal control systems which operated during 2009 and up to the date of signing the accounts are documented in the Group's Corporate Governance and Policy and Control Manual. This manual has been circulated throughout the Group.

Day-to-day responsibility for the management and operations of the business has been delegated to the Chief Executive Officer and his Executive Committee; comprising the Chief Financial Officer, Commercial Director, Operations Director and General Director Ukraine. The Company Secretary attends all Executive Committee meetings.

Certain specific administrative functions are controlled centrally. Taxation, treasury and insurance functions report to the Chief Financial Officer. The Chief Financial Officer is not currently a Board member, but is a member of the Executive Committee, he reports to the Chief Executive Officer and attends Board meetings by invitation. The legal function is managed by the Company Secretary who reports to the Board and also attends all Board and Executive Committee Meetings. The Health and Safety and Environment functions report to the Chief Executive Officer. An overview of the Group's treasury policy is set out on page 12.

The Group does not have an internal audit function. Due to the small scale of the Group's operations at present, the Board do not feel that it is appropriate or economically viable to have this function in place. The Audit Committee will continue to consider the position periodically.

Relations with shareholders

The Chairman and Executive Directors of the Company have a regular dialogue with analysts and substantial shareholders. The outcome of these discussions are reported to the Board and discussed in detail.

The Annual General Meeting is used as an opportunity to communicate with all shareholders. In addition, preliminary results are posted on the Company's website, www.cadoganpetroleum.com, as soon as they are announced. The Notice of the Annual General Meeting is contained in a separate document and will be sent to shareholders at least 20 business days before the meeting. Each substantially separate issue will be proposed in the Notice of Annual General Meeting as a separate resolution and there are separate resolutions relating to the Annual Financial Report and the Directors' Remuneration Report. Furthermore, it is intended that the Chairmen of the Nomination, Audit and Remuneration Committees will be present at the Annual General Meeting. The results of all resolutions will be published on the Company's website www.cadoganpetroleum.com.

Going concern

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Consolidated and Company Financial Statements. For further detail refer to the detailed discussion of the assumptions outlined in note 3(c) to the Consolidated Financial Statements.

Corporate Governance Statement

continued

Directors' responsibilities

The Directors are responsible for preparing the Annual Report, Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. The Directors are required by the International Accounting Standards ('IAS') Regulation to prepare the Group financial statements under International Financial Reporting Standards ('IFRS') as adopted by the European Union and have also elected to prepare the parent company financial statements in accordance with IFRS as adopted by the European Union. Under company law, the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and Group and of the profit or loss of the Company and Group for that period. In preparing the Company and Group's financial statements, the Directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The Directors are responsible for keeping proper accounting records that are sufficient to show and explain the Company and Group's transactions and disclose with reasonable accuracy at any time the financial position of the Company and Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

Directors' responsibilities statement

We confirm to the best of our knowledge:

- (1) the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation as a whole; and
- (2) the management report, which is incorporated into the Directors' Report, includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Disclosure of information to auditors

As required by section 416 of the Companies Act 2006, each of the Directors as at 27 April 2010 confirms that:

- (a) so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- (b) the Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Words and phrases used in this confirmation should be interpreted in accordance with section 416 of the Companies Act 2006.

Board Committee Reports

Audit Committee Report

Philip Dayer (Chairman)

Alan Cole (non-executive Director)

James Donaldson (non-executive Director)

The Audit Committee (the 'Committee') is appointed by the Board, on the recommendation of the Nomination Committee, from the non-executive Directors of the Group. The Committee's terms of reference include all matters indicated by the Combined Code. They are reviewed annually by the Committee and any changes are then referred to the Board for approval. The terms of reference of the Committee are published on the Company's website, www.cadoganpetroleum.com, and are also available from the Company Secretary at the Registered Office. Three members constitute a quorum.

Responsibilities

- To monitor the integrity of the annual and interim financial statements, the accompanying reports to shareholders, and announcements regarding the Company's results.
- To review and monitor the effectiveness and integrity of the Company's financial reporting and internal financial controls.
- To review the effectiveness of the process for identifying, assessing and reporting all significant business risks and the management of those risks by the Company.
- To oversee the Company's relations with the external auditors and to make recommendations to the Board, for approval by shareholders, on the appointment and removal of the external auditors.
- To consider whether an internal audit function is appropriate to enable the Committee to meet its objectives.
- To review the Company's arrangements by which staff of the Company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

Governance

The Committee was in place throughout 2009. On 9 June 2009 Mr NC Corby resigned as a member of the Committee following his appointment as part time Commercial Director of the Group. All three members were non-executive Directors who are considered to be independent in accordance with provision A.3.1 of the Combined Code.

The Committee is chaired by Mr PJ Dayer who is a chartered accountant and has recent and relevant financial experience in corporate finance, specialising in advising small and mid cap companies and as a non-executive director of several other listed companies.

The Committee met seven times during the year. Attendance at meetings is shown on page 20.

At the invitation of the Committee, the Chief Financial Officer, Group Financial Controller and external auditors regularly attend. The Company Secretary attends all meetings of the Committee.

The Audit Committee also meets the external auditors without management being present.

Activities of the Audit Committee

During the year, the Committee discharged its responsibilities as follows:

Financial statements

The Committee examined the Group's consolidated and Company's financial statements, and considered the appropriateness of accounting policies adopted and whether the financial statements give a true and fair view, prior to recommending them to the Board. In view of the disclosure that certain sums in 2006, 2007 and 2008 were inappropriately capitalised, the Committee recommended to the Board that the previously issued financial statements for 2008 be withdrawn, and a restated version for 2008 be published with a fundamental uncertainty statement attached to them.

Internal controls and risk management

In addition the Committee reviews and keeps under review financial and control issues throughout the Group including the Group's key risks and the approach for dealing with them. Following the discovery of certain procurement irregularities and alleged fraud against the Company by two of the former executive Directors, the Committee supervised a review by management of all payments in excess of US\$50,000 made in the three preceding years both in Ukraine and the United Kingdom.

External auditors

The Committee is responsible for recommending to the Board, for approval by the shareholders, the appointment of the external auditors.

The Committee considers the scope and materiality for the audit work, approves the audit fee, and reviews the results of the external auditors' work. Following the conclusion of each year's audit, it considers the effectiveness of the external auditors during the process.

There is an agreed policy on the engagement of the external auditors for non-audit services to ensure that their independence and objectivity are safeguarded. Work closely related to the audit, such as taxation or financial reporting matters, can be awarded to the auditors by the executive Directors provided the work does not exceed £50,000 in fees per item. Work exceeding £50,000 requires approval by the Committee. In addition, the Committee reviewed the independence of the advice given to the Remuneration

Board Committee Reports

continued

Committee by Deloitte LLP and satisfied itself that sufficient procedures were in place to guarantee independence. All other non-audit work either requires Committee approval or forms part of a list of prohibited services, where it is felt the external auditors' independence or objectivity may be compromised.

Internal audit

During the year the Committee considered the necessity for an internal audit function. It concluded that at the present time, due to the size of the Group and the current stage of development, an internal audit function will be of little benefit to the Group. The Committee intends to review this periodically.

The Group's whistle-blowing procedure provides a mechanism for employees to raise serious concerns. This was implemented during 2008 and the Committee received confirmation that it had been circulated to all staff in the UK and Ukraine.

Overview

As a result of its work during the year, the Committee has concluded that it has acted in accordance with its terms of reference and has ensured the independence and objectivity of the external auditors. A formal review of the Committee's effectiveness has not been undertaken, however, a review will be conducted alongside the Board evaluation process depending on the strategy pursued by the Group. The Chairman of the Audit Committee will be available at the Annual General Meeting to answer any questions about the work of the Committee.

On behalf of the Audit Committee

Philip Dayer

Chairman of the Audit Committee

Health, Safety and Environment Committee Report

Ian Baron (Chairman)

Nick Hooke (non-executive Director)

Peter Bradley (Operations Director)

The Health, Safety and Environment Committee (the 'Committee') is appointed by the Board, on the recommendation of the Nomination Committee. The Committee's terms of reference are reviewed annually by the Committee and any changes are then referred to the Board for approval. The terms of reference of the Committee are published on the Company's website, www.cadoganpetroleum.com, and are also available from the Company Secretary at the Registered Office. Two members constitute a quorum, one of whom must be an independent non-executive Director.

Responsibilities

- To develop a framework of the policies and guidelines for the management of health, safety and environment issues within the Group.
- Evaluate the effectiveness of the Group's policies and systems for identifying and managing health, safety and environmental risks within the Group's operation.
- Assess the policies and systems within the Group for ensuring compliance with health, safety and environmental regulatory requirements.
- Assess the performance of the Group with regard to the impact of health, safety, environmental and community relations decisions and actions upon employees, communities and other third parties and also assess the impact of such decisions and actions on the reputation of the Group and make recommendations to the Board on areas for improvement.
- On behalf of the Board, receive reports from management concerning all fatalities and serious accidents within the Group and actions taken by management as a result of such fatalities or serious accidents.
- Evaluate and oversee, on behalf of the Board, the quality and integrity of any reporting to external stakeholders concerning health, safety, environmental and community relations issues.
- Where it deems it appropriate to do so, appoint an independent auditor to review performance in regard to health, safety, environmental and community relations matters and review any strategies and action plans developed by management in response to issues raised and, where appropriate, make recommendations to the Board concerning the same.

Governance

The Committee was in place throughout 2009. On 19 March 2009 Mr MC Tolley resigned as a Director of the Company and the Chief Executive Officer, Mr IR Baron, was appointed Chief Executive Officer and became Chairman of the Committee. On 30 June 2009, following his resignation as a Director of the Group, Mr PA Biddlestone left the Committee. On 16 September 2009, Mr P Bradley, Operations Director was appointed to the Committee. Mr V Jovanovich, HSE Director, left the Company with effect from 12 December 2009. The Company Secretary attends all meetings of the Committee.

The Committee met six times during the year. It now meets monthly to monitor continuously progress by management.

Activities of the Health, Safety and Environment Committee

During the year the Committee discharged its responsibilities as follows:

- Reviewed existing Health, Safety and Environment policies to ensure completeness.
- Monitored the implementation of the Environmental Action Plan.
- Oversaw the commencement of the development of a system that will ensure that a safety and environmental protection culture is embedded in the organisation.
- Developed a Corporate Health Safety and Environmental statement for adoption by the Board.
- Ensured reporting has improved so that it covers performance statistics for exposure to safety, health and environmental hazards.

Overview

As a result of its work during the year, the Committee has concluded that it has acted in accordance with its terms of reference.

On behalf of the Health, Safety and Environment Committee

Ian Baron

Chairman of the Health, Safety and Environment Committee

Board Committee Reports

continued

Nomination Committee Report

Simon Duffy (Chairman)

James Donaldson (non-executive Director)

Nick Hooke (non-executive Director)

The Nomination Committee (the 'Committee') is appointed by the Board predominantly from the non-executive Directors of the Group. All the members of the Committee are presently independent non-executive Directors. The Committee's terms of reference include all matters indicated by the Combined Code. They are reviewed annually by the Committee and any changes are then referred to the Board for approval. The terms of reference of the Committee are published on the Company's website, www.cadoganpetroleum.com, and are also available from the Company Secretary at the Registered Office. Three members constitute a quorum.

Responsibilities

- To regularly review the structure, size and composition (including the skills, knowledge and experience) required of the Board compared to its current position and make recommendations to the Board with regard to any changes.
- Be responsible for identifying and nominating for the approval of the Board candidates to fill Board vacancies as and when they arise.
- Before appointment is made by the Board, evaluate the balance of skills knowledge and experience on the Board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment. In identifying suitable candidates, the Committee shall use open advertising or the services of external advisers to facilitate the search and consider candidates from a wide range of backgrounds on merit, taking care that appointees have enough time available to devote to the position.

The Committee shall also make recommendations to the Board concerning:

- Formulating plans for succession for both executive and non-executive Directors and in particular for the key roles of Chairman and Chief Executive Officer.
- Membership of the Audit and Remuneration Committees, in consultation with the Chairmen of those committees.
- The reappointment of any non-executive Director at the conclusion of their specified term of office, having given due regard to their performance and ability to continue to contribute to the Board in the light of the knowledge, skills and experience required.
- The re-election by shareholders of any Director under the 'retirement by rotation' provisions in the Company's Articles of Association having due regard to their performance and ability to continue to contribute to the Board in the light of the knowledge, skills and experience required.
- Any matters relating to the continuation in office of any Director at any time including the suspension or termination of service of an executive Director as an employee of the Company subject to the provisions of the law and their service contract.

Governance

The Committee was in place throughout 2009. On 30 June 2009, following his resignation as a Director of the Group, Mr PA Biddlestone left the Committee. All members are now non-executive Directors who are considered to be independent in accordance with provision A.3.1 of the Combined Code.

The Committee met twice during the year. Attendance at meetings is shown on page 20.

At the invitation of the Committee, the Chief Executive Officer can attend the meeting. The Company Secretary attends all meetings of the Committee.

Activities of the Nomination Committee

During the year the Committee discharged its responsibilities as follows:

- Reviewing the structure and composition of the Board to ensure that there is sufficient high calibre management at executive Director and Executive Committee level to resolve the issues that the Group currently faces and develop a strategy for the future.

Overview

As a result of its work during the year, the Committee has concluded that it has acted in accordance with its terms of reference. A formal review of the Committee's effectiveness has not been undertaken, however, a review will be conducted alongside the Board evaluation process depending on the strategy pursued by the Group. The Chairman of the Nomination Committee will be available at the Annual General Meeting to answer any questions about the work of the Committee.

On behalf of the Nomination Committee

Simon Duffy

Chairman of the Nomination Committee

Other Statutory Information

Directors

The following were Directors during the year and held office throughout the year, unless otherwise indicated:

Simon Duffy, Chairman
 Ian Baron, Chief Executive Officer (appointed on 19 March 2009)
 Nicholas Corby, Commercial Director, (appointed as part time executive Director on 9 June 2009, previously a non-executive Director)
 Philip Dayer, non-executive Director
 Alan Cole, non-executive Director
 James Donaldson, non-executive Director
 Nick Hooke, non-executive Director
 Mark Tolley, Chief Executive Officer (resigned 19 March 2009)
 Alexander Sawka, Chief Financial Officer (resigned 18 June 2009)
 Peter Biddlestone, Asset Development Director (resigned 30 June 2009)
 Vasyi Vivcharyk, Chief Operating Officer (resigned 9 June 2009)

Biographical details for all Directors are shown on page 19.

Directors' interests in shares

The beneficial interests of the Directors in office as at 31 December 2009 and connected persons in the Ordinary shares of the Company at 31 December 2009 are set out below. Options granted under the 2007 Share Option Plan, the 2008 Share Option Plan and the 2008 Approved Option Plan and shares awarded under the 2008 Performance Share Plan are shown on pages 34 and 35 of this report.

There have been no changes in the Directors' interests in shares granted by the Company between the end of the financial year and 27 April 2010. An update will be given in the Notice of Annual General Meeting.

Shares as at	2009	2008
SP Duffy	32,609	32,609
IR Baron (on appointment on 19 March 2009)	—	—
PJ Dayer	21,739	21,739
AJ Cole	17,391	17,391
NC Corby	423,333	423,333
JC Donaldson	—	—
NJ Hooke	17,392	17,392

Dividends

The Directors do not recommend payment of a dividend for the year to 31 December 2009 (2008: £nil).

Law of Member State of Incorporation

Cadogan Petroleum plc is subject to the laws of England and Wales.

Structure of share capital

The authorised share capital of the Company is currently £30,000,000 divided into 1,000,000,000 Ordinary shares of 3 pence each. The number of shares in issue as at 31 December 2009 is 231,091,734 Ordinary shares of 3 pence each with a nominal value of £6,932,752. The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (the 'Regulations') allow companies to hold shares in treasury rather than cancel them. Following the consolidation of the issued capital of the Company on 10 June 2008, 66 residual new Ordinary shares were transferred to treasury. No dividends have been paid on shares whilst held in treasury and no voting rights attach to the shares held in treasury.

Following the passing of a special resolution of members of the Company at a General Meeting held on 11 November 2009, the High Court of Justice of England and Wales approved the cancellation of the Company's share premium accounts pursuant to a court order dated 9 December 2009. Such court order was subsequently registered with the Registrar of Companies on 17 December 2009.

Rights and obligations of Ordinary shares

On a show of hands at a general meeting every holder of Ordinary shares present in person or by proxy and entitled to vote shall have one vote and on a poll, every member present in person or by proxy, shall have one vote for every Ordinary share held. In accordance with the provisions of the Company's Articles of Association, holders of Ordinary shares are entitled to a dividend where declared or paid out of profits available for such purposes. On a return of capital on a winding up, holders of Ordinary shares are entitled to participate in such a return.

Other Statutory Information

continued

Restrictions on transfer of securities

The restrictions on the transfer of shares in the Company are as follows:

- The Board may, in its absolute discretion and without giving any reason, decline to register any transfer of any share which is not a fully paid share.
- The Board may also decline to register any transfer of a certificated share unless:
 - (a) the instrument of transfer, duly stamped (or duly certified or otherwise shown to the satisfaction of the Board to be exempt from stamp duty), is lodged at the place where the register of members of the Company is kept accompanied by the certificate for the shares to which it relates (save in the case of a transfer by a person to whom the Company is not required by law to issue a certificate and to whom a certificate has not been issued) and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer and, if the instrument of transfer is executed by some other person on his behalf, the authority of that person so to do;
 - (b) the instrument of transfer is in respect of only one class of share; and
 - (c) in the case of a transfer to joint holders, the number of joint holders to whom the share is to be transferred does not exceed four.
- Where a shareholder has declined to provide certain information requested by the Company in accordance with the Companies Act, the Board can, in certain circumstances, refuse to register a transfer of such shares.
- Restrictions may be imposed on certain employees who are required to seek approval from the Company before dealing in shares in accordance with the requirements of the Listing Rules of the United Kingdom Listing Authority.
- Awards of shares under the Company incentive arrangements, the Performance Share Plan, are subject to restrictions on transfers of shares prior to vesting.
- Certain institutional and private investors (the 'Locked-up Shareholders'), the Directors and certain senior management agreed to enter into lock-up arrangements in respect of their holdings of, or options to subscribe for, Ordinary shares held prior to the Global Offer in June 2008. The executive Directors and senior management have agreed not to sell any Ordinary shares or options to subscribe for Ordinary shares held by them for a staggered period of three years from 23 June 2008, the date of Admission, subject to customary exceptions, such that one third of Ordinary shares/options to subscribe held by them will become free of lock-up at each of the following times: a) 12 months from Admission; b) following publication of the preliminary results for the year ending 31 December 2009; and c) following publication of preliminary results for the year ending 31 December 2010. The non-executive Directors agreed not to sell any Ordinary shares held by them for a period 12 months from Admission.

Exercise of rights of shares in employee share schemes

None of the share awards under the Company's incentive arrangements are held in trust on behalf of the beneficiaries.

Restrictions on voting deadlines

The notice of any general meeting of the Company shall specify the deadline for exercising voting rights and appointing a proxy or proxies to vote at a general meeting. It is the Company's policy at present to take all resolutions at a general meeting on a poll and the results of the poll are published on the Company's website after the meeting.

Significant direct and indirect holdings of securities

As at 27 April 2010, the Company had been notified of the following voting rights attached to the Company's shares in accordance with the Disclosure and Transparency Rules:

Major shareholder	Number of shares held	% of total voting rights
Weiss Capital LLC	57,804,756	25.01
QVT Financial LP	36,628,570	15.85
HBK Capital Management	16,525,999	7.15
Lloyds Banking Group plc	14,841,482	6.42
European Bank of Reconstruction and Development Ltd	11,632,866	5.03
JP Morgan	11,625,000	5.03

An update will be given in the Notice of the Annual General Meeting.

Directors' indemnities and insurance

The Company continues to maintain Directors and Officers Liability Insurance. The Company has not entered into any indemnities directly with individual Directors.

Appointment and replacement of Directors

The Company may, by ordinary resolution, appoint any individual to the Board. The Board may appoint any individual willing to act as a Director either to fill a vacancy or act as an additional Director. The appointee can only hold office until the next annual general meeting whereupon he will be put forward for reappointment.

The Company's Articles of Association prescribe that there should be no less than three Directors and no more than 15.

Amendment of the Company's Articles of Association

The Company's Articles of Association can only be amended by a special resolution at a general meeting of shareholders.

Payments to creditors

It is the Group's policy to make payments to suppliers in accordance with agreed terms provided that the supplier has performed in accordance with the relevant terms and conditions. Creditor days for the Group for the year ended 31 December 2009 were an average of 38 days (2008: 20 days). The Company creditor days at 31 December 2009 were 62 days (2008: 12 days).

Charitable and political donations

The Group has made charitable donations of £38,514 (2008: £363,382) during the year principally to charities serving the local communities in which the Group operates in Ukraine. No payments were made to political parties.

Post balance sheet events

In February 2010, the Group reached an agreement with one of the Defendants in the litigation, Smith Eurasia Limited ('Smith Eurasia') and various related parties with respect to potentially improper payments made by Smith Eurasia to former executives of the Company prior to March 2009. In accordance with the agreement, Smith Eurasia does not accept fault or liability in relation to the allegedly improper payments and the Company will receive USD4,500,000. In addition, the agreement resolves all other outstanding commercial issues between Smith Eurasia and the Company.

Auditors

Deloitte LLP have indicated that they are willing to continue in office. Their reappointment, at a remuneration to be agreed by the Directors, will be proposed at the Annual General Meeting.

Powers of Directors

The Directors are responsible for the management of the business and may exercise all powers of the Company subject to UK legislation, any directions given by special resolution and the Memorandum and Articles of Association.

Change of control – significant agreements

The Company has no significant agreements which contains provisions which allow a counterparty to alter and amend the terms of the agreement following a change of control of the Company.

Should a change in control occur then certain senior staff are entitled to a payment of salary and benefits for a period of six months.

Certain of the Company's long-term incentive arrangements contain provisions which permit awards or options to vest or become exercisable on a change of control in accordance with the rules of the plans.

This Directors' Report comprising pages 11 to 29 has been approved by the Board and signed on its behalf by:

Stefan Bort

Company Secretary
27 April 2010

Registered Office:

5th Floor, 4/5 Grosvenor Place, London SW1X 7HJ
Company registered in England and Wales – No 5718406

Remuneration Committee Report

Throughout 2009 the Remuneration Committee has met three times to discuss and decide on appropriate action with regard to Directors' remuneration to assist the Board to resolve the various challenges that the Group faced. The Group is currently in a transitional phase and although initial discussions on remuneration policy have been held, no formal policy will be put in place until the Group's strategy is fully determined.

On 19 March 2009 Mr MC Tolley resigned as Chief Executive Officer and Mr IR Baron was appointed initially on an interim basis. Subsequent to that date, Messrs Vivcharyk, Sawka and Biddlestone resigned as executive Directors of the Group. Following the resignation of Mr Tolley, certain procurement irregularities, which are currently subject to High Court proceedings in London, were discovered. As a consequence of this, no contractual termination payments were made to either Messrs Tolley or Vivcharyk although they have, in their defences to the High Court action, made a counterclaim relating to their contractual entitlement. Mr Sawka agreed to terminate his contract as a director on 30 June 2009 and his service agreement for employment on 30 September 2009 with no compensation for loss of office. The Remuneration Committee agreed to put in place a retainer arrangement for Mr Sawka to assist the Group with the resolution of the remaining matters arising from the internal investigation. A settlement agreement was entered into with Mr PA Biddlestone whereby he received a lump sum payment of £120,000 for loss of office equating to eight months of his remaining contractual notice period of ten months.

The appointment of Mr Baron was initially on an interim basis to undertake a review of the Group's business in Ukraine. The initial three month contract has been replaced with a contract with a rolling three month notice period. On 9 June 2009 Mr N Corby transferred from a non-executive status to a part-time executive basis to assist with the resolution of the issues that existed.

Bonus payments have only been made to Mr Baron, who under his contract was entitled to a discretionary award to be determined by the Remuneration Committee. Full details are disclosed on page 34.

The Company has not made any awards in 2009 under any of the long-term incentive arrangements agreed by shareholders in 2008. The performance criteria associated with the awards made in 2008 to certain key employees are no longer realistic but they have not been revised or altered to reflect the changed circumstances of the Group. Most of the individuals who received these awards have now left the Company and the Remuneration Committee will reconsider the use of the long-term incentives when it considers the Group's remuneration policy for the future business.

As a result of its work during the year, the Committee has concluded that it has acted in accordance with its terms of reference. A formal review of the Committee's effectiveness has not been undertaken, however, a review will be conducted alongside the Board evaluation process depending on the strategy pursued by the Group.

The Remuneration Committee unanimously recommends that shareholders vote to approve the Directors' Remuneration Report at the 2010 Annual General Meeting.

Philip Dayer

Chairman of the Remuneration Committee

Directors' Remuneration Report

This report has been prepared in accordance with the Combined Code on Corporate Governance, Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the UK Listing Authority Listing Rules and will be submitted to the shareholders for their approval at the Annual General Meeting of the Company. In preparing this report, the Board has followed the provisions of Schedule A to the June 2008 FRC Combined Code.

Composition and terms of reference of the Remuneration Committee

The Remuneration Committee (the 'Committee') is appointed by the Board, on the recommendation of the Nomination Committee, from the non-executive Directors of the Company.

The Committee is committed to principles of accountability and transparency to ensure that remuneration arrangements demonstrate a clear link between reward and performance. In its work, the Committee considers fully the principles and provisions of the Combined Code on Corporate Governance. The terms of reference of the Committee (which will be reviewed annually) are published on the Company's website, www.cadoganpetroleum.com, and are also available from the Company Secretary at the Registered Office.

Responsibilities

In summary, the Committee's responsibilities, as set out in its terms of reference, are as follows:

- To set remuneration policy for executive Directors, the Company Secretary and other members of the executive management as appropriate.
- To approve the design, award levels, performance measures and targets for any annual or long-term incentives and approve any payments made and awards vesting under such schemes.
- To determine the total individual remuneration package of each executive Director and other senior executives including bonuses, incentive payments and share options or other share awards.
- To ensure that contractual terms on termination, and any payments made, are fair to the individual and the Company.

Governance

The Committee for the year ending 31 December 2009 comprised the following non-executive Directors: PJ Dayer, AJ Cole and NJ Hooke. Mr NC Corby was appointed part-time Commercial Director on 9 June 2009 and ceased to be a member of the Committee. All three members are non-executive Directors who are considered to be independent in accordance with provision A.3.1 of the Combined Code.

The Committee met three times during the year. Attendance at meetings is shown on page 20.

The Committee appointed Deloitte LLP as its remuneration adviser. Deloitte LLP provide independent advice to the Committee on remuneration issues in accordance with the Committee's terms of reference. They do not provide any other advice to the Company on remuneration. Deloitte LLP also provide audit services to the Company. Advisory partners and staff have no involvement in the audit, and are not involved in the preparation of audited information. The Committee also received legal advice from Denton Wilde Sapte LLP, who also provide other legal services to the Company.

At the discretion of the Committee, the Chairman and Chief Executive Officer can be invited to attend meetings when appropriate, but are not present when their own remuneration is being discussed. The Committee is also supported by the Company Secretary.

The Chairman of the Remuneration Committee will be available at the Annual General Meeting to answer any questions regarding the Company's remuneration policy and about the work of the Committee.

Remuneration policy and package for executive Directors

The Committee's philosophy is that remuneration arrangements should be appropriately positioned to support the Group's business strategy over the longer term and create value for shareholders. In this context the following key principles are considered to be important:

- remuneration arrangements should align executive and employee interests with those of shareholders;
- remuneration arrangements should help retain key executives and employees; and
- remuneration arrangements should incentivise executives to achieve short, medium and long-term business targets which represent value creation for shareholders. Exceptional reward should only be delivered if there are exceptional returns.

As explained in the Remuneration Committee Report on page 30 the Group is currently relying on interim consultants to resolve the various issues that the Group is facing. Therefore the packages that the executive Directors are currently receiving are in response to those circumstances.

The Remuneration Committee plans to review remuneration arrangements in 2010 with a view to returning to a more traditional remuneration policy, based on a fixed base salary and the ability to receive annual cash bonuses and annual rewards under the Company's Performance Share Plan. When establishing any future remuneration arrangements, the Committee will take into account the above principles and UK market practice, as well as considering pay and conditions for employees below executive Directors. If it is intended to make any significant changes to the policy, the Committee will consult with shareholders.

Directors' Remuneration Report

continued

Board changes

On 19 March 2009 Mr MC Tolley relinquished the role of Chief Executive Officer and resigned from the Board. Mr IR Baron was appointed Interim Chief Executive Officer and a Director on that date.

As a consequence Mr Tolley's service agreement and the consultancy agreement between Mr Tolley, Marksman International Limited and the Company were terminated on 19 March 2009. In view of the High Court action against Mr Tolley, brought by the Company, no termination payments have been made to him. He has, however, in his defence to the High Court action made a counterclaim relating to his contractual entitlement. The Remuneration Committee has decided not to exercise its discretion over awards made to Mr Tolley under the 2007 Share Option Plan and the 2008 Performance Share Plan and accordingly only awards which have vested under the 2007 Share Option Plan can be exercised by him in the 12 month period following termination. These awards are disclosed in the tables on page 35.

Mr VP Vivcharyk resigned as a director on 9 June 2009 and his consultancy agreement with VPV International Oil & Gas Inc. was terminated on that day. In view of the High Court action against Mr Vivcharyk, brought by the Company, no termination payments have been made to him. He has, however, in his defence to the High Court action made a counterclaim relating to his contractual entitlement. The Remuneration Committee has decided not to exercise its discretion over awards made to Mr Vivcharyk under the 2007 Share Option Plan and the 2008 Performance Share Plan and accordingly only awards which have vested under the 2007 Share Option Plan can be exercised by him in the 12 month period following termination. These awards are disclosed in the tables on page 35.

Mr A Sawka resigned as a director on 19 June 2009, as a consequence Mr Sawka's service agreement was terminated on 19 June 2009 and the consultancy agreement between Mr Sawka, Ryberg Ltd and the Company were terminated on 30 June 2009. No termination payments were made to him under either contract. The Remuneration Committee has decided not to exercise its discretion over awards made to Mr Sawka under the 2007 Share Option Plan and the 2008 Performance Share Plan and accordingly only awards which have vested under the 2007 Share Option Plan can be exercised by him in the 12 month period following termination. These awards are disclosed in the tables on page 35. The Remuneration Committee agreed to put in place a retainer arrangement for Mr Sawka of £5,000 per calendar month, which can be terminated on one month's notice, to assist the Group with the resolution of the remaining matters arising from the internal investigation. The payment under this agreement has been reduced to £2,500 per calendar month with effect from 1 January 2010.

Mr PA Biddlestone resigned as a director of the Company on 30 June 2009, as a consequence Mr Biddlestone's service agreement was terminated on 30 June 2009. A settlement agreement was entered into with Mr Biddlestone whereby he received a lump sum payment of £120,000 for loss of office equating to eight months of his remaining contractual notice period of ten months. The Remuneration Committee has decided not to exercise its discretion over awards made to Mr Biddlestone under the 2008 Share Option Plan and the 2008 Performance Share Plan and accordingly all awards under the Plans have lapsed.

Arrangements for new Directors

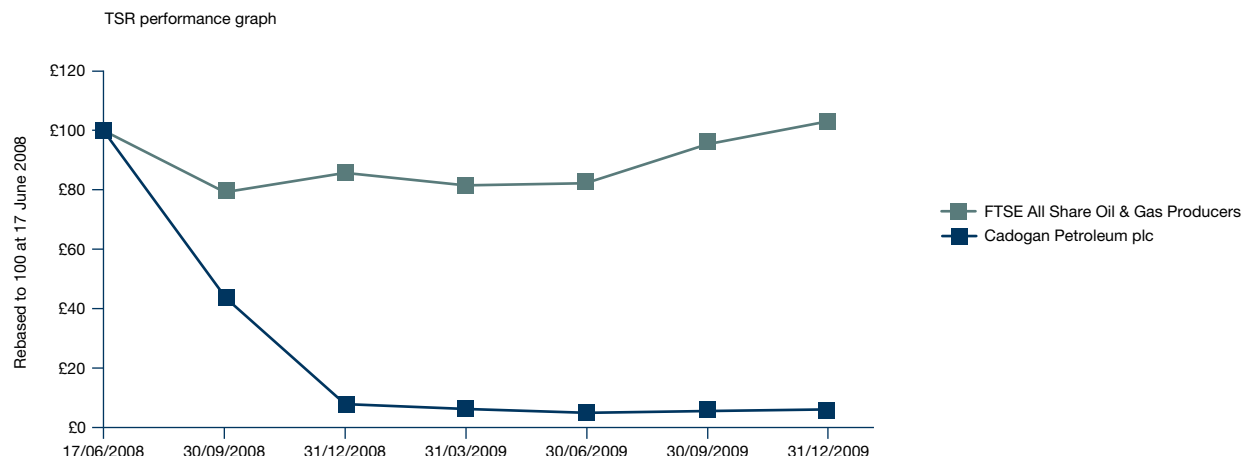
The appointment of Mr IR Baron was initially on an interim fixed term basis of three months, to undertake a review of the Group's business and assets in Ukraine. The Company entered into an agreement with Mr Baron and Energy Services Group Ltd, which provides Mr Baron's services, for him to act as Chief Executive Officer. The initial agreement, as Interim Chief Executive Officer, was for a period of three months ending on 30 June 2009 and was for a fee of USD 45,000 per calendar month plus expenses. The agreement was extended for an indefinite period on 1 July 2009 with a notice period of three months by either Mr Baron or the Company. The agreement provides for the Remuneration Committee to agree a bonus award of up to 100% of the fees invoiced in each calendar year. The Company can, with the agreement of Mr Baron, make this bonus award in the form of shares should it so decide. The contract can be terminated by the executive in the event that there is a change in control of the Board. In this event the contract will terminate at the end of the calendar month that notice was given with no entitlement to compensation after that date.

The Remuneration Committee recommended that a 100% award be made to Mr Baron for the first three month contract in view of the strong progress that had been made during this period and the unexpected challenges that had arisen. The bonus award for the remaining six months of 2009 was set at 50% of the monthly fees invoiced reflecting Mr Baron's performance against strategic milestones. In the event of a breach by either Mr Baron or the Company, this agreement becomes terminable immediately and without compensation for loss of office.

On 9 June 2009, Mr NC Corby transferred from a non-executive director status to a part-time executive basis to assist with the resolution of the issues that existed. In view of the uncertainty at the time, the Remuneration Committee agreed that Mr Corby be paid a fixed daily rate of £2,000 for the days incurred working on the Group's business. This arrangement can be terminated on three months' notice, and does not include any entitlement to a bonus, long term incentive or pension. The contract can be terminated by the executive in the event that there is a change in control of the Board. In this event the contract will terminate at the end of the calendar month that notice was given with no entitlement to compensation after that date. This arrangement has been changed to a £15,000 per month retainer for 2010 on the same terms.

Performance graph

The graph below highlights the Company's total shareholder return ('TSR') performance since listing compared to the FTSE All Share Oil & Gas Producers index. This index has been selected on the basis that it represents a sector specific group which is an appropriate group for the Company to compare itself against. TSR is the return from a share or index based on share price movements and notional reinvestment of declared dividends.



Pension

No specific pension arrangements have been put in place for the executive Directors. UK tax resident Directors are entitled to participate in the Company Stakeholder arrangements which is a defined contribution scheme, but are not eligible for a Company contribution.

Service agreements

The Company's policy on service agreements is that executive Directors' agreements should, following any necessary initial notice period, be terminable by either the Company or the Director on not more than six months' notice. The service agreements contain provision for early termination, among other things, in the event of a breach by the executive but make no provision for any termination benefits except in the event of a change of control of the Company where the executive becomes entitled to 12 months' salary on termination by the Company. The service agreements contain restrictive covenants for a period of 12 months following termination of the agreement. At present, the Company has not issued the standard agreement to any executive Director, as the nature of the Group's business at present has relied on one-off contractual arrangements for interim appointments.

Details of service agreements in place as at 31 December 2009 are set out below:

Director	Current agreement start date	Unexpired term	Notice period
IR Baron	1 July 2009	Three months	Three months
NC Corby	1 June 2009	Three months	Three months

Non-executive Directors

The payment policy for non-executive Directors is to pay the market rate to secure persons of a suitable calibre. The remuneration of the non-executive Directors is determined by the Board. External benchmarking data and specialist advisers are used when setting fees, which will be reviewed at appropriate intervals.

The non-executive Directors' fees are non-pensionable. The non-executive Directors are not eligible to participate in any incentive plans. All non-executive Directors have a letter of appointment that appoints them to the Board for an initial three year period. They are subject to retirement and reappointment by shareholders at the first annual general meeting following appointment, and then at least once every three years thereafter. Appointments can be terminated immediately by the Company by three months' notice or immediately due to a breach.

The Company's policy was to pay a basic fee of £40,000 to all non-executive Directors. Additional fees of £5,000 are payable for chairmanship of a Board Committee and for being a Senior Independent Director. There has been no increase in fees since June 2008. From 1 April 2010 the basic fee has been reduced to £25,000 with no chairmanship fee.

Directors' Remuneration Report

continued

The dates of the non-executive Directors' original appointment and expiry of current term in accordance with their letters of appointment are:

Non-executive Director	Date of appointment	Expiry of current term
SP Duffy	9 May 2008	9 May 2011
AJ Cole	9 May 2008	9 May 2011
PJ Dayer	9 May 2008	9 May 2011
JC Donaldson	29 May 2008	29 May 2011
NJ Hooke	9 May 2008	9 May 2011

No executive Director held any appointment on the board of another listed company, apart from Mr IR Baron who was appointed a Director on 19 March 2009, who is a non-executive director of Petro Vista Energy Corporation. All fees paid are retained by Mr Baron.

Information subject to audit:

2009 Directors' emoluments

Director	Salary/fees	Performance payments	Termination payments	Benefits in kind ⁽¹⁾	Total	2008
SP Duffy	125,000	—	—	—	125,000	80,609
IR Baron (re-appointed 19 March 2009) ⁽²⁾	269,834	181,718	—	—	451,552	16,500
NC Corby	238,946	—	—	—	238,946	35,519
PJ Dayer	55,000	—	—	—	55,000	35,468
AJ Cole	40,000	—	—	—	40,000	25,795
JC Donaldson	59,901	—	—	—	59,901	57,896
NJ Hooke	40,000	—	—	—	40,000	25,795
MC Tolley (resigned 19 March 2009)	66,434	—	—	740	67,174	259,337
PA Biddlestone (resigned 30 June 2009)	97,023	—	120,000	209	217,232	228,917
A Sawka (resigned 19 June 2009)	140,003	—	—	2,840	142,843	180,822
VP Vivcharyk (resigned 9 June 2009)	69,139	—	—	—	69,139	159,884
WPH Jeffcock (resigned 18 April 2008)	—	—	—	—	—	18,000
Total	1,201,280	181,718	120,000	3,789	1,506,787	1,124,542

(1) The non-cash element of the emoluments is disclosed as benefits-in-kind and is comprised of medical insurance.

(2) Resigned 18 April 2008 re-appointed 19 March 2009.

(3) The remuneration of the highest paid Director, Mr Baron, was £451,552 (2008: £16,500).

Following the internal investigation as a result of the alleged procurement irregularities, the Committee became aware that MC Tolley and VP Vivcharyk had several employment contracts with the Group's Ukrainian subsidiary companies. The payments made under these undisclosed contracts for the year ended 2009, which are not included above, amounted to £6,970 (2008: £19,050) in respect of Mr Tolley and £78,261 (2008: £102,428) in respect of Mr Vivcharyk. These contracts have now been terminated.

The completeness of disclosure of related party transactions and Directors' remuneration is affected by the ongoing investigations into alleged procurement irregularities involving certain former executive Directors. The investigation has identified certain potential procurement irregularities in respect of the certain former executive Directors which call into question the completeness and accuracy of the disclosures of related party transactions and Directors' Remuneration.

Share Incentive Arrangements

The Company currently operates the following incentive plans in place:

- 2008 Performance Share Plan.
- 2008 Share Option Plan with a corresponding HMRC approved plan.
- 2007 Share Option Plan.

No awards have been made under any of the above plans to the current executive Directors. The Remuneration Committee will keep the use of share incentives under review. Appropriate performance metrics will be determined at the time of award which will be stretching and support shareholder value creation.

2008 Performance Share Plan

The PSP offers the opportunity to earn shares in the Company subject to the achievement of stretching performance targets. Awards can be made under the PSP at the direction of the Remuneration Committee with a value of up to a maximum of 200 per cent of base salary (400 per cent in exceptional circumstances).

The following table sets out the interests of the Directors who held office during the year in the 2008 Performance Share Plan as at 31 December 2009. The nature of these awards is set out in note 26 to the Consolidated Financial Statements.

Director	Grant date	Awards held at 1 January 2009	Lapsed	Awards held at 31 December 2009
MC Tolley	9 October 2008	470,930	470,930	—
PA Biddlestone	9 October 2008	313,953	313,953	—
A Sawka	9 October 2008	313,953	313,953	—
VP Vivcharyk	9 October 2008	313,953	313,953	—

Share options

The Company operates three share option plans: the 2007 Share Option Plan and the 2008 Share Option Plan (both of which are unapproved for HMRC purposes), and the 2008 Approved Option Plan ('CSOP') (which is an HMRC approved plan). It is no longer intended to make awards under the 2007 Share Option Plan.

Options cannot be exercised under any plan unless a target has been met. The targets associated with awards made in 2008 under the 2008 Share Option Plan and the 2008 Approved Option Plan are detailed below.

In 2007 (prior to Admission), executive Directors were granted awards under the 2007 Share Option Plan in order to reward them for their services since the Company's incorporation and to incentivise them to achieve stretching share price and production targets. The targets associated with these awards are as follows:

- 40 per cent of the option vested and became exercisable on the grant date.
- 20 per cent of the option will vest and become exercisable when the Group has sales over a continuous period of 90 days of at least 5,000 boepd.
- 20 per cent of the option will vest and become exercisable when the Group has sales over a continuous period of 90 days of at least 10,000 boepd.
- 20 per cent of the option will vest and become exercisable upon the earlier of:
 - (a) after admission, maintaining a daily average price per share of at least £3.276 for any period of 45 consecutive days; and
 - (b) a trade sale at a price of at least £3.276.

The following table sets out the maximum interests of the Director, who held office during the year, in the various Share Option Plans at 31 December 2009.

Director	MC Tolley	A Sawka	VP Vivcharyk	PA Biddlestone	PA Biddlestone
Share Option Plan	2007 Option Plan	2007 Option Plan	2007 Option Plan	2008 Option Plan	2008 CSOP
Date of resignation	19 March 2009	18 June 2009	9 June 2009	30 June 2009	30 June 2009
Date from which exercisable	11 September 2007	11 September 2007	11 September 2007	9 October 2011	9 October 2011
Expiry date	11 September 2012	11 September 2012	11 September 2012	9 October 2018	9 October 2018
Exercise price (pence)	81.9	81.9	81.9	86	86
Outstanding at 1 January 2009	8,230,608	2,027,243	4,024,078	802,325	34,883
Forfeited	4,938,365	1,216,346	2,414,447	802,325	34,883
Outstanding at 31 December 2009	3,292,243	810,897	1,609,631	—	—
Exercisable at 31 December 2009	3,292,243	810,897	1,609,631	—	—

Options awarded under the 2007 Option Plan become exercisable on achievement of the performance target as detailed above. The vested options, which will lapse 12 months after the individuals resignation date, have an exercise price of 81.9 pence.

No options have been exercised under any Option Scheme and thus no gain on exercise has been realised.

The market price of Ordinary shares subject to the above options as at 31 December 2009 was 17.5 pence. During the year the shares traded in the range 5.1 pence to 23.25 pence (prices at mid market close).

This Directors' Remuneration Report comprising pages 31 to 35 has been approved by the Board and signed on its behalf by:

Stefan Bort

Company Secretary
27 April 2010

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Independent Auditors' Report

to Members of Cadogan Petroleum plc

We have audited the financial statements of Cadogan Petroleum plc for the year ended 31 December 2009 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements, the Consolidated and Parent Company Statements of Changes in Equity and the related notes 1 to 43. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Qualified opinion on financial statements arising from limitation in scope

Note 3(b) to the Consolidated Financial Statements explains that the Board commenced an investigation in March 2009 into potential procurement irregularities within the Group. Certain payments were identified as inappropriately capitalised in the years ended 31 December 2006, 2007 and 2008 and, in addition, the investigation also cast doubt on the recoverability of goodwill, exploration and evaluation assets, property plant and equipment and inventory. The investigation has concluded in respect of the capitalisation and recoverability of assets as at 31 December 2009 but it has not been possible to conclude retrospectively whether the revised values of assets as at 31 December 2008 and 31 December 2007 require further revision. In view of this, we have not been able to obtain sufficient appropriate audit evidence regarding the carrying values as at these dates. Had we been able to do so, it is possible that adjustments might be needed to the Consolidated and Parent Company Balance Sheets as at 31 December 2008, together with consequential amendments to the Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated and Parent Company Cash Flow Statements, Consolidated and Parent Company Statement of Changes in Equity and related notes for the years ended 31 December 2008 and 2009.

In addition, as set out in note 3(b) to the Consolidated Financial Statements and the Directors' Remuneration Report, the investigation has identified certain potential irregularities relating to former executive Directors which call into question the completeness and accuracy of the disclosures of related party transactions and Directors' remuneration. These investigations are still ongoing and, pending completion, we have been unable to obtain sufficient appropriate audit evidence in relation to these matters.

Except for the financial effect of adjustments and additional disclosures, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the matters referred to in the preceding paragraphs, in our opinion:

- the financial statements give a true and fair view of the state of the Group's and the Parent Company's affairs as at 31 December 2009 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Independent Auditors' Report

to Members of Cadogan Petroleum plc continued

Emphases of matter – going concern and possible outcome of legal proceedings

In forming our opinion on the financial statements, we have considered:

- the adequacy of the disclosures made in note 3(c) to the consolidated financial statements concerning the Company's and the Group's ability to continue as a going concern. Resolutions have been proposed by the Company's largest shareholder at the next Annual General Meeting to replace the current Board and management with a new Board comprising nominees of the Company's largest shareholder, and to return almost all of the available cash of the Group to the Company's shareholders. This in the Directors' view is likely to result in the liquidation of the Group's assets and ultimately the Company. These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Company's and the Group's ability to continue as a going concern and hence realise their assets and discharge their liabilities in the ordinary course of business, rather than to cease exploration and by liquidating the assets to return the remaining cash to investors. The financial statements do not include the adjustments that would result if the Company and the Group were unable to continue as a going concern; and
- the adequacy of the disclosures made in note 4(c) to the consolidated financial statements concerning the current status of legal proceedings contesting the validity of certain of the Group's licences in Ukraine. As stated in note 4(c) to the consolidated financial statements, the Group's licences remain valid and effective. However, the ultimate outcome is uncertain, and should the courts in Ukraine continue to rule that the licences were improperly awarded and further annul the existing licences, the Group would be required to further impair the value of these assets. The amounts capitalised within intangible exploration and evaluation assets and property, plant and equipment in respect of these licences as at 31 December 2009, was £22.7 million. No provision for impairment has been made in the Consolidated Financial Statements in this regard on the basis that the Directors believe that, notwithstanding the uncertainties, the validity of the Group's licences is expected to be reconfirmed.

Opinion on other matters prescribed by the Companies Act 2006

Except for any adjustments to the disclosures of Directors' remuneration arising from the results of the investigations described above, in our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you that:

- in respect solely of the limitation in scope referred to above, we have not obtained all the information and explanations that we considered necessary for the purpose of our audit;
- in respect solely of the limitation in scope referred to above, we were unable to determine whether proper accounting records have been maintained; and
- in respect solely of the limitation in scope regarding the related party transactions and Directors' remuneration referred to above, we have been unable to determine with certain disclosures of Directors' remuneration specified by law have been made.

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have nothing to report arising from the reviews which we were required by the Listing Rules to perform of:

- the Directors' statement contained within note 3(c) to the consolidated financial statements in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Graham Hollis (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditors

London, UK

27 April 2010

Consolidated Income Statement

For the year ended 31 December 2009

	Notes	2009 £'000	2008 £'000
Continuing operations			
Revenue	5	2,342	1,792
Cost of sales		(2,022)	(1,966)
Gross profit/(loss)		320	(174)
Administrative expenses:			
IPO fees expensed		–	(4,399)
Other administrative expenses		(20,658)	(21,750)
Impairment of oil and gas assets	7	(63,499)	–
Impairment of other assets	7	(23,752)	(834)
Operating loss		(107,589)	(27,157)
Investment revenue	11	407	2,850
Finance costs	12	(8)	(56)
Loss before tax		(107,190)	(24,363)
Tax	13	(113)	(514)
Loss for the year	8	(107,303)	(24,877)
Attributable to:			
Equity holders of the parent		(107,303)	(24,039)
Minority interest		–	(838)
		(107,303)	(24,877)
		£	£
Loss per ordinary share			
Basic and diluted	14	(0.46)	(0.17)

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2009

	Unaudited	
	2009 £'000	2008 £'000
Loss for the year	(107,303)	(24,877)
Unrealised currency translation differences	(11,377)	(9,486)
Total comprehensive loss for the year	(118,680)	(34,363)

Consolidated Balance Sheet

As at 31 December 2009

	Notes	2009 £'000	2008 £'000
Assets			
Non-current assets			
Goodwill	15	–	2,508
Intangible exploration and evaluation assets	16	–	47,870
Property, plant and equipment	17	32,009	39,067
Other non-current receivables	20	18,835	18,866
Restricted cash	20	450	–
		51,294	108,311
Current assets			
Inventories	19	5,522	8,156
Trade and other receivables	20	5,390	21,489
Cash and cash equivalents		30,505	72,026
		41,417	101,671
Total assets		92,711	209,982
Liabilities			
Non-current liabilities			
Deferred tax liabilities	21	(973)	(1,238)
Long-term provisions	23	(176)	(469)
		(1,149)	(1,707)
Current liabilities			
Trade and other payables	22	(7,237)	(4,325)
Current tax liabilities		(16)	(55)
Current provisions	23	(698)	(450)
		(7,951)	(4,830)
Total liabilities		(9,100)	(6,537)
Net assets		83,611	203,445
Equity			
Share capital	24	6,933	6,933
Share premium account	25	–	250,373
Retained earnings/(accumulated deficit)	25	93,593	(49,477)
Cumulative translation reserves		(21,374)	(9,997)
Other reserves		5,093	6,247
Equity attributable to equity holders of the parent		84,245	204,079
Minority interest		(634)	(634)
Total equity		83,611	203,445

The financial statements of Cadogan Petroleum plc, registered in England and Wales no. 5718406, were approved by the Board of Directors and authorised for issue on 27 April 2010. They were signed on its behalf by:

Philip Dayer
Director
27 April 2010

The notes on pages 44 to 69 form part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2009

	Notes	2009 £'000	2008 £'000
Net cash outflow from operating activities	27	(18,952)	(42,532)
Investing activities			
Acquisition of subsidiaries		–	(2,416)
Purchases of property, plant and equipment		(7,569)	(32,444)
Purchases of intangible exploration and evaluation assets		(15,896)	(38,329)
Proceeds from sale of property, plant and equipment		432	5
Interest received		501	2,761
Net cash used in investing activities		(22,532)	(70,423)
Financing activities			
Proceeds from issue of shares		–	171,404
Net cash from financing activities		–	171,404
Net (decrease)/increase in cash and cash equivalents		(41,484)	58,449
Effect of foreign exchange rate changes		(37)	(380)
Cash and cash equivalents at beginning of year		72,026	13,957
Cash and cash equivalents at end of year		30,505	72,026

Consolidated Statement of Changes in Equity

For the year ended 31 December 2009

	Share capital £'000	Share premium account £'000	Shares to be issued £'000	Retained earnings £'000	Cumulative translation reserves £'000	Other reserves			Total £'000
						Share-based payment £'000	Reorganisation £'000	Minority interest £'000	
As at 1 January 2008	4,169	78,028	2,260	(25,438)	(511)	4,674	890	204	64,276
Issue of equity shares	2,709	179,423	—	—	—	—	—	—	182,132
Equity shares to be issued	55	2,205	(2,260)	—	—	—	—	—	—
Expenses of issue of equity shares	—	(9,145)	—	—	—	—	—	—	(9,145)
Share-based payments	—	(138)	—	—	—	683	—	—	545
Net loss for the year	—	—	—	(24,039)	—	—	—	(838)	(24,877)
Exchange translation differences on foreign operations	—	—	—	—	(9,486)	—	—	—	(9,486)
As at 1 January 2009	6,933	250,373	—	(49,477)	(9,997)	5,357	890	(634)	203,445
Share-based payments	—	—	—	—	—	(1,154)	—	—	(1,154)
Net loss for the year	—	—	—	(107,303)	—	—	—	—	(107,303)
Capital reduction (note 25)	—	(250,373)	—	250,373	—	—	—	—	—
Exchange translation differences on foreign operations	—	—	—	—	(11,377)	—	—	—	(11,377)
As at 31 December 2009	6,933	—	—	93,593	(21,374)	4,203	890	(634)	83,611

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009

1. General information

Cadogan Petroleum plc (the 'Company', together with its subsidiaries the 'Group'), is incorporated in England and Wales under the Companies Act. The address of the registered office is 5th Floor, 4/5 Grosvenor Place, London SW1X 7HJ. The nature of the Group's operations and its principal activities are set out in the Operations Review on pages 8 to 10 and the Financial Review on pages 11 and 12.

These financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the Company operates. Foreign operations are included in accordance with the policies set out in note 3(a).

2. Adoption of new and revised Standards

In the current year, the following new and revised Standards have been adopted and have affected the amounts reported in these financial statements.

Standards affecting presentation and disclosure

IAS 1 (revised 2007) *Presentation of Financial Statements* – In the current year the Group has adopted IAS 1 (revised 2007), which introduces a statement of comprehensive income, which presents all items of income and expenses which are not recognised in the income statement. This has resulted in the Company presenting these statements separately for 2009 and 2008. Although a third balance sheet would technically be required, this has not been presented as there were no changes to that of the comparative balance sheet presented in the Revised 2008 Annual Financial Report.

IFRS 8 *Operating Segments* – The adoption of this standard has not led to any changes to the disclosures made by the Group.

Improving Disclosures and Financial Instruments (Amendments to IFRS 7 *Financial Instruments: Disclosures*) – The amendments to IFRS 7 expand the disclosures required in respect of fair value measurements and liquidity risk. The Group has elected not to provide comparative information for these expanded disclosures in the current year in accordance with the transitional reliefs offered in these amendments.

The adoption of these Interpretations has not led to any changes in the Group's accounting policies.

At the date of authorisation of the financial statements, the following Standards and Interpretations which have not been applied in the financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

IFRS 1 (amended)/IAS 27 (amended)	<i>Cost of an investment in a subsidiary, jointly controlled entity or associate</i>
IFRS 1 (amended)	<i>Additional exemptions for first time adopters</i>
IFRS 2 (amended)	<i>Group cash-settled share-based payment transactions</i>
IFRS 3 (revised 2008)	<i>Business Combinations</i>
IFRS 9	<i>Financial Instruments</i>
IAS 24 (revised 2009)	<i>Related Party Disclosures</i>
IAS 27 (revised 2008)	<i>Consolidated and Separate Financial Statements</i>
IAS 28 (revised 2008)	<i>Investments in Associates</i>
IAS 32 (amended)	<i>Classification of rights issues</i>
IFRIC 14 (amended)	<i>Prepayment of a minimum funding requirement</i>
IFRIC 17	<i>Distributions of Non-cash Assets to Owners</i>
IFRIC 18	<i>Transfers of Assets from Customers</i>
IFRIC 19	<i>Extinguishing Financial Liabilities with Equity Instruments</i>
Improvements to IFRSs (April 2009)	

The Directors do not expect that the adoption of these Standards or Interpretations in future periods will have a material impact on the financial statements of the Company or the Group except for the treatment of acquisitions of subsidiaries and associates when IFRS 3 (revised 2008), IAS 27 (revised 2008) and IAS 28 (revised 2008) come into effect for business combinations for which the acquisition date is after 1 January 2010.

3. Significant accounting policies

(a) Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB') and as adopted by the European Union ('EU'), and therefore the Group financial statements comply with Article 4 of the EU IAS Regulation.

The financial statements have been prepared on the historical cost convention basis, except for share-based payments and other receivables that have been measured at fair values, and using accounting policies consistent with IFRS. The principal accounting policies adopted are set out below.

(b) Fundamental uncertainty associated with opening balances and previous restatement

In March 2009, the former Chief Executive Officer resigned as Director of the Company and, subsequent to the departure of the former Chief Executive Officer, the Board commenced an internal investigation into potential procurement irregularities within the Group. In June 2009 the former Chief Financial Officer, Chief Operating Officer, and Asset Development Director also resigned.

3. Significant accounting policies continued

During the Board's investigation, certain payments were identified that were inappropriately capitalised in the Company's consolidated financial statements for the years ended 31 December 2006, 2007 and 2008. As a result of this investigation, the original Annual Financial Report for 2008, issued on 26 June 2009, was reissued on 8 October 2009 (the Revised Annual Financial Report), to adjust for those items known at the date of the Revised Annual Financial Report. The effect of these adjustments was to reduce exploration and evaluation ('E&E') assets by £4.3 million, and property, plant and equipment ('PP&E') by £0.6 million as at 31 December 2008, with a corresponding decrease in equity £4.9 million at the same date (of which £3.9 million represented the attributable decrease to equity as at 31 December 2007). The comparative amounts for the year ended 31 December 2008 are those which were issued in the 2008 Revised Annual Financial Report.

In view of the events and circumstances which occurred in the Group during the year, which indicated that there could be doubts concerning the recoverability of the Group's goodwill, E&E and PPP&E assets, the Board has taken the following action:

- Internal investigation into procurement irregularities with adjustments made for all known payments inappropriately capitalised in the Group's consolidated financial statements for the years ended 31 December 2006, 2007 and 2008 (refer to Revised Annual Financial Report 2008);
- Ongoing litigation at the High Court in London;
- Review of inventories held by the Group with a provision provided to reduce the carrying value of the inventory to net realisable value (see note 19); and
- Receipt of a Reserves and Resources Evaluation to support the carrying value of E&E, PP&E and goodwill assets as at 31 December 2009, resulting in an impairment charge (see note 7).

The investigation has concluded in respect of the capitalisation and recoverability of assets as at 31 December 2009, but it is not possible to conclude retrospectively whether the values of assets as at 31 December 2008 and 31 December 2007 were correct. The Board is of the opinion that uncertainties regarding the recognition, measurement and presentation of the Group's assets and liabilities as at 31 December 2009 have been eliminated and that the assets and liabilities are appropriately presented within the Group's Balance Sheet. Although uncertainties still exist over the balances at 31 December 2008, the Board does not consider that an exercise to restate the position as at 31 December 2008 would be an effective use of the Group's resources, and therefore such an exercise has not been performed.

(c) *Going concern*

The Group's business activities, together with the factors likely to affect future development, performance and position are set out in the Business Review on pages 4 to 18. The financial position of the Group, its cash flow and liquidity position are described in the Financial Review on pages 11 and 12.

The Group's cash balance at 31 December 2009 was £30.5 million (2008: £72.0 million), with no external debt financing to date and the Directors believe that the capital available at the date of the issue of these financial statements is sufficient for the Group to manage its business risks successfully despite the current uncertain economic outlook.

The Group's forecasts and projections, taking into account reasonably possible changes in operational performance, start dates and flow rates for commercial production and the price of hydrocarbons sold to Ukrainian customers, show that there are reasonable expectations that the Group will be able to operate on funds currently held and those generated internally, for the foreseeable future, without the requirement to seek external financing.

As the Group engages in oil and gas exploration and development activities, the most significant risk faced by the Group is further delays encountered in achieving commercial production from the Group's major fields. In order to conserve cash, the Group has curtailed capital expenditure and is actively pursuing a farm-out campaign. If successful, the farm-out campaign will enable the Group to farm-out a portion of its interests in its oil and gas licences to spread the risks associated with further exploration and development. Whilst such curtailments and other measures if undertaken could have an adverse effect on the Group over the longer term, including putting certain of its licence interests potentially at risk if the Group is not able to fulfil its licence obligations, there would not be any significant doubt over the Group's ability to continue as a going concern for the foreseeable future.

For the reasons set out above, the Directors consider that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. However, as disclosed in the Chairman's Statement on pages 4 to 7, certain resolutions have been proposed by the Company's largest shareholder, Weiss Asset Management LLP ('Weiss'), to replace the current Board and management with a new Board comprising nominees of Weiss, and to return almost all of the available cash of the Group to the Company's shareholders. These resolutions are being put to the forthcoming Annual General Meeting and the Directors believe Weiss' actions are likely to result in the liquidation of the Group's assets and ultimately of the Company. More details of these resolutions can be found in the Chairman's Statement on pages 4 to 7. The Directors do not believe that these resolutions are in the best interests of the Company's shareholders and therefore have recommended the shareholders to vote against these resolutions. However, as the outcome of the Annual General Meeting cannot be predicted with certainty, this therefore gives rise to a material uncertainty which casts significant doubt as to the Company's and the Group's ability to continue as a going concern, and therefore to realise their assets and discharge their liabilities in the ordinary course of business rather than to cease exploration and by liquidating the Group's assets to return the remaining cash to investors.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

3. Significant accounting policies continued

After making enquiries and considering the uncertainties described above, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and consider the going concern basis of accounting to be appropriate. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

(d) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring accounting policies used into line with those used by the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interests in the subsidiary's equity are allocated against the interest of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

(e) Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 *Business Combinations* are recognised at their fair value at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for resale in accordance with IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*, which are recognised and measured at fair value less costs to sell.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceed the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

(f) Goodwill

Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment loss. Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets in the unit pro rata on the basis of the carrying amount of each asset in the unit.

On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

(g) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for hydrocarbon products and services provided in the normal course of business, net of discounts, value added tax ("VAT") and other sales-related taxes.

Sales are recognised when hydrocarbons are delivered and title has passed.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

To the extent that revenue arises from test production during an evaluation programme, an amount is charged from evaluation costs to cost of sales, so as to reflect a zero net margin.

3. Significant accounting policies continued

(h) Foreign currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group company are expressed in pounds sterling, which is the functional currency of the Company, and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual companies, transactions in currencies other than the functional currency of each Group company ('foreign currencies') are recorded in the functional currency at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated into the functional currency at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognised in the profit or loss in the period in which they arise except for exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur, which form part of the net investment in a foreign operation, and which are recognised in the foreign currency translation reserve and recognised in profit or loss on disposal of the net investment.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the date of transactions are used.

Exchange differences arising, if any, are recognised in other comprehensive income and accumulated equity (attributed to minority interests as appropriate), transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

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

(i) Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

(j) Property, plant and equipment and other intangible assets

PP&E and other intangible assets are carried at cost less accumulated depreciation and any recognised impairment loss.

Other intangible assets are carried at cost less accumulated amortisation and any recognised impairment loss.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

3. Significant accounting policies continued

Depreciation and amortisation is charged so as to write off the cost or valuation of assets, other than land, over their estimated useful lives, using the straight-line method, on the following bases:

Other:

Buildings	4%
Fixtures and equipment	10% to 30%

Other intangible assets:

Software licences	20% to 50%
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The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

(k) Impairment of tangible and other intangible assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(l) Intangible exploration and evaluation assets

The Group applies the full cost method of accounting for E&E costs, having regard to the requirements of IFRS 6 *Exploration for and Evaluation of Mineral Resources*. Under the full cost method of accounting, costs of exploring for and evaluating oil and gas properties are accumulated by reference to appropriate cost centres being the appropriate oil or gas property, but are tested for impairment on a cost pool basis as described below.

E&E assets comprise costs of (i) E&E activities that are ongoing at the balance sheet date, pending determination of whether or not commercial Reserves exist and (ii) costs of E&E that, whilst representing part of the E&E activities associated with adding to the commercial Reserves of an established cost pool, did not result in the discovery of commercial Reserves.

Costs incurred prior to having obtained the legal rights to explore an area are expensed directly to the income statement as they are incurred.

Exploration and Evaluation costs

All costs of E&E are initially capitalised as E&E assets. Payments to acquire the legal right to explore, costs of technical services and studies, seismic acquisition, exploratory drilling and testing are capitalised as intangible E&E assets.

Tangible assets used in E&E activities (such as the Group's vehicles, drilling rigs, seismic equipment and other property, plant and equipment) are classified as property, plant and equipment. However, to the extent that such a tangible asset is consumed in developing an intangible E&E asset, the amount reflecting that consumption is recorded as part of the cost of the intangible asset. Such intangible costs include directly attributable overheads, including the depreciation of property plant and equipment utilised in E&E activities, together with the cost of other materials consumed during the exploration and evaluation phases.

E&E costs are not amortised prior to the conclusion of appraisal activities.

Treatment of E&E assets at conclusion of appraisal activities

Intangible E&E assets related to each exploration licence/prospect are carried forward, until the existence (or otherwise) of commercial Reserves has been determined. If commercial Reserves have been discovered, the related E&E assets are assessed for impairment on a cost pool basis as set out below and any impairment loss is recognised in the income statement. The carrying value, after any impairment loss, of the relevant E&E assets is then reclassified as development and production assets.

3. Significant accounting policies continued

Intangible E&E assets that relate to E&E activities that are determined not to have resulted in the discovery of commercial Reserves remain capitalised as intangible E&E assets at cost less accumulated amortisation, subject to meeting a pool-wide impairment test in accordance with the accounting policy for impairment of E&E assets set out below. Such E&E assets are amortised on a unit-of-production basis over the life of the commercial Reserves of the pool to which they relate.

Impairment of E&E assets

E&E assets are assessed for impairment when facts and circumstances suggest that the carrying amount may exceed its recoverable amount. Such indicators include, but are not limited to, those situations outlined in paragraph 20 of IFRS 6 *Exploration for and Evaluation of Mineral Resources* and include the point at which a determination is made as to whether or not commercial Reserves exist.

Where there are indications of impairment, the E&E assets concerned are tested for impairment. Where the E&E assets concerned fall within the scope of an established full cost pool, the E&E assets are tested for impairment together with all development and production assets associated with that cost pool, as a single cash generating unit.

The aggregate carrying value is compared against the expected recoverable amount of the pool, generally by reference to the present value of the future net cash flows expected to be derived from production of commercial Reserves. Where the E&E assets to be tested fall outside the scope of any established cost pool, there will generally be no commercial Reserves and the E&E assets concerned will generally be written off in full.

Any impairment loss is recognised in the income statement as additional depreciation and amortisation, and separately disclosed.

The Group considers the whole of Ukraine to be one cost pool and therefore aggregates all Ukrainian assets for the purposes of determining whether impairment of E&E assets has occurred.

(m) Development and production assets

Development and production assets are accumulated generally on a field-by-field basis and represent the cost of developing the commercial Reserves discovered and bringing them into production, together with E&E expenditures incurred in finding commercial Reserves transferred from intangible E&E assets.

The cost of development and production assets also includes the cost of acquisitions and purchases of such assets, directly attributable overheads, finance costs capitalised, and the cost of recognising provisions for future restoration and decommissioning.

Depreciation of producing assets

The net book values of producing assets are depreciated generally on a field-by-field basis on a unit of production method by reference to the ratio of production in the year and the related proved and probable Reserves of the field, taking into account future development expenditures necessary to bring those Reserves into production.

Producing assets are generally grouped with other assets that are dedicated to serving the same Reserves for depreciation purposes, but are depreciated separately from producing assets that serve other Reserves.

Impairment of development and production assets

An impairment test is performed whenever events and circumstances arising during both the development and production phase indicate that the carrying value of a development or production asset may exceed its recoverable amount.

The carrying value is compared against the expected recoverable amount of the asset, generally by reference to the present value of the future cash flows expected to be derived from production of commercial Reserves. The cash-generating unit applied for impairment test purpose is generally the field, except that a number of the field interests may be grouped as a single cash generating unit where the cash flow of each field is interdependent.

(n) Inventories

Inventories are stated at the lower of cost and net realisable value. Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is allocated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(o) Financial instruments

Recognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

3. Significant accounting policies continued

Derecognition of financial assets and financial liabilities

The Group derecognises a financial asset only when the contractual rights to cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for the amount it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

The Group derecognises financial liabilities when the Group's obligations are discharged, cancelled or expired.

Trade receivables

Trade receivables and other receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty;
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis.

The carrying amount of the financial assets is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash with three months or less remaining to maturity and are subject to an insignificant risk of changes in value.

Trade payables

Trade payables are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

(p) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

(q) Decommissioning

Provision for decommissioning is recognised in full when the related facilities are installed. The decommissioning provision is calculated as the net present value of the Group's share of the expenditure expected to be incurred at the end of the producing life of each field in the removal and decommissioning of the production, storage and transportation facilities currently in place. The cost of recognising the decommissioning provision is included as part of the cost of the relevant asset and is thus charged to the income statement on a unit of production basis in accordance with the Group's policy for depletion and depreciation of tangible non-current assets. Period charges for changes in the net present value of the decommissioning provision arising from discounting are included within finance costs.

(r) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

3. Significant accounting policies continued

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

(s) *Share-based payments*

The Group has applied IFRS 2 *Share-based Payment* for all grants of equity instruments.

The Group issues equity-settled share-based payments to certain parties in return for services or goods. The goods or services received and the corresponding increase in equity are measured directly at the fair value of the goods or services received at the grant date. The fair value of the services or goods received is recognised as an expense except in so far as they relate to the cost of issuing or acquiring its own equity instruments. The costs of an equity transaction are accounted for as a deduction from equity to the extent they are incremental costs directly attributable to the equity transaction that would otherwise have been avoided.

The Group also issues equity-settled share-based payments to certain Directors and employees. Equity settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value determined at the grant date for each tranche of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest and adjusted for the effect of non market-based vesting conditions. At each balance sheet date, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non market-based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the equity-settled employee benefits reserve.

For those equity settled share-based payments with market-based performance conditions, fair value is measured by use of the Stochastic model. For those which are not subject to any market based performance conditions, fair value is measured by use of the Black-Scholes model. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

4. Critical accounting judgements and key sources of estimation uncertainty

In the application of the Group's accounting policies, which are described in note 3, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of the assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both the current and future periods.

The following are the critical judgements and estimations that the Directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements:

(a) *Impairment of E&E, PP&E, and goodwill*

IAS 36 *Impairment of Assets* and IFRS 6 *Exploration for and Evaluation of Mineral Resources* require that a review for impairment be carried out if events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. As a result of the significant downward revisions to the Group's Reserves and Resources estimates in the independent Reserves and Resources Evaluation (the 'Report') as outlined in the Statement of Reserves and Resources on page 17, poor test results on wells drilled to date and the Group's strategy of suspending operations on major licences, the Directors believed it appropriate to assess the carrying value of the Group's oil and gas assets including E&E assets, PP&E and associated goodwill for impairment at 31 December 2009.

In order to assess the present value of the future cash flows attributable to the Group's goodwill, E&E and PP&E assets at 31 December 2009, reference was made to the Report. The present value of the Group's commercial reserves (2P reserves) estimated within the Report as at 31 December 2009 is £25.7 million, which has been used to support that carrying value of the Group's PP&E, E&E and goodwill assets.

For PP&E assets the aggregate carrying value of each cash generating unit ('CGU') was compared against the expected recoverable amount of the related asset, by reference to the net present value of the future cash flows expected to be derived from the production of commercial Reserves (2P Reserves) of that unit. On this basis, an impairment loss of £4.9 million (2008: £nil) has been provided at 31 December 2009, reducing the carrying value of PP&E to £32.0 million (2008: £39.0 million).

As the Group applies the full cost method of accounting for E&E costs, the E&E assets are tested for impairment on a cost pool basis. At 31 December 2009, no commercial Reserves were assigned to the oil and gas licences within the Report included within E&E assets as insufficient work had been performed to determine the commerciality of the assigned Resources. Under the circumstances, a formal impairment test was triggered, however, as only the commercial Reserves (2P Reserves) assigned to the wider cost pool of Ukraine have been used to determine the net present value of the future cash flows, the Contingent and Prospective Resources assigned to these licences are not reflected in the recoverable amount. As a result the entire balance was provided for at 31 December 2009, resulting in the carrying value of £56.4 million being impaired in full.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

4. Critical accounting judgements and key sources of estimation uncertainty continued

The Group's goodwill was allocated to the wider cost pool of Ukraine and as such was assessed for impairment based on the net present value of the future cash flows expected to be derived from production of commercial Reserves. The recoverable amount of the cash generating unit to which goodwill was allocated was less than the carrying value of goodwill and as a result the entire balance was provided for at 31 December 2009, resulting in the carrying value of £2.3 million being impaired in full.

In addition to the impairment provided against the Group's goodwill, E&E and PP&E assets, further impairment charges against the carrying value of certain other assets have been provided for. These are: a charge of £6.6 million (2008: £nil) to reduce the carrying value of the Group's inventory at 31 December 2009 to its net realisable value; a charge of £3.9 million (£2008: £nil) to reduce the carrying value of other receivables, in relation to the settlement agreement reached with Global Processing Systems LLC; and a charge of £13.2 million (2008: £0.8 million) against the carrying value of VAT receivable in Ukraine.

Total impairments charged to the Group's Consolidated Income Statement in 2009 were £87.3 million (2008: £0.8 million).

The recoverable amounts are determined with reference to value in use calculations. The key assumptions for the value in use calculations are those regarding the production flow rates, discount rates, relevant elements of Ukraine fiscal regime for petroleum operators, and expected changes to selling prices and direct cost during the year. These assumptions reflect management's best estimates and have been revised in the year in light of the current economic environment which has resulted in more conservative estimates about the future. Management estimates discount rates that reflect the current market assessments of the time value of money and the risks specific to the CGUs. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The key assumptions used to forecast cash flows from Ukraine operations are as follows:

- production flow rates confirmed by experienced in-house geologists and engineers, supported by the Report produced by an independent reservoir engineer, Gaffney, Cline & Associates Ltd;
- pre-tax discount rate of 20% (post-tax of 15%);
- inclusion of relevant elements of Ukraine fiscal regime for petroleum operators (such as production and royalty tax relevant to each licence and corporate income tax of 25%);
- expected future selling prices (based on current and anticipated market conditions for oil, condensate and gas);
- costs based on best estimates with consideration to previous experience and inflation; and
- cash flows projected up to 2032 depending on the field to which they relate and an assumption has been made that the relevant licences will be extended.

Refer to notes 15, 16 and 17 for further details on the carrying values and the impairments recognised on goodwill, E&E and PP&E assets, respectively and note 7 for the total impairment provided for by the Group at 31 December 2009.

(b) Reserves

Commercial Reserves are proven and probable oil and gas Reserves, which are defined as the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 per cent statistical probability that the actual quantity of recoverable Reserves will be more than the amount estimated as proven and probable Reserves and a 50 per cent statistical probability that it will be less.

Commercial Reserves used in the calculation of depreciation and for impairment test purposes are determined using estimates of oil and gas in place, recovery factors and future oil and gas prices. Management base their estimate of oil and gas Reserves and Resources upon the Report provided by independent advisers.

In March 2010, the Group commissioned a Report to estimate the Group's Reserves and Resources at 31 December 2009 (refer to page 17 for Statement of Reserves and Resources).

(c) Legal proceedings surrounding the validity of the Pirkovskoe and Zagoryanska licences

The Group is currently involved in legal proceedings surrounding the validity of the Pirkovskoe and Zagoryanska licences. The Poltava Regional Commercial Court ('Poltava Court') made a ruling dated 12 June 2008, in favour of Poltavanaftogazgeology ('PNG'), a subsidiary of the Group's joint venture partner, NJSC Nadra Ukraine, a state-owned company ('Nadra'), in relation to the licences held formerly by PNG, relating to the Pirkovskoe and Zagoryanska fields. These licences had been re-registered from PNG to Nadra prior to re-registration to the Group. The court: (a) declared as invalid the re-registration of the licences from PNG to Nadra; and (b) recognised as valid the earlier licences held by PNG.

On 28 July 2008, the Ministry of Environmental Protection of Ukraine (the 'Ministry') issued an order, making reference to the decisions of the Poltava Court on 12 June 2008, in favour of PNG, invalidating the Group's licences for its Pirkovskoe and Zagoryanska fields.

4. Critical accounting judgements and key sources of estimation uncertainty continued

The following developments have occurred as a result of legal actions taken by the Group to protect its licences:

- (1) on 29 September 2008, the Kharkiv Appeal Administrative Court (the 'Appeal Court') cancelled the written rulings of the Poltava Court of 12 June 2008. The Administrative Court rejected in full the claim filed by PNG that the special permit which was issued to Nadra was invalid and that the earlier licences held by PNG remained valid;
- (2) on 7 October 2008, following a court judgement, the Group received written confirmation that the Ministry had revoked its earlier orders nullifying the Pirkovskoe and Zagoryanska licences and declared the special permits dated 19 October 2007, issued to Group subsidiary companies LLC Astroinvest-Ukraine and LLC Astro Gas JAA for the Pirkovskoe licence and LLC Astroinvest-Energy for the Zagoryanska licence, valid;
- (3) on 7 October 2008, the Group signed a co-operation agreement with the Ministry demonstrating the Ministry's full confirmation of Cadogan's rights to licences;
- (4) on 17 October 2008, PNG, and on 24 October 2008 Nadra, submitted their claims on the Appeal Court judgements of 29 September 2008 to the High Administrative Court of Ukraine (the 'High Court');
- (5) in January 2009, the Group received from the Ministry a five year extension for the Zagoryanska licence now expiring in April 2014;
- (6) on 25 February 2009, the High Court found in favour of PNG in the appeal hearing in relation to the transfer of the Pirkovskoe licence to Nadra in June 2007 (the 'Resolution'). Notwithstanding this decision, the Group's licence to operate the Pirkovskoe field remains valid and there has to date been no direct legal challenge to the Group's interest in this licence. The Group has been advised that new legal proceedings would need to be brought against it and would need to succeed before its interests in its licences would be affected. The Group has yet to receive a date for the PNG initiated appeal hearing with respect to the Zagoryanska licence;
- (7) on 23 March 2009, LLC Astro Gas filed a claim supported by the claim dated 30 March 2009 made by the Prosecutor General Office of Ukraine (the 'Prosecutor General Office') to the Supreme Court of Ukraine (the 'Supreme Court') arguing that the High Court had been mistaken in reaching its decision and that the Resolution is therefore invalid;
- (8) on 16 June 2009, the Supreme Court upheld the claim made by the Prosecutor General Office and partially upheld the claim made by LLC Astro Gas JAA. The Resolution of the High Court dated 25 February 2009 was cancelled and the case was returned to the court of first instance, the Poltava Court, for further consideration;
- (9) on 11 December 2009, the High Court commenced the appeal on the decision made by the Appeal Court associated with the Pirkovskoe licence. The date of the hearing has not yet been set, however the High Court requested LLC Astro Gas to submit information on PNG's and Nadra's claims dated 17 October 2008 and 24 October 2008 respectively; and
- (10) there have been no developments in the case concerning the Zagoryanska field licence.

The Group's licences remain valid and effective despite the Resolution. The Board remains firmly of the view that the challenges to the licences previously held by PNG are wholly unwarranted and this would result in a curtailment of a significant part of the Group's operations. An appeal is currently being lodged against the Resolution at the Appeal Court in Ukraine.

As of the date of these financial statements, the above outcomes remain subject to appeal.

The Directors have considered the implications of IAS 36 *Impairment of Assets* and IFRS 6 *Exploration for and Evaluation of Mineral Resources*, and have concluded that recognition of impairment in respect of these matters is not appropriate on the basis that the Directors believe that, notwithstanding the uncertainties described above, the validity of the Group's licences is expected to be reconfirmed. However, the ultimate outcome is uncertain and should the Courts in Ukraine ultimately rule that the licences were improperly awarded, and further annul the existing licences, the Group would be required to further impair the value of these assets in Ukraine. The amounts capitalised within intangible exploration and evaluation assets and property, plant and equipment in respect of these licences at 31 December 2009 was £22.7 million (2008: £43.3 million) and the related VAT recoverable was £nil (2008: £4.5 million).

(d) Other receivable recognised in relation to settlement with Global Processing Systems LLC ('GPS')

Non-current and current other receivables have been recognised at 31 December 2009, of £18.8 million and £4.1 million respectively, representing receivables from a settlement agreement reached with GPS (note 20).

During October 2009, a settlement was reached with GPS resolving previous disputes which existed between the Group and GPS concerning the manufacture and delivery of two gas treatment plants for a total purchase price of USD54.5 million.

The key commercial terms of the settlement provide for GPS exclusively to market the two gas plants for a 10 month period and, if a sale is achieved, for the Group to receive in stage payments an aggregate cash consideration of USD38.5 million. If the plants are not sold within this period, then GPS has agreed to take the plants to stock and the Group will receive stage payments for an aggregate cash consideration of USD37.5 million. The settlement also provides for the release by GPS of a potential USD10.9 million contractual claim against the Group for the unpaid balance of the consideration for the plants. The amounts paid to GPS in respect of the gas plants as at 31 December 2008 of USD43.5 million were previously recognised as prepayments, as title to the gas plants was to pass on delivery. As a result of the settlement, these prepayments were then reclassified as receivables included within other receivables at 31 December 2009.

The portion that is not expected to be recovered within the next twelve months has been presented as a non-current receivable.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

4. Critical accounting judgements and key sources of estimation uncertainty continued

An impairment charge of £3.9 million has been provided in the year to reduce the carrying value of the original prepayments to their fair value, being the expected proceeds from the settlement.

(e) Recoverability of VAT

The Group has significant receivables from the State Budget of Ukraine relating to reimbursement of VAT arising on purchases of goods and services from external service and product providers. Management anticipates no significant cash settlements of receivables from the State Budget. Consequently, the Group recognises recoverable VAT only to the extent that it is probable that VAT payable arising on the sales of gas production will be sufficient to offset the VAT due from the State within a reasonable period. Estimating the recoverability of VAT requires management to make an estimate of the future revenues in order to calculate amounts and timing of the VAT payable available for offset. At 31 December 2009, the Directors are uncertain as to the commercial viability of the Group's major fields and therefore believe it inappropriate to present these amounts as assets given the uncertainties surrounding the expectation for recovery. A provision of £13.2 million (2008: £0.8 million) has been recognised as at 31 December 2009 as the Directors are no longer certain that VAT previously recognised as an asset will be recovered.

(f) Going concern

The Group's business activities, together with the factors likely to affect future development, performance and position are set out in the Business Review on pages 4 to 18. The financial position of the Group, its cash flow and liquidity position are described in the Financial Review on pages 11 and 12. In addition, note 3(c) to the consolidated financial statements provides details as to the basis on which the Director's has adopted the going concern basis of accounting in preparing the annual financial statements.

(g) Decommissioning

The Group recognises a provision for asset retirement obligation for expected decommissioning and site restoration costs expected to incur in approximately one to 17 years. At 31 December 2009, a provision has been made for costs of £0.7 million (2008: £0.5 million) which are expected to be incurred within the next year due to the demobilisation of drilling equipment and respective site restoration. A further provision of £0.1 million (2008: £0.4 million) has been made for long-term costs. The provision is estimated taking into consideration existing technology and current prices of site restoration after adjusting for expected future inflation as discounted using rates reflecting current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The Group makes an estimate based on its experience and historical data (see note 23).

(h) Share-based payments

The Group has equity-settled share option schemes and a performance share plan available to certain Directors and employees. In accordance with IFRS 2 *Share-based payment*, in determining the fair value of options granted, the Group has applied the Black-Scholes and stochastic models. As a result, the Group makes assumptions for expected volatility, expected life, risk free rate and expected dividend yield. The fair value of options granted at 31 December 2009 is shown in note 26.

5. Revenue

An analysis of the Group's revenues is as follows:

	2009 £'000	2008 £'000
Sale of hydrocarbon products	2,342	1,792
Investment revenue (note 11)	407	2,850
	2,749	4,642

6. Business and geographical segments

Following the adoption of IFRS 8 *Operating Segments* with effect from 1 January 2009, the Directors continue to consider there to be only one business segment, the exploration and development of oil and gas revenues and only one geographical segment, being Ukraine.

7. Impairment of oil and gas and other assets

	2009 £'000	2008 £'000
Goodwill (note 15)	2,258	–
Exploration and evaluation costs (note 16)	56,379	–
Property, plant and equipment (note 17)	4,862	–
Impairment of oil and gas assets	63,499	–
Inventories (note 19)	6,586	–
Other receivables (note 4(d))	3,925	–
VAT recoverable (note 20)	13,241	834
Impairment of other assets	23,752	834
Total impairment	87,251	834

7. Impairment of oil and gas and other assets continued

Refer to notes 15, 16 and 17 for further details on the impairment of goodwill, E&E and PP&E assets, respectively and to note 4(a) for a discussion of the assumptions made to calculate the various impairments.

The carrying value of inventory as at 31 December 2009 has been impaired to reduce it to net realisable value (see note 19).

Prepayments previously recognised at 31 December 2008 related to payments made for the acquisition of two new gas plants on the Pirkovskoe and Bitlyanska licences. As discussed in note 4(d), the total amount paid for the gas plants has been impaired reducing the carrying value to the expected proceeds from the settlement agreement which was reclassified at 31 December 2009 to other receivables. Refer also to note 20.

VAT recoverable has been impaired as at 31 December 2009 as the Directors are no longer certain that VAT recoverable in Ukraine previously recognised as an asset will actually be recovered (see note 20).

8. Loss for the year

The loss for the year has been arrived at after charging/(crediting):

	2009 £'000	2008 £'000
Depreciation of property, plant and equipment	1,112	1,067
Loss on disposal of property, plant and equipment	5,000	112
Impairment (note 7)	87,251	834
Consultancy fees	785	6,358
Staff costs	2,748	3,715
Net foreign exchange (gains)/losses	(4,641)	1,482

Consultancy fees relate to consultancy fees paid in order to defend the legal issues over the Pirkovskoe and Zagoryanska licences and with the successful extension of the Zagoryanska licence.

Included within staff costs, is income of £0.8 million (2008: £nil) relating to the reversal of equity-settled share-based payment transactions previously recognised.

In addition to the depreciation of property, plant and equipment of £1.1 million (2008: £1.1 million), in the year ended 31 December 2009, depreciation of £1.6 million (2008: £1.7 million) was capitalised to E&E assets being depreciation of tangible assets used in E&E activities.

9. Auditors' remuneration

The analysis of auditors' remuneration is as follows:

	2009 £'000	2008 £'000
Audit fees		
Fees payable to the Company's auditors for the audit of the Company's annual accounts	165	213
Fees payable to the Company's auditors and their associates for the audit of the Company's subsidiaries pursuant to legislation	20	20
Total audit fees	185	233
Non-audit fees		
– Other services pursuant to legislation	–	133
– Tax services	98	111
– Remuneration services	10	70
– Corporate finance services	–	1,594
– Other services	18	79
Non-audit fees	126	1,987

Corporate finance services provided in 2008 represent the fee in respect of reporting accountants work performed in relation to the Initial Public Offering ('IPO') and listing of the Company's shares.

Other services in 2008 represent fees paid in respect of a staff secondment to the Company in relation to its financial reporting procedures as part of the IPO process.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

10. Staff costs

The average monthly number of employees (including Executive Directors) was:

	2009 Number	2008 Number
Executive Directors	3	4
Other employees	397	407
	400	411
Total number of employees at 31 December	153	518

	£'000	£'000
Their aggregate remuneration comprised:		
Wages and salaries	3,042	3,581
Termination agreement	120	–
Other pension costs	15	2
Social security costs	494	31
Share-based payments	(1,154)	523
	2,517	4,137

The termination payment was made to a former Director of the Group under a termination compromise agreement.

Within wages and salaries, £0.4 million (2008: £0.2 million) relates to amounts paid to executive Directors for services rendered.

Included within wages and salaries, is £0.1 million (2008: £0.1 million) capitalised to intangible exploration and evaluation assets. Within share-based payments, was a reversal to costs capitalised in 2008 of £0.2 million to intangible exploration and evaluation assets and £0.1 million capitalised to development and production assets.

11. Investment revenue

	2009 £'000	2008 £'000
Interest on bank deposits	407	2,850

No additional investment revenue earned from loan and receivables (including cash and bank balances) has been recognised other than interest on bank deposits.

12. Finance costs

	2009 £'000	2008 £'000
Unwinding of discount on decommissioning provision (note 23)	8	56

The transaction costs of equity transactions are accounted for as a deduction from equity to the extent that they are incremental costs directly attributable to the equity transaction that would otherwise have been avoided.

No additional gains or losses have been recognised on financial liabilities measured at amortised cost.

13. Tax

	2009 £'000	2008 £'000
Current tax	241	392
Deferred tax	(128)	122
	113	514

The Group's operations are conducted primarily outside the UK. The most appropriate tax rate for the Group is therefore considered to be 25% (2008: 25%), the rate of profit tax in Ukraine which is the primary source of revenue for the Group. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

13. Tax continued

The taxation charge for the year can be reconciled to the loss per the income statement as follows:

	2009 £'000	2009 %	2008 £'000	2008 %
Loss before tax				
Continuing operations	(107,190)	100	(24,363)	100
Tax credit on loss at Ukraine corporation tax rate of 25%	(26,798)	25	(6,091)	25
Permanent differences	8,320	(8)	4,453	(18)
Foreign exchange on operating activities	227	–	(545)	2
Tax losses generated in the year not yet recognised	3,201	(3)	592	(2)
Other temporary differences for which no deferred tax has been recognised	16,204	(14)	2,134	(9)
Utilisation of deferred tax asset not previously recognised on losses	(91)	–	(29)	–
Non-taxable income	(29)	–	–	–
Reversal of deferred tax liability due to impairment	(338)	–	–	–
Effect of different tax rates	(452)	–	–	–
Prior year adjustment	(131)	–	–	–
Tax expense and effective tax rate for the year	113	–	514	(2)

14. Loss per Ordinary share

Basic loss per Ordinary share is calculated by dividing the net loss for the year attributable to Ordinary equity holders of the parent by the weighted average number of Ordinary shares outstanding during the year. The calculation of the basic and diluted loss per share is based on the following data:

Losses	2009 £'000	2008 £'000
Loss for the purposes of basic loss per share being net loss attributable to equity holders of the parent	(107,303)	(24,039)
Number of shares	2009 Number '000	2008 Number '000
Weighted average number of Ordinary shares for the purposes of basic loss per share	231,092	139,721
Loss per Ordinary share	2009 £	2008 £
Basic and diluted	(0.46)	(0.17)

Diluted loss per Ordinary share equals basic loss per Ordinary share as, due to the losses incurred in 2009 and 2008, there is no dilutive effect from the subsisting share warrants and share options.

15. Goodwill

Cost	£'000
At 1 January 2008	2,804
Exchange differences	(296)
At 1 January 2009	2,508
Exchange differences	(281)
At 31 December 2009	2,227
Impairment	
At 1 January 2008 and 2009	–
Impairment charge (note 7)	2,258
Exchange differences	(31)
At 31 December 2009	2,227
Carrying amount	
At 31 December 2009	–
At 31 December 2008	2,508

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. The fair value of goodwill was allocated to all Ukraine assets as management believes that the anticipated future operating synergies gained on business acquisition can be used across the Group's entire asset base in Ukraine.

Notes to the Consolidated Financial Statements

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15. Goodwill continued

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired.

The Group's goodwill was allocated to the wider cost pool of Ukraine and as such was assessed for impairment based on the present value of the future cash flows expected to be derived from production of commercial Reserves. The recoverable amount of the cash-generating unit to which goodwill was allocated was less than the carrying value of the unit due to changes during the year in the assumptions detailed in note 4(a) and as a result the entire amount of goodwill was provided for at 31 December 2009, resulting in an impairment loss of £2.3 million (2008: £nil).

16. Intangible exploration and evaluation assets

Cost	£'000
At 1 January 2008	25,024
Additions on acquisition of subsidiaries	2,077
Additions	24,065
Change in estimate of decommissioning assets (note 23)	190
Transfer to property, plant and equipment (note 17)	(537)
Exchange differences	(2,949)
At 1 January 2009	47,870
Additions	17,428
Change in estimate of decommissioning assets (note 23)	(29)
Transfer to property, plant and equipment (note 17)	(298)
Disposals	(4,073)
Exchange differences	(5,299)
At 31 December 2009	55,599
Impairment	
At 1 January 2008 and 2009	–
Impairment charge (note 7)	56,379
Exchange differences	(780)
At 31 December 2009	55,599
Carrying amount	
At 31 December 2009	–
At 31 December 2008	47,870

IFRS 6 *Exploration for and Evaluation of Mineral Resources* requires that a review for impairment be carried out if events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. As outlined in note 4(a), due to a change in events and circumstances during the year, the Directors believed it was appropriate to reassess the carrying value of Group's oil and gas assets including, exploration and evaluation assets ('E&E').

As the Group applies the full cost method of accounting for E&E costs, the E&E assets are tested for impairment on a cost pool basis. At 31 December 2009, no commercial Reserves were assigned to the oil and gas licences within the independent Reserves and Resources Evaluation included within E&E assets as insufficient work had been performed to determine the commercial recoverability of the assigned Resources. Under the circumstances, a formal impairment test has been triggered. In accordance with the Group's accounting policy, only the commercial Reserves (2P Reserves) assigned to the wider cost pool of Ukraine have been used to determine the net present value of the future cash flows, resulting in the Contingent and Prospective Resources assigned to these licences not being reflected in the recoverable amount due to the uncertainties associated with these Resources. As a result, the entire amount of E&E was provided for at 31 December 2009, resulting in an impairment loss of £56.4 million (2008: £nil).

Total intangible exploration and evaluation assets at 31 December 2009 include £nil (2008: £0.9 million) in respect of decommissioning assets. Additions during the year to the pre-impairment amount include £1.6 million (2008: £1.7 million) of capitalised depreciation of development and production assets used in exploration and evaluation activities.

Refer to note 4(c) for a detailed discussion on the legal proceedings surrounding the validity of the Group's licences.

17. Property, plant and equipment

	Other £'000	Development and production assets £'000	Total £'000
Cost			
At 1 January 2008	1,815	22,077	23,892
Additions on acquisition of subsidiaries	–	21	21
Additions	1,957	19,414	21,371
Transfer from intangible exploration and evaluation assets (note 16)	(545)	1,082	537
Change in estimate of decommissioning assets (note 23)	–	21	21
Disposals	(151)	(3)	(154)
Exchange differences	(162)	(2,334)	(2,496)
At 1 January 2009	2,914	40,278	43,192
Additions	353	7,248	7,601
Transfer from intangible exploration and evaluation (note 16)	–	298	298
Change in estimate of decommissioning assets (note 23)	–	102	102
Disposals	(411)	(3,800)	(4,211)
Exchange differences	(295)	(4,479)	(4,774)
At 31 December 2009	2,561	39,647	42,208
Accumulated depreciation and impairment			
At 1 January 2008	217	1,205	1,422
Charge for the year	566	2,463	3,029
Disposals	(37)	–	(37)
Exchange differences	(68)	(221)	(289)
At 1 January 2009	678	3,447	4,125
Charge for the year	568	2,222	2,790
Impairment charge (note 7)	–	4,862	4,862
Disposals	(179)	(864)	(1,043)
Exchange differences	(72)	(463)	(535)
At 31 December 2009	995	9,204	10,199
Carrying amount			
At 31 December 2009	1,566	30,443	32,009
At 31 December 2008	2,236	36,831	39,067

IAS 36 *Impairment of Assets* requires that a review for impairment be carried out if events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. As outlined in note 4(a), due to a change in events and circumstances during the year, the Directors believed it was appropriate to reassess the carrying value of Group's oil and gas assets including, PP&E assets.

For PP&E assets the aggregate carrying value was compared against the expected recoverable amount of the asset, by reference to the present value of the future cash flows expected to be derived from production of commercial Reserves (2P Reserves). An impairment loss of £4.9 million (2008: £nil) was provided at 31 December 2009, reducing the carrying value of PP&E to £32.0 million (2008: £39.1 million).

18. Subsidiaries

The Company had investments in the following subsidiary undertakings as at 31 December 2009, which principally affected the losses and net assets of the Group:

Name	Country of incorporation and operation	Proportion of voting interest %	Activity
Directly held			
Cadogan Petroleum Holdings Ltd	UK	100	Holding company
Ramet Holdings Ltd	Cyprus	100	Holding company
Indirectly held			
Colby Petroleum Ltd	British Virgin Islands	100	Holding company
Rentoul Ltd	Isle of Man	100	Holding company
LLC Industrial Company Gazvydobuvannya	Ukraine	100	Exploration
LLC AstroInvest – Ukraine	Ukraine	100	Exploration
LLC Astro Gas	Ukraine	90	Exploration
Stickle Ltd	Isle of Man	100	Holding company
USENCO International Inc.	USA	100	Holding company
DP USENCO Ukraine	Ukraine	100	Exploration
USENCO Nadra	Ukraine	90	Exploration
Momentum Energy International Inc.	Canada	100	Holding company
Momentum Enterprise Inc.	Canada	100	Holding company
Momentum Enterprise (Europe) Ltd	Cyprus	100	Holding company
LLC JV Delta	Ukraine	100	Exploration
Radley Investments Ltd	UK	100	Holding company
LLC Astro-Energy	Ukraine	100	Exploration
LLC Astroinvest-Energy	Ukraine	90	Exploration
OJSC AgroNaftoGasTechService	Ukraine	79.9	Construction services
LLC Mercor	Ukraine	100	Exploration
LLC Cadogan Ukraine	Ukraine	100	Corporate services
Cadogan Petroleum Holdings BV	Netherlands	100	Holding company

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19. Inventories

	2009 £'000	2008 £'000
Cost	12,108	8,156
Impairment provision (note 7)	(6,586)	–
Carrying amount	5,522	8,156

The impairment as at 31 December 2009 is made so as to reduce the carrying value of the inventories to net realisable value.

20. Other financial assets

Other non-current receivables

	2009 £'000	2008 £'000
Other receivables	18,835	301
VAT recoverable	–	8,153
Prepayments	–	10,412
	18,835	18,866

Trade and other receivables

	2009 £'000	2008 £'000
Other receivables	4,675	304
VAT recoverable	336	1,814
Prepayments	379	19,371
	5,390	21,489

All sales are made on a prepayment basis, so there are no trade debtors.

The amounts of £18.8 million and £4.1 million shown as other receivables represent receivables from a settlement agreement with GPS. This amount is stated after impairment of £3.9 million representing the difference between the original prepayment and the amount receivable in accordance with the settlement. Refer to further discussion in note 4(d).

VAT recoverable from Ukraine tax authorities will only be recovered once significant production commences. As at 31 December 2009, the Directors are uncertain as to the commercial viability of the Group's major fields and therefore believe it inappropriate to present these amounts as assets given the uncertainties surrounding the likelihood of recovery. A provision of £13.2 million (2008: £0.8 million) has thus been recognised as at 31 December 2009.

The Directors consider that the carrying amount of the remaining other receivables approximates their fair value and none of which are past due.

Cash and cash equivalents

Cash and cash equivalents as at 31 December 2009 of £30.5 million (2008: £72.0 million) comprise cash held by the Group and the Company. The Directors consider that the carrying amount of these assets approximates their fair value.

Restricted cash

Restricted cash of £0.5 million relates to amounts held in escrow by the Group's lawyers in Cyprus to support a bank guarantee provided to the Cypriot court in relation to obtaining a freezing order in Cyprus associated with the litigation against one of the former executive Directors (see note 29).

21. Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period:

	Temporary differences £'000
Liability as at 1 January 2008	967
Acquisition of subsidiaries	314
Charge to income	122
Exchange differences	(165)
Liability as at 1 January 2009	1,238
Deferred tax expense	210
Reversal of deferred tax liability due to impairment	(338)
Exchange differences	(137)
Liability as at 31 December 2009	973

21. Deferred tax continued

At 31 December 2009, temporary differences of £2.2 million (2008: £38.9 million) existed in respect of foreign exchange gains arising on net investments in foreign subsidiaries for which deferred tax liabilities have not been recognised. No deferred tax liabilities have been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

At 31 December 2009, the Group had the following unused tax losses available for offset against future taxable profits:

	2009 £'000	2008 £'000
UK	4,712	4,522
USA	3,341	1,800
Ukraine	40,072	38,400
	48,125	44,722

Deferred tax assets have not been recognised in respect of these tax losses owing to the uncertainty that profits will be available in future periods against which they can be utilised.

The Group's unused tax losses of £4.7 million (2008: £4.5 million) relating to losses incurred in the UK are available to shelter future non-trading profits arising within Cadogan Petroleum Holdings Ltd. These losses are not subject to a time restriction on expiry.

Total unused tax losses of £3.3 million (2008: £1.8 million) relate to losses incurred by USENCO International Inc. in the USA. Net operating losses ('NOL') can be carried forward and utilised to offset taxable income arising in the succeeding 20 years from the year the loss was incurred. However, on a change in ownership, the losses are subject to an annual limitation, being broadly the value of the Company before the change in ownership, multiplied by the federal long-term tax-exempt interest rate at that time.

Unused tax losses incurred by Ukraine subsidiaries, amount to £40.1 million (2008: £38.4 million). Under general provisions, these losses may be carried forward indefinitely to be offset against any type of taxable income arising from the same company of origination. Tax losses may not be surrendered from one Ukraine subsidiary to another. However, in the past, Ukrainian legislation has been imposed which restricted the carry forward of tax losses. While no such restrictions were imposed in 2008 or 2009, similar restrictions could be introduced in future periods. If such restrictions are introduced before the Ukraine companies become profitable, the accumulated tax losses at 31 December 2009 may potentially not be used.

There are further temporary differences arising on assets in Ukraine for which deferred tax assets of £12.2 million have not been recognised due to the uncertainty of future recovery.

22. Other financial liabilities

Trade and other payables

	2009 £'000	2008 £'000
Trade creditors	4,035	3,012
Other taxes and social security	20	43
Other creditors and payables	227	318
Accruals	2,955	952
	7,237	4,325

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 38 days (2008: 20 days). The Group has financial risk management policies to ensure that all payables are paid within the credit timeframe.

The Directors consider that the carrying amount of trade and other payables approximates to their fair value. No interest is generally charged on balances outstanding.

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For the year ended 31 December 2009 continued

23. Provisions

	Decommissioning £'000	Other £'000	Total £'000
At 1 January 2008	736	38	774
Additions	–	21	21
Change in estimate (note 16 and 17)	211	–	211
Utilisation of provision	(57)	–	(57)
Unwinding of discount on decommissioning provision (note 12)	56	–	56
Exchange differences	(86)	–	(86)
At 1 January 2009	860	59	919
Change in estimate (note 16 and 17)	73	–	73
Utilisation of provision	–	(29)	(29)
Unwinding of discount on decommissioning provision (note 12)	8	–	8
Exchange differences	(97)	–	(97)
At 31 December 2009	844	30	874
At 31 December 2008			
Included in long-term provisions	410	59	469
Included in current provisions	450	–	450
	860	59	919
At 31 December 2009			
Included in long-term provisions	146	30	176
Included in current provisions	698	–	698
	844	30	874

In accordance with the Group's environmental policy and applicable legal requirements, the Group intends to restore the sites of geological exploration upon the completion of the exploration phase. A short-term provision of £0.7 million (2008: £0.5 million) has been made for decommissioning costs, which are expected to be incurred within the next year as a result of the demobilisation of drilling equipment and respective site restoration.

The long-term provision recognised in respect of decommissioning reflects management's estimate of the net present value of the Group's share of the expenditure expected to be incurred in this respect. This amount has been recognised as a provision at its net present value, using a discount rate that reflects the market assessment of time value of money at that date, and the unwinding of the discount on the provision has been charged to the income statement. These expenditures are expected to be incurred at the end of the producing life of each field in the removal and decommissioning of the facilities currently in place (currently estimated to be between one and 17 years). The effect of discounting on provisions would be immaterial.

24. Share capital

Authorised and issued equity share capital

	2009		2008	
	Number '000	£'000	Number '000	£'000
Authorised				
Ordinary shares of £0.03 each	1,000,000	30,000	1,000,000	30,000
Issued				
Ordinary shares of £0.03 each	231,092	6,933	231,092	6,933

The Company has one class of Ordinary shares which carry no right to fixed income. On 10 June 2008, the authorised share capital was increased by £24.0 million by the creation of an additional 800 million Ordinary shares of £0.03 each.

Issued equity share capital

	Ordinary shares of £0.03 Number
At 1 January 2008	138,980,287
Allotment of shares	92,111,447
At 31 December 2008 and 2009	231,091,734

24. Share capital continued

On 10 June 2008, the Company consolidated every three Ordinary shares at £0.01 each in the capital of the Company into one Ordinary share of £0.03 each. During 2008, the Company issued an additional 92,111,447 Ordinary shares at £0.03 each, as follows:

- (a) 1,023,991 Ordinary shares at £0.03 each were agreed to be issued as part of the consideration for the acquisition of Ramet Holdings Limited that took place on 26 December 2007. These shares were then issued in January 2008;
- (b) 813,577 Ordinary shares at £0.03 each for which funds in the amount of £1,000,700 were received in 2007 and shares were issued in January and February of 2008 at which time the amounts were reclassified as share capital and share premium;
- (c) Issuance of 1,287,263 Ordinary shares of £0.03 each on 9 April 2008;
- (d) The Company issued 22,543,137 Ordinary shares of £0.03 each through private equity fundraising for total gross proceeds of £27.7 million; and
- (e) On 18 June 2008, the Company completed its initial public offering on the main market of the London Stock Exchange, by issuing 66,443,479 new Ordinary shares at £0.03 each for total gross proceeds of £152.8 million.

The information shown above in (a) to (e) has been restated to reflect the share consolidation that took place on 10 June 2008.

25. Capital reduction

On 9 December 2009, the High Court approved the cancellation of the Company's share premium account (£250.4 million) and on 28 December 2009 the approval was registered with Companies House. The cancellation of the share premium account has been offset against the Group's accumulated deficit creating retained earnings of £93.6 million as at 31 December 2009.

26. Share-based payments

Equity-settled share-based payments

Under the terms of an agreement dated 17 February 2006, which was subsequently updated on 20 September 2006 and 8 May 2007 the Company's then broker and financial adviser Fox-Davies Capital ('Fox-Davies') were granted 15.2 million (2008: 15.2 million) warrant rights, to be exercisable at an average price of £0.82 and £1.23 (price post-share consolidation) and to be exercisable at any time within the five year period following completion of the placing.

Equity-settled share option scheme

The Company has two Share Option schemes, the 2007 and 2008 Share Option Plans, under which options to subscribe for the Company's shares have been granted to certain executive Directors and employees of the Group. Options are exercisable at various prices and vest on achieving certain performance criteria. If the options remain unexercised after a period of five years from the date of grant, the options expire. Options are forfeited if the executive Director or employee leaves the Group before the options vest. All 2007 share option plans have been restated to Ordinary shares of £0.03 (post-share consolidation).

Details of the share options outstanding at the end of the year were as follows:

	2007 Share Option Plan		2008 Share Option Plan		Total	
	Number of share options '000	Weighted average price £	Number of share options '000	Weighted average price £	Number of share options '000	Weighted average price £
Outstanding at 1 January 2008	14,282	0.82	–	–	14,282	0.82
Granted during the year	217	1.23	837	0.86	1,054	0.94
Outstanding at 1 January 2009	14,499	0.83	837	0.86	15,336	0.83
Forfeited during the year	(8,786)	0.83	(837)	0.86	(9,623)	0.83
Outstanding at 31 December 2009	5,713	0.82	–	–	5,713	0.82
Exercisable at 1 January 2008, 1 January 2009 and 31 December 2009	5,713	0.82	–	–	5,713	0.82

No share options were exercised or expired during the year (2008: nil). Options were granted under the 2007 Share Option Plan on 11 September 2007 and 19 February 2008, and under the 2008 Share Option Plan, on 9 October 2008. The options outstanding at 31 December 2009 had a weighted average exercise price of £0.82 (2008: £0.83), and a weighted average remaining contractual life of 33 months (2008: 49 months).

The options are split into three tranches with each tranche subject to performance conditions as follows (note that the 2007 Share Option Plan included options under tranches 1, 2, and 3, the 2008 Share Option Plan included only tranche 2 and 3):

Option Tranche 1

Options vest immediately upon grant date.

Option Tranche 2

- 50% of this Tranche of options granted will vest and become exercisable when the Group has sales over a continuous period of 90 days of at least 5,000 barrels of oil equivalent per day; and
- 50% of this Tranche of options granted will vest and become exercisable when the Group has sales over a continuous period of 90 days of at least 10,000 barrels of oil equivalent per day.

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For the year ended 31 December 2009 continued

26. Share-based payments continued

Barrels of oil equivalent means the aggregate of: barrels of oil, barrels of condensate; and gas converted to equivalent barrels on the basis of 6,000 standard cubic feet per barrel at a standard temperature and pressure.

Sales shall not include sales to any subsidiary or sales which are not on an arm's length basis.

Option Tranche 3

Under the 2007 Option plan, options vest upon the earlier of:

- admission, being the date on which the shares are first admitted on any stock exchange, at an initial price per share of £3.28 and maintaining a daily average price per share of at least £3.28 for any period of 45 consecutive days after admission; and
- a trade sale at a price per share of at least £3.28.

Under the 2008 Option plan, options vest upon the earlier of:

- when a daily average price per share of at least £3.28 is maintained for any period of 45 consecutive days after admission; and
- a sale at a price per share of at least £3.28.

Details for each tranche outstanding at the end of the year and subject to continuous employment were as follows:

	2007 Share Option Plan			2008 Share Option Plan			Total '000
	Tranche 1 '000	Tranche 2 '000	Tranche 3 '000	Tranche 1 '000	Tranche 2 '000	Tranche 3 '000	
Outstanding at 1 January 2008	5,713	5,713	2,856	–	–	–	14,282
Granted during the year	–	217	–	–	558	279	1,054
Outstanding at 1 January 2009	5,713	5,930	2,856	–	558	279	15,336
Forfeited during the year	–	(5,930)	(2,856)	–	(558)	(279)	(9,623)
Exercisable at 1 January 2008, 1 January 2009 and 31 December 2009	5,713	–	–	–	–	–	5,713

The fair values of the options have been calculated using the following models:

- Option Tranches 1 and 2 – not subject to any market-based performance conditions, and therefore the Black-Scholes model has been used.
- Option Tranche 3 – market-based performance conditions must be included in the calculation of fair value and therefore the Stochastic model has been considered the most appropriate.

The inputs into the models were as follows:

	2007 Share Option Plan		2008 Share Option Plan	
	Black-Scholes	Stochastic	Black-Scholes	Stochastic
Weighted average share price (£)	1.23	1.23	0.87	0.87
Weighted average exercise price (£)	0.82	0.82	0.86	0.86
Expected volatility (%)	55	55	56.9	56.9
Expected term (years)	2.5	5	6.5	9
Risk free rate (%)	4.99	4.98	4.29	4.29
Expected dividend yield (%)	–	–	–	–

As the Company has listed shares, the expected volatility was determined by considering the historical volatility of other similar entities. Similar entities have been chosen as the FTSE AIM Oil & Exploration constituents (with a market capitalisation of greater than £100 million) for the 2007 Share Option Plan and the FTSE All Share Oil & Exploration sector (with a market capitalisation between £40 million and £500 million) for the 2008 Share Option Plan at the grant date.

The exercise price was established in accordance with the terms included within the share option scheme.

The aggregate of the estimated fair values of the options granted under the two share option plans at 31 December 2009 is £3.6 million (2008: £9.4 million), split respectively between the various tranches as follows: Option Tranche 1: £3.6 million (2008: £3.6 million); Option Tranche 2: £nil (2008: £3.9 million); Option Tranche 3: £nil (2008: £1.9 million). Due to certain employees and Directors resigning from their duties to the Company, share options granted under Option Tranche 2 and 3 were forfeited during the year.

The Group recognised no expense in 2009 related to equity-settled share based payment transactions (2008: £0.5 million), however, it recognised a reversal of £1.2 million (2008: £nil) relating to equity settled share-based payment transactions previously expensed due to certain options being forfeited during the year, of which 0.3 million was capitalised (2008: £nil).

The recognition of expense has been based on a vesting period as determined by reference to the Group's cash flow projections and forecasts.

26. Share-based payments continued

Equity-settled performance share plan

Following the IPO of the Company on 23 June 2008, the Company implemented an equity-settled share option ('PSP') scheme for executive Directors and certain employees within the Group. Awards under the PSP are satisfied by the issue of new shares or from shares purchased in the market. The PSP offers an option that grants the right to acquire shares at no cost, subject to meeting performance and vesting criteria.

The PSP awards entitled the recipient to up to 150 per cent of their salary valued at the share price at the grant date. The awards vest three years after being issued subject to the Company achieving certain production and Reserves targets. The production performance criteria will be measured on the average barrels of oil equivalent per day for the period 1 July 2010 to 31 December 2010. Proved and probable Reserves will be measured at the end of the 2010 financial year. PSP awards require service with the Company for three years.

Details for each tranche outstanding at the end of the year were as follows:

	Number of share awards '000
Outstanding at 1 January 2008	–
Granted during the year	2,522
Outstanding at 1 January 2009	2,522
Forfeited during the year	(1,674)
Outstanding at 31 December 2009	848

No PSP awards were exercised or expired during the year (2008: nil) and no PSP awards are exercisable at 31 December 2009 (2008: nil).

The options outstanding at 31 December 2009 had a nil-cost exercise price, and a weighted average remaining contractual life of 21 months (2008: 33 months).

The awards are not subject to any market-based performance conditions and therefore the Black-Scholes model has been used. The inputs into the models were as follows:

	Black-Scholes
Weighted average share price (£)	0.87
Weighted average exercise price (£)	–
Expected volatility (%)	51.5
Expected term (years)	3
Risk free rate (%)	–
Expected dividend yield (%)	–

As the Company has listed shares, the expected volatility was determined by considering the historical volatility of other similar entities. Similar entities have been chosen as the FTSE All Share Oil & Exploration sector (with a market capitalisation between £40 million and £500 million) at the grant date.

The estimated fair value of the awards granted under the PSP is £0.8 million (2008: £2.2 million).

The Group did not recognise any expense associated with these awards as the Directors do not believe that achievement of the performance conditions will be met (2008: £nil).

27. Notes to the cash flow statement

	2009 £'000	2008 £'000
Operating loss	(107,589)	(27,157)
Adjustments for:		
Depreciation of property, plant and equipment	1,112	1,067
Impairment of other receivables	3,925	–
Impairment of property, plant and equipment and evaluation and exploration assets	61,241	–
Impairment of goodwill	2,258	–
Impairment of inventories	6,586	–
Impairment of VAT recoverable	13,241	834
Loss on disposal of property, plant and equipment	5,000	112
Share-based payments	(814)	205
Effect of foreign exchange rate changes	(1,693)	(3,961)
Operating cash flows before movements in working capital	(16,733)	(28,900)
Increase in inventories	(2,065)	(6,494)
Increase in receivables	(2,316)	(8,242)
Increase in payables	2,882	1,383
Increase in restricted cash	(450)	–
Cash used in operations	(18,682)	(42,253)
Income taxes paid	(270)	(279)
Net cash outflow from operating activities	(18,952)	(42,532)

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

27. Notes to the cash flow statement continued

Cash and cash equivalents (which are presented as a single class of assets on the balance sheet) comprise cash at bank and short-term bank deposits with an original maturity of three months or less. The carrying value of these assets is approximately equal to their fair value.

28. Financial instruments

Capital risk management

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern, while maximising the return to shareholders. The Group's overall strategy remains unchanged from 2008.

The capital resources of the Group consists of cash and cash equivalents arising from equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in the Consolidated Statement of Changes in Equity.

Externally imposed capital requirement

The Group is not subject to externally imposed capital requirements.

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement, the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 3 to the Consolidated Financial Statements.

Categories of financial instruments

	2009 £'000	2008 £'000
Financial assets		
Cash and cash equivalents	30,505	72,026
Restricted cash	450	–
Other receivables (current and non-current)	23,510	390
	54,465	72,416
Financial liabilities		
Trade creditors	4,035	3,012
Other creditors and payables	227	305
	4,262	3,317

Financial risk management objectives

Management provides services to the business, co-ordinates access to domestic and international financial markets and monitors and manages the financial risks relating to the operations of the Group in Ukraine through internal risks reports which analyse exposures by degree and magnitude of risks. These risks include commodity price risks, foreign currency risk, credit risk, liquidity risk and cash flow interest rate risk.

The Group does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

As the Group has no committed borrowings, the Group is not exposed to any risks associated with fluctuations in interest rates on loans. A five per cent fluctuation in interest rates applied to cash balances held at the balance sheet date would impact the Group by approximately £1.6 million over a twelve month period.

The Audit Committee of the Board reviews and monitors risks faced by the Group through meetings held throughout the year.

Commodity price risk

The commodity price risk related to Ukrainian gas and condensate prices and, to a lesser extent, prices for crude oil are the Group's most significant market risk exposures. World prices for gas and crude oil are characterised by significant fluctuations that are determined by the global balance of supply and demand and worldwide political developments, including actions taken by the Organisation of Petroleum Exporting Countries. These fluctuations may have a significant effect on the Group's revenues and operating profits going forward. The Ukrainian gas price has historically been, and currently remains, at a discount to gas prices prevailing in the European Union. The principal factor in the current Ukrainian gas price is bilateral negotiations with Gazprom to establish the price of gas imports from Russia. The price for Ukrainian gas is based on the current price of these gas imports from Russia, which are nonetheless influenced by world prices, and it is expected that the trend of Ukrainian prices becoming more aligned with prevailing European and world prices will continue. Ukrainian gas prices are also influenced in some degree by local supply and demand. Management continues to expect that the Group's principal market for gas will be the Ukrainian domestic market.

The Group does not hedge market risk resulting from fluctuations in gas, condensate and oil prices, and holds no financial instruments which are sensitive to commodity price risk.

Foreign exchange risk and foreign currency risk management

The Group undertakes certain transactions denominated in foreign currencies. Hence, exposures to exchange rate fluctuations arise, however, as the Group does not hold large quantities of foreign currency it is not therefore exposed to significant foreign currency risk.

28. Financial instruments continued

The Group to date has elected not to hedge its exposure to the risk of changes in foreign currency exchange rates.

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Liabilities		Assets	
	2009 £'000	2008 £'000	2009 £'000	2008 £'000
US dollars ("USD")	490	–	24,214	15,289

Foreign currency sensitivity analysis

The Group is exposed primarily to movements in other currencies against the GBP as this is the presentational currency of the Group. In order to fund operations, USD funds are primarily converted from GBP into USD at which time they are converted to UAH. Sensitivity analyses have been performed to indicate how the profit or loss would have been affected by changes in the exchange rate between the GBP and USD. The analysis is based on a weakening of the GBP by 10 per cent against the USD in which the Group has significant assets and liabilities at the end of each respective period. A movement of 10 per cent reflects a reasonably possible sensitivity when compared to historical movements over a three to five year timeframe. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a ten per cent change in foreign currency rates.

A positive number below indicates a decrease in profit where GBP strengthens ten per cent against the USD. For a ten per cent weakening of the GBP against the USD, there would be an equal and opposite impact on the profit, and the balances would be negative.

The following table details the Group's sensitivity to a ten per cent decrease in the GBP against the USD.

	2009 £'000	2008 £'000
Income statement	(3,779)	(2,214)

The Group's sensitivity to foreign currency has increased due to a weakening of the GBP against the USD; however this has been offset by a weakening of the UAH, the Group's operating currency. In management's opinion, the sensitivity analysis is unrepresentative of the inherent foreign exchange risk.

Inflation risk management

Inflation in Ukraine and in the international market for oil and gas may affect the Group's cost for equipment and supplies. The Directors expect that the Group's practices of raising funds in GBP and keeping deposits in GBP and USD accounts until funds are needed and selling its production in the spot market, coupled with the linkage of the currency in Ukraine and to the US dollar, enable the Group to manage the risk of inflation.

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group does not have any significant credit risk exposure on trade receivables as the normal terms for sales of gas and condensate to the Group's customers require payment before delivery. In the future, the Group could face issues with customers if curtailments of throughput in the gas transportation system delays delivery to customers, but the Group has yet to experience such issues and transportation remains the responsibility of the customer once the Group has delivered product to the transportation system.

The Group makes allowances for impairment of receivables where there is an identified event which, based on previous experience, is evidence of a reduction in the recoverability of cash flows.

The credit risk on liquid funds (cash) is considered to be limited because the counterparties are financial institutions with high and good credit ratings, assigned by international credit-rating agencies in the UK and Ukraine respectively.

The credit risk on other receivables is mostly mitigated as the Company maintains title of the assets throughout the settlement period (refer to note 4(d)).

The carrying amount of financial assets recorded in the financial statements represents the Group's maximum exposure to credit risk.

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. The Group manages liquidity risk by maintaining adequate cash reserves and by continuously monitoring forecast and actual cash flows.

The Group's financial liabilities are not significant and therefore no maturity analysis has been presented. All financial liabilities held by the Group are non-interest bearing.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2009 continued

29. Commitments and contingencies

Joint activity agreements

The Group has interests in eight licences for the conduct of its exploration and development activities within Ukraine. Each licence is held with the obligation to fulfil a minimum set of exploration activities within its term and is summarised on an annual basis, including the agreed minimum amount forecasted expenditure to fulfil those obligations. The activities and proposed expenditure levels are agreed with the government licensing authority Nadra.

The minimum required future financing of exploration and development work on fields under the licence obligations are as follow:

	2009 £'000	2008 £'000
Within one year	13,482	24,475
Between two and five years	32,944	7,399
	46,426	31,874

A greater level of capital expenditure could, however, be incurred in the above period to achieve the Group's corporate targets.

Cypriot court

The Group has put in escrow £0.5 million held by the Group's lawyers in Cyprus to support a bank guarantee provided to the Cypriot Court (the 'Court') in relation to obtaining a freezing order in Cyprus associated with the litigation against one of the former executive Directors. At 31 December 2009, this amount is presented as restricted cash included within non-current assets.

The Group has also provided a guarantee to the Court to pay up to £0.3 million in the event that the Court is found liable for damages as a result of erroneously issuing a freezing order associated with the litigation against one of the former executive Directors, in favour of the Group.

Ramet Holdings Limited

Under the terms of acquisition of Ramet Holdings Limited, the Group had a contingent liability in relation to the deferred consideration equal to the number of recoverable proven and probable barrels of oil equivalent from the first two wells drilled and tested in the Malynovestske Field (the Malynovestske licence area in the Bogorodchansky Administration District of the Ivano-Frankivska Administration Region in western Ukraine) as assessed by a suitably qualified and insured independent expert of at least 10 years' standing. Payment should be made within 30 days of the expert's report and, notwithstanding that report, should not exceed USD5.0 million. At the end of 2009, the Malynovestske licence was annulled by the Government and it is therefore unlikely that the targets relating to this contingent liability will be met. A counterclaim has been made by the former Chief Executive Officer relating to this payment, however, the Company has been advised that the counterclaim has no merit.

30. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 Related Party Disclosures. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report on pages 34 to 35.

Termination of £0.1 million was paid during the year to the Group's former Asset Development Director, Mr PA Biddlestone.

	Purchase of services		Amounts owing	
	2009 £'000	2008 £'000	2009 £'000	2008 £'000
Short-term employee benefits	1,722	1,257	181	103
Share-based payments	(1,132)	523	–	–
Energy Services Group Ltd	125	–	–	–
Bridge Asset Management	38	–	–	–
Lavruk T.V.	57	58	–	–
Boechko R.A.	11	–	6	–
Vivcharyk V.P.	16	–	–	–
Vivcharyk O.M.	–	1	–	–
	837	1,839	187	103

The total remuneration of the highest paid Director was £0.5 million in the year (2008: £0.3 million).

In 2009, Energy Services Group Ltd ('ESG') was engaged to perform a review of the Group's technical capabilities and make an assessment of Ukrainian assets. Mr IR Baron, the Company's Chief Executive Officer, is a managing partner of Energy Services Group.

Bridge Asset Management was engaged to assist with legal and advisory work during 2009. Mr NC Corby, a Director of the Company, is a managing partner of Bridge Asset Management.

30. Related party transactions continued

During 2009, the Group paid rental income to Lavruk T.V. and Boechko R.A. in relation to buildings owned by Oxana Vivcharyk, the wife of Vasyl Vivcharyk the former Chief Operating Officer of the Company.

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received and no provisions have been made for doubtful debts in respect of the amounts owed by related parties.

Other related party transactions

The completeness of the disclosure of related party transactions is affected by the ongoing investigations into alleged irregularities involving certain former Directors. Refer to note 3(b).

31. Events after the balance sheet date**Smith Eurasia**

In June 2009, the Company and several of its subsidiaries commenced litigation at the High Court in London against the former Chief Executive Officer and Chief Operating Officer and certain third parties in order to seek return of funds to the Company associated with the procurement of and payment for certain assets and services. In February 2010, the Group reached an agreement with one of the Defendants in the litigation, Smith Eurasia Limited ('Smith Eurasia'), and various related parties with respect to potentially improper payments made by Smith Eurasia to former executives of the Company prior to March 2009. In accordance with the agreement, Smith Eurasia does not accept fault or liability in relation to the allegedly improper payments and the Company will receive USD4,500,000. In addition, the agreement resolves all other outstanding commercial issues between Smith Eurasia and the Company as follows:

- (1) The Group will pay outstanding invoices totalling approximately USD2,900,000 owing to Smith Eurasia and related parties for goods and services supplied to the Company in Ukraine. These amounts are included in Trade creditors (see note 22) as at 31 December 2009; and
- (2) Smith Eurasia will repurchase from the Group certain unused plant and equipment and Smith Eurasia will pay the Group approximately USD1,000,000. These assets were included within the Group's inventory balance at 31 December 2009 at amounts not more than the amount of repurchase (see note 19).

All amounts due under the Agreement have been settled in full.

Company Balance Sheet

As at 31 December 2009

	Notes	2009 £'000	2008 £'000
Assets			
Non-current assets			
Investments	34	–	4,145
Receivables from subsidiaries	35	61,330	205,130
		61,330	209,275
Current assets			
Trade and other receivables	35	32	139
Cash and cash equivalents	35	22,737	45,218
		22,769	45,357
Total assets		84,099	254,632
Liabilities			
Current liabilities			
Trade and other payables	36	(488)	(587)
Total liabilities		(488)	(587)
Net assets		83,611	254,045
Equity			
Share capital	37	6,933	6,933
Share premium account	38	–	250,373
Retained earnings/(accumulated deficit)	38	72,475	(8,618)
Share-based payment reserve		4,203	5,357
Total equity		83,611	254,045

The financial statements were approved by the Board of Directors and authorised for issue on 27 April 2010.

They were signed on its behalf by:

Philip Dayer
Director
27 April 2010

The notes on pages 73 to 75 form part of these financial statements.

Company Cash Flow Statement

For the year ended 31 December 2009

	Notes	2009 £'000	2008 £'000
Net cash outflow from operating activities	40	(1,893)	(5,919)
Investing activities			
Acquisition of subsidiary		–	(149)
Interest received		298	2,290
Loans to subsidiary companies		(20,886)	(122,492)
Net cash used in investing activities		(20,588)	(120,351)
Financing activities			
Proceeds from issue of shares		–	171,404
Net cash from financing activities		–	171,404
Net (decrease)/increase in cash and cash equivalents		(22,481)	45,134
Cash and cash equivalents at beginning of year		45,218	84
Cash and cash equivalents at end of year		22,737	45,218

Company Statement of Changes in Equity

For the year ended 31 December 2009

	Share capital £'000	Share premium account £'000	Shares to be issued £'000	Retained earnings £'000	Share-based payment reserve £'000	Total £'000
As at 1 January 2008	4,169	78,028	2,260	(4,447)	4,674	84,684
Issue of equity shares	2,709	179,423	–	–	–	182,132
Equity shares to be issued	55	2,205	(2,260)	–	–	–
Expenses of issue of equity shares	–	(9,145)	–	–	–	(9,145)
Share-based payment (note 39)	–	(138)	–	–	683	545
Net loss for the year	–	–	–	(4,171)	–	(4,171)
As at 1 January 2009	6,933	250,373	–	(8,618)	5,357	254,045
Share-based payment (note 39)	–	–	–	–	(1,154)	(1,154)
Capital reduction (note 38)	–	(250,373)	–	250,373	–	–
Net loss for the year	–	–	–	(169,280)	–	(169,280)
As at 31 December 2009	6,933	–	–	72,475	4,203	83,611

Notes to the Company Financial Statements

For the year ended 31 December 2009

32. Significant accounting policies

The separate financial statements of the Company are presented as required by the Companies Act 2006 (the 'Act'). As permitted by the Act, the separate financial statements have been prepared in accordance with International Financial Reporting Standards.

The financial statements have been prepared on the historical cost basis. The principal accounting policies adopted are the same as those set out in note 3 to the Consolidated Financial Statements except as noted below.

As permitted by section 408 of the Act, the Company has elected not to present its profit and loss account for the year. Cadogan Petroleum plc reported a loss for the financial year ended 31 December 2009 of £169.3 million (2008: £4.2 million).

Investments

Investments in subsidiaries are stated at cost less, where appropriate, provisions for impairment.

Critical accounting judgements and key sources of estimation uncertainty

The Company's financial statements, and in particular its investments in and receivables from subsidiaries, are affected by certain of the critical accounting judgements and key sources of estimation uncertainty described in note 4 to the Consolidated Financial Statements.

33. Auditors' remuneration

The auditors' remuneration for audit and other services is disclosed in note 9 to the Consolidated Financial Statements.

34. Investments

The Company's subsidiaries are disclosed in note 18 to the Consolidated Financial Statements. The investments in subsidiaries are all initially stated at cost. As a result of significant impairment losses provided by the Group (see note 7), the carrying value of the Company's investments in Ukraine subsidiaries was assessed for impairment. At 31 December 2009, an impairment loss of £4.1 million (2008: £nil) was provided reducing the carrying value of the investments to £nil (2008: £4.1 million), representing the present value of the net future cash flows expected to be derived from the Group's Ukrainian subsidiaries.

35. Financial assets

Receivables from subsidiaries

At the balance sheet date gross amounts receivable from the fellow Group companies were £225.6 million (2008: £205.1 million). As a result of the impairment losses provided by the Group (see note 7), the carrying value of the Company's receivables from Ukraine subsidiaries was assessed. At 31 December 2009, an impairment loss of £164.3 million (2008: £nil) was provided reducing the carrying value of the receivables to £61.3 million (2008: £205.1 million). There are no past due receivables.

Trade and other receivables

	2009 £'000	2008 £'000
Other receivables	5	50
VAT recoverable	9	54
Prepayments	18	35
	32	139

Cash and cash equivalents

The Company's principal financial assets are bank balances and cash and receivables from related parties none of which are past due. The Directors consider that the carrying amount of receivables from related parties approximates their fair value.

These comprise cash held by the Company and short-term bank deposits with an original maturity of three months or less. The carrying value of these assets approximates their fair value.

36. Financial liabilities

Trade and other payables

	2009 £'000	2008 £'000
Trade creditors	109	381
Other creditors and payables	379	206
	488	587

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 62 days (2008: 12 days).

The Directors consider that the carrying amount of trade and other payables approximates to their fair value. No interest is charged on balances outstanding.

Notes to the Company Financial Statements

For the year ended 31 December 2009 continued

37. Share capital

The Company's share capital is disclosed in note 24 to the Consolidated Financial Statements.

38. Capital reduction

The Company's capital reduction is disclosed in note 25 to the Consolidated Financial Statements.

39. Share-based payments

The Company's share-based payments information is disclosed in note 26 to the Consolidated Financial Statements.

40. Notes to the cash flow statement

	2009 £'000	2008 £'000
Operating loss from continuing operations	(169,532)	(6,501)
Adjustments for:		
Investment write down	4,145	–
Intercompany loan write down	164,346	–
Share-based payments	(815)	205
Operating cash flows before movements in working capital	(1,856)	(6,296)
Decrease/(Increase) in receivables	62	(35)
(Decrease)/Increase in payables	(99)	412
Net cash outflow from continuing operations	(1,893)	(5,919)

41. Financial instruments

The Company manages its capital to ensure that it is able to continue as a going concern while maximising the return to shareholders. Refer to note 28 for the Group's overall strategy and financial risk management objectives.

The capital resources of the Group consists of cash and cash equivalents arising from equity, comprising issued capital, reserves and retained earnings.

Categories of financial instruments

	2009 £'000	2008 £'000
Financial assets		
Cash and cash equivalents	22,737	45,218
Amounts due from subsidiaries	61,330	205,130
	84,067	250,348
Financial liabilities		
Trade creditors	(109)	(381)
Other creditors and payables	(345)	(201)
	454	(582)

Interest rate risk

All financial liabilities held by the Company are non-interest bearing. As the Company has no committed borrowings, the Company is not exposed to any significant risks associated with fluctuations in interest rates. A five per cent fluctuation in interest rates applied to cash balances held at the balance sheet date would impact the Company by approximately £1.1 million over a twelve month period.

Credit risk

Credit risk refers to the risk that counterparty will default on its contractual obligations resulting in financial loss to the Company. For cash and cash equivalents, the Company only transacts with entities that are rated the equivalent to investment grade and above. Other financial assets consist of amounts receivable from related parties.

The Company's credit risk on liquid funds is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies.

The carrying amount of financial assets recorded in the Company financial statements, which is net of any impairment losses, represents the Company's maximum exposure to credit risk.

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has built an appropriate liquidity risk management framework for the management of the Company's short, medium and long-term funding and liquidity management requirements. The Company maintains adequate reserves, by continuously monitoring forecast and actual cash flows.

The Company's financial liabilities are not significant and therefore no maturity analysis has been presented.

42. Related parties

Amounts due from subsidiaries

The Company has entered into a number of unsecured related party transactions with its subsidiary undertakings. The most significant transactions carried out between the Company and its subsidiary undertakings are mainly for short and long-term financing. Amounts owed from these entities are detailed below:

	2009 £'000	2008 £'000
Cadogan Petroleum Holdings Limited	61,330	204,784
Ramet Holdings Limited	–	6
LLC Astroinvest-Ukraine	–	82
LLC Industrial Company Gazvydobuvannya	–	82
DP Usenco Ukraine	–	82
Momentum Enterprises (Europe) Limited	–	41
LLC Astroinvest-Energy	–	53
	61,330	205,130

The remuneration of the Directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report on pages 34 to 35.

Refer to note 35 for a discussion on the Company's receivables due from subsidiaries.

	Purchase of services		Amounts owing	
	2009 £'000	2008 £'000	2009 £'000	2008 £'000
Short-term employee benefits	1,222	1,257	155	103
Share-based payments	(1,132)	523	–	–
	90	1,780	155	103

The total remuneration of the highest paid Director was £0.5 million in the year (2008: £0.3 million).

43. Events after the balance sheet date

Events after the balance sheet date are disclosed in note 31 to the Consolidated Financial Statements.

Glossary

IPO	Initial public offering
IFRSs	International Financial Reporting Standards
JAA	Joint activity agreement
UAH	Ukrainian hryvnia
GBP	Great Britain pounds
\$/USD	United States dollars
bbl	Barrel
boe	Barrel of oil equivalent
mmboe	Million barrels of oil equivalent
mboe	Thousand barrels of oil equivalent
mboepd	Thousand barrels of oil equivalent per day
boepd	Barrels of oil equivalent per day
bcf	Billion cubic feet
mmcm	Million cubic metres
mcm	Thousand cubic metres
Reserves	Those quantities of petroleum anticipated to be commercially recoverable by application of development projects to known accumulations from a given date forward under defined conditions. Reserves include proved, probable and possible reserve categories.
Proved Reserves	Those additional Reserves which analysis of geoscience and engineering data can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from reservoirs and under defined economic conditions, operating methods and government regulations.
Probable Reserves	Those additional Reserves which analysis of geoscience and engineering data indicate are less likely to be recovered than proved Resources but more certain to be recovered than possible Reserves.
Possible Reserves	Those additional Reserves which analysis of geoscience and engineering data indicate are less likely to be recoverable than probable Reserves.
Contingent Resources	Those quantities of petroleum estimated, as of a given date, to be potentially recoverable from known accumulations by application of development projects, but which are not currently considered to be commercially recoverable due to one or more contingencies.
Prospective Resources	Those quantities of petroleum which are estimated as of a given date to be potentially recoverable from undiscovered accumulations.
1P	Proved Reserves
2P	Proved plus probable Reserves
3P	Proved plus probable plus possible Reserves
Carboniferous	A geological period 295 million to 354 million years before present
Devonian	A geological period between 417 million and 354 million years before present
Viséan	Geological period within the early to middle Carboniferous
Spud	To commence drilling, once the cement cellar and conductor pipe at the well-head have been constructed
TD	Target depth
Workover	The process of performing major maintenance or remedial treatment of an existing oil or gas well
LWD	Logging while drilling

Shareholder Information

Enquiries relating to the following administrative matters should be addressed to the Company's registrars: Capita Registrars Limited, Northern House, Woodsome Park, Fenay Bridge, Huddersfield, West Yorkshire HD8 0LA

Telephone number: +44 (0) 871 664 0300

- Loss of share certificates.
- Notification of change of address.
- Transfers of shares to another person.
- Amalgamation of accounts: if you receive more than one copy of the Annual Financial Report, you may wish to amalgamate your accounts on the share register.

You can access your shareholding details and a range of other services at the Capita website www.capitashareportal.com.

Information concerning the day-to-day movement of the share price of the Company can be found on the Group's website www.cadoganpetroleum.com or that of the London Stock exchange www.prices.londonstockexchange.com.

Boiler room scams

Over the last year, many companies have become aware that their shareholders have received unsolicited phone calls or correspondence concerning investment matters. These are typically from overseas based 'brokers' who target UK shareholders, offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. These operations are commonly known as 'boiler rooms'. These 'brokers' can be very persistent and extremely persuasive, and a 2006 survey by the Financial Services Authority ('FSA') has reported that the average amount lost by investors is around £20,000.

It is not just the novice investor that has been duped in this way; many of the victims had been successfully investing for several years. Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free company reports. If you receive any unsolicited advice:

- make sure you get the correct name of the person and organisation;
- check that they are properly authorised by the FSA before getting involved by visiting: www.fsa.gov.uk/register;
- report the matter to the FSA either by calling +44 (0) 845 606 1234 or visiting: www.moneymadeclear.fsa.gov.uk; and
- if the call persists, hang up.

If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. The FSA can be contacted by completing an online form at: www.fsa.gov.uk/pages/doing/regulated/law/alert/overseas.shtml.

Details of any share dealing facilities that the Company endorses will be included in Company mailings.

More detailed information on this or similar activity can be found on the FSA website: www.moneymadeclear.fsa.gov.uk.

Unsolicited mail

As the Company's share register is, by law, open to public inspection, shareholders may receive unsolicited mail from organisations that use it as a mailing list. To reduce the amount of unsolicited mail you receive, contact: The Mailing Preference Service, FREEPOST 22, London W1E 7EZ. Telephone: 0845 703 4599. Website: www.mpsonline.org.uk.

Financial calendar 2010/2011

Interim Management Statement	17 May 2010
Annual General Meeting	2 June 2010
Half Yearly Report	August 2010
Interim Management Statement	November 2010
Results announcement for 2010	April 2011

Investor relations

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continued

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