



ANNUAL FINANCIAL REPORT 2010

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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 2010 included the following:

- > Extension received on the Pirkovskoe licence to 2015
- > Farm-out campaign being pursued to conserve existing cash and spread the risks associated with further exploration and development
- > Resolution of Pirkovskoe and Zagoryanksa licences issues
- > Total capital expenditure of £7.8 million (2009: £23.5 million) during the year
- > Net cash and cash equivalents at year end of £23.5 million (2009: £30.5 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.



1. Borynya and Bitlya fields (Bitlyanska-Carpathian basin)

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.

2. Pokrovskoe field (Dnieper-Donets basin)

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.

3. Pirkovskoe field (Dnieper-Donets basin)

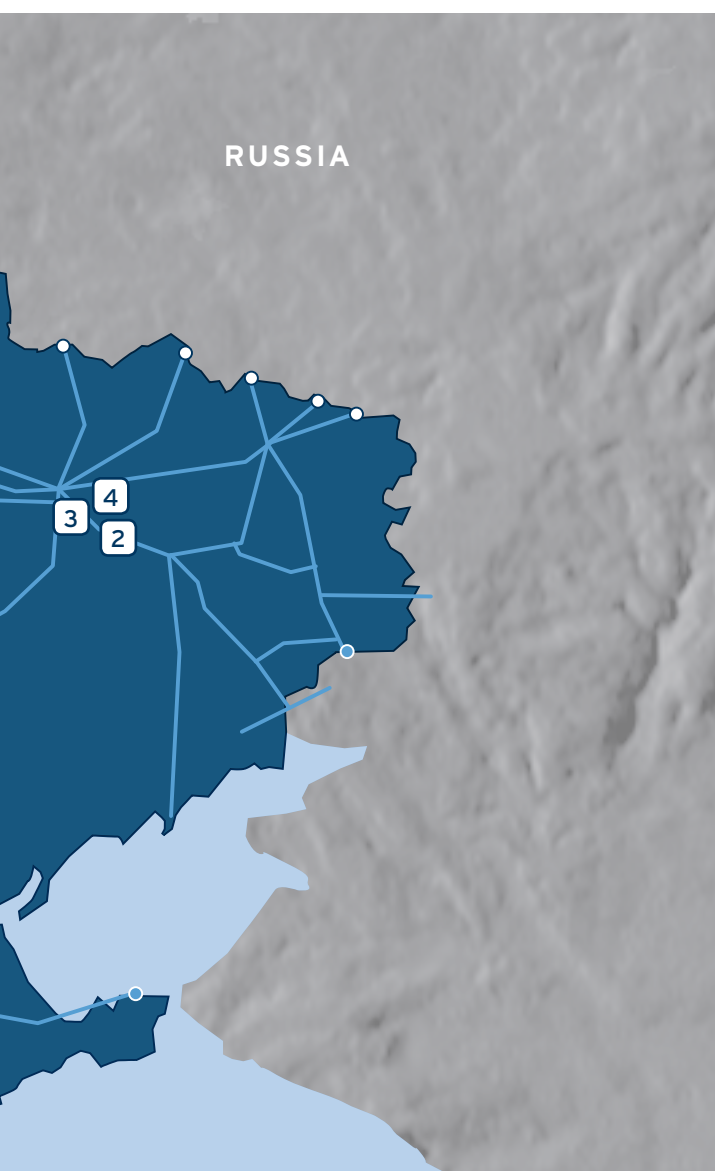
Pirkovskoe is located in the faulted transgression zone that forms the northern shoulder of the Dnieper-Donets Graben. The exploration and appraisal licence covers 71.6 square kilometres and holds 2.4 million barrels of oil equivalent ('mmbob') of proved and probable Reserves. Cadogan owns the Kraznozayarska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

4. Zagoryanska field (Dnieper-Donets basin)

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.

5. Minor fields (Carpathian basin)

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).



Chairman's Statement

Introduction and strategic alliance with Eni

I am delighted to be able to report that, since shareholders approved the resolutions at the 2010 Annual General Meeting giving the Board a clear mandate to pursue its operational strategy in Ukraine, significant progress has been made. The Group has completed the rationalisation of its operations in Ukraine and is now in a position to develop its assets more aggressively. Licence issues, one of the factors that have hindered the Group's potential since the IPO in June 2008, have now been resolved.

In addition, on 13 April 2011, the Company announced a very significant agreement, conditional on the approval of shareholders and the relevant Ukrainian authorities, with Eni S.p.A ('Eni') the major Italian integrated energy company. Eni will initially acquire a 30 per cent interest in our Pokrovskoe licence, with the option to acquire a further 30 per cent interest in the future. Eni will also acquire a 60 per cent interest in our Zagoryanska licence. Both licences are in eastern Ukraine. The initial consideration will comprise 100 per cent funding of a work programme of approximately USD30 million (excluding VAT), including drilling and seismic re-processing, plus a USD38 million payment. Subject to successful results from the above programmes and award of production licences, Eni will pay the Group further amounts of up to USD90 million.

The announcement of this major transaction signifies a turning point for Cadogan. With Eni as a strategic partner, the Group can more rapidly develop the potential in these two licences and can embark on other significant oil and gas opportunities in Ukraine.

The transaction, which is a class one transaction under the UKLA Listing Rules, is subject to Cadogan shareholder and Ukrainian Anti-Monopoly Commission approval. The Company plans to issue a circular to shareholders in May 2011, giving full details of the proposed transaction and convening a general meeting of the Company prior to mid-June 2011. It is planned that the transaction will complete on or around 30 June 2011.

Operations summary

During the first half of 2010 the Board kept operations to a minimum, whilst the future of the Group was determined. Once it was clear that shareholders had mandated the Board to pursue its operational strategy in Ukraine, a number of relatively low-cost work programmes were initiated. At Zagoryanska 3, a successful well-testing programme was completed in joint venture with a local contractor and the well tied-in to nearby production facilities. Commercial production commenced in August. At Pokrovskoe 1, a deepening of the well commenced in October and was suspended in December at 5,450 metres. We encountered strong indications of gas on the LWD logs over significant sections in the Lower Visean. Completion of this well is expected within the current year as part of the Eni work programme.

At Bitlyanska, our exploration asset in the west of Ukraine, a 2D seismic survey of the licence area was successfully undertaken in the later part of the year and the data acquired is currently being interpreted.

Licence developments

In September 2010 the Higher Administrative Court of Ukraine formally approved the terms of a settlement agreement between Cadogan and NSJC Nadra Ukraine ('Nadra'), a state-owned company, whereby Nadra and its subsidiary

Poltavnaftogazgeology withdrew the case between them over the licences currently owned by Cadogan for the Pirkrovskoe and Zagoryanska fields. As part of the settlement the Group purchased five deep wells on the Zagoryanska field and the development of this field forms part of the agreed work plan with Eni. The Board now views the previous challenge to the Pirkrovskoe and Zagoryanska licences as fully concluded. Nadra is a significant presence in Ukraine and Cadogan looks forward to cooperating with them in the future.

Overview of financial position

At 21 April 2011 the Group had current cash and cash equivalents of approximately £23.1 million. This is more than adequate to fulfil the Group's current work programmes and the proceeds from the Eni transaction will enable the Group to grow its position in Ukraine.

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. The action was initiated to seek a return of funds to the Group associated with the procurement of and payment for certain assets and services. For the year to 31 December 2010 the Group has incurred costs of £1.4 million (2009: £6.1 million). The litigation has yet to come to trial, but the Group has secured a number of settlements with the various parties in the case. The resultant settlements have in 2010 generated £6.0 million which has been disclosed in Other Operating Income. The litigation continues against the former Chief Operating Officer.

In addition under the settlement with Global Process Systems LLC ('GPS') entered into in October 2009, GPS took two gas plants back into stock and undertook to pay the Group USD37.5 million. The Group received USD1 million on execution in 2009, USD3.5 million in 2010 and an additional USD3.0 million in January this year. All three payments have been recorded as a settlement of a receivable. The balance is due in three

equal tranches, each of USD10 million, during 2011. The first payment of USD10 million of the remaining USD30 million was due to be paid to the Group on 14 February 2011 but was not received. A cure period expired on 18 April 2011. In April 2011 the Board commissioned a desktop study of the plants by an independent third party, which included an estimate of value subject to certain assumptions and caveats. Having taken the foregoing into account, the Board considers that the plants are likely to be worth close to the USD30 million (approximately £19.4 million) receivable that remains outstanding under the agreement. The Group retains legal title to the plants until the final payment has been received from GPS, with whom negotiations continue.

Employees

2010 was a challenging year for Cadogan's employees, especially with the uncertainty over the Group's future undecided until mid-year. As always the staff has responded positively to events and continue to remain committed to building a business in Ukraine. The Board would like to thank them for their dedication and hard work.

Board and governance

Since the 2010 Annual General Meeting the Board has been restructured with the addition of three new directors - Alessandro Benedetti and Bertrand des Pallieres, who represent SPQR Capital Holdings S.A. which purchased a significant shareholding in the Company and is supportive of management's plans, and Gordon Stein as Chief Financial Officer. All three directors will seek reappointment at the forthcoming annual general meeting.

Alan Cole and I have decided not to seek re-election at the forthcoming annual general meeting. As a result our Senior Independent Director Philip Dayer will act as interim chairman and lead the search for a new chairman and an additional independent non-executive director. As is best practice, all the remaining Directors will be putting themselves forward for re-election at the annual general meeting.

Prospects

The Board remain committed to building a successful oil and gas business in Ukraine. Over the past year management have successfully rebased the Company commensurate with its financial resources, whilst completing the total overhaul of its operating procedures, and improved the technical analysis and management of its resource base. The transaction with Eni will, if approved by shareholders, prove transformational to the prospects of the Group, facilitating the exploitation of the Pokrovskoe and Zagoryanska licences and aligning the interests of a major integrated energy company with Cadogan in Ukraine, a country where the opportunities in oil and gas remain abundant. The Board looks forward to the future with confidence.

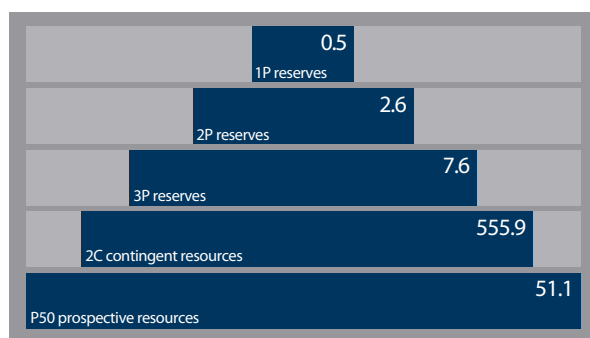
Simon Duffy

Non-executive Chairman
21 April 2011

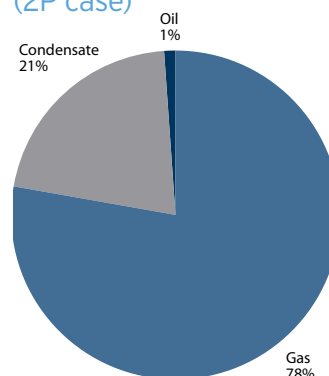
Operations Review

At the beginning of 2011 the Group held working interests in nine (2009: 11) gas, condensate and oil exploration and production licences in the east and west of Ukraine. 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 (mmboe)



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 ⁽³⁾	August 2011	E&D
90.0	Zagoryanska	April 2014	E&D
97.0	Pirkovskoe	October 2010	E&D
Major licences			
98.3	Debeslavtska	October 2026	Production
49.8	Cheremkhivska	May 2018	Production
100.0	Slobodo-Rungerska	April 2011	E&D
95.0	Monastyretska ⁽⁴⁾	November 2014	E&D
40.0	Mizhrichenska	June 2011	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 Joint Activity Agreement ('JAA') also distinguishes working interests on new wells and workover wells with the former offering a higher share to the Group. Effective working interests are shown above.

(3) Discussions are currently underway with the Ministry of Environmental Protection in Ukraine to renew the licence for a further five years in August 2011.

(4) Although this licence expired in December 2009, it was reacquired by the Group in September 2010 at commercially advantageous terms.

Licences



Bitlyanska licence area

The Bitlyanska 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 211.5 mmboe (2009: 211.5 mmboe) and 113.92 mmboe (2009: 113.9 mmboe) of Contingent Resources respectively, while no Reserves and Resources have been attributed to the Vovchenska field.

The required work programme for this licence 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.

The Borynya 3 well was terminated at a drilled depth of 5,325 metres in 2009 and the well was suspended for future evaluation. 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.

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. A targeted seismic 2D survey of the licence area was successfully undertaken in September 2010 and the data acquired is currently being interpreted. Although the structure is confirmed by earlier analysis the seismic survey undertaken in 2010 will indicate the geometry and extent of the closure.

Pokrovskoe licence

The Group has a 100 per cent working interest in the Pokrovskoe licence which holds 51.1 mmboe (2009: 51.1 mmboe) of Prospective Resources. The exploration licence covers 49.5 square kilometres and runs until August 2011. Discussions are currently underway with the Ministry of Environmental Protection in Ukraine to renew the licence for a further five years. There is a two well drilling commitment (the wells have been partially drilled), 3D seismic work commitment as well as the construction of a gas treatment plant if required. Interpretation of the 3D seismic was completed in early 2010 and confirmed 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.

Deepening of the Pokrovskoe 1 well commenced in October 2010 and supported management's revised structural interpretation. The well

encountered strong indications of gas during drilling and on the LWD logs over significant sections in the Lower Visean. Due to the onset of winter weather and the complexity of the drilling operations, it was decided to suspend drilling operations at 5,450 metres. An alternative all weather rig has been sourced and commercial negotiations are underway with a view to recommencing drilling operations in the second quarter of 2011.

Pokrovskoe 2 was the first exploration well drilled on the Pokrovskoe structure and was terminated at a drilling depth of 5,185 metres, where the well suspended for future evaluation and possible deepening. During drilling and coring operations across the Visean (V17 to V22) formations, there was strong gas influx into the well bore.

Since the year end, the Group has announced that it has reached agreement with Eni S.p.A ('Eni'), the major Italian integrated energy company, for the acquisition of an interest in the Group's Pokrovskoe licence. Subject to approval by shareholders, Eni will initially acquire a 30 per cent interest in the licence, with the option to acquire a further 30 per cent interest in the future. The consideration will comprise 100 per cent funding of a work programme of approximately USD30 million (excluding VAT), which will be used to fulfil the work obligations on the licence through the deepening of Pokrovskoe 1 and the deepening or re-drilling of Pokrovskoe 2 in order to well test the potential of the Upper and Lower Visean intervals.

Operations Review continued

Zagoryanska licence

The Group has a 90 per cent working interest in the Zagoryanska licence area. The Zagoryanska licences hold 96.4 mmboe of Contingent Resources (2009: 96.4 mmboe of Contingent Resources). The exploration and development licence covers 49.6 square kilometres and the licence was extended in 2009 until 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 had been drilled in 2008, to a TD of 5,110 metres in the Lower Visean (V26) and was suspended in order to evaluate the data obtained from testing. In late 2009, additional testing of the well was farmed-out to a local company to test the well at their own expense in return for a share of any future production from the well. The test indicated sufficient gas in the Upper Visean (V18) for commercial production to commence and the well was tied into the Group's Zagoryanska gas treatment plant. Production commenced in August 2010 at a flow rate of 55 mcm/day (2 million scf/day) of gas and 15 t/day (120 bpd) of condensate. Average monthly production rates during 2010 were 51 mcm/day gas and 10 t/day condensate.

As a result of the settlement agreement entered into with NSJC Nadra Ukraine in September 2010 (refer to note 4(f) to the Consolidated Financial Statements), the Group has purchased the Zagoryanska 3 well, which it was previously renting, together with four additional wells on the field. The Group intends to workover some of these wells in 2011 and if successful put them into production.

As part of the transaction with Eni, announced since the year end and subject to shareholders approval, Eni will acquire a 60 per cent interest in the Zagoryanska licence for a payment of USD38 million, should the transaction complete later in the year.

Pirkovskoe licence

The Group has a 97 per cent working interest in the Pirkovskoe licence which holds 2.4 mmboe (2009: 2.4 mmboe) of proved and probable Reserves, 5.0 mmboe (2009: 5.0 mmboe) of possible Reserves, 134.0 mmboe of Contingent Resources (2009: 134.0 mmboe of Contingent Resources). The exploration and appraisal licence covers 71.6 square kilometres and has been renewed until October 2015.

The required work programme includes workover of the Pirkovskoe 460 well (completed), and the testing of Pirkovskoe 1 and deepening followed by testing of the suspended Pirkovskoe 2 wells, the drilling of a new well scheduled for 2013 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 produced small volumes of oil and gas and is currently shut-in.

The 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. However there is an obligation to deepen to TD of 5,450 metres.

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 cm/day of gas and 150 t/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 0.2 mmboe of proved, probable and possible Reserves (2009: 0.3 mmboe). This licence is currently producing 100.7 boepd (2009: 132.0 boepd). The Group drilled a series of three shallow wells on the field using its own drilling rig. Results of this programme are under evaluation.
- > **Cheremkhivska licence area**
A production licence containing 0.1 mmboe of proved, probable and possible Reserves (2009: 0.1 mmboe). This licence is currently producing 33.2 boepd (2009: 56.2 boepd).
- > **Slobodo-Rungerska licence area**
An exploration and development licence, with no booked Reserves and Resources (2009: nil). During 2010 the six producing wells on this licence were abandoned as they were no longer commercially viable. In 2009 only 7.6 bopd were produced from the shallow wells in difficult mountainous forest terrain. Reprocessing of seismic data is currently underway to assess the deeper potential of this licence.
- > **Monastreyetska licence area**
An exploration and development licence, with no booked Reserves or Resources (2009: nil). Re-entry of the Blazhiv 1 well was undertaken and minor oil production re-established at the rate of 10 bopd.

Financial Review

Overview

In 2010, the activities of the Group continued to be mainly in the exploration and development stage. However the commencement of production at the Zagoryanska 3 well and the expansion of activities at the Debeslavetske field enabled revenue to increase from £2.3 million in 2009 to £3.3 million in 2010. This increase, together with the continuation of the cost reduction programme initiated in 2009 and the recoveries achieved during the year, enabled the Group to achieve a small profit after tax of £0.9 million for 2010 (2009: loss of £107.3 million of which £87.3 million related to one-off impairments booked in that year). This profit was reflected by a corresponding small increase in the net asset position as at 31 December 2010 to £84.8 million from £83.6 million as at 31 December 2009. The curtailment of cash outflows initiated on the change of management was reflected by the net outflow for the year being reduced to £7.0 million (2009: £41.5 million).

Income statement

Profit before tax was £0.5 million (2009: loss of £107.2 million after impairments of £87.3 million). Revenues comprised sales of gas from the Debeslavetske and Cheremkivske fields and, additionally in 2010, of gas and condensate from the Zagoryanska 3 well. Cost of sales, which represents production royalties and taxes, depreciation and depletion of producing wells and direct staff costs increased to £2.7 million in 2010 from £2.0 million in 2009 to give a gross profit of £0.6 million (2009: £0.3 million).

Other administrative expenses of £8.4 million (2009: £25.3 million) comprise other staff costs, professional fees, Directors' remuneration, depreciation charges on non-producing property, plant and equipment. In addition to recurring administrative expenses, £1.4 million (2009: £6.1 million) of professional costs were incurred in relation to litigation, £0.1 million (2009: £5.0 million) loss on disposal of property, plant and equipment, £nil (2009: £1.1 million) provision for bad and doubtful debts, and £nil (2009: £0.8 million) of consultancy fees were incurred to defend the legal challenges indirectly associated with the Pirkovskoe and Zagoryanska licences and also to extend the Zagoryanska licence.

- Other operating income has been disclosed separately in the income statement so as not to distort the comparison of administrative expenses by netting recoveries against them. Of the total of £7.6 million shown in this category for 2010, £6.0 million (2009: £nil) is represented by recoveries from former members of management, suppliers and related parties through out of court settlements and the remainder of £1.6 million (2009: £4.6 million) relates to net foreign exchange gains.
- Reversal of impairment charges in 2010 comprised of £1.5 million (2009: £13.2 million impairment) representing net recoveries of Ukrainian VAT. Net losses of £0.9 million (2009: £6.6 million) were incurred on sales of surplus inventories and provision for inventory. The income statement for 2009 shows impairment charges of £87.3 million which were made to reduce the carrying values of goodwill, E&E assets, PP&E assets, prepayments, inventories and other receivables as at 31 December 2009 (see below). No further impairment charges were made in 2010.

Investment revenue decreased during the year to £0.1 million (2009: £0.4 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 36 shows expenditure of £4.0 million (2009: £15.9 million) on intangible E&E assets and £3.8 million (2009: £7.6 million) on PP&E.

Balance sheet

As at 31 December 2010, the Group had net cash and cash equivalents of £23.5 million (2009: £30.5 million). Intangible E&E assets of £4.0 million (2009: £nil) represent the carrying value of the Group's investment of exploration and appraisal assets during the year to 31 December 2010 following the impairment as at 31 December 2009 noted above. The PP&E balance of £34.9 million at 31 December 2010 (2009: £32.0 million), mainly comprised of the cost of developing fields with commercial reserves and bringing them into production. Trade and other receivables of £25.0 million include £21.3 million (2009: £18.8 million as non-current other receivable; £4.1 million as current other receivable) receivable in respect of the settlement with GPS (refer to note 4(a) to the Consolidated Financial Statements).

Financial Review continued

Key performance indicators

The Group monitors 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 barrels of oil equivalent produced per day ('boepd');
- > to increase the Group's oil and gas reserves by de-risking possible resources and contingent reserves into proved plus probable reserves ('2P'). This is measured in million barrels of oil equivalent ('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.

In 2009 the Group focused on reducing costs and headcount and therefore used reduction in monthly cash outflows from operating and investing activities together with the reduction in the numbers employed to monitor its performance. In 2010 the Group has resumed using KPIs which it used prior to 2009.

These KPIs are applied across the Group. The Group's performance in 2010 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	2010	2009
Financial KPIs			
Average production (working interest basis) ⁽¹⁾	boepd	268	234
2P Reserves ⁽²⁾	mmboe	2.6	2.7
Realised price per 1,000 cubic metres ⁽⁴⁾	£	197.7	188.5
Basic and diluted earnings per share ⁽⁵⁾	pence	0.4	(46.4)
Non-financial KPIs			
Lost time incidents ⁽⁵⁾	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 is based on Gaffney, Clines & Associates' independent reserves report dated 16 March 2010. Reserves at 31 December 2010 are updated for the actual production during 2010.

(3) This represents the average price received for gas sold during the year (including VAT).

(4) Basic profit/(loss) per Ordinary share is calculated by dividing the net profit/(loss) for the year attributable to Ordinary equity holder of the parent by the weighted average number of Ordinary shares during the year.

(5) Lost time incidents relate to injuries where an employee/contractor is injured and has time off work.

Related party transactions

Related party transactions are set out in note 30 to the Consolidated Financial Statements.

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. Executive management review the potential risks and then classify them as having

a high impact, above USD5 million, medium impact above USD1 million but below USD5 million, and low impact below USD1 million. They also assess the likelihood of these risks occurring. Risk mitigation factors are reviewed and documented based on the level and likelihood of occurrence. The Audit Committee reviews the risk

register and monitors the implementation of improved risk mitigation procedures via the Executive Committee.

The Group has analysed the following categories as key risks:

Operational risks

Risk	Mitigation
HSE The oil & gas industry is by its nature an activity which can be seriously impacted by health, safety & environmental incidents. Serious incidents cannot only lead to a financial impact but can also damage reputation in country and the opportunity to undertake further projects.	The Group ensures that there is a proper HSE system in place and demands that management, staff and contractors adhere to it. The system which is fully documented ensures that the Group meets Ukraine legislative standards in full and achieves international standards to the maximum extent possible.
Drilling operations The technical difficulty of drilling wells in the Group's locations and equipment limitations can result in the unsuccessful completion of the well.	The incorporation of detailed subsurface analysis into a robust engineered well design and work programme, with appropriate procurement procedures and on site management competence aims, to minimise risk.
Production and maintenance Some of the Group's facilities have been inherited, and although fully checked were not installed under our supervision and there is a risk of plant failure. There is a risk that production or transportation facilities can fail due to poor performance of the Group's suppliers and control of some facilities being with other governmental or commercial organisations.	All plants are operated at standards above the Ukraine minimum legal requirements. Operative staff are chosen for their experience and receive supplemental training to ensure that facilities are operated and maintained at a high standard. Service providers are rigorously reviewed at tender stage and monitored during the contract period.
Work over and abandonment Certain of the Group's wells were drilled by the state and will be worked over. There is a risk that Cadogan activities fail because of problems inherited with these sites. Any well stock that is not considered satisfactory for purpose or poses an environmental hazard will be abandoned.	Work programmes will be designed to assess the status of the wells and any work that is not safe or is not technically feasible will be abandoned. Qualified professionals will be used to design a step-by-step approach to re-entering old wells. All sites that are abandoned will be restored and recultivated to meet or exceed standards required by environmental control authorities.

Subsurface risks

Risk	Mitigation
The success of the business relies on accurate and detailed analysis of the subsurface. This can be impacted by poor quality data, either historic or recently gathered, and limited coverage. Certain information provided by external sources may not be accurate.	All externally provided and historic data is rigorously examined and discarded when appropriate. New data acquisition is considered and appropriate programmes implemented, but historic data can be reviewed and reprocessed to improve the overall knowledge base.
Some local contractors may not acquire data accurately, and there can sometimes be limited choice of locally available equipment or contractors.	Detailed supervision of local contractors by Cadogan management is followed. Plans are discussed well in advance with both local and international contractors to ensure that appropriate equipment is available.
Data can be misinterpreted leading to the construction of inaccurate models and subsequent plans.	All analytical outcomes are challenged internally and peer reviewed. Interpretations are carried out on modern geological software. A staff training programme has been put in place.

Risks and Uncertainties continued

Financial risks

Risk	Mitigation
The Group may not be successful in achieving commercial production from an asset and consequently the carrying values of the Group's oil and gas assets may not be recovered through future revenues.	The Group considers on an annual basis whether to commission a Competent Person's Report ('CPR') from an independent reservoir engineer. The CPR provides an estimate of the Group's reserves and resources by field/licence area. A new CPR will be prepared for Cadogan at the end of 2011. In 2009 a detailed review of operations was completed and the commercial viability of the Group's oil and gas assets was considered. Appraisal drilling recommenced in 2010 and the Board has approved a work programme for 2011. Further attempts to bring in partners and mitigate the risk exposure is underway.
Insufficient funds are available to meet development obligations to allow the Group to continue as a going concern.	The Group manages liquidity risk by maintaining adequate cash reserves and monitoring forecasts. New management reporting procedures have been introduced which include a rolling forecast considering different future capital expenditure requirements. The 2011 budget includes a contingent capital expenditure budget which the Board may apply if sufficient funds are available. The farm-out campaign to conserve cash and spread risk will continue through 2011.
Insufficient cash flow is generated from the Group's Ukraine operations to exploit and commercialise the Group's major licences.	
The Group could be impacted by failing to meet regulatory reporting requirements in the UK, and statutory tax and filing requirements in both Ukraine and the UK.	These risks are mitigated by employing suitably qualified professionals in both the UK and Ukraine who, working with advisers when needed, are monitoring regulatory reporting requirements, and who ensure that timely submissions are made.
The Group operates primarily in Ukraine, an emerging market, where certain inappropriate business practices may from time to time occur. This includes bribery, theft of Group property, and fraud all of which can lead to financial loss.	Thorough authority levels and approval processes are in place, with stringent controls over cash management and the tendering and procurement process. Adequate office and site protection is in place to protect assets.
The Group is at risk from changes in the economic environment both in Ukraine and globally which can cause foreign exchange movements, changes in the rate of inflation and interest rates and lead to credit risks with key suppliers in Ukraine.	Revenues are received in UAH and expenditure is made in UAH, but funds are transferred in USD to Ukraine. The Group continues to hold most of its cash reserves in the UK in USD and some GBP deposits with leading financial institutions. The Group's is predominantly a USD denominated business. Foreign exchange risk is considered a normal and acceptable business exposure and the Group does not hedge against this risk. Inflation effects in Ukraine are closely monitored and budgets adjusted accordingly. The retention of cash reserves in USD in the UK enables the group to lessen the impact of inflation. The Group does not hedge against interest rate risk as it considers it as a normal business risk. It maintains cash reserves in several UK financial institutions which are all approved by the Audit Committee. Refer to note 28 to the Consolidated Financial Statements for detail on financial risks.
The Group does not at present have a considerable credit risk exposure except for the receivable from GPS.	The Board has reviewed a valuation of the GPS plants and is at present satisfied that the outstanding receivable is covered by the value of the plants.

Corporate risks

Risk	Mitigation
Should the Group not comply with licence obligations there is a risk that its entitlement to the licence will be lost.	The Group designs a work programme and budget to ensure that all licence obligations are met. The Group engages proactively with government to re-negotiate terms and ensure that they are not onerous.
Ukraine is an emerging market and as such the Group is exposed to greater regulatory, economic and political risks than other jurisdictions. Emerging economies are generally subject to rapid change of political risk which could adversely impact on Cadogan's ability to operate in the market.	Management will, once operations in Ukraine become profitable, consider alternative markets to diversify the risk.
The Group carries an insurance programme appropriate for the risks that are incurred. There is a risk that insurance levels are not sufficient or that insurance policies placed in Ukraine are not honoured.	The Group ensures it has adequate levels of cover in place by reviewing policy levels with its brokers on a quarterly basis. Operational policies have been moved from Ukraine to the UK and remaining non-operational policies in Ukraine are being reviewed.

Statement of Reserves and Resources

The Group did not commission an independent Reserves and Resources Evaluation of the Group's oil and gas assets in Ukraine, as at 31 December 2010 due to the limited level of drilling and operational activity undertaken during 2010. The summary of the Reserves and Resources below are based on the Independent Reserves and Resources Evaluation performed by Gaffney Cline and Associates as at 31 December 2009 adjusted for 2010 actual production.

Summary of reserves as of 31 December 2010

	Working interest basis		
	Gas bcf	Condensate mmbbl	Oil mmbbl
Proved and Probable Reserves at 1 January 2010	11.5	0.6	–
Production	(0.2) ⁽¹⁾	–	–
Proved and Probable Reserves at 31 December 2010	11.3	0.6	–
Possible Reserves at 1 January 2010 and 31 December 2010	19.5	1.5	–

(1) During 2010 the Group produced additional 0.3bcf of natural gas and 0.01mmbbl of condensate from Zagoryanska field which were not included by Gaffney Cline and Associates in the reserves balances at 31 December 2009 provided in the Reserves and Resources Evaluation Report as at that date.

Summary of contingent resources as of 31 December 2010

	Working interest basis			
	Gas bcf	Condensate mmbbl	Oil mmbbl	Total mmboe
Contingent Resources at 1 January 2010 and 31 December 2010	2,488.0	108.1	–	555.9

Reserves are only assigned to Pirkovskoe, Debeslavetska and Cheremkhivska fields.

Although commercial production has been achieved at Zagoryanska field no 2P reserves have been booked as of 31 December 2010 as the Group did not receive an update CPR to independently confirm the Reserves quantities.

Contingent Resources are assigned to Pirkovskoe, Zagoryanska, Borynya and Bitlya fields, where development is contingent on further appraisal.

Prospective Resources of 237 bcf gas and 8.4mmbbl condensate are attributed to Pokrovskoe field, 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 Group 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 21.

Health safety and environment

A full Health and Safety Management System is currently in place. During 2010 the Group developed a new integrated Health Safety and Environmental management system. The system aims by a continuous improvement programme to ensure that a safety and environmental protection culture is embedded in the organisation's operation in Ukraine. The HSE management system ensures that both Ukrainian and international standards can be met with the Ukrainian HSE legislation requirements taken as an absolute minimum although the international

requirements are in the main met or exceeded. Both the local operating companies in east and west Ukraine have all necessary documentation and systems in place to ensure compliance with Ukrainian legislation.

Incident reporting has been improved and covers performance statistics for exposure to safety, health and environmental hazards. A comprehensive approach to staff training on HSE matters has been adopted identifying individual staff needs and planning a structured programme. At present special attention is being given to hazard and operational ('HAZOP') studies and risk assessments ensuring that international standards are maintained even if they exceed that required by Ukrainian legislation.

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 2010, the Group has recorded a total of 365,456 man hours without a single lost time incident. The last lost time incident occurred in August 2008 and the total man hours since the last incident now exceeds 2,000,000.

The European Bank of Reconstruction and Development is a substantial shareholder in the Company and closely monitors the environmental and community aspects of the Group's activities. An environmental report is submitted to them each year summarising the Group's compliance with local HSE regulation and standards. It requires audits to be undertaken by external consultants to generate an environmental action plan, the results of which are reviewed by the bank.

During 2010 the Group identified that six shallow wells in its Slobodo-Rungurske field in the forested mountainous area in the west of Ukraine were no longer economic. These were producing a low volume of oil with significant water content and there was a concern that they could become an environmental threat. The wells were permanently

decommissioned and a comprehensive reclamation programme put in place.

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.

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 in which the Group operates and from which 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 25).

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, 61

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, 54

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.

Gordon Stein, 52

Chief Financial Officer

Mr Stein is a member of the Chartered Institute of Public Finance and Accountancy and was previously CFO and a co-founder of Vanguard Energy Limited, an upstream oil company focused on the North Sea and North Africa. Preceding this, he was CFO of Regal Petroleum plc from January 2007 to January 2008 and he has also held senior financial and operational management positions in Fairfield Energy Limited, Acorn Oil & Gas Limited, LASMO plc, Monument Oil & Gas plc, Centrica plc and BG plc. He has over 21 years' experience in the upstream oil and gas sector in the UK and internationally, including Ukraine, Tunisia, Venezuela, Algeria and Turkmenistan.

Philip Dayer, 60

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 AVEVA Group plc, Parkmead Group plc, KazMunaiGas E&P JSC, Hurricane Exploration plc, Navigators Underwriting Agency Ltd, and chairman of IP Plus plc. Mr Dayer joined the Board on 9 May 2008. He is Chairman of the Audit Committee and Senior Independent Director.

Alan Cole, 69

Independent non-executive Director

Mr Cole was formerly a non-executive chairman of several companies including JP Morgan Income Growth plc and NAAFI Pension Trustees. He is currently 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. He is Chairman of the Remuneration Committee.

Nick Hooke, 53

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.

Alessandro Benedetti, 49

Non-executive Director

Mr Benedetti is an Italian national with nearly 30 years of business experience in a diverse range of industries including telecoms, agro-industrial engineering, industrial mining, real estate, renewable and non-renewable energy and investment companies. He is fully conversant with business conditions and operating procedures in the world's key markets, especially Western and Eastern Europe, Scandinavia, CIS, Africa, North America and the Middle East.

From 2002 onward he began structuring the acquisition of a controlling interest in Italian telecom giant WIND Telecom, and subsequently formed a consortium to close a €17.2 billion leveraged buyout in 2005, at that time the largest deal of its type in Europe. Taking control of SAE Capital in 2003 he disposed of the production and distribution activity transforming the Group into a M&A boutique, which has structured various multi-billion Euro acquisitions, focusing on the telecom and energy market across Europe. He is a non-executive director of Versatile Systems Inc., which is listed on the Toronto and London Stock Exchanges, and Equus Total return, Inc., listed on the NYSE. Mr Benedetti joined the Board on 26 August 2010.

Bertrand des Pallieres, 45

Non-executive Director

Mr des Pallieres, a French national, is the CEO of SPQR Capital LLP. Previously he was the Global Head of Principal Finance and member of the Global Market Leadership Group of Deutsche Bank from 2005 to 2007. From 1992 to 2005 he held various positions at JPMorgan including Global Head of Structured Credit, European Head of Derivatives Structuring and Marketing and Co-head of sales for Europe, Middle East and Africa. He is a non-executive director of Versatile Systems Inc. listed on the Toronto and London Stock Exchanges and Equus Total return, Inc., listed on the NYSE. Mr des Pallieres joined the Board on 26 August 2010.

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 UK Corporate Governance Code (the 'Code').

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

During the year under review, the Group 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 17 under the heading 'Performance evaluation 2010'.

Board

The Board provides leadership and stewardship. The Board comprises the Chairman, Chief Executive Officer, Chief Finance Officer, three independent non-executive Directors and two non-executive Directors appointed by SPQR Capital Holdings SA. Messrs A Benedetti and B des Pallieres were appointed Directors on 26 August 2010, Mr GB Stein was appointed a Director on 3 November 2010 and Messrs NC Corby and JC Donaldson ceased to be Directors on 30 June 2010. All other 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 15.

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 six times formally during 2010.

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. During the year the Board visited the Group's offices and operations in western Ukraine and reviewed plans for that region with staff.

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	6	3	2	3
No. Attended:				
SP Duffy	6	-	2	-
IR Baron	6	-	2	-
PJ Dayer	6	3	2	3
AJ Cole	6	3	-	3
NJ Hooke	6	3	-	3
A Benedetti ⁽¹⁾	2	-	-	-
B des Pallieres ⁽¹⁾	2	-	-	-
GB Stein ⁽²⁾	1	-	-	-

(1) There have only been two formal Board meetings during 2010 since A Benedetti and B des Pallieres joined the Board.

(2) There has only been one formal Board meeting during 2010 since GB Stein joined the Board.

In addition to the six formal Board meetings, five conference calls were convened to discuss urgent issues as they arose, most of them attended by the majority of Directors. 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. Three of the non-executive Directors, Messrs Dayer, Cole and Hooke, are considered by the Board, in accordance with the Code, to be independent. Messrs Benedetti and des Pallieres are not considered to be independent in accordance with the Code as they are appointed by the major shareholder, SPQR Capital Holdings SA. The letters of appointment for the independent 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 2010

As a consequence of the issues and challenges that the Board has had to face throughout 2010 no formal review of Board performance has been undertaken. It is the Board's intention to undertake a review of its performance during 2011 and the outcome of this review will be reported in the next Annual Financial Report. Despite not having undertaken a formal review, the Chairman is satisfied that each of the independent 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 19 to 22 and page 26.

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) to the Consolidated Financial Statements for further information). All senior management at Executive Committee level and above have in place at the time of the IPO in June 2008 resigned during 2009. The Board will continue to review the procedures and systems that have already been or are 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 2010 and up to the date of signing the accounts are documented in the Group's Corporate Governance Manual and Finance Manual. These manuals have 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, Operations Director and General Director Ukraine.

Certain specific administrative functions are controlled centrally. Taxation, treasury and insurance functions report to the Chief Financial Officer. 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 10.

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 under that law to prepare the Group financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union and Article 4 of the IAS regulation and have also elected to prepare the Parent Company financial statements under IFRSs 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 for that period. In preparing the Company and Group's financial statements, International Accounting Standards ('IAS') Regulation requires that Directors:

- > 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 and Group'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 21 April 2011 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)

Nick Hooke (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. Two 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 Group's results.
- > To review and monitor the effectiveness and integrity of the Group'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 Group.
- > To oversee the Group'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 Group's arrangements by which staff of the Group may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters

Governance

The Committee was in place throughout 2010. On 30 June 2010 Mr JC Donaldson resigned as a member of the Committee. Mr N Hooke was appointed a member of the Committee on 25 August 2010. 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 three times during the year. Attendance at meetings is shown on page 16.

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.

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.

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 Committee by Deloitte LLP in the first half of 2010, 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.

Board Committee Reports continued

Internal audit

In 2009 the Committee considered the necessity for an internal audit function. It concluded that at that 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 did not reconsider this in 2010 but intends to review the function 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 planned for mid 2011. 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)

Andrew Cooper (Operations Manager)

Oleg Sybria (HSE Manager)

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 2010. Mr O Sybria was appointed HSE manager on 17 March 2010 and joined the Committee. Since the year end Mr P Bradley left the Company and Mr Andrew Cooper was appointed Operations Manager and joined the Committee. The Company Secretary attends all meetings of the Committee.

The Committee 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 development of a system that will ensure that a safety and environmental protection culture is embedded in the organisation.
- > 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)
Ian Baron (Chief Executive)
Philip Dayer (non-executive Director)

The Nomination Committee (the 'Committee') is appointed by the Board predominantly 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. Two 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 2010. On 30 June 2010, following his resignation as a Director of the Group, Mr JC Donaldson left the Committee. On 30 June 2010 Mr NC Hooke stood down as a member and Messrs Baron and Dayer joined the Committee.

The Committee met twice during the year. Attendance at meetings is shown on page 16.

The Company Secretary attends all meetings of the Committee.

Activities of the Nomination Committee

During the year the Committee discharged its responsibilities as follows:

- > Considered the Company's requirements for financial management and developed a job specification for a Chief Financial Officer.
- > Appointed a search agency to review appropriate internal and external candidates, reviewed the candidates arising from their review and recommended to the Board the appointment of a Chief Financial officer and director from outside of the Company.

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 planned for mid 2011. 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
 Gordon Stein, Chief Finance Officer (appointed 3 November 2010)
 Philip Dayer, non-executive Director
 Alan Cole, non-executive Director
 Nick Hooke, non-executive Director
 Alessandro Benedetti, non-executive Director (appointed 26 August 2010)
 Bertrand des Pallieres, non-executive Director (appointed 26 August 2010)
 Nicholas Corby, Commercial Director (resigned 30 June 2010)
 James Donaldson, non-executive Director (resigned 30 June 2010)

Biographical details for all Directors are shown on page 15.

Directors' interests in shares

The beneficial interests of the Directors in office as at 31 December 2010 and connected persons in the Ordinary shares of the Company at 31 December 2010 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 55 and 57 of this report.

There have been no changes in the Directors' interests in shares between the end of the financial year and 21 April 2011. An update will be given in the Notice of Annual General Meeting.

Shares as at	2010	2009
SP Duffy	32,609	32,609
IR Baron	500,000	-
GB Stein	-	-
PJ Dayer	21,739	21,739
AJ Cole	17,391	17,391
NJ Hooke	17,392	17,392
A Benedetti	-	17,392
B des Pallieres	200,000	-

Dividends

The Directors do not recommend payment of a dividend for the year to 31 December 2010 (2009: £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 2010 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.

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 ended 31 December 2009; and c) following publication of preliminary results for the year ended 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 21 April 2011, 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
SPQR Capital Holdings SA (formerly SAE Capital Holdings SA)	67,298,498	29.12
Lloyds Banking Group plc	21,007,309	9.09
J Benaim	18,787,886	8.12
European Bank of Reconstruction and Development Ltd	11,632,866	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 2010 were an average of 58 days (2009: 38 days). The Company creditor days at 31 December 2010 were 43 days (2009: 62 days).

Charitable and political donations

The Group has made charitable donations of £25,211 (2009: £38,514) 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

Farm-out of Pokrovskoe and Zagoryanskoe licenses

On 13 April 2011, the Group has announced an agreement with Eni which will initially acquire 30 and 60 per cent interests in Pokrovskoe and Zagoryanskoe licenses respectively. The initial consideration will comprise 100 per cent funding of a Pokrovskoe work programme of approximately USD30 million (excluding VAT), including drilling and seismic reprocessing, plus a USD38 million payment for interest in Zagoryanskoe license. Subject to successful results from the above programmes and award of production licences, Eni will pay the Group further amounts of up to USD90 million.

GPS

The first payment of USD10 million of the remaining USD30 million was due to be paid to the Group on 14 February 2011 but was not received. A cure period expired on 18 April 2011. In April 2011 the Board commissioned a desktop study of the plants by an independent third party, which included an estimate of value subject to certain assumptions and caveats. Having taken the foregoing into account, the Board considers that the plants are likely to be worth close to the USD30 million (approximately £19.4 million) receivable that remains outstanding under the agreement. The Company retains legal title to the plants until the final payment has been received from GPS, with whom negotiations continue.

Litigation

£2.8 million in cash and other assets were received in January and February 2011 under the terms of the settlement agreement with MC Tolley dated 17 December 2010.

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 4 to 25 has been approved by the Board and signed on its behalf by:

Stefan Bort

Company Secretary
21 April 2011

Registered Office:
One Fleet Place, London, EC4M 7WS
Company registered in England and Wales – No 5718406

Remuneration Committee Report

The Remuneration Committee has met three times during the year. Although the membership of the Committee remained the same, the Chairmanship changed with Alan Cole becoming Chairman in place of Philip Dayer. Following a Group wide review of advisers, PricewaterhouseCoopers were appointed Remuneration Committee adviser in place of Deloitte LLP. The appointment of Mr IR Baron as Chief Executive Officer in March 2009 was initially on an interim basis to undertake a review of the Group's business. The initial three month contract was subsequently extended to include a rolling three month notice period. Following the Annual General Meeting in 2010, when the strategy of the Company became clearer, discussions were held with Mr Baron with a view to securing his services on a more permanent basis. After the year end, the Company entered into a service agreement with Mr Baron. On 3 February 2011, he was granted an award of 1,600,000 options under the 2008 Share Option Plan, details of which are disclosed on page 28. The agreement with Mr Baron envisages the award of further options provided certain commercial transactions are completed during 2011. The Committee believes, having considered advice from PricewaterhouseCoopers, that the arrangements entered into with Mr Baron are appropriate in view of the major contribution that he has made towards restoring the fundamentals of the Group.

In November 2010, Mr GB Stein was recruited as Chief Financial Officer and appointed to the Board. The Remuneration Committee agreed his package, following a benchmarking exercise carried out by PricewaterhouseCoopers.

The arrangement put in place with MR NC Corby in June 2009, when he transferred from non-executive to a part-time executive, was terminated during the year after he ceased to be a Director following the Annual General Meeting.

As previously reported, significant changes to the Board composition were required in 2009. Following the commencement of an action in the High Court against two of the former directors, Messrs MC Tolley and VP Vivcharyk, no contractual termination payments were paid to either when their contracts were terminated. In their defences to the High Court action, both made a counterclaim relating to their contractual entitlement. The action against Mr Tolley has now been settled, and he has withdrawn his claim against the Company. The action continues against Mr Vivcharyk. The Remuneration Committee agreed in 2009 to put in place a retainer arrangement for Mr A Sawka, the former Chief Financial Officer, to assist the Company with the resolution of issues arising from an internal investigation concerning procurement irregularities. In October 2010, following conclusion of the investigation, this arrangement was terminated.

The Committee has reviewed its terms of reference and believes that it has acted in accordance with them. A formal review of the Committee's effectiveness has not been undertaken during 2010 but will be carried out in 2011.

The Remuneration Committee unanimously recommends that shareholders vote to approve the Directors' Remuneration Report at the 2011 Annual General Meeting.

Alan Cole

Chairman of the Remuneration Committee

Directors' Remuneration Report

This report has been prepared in accordance with the UK Corporate Governance Code (the 'Code'), 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 of the 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 Code. 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 2010 comprised the following non-executive Directors: AJ Cole, PJ Dayer and NJ Hooke. All three members are non-executive Directors who are considered to be independent in accordance with provision B.1.1 of the Code.

The Committee met three times during the year. Attendance at meetings is shown on page 16.

During the year the Committee appointed PricewaterhouseCoopers LLP as its remuneration adviser. PricewaterhouseCoopers 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. The Remuneration Committee advisers up until 26 August 2010 were Deloitte LLP. The Committee also received legal advice from SNR Denton, 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.

In the first half of 2010 the Group relied on interim consultants to resolve the various issues that the Group faced. Following the Annual General Meeting in June 2010 the Committee began to agree packages with the Chief Executive Officer to secure his services on a permanent basis and to recruit a Chief Financial Officer to develop and build the business. The packages put in place returned the business to a more traditional remuneration structure, based on a fixed base salary and the ability to receive annual cash bonuses and annual awards under the Company's Performance Share Plan or Share Option Plan.

Directors' Remuneration Report continued

Arrangements for existing 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 USD45,000 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 provided 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. No bonus payment was made in 2010 to Mr Baron.

Mr Baron's permanent contract was entered into on 24 March 2011 and provides for a basic salary of £220,000 with a bonus opportunity of 100% for achieving pre-determined targets based on the Group's forecast production and revenue targets, its budgeted costs for the year, the achievement of no lost time incidents for any employees and contractors and specific personal targets. Any award made for 2011 under this arrangement will be reported, against the original targets set, in the Remuneration report for that year.

Mr Baron was granted an option over 1,600,000 shares at an exercise price of 35p on 3 February 2011. The Option shall vest (but not become exercisable) if and when the share price of an ordinary share in the Company achieves a mid-market closing price of not less than 50 pence over a continuous period of 10 trading days during the period from the Grant Date of the Option and ending on 3 February 2014. Trading days means the days on which the London Stock Exchange is open for business. The Option shall become exercisable, but only to the extent vested on the 3 February 2014. The option will remain exercisable until 3 February 2021.

Mr GB Stein was appointed to the Board on 3 November 2010. His package which was benchmarked by PricewaterhouseCoopers LLP consist of a basic salary of £180,000 with a bonus opportunity of 100% for achieving pre-determined targets based on the Group's forecast production and revenue targets, its budgeted costs for the year; the achievement of no lost time incidents for any employees and contractors; and specific personal targets. Any award made for 2011 under this arrangement will be reported against the original targets set in the Remuneration report for that year.

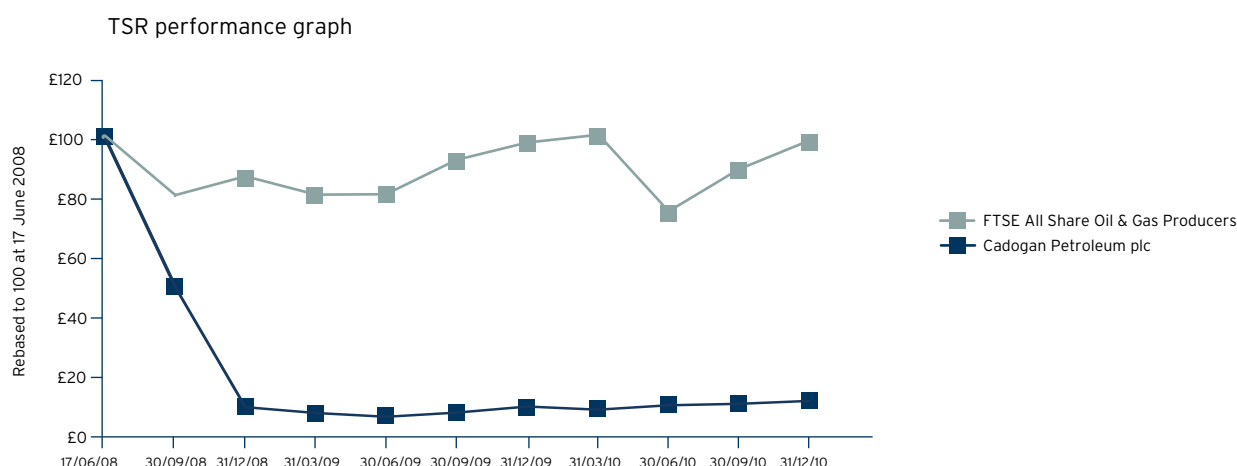
Arrangements for past directors

The Remuneration Committee agreed in 2009 to put in place a retainer arrangement for Mr Sawka, the former Chief Financial Officer, of £5,000 per calendar month, which could be terminated on one month's notice, to assist the Group with the resolution of the remaining matters arising from the internal investigation into procurement irregularities. The payment under this agreement was reduced to £2,500 per calendar month with effect from 1 January 2010 and terminated on 31 October 2010.

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 certain litigation issues. 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 was changed to £15,000 per month retainer for 2010 and terminated by agreement on 31 October 2010 following his resignation from the Board on 30 June 2010.

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

Messrs Baron and Stein, as executive Directors, are entitled to a payment of 10% of their base salary into a suitable pension arrangement as long as they can demonstrate that they have made a contribution equating to 5% of salary to the arrangement. Although no payments were made in 2010 an adjustment payment was made for Mr Stein in March 2011 and payments will commence for Mr Baron in April 2011.

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. Mr Stein's contract provides for the notice period to increase to six months on 1 May 2011 and for the change of control notice period to increase to 12 months, following the conclusion of six months service with the Company. The service agreements contain restrictive covenants for a period of 12 months following termination of the agreement. Details of service agreements in place as at the date of this report are set out below

Director	Current agreement start date	Unexpired term	Notice period
IR Baron	1 April 2011	Six months	Six months
GB Stein	1 November 2010	Three months	Three months*

(1) Extends to 6 months after 1 May 2011

Non-executive Directors

Independent non-executive Directors

The payment policy for independent 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 Company's policy at IPO was to pay a basic fee of £40,000 a year to all non-executive Directors. Additional fees of £5,000 were payable for chairmanship of a Board Committee and for being a Senior Independent Director. From 1 April 2010 the non-executive Directors agreed to reduce their basic fee to £25,000 with no chairmanship fee as a result of the difficulties that the Group faced. The Chairman's fee was reduced from £120,000 a year to £40,000 a year.

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.

Other non-executive Directors

During 2010 at the request of its largest shareholder, SPQR Capital Holding SA, Messrs Benedetti and des Pallieres were appointed as non-executive Directors. They are not independent as defined by the Code. Messrs Benedetti and des Pallieres have waived the right to a fee and do not have letters of appointment. Their expenses associated with the business of the Group are met by the Group.

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
NJ Hooke	9 May 2008	9 May 2011
A Benedetti	26 August 2010	Not applicable
B des Pallieres	26 August 2010	Not applicable

No executive Director held any appointment on the board of another listed company, apart from Mr IR Baron, who is a non-executive director of Petro Vista Energy Corporation and Stream Oil and Gas Ltd. All fees paid are retained by Mr Baron.

Directors' Remuneration Report continued

Information subject to audit:

2010 Directors' emoluments

Director	Salary/fees £	Total £	2009 £
SP Duffy	61,250	61,250	125,000
IR Baron	353,791	353,791	451,552
GB Stein (appointed 3 November 2010)	30,000	30,000	-
PJ Dayer	32,500	32,500	55,000
AJ Cole	28,750	28,750	40,000
NJ Hooke	28,750	28,750	40,000
A Benedetti (appointed 26 August 2010)	-	-	-
B des Pallieres (appointed 26 August 2010)	-	-	-
NC Corby (resigned 30 June 2010)	196,773	196,773	238,946
JC Donaldson (resigned 30 June 2010)	17,939	17,939	59,901
MC Tolley (resigned 19 March 2009)	-	-	67,174
PA Biddlestone (resigned 30 June 2009)	-	-	271,232
A Sawka (resigned 19 June 2009)	22,500	22,500	142,843
VP Vivcharyk (resigned 9 June 2009)	-	-	69,139
TOTAL	772,253	772,253	1,506,787

(1) The remuneration of the highest paid Director, Mr Baron, was £353,791 (2009: £451,552).

There were no performance payments or benefits in kind paid in 2010.

Share Incentive Arrangements

The Company currently operates the following incentive plans:

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

The Company made no awards in 2010 to any individuals under either plan.

2008 Performance Share Plan ('PSP')

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).

No Directors who held office during the year have received any awards under the PSP.

Share options

The Company operates two share option plans: the 2008 Share Option Plan (unapproved for HMRC purposes) and the 2008 Approved Option Plan ('CSOP') (which is an HMRC approved plan). On 3 February 2011 the Company made an option grant under the 2008 Share Option plan to Mr I Baron and one other senior manager at a price of 35p a share, the mid-market closing price for the trading day prior to the date of grant. The Option shall vest (but not become exercisable) if and when the share price of an ordinary share in the Company achieves a mid-market closing price of not less than 50 pence over a continuous period of 10 trading days during the period from the Grant Date of the Option and ending on 3 February 2014. Trading days means the days on which the London Stock Exchange is open for business. The Option shall become exercisable, but only to the extent vested under paragraph 1, on the 3 February 2014. The award made to Mr I Baron was 1,600,000 options over Ordinary shares of 3p.

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

No options are outstanding at 31 December 2010 as all forfeited or lapsed.

The market price of Ordinary shares subject to the above options as at 31 December 2010 was 21.75 pence. During the year the shares traded in the range 14.00 pence to 22.97 pence (prices at mid-market close).

This Directors' Remuneration Report comprising pages 27 to 30 has been approved by the Board and signed on its behalf by:

Stefan Bort
Company Secretary
21 April 2011

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Independent Auditor's Report

to Members of Cadogan Petroleum plc

We have audited the financial statements of Cadogan Petroleum plc for the year ended 31 December 2010 which comprise 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 auditor's 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 auditor

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 and express an opinion on 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 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.

Basis for qualified opinion on the financial statements

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 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 statements of changes in equity and related notes for the years ended 31 December 2009.

In addition, as set out in note 3(b) to the consolidated financial statements and the Directors' Remuneration report, the investigation identified certain potential irregularities relating to certain former executive directors which call into question the completeness and accuracy of the disclosures of related party transactions and Directors' remuneration. These investigations have concluded but we have been unable to obtain sufficient appropriate audit evidence in relation to these matters.

Qualified opinion on the financial statements

In our opinion, except for the possible effects of the matters described in the Basis for Qualified Opinion paragraph:

- > the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2010 and of the Group's profit 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.

Emphasis of matter

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in note 4(a) to the consolidated financial statements which describes an uncertainty over recoverability of an amount of £21.3 million included within current other receivables in respect of two gas plants being sold by Global Process Systems LLC. One payment of an instalment is now overdue. The directors have explained that they have security over the plants and that on the basis of a desktop study of the plants, they expect the value to be recovered in full. However, given the difficulties experienced to date in collecting the amounts due and the inherent uncertainty in estimating the value of the plants, this has been disclosed as a key judgement.

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

In respect solely of the limitations on our work referred to above, related to the consolidated income statement, consolidated statement of comprehensive income, consolidated and parent company cash flow statements, consolidated and parent company statements of changes in equity and related notes for the year ended 31 December 2009:

- > we have not obtained all the information and explanations that we considered necessary for the purpose of our audit;
- > we were unable to determine whether adequate accounting records have been kept by the Parent Company; and
- > we were unable to determine whether 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;
- > 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; and
- > certain elements of the report to shareholders by the Board on Directors' remuneration.

Graham Hollis ACA (Senior Statutory Auditor)

for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
21 April 2011

Consolidated Income Statement

For the year ended 31 December 2010

	Notes	2010 £'000	2009 £'000
Continuing operations			
Revenue	5	3,251	2,342
Cost of sales		(2,683)	(2,022)
Gross profit		568	320
Administrative expenses:			
Other administrative expenses (restated - note 3(a))		(8,396)	(25,299)
Impairment of oil and gas assets	8	-	(63,499)
Reversal of/(impairment) of other assets	8	608	(23,752)
		(7,788)	(112,550)
Other operating income (restated - note 3(a))	6	7,625	4,641
Operating profit/(loss)		405	(107,589)
Investment revenue	12	130	407
Finance costs	13	(4)	(8)
Profit/(loss) before tax		531	(107,190)
Tax	14	320	(113)
Profit/(loss) for the year	9	851	(107,303)
Attributable to:			
Owners of the Company		851	(107,303)
Non-controlling interest		-	-
		851	(107,303)
		pence	pence
Profit/(loss) per Ordinary share			
Basic and diluted	15	0.4	(46.4)

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2010

	2010 £'000	2009 £'000
Profit/(loss) for the year	851	(107,303)
Unrealised currency translation differences	338	(11,377)
Total comprehensive profit/(loss) for the year	1,189	(118,680)
Attributable to:		
Owners of the Company	1,189	(118,680)
Non-controlling interest	-	-
	1,189	(118,680)

Consolidated Balance Sheet

As at 31 December 2010

	Notes	2010 £'000	2009 £'000
Assets			
Non-current assets			
Intangible exploration and evaluation assets	16	3,984	-
Property, plant and equipment	17	34,861	32,009
Other non-current receivables	20	-	18,835
Other financial assets	20	429	450
		39,274	51,294
Current assets			
Inventories	19	2,576	5,522
Trade and other receivables	20	24,993	5,390
Other financial assets	20	240	-
Cash and cash equivalents		23,545	30,505
		51,354	41,417
Total assets		90,628	92,711
Liabilities			
Non-current liabilities			
Deferred tax liabilities	21	(635)	(973)
Long-term provisions	23	(293)	(176)
		(928)	(1,149)
Current liabilities			
Short-term borrowings		(240)	-
Trade and other payables	22	(4,375)	(7,237)
Current tax liabilities		-	(16)
Current provisions	23	(285)	(698)
		(4,900)	(7,951)
Total liabilities		(5,828)	(9,100)
Net assets		84,800	83,611
Equity			
Share capital	24	6,933	6,933
Retained earnings	25	98,078	93,593
Cumulative translation reserves		(21,036)	(21,374)
Other reserves		1,459	5,093
Equity attributable to owners of the Company		85,434	84,245
Non-controlling interest		(634)	(634)
Total equity		84,800	83,611

The consolidated 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 21 April 2011. They were signed on its behalf by:

Gordon Stein
Chief Financial Officer
21 April 2011

The notes on pages 38 to 62 form an integral part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2010

	Notes	2010 £'000	2009 £'000
Net cash inflow/(outflow) from operating activities	27	22	(18,952)
Investing activities			
Purchases of property, plant and equipment		(3,808)	(7,569)
Purchases of intangible exploration and evaluation assets		(3,998)	(15,896)
Proceeds from sale of property, plant and equipment		407	432
Interest received		130	501
Net cash used in investing activities		(7,269)	(22,532)
Financing activities			
Proceeds from short-term borrowings		240	-
Net cash from financing activities		240	-
Net decrease in cash and cash equivalents		(7,007)	(41,484)
Effect of foreign exchange rate changes		47	(37)
Cash and cash equivalents at beginning of year		30,505	72,026
Cash and cash equivalents at end of year		23,545	30,505

Consolidated Statement of Changes in Equity

For the year ended 31 December 2010

	Other reserves							
	Share capital £'000	Share premium account £'000	Retained earnings £'000	Cumulative translation reserves £'000	Share- based payment £'000	Reorganisation £'000	Non- controlling interest £'000	Total £'000
As at 1 January 2009	6,933	250,373	(49,477)	(9,997)	5,357	890	(634)	203,445
Share-based payments (note 26)	-	-	-	-	(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 1 January 2010	6,933	-	93,593	(21,374)	4,203	890	(634)	83,611
Share-based payments (note 26)	-	-	3,634	-	(3,634)	-	-	-
Net income for the year	-	-	851	-	-	-	-	851
Exchange translation differences on foreign operations	-	-	-	338	-	-	-	338
As at 31 December 2010	6,933	-	98,078	(21,036)	569	890	(634)	84,800

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

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 One Fleet Place, London, EC4M 7WS. The nature of the Group's operations and its principal activities are set out in the Operations Review on pages 6 to 8 and the Financial Review on pages 9 and 10.

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.

2. Adoption of new and revised Standards

In the current year, the following new and revised Standards and Interpretations have been adopted:

IFRS 3(2008) *Business Combinations*
IAS 27(2008) *Consolidated and Separate Financial Statements*;
IAS 28(2008) *Investments in Associates*

These standards have introduced a number of changes in the accounting for business combinations when acquiring a subsidiary or an associate. IFRS 3(2008) has also introduced additional disclosure requirements for acquisitions (see note 3(d) and 3(e)).

IFRIC 17 *Distributions of Non-cash Assets to Owners*
IFRS 2 (amended) *Group Cash-settled Share-based Payment Transactions*
Improvements to IFRSs (2009): Amendment to IFRS 2 Share-based Payment, IAS 17 Leases, and IAS 39 Financial Instruments: Recognition and Measurement

The adoption of these new and revised Standards and Interpretations has not had any significant impact of the amounts reported in these financial statements but may impact the accounting for future transactions and arrangements.

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 9	<i>Financial Instruments</i>
IAS 24 (amended)	<i>Related Party Disclosures</i>
IAS 32 (amended)	<i>Classification of Rights Issues</i>
IFRIC 19	<i>Extinguishing Financial Liabilities with Equity Instruments</i>
IFRIC 14 (amended)	<i>Prepayments of a Minimum Funding Requirement</i>
Improvements to IFRSs (May 2010)	

The adoption of IFRS 9 will impact both the measurement and disclosures of financial instruments.

The Directors do not expect that the adoption of the other Standards or Interpretations will have a material impact on the financial statements of the Company or the Group in future periods.

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 which have been measured at fair values, and using accounting policies consistent with IFRS.

The principal accounting policies adopted are set out below. The policies are applied consistently in both years. The prior year consolidated income statement reflects a reclassification of £4.6 million of foreign exchange gain from other administrative expenses to other operating income so as not to distort the comparison of the administrative expenses by netting recoveries against them.

(b) Fundamental uncertainty associated with opening balances for 2009 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. These balances enter into the calculation of the comparative amounts for the consolidated income statement, consolidated statement of comprehensive income, consolidated and parent company cash flow statements, and consolidated and parent company statement of changes in equity for the year ended 31 December 2009.

In view of the events and circumstances which occurred in the Group during 2009, which indicated that there could be doubts concerning the recoverability of the Group's goodwill, E&E and PP&E assets, the Board took the following action during 2009:

- > 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 for that year (see note 8).

The investigation concluded in respect of the capitalisation and recoverability of assets as at 31 December 2009, but not in respect of the values of assets as at 31 December 2008 which enter into the calculation of the consolidated income statement, consolidated statement of comprehensive income, consolidated and parent company cash flow statements, and consolidated and parent company statement of changes in equity for the year to 31 December 2009. 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 Sheets at 31 December 2009 and subsequently.

(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 14. The financial position of the Group, its cash flow and liquidity position are described in the Financial Review on pages 9 and 10.

The Group's cash balance at 31 December 2010 was £23.5 million (2009: £30.5 million) with no material external debt 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.

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 taking into account receivables from litigation and 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 delays encountered in achieving commercial production from the Group's major fields. The Group also continues to pursue its farm-out campaign, which, if successful, will enable it to farm-out a portion of its interests in its oil and gas licences to spread the risks associated with further exploration and development.

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.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

3. Significant accounting policies continued

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. The interests of non-controlling shareholders may be initially measured at fair value or at the non-controlling interests' proportionate share of the fair value of the acquiree's identifiable net assets. The choice of measurement is made on an acquisition-by-acquisition basis. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance. Changes in the Group's interests in subsidiaries that do not result in a loss of control are accounted for as equity transactions. The carrying amount of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Company.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities are disposed of. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 Financial Instruments: Recognition and Measurement or, when applicable, the costs on initial recognition of an investment in an associate or jointly controlled entity.

(e) Business combinations

The acquisition of subsidiaries is accounted for using the acquisition 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. Acquisition-related costs are recognised in profit or loss as incurred. 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.

(f) Goodwill

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest (if any) in the entity over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

If, after reassessment, the Group's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Goodwill is not amortised but is reviewed for impairment at least annually. 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 of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, associate or jointly controlled venture 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 of hydrocarbons are recognised when the 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 on initial recognition.

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 results and financial position of each entity of the Group are translated into pounds sterling as follows:

- i) assets and liabilities of the Group's foreign operations are translated at the closing rate on the balance sheet date;
- ii) income and expenses 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 the transactions are used; and
- iii) all resulting exchange differences arising, if any, are recognised in other comprehensive income and accumulated equity (attributed to non-controlling 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 in other comprehensive income, in which case the deferred tax is also dealt with in other comprehensive income.

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

Property, plant and equipment ('PP&E') and other intangible assets are carried at cost less accumulated depreciation and any recognised impairment loss.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

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:

Buildings	4%
Fixtures and equipment	10% to 30%

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 assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible 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.

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.

(l) Intangible exploration and evaluation assets

The Group applies the full cost method of accounting for intangible exploration and evaluation ('E&E') expenditure as set out in IFRS 6 Exploration for and Evaluation of Mineral Resources. Under the full cost method of accounting, expenditure made on exploring for and evaluating oil and gas properties is accumulated and initially capitalised as an intangible asset, by reference to appropriate cost centres being the appropriate oil or gas property. E&E assets are then assessed for impairment on a cost pool basis as described below.

E&E assets comprise costs of (i) E&E activities which are in progress at the balance sheet date, but where the existence of commercial Reserves has yet to be determined (ii) E&E expenditure which, 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 incurred.

Exploration and Evaluation costs

E&E expenditure is initially capitalised as an E&E asset. Payments to acquire the legal right to explore, costs of technical services and studies, seismic acquisition, exploratory drilling and testing are also 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 normally classified as PP&E. However, to the extent that such assets are 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 PP&E items utilised in E&E activities, together with the cost of other materials consumed during the exploration and evaluation phases.

E&E assets 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 property 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 to the development and production assets within PP&E.

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.

3. Significant accounting policies continued

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, they 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 of the relevant assets 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 from that pool. 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 impaired in full.

Impairment losses are recognised in the income statement as additional depreciation and amortisation and are 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 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 comprises 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

Depreciation is calculated on the net book values of producing assets on a field-by-field basis using the unit of production method. The unit of production method refers to the ratio of production in the reporting year as a proportion of the proved and probable Reserves of the relevant 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

Development and production assets are assessed for impairment 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 of the asset is compared with its 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 from it. The cash-generating unit applied for impairment test purpose is normally the field or group of fields if the cash flow of the relevant fields 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.

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.

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For the year ended 31 December 2010

3. Significant accounting policies continued

Trade and other receivables

Trade 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 of the receivable 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 reorganisation.

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, on-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 and short-term borrowings

Trade payables and short-term borrowings 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

A 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.

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 Payments 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.

3. Significant accounting policies continued

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 estimates 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) Other receivable recognised in relation to settlement with Global Process Systems LLC ('GPS')

An amount of £21.3 million has been recognised in current other receivables as at 31 December 2010, representing receivables from a settlement agreement reached with GPS (2009: £18.8 million as non-current other receivable; £4.1 million as current other receivable, see 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 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 of USD43.5 million paid to GPS in respect of the gas plants had previously been 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.

GPS were not able to sell the plants within the stipulated period, and so the stage payments terms apply. During the years to 31 December 2009 and 2010, USD1 million and USD3.5 million were received from GPS respectively. A further USD3 million was received on 4 January 2011.

The first payment of USD10 million of the remaining USD30 million was due to be paid to the Group on 14 February 2011 but was not received. A cure period expired on 18 April 2011. In April 2011 the Board commissioned a desktop study of the plants by an independent third party, which included an estimate of value subject to certain assumptions and caveats. Having taken the foregoing into account, the Board considers that the plants are likely to be worth close to the USD30 million (approximately £19.4 million) receivable that remains outstanding under the agreement. The Group retains legal title to the plants until the final payment has been received from GPS, with whom negotiations continue.

An impairment charge of £3.9 million has been provided in the year ended to 31 December 2009 to reduce the carrying value of the original prepayments to their fair value, being the expected proceeds from the settlement.

No such charge has been made in the year to 31 December 2010 as the Directors consider that the remaining amounts are likely to be recovered. However, given the difficulties experienced to date in collecting the amounts due from GPS, and inherent uncertainty involved in estimating the value of the plants, this is judgemental.

(b) Impairment of E&E and PP&E

At 31 December 2010 the Group reviewed the carrying amounts of its PP&E and E&E assets to determine whether there is any indication that those assets have suffered an impairment loss. No indicators of non-recoverability of the carrying amounts of the above mentioned assets existed at the balance sheet date. The Directors believe that the Pokrovskoe exploration license which expires in August 2011 will be renewed for further five years.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

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

Impairments of £63.5 million were charged in 2009 to reduce the carrying values of the Group's goodwill, E&E assets and PP&E assets as required by IAS 36 Impairment of Assets and IFRS 6 Exploration for and Evaluation of Mineral Resources as a result of the significant downward revisions to the Group's Reserves and Resources estimates in the independent Reserves and Resources Evaluation received in early 2010 and poor test results on wells drilled to that date.

In addition to the impairment provided in 2009 against the Group's goodwill, E&E and PPE assets, further impairment charges of £23.8 million against the carrying value of certain assets were provided for in 2009 (see note 8). Refer to the 2009 Annual Financial Report for a detailed discussion of the assumptions made to calculate the various impairments in 2009. Also refer to notes 16, 17 and 20 for details of the carrying value of these assets.

(c) Reserves

Commercial Reserves are proven and probable ('2P') 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.

Although as at 31 December 2009 no 2P reserves were identified at Zagoryanska, subsequent to the issue of the 2009 Annual Financial Report, commercially recoverable gas was identified in that field.

The extension of the Pirkovskoe licence to 2015 was approved on 23 September 2010 by the Ministry of Ecology and Cadogan and the license was extended to November 2015.

(d) 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. Although £1.8 million of Ukrainian VAT was recovered in the year to 31 December 2010, largely through a bond scheme initiated by the Government of Ukraine, the Directors consider that this scheme was one-off in nature. Management anticipates no significant cash settlements of receivables from the State Budget.

The Group therefore 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 were uncertain as to the commercial viability of the Group's major fields and therefore believed it inappropriate to present these amounts as assets given the uncertainties surrounding the expectation for recovery, and impaired the Ukrainian VAT receivable of the Group in full. A provision of £12.2 million (2009: £14.0 million) against Ukrainian VAT receivable has thus been recognised as at 31 December 2010.

(e) 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 14. The financial position of the Group, its cash flow and liquidity position are described in the Financial Review on pages 9 and 10. In addition, note 3(c) provides details as to the basis on which the Directors have adopted the going concern basis of accounting in preparing the annual financial statements.

The following matter was previously disclosed as a critical accounting judgement but has now been resolved.

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

The Group was involved in legal proceedings, surrounding the validity of the Pirkovskoe and Zagoryanska licences challenged by Poltavanaftogasgeology ('PNGG'), a subsidiary of the Group's joint venture partner, NJSC Nadra Ukraine, a state-owned company ('Nadra'), in relation on previous possession of these licences.

With regard to these proceedings on 8 September 2010, the Group entered into a mutual settlement agreement with Nadra and PNGG, whereby PNGG and Nadra applied to the Higher Administrative Court (the 'Court') of Ukraine to withdraw the cases between them over the previous ownership of the licences for the Pirkovskoe and Zagoryanska fields and the Group also agreed to purchase five wells on the Zagoryanska licence area.

PNGG and Nadra applied to the Court to withdraw the cases on 13 September 2010. The Court approved the agreement and these applications on 14 October 2010 in respect of the Pirkovskoe licence and on 21 December 2010 in respect of the Zagoryanska licence. The sale and purchase agreements with Nadra to acquire the Zagoryanska 3 well and four additional wells, for a total outlay of USD3.2 million (£2.0 million) excluding VAT were executed on 2 December 2010 and on 24 December 2010 respectively. As a consequence the indirect challenges to the Group's licences at Pirkovskoe and Zagoryanska have now been withdrawn from the Court by Nadra.

5. Revenue

	2010 £'000	2009 £'000
Sale of hydrocarbon products	3,251	2,342
Investment revenue (note 12)	130	407
	3,381	2,749

Information about major customers

Included in revenues for the year ended 31 December 2010 are revenues of £1.7 million (2009: £1.3 million) which arose from sales to the Group's largest customer, which is the only customer that individually account for more than 10% of the Group's revenues.

6. Other operating income

	2010 £'000	2009 £'000
Out of court settlements	6,003	-
Net foreign exchange gains (restated - note 3(a))	1,622	4,641
	7,625	4,641

Out of court settlements represent £2.9 million received during the year from Smith Eurasia a former supplier to the Group and £3.1 million from the Group's former executives.

7. Business and geographical segments

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.

8. Reversal/(impairment) of oil and gas and other assets

	2010 £'000	2009 £'000
Goodwill	-	(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	(880)	(6,586)
Other receivables (note 4(a))	-	(3,925)
VAT recoverable (note 4(d))	1,488	(13,241)
Reversal/(impairment) of other assets	608	(23,752)
Total reversal/(impairment)	608	(87,251)

Refer to note 4(b) for further details on the various impairments recognised in the prior year.

The carrying value of inventory as at 31 December 2010 and 2009 has been impaired to reduce it to net realisable value (see note 19).

During the year £1.8 million of Ukrainian VAT was recovered through a one-off bond scheme initiated by the Government of Ukraine. The remaining recoverable balance as of 31 December 2010 of £12.2 million (2009: £13.2 million) has been impaired as the Directors are not certain that VAT recoverable in Ukraine previously recognised as an asset will actually be recovered (see note 20).

9. Profit/(loss) for the year

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

	2010 £'000	2009 £'000
Depreciation of property, plant and equipment	(1,217)	(1,112)
Loss on disposal of property, plant and equipment	(103)	(5,000)
Reversal/(impairment) (note 8)	608	(87,251)
Consultancy fees	-	(785)
Staff costs	(2,989)	(2,748)
Net foreign exchange gains	1,622	4,641

Consultancy fees in 2009 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 credit of £nil (2009: £0.8 million) relating to the reversal of equity-settled share-based payment transactions previously recognised.

In addition to the depreciation of PP&E of £1.2 million (2009: £1.1 million), in the year ended 31 December 2010, depreciation of £0.4 million (2009: £1.6 million) was capitalised to E&E assets being depreciation of tangible assets used in E&E activities.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

10. Auditor's remuneration

The analysis of auditor's remuneration is as follows:

	2010 £'000	2009 £'000
Audit fees		
Fees payable to the Company's auditor for the audit of the Company's annual accounts	110	174
Fees payable to the Company's auditor and their associates for the audit of the Company's subsidiaries pursuant to legislation	20	21
Total audit fees	130	195
Non-audit fees		
- Tax services	78	98
- Remuneration services	2	10
- Other services	15	26
Non-audit fees	95	134

11. Staff costs

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

	2010 Number	2009 Number
Executive Directors	2	3
Other employees	121	397
	123	400

Total number of employees at 31 December	117	153
	£'000	£'000
Their aggregate remuneration comprised:		
Wages and salaries	2,543	3,042
Termination agreement	-	120
Other pension costs	18	15
Social security costs	304	494
Share-based payments	-	(1,154)
	2,865	2,517

The termination payment in 2009 was made to a former Director of the Group under a termination compromise agreement.

Within wages and salaries, £0.5 million (2009: £0.4 million) relates to amounts paid to executive Directors for services rendered.

Included within wages and salaries, is £0.1 million (2009: £0.1 million) capitalised to intangible E&E assets and £0.1 million (2009: £0.1 million) capitalised to development and production assets.

12. Investment revenue

	2010 £'000	2009 £'000
Interest on bank deposits	130	407

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

13. Finance costs

	2010 £'000	2009 £'000
Unwinding of discount on decommissioning provision (note 23)	4	8

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.

14. Tax

	2010 £'000	2009 £'000
Current tax	48	241
Deferred tax (note 21)	(368)	(128)
	(320)	113

The Group's operations are conducted primarily outside the UK. The most appropriate tax rate for the Group is therefore considered to be 25% (2009: 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.

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

	2010 £'000	2010 %	2009 £'000	2009 %
Profit/(loss) before tax				
Continuing operations	531	100	(107,190)	100
Tax charge/(credit) at Ukraine corporation tax rate of 25%	133	25	(26,798)	25
Permanent differences	2,122	400	8,320	(8)
Foreign exchange on operating activities	(299)	(56)	227	-
Tax losses generated in the year not yet recognised	1,060	200	3,201	(3)
Other temporary differences	(1,529)	(288)	16,204	(14)
Utilisation of deferred tax asset not previously recognised on losses	(1,593)	(300)	(91)	-
Non-taxable income	(268)	(50)	(29)	-
Reversal of deferred tax liability due to impairment	-	-	(338)	-
Effect of different tax rates	(34)	(6)	(452)	-
Prior year adjustment	88	17	(131)	-
Tax (credit)/charge and effective tax rate for the year	(320)	(60)	113	-

15. Profit/(loss) per Ordinary share

Basic profit/(loss) per Ordinary share is calculated by dividing the net profit or loss for the year attributable to owners of the Company by the weighted average number of Ordinary shares outstanding during the year. The calculation of the basic and diluted profit/(loss) per share is based on the following data:

Profit/(loss) attributable to owners of the Company	2010 £'000	2009 £'000
Profit/(loss) for the purposes of basic profit/(loss) per share being net profit/(loss) attributable to owners of the Company	851	(107,303)
Number of shares	2010 Number '000	2009 Number '000
Weighted average number of Ordinary shares for the purposes of basic profit/(loss) per share	231,092	231,092
Effect of dilutive potential ordinary shares:		
Options and warrants outstanding (note 26)	5,076	-
Weighted average number of Ordinary shares for the purposes of diluted profit/(loss) per share	236,168	231,092
	2010 pence	2009 pence
Profit/(loss) per Ordinary share		
Basic	0.4	(46.4)
Diluted	0.4	(46.4)

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

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

16. Intangible exploration and evaluation assets

Cost	£'000
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 1 January 2010	55,599
Additions	4,397
Change in estimate of decommissioning assets (note 23)	(53)
Transfer to property, plant and equipment (note 17)	(21,029)
Exchange differences	2,002
At 31 December 2010	40,916
Impairment	
At 1 January 2009	-
Impairment charge (note 8)	56,379
Exchange differences	(780)
At 1 January 2010	55,599
Transfer to property, plant and equipment (note 17)	(20,669)
Exchange differences	2,002
At 31 December 2010	36,932
Carrying amount	
At 31 December 2010	3,984
At 31 December 2009	-

Refer to note 4(b) for a discussion of the impairment charge in the prior year.

Additions during the year include £0.4 million (2009: £1.6 million) of capitalised depreciation of development and production assets used in exploration and evaluation activities.

During the year one of the exploration fields of the Group has received a commercial hydrocarbons flow and the net of cost and accumulated impairment of £0.4 million (2009: £nil) of intangible exploration and evaluation costs have transferred to property, plant and equipment.

Within the carrying amount of intangible and exploration assets at 31 December 2010 £2.8 million (2009: £nil) relates to Pokrovskoe licence which expires in August 2011. The Group is taking all the necessary steps to extend this licence and expects the extension in August 2011.

17. Property, plant and equipment

	Other £'000	Development and production assets £'000	Total £'000 Cost
Cost			
At 1 January 2009	2,914	40,278	43,192
Additions	353	7,248	7,601
Transfer from intangible exploration and evaluation assets (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 1 January 2010	2,561	39,647	42,208
Additions	132	4,462	4,594
Transfer from intangible exploration and evaluation (note 16)	-	360	360
Transfer between property, plant and equipment	(23)	23	-
Change in estimate of decommissioning assets (note 23)	-	(259)	(259)
Disposals	(473)	(2,050)	(2,523)
Exchange differences	81	1,414	1,495
At 31 December 2010	2,278	43,597	45,875
Accumulated depreciation and impairment			
At 1 January 2009	678	3,447	4,125
Charge for the year	568	2,222	2,790
Impairment charge (note 8)	-	4,862	4,862
Disposals	(179)	(864)	(1,043)
Exchange differences	(72)	(463)	(535)
At 1 January 2010	995	9,204	10,199
Charge for the year	422	1,323	1,745
Disposals	(282)	(1,075)	(1,357)
Exchange differences	30	397	427
At 31 December 2010	1,165	9,849	11,014
Carrying amount			
At 31 December 2010	1,113	33,748	34,861
At 31 December 2009	1,566	30,443	32,009

Refer to note 4 (b) for a discussion of the impairment charge in prior year.

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For the year ended 31 December 2010 continued

18. Subsidiaries

The Company had investments in the following subsidiary undertakings as at 31 December 2010, 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	95	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	Holding Company
LLC Astroinvest-Energy	Ukraine	90	Exploration
OJSC AgroNaftoGasTechService	Ukraine	79.9	Construction services
LLC Mercor (see below)	Ukraine	100	Exploration
LLC Cadogan Ukraine	Ukraine	100	Corporate services
Cadogan Petroleum Holdings BV	Netherlands	100	Holding company
Cadogan Bitlyanske BV	Netherlands	100	Holding company
Cadogan Delta BV	Netherlands	100	Holding company

During the year ended 31 December 2010, the Directors decided to rationalise the Group structure both so as to reduce the number of legal entities inside Ukraine and also to replace the structure of multiple jurisdictions with one based on a series of sub-holding companies incorporated in the Netherlands for each licence area.

As part of this process, LLC Mercor, ('Mercor') a company which had investments in a suspended well in the Zagoryanska licence area, but which had in fact been dormant for several years, was put into bankruptcy on 22 September 2010. This bankruptcy was confirmed by the court on 15 February 2011. The company will be deconsolidated as at the date of liquidation.

Since 31 December 2010, as part of the same process, Colby Petroleum Ltd, Stickle Ltd and Usenco International Inc were put into either liquidation or dissolution, and Momentum Energy International Inc and Momentum Enterprises Inc were merged to form Cadogan Momentum Holdings Inc. The restructuring of the Group continues into 2011 (see note 31).

19. Inventories

	2010 £'000	2009 £'000
Cost	3,939	12,108
Impairment provision	(1,363)	(6,586)
Carrying amount	2,576	5,522

The impairment provision as at 31 December 2010 and 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

	2010 £'000	2009 £'000
Other receivables	-	18,835
	-	18,835

Trade and other receivables

	2010 £'000	2009 £'000
Other receivables	24,622	4,675
VAT recoverable	90	336
Prepayments	281	379
	24,993	5,390

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

Out of £24.6 million of other receivables £21.3 million as at 31 December 2010 (2009: amounts of £18.8 million and £4.1 million) represent receivables from a settlement agreement with GPS (note 4(a)). This amount is stated after impairment of £3.9 million incurred in 2009 representing the difference between the original prepayment and the amount receivable in accordance with the settlement.

Within the other receivables balance, £2.8 million (2009: £nil) relates to the accrued litigation income from settlement reached in December 2010 with the former Chief Executive of the Group, received in early 2011.

VAT recoverable from the Ukraine tax authorities is only expected to be recovered once significant production commences. As at 31 December 2010, the Directors are uncertain as to the timing of commencement of significant production from 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 £12.2 million (2009: £14.0 million) has thus been recognised as at 31 December 2010.

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 2010 of £23.5 million (2009: £30.5 million) comprise cash held by the Group and the Company. The Directors consider that the carrying amount of these assets approximates to their fair value.

Other financial assets

Other financial assets of £0.7 million (2009: £0.5 million) comprises £0.5 million (2009: £0.5 million) 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) and short-term deposit of £0.2 million (2009: £nil) which relates to the collateral for short-term borrowings.

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 2009	1,238
Deferred tax expense	210
Reversal of deferred tax liability due to impairment	(338)
Exchange differences	(137)
Liability as at 1 January 2010	973
Deferred tax expense	(368)
Exchange differences	30
Liability as at 31 December 2010	635

At 31 December 2010, temporary differences of £6.2 million (2009: £2.2 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.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010 continued

21. Deferred tax continued

At 31 December 2010, the Group had the following unused tax losses available for offset against future taxable profits:

	2010 £'000	2009 £'000
UK	1,605	4,712
USA	-	3,341
Ukraine	44,900	40,072
	46,505	48,125

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 £1.6 million (2009: £4.7 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.

Usenco International Inc was put into liquidation following 31 December 2010 as the result of which all unused tax losses will be forfeited.

Unused tax losses incurred by Ukraine subsidiaries, amount to £44.9 million (2009: £40.1 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 2009 or 2010, similar restrictions could be introduced in future periods. If such restrictions are introduced before the Ukraine companies become profitable, the accumulated tax losses in Ukraine at 31 December 2010 may potentially not be used.

There are further temporary differences arising on assets in Ukraine for which deferred tax assets of £9.8 million (2009: £12.2 million) have not been recognised due to the uncertainty of future recovery.

22. Other financial liabilities

Trade and other payables

	2010 £'000	2009 £'000
Trade creditors	2,615	4,035
Other taxes and social security	16	20
Other creditors and payables	226	227
Accruals	1,518	2,955
	4,375	7,237

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 58 days (2009: 38 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.

23. Provisions

	Decommissioning £'000	Other £'000	Total £'000
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 13)	8	-	8
Exchange differences	(97)	-	(97)
At 1 January 2010	844	30	874
Change in estimate (note 16 and 17)	(312)	-	(312)
Utilisation of provision	-	(18)	(18)
Unwinding of discount on decommissioning provision (note 13)	4	-	4
Exchange differences	30	-	30
At 31 December 2010	566	12	578
Included in long-term provisions	146	30	176
Included in current provisions	698	-	698
At 1 January 2010	844	30	874
Included in long-term provisions	281	12	293
Included in current provisions	285	-	285
At 31 December 2010	566	12	578

23. Provisions continued

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 £0.3 million (2009: £0.7 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

	2010		2009	
	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.

Issued equity share capital

	Ordinary shares of £0.03 Number
At 1 January 2009, 31 December 2009 and 2010	231,091,734

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 was 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 5.1 million warrant rights, to be exercisable at an average price of £0.82 and £1.23 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.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010 continued

26. Share-based payments continued

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 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 1 January 2010	5,713	0.82	-	-	5,713	0.82
Forfeited during the year	(5,713)	0.82	-	-	(5,713)	0.82
Outstanding at 31 December 2010	-	-	-	-	-	-
Exercisable at 1 January 2009 and 2010	5,713	0.82	-	-	5,713	0.82
31 December 2010	-	-	-	-	-	-

No share options were exercised or expired during the year (2009: 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 were 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.

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
	Tranche 1 '000	Tranche 2 '000	Tranche 3 '000	Tranche 1 '000	Tranche 2 '000	Tranche 3 '000	'000
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)
Outstanding at 1 January 2010	5,713	-	-	-	-	-	5,713
Forfeited during the year	(5,713)	-	-	-	-	-	(5,713)
Outstanding at 31 December 2010	-	-	-	-	-	-	-
Exercisable at 1 January 2009 and 1 January 2010	5,713	-	-	-	-	-	5,713
31 December 2010	-	-	-	-	-	-	-

26. Share-based payments continued

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 2010 is £nil (2009: £3.6 million), split respectively between the various tranches as follows: Option Tranche 1: £nil (2009: £3.6 million); Option Tranche 2: £nil (2009: £nil); Option Tranche 3: £nil (2009: £nil). Due to certain employees and Directors resigning from their duties to the Company in 2009, share options granted under Option Tranche 1 were forfeited during the year (2009: option tranches 2 and 3).

The Group recognised no expense in 2010 related to equity-settled share based payment transactions (2009: £1.2 million reversal). In 2010 £3.6 million (2009: £nil) previously recognised in other reserves in respect of the vested options that have expired during the year were transferred to retained earnings from other reserves.

Equity-settled performance share plan

Following the IPO of the Company on 23 June 2008, the Company implemented an equity-settled performance share plan ('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. 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 2009	2,522
Forfeited during the year	(1,674)
Outstanding at 1 January 2010	848
Forfeited during the year	(532)
Outstanding at 31 December 2010	316

No PSP awards were exercised or expired during the year (2009: nil) and no PSP awards are exercisable at 31 December 2010 (2009: nil).

The options outstanding at 31 December 2010 had a nil-cost exercise price, and a weighted average remaining contractual life of nine months (2009: 21 months).

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For the year ended 31 December 2010 continued

26. Share-based payments continued

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 £0.3 million (2009: £0.8 million).

The Group did not recognise any expense associated with these awards as the achievement of the performance conditions was not met (2009: £nil).

27. Notes to the cash flow statement

	2010 £'000	2009 £'000
Operating profit/(loss)	405	(107,589)
Adjustments for:		
Depreciation of property, plant and equipment	1,217	1,112
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	880	6,586
Impairment of VAT recoverable	(1,488)	13,241
Loss on disposal of property, plant and equipment	103	5,000
Share-based payments	-	(814)
Effect of foreign exchange rate changes	(59)	(1,693)
Operating cash flows before movements in working capital	1,058	(16,733)
Decrease/(increase) in inventories	2,066	(2,065)
Decrease/(increase) in receivables	44	(2,316)
(Decrease)/increase in payables and provisions	(2,862)	2,882
Increase in restricted cash	(219)	(450)
Cash used in operations	87	(18,682)
Income taxes paid	(65)	(270)
Net cash outflow from operating activities	22	(18,952)

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 2009.

The capital resources of the Group consists of cash and cash equivalents arising from equity attributable to owners of the Company, 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.

28. Financial instruments continued**Categories of financial instruments**

	2010 £'000	2009 £'000
Financial assets – loans and receivables (includes cash and cash equivalents)		
Cash and cash equivalents	23,545	30,505
Other financial assets (current and non-current)	669	450
Other receivables (current and non-current)	24,622	23,510
	48,836	54,465
Financial liabilities – measured at amortised cost		
Trade creditors	2,615	4,035
Short-term borrowing	240	-
Other creditors and payables	226	227
	3,081	4,262

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, except for the short-term borrowing of £0.2 million (2009: £nil), the Group is not exposed to any significant risks associated with fluctuations in interest rates on loans. A 5 per cent fluctuation in interest rates applied to cash balances held at the balance sheet date would impact the Group by approximately £1.2 million (2009: £1.6 million) over a 12 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.

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	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
US dollars ('USD')	63	490	39,272	24,214

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For the year ended 31 December 2010

28. Financial instruments continued

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 10 per cent change in foreign currency rates.

A positive number below indicates a decrease in profit where GBP strengthens 10 per cent against the USD. For a 10 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.

Inflation risk management

The following table details the Group's sensitivity to a 10 per cent decrease in the GBP against the USD.

	2010 £'000	2009 £'000
Income statement	(3,735)	(3,779)

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 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

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

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 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 except for the short-term borrowing with interest of 11.5% per annum.

29. Commitments and contingencies

Joint activity agreements

The Group has interests in nine 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 follows:

	2010 £'000	2009 £'000
Within one year	10,150	13,482
Between two and five years	44,932	32,944
	55,082	46,426

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 2010 and 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.

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 page 30.

A termination sum of £0.1 million was paid during the year to 31 December 2009 the Group's former Asset Development Director, Mr PA Biddlestone.

	Purchase of services		Amounts owing	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Short-term employee benefits	912	1,722	29	181
Share-based payments	-	(1,132)	-	-
Energy Services Group Ltd	-	125	-	-
Bridge Asset Management ⁽¹⁾	-	38	-	-
Lavruk T.V. ⁽¹⁾	-	57	-	-
Boechko R.A. ⁽¹⁾	-	11	-	6
Vivcharyk V.P. ⁽¹⁾	-	16	-	-
	912	837	29	187

(1) Not a related party at 31 December 2010.

The total remuneration of the highest paid Director was £0.4 million in the year (2009: £0.5 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, was then 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 in 2009, is a managing partner of Bridge Asset Management.

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.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2010

30. Related party transactions continued

Other related party transactions

The completeness of the disclosure of related party transactions for the year ended 31 December 2009 was affected by the investigations into alleged irregularities involving certain former Directors (refer to note 3(b)).

31. Events after the balance sheet date

Farm-out of Pokrovskoe and Zagoryanskoe licenses

On 13 April 2011, the Group has announced an agreement with Eni S.p.A ('Eni'), the major Italian integrated energy company, which will initially acquire 30 and 60 per cent interests in Pokrovskoe and Zagoryanskoe licenses respectively. The initial consideration will comprise 100 per cent funding of a Pokrovskoe work programme of approximately USD30 million (excluding VAT), including drilling and seismic reprocessing, plus a USD38 million payment for interest in Zagoryanskoe license. Subject to successful results from the above programmes and award of production licences, Eni will pay the Group further amounts of up to USD90 million.

GPS

The first payment of USD10 million of the remaining USD30 million was due to be paid to the Group on 14 February 2011 but was not received. A cure period expired on 18 April 2011. In April 2011 the Board commissioned a desktop study of the plants by an independent third party, which included an estimate of value subject to certain assumptions and caveats. Having taken the foregoing into account, the Board considers that the plants are likely to be worth close to the USD30 million (approximately £19.4 million) receivable that remains outstanding under the agreement. The Group retains legal title to the plants until the final payment has been received from GPS, with whom negotiations continue.

Group restructuring

As part of the ongoing restructuring of the Group (note 18), the following changes have taken place to the structure of the Group since 31 December 2010:

- > on 1 January 2011, Momentum Energy International Inc and Momentum Enterprises Inc, two sub-holding subsidiaries incorporated in Canada, were merged to form Cadogan Momentum Holdings Inc.;
- > Usenco International Inc (USA), and Colby Petroleum Limited (BVI) were put into liquidation;
- > Stickle Ltd (Isle of Man) began dissolution proceedings; and
- > three new Dutch subsidiaries, Cadogan Pokrovskoe BV, Cadogan Zagoryanska BV and Cadogan Pirkovskoe BV were incorporated as sub-holding companies for the licence activities in these respective areas.

Litigation

£2.8 million in cash and other assets were received in January and February 2011 under the terms of the settlement agreement with MC Tolley dated 17 December 2010.

Company Balance Sheet

As at 31 December 2010

	Notes	2010 £'000	2009 £'000
Assets			
Non-current assets			
Investments	34	-	-
Receivables from subsidiaries	35	72,437	61,330
		72,437	61,330
Current assets			
Trade and other receivables	35	38	32
Cash and cash equivalents	35	10,257	22,737
		10,295	22,769
Total assets		82,732	84,099
Liabilities			
Current liabilities			
Trade and other payables	36	(438)	(488)
Total liabilities		(438)	(488)
		82,294	83,611
Net assets			
Equity			
Share capital	37	6,933	6,933
Retained earnings	38	74,792	72,475
Share-based payment reserve	39	569	4,203
Total equity		82,294	83,611

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 21 April 2011.

They were signed on its behalf by:

Gordon Stein
Chief Financial Officer
21 April 2011

The notes on pages 66 to 68 form part of these financial statements.

Company Cash Flow Statement

For the year ended 31 December 2010

	Notes	2010 £'000	2009 £'000
Net cash outflow from operating activities	40	(1,422)	(1,893)
Investing activities			
Interest received		49	298
Loans to subsidiary companies		(11,107)	(20,886)
Net cash used in investing activities		(11,058)	(20,588)
Net decrease in cash and cash equivalents		(12,480)	(22,481)
Cash and cash equivalents at beginning of year		22,737	45,218
Cash and cash equivalents at end of year		10,257	22,737

Company Statement of Changes in Equity

For the year ended 31 December 2010

	Share capital £'000	Share premium account £'000	Retained earnings £'000	Share-based payment reserve £'000	Total £'000
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 1 January 2010	6,933	-	72,475	4,203	83,611
Share-based payment (note 39)	-	-	3,634	(3,634)	-
Net loss for the year	-	-	(1,317)	-	(1,317)
As at 31 December 2010	6,933	-	74,792	569	82,294

Notes to the Company Financial Statements

For the year ended 31 December 2010

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 reports a loss for the financial year ended 31 December 2010 of £1.3 million (2009: £169.3 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. Auditor's remuneration

The auditor's remuneration for audit and other services is disclosed in note 10 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 in 2009 (see note 8), the carrying value of the Company's investments in Ukraine subsidiaries was assessed for impairment. At 31 December 2009 the carrying value of the investments was impaired to £nil. No additional investments were made directly by the Company during 2010.

35. Financial assets

Receivables from subsidiaries

At the balance sheet date gross amounts receivable from the fellow Group companies were £236.7 million (2009: £225.6 million). As a result of the impairment losses provided by the Group in 2009 (see note 8), the carrying value of the Company's receivables from Ukraine subsidiaries was assessed. At 31 December 2009, an impairment loss of £164.3 million was provided reducing the carrying value of the receivables to £61.3 million. No additional impairment was recognised in 2010. The carrying value of the receivables from the fellow Group companies as at 31 December 2010 was £72.4 million. There are no past due receivables.

Trade and other receivables

	2010 £'000	2009 £'000
Other receivables	1	5
VAT recoverable	25	9
Prepayments	12	18
	38	32

The Company's principal financial assets are bank balances and cash and cash equivalents 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.

Cash and cash equivalents

Cash and cash equivalents 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

	2010 £'000	2009 £'000
Trade creditors	195	109
Other creditors and payables	243	379
	438	488

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 43 days (2009: 62 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.

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

	2010 £'000	2009 £'000
Operating loss from continuing operations	(1,351)	(169,532)
Adjustments for:		
Investment write down	-	4,145
Intercompany loan write down	-	164,346
Share-based payments	-	(815)
Operating cash flows before movements in working capital	(1,351)	(1,856)
(Increase)/Decrease in receivables	(6)	62
Increase/(Decrease) in payables	(50)	(99)
Cash used in operations	(1,407)	(1,893)
Income taxes paid	(15)	-
Net cash outflow from continuing operations	(1,422)	(1,893)

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

	2010 £'000	2009 £'000
Financial assets – loans and receivables (includes cash and cash equivalents)		
Cash and cash equivalents	10,257	22,737
Amounts due from subsidiaries	72,437	61,330
	82,694	84,067
Financial liabilities – measured at amortised cost		
Trade creditors	(195)	(109)
Other creditors and payables	(29)	(345)
	(224)	(454)

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 5 per cent fluctuation in interest rates applied to cash balances held at the balance sheet date would impact the Company by approximately £0.5 million (2009: £1.1 million) over a 12 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.

Notes to the Company Financial Statements

For the year ended 31 December 2010

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:

	2010 £'000	2009 £'000
Cadogan Petroleum Holdings Limited	72,437	61,330
	72,437	61,330

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 27 to 30.

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

	Purchase of services		Amounts owing	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Short-term employee benefits	766	1,222	29	155
Share-based payments	-	(1,132)	-	-
	766	90	29	155

The total remuneration of the highest paid Director was £0.4 million in the year (2009: £0.5 million).

Other related party transactions

The completeness of the disclosure of related party transactions for the year ended 31 December 2009 was affected by the investigations into alleged irregularities involving certain former Directors (refer to note 3(b)).

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
Visean	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

Recently, 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 2011/2012

Interim Management Statement
Annual General Meeting
Half Yearly Report
Interim Management Statement
Results announcement for 2011

May 2011
June 2011
August 2011
November 2011
April 2012

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