

Drillsearch

Mission Statement

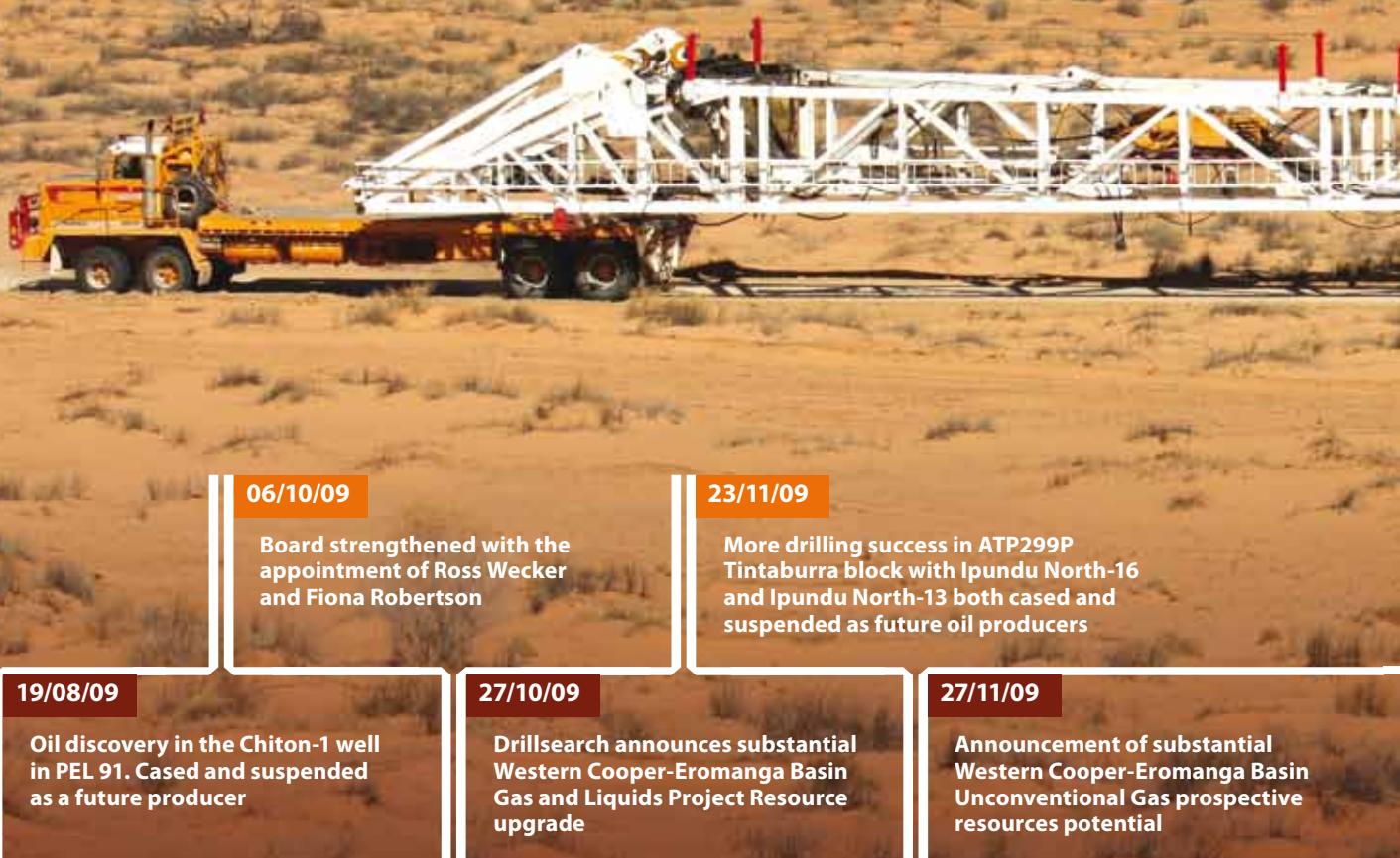
Drillsearch's strategic vision is to become the Cooper-Eromanga Basin's leading mid-tier oil and gas exploration and production company.

To achieve this vision we will:

- Explore our current Cooper-Eromanga Basin acreage for conventional oil & gas;
- Develop and commercialise our significant unconventional gas potential resource;
- Pursue attractive opportunities to expand our current Cooper-Eromanga Basin acreage either through the acquisition of assets directly or through friendly mergers.

AGM

Notice is hereby given that the Annual General Meeting will be held at the Museum of Sydney (AGL Theatre, level 2), Corner of Phillip and Bridge Streets, Sydney NSW on 23 November 2010, commencing at 10.00am.



19/08/09

Oil discovery in the Chiton-1 well in PEL 91. Cased and suspended as a future producer

06/10/09

Board strengthened with the appointment of Ross Wecker and Fiona Robertson

27/10/09

Drillsearch announces substantial Western Cooper-Eromanga Basin Gas and Liquids Project Resource upgrade

23/11/09

More drilling success in ATP299P Tintaburra block with Ipundu North-16 and Ipundu North-13 both cased and suspended as future oil producers

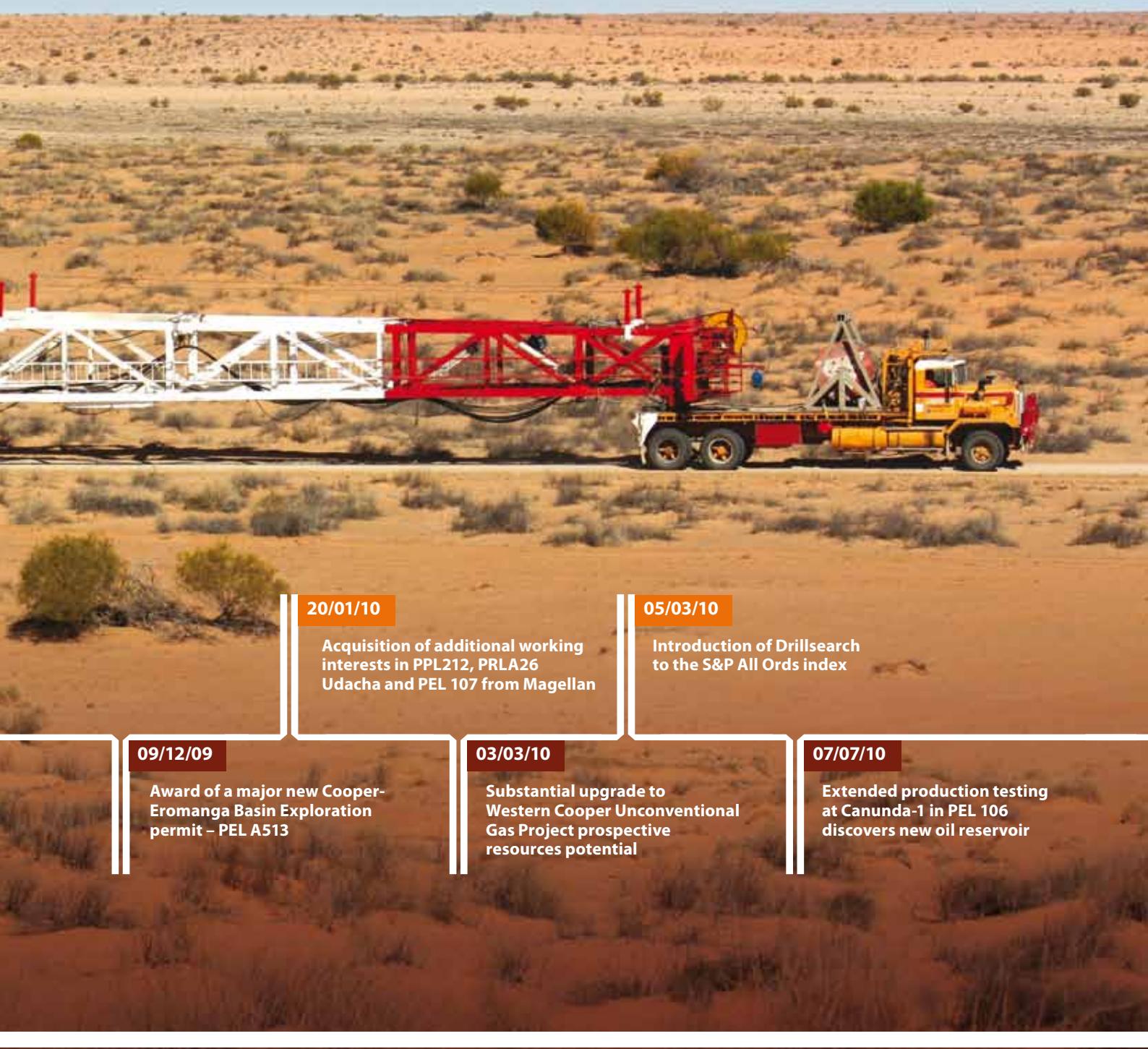
27/11/09

Announcement of substantial Western Cooper-Eromanga Basin Unconventional Gas prospective resources potential

Drillsearch

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Dear Shareholder,

Water

There is considerable irony in a continent as dry as Australia and after extensive drought conditions that we have so much water in the Cooper-Eromanga Basin that it headlines my Chairman's Report to you. But the reality is our progress this year has been materially impacted by the water on our primary area of operations and this has reduced our production, inhibited the sale of oil inventory and most significantly deferred a five well drilling program in our highly prospective PEL 91 permit. Whilst the flooding has had an impact on our field operations, it has not stopped us in developing our organisational capability and progressing to a bigger and better future.

Strategy

Our vision for the Company is to become a leading mid-tier oil and gas explorer and producer. To achieve this vision we need both scale and focus, in other words we want to be bigger so that we can develop the expertise to be a market leader and focus so that our expertise is not spread too thin.

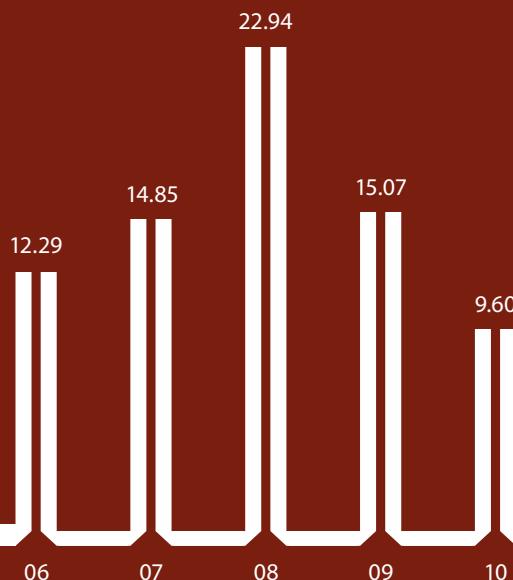
Consequently we have directed our focus on the Cooper-Eromanga Basin where we have built a tremendous asset base. Our approach to managing these assets, and in line with our desire to build expertise, has been to categorised our holdings into four key business areas: Mature Oil, New Oil, Wet Gas and Unconventional Gas. Each business has its own strategy, milestones and accountabilities. This approach has brought a clear focus and already we have seen a number of successes in each business. These successes are discussed further in the Managing Director's Report and Operational Report of this document.

Resources and Reserves

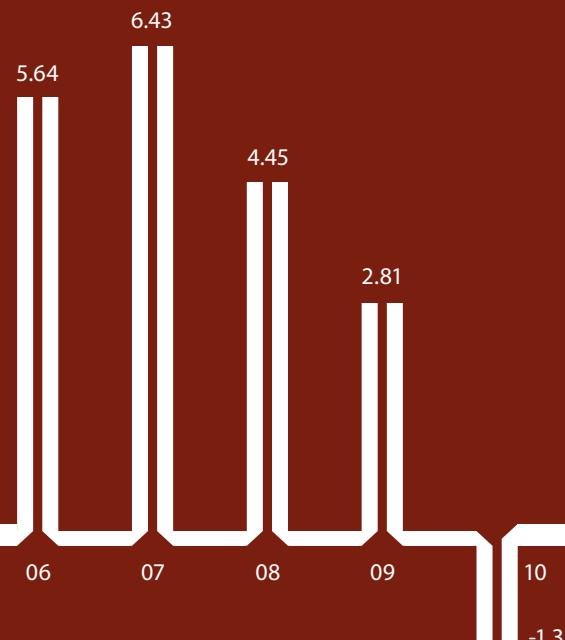
Considerable work was undertaken over the year to prove up our reserves and resources. Our reserves have decreased due to the divestment of our Canadian assets and our 2% interest in the Naccowlah Oil Field, in addition to natural decline in our other producing assets. Our 2C resources have however increased significantly over the year by 51%. This provides significant support to our underlying share value and confirms the Board's and management's belief in our strategy and the longer term potential of the Company.

The commercialisation of the Chiton-1 discovery in PEL 91 was very encouraging where we went from discovery to first oil in under six months. The deferred five well drilling program and the identification of 17 highly prospective targets is an absolute priority for us.

**Sales
(\$'m)**



**EBITDAX
(\$'m)**



Strong advancements in our Wet Gas exploration, appraisal, development and commercialisation initiatives were also encouraging. The extended production testing program for the Brownlow and Canunda Wet Gas discoveries provided exceptional results and additional testing was done on the Middleton and Udacha Wet Gas discoveries.

The disposal of our 79% shareholding in the Canadian listed Circumpacific Energy at a 100% premium to the recent trading price was a good result for the Company and confirms our focus on the Cooper-Eromanga Basin. Circumpacific's interest in eight exploration permits in South West Queensland, previously held jointly with the Company, have been bought out completely allowing us to focus on evaluating and developing this opportunity.

We have recently announced a proposed friendly merger with Innamincka Petroleum Limited which materially adds to our Cooper-Eromanga Basin focus, provides some experienced operational and technical people and further extends the scale of our operation.

People

The last year has seen stability in senior management with an increase in depth across all areas. Our technical team continues to strengthen as we build up resources to meet the many projects on foot. We have also strengthened the commercial and finance teams.

Organisation

An area of key concern to your Board has been building up the organisational capability of the Company to manage and execute on its strategies. Drillsearch has been an opportunity rich company and it is important that we now build our capability in terms of people, systems and culture, so that we can deliver on these opportunities.

Finance and Results

The Company reported a loss for the year of \$24.8 million (2009: \$9.5 million). This included an impairment charge of \$11.3 million which was primarily the result of a revaluation of the carrying value of the Tintaburra Block in which we have an 11% interest with Santos owning the balance.

During the year, your Company developed a capital management strategy and plan to ensure that we are able to fund our opportunities.

Corporate Governance

At the beginning of the financial year, the Company engaged a corporate governance expert to assist with developing and implementing a set of benchmark committee charters and company policies. I am pleased to report that good corporate governance is now part of our culture and continues to evolve as the organisation matures.

I take this opportunity to thank your Managing Director, Brad Lingo, for his vision and commitment during the past year, your executive team John Whaley (Chief Commercial Officer), David Evans (Chief Technical Officer), and Ian Bucknell (Chief Financial Officer and Company Secretary), their staff, consultants and the contribution of our partners.

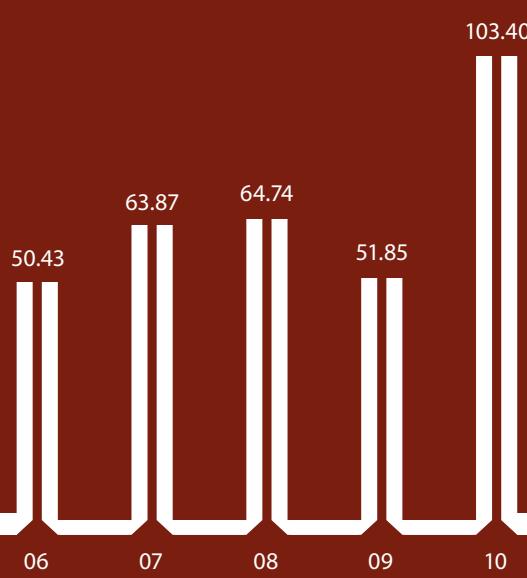
Finally, I would like to thank you, our shareholders for your strong support and belief in Drillsearch's vision and future direction.

We look forward to an exciting future.

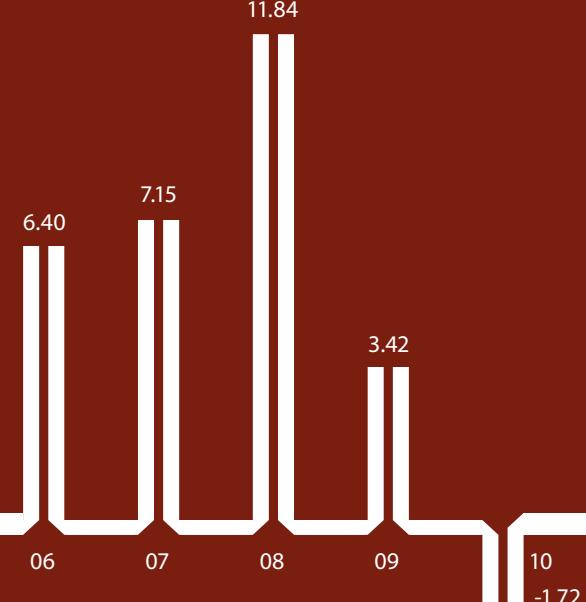


Jim McKerlie
Chairman

Market Capitalisation (\$'m)



Gross Profit (\$'m)



**WE AIM TO CREATE
SHAREHOLDER VALUE
BY HARNESSING
BOTH OUR FINANCIAL
AND HUMAN CAPITAL**

Established



Dear Shareholder,

After my first year as Managing Director of your Company, I am pleased to say that I am now more optimistic than ever as to our future prospects. Our focus over the year has been to single-mindedly deliver on our strategy. All of our activities have been guided by creating shareholder value through delivering on our strategy. We have acted to achieve a number of exciting operational successes across each of our core businesses, rationalised and enhanced our asset base and continued to build strong internal capabilities.

Vision and strategy remain consistent

Our vision and strategy remain consistent from when I wrote to you in our annual report last year. We aim to create shareholder value by harnessing both our financial and human capital to become the leading mid-tier oil and gas exploration and production company in the Cooper-Eromanga Basin. Our strategy is highly-focused and targeted at the realisation of this vision and is reflected as follows across our key business units:

- **Mature Oil** – lifting production and profitability across the board and as opportunities present expanding our ownership level of existing assets
- **New Oil** – executing an aggressive exploration program within our prime acreage position in the Western Flank Oil Fairway
- **Wet Gas** – the disciplined and determined development of our numerous discoveries towards commercialisation
- **Unconventional Resources** – the execution of systematic exploration and appraisal initiatives to expand on our existing resources base and then prove up these assets into independently validated commercial reserves

To us, strategy is not about what you say you are going to do, it's about doing what you say, it's about performance.

Why focus on the Cooper-Eromanga Basin?

Our decision to focus solely on the Cooper-Eromanga Basin is based on our view that it remains a highly prospective area for oil and gas exploration where profitable and rewarding investment can be made. Furthermore, we hold the largest acreage position of any company in this region and see huge growth potential over the longer term.

There are many reasons to be optimistic about the Cooper-Eromanga Basin. These include:

- The basin is a proven oil and gas province which has been a significant provider of Australia's energy needs for over 50 years
- The Cooper-Eromanga Basin remains significantly underexplored by industry standards and major advancements in drilling and seismic analysis have been scarcely utilised
- Exploration success rates in the region are very high, at over 50% following 3D seismic analysis
- Drilling costs are low given the basin is located onshore with easy access to equipment
- Access to infrastructure is excellent, meaning the path to commercialisation for successful discoveries is both short and inexpensive

The combination of these factors means the economic case for investing capital in exploration and development activities in the Cooper-Eromanga Basin is compelling. On our internal estimates, the payback period on our investment spend in our New Oil business is less than 1 year. The return on investment in our Wet Gas business takes longer to mature but is equally compelling.

The 3 P's are in place – people, projects and plan

I am confident that we have all the necessary pieces in place to successfully deliver on our strategy and create significant value for shareholders.

On the people front, we have enhanced our internal capabilities significantly over the past year. We have moved to aggressively bolster our in-house geo-technical capabilities with the expansion of our full-time technical staff from three at the end of June 2009 to seven at the end of June 2010. I believe this provides us with an excellent human resource platform to move forward and deliver on our ambitious but achievable strategic growth goals.

Additionally, our proposed merger with Innamincka will deliver a highly experienced and well regarded oil production operating team as well as some key additional geo-technical staff, whose talents will be valuable across not only our current assets but also on a wide range of other projects.

For a company the size of Drillsearch, our asset base and project portfolio opportunities are extraordinary. As noted, we are the largest acreage holder in the Cooper-Eromanga Basin. Within this region we hold the pre-eminent position in what I believe to be the most prospective area for oil and gas exploration, the Western Flank Oil Fairway. The Innamincka merger will significantly expand this position with PEL 182.

This prime acreage provides the basis for a highly-prospective, long-term exploration pipeline for Drillsearch over the next 5-10 years, and beyond. I firmly believe that these opportunities will in time, deliver excellent financial returns for shareholders.

I am convinced that we have the right strategic plan to maximise shareholder value over the longer term. This plan in itself is quite simple. The Cooper-Eromanga Basin is a highly prospective and underexplored region for oil and gas and we boast an unrivalled footprint within it. Therefore, the implementation of a focused plan to explore and develop this acreage using the skills of a highly qualified and experienced team is set to create value for our shareholders.

Operational highlights during 2010

On an operational front, 2010 was a very encouraging year. A number of successes were achieved which have strengthened my confidence in the quality of our asset base, the merits of our strategic plan and also my belief that this plan will deliver significant shareholder value.

First and foremost, I am very pleased with the way we have developed our assets through both organic and transactional means. Success in this area is best reflected in the significant increase in contingent resources upgrade for our wet gas discoveries and the discovered reserves at the Chiton Oil Field.

Secondly, I think that the discovery and commercialisation of our major oil discovery at Chiton-1 in PEL 91 is worth noting. After drilling this well in August 2009 we were able to achieve first oil by the end of January 2010. In addition, we approved a further five-well exploration program in PEL 91 to take place

later this year following up on this initial success in the Western Flank Oil Fairway. This highlights that we have the right team in place to not only make successful discoveries, but to also efficiently develop and commercialise them.

Most recently, a number of exciting advancements in our Wet Gas business have been made. Progress has occurred on exploration, appraisal, development and commercialisation fronts. During the year we have been able to progressively increase our Contingent Resources and with the recent testing program we have been able to announce independently audit reviewed contingent resources by Gaffney, Cline & Associates. Drillsearch now holds 2C resources of over 1.63 mmbbls of condensate, 45.4 BCF of sales gas and 201 thousand tonnes of LPG.

In May 2010 we announced the commencement of our extended production testing program for the Brownlow and Canunda Wet Gas discoveries in the Western Cooper Gas & Liquids Project area. The results of the test program were exceptional.

With Brownlow the extended production test achieved a maximum stabilised flow rate of 18.4 MMscf/day and over 250 BOPD of condensate. This demonstrated that Brownlow has both exceptionally good reservoir and 2C resources of 0.38 mmboe.

The results were even more exciting for the Canunda Wet Gas discovery. The extended production test commenced in late June and very quickly delivered both exciting and unexpected results with Canunda proving to be a very liquids rich discovery producing 180 bbls of condensate and light oil per MMscf.

The test ultimately had to be suspended because of insufficient oil production storage and transportation capacity, having in the first 10 days of the test produced over 2,500 bbls. The extended production test is continuing.

Also as part of the Brownlow and Canunda program, additional testing was done on the Middleton and Udacha Wet Gas discoveries. These tests confirmed that the discoveries respectively contain 2C Contingent Resources of 2.14 mmboe and 2.25 mmboe net to Drillsearch.

Strict focus on portfolio enhancement/rationalisation remains intact

We remain disciplined in our endeavours to both enhance and rationalise our asset portfolio. Drillsearch has an excellent footprint in the Cooper-Eromanga Basin and I consider our remaining assets located outside of this region as beyond the scope of our future strategic growth objectives. As a consequence, we will continually look to divest these assets as and when commercially viable opportunities materialise.

Results of our strict strategy in this area is evidenced by our actions over the past year. On the growth front, we have announced the exciting merger with Innamincka. The strategic and financial benefits of this transaction to Drillsearch are enormous. These include the following:

- Enhanced scale & diversification
- Unconventional resource opportunity
- Production operating capability
- Improved funding capacity

The acquisition also opens up a major new component to our Unconventional Resource business – Tight Oil with the Flax and Juniper oil discoveries which currently have gross 2P oil in place reserves of 31 mmbbls with a net 2P/2C oil-in-place to Drillsearch of 11.7 mmbbls. As with Unconventional Gas resources, technology is making leaps and bounds in opening up tight oil resources that were previously considered too difficult to produce – perfect examples of this are the explosion in the Bakken Oil Shale and the Cardium Tight Oil play in Western Canada.

On the divestment side, we have been equally busy. Recent action here has included the divestment of our stake in Circumpacific, along with our small interest in the Naccowlah block and also our interests in Papua New Guinea. Our rationale behind these divestments was that Drillsearch had ample commercial growth opportunities within its existing Cooper-Eromanga Basin located projects. Endeavours residing outside of this region were both unnecessary for the creation of shareholder value, as well as stretching the resources of our operational and management team.

Flood delays soon to subside

My only real frustration over the past year has been the historic flooding of the Cooper-Eromanga Basin. Flooding in this desert-like landscape is a highly unusual event. Scientists are making the most of the rare opportunity to view the influx of fauna and flora from this once-in-a-generation event.

Unfortunately, this flooding has been a less welcome event for us at Drillsearch. It has resulted in both a delay to our exploration program in PEL 91 and also a disruption to production from our Chiton-1 oil facility.

However, Drillsearch has remained active in the area despite these frustrating delays. We have taken action to mitigate the impact of this flood and also safeguard our assets from future flooding. We have finalised the construction of a new road which will provide us with enhanced access to both PEL 91 and our Chiton-1 facility. Importantly, this road was constructed on higher ground than our existing route, thus reducing the risk of flooding problems in future periods. The new road will enable early re-commencement of production from Chiton-1 and also the continuation of our drilling program in PEL 91 before the end of the 2010 calendar year.



Bird life at Coopers Bridge.

Well positioned in an uncertain global outlook

While the outlook for the global economy appears somewhat uncertain, I am comforted by the strength of our existing financial position and my view that this should mitigate the impact of any adverse developments or events.

The recent BP oil spill in the Gulf of Mexico is a tragic event which can only be described as an environmental disaster. I believe the flow on effects of this event could be both material and potentially long lasting. Importantly however, I do not see any likely developments from the disaster as having negative consequences for Drillsearch. The inevitable tightening of global oil supplies should have a positive impact on pricing levels and the potential wave of regulatory reform is likely to be restricted to the more environmentally risky off-shore oil and gas exploration projects meaning companies which only drill onshore, like Drillsearch, will remain unaffected.

Thank you

Finally, I would like to extend my sincere thanks for your continued support. As I have mentioned, I am very confident of the future success of your Company and I eagerly look forward to sharing in this exciting time with each of you.

Yours sincerely,

Brad W. Lingo
Managing Director



WE ARE THE
LARGEST ACREAGE
HOLDER IN
THE COOPER-
EROMANGA BASIN

Resilient

Table of tenements

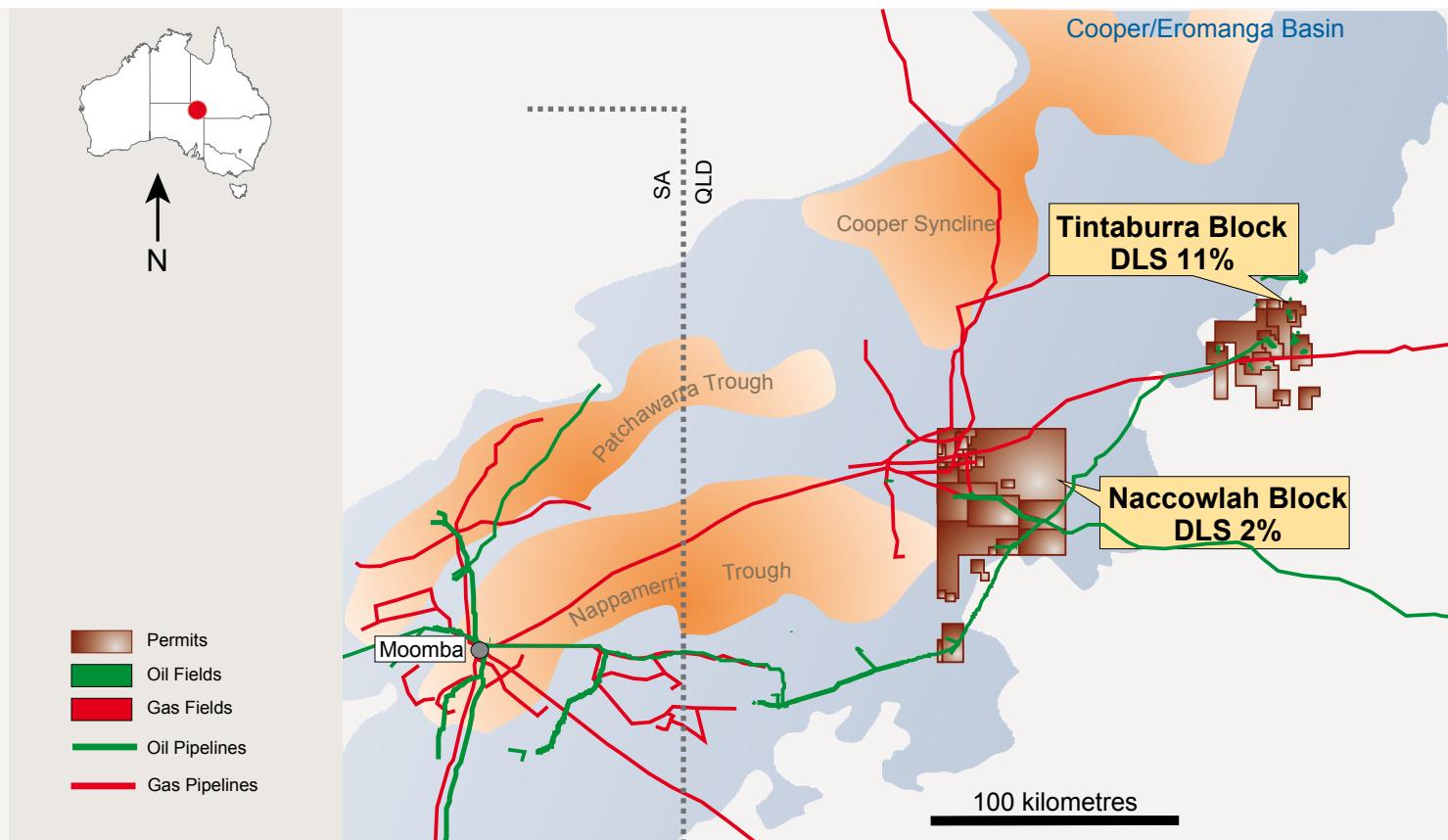
Drillsearch has four focused businesses. Below is a breakdown of the permits that are included in each business stream as at 30 June 2010. Note that some permits are included in more than one business stream.

Name of Joint Venture	Operator	Principal activity	Ownership interest	
			2010	2009
Mature Oil				
ATP 299P & PPL's (Tintaburra)	Santos Limited	Oil production	11%	11%
ATP 259P & PPL's (Naccowlah)	Santos Limited	Oil production	–	2%
PL 5 (Pickanjinnie)	Santos Limited	Gas production	75%	75%
New Oil				
PEL 91 (Cooper)	Beach Energy Limited	Exploration	60%	60%
ATP 539P (Eromanga)	Great Artesian Oil & Gas Ltd	Exploration	50%	100%
ATP 549P (West Block)	Icon Energy Limited	Exploration	25%	25%
ATP 549P (Cypress Block)	Australian Gasfield Limited	Exploration	40%	40%
ATP 783P (Chandos Block)	Drillsearch Energy Limited	Exploration	100%	100%
ATP 917P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 920P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 924P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 927P (Eromanga)	Drillsearch Energy Limited	Exploration	100%	100%
ATP 932P (Cooper)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 956P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 959P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
Wet Gas				
PEL 106A (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%*	100%
PEL 106B (Cooper)	Beach Energy Limited	Exploration	50%	50%
PEL 107 (Cooper)	Beach Energy Limited	Exploration	60%	40%
PELA 513 (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%	0%
PPL 212 (Cooper)	Beach Energy Limited	Oil production	60%	30%
Unconventional				
PEL 106A (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%*	100%
PEL 106B (Cooper)	Beach Energy Limited	Exploration	50%	50%
PEL 107 (Cooper)	Beach Energy Limited	Exploration	60%	40%
PELA 513 (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%	0%
ATP 940P (Cooper)	Circumpacific Energy Corporation	Exploration	100%	100%
Divestment				
VIC/P63 (Gippsland)	Great Artesian Oil & Gas Ltd	Exploration	100%	100%
VIC/P64 (Gippsland)	Great Artesian Oil & Gas Ltd	Exploration	100%	100%
T/46P (Gippsland)	Great Artesian Oil & Gas Ltd	Exploration	100%	100%
PPL 244 (Papua)	Talisman Oil Limited	Exploration	–	5%
Talbot Lake (Canada)	Drillsearch Energy (Canada) Inc.	Gas production	100%	100%
Talbot Lake (Canada)	Energy Venture Inc.	Gas production	25%	25%
Circumpacific Energy Corp	Various	Oil production	N/A	N/A
Circumpacific Energy Corp	Various	Gas production	N/A	N/A

Notes:

1. Drillsearch Energy (Canada) Inc. is a 100% owned subsidiary of Drillsearch Energy Limited.
2. Circumpacific Energy Corporation is a 79.37% owned subsidiary of Drillsearch Energy Limited.
3. Drillsearch announced the sale of Naccowlah to Bounty Oil on 16 August 2010.
4. Drillsearch has relinquished its interest in PPL244.

* Subject to farmin interests.



Mature Oil Business

Tintaburra Block – ATP 299P and associated PLs – (Drillsearch 11%)

Drillsearch owns 11% of the Santos operated Tintaburra Joint Venture (Santos Ltd 89%) which consists of a number of Production Licences (PLs) and the exploration licence ATP299P. The Tintaburra Joint Venture encompasses 13 developed oil fields with estimated 2P reserves of 7.1 MMbbls.

In November 2009, Drillsearch achieved drilling success at both the Ipundu-16 and Ipundu North-13 development wells in the Tintaburra Block. Both of these wells have been cased and suspended as future oil producers. Since these wells, further drilling has been deferred due to wet weather in the Cooper-Eromanga Basin.

The Tintaburra Joint Venture approved and recently completed the acquisition of 207km² of 3D seismic around the Tintaburra and Tooboonyah fields, completing 3D coverage over all the producing fields in the Tintaburra Joint Venture area at the beginning of July 2010.

The Tintaburra Joint Venture is undertaking a program of surface facility replacement to put idle wells back into production. In most instances these facility upgrades involve the replacement of non-operating progressive cavity pumps with either traditional beam pumps or linear rod pumps first trialed in the Tintaburra Block in 2009.

The Santos-operated Jackson-Moonie Crude Oil Pipeline (JMP) commenced decommissioning in April 2010 and through new transportation arrangements with Santos, Drillsearch has now commenced transporting all of its crude oil production from the Tintaburra Block Joint Venture areas through the Santos' Crude West pipelines system. As a result of the JMP decommissioning process Drillsearch recognised an accumulation of crude oil inventory in the JMP of approximately 58,000 bbls which has now effectively been evacuated and is in transit for sale.

Naccowlah Block – ATP 259P and associated PLs – (Drillsearch 2%)

Block activities have focused on completing and connecting recent discoveries for production, production optimisation and cost reduction in a low oil price environment.

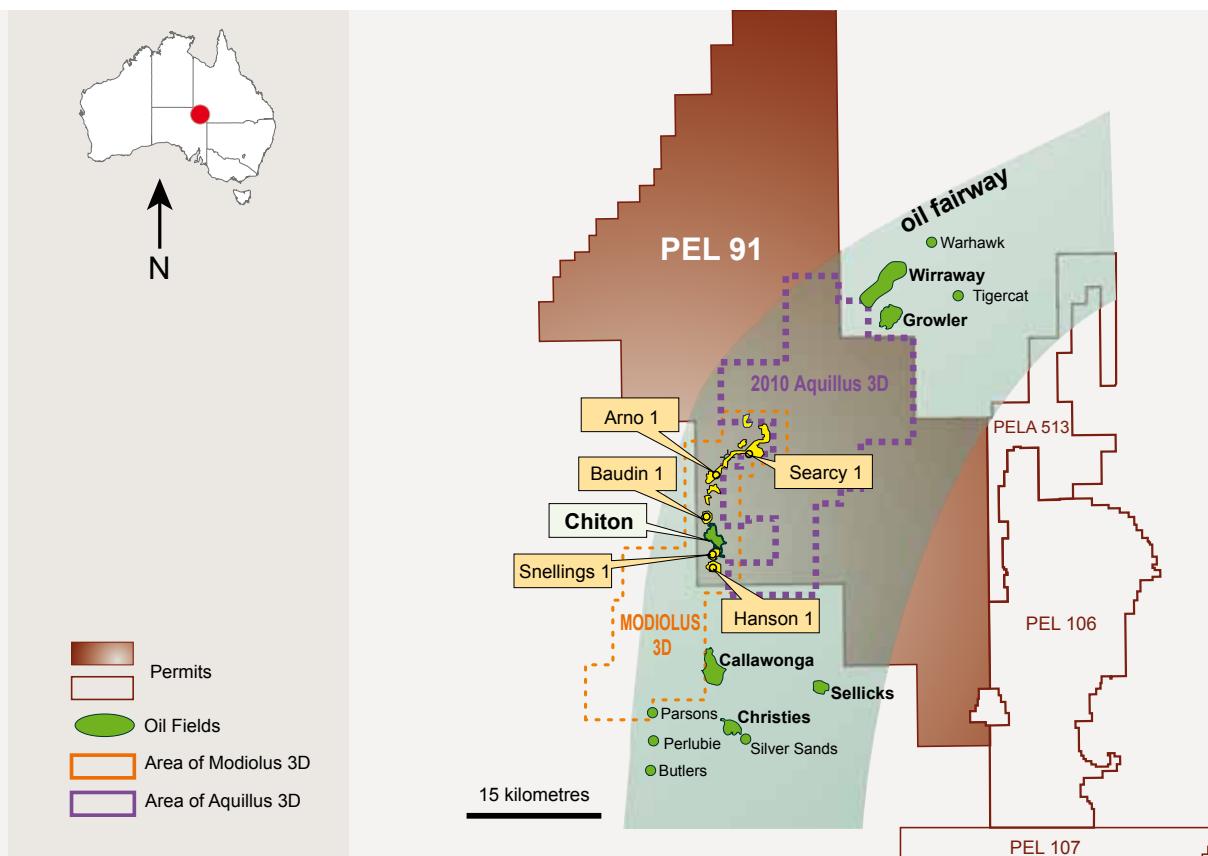
On 16 August 2010, the Company announced the sale of the Naccowlah Block (Drillsearch 2%) to Bounty Oil and Gas NL for \$1.15 million comprising \$950,000 in cash and \$200,000 in Bounty common stock.

New Oil Business

PEL 91 (Drillsearch 60%)

PEL 91 is a highly prospective oil prone block on the Western Flank, situated over and outside of the edge of the Cooper-Eromanga Basin.

Following the discovery of the Chiton Oil Field in August 2009, the Chiton-1 discovery well has been completed for production. Chiton-1 is the first commercial oil discovery in PEL 91 and the PEL 91 Joint Venture, Drillsearch (60%) and Beach (40%), has completed the design, construction and installation of early



production facilities capable of handling 7,000 bbls of fluids per day. The cost of the facility was \$1.7 million of which Drillsearch's share was approximately \$1 million. Chiton-1 has recoverable oil reserves of 80,000 barrels (P50) and up to 270,000 barrels (P10) net to Drillsearch.

Development of the Chiton discovery was a key foundation upon which to build and develop the company's Western Flank oil business. Successful completion of this initial development at the Chiton Oil Discovery had the potential to increase substantially the company's oil production over the year providing quick payback on the investment made in the Chiton and Marino PEL 91 exploration program. However after only a few days production the well had to be shut in due to flooding around the facilities. The PEL 91 Joint Venture has constructed a new Chiton road on more elevated topography to enable better access during any future flooding event. Production should be reinstated in the last quarter of 2010.

The PEL 91 Joint Venture approved a 434km² "Aquillus" 3D seismic survey which will address further exploration prospectivity in the block. The new survey will cover over 20 Namur sandstone oil prospects previously identified as well as potential prospective Birkhead Formation plays immediately south of the PEL 114/PEL 104 Wirraway, Growler and Snatcher oil discoveries. Seismic acquisition will commence when seismic crews are able to gain access to the area, expected to commence fourth quarter 2010. Like many operators in the region summer floodwaters from the Cooper Creek compounded by long lived and heavy winter rains are effecting operations.

Drillsearch announced early in July 2010 the planned drilling of five exploration wells in PEL 91 in the Western Flank Oil Fairway in South Australia. A four well drilling program in PEL 91

(Drillsearch 60%) originally planned for the second quarter 2010, had to be deferred like the 3D seismic because of extensive flooding. As such an additional well was added to the program within the previously acquired and interpreted 2008 3D Modiolis seismic survey area. The start date for the program will be dependent upon the extent of flooding in the region and rig availability but is expected to be January 2011.

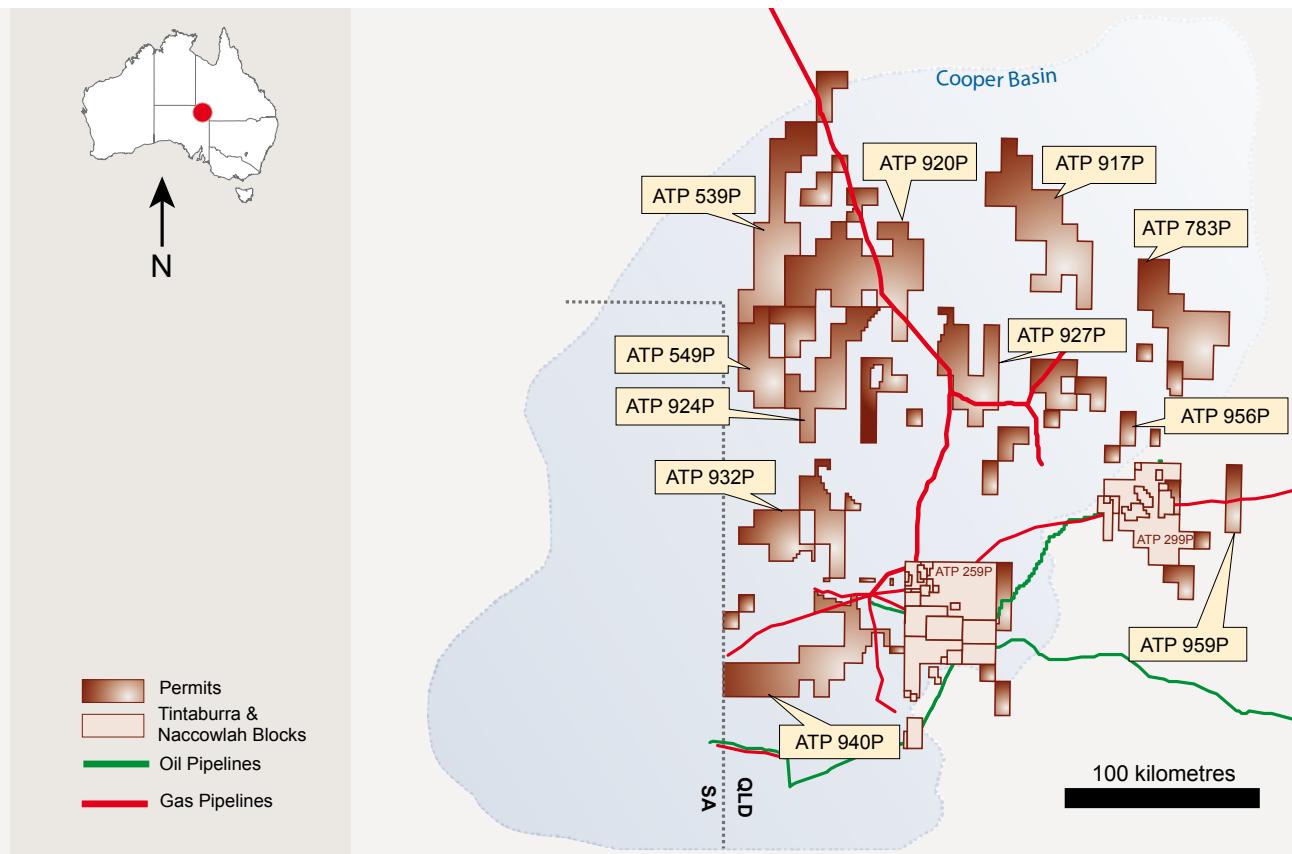
The five prospects are named Baudin, Hanson, Snellings, Arno and Searcy and target on a combined basis, a mean un-risked recoverable prospective oil resource potential of 3.5 mmbbls (operators estimate). However there is scope for significantly higher recoverable volumes.

A discovery in any of these prospects would add significantly to Drillsearch's reserves and overall production. Drillsearch is optimistic as to the likelihood of drilling success given the 50% historical success rate of exploration wells based on 3D seismic data in the region.

All of these prospects are in close proximity to the Chiton Oil Field and infrastructure, meaning any discovery could be commercialised quickly and would provide production cash flow to Drillsearch.

ATP 539P (Drillsearch 50%)

Bandanna Energy (50%) funded and drilled Planet Downs – 1 well in March 2009 as part of their farmin commitments. The well encountered minor oil shows in the Murta, Westbourne, Birkhead Formations and Hutton Sandstone. Drillsearch as operator is encouraged by this result and continues to review and incorporate these data into an extensive ongoing regional study. The future activity on the permit is likely to include 3D seismic acquisition in the medium term.



ATP 783P – Chandos Block (Drillsearch 100%)

The Chandos Block is currently under application awaiting completion of the Native Title – Right-to-Negotiate process. As part of a farmin agreement, Santos is managing the Native Title process and can earn an interest in the permit by funding 3D seismic acquisition and drilling.

South West Queensland Group Project (Drillsearch 50%; Circumpacific 50%)

In October 2007, Drillsearch and Circumpacific were announced successful tenderers for eight exploration application blocks and entered into a Joint Evaluation Agreement whereby each of Drillsearch and Circumpacific held a 50% interest in each block and Drillsearch was appointed operator.

Currently the blocks are undergoing the Native Title "Right-to-Negotiate process" and are progressing well. An important milestone achieved during 2010 was the granting of Environmental Authority's for each of the eight South West Queensland application Blocks.

All publicly available geologic and geophysical data continues to be compiled and input into a comprehensive assessment of the remaining petroleum prospectivity of the basin. This basin-wide study has been ongoing for the past 12 months as part of the joint evaluation activities to high-grade the eight application blocks and plan initial work programs including 3D seismic.

ATP 549P (West Block – Drillsearch 25%, Cypress Block – Drillsearch 40%)

An application for renewal over a reduced area was lodged on 30 March 2009 and granted on 25 August 2009. There has been limited activity on these blocks other than the input from the regional study noted above.

PPL 212 – Kiana Oilfield (Drillsearch 60%)

The Kiana oilfield produced 1,293 bbls during the financial year (July 2009-June 2010). This was 776 bbls more than the previous financial year. The projected production figures changed because our working interest has increased to 60%. However the field is nearing the end of its economic life. The remaining 2P reserves net to Drillsearch are 570 bbls.

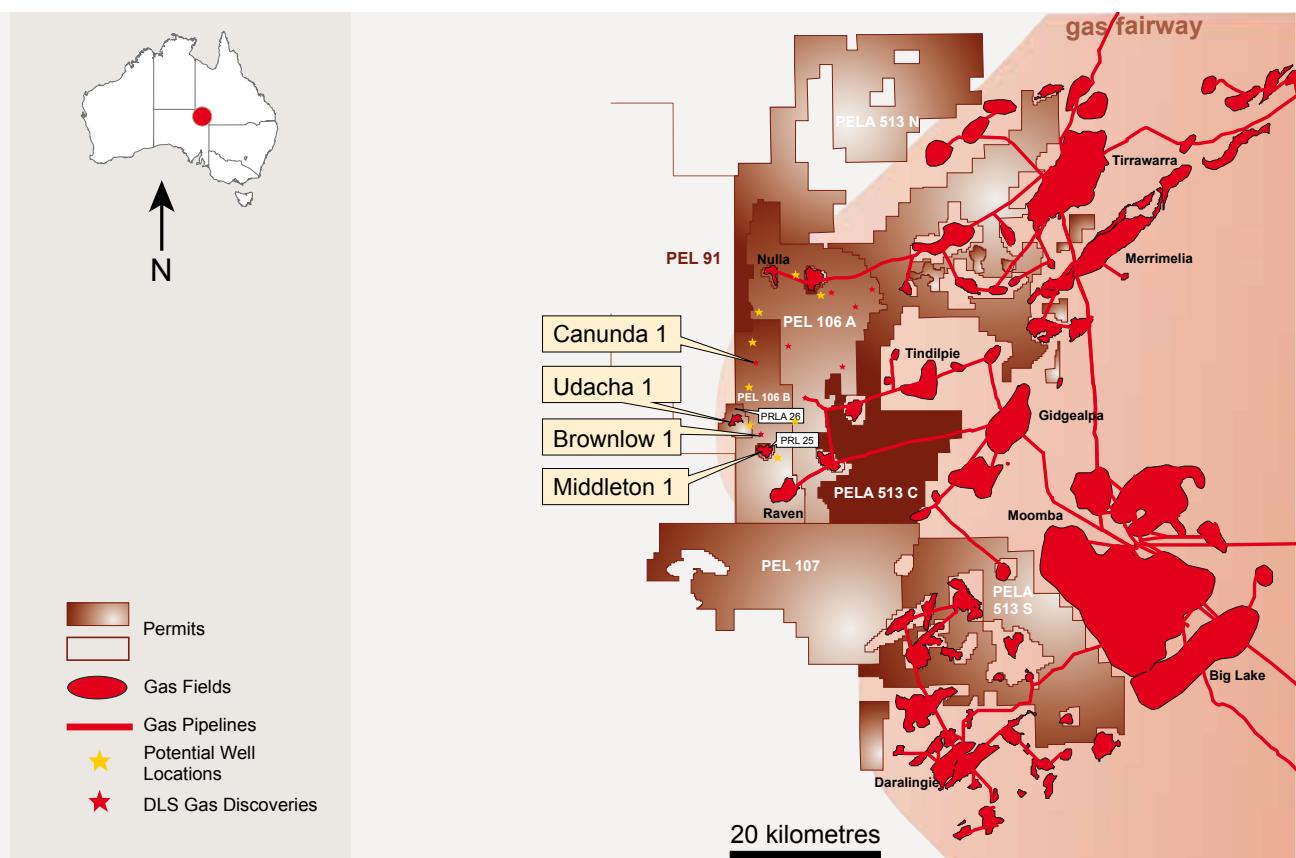
Wet Gas Business

PEL 106A (Drillsearch 100%) PEL 106B Beach Energy Farmin Block (Drillsearch 50%) PRL 25 Middleton (Drillsearch 50%) PRLA 26 Udacha (Drillsearch 75%)

Over the last few years there have been eight wet gas discoveries from twelve exploration wells within PEL 106. Four of these wells are within PEL 106B which is 50% owned and operated by Beach Energy.

On 27 October 2009, Drillsearch announced a major resource upgrade which was independently reviewed by Gaffney, Cline & Associates Pty Ltd (GCA) endorsing Company estimates of gross contingent resources which marks an important milestone on the path towards commercialisation. The GCA Report has provided the company with independent confirmation of the discovered gas and liquids resources and the additional low risk exploration potential within PEL 106. The review has assisted Drillsearch in formulating an exploration and development plan for the project. This plan can be broken down into three main components:

- **Extended Production Testing of Existing Discoveries:** This ongoing appraisal program involved the extended production testing (EPT) of the Brownlow and Canunda gas



discoveries in the PEL 106B. In addition, further static pressure data was acquired in the Middleton and Udacha discoveries. The EPT of the Canunda gas discovery is not yet complete having been delayed by recent rains. Data from the partly completed testing of Canunda and the completed testing of Brownlow, Middleton and Udacha are being evaluated and have been incorporated into revised resource estimates.

- Gas and Liquids Marketing:** Drillsearch holds the gas marketing rights for the Western Cooper Gas and Liquid Project (WCGL Project) for PEL 106A, PEL 106B, PRL 25 and PRLA 26. Drillsearch has previously successfully negotiated gas sales to the South Australian Cooper Basin Joint Venture (SACBJV) from the Smegsy Gas Field and connection to the Joint Venture pipeline system. Drillsearch has initiated preliminary discussions with the SACBJV seeking to secure similar arrangements and confidential discussions are ongoing. The Company is also evaluating other options including independent liquids stripping and small scale LNG production.
- Additional Exploration and Appraisal Drilling:** Drillsearch is currently assessing in conjunction with Beach Energy the next steps in exploration and appraisal drilling required in PEL 106 over the next 12 months. Ideally, the Company believes that a multi well program should be implemented to establish additional Contingent Resources to underpin the WCGL Project.

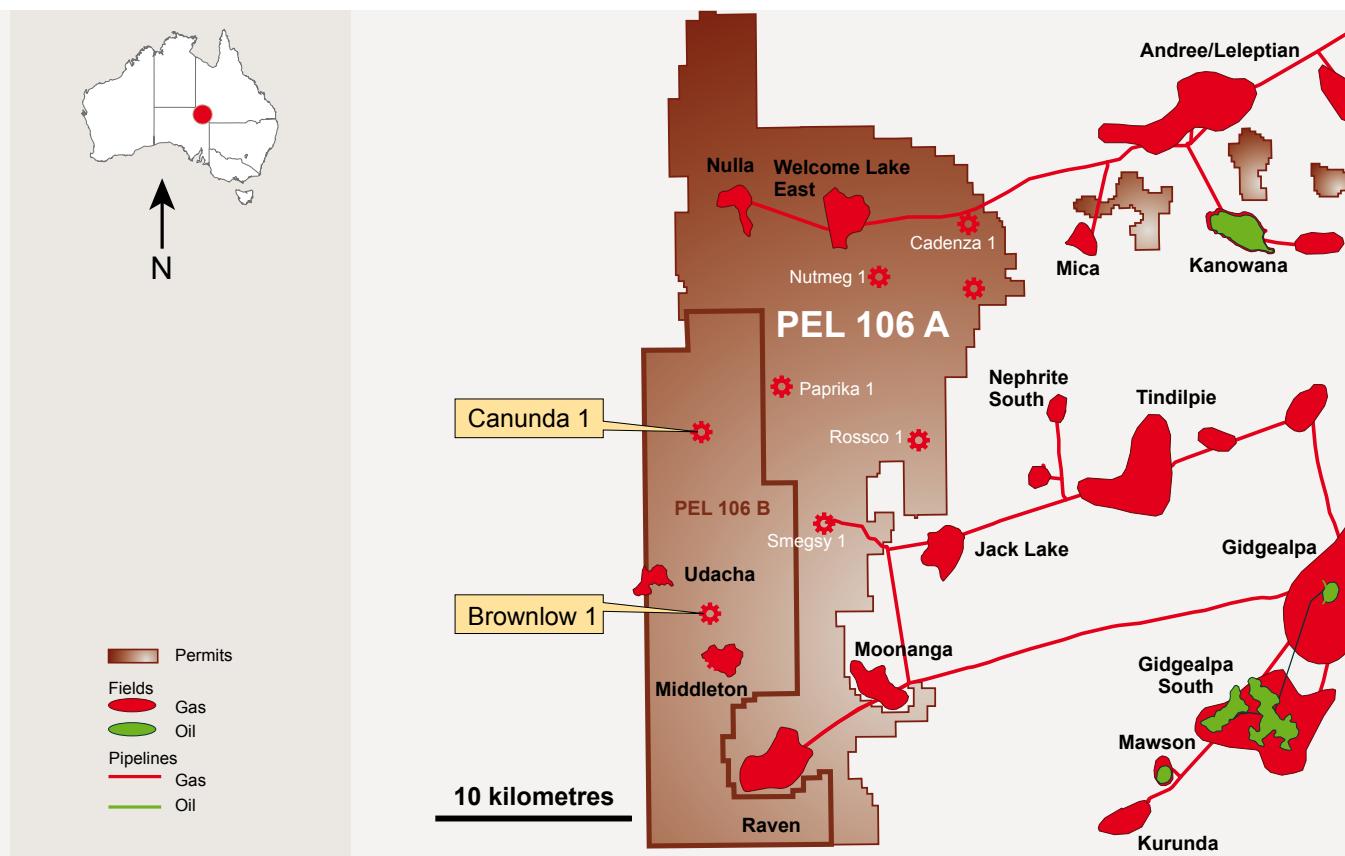
In September 2010, Gaffney Cline and Associates (GCA) were commissioned to provide a third party independent review of the contingent and prospective resources within PEL 106A and PEL 106B which incorporated the recent extended production test data.

GCA have categorised these resources as Contingent Resources because development is contingent upon obtaining sales agreements and a committed development plan. When these are in place GCA expects to categorise the relevant fields as Reserves. Table on page 14 summarises Drillsearch's share of the Contingent Resources reported by GCA.

The Brownlow production test achieved a peak test rate of 18.1 million cubic feet of gas per day through a 1-inch choke. On an energy equivalent basis, this production rate is equal to over 2,350 barrels of oil equivalent per day after accounting for CO₂ content. Condensate production was approximately 10 bbls per million cubic feet of gas.

The production test rate from Brownlow is equal to the highest production test rates historically achieved in the South Australian Cooper-Eromanga Basin. This flow rate is equivalent to the flow rates achieved by some of the biggest fields in the South Australian Cooper-Eromanga Basin including the Moomba, Big Lake, Della, Toolache and Strzelecki Gas Fields.

Initial production rates from Canunda reached as high as 800 bbl/d of liquids. Testing of the well was choked back to a 12/64" choke producing 1 MMscfd of gas and 180 bbl/d of liquids at a stabilised rate with no water production and minor reservoir pressure depletion. Due to heavy winter rains, limitations on liquids storage at the well site and available trucking to transport the condensate and light oil to Moomba for sale, the well has been temporarily shut in. Over the 10 day testing of the upper zone, the Canunda well produced over 2500 bbls of condensate and light oil.



In early March Gaffney, Cline & Associates delivered a high level screening study of independent development options for commercialising the Company's multiple Wet Gas discoveries in PEL 106. This has now been reviewed. As a result, the Company will be undertaking further work examining two of the options in more detail: independent liquids stripping and small scale LNG production.

PEL 106 Contingent Resources by Field – Drillsearch's Net Working Interest as at 30 June 2010

	mmboe		
	1C	2C	3C
Brownlow	0.18	0.38	1.83
Canunda	0.91	3.38	10.35
Middleton	0.64	2.14	3.95
Udacha	0.43	2.25	6.17
Paprika	0.77	1.59	3.15
Rosco	0.14	0.29	0.55
Smegsy	0.35	0.91	1.96
Cadenza	0.25	0.59	1.28
Total	3.66	11.52	29.24

PEL 106 Contingent Resources by Product – Drillsearch's Net Working Interests as at 30 June 2010

	1C	2C	3C
Sales gas (bcf)	14.35	45.38	114.6
Condensate (MMBbl)	0.59	1.63	3.91
LPG (ktonnes)	58.7	201.2	539.5

PELA 513 (Drillsearch 100%)

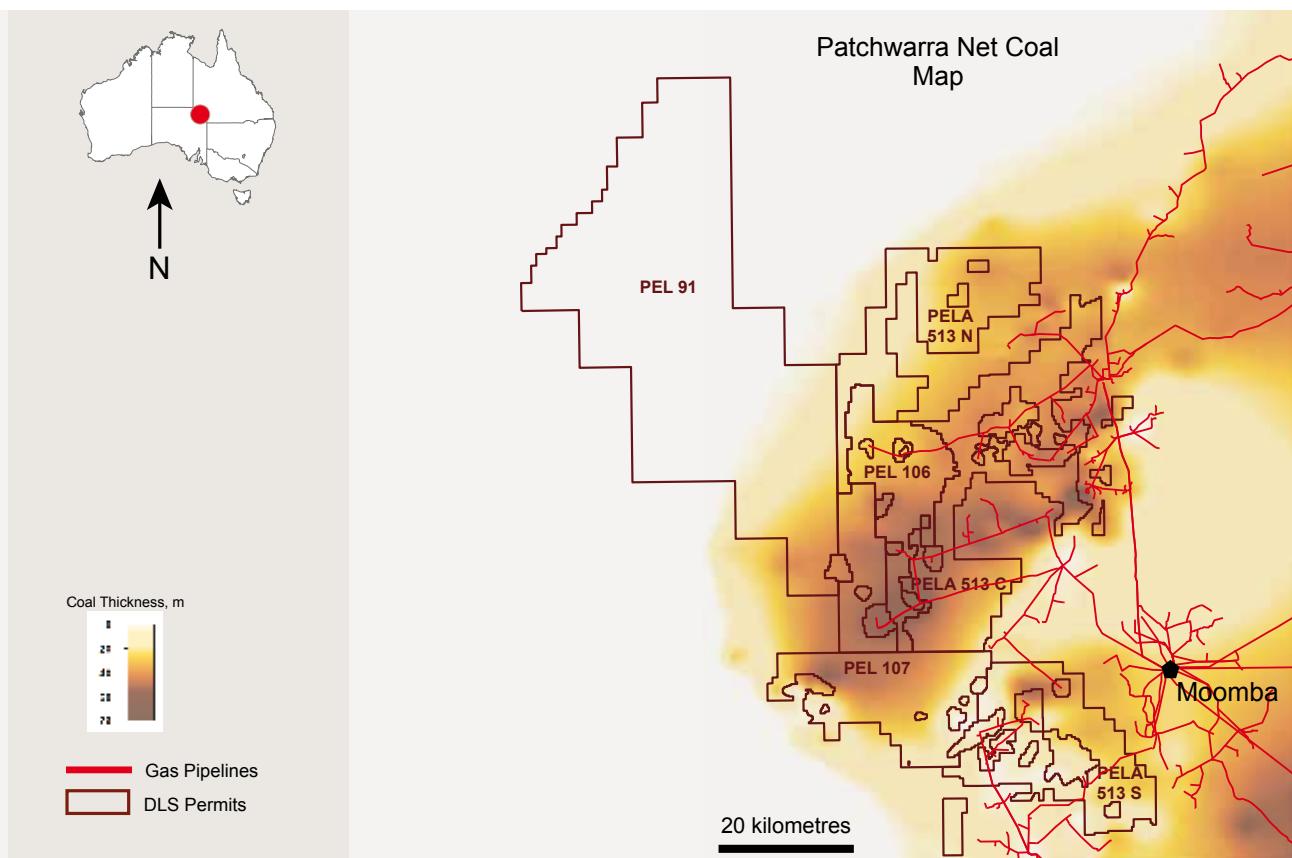
On 9 December 2009, Drillsearch announced that it had been awarded a major new exploration permit by the Government of South Australia, being PELA 513 (previously referred to as CO-2009 Block B). PELA 513 is an excellent strategic fit with Drillsearch's existing position in the Western Cooper-Eromanga Basin. It covers portions of the Western Flank Oil, the Wet Gas and Unconventional Gas play fairways that Drillsearch has outlined.

The permit will be issued once native title agreements are finalised.

For management purposes the block has been split into three parts, 513 North, 513 Central and 513 South. In the next 12 months the focus will be on reviewing existing 3D seismic in the 513 South area and planning infill 3D seismic in the 513 Central area to tie in with the existing Spinel 3D survey and other 3D seismic in the area. New wells will be drilled in the second year of the permit.

PEL 107 (Drillsearch 60%)

PEL 107 was renewed effective 2 December 2008 for a final five year term expiring 1 December 2013. The permit area was reduced by 50% as part of the renewal process. Mapping of conventional and unconventional leads and prospects continues to be undertaken across the permit working up similar play concepts to PEL 106.



Unconventional Business

Drillsearch has two key unconventional petroleum areas being:

- Western Cooper unconventional deep coal seam gas project, and
- Central Cooper shale gas play.

The Western Cooper Unconventional project area covers Drillsearch's permit holdings in PEL 106, 107, 91 and the newly awarded PELA 513 – North, South and Central Blocks. These permit holdings cover an extensive, contiguous area in the Western Cooper-Eromanga Basin covering a core resource prospective project area of 2,805km² (693,100 acres). Drillsearch has greater than 50% ownership interests and operates a substantial part of this area.

An independent review was conducted by MBA Petroleum Consultants of the resource potential of the Western Cooper Unconventional Gas Project who delivered their report in March 2010 (MBA Report). The MBA Report details estimates of gross Deep Coal Seam Gas-in-Place of 40 Tcf and confirms gross prospective resource potential of between 10 and 20 Tcf. This estimate is based on the analysis of 450 conventional oil and gas well logs to identify the presence and distribution of

suitable Permian and Triassic coals throughout the project area. The Report covers a detailed review of the Patchwarra, Epsilon, Daralingie, Toolachee and Poolowanna Formations.

It should be noted that these figures do not include the additional impact of the recently awarded PEL A 513 permit. Regardless, these results are very encouraging for Drillsearch. To put the scale of this in perspective, around 2 TCF is sufficient to supply one 1.5m tonnes per annum (tpa) LNG plant for 20 years.

Through its conventional exploration activity in PELs 106, 107 and 91 which includes extensive 2D and 3D seismic coverage and exploration well coverage, Drillsearch has confirmed the presence of thick extensive Permian coal seams which have demonstrated significant gas readings while drilling.

To establish the commerciality of this resource the Company has engaged MBA to assist it in the development of a detailed forward work program covering the next 2 years, designed to take the unconventional gas resources from Prospective to Contingent Resources and with positive technical outcomes into commercial Reserves. The Company is of the view that there is a lot of work that needs to be done to establish this Prospective Resource as a commercially viable project.

Western Cooper Deep Coal Seam Gas Project Prospective Resources*

Consolidated	Project Area (km ²)	Net Coal Thickness (m)	Net Coal to Formation Ratio	Gas-in-Place (TCF)	Prospective Resource (TCF)
New Estimate	2805	Up to 63	Up to 14%	39.9	9.9 to 19.9
Nov 2009	780	16 to >48	–	10.9	2.7 to 5.4

* Source: MBA Petroleum Consultants Western Cooper-Eromanga Basin Coal Seam Gas Gas-in-Place & Prospective Resource Estimate. Prospective Resource range based on 25-50% recovery factors. The Nov 2009 Prospective Resource estimate only determined resource potential for Patchwarra Formation coal seams and did not include PEL A 513.

Adjacent operators have demonstrated that the gas in these thick deep coal seams is moveable and capable of being produced to surface through the use of artificial fracture stimulation. During 2011 the primary focus will be on designing an unconventional (coal) coring program that can be integrated with the next phase of conventional exploration, appraisal and development drilling in the Western Cooper Gas & Liquids Project area in PEL 106.

Drillsearch continues to plan to incorporate additional data collection and testing of the coals to assess gas deliverability as part of any conventional drilling program in the area.

The Central Cooper shale gas play is based around 2,800 km² permit holding in the Nappamerri Trough which has been identified as highly prospective for shale gas by Beach who are currently drilling close by in the Nappamerri Trough to evaluate the play.

Divestment Assets

Gippsland Basin

VIC/P63, VIC/P64, T/46P (Drillsearch 100%)

Interpretation of the more than 4,000km of 2D seismic data, reprocessed by Drillsearch, was completed during the June quarter 2009. A number of structural and stratigraphic prospects have been identified on the southern margin of the Gippsland Basin which the Company believes is a focus for hydrocarbons migrating out of the main source area immediately to the north. Prospective Resource estimates range from 10-50 mmbbls in the structural traps to almost a billion barrels in the largest stratigraphic trap.

Planning, acquisition and processing of the 1,864km Furneaux 2D seismic survey data was completed during the year. In addition a licence variation has been agreed to with the authorities that moves the commitment well into year 6, 2013.

Drillsearch continues to actively market the play fairway covered by the permits both locally and internationally.

PPL 244 (Drillsearch 5%)

Drillsearch has withdrawn from its 5% interest in offshore Papua New Guinea (PNG) Papuan Basin licence PPL 244 which currently expires in February 2011, as it is non core to Drillsearch's strategy. The outstanding commitments are currently being finalised through agreement with Oil Search, the operator, and the PNG Government.

Naccowlah Block – ATP 259P and associated PLs – (Drillsearch 2%)

Drillsearch has agreed to sell its 2% Naccowlah Block Joint Venture interest and associated exploration permit ATP 259P and production licences to Bounty Oil and Gas Limited (Bounty) for \$1.15 million comprised of \$950,000 in cash and \$200,000 in Bounty securities. The Naccowlah Block Joint Venture is owned by Santos Ltd (Santos) (55.5%) as operator, Beach Energy Ltd (Beach) (38.5%), IOR Energy Pty Ltd (2%), Energy World Corporation Ltd (2%) and Drillsearch (2%).

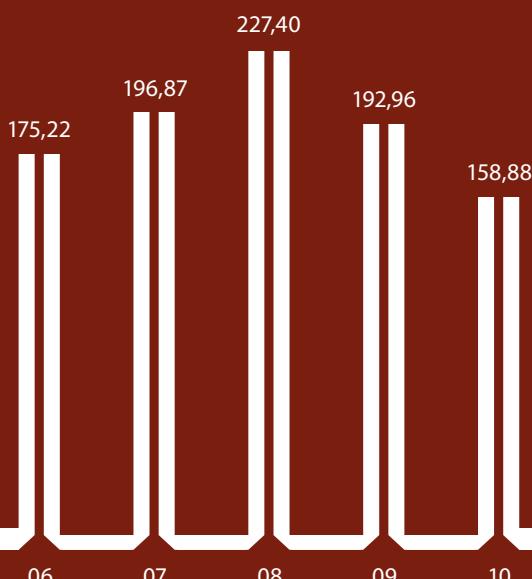
The sale is subject to completion of certain limited documentation conditions. Bounty has paid Drillsearch a non-refundable deposit of \$105,000. The effective date of the purchase was 1 April 2010.

Drillsearch's decision to sell the 2% interest in Naccowlah was due to the minority interest and its intention to focus on the production from its more meaningful 11% interest in Tintaburra.

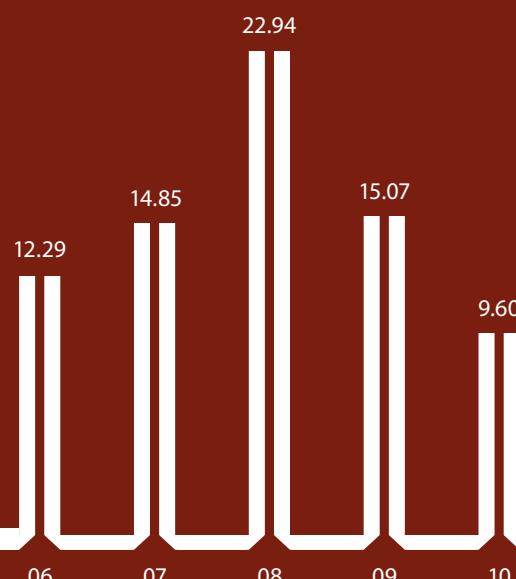
Western Canada Sedimentary Basin

Drillsearch's interest in Canada are held through its subsidiaries Circumpacific Energy Corporation (79.37%) and Drillsearch Energy (Canada) Inc (100%). Circumpacific holds a large suite of production and development interests in the Western Canada Sedimentary Basin. No new seismic or drilling was undertaken during this financial year.

**Net production
(boe)**



**Revenue
(\$'m)**



Circumpacific Energy Corporation (79.37%)

Circumpacific has entered into an Arrangement Agreement to be acquired by Western Petroleum Commodities Inc. following completion of the Arrangement Drillsearch has agreed to purchase Circumpacific's Joint Venture interest in eight exploration tenements in South West Queensland, Australia.

For full details of the activities conducted see the Circumpacific Annual Report which can be obtained from www.circumpacific.com.

Petroleum Sales and Revenues

Drillsearch's Group sales volumes for the Financial Year 2010 were 134,948 boe (2009: 173,737 boe), with Australian sales contributing 72,249 boe (2009: 103,425 boe) and Canada 62,699 boe (2009: 70,312 boe).

Reserves

A re-evaluation of reserves at Tintaburra, Naccowlah and Kiana, resulted in a reduction in the estimated original oil in place with a consequent fall in estimated reserves.

Competent Person Statement

Information on the Reserves and Resources in this report is based on information provided by Joint Venture Operators and compiled by Mr David Evans, Chief Technical Officer and a full time employee of Drillsearch who has given his consent as of the date of this report to the inclusion of this statement and the information in the form and the context in which they appear in this release.

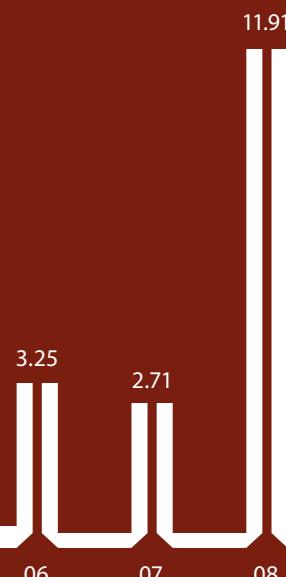
Cash & cash equivalent

Although year on year cash has fallen, Drillsearch cash balance as at 30 June 2010 was \$6.52 million (2009: \$8.14 million) and compares favourably with earlier year cash positions.

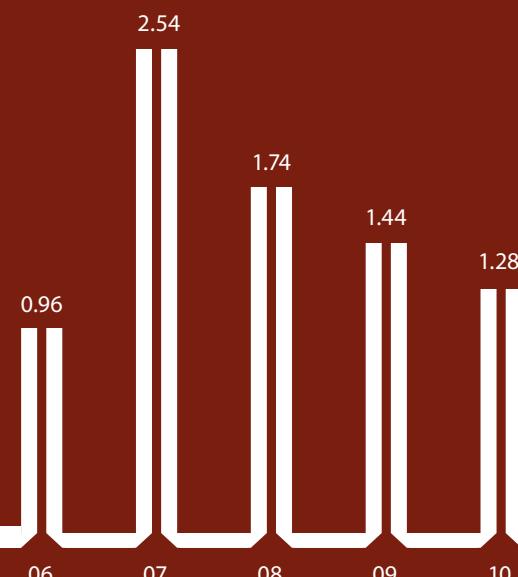
Financial Performance

Year to 30 June 2010		2006	2007	2008	2009	2010	% Change 09/10
Oil and gas production	(boe)	175,224	196,873	227,400	192,961	158,880	-18%
Net oil sales	(boe)	150,986	188,154	222,549	173,737	134,948	-22%
Realised oil price on Australian production	(AUD/boe)	88.86	86.68	109.97	91.88	82.56	-10%
Revenue	\$'million	12.48	15.54	24.14	15.63	9.24	-41%
Operating costs, other expenses	\$'million	(6.84)	(9.10)	(19.69)	(12.82)	(10.54)	-18%
EBITDAX	\$'million	5.64	6.43	4.45	2.81	(1.31)	-147%
EBIT	\$'million	3.98	3.23	(13.68)	(9.02)	(24.63)	-173%
Profit / (loss) after tax	\$'million	3.64	3.03	(13.47)	(9.49)	(24.76)	-161%
Earnings per share	Cents	1.0000	0.7400	(2.1177)	(0.5884)	(1.2695)	-116%
Net cash and cash equivalent	\$'million	3.25	2.71	11.91	8.14	6.52	-20%

Cash & cash equivalent (\$'m)



2p Reserves (mmboe)



Corporate Governance Statement

In June 2009, Drillsearch underwent a significant change in its leadership with the appointment of a new Chairman and a new Managing Director. This change in leadership has resulted in a change in the values that underpin the Company's decision making and operations. Under the new leadership team, a strong emphasis has been placed on corporate governance and during the 2009/2010 financial year, Drillsearch undertook an extensive corporate governance review with the goal of reaching the highest standards of governance practices.

The corporate governance review consisted of a board renewal process, a committee review process, a review of all policies and procedures of the Company and a risk management review. A corporate governance specialist was engaged to advise the Board during the review process and conduct a workshop with the Board on corporate governance matters.

The elements of the corporate governance review will be set out in detail below.

Board Renewal

A Board renewal process occurred to ensure that Drillsearch has a strong, experienced and independent board that will drive and oversee the Company's growth objectives. The first step of the renewal process was an analysis of the skills required by the Board and this was followed by a wide-ranging candidate search. As a result of this process, two new Directors, Fiona Robertson and Ross Wecker, were appointed to the Board of Directors in October 2009.

Fiona Robertson has more than 30 years' experience in corporate finance and the resources sector including extensive experience in corporate governance, financial reporting, international corporate finance and working with emerging resource companies.

Ross Wecker has more than 35 years' experience in the oil and gas industry and is a highly experienced geologist with extensive exploration knowledge of the Cooper and Eromanga Basins. He has provided specialist technical advice to several Australian and American companies regarding the acquisition and management of exploration acreage in the Cooper and Eromanga Basins.

Review of Committees

Drillsearch also conducted a review of all of its Committees including the types of committees required, the membership of the various committees, the various committee charters and the required minimum number of meetings per year for each committee.

Review of Policies and Procedures

An extensive review of all company policies and procedures was conducted during the 2009/2010 financial year and, as a result, numerous policies, including the Business Records Management Policy, have been introduced and others, including the Disclosure Policy, have been amended. The Board Charter, the Audit and Risk Committee Charter and the Remuneration and Nomination Committee Charter were also amended during the 2009/2010 financial year.

Copies of the Company's policies and procedures, including the Board and Committee Charters, can be found at www.drillsearch.com.au.

Risk Management Review

During the past year, Drillsearch conducted an extensive risk management review which included creating the Risk Management Policy and Framework, the Risk Management Disclosure Statement and the Risk Register. The Audit and Risk Committee has been working very closely with management on the risk management review and two Audit and Risk Committee meetings each year will be devoted to risk management.

Corporate Governance Principles and Recommendations

During the financial year ended 30 June 2010, Drillsearch's corporate governance practices and policies have accorded with those outlined in the ASX Corporate Governance Council's Principles and Recommendations (2nd Edition), except as noted below.

Principle 1 – Lay solid foundations for management and oversight

The Board has adopted a formal charter which has defined the functions reserved to the Board and those delegated to management to facilitate accountability to the Company and its shareholders. (Recommendation 1.1)

Directors receive formal letters of appointment setting out the key terms, conditions and expectations of their appointment. (Recommendation 1.1)

The Remuneration and Nomination Committee reviews the performance of senior managers on a regular basis. The Remuneration and Nomination Committee is currently reviewing the human resources framework for the Company and has engaged an external consultant to help with this review. The review includes the performance evaluation procedures for senior managers and a new procedure is expected to be in place shortly. Once the review has been completed, a performance evaluation for the senior managers will be carried out in accordance with the new procedures.

The Board also assesses the performance of the Managing Director annually. The Chairman meets with the Managing Director and gives him feedback on that assessment. (Recommendation 1.2)

Copies of the Board Charter and Charters for each of the two committees are posted on Drillsearch's website in the corporate governance section. (Recommendation 1.3)

Principle 2 – Structure the Board to add value

During the financial year ended 30 June 2010, a majority of Drillsearch's directors were independent as assessed in accordance with the Board Charter. (Recommendation 2.1)

The Chairman, Mr Jim McKerlie is an independent Director. (Recommendation 2.2)

The roles of Chairman and Chief Executive Officer are exercised by different individuals. Mr Jim McKerlie is the Chairman of the Board of Directors and Mr Brad Lingo is the Managing Director. (Recommendation 2.3)

The Board has established a Nomination and Remuneration Committee. (Recommendation 2.4)

The process for evaluating the performance of the Board is contained in the Board Charter. Each year, the Board evaluates itself and individual directors with the assistance of the Nomination & Remuneration Committee. The evaluation:

- (a) compares the Board's performance with the requirements of the Board Charter;
- (b) sets goals and objectives of the Board for the upcoming year; and
- (c) provides any improvements to the Board Charter that are necessary or desirable.

Each Committee conducts its own evaluation and reports its results to the Board. (Recommendation 2.5)

The skills, experience and expertise relevant to the position of Director held by each Director in office at the date of the annual report is detailed in the Directors' Report. (Recommendation 2.6)

The independent Directors at the date of this report are: Mr Jim McKerlie (Chairman); Dato' Beng Kai Choo; Mrs Fiona Robertson and Mr Ross Wecker. Drillsearch has one Executive Director, Mr Brad Lingo (Chief Executive Officer) and he is not treated as independent.

When determining whether a Director is independent, the Board has regard, among other things, to the matters detailed in point 4 of the Drillsearch Independent Directors Policy. The Independent Directors Policy is available on Drillsearch's website in the corporate governance section. (Recommendation 2.6)

There is a procedure in place for directors to take independent professional advice at the Company's expense. In particular, a Director may obtain independent professional advice if reasonably required to assist the Director in the proper exercise of powers and discharge of duties as a director of the Company. The costs of such independent professional advice are borne by the Company provided that before engaging the independent professional adviser, the Director obtains the approval of the Chairman, or, if the Director is the Chairman, the approval of a majority of the non-executive directors of the Company. (Recommendation 2.6)

The period of office held by each Director at the date of the 2010 Annual Report is specified in the Directors' Report. (Recommendation 2.6)

Details of the names and qualifications of the members of the Remuneration and Nomination Committee and their attendance at meetings of the Committee during the year are given in the Directors' Report. (Recommendation 2.6)

A performance evaluation for the Board, its Committees and the Directors was started in May 2010 and was concluded at the July 2010 Board meeting. The performance evaluation was conducted in accordance with the procedures described above.

Drillsearch's Constitution and the Remuneration and Nomination Committee Charter are available on the Drillsearch website in the corporate governance section. (Recommendation 2.6)

Principle 3: Companies should actively promote ethical and responsible decision making

Drillsearch actively promotes ethical and responsible decision making.

The Company has a Code of Conduct to guide the Directors, the Managing Director, and other key executives as to practices acceptable to the Company. The Code of Conduct is available on Drillsearch's website in the corporate governance section. (Recommendation 3.1)

Drillsearch has a Securities Trading Policy. The overriding policy is that employees may not deal in Drillsearch securities in any period they are in possession of price sensitive information or during a blackout period. Blackout periods are defined as the two weeks prior to and including the day of release of the full year results, the half yearly results or the quarterly results to the ASX. Further, the Board and Senior Management are at all times prohibited from dealing in Drillsearch securities except for the 28 days immediately following the release of the preliminary final statement, the half-yearly or quarterly reports to the ASX or the 28 days immediately following Drillsearch's annual general meeting or at any other time as determined by the Board. The Securities Trading Policy is available on Drillsearch's website in the corporate governance section. (Recommendation 3.2)

Principle 4 – Safeguard integrity in financial reporting

The Board has established an Audit and Risk Committee. (Recommendation 4.1)

The Audit and Risk Committee is composed solely of independent, non-executive directors. (Recommendation 4.2)

At all times during the 2009/2010 financial year, the Committee was chaired by an independent director, who was not the Chair of the Board. (Recommendation 4.2)

Except for the period prior to the appointment of Mrs. Fiona Robertson and Mr Ross Wecker to the Committee on 14 October 2009, the Audit and Risk Committee consisted of at least three members. (Recommendation 4.2)

The Audit and Risk Committee has a formal charter which details its role and responsibilities, composition, structure and membership requirements. (Recommendation 4.3)

Details of the names and qualifications of the members of the Audit and Risk Committee and their attendance at meetings of the Committee during are given in the Directors' Report. (Recommendation 4.4)

The number of Audit and Risk Committee meetings held during the year are noted in the Directors' Report. (Recommendation 4.4)

Deloitte Touche Tohmatsu were appointed the Company's auditors at the Annual General Meeting of the Company held 28 November 2008. The Audit and Risk Committee reviews the performance of the external auditor, including partner rotation plans, and makes recommendations to the Board on the appointment of the external auditor. The Committee had a closed session (without management present) at each meeting attended by Deloitte Touche Tohmatsu. (Recommendation 4.4)

The Audit and Risk Committee Charter is available on Drillsearch's website in the corporate governance section. (Recommendation 4.4)

Principle 5 – Make timely and balanced disclosures

Drillsearch promotes timely and balanced disclosure of all material matters concerning the Company.

It has put in place mechanisms designed to ensure compliance with ASX Listing Rule requirements such that:

- all investors have equal and timely access to material information concerning the Company – including its financial position, performance, ownership and governance; and
- Company announcements are factual and presented in a clear and balanced way including disclosure of both positive and negative information.

Drillsearch has established written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior management level for that compliance. (Recommendation 5.1)

The company's Disclosure Policy is available on Drillsearch's website in the corporate governance section. (Recommendation 5.2)

Principle 6 – Respect the rights of shareholders

Drillsearch respects the rights of all shareholders, irrespective of the size of their interest in the Company, and facilitates the effective exercise of those rights in any way it reasonably can.

Drillsearch empowers its shareholders by:

- communicating effectively with them;
- giving them ready access to balanced and understandable information about the Company and corporate proposals; and
- making it easy for them to participate in shareholder meetings.

The Company has a Communications Policy for promoting effective communication with shareholders and encouraging their participation at shareholder meetings. The Company's Shareholder Communication Guidelines and Policy is available on Drillsearch's website in the corporate governance section. (Recommendation 6.1)

Information is communicated to the members through compliance with ASX Listing Rules and the Corporations Act 2001, by way of announcements to the ASX, media releases, the Annual Report, Half-Yearly Report, the Annual General Meeting and other meetings that may be called from time to time. The Company maintains a website which provides a description of the Company's projects and all material announcements are released to the ASX. (Recommendation 6.2)

Principle 7 – Recognise and manage risk

Drillsearch recognises that risk management is an integral part of the oil and gas business and has established a sound system of risk oversight, management and internal control. It has established policies for the oversight of and management of material business risk. Those policies are summarised below. (Recommendation 7.1)

The Board continuously reviews the activities of the Company to identify key business and operational risks and, where possible, will implement policies and procedures to address those risks. The Audit and Risk Committee plays an active role in managing the risks the Company faces.

The Board is conscious of mitigating sovereign, commodity, interest rate and foreign exchange risks which arise through the activities of the Company. The Board is provided with regular reporting on the management of operations and the financial circumstances of the Company aimed at ensuring that risks are identified, assessed and appropriately managed as and when they arise. (Recommendation 7.1)

During the 2009/2010 financial year, management designed and implemented a risk management and internal control system to manage and report on the Company's material business risks. Management has reported to the Board during the 2009/2010 financial year on the effectiveness of the Company's management of its material business risks. (Recommendation 7.2)

Given Drillsearch's size and complexity and the types of risks involved, it does not consider it necessary to have an internal audit function. (Recommendation 7.2)

Drillsearch's Managing Director and Chief Financial Officer are required to state in writing to the Board that their statements concerning the integrity of the Company's financial statements are founded on a sound system of risk management and internal compliance and control which implements the Board's policies. The Board also received assurance from the Managing Director and the Chief Financial Officer in 2010 in accordance with section 295A of the Australian Corporations Act. (Recommendation 7.3)

The Board has adopted a Health, Safety and Environment (HSE) Policy and Risk Committee Charter which are available on the Drillsearch website in the corporate governance section. (Recommendation 7.4)

Principle 8 – Remunerate fairly and responsibly

The Company has established a Remuneration and Nomination Committee. This Committee is structured so that it consists of a majority of independent Directors, is chaired by an independent Director and has at least three members. It is comprised of Mr. Jim McKerlie (Committee Chairman), Mrs. Fiona Robertson and Mr Ross Wecker. (Recommendation 8.1)

Drillsearch clearly distinguishes the structure of Non-Executive Director's remuneration from that of executives. Drillsearch's policy in relation to remuneration is detailed in the Remuneration Report. (Recommendation 8.2)

Details of the names and qualifications of the members of the Remuneration and Nomination Committee and their attendance at meetings of the Committee during the year are given in the Directors' Report. (Recommendation 8.3)

The remuneration of Non-Executive Directors is within the aggregate amount approved for such remuneration by shareholders. The level of remuneration payable to Non-Executive Directors is determined by the Nomination and Remuneration Committee. All Non-Executive Directors are entitled to remuneration of \$50,000 each per annum (inclusive statutory superannuation) inclusive of Committee responsibilities. The Chairman receives remuneration of \$100,000 per annum (inclusive statutory superannuation). There are no arrangements for payment of retirement benefits to Non-Executive Directors. (Recommendation 8.3)

The Remuneration and Nomination Committee Charter is available on Drillsearch's website in the corporate governance section. (Recommendation 8.3)

Continuing Improvement

Although the Company conducted an extensive corporate governance review during the 2009/2010 financial year, it will continue to monitor its corporate governance procedures to take account of shifting knowledge, attitudes and awareness and will make the necessary changes as required. For example, the Board determined that a committee was required to advise the Board on technical matters and to be involved with the review of all reserve statements. As a result, the Technical Committee was created in July 2010.

Achieving the highest standards of corporate governance is an ongoing commitment and Drillsearch is dedicated to ensuring that the Company reaches this objective.

Further information about the Company's corporate governance practices is set out on the Company's website at www.drillsearch.com.au.



Board of Directors

Jim McKerlie

Chairman
B.Econ, FCA, FAICD

Mr McKerlie is a Chartered Accountant and business consultant and has had a global career consulting to small and large companies on growth strategies as a Managing Partner at KPMG and Partner in Charge at Deloitte. He has extensive corporate experience as Director and Chairman of private and public companies. Mr McKerlie is Group Chief Executive of Bullseye, which he founded.

Date of appointment, Great Artesian: 14 September 2007, appointed Drillsearch: 12 August 2008. Chairman of the Nomination and Remuneration Committee and member of the Audit and Risk Committee and Technical Committee.

Bradley Lingo

Managing Director

Brad Lingo has more than 25 years of oil & gas experience ranging from frontier deepwater exploration offshore West Africa to commercialisation of major gas projects in Australia. He has been involved in all phases of the oil & gas business and project development, mergers & acquisitions, financing and equity capital raising for both listed and private companies both in Australia and internationally.

Date of appointment to the Drillsearch Board: 19 May 2009 and as Managing Director since 15 June 2009. Member of the Technical Committee.

Skilled



Choo Beng Kai

Director

Dato', AMK, DSAP

Dato' Choo Beng Kai (BK) joined the family owned property development company in 1996. He later started his own company, Masmeyer Holdings Sdn Bhd in 2002 of which he is Managing Director. BK has many successful years entrepreneurial experience majoring in developing and implementing innovative business concepts. These developments have lead to the successful establishment of a number of businesses. In addition to hands on project management, BK is also Deputy Chairman of Penang Choo's Association and a member of the central committee of the World Choo's Association. BK is a Member of the "Order of the Crown of Kedah" (AMK) and a Knight Commander of the "Most Honourable Order of Sultan Ahmad Shah" (DSAP). He was also appointed Justice of Peace by the State government of Kedah, Malaysia 2008.

Date of appointment: 2 March 2009.

Fiona Robertson

Director

MA (Oxon), FAICD, MAusIMM

Fiona Robertson currently works as the Chief Financial Officer of Petsec Energy Ltd and has a background of more than 30 years in corporate finance and the resources sector. She has extensive experience in financial reporting, international corporate finance, corporate governance and in working with emerging resource companies. Her career includes roles with Delta Gold and The Chase Manhattan Bank in New York, London and Sydney.

Date of appointment: 6 October 2009. Chairman of the Audit and Risk Committee and member of the Nomination and Remuneration Committee.

Ross Wecker

Director

B Sci (Met and Geol)

Ross Wecker was previously the Managing Director of Innamincka Petroleum Limited and has more than 35 years' experience in the oil and gas industry. He is a highly experienced geologist with extensive exploration knowledge of the Cooper and Eromanga Basins. Prior roles include the direction of an exploration team in the Cooper-Eromanga Basin for Delhi Petroleum Pty Ltd and Esso Australia Limited and providing specialist technical advice to several Australian and American companies regarding the acquisition and management of exploration acreage in the Cooper and Eromanga Basins.

Date of appointment: 6 October 2009. Chairman of the Technical Committee and member of the Audit and Risk Committee and Nomination and Remuneration Committee.

Financial Report

For the year ended 30 June 2010

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Drillsearch

Directors' Report

The Directors of Drillsearch Energy Limited ('Drillsearch' or the 'Company') submit herewith the annual financial report of the Company for the financial year ended 30 June 2010. In order to comply with the provisions of the Corporations Act 2001, the Directors report as follows:

Information about the Directors and key management personnel

The names and particulars of the Directors of the Company during or since the end of the financial year are:

Name	Particulars
Mr J.D. McKerlie	Chairman. Appointed Chairman 11 June 2009. Bachelor of Economics, Diploma Financial Management, University of New England, Fellow Institute of Chartered Accountants. FAICD. Appointed non-executive Director 12 August 2008.
Mr B.W. Lingo	Non-executive Director from 15 June 2009. Appointed Managing Director 19 May 2009.
Mr B.K. Choo	Non-executive Director. Dato' Choo is a Malaysian national with extensive business interests in Malaysia through his role as Group Managing Director of Masmeyer Holdings Sdn Bhd. Appointed 2 March 2009.
Mr P.A. Wicks	Non-executive Director. Fellow Institute of Chartered Accountants. Appointed 17 April 2008. Resigned 14 September 2009.
Mrs F.A. Robertson	Non-executive Director. Master of Arts, Oxford University UK, FAICD, MAusIMM. Appointed 6 October 2009.
Mr H.R.B. Wecker	Non-executive Director. Bachelor of Science (Met and Geol) Queensland University. Mr Wecker served as the Managing Director of Innamincka Petroleum Ltd. from 6 November 2003 to 30 March 2009. Appointed 6 October 2009.

Directorships of other listed companies

Directorships of other listed companies held by Directors in the 3 years immediately before the end of the financial year are as follows:

Name	Company	Period of directorship
Mr J.D. McKerlie	Circumpacific Energy Corporation Great Artesian Oil & Gas Limited	26 November 2009 to present 12 September 2007 to 12 August 2008
Mr B.W. Lingo	Circumpacific Energy Corporation	26 November 2009 to present
Mr B.K. Choo	Republic Gold Limited	28 May 2008 to present
Mr P.A. Wicks	Republic Gold Limited	2 November 2005 to present
	ETT Limited	23 May 2008 to 22 October 2008
Mrs F.A. Robertson	Nil	Nil
Mr H.R.B. Wecker	Innamincka Petroleum Limited	6 November 2003 to 30 March 2009

Directors' shareholdings

The following table sets out each Director's relevant interest in shares and options in shares of the Company or a related body corporate as at the date of this report.

Directors	Number of fully paid ordinary shares held by key management personnel		
	Balance 30 June 2009	Shares purchased during the financial year	Balance 30 June 2010
Mr J.D. McKerlie	2,810,000	800,000	3,610,000
Mr B.W. Lingo	–	925,000	925,000
Mr B.K. Choo	10,420,000	950,000	11,370,000
Mrs F.A. Robertson	–	300,000	300,000
Mr H.R.B. Wecker	–	300,000	300,000

Remuneration of Directors and key management personnel

Information about the remuneration of Directors and key management personnel is set out in the remuneration report of this Directors' report, on pages 30 to 34.

Share options granted to Directors and key management personnel

During and since the end of the financial year an aggregate 70,000,000 share options were granted to the following Directors and key management personnel of the Company as part of their remuneration.

Directors and senior management	Issuing entity	Number of options granted	Number of options cancelled	Number of ordinary shares under option
Mr J.D. McKerlie	Drillsearch Energy Limited	12,000,000	–	12,000,000
Mr B.W. Lingo	Drillsearch Energy Limited	12,000,000	–	12,000,000
Mr B.K. Choo	Drillsearch Energy Limited	8,000,000	–	8,000,000
Mrs F.A. Robertson	Drillsearch Energy Limited	8,000,000	–	8,000,000
Mr H.R.B. Wecker	Drillsearch Energy Limited	8,000,000	–	8,000,000
Mr J.S. Whaley	Drillsearch Energy Limited	10,000,000	–	10,000,000
Mr D. Evans	Drillsearch Energy Limited	10,000,000	–	10,000,000
Mr I.W. Bucknell	Drillsearch Energy Limited	2,000,000	–	2,000,000
		70,000,000	–	70,000,000

Company secretary

Mr I.W. Bucknell, Certified Practising Accountant, held the position of Company Secretary of Drillsearch Energy Limited at the end of the financial year. He joined Drillsearch Energy Limited in August 2008 and previously held the Company Secretary position at Great Artesian Oil and Gas Limited. He is an associate of the Chartered Institute of Company Secretaries in Australia.

Principal activities

The consolidated entity's principal activities in the course of the financial year were oil and gas exploration, development and production. No significant change in the nature of these activities occurred during the financial year.

Operating results

The gross loss for the year of the consolidated group was \$1,715,933 (2009: gross profit \$1,005,946). This reduction was largely driven by a 39% reduction in revenues as a result of falling production.

The consolidated group result attributable to equity holders of the parent after providing for income tax and eliminating minority equity interests amounted to a loss of \$24,604,908 (2009: loss \$9,728,253).

Review of operations

A summary of consolidated revenues and results of significant segments is set out in Note 5 of the financial report.

Significant events which occurred during the year under review included:

Corporate

- On 14 August 2009, the Beach Energy Limited (Beach) takeover bid lapsed. Beach subsequently sold all of their holding in the Company on market. They no longer hold any interest in Drillsearch.
- On 6 October 2009, the Company announced the appointment of two new Non-Executive Directors in Fiona Robertson and Ross Wecker. This marked the conclusion of an extensive board renewal process.
- On 5 March 2010, the Company was included in the Standard and Poor's ASX All Ordinaries.

Australia

- The parent entity continued producing oil from its Naccowlah and Tintaburra Joint Venture interests in south west Queensland. During the year 67,201 bbls of oil were sold by the Company from these properties (2009: 97,472 bbls).
- On 17 August 2009, the Chiton-1 well was announced as a new oil field discovery. First production from Chiton-1 began in January 2010 but after a short time was shut in by flooding in the Cooper-Eromanga Basin.
- In November 2009, 2 wells were drilled in Tintaburra, Ipundu North-16 and Ipundu North-13. Both wells were cased and suspended as future oil producers.
- On 9 December 2009, the Company announced the award of block B, now known as PEL A 513, which significantly increased its position in the Cooper-Eromanga Basin Western Flank.
- The Company released a number of upgrades to Contingent Resources and Prospective Resources in both its Wet Gas business and Unconventional business streams.
- On 14 May 2010, Drillsearch announced that the Brownlow production test flow rate had equalled the highest production test rates known in the Cooper-Eromanga Basin.

Canada

- A 79.37% (as at 30 June 2010) owned Canadian listed controlled entity of Drillsearch Energy Limited, Circumpacific Energy Corporation ("CER") continued oil and gas production in Canada and reported a loss after tax for the year of AUD\$742,334 (2009: profit AUD\$401,680).

Financial position

The net assets of the consolidated group have decreased by \$7,907,929 from 30 June 2009 to \$65,749,681. This decrease is largely the result of impairment of Tintaburra Joint Venture carried asset value.

Working capital increased during the year by \$4,275,025 due largely to the reclassification of ATP259P (the Naccowlah Block) and Circumpacific Energy Corporation as Assets classified as held for sale. Partly off-setting this was a decline in cash on year to \$4,361,222 (2009: \$8,141,877).

Changes in state of affairs

During the financial year, the consolidated entity was successful in its defence against a hostile takeover bid from Beach Petroleum Limited.

Other than the above, there was no significant change in the state of affairs of the consolidated entity during the financial year.

Subsequent events

Subsequent to balance date the following material events have occurred:

- On 7 July 2010, preliminary testing results for the Canunda Wet Gas discovery in PEL 106B reported the production of exceptionally high levels of volatile oil/condensate. Drillsearch owns 50% of this discovery.
- On 13 July 2010, Drillsearch announced a new oil discovery in the Naccowlah block Watson West-1 exploration well. The discovery was cased and suspended as a future oil producer in the Basal Birkhead Formation.
- On 15 July 2010, the planned drilling of up to 5 exploration wells in PEL 91 in the Cooper-Eromanga Basin Western Flank Oil Fairway in South Australia was announced with an expected start date of December 2010 / January 2011.
- On 16 August 2010, the Group agreed to sell its 2% Naccowlah Block Joint Venture interest and associated exploration permit ATP 259P and production licenses to Bounty Oil & Gas NL (ASX:BUY) for \$1.15 million comprised of \$950,000 in cash and \$200,000 in BUY common stock. The effective date of the sale is 1 April 2010.
- On 26 August 2010, the Company and Circumpacific Energy Corporation (TSXV:CER) announced that it had entered into an Arrangement Agreement pursuant to which all of the outstanding shares of CER are to be acquired by Western Petroleum Commodities Inc. ("WPC"), a private Canadian oil and gas company, for approximately \$9.6 million, or \$0.18 per share, representing a 100% premium over CER's 12-month volume weighted average trading price. Following the completion of the Arrangement, Drillsearch has also agreed to purchase CER's Joint Venture interest in eight exploration tenements in South West Queensland, Australia (the "SWQ Blocks") for \$1.8 million. The completion of the Plan of Arrangement is subject to the approval of 66.6% of the shareholders of CER.

Future developments

Disclosure of information regarding likely developments in the operations of the consolidated entity in future financial years and the expected results of those operations is likely to result in unreasonable prejudice to the consolidated entity. Accordingly, this information has not been disclosed in this report.

Environmental regulations

The parent entity is subject to significant environmental regulation in respect of its operated and non-operated Joint Venture interests in petroleum exploration, development and production. Its oil production interests in the state of Queensland are operated by Santos Limited, which complies with all relevant environmental legislation. Its oil production interests in the state of South Australia are operated by Beach Energy Limited, which complies with all relevant environmental legislation. Its other exploration operations in South Australia, Queensland, Victoria and Tasmania, are operated by the parent entity and it complies with all relevant environmental legislation. Its subsidiary, Circumpacific Energy Corporation, complies with all relevant environmental regulations in the Provinces of British Columbia, Alberta and Saskatchewan, Canada.

Dividends

During the year no dividends were paid. No dividend is proposed for the current year.

Shares under option or issued on exercise of options

Details of unissued shares or interests under option as at the date of this report are:

Issuing Entity	Number of shares under option	Class of shares	Exercise price of option	Expiry date of options
Drillsearch Energy Limited	10,000,000	Ordinary	\$0.05	29 October 2010
Drillsearch Energy Limited	10,000,000	Ordinary	\$0.05	31 January 2011
Drillsearch Energy Limited	10,000,000	Ordinary	\$0.05	29 July 2011
Drillsearch Energy Limited	1,500,000	Ordinary	\$0.04	12 August 2012
Drillsearch Energy Limited	24,000,000	Ordinary	\$0.05	28 November 2012
Drillsearch Energy Limited	2,000,000	Ordinary	\$0.09	2 March 2013
Drillsearch Energy Limited	12,000,000	Ordinary	\$0.04	10 November 2013
Drillsearch Energy Limited	36,000,000	Ordinary	\$0.07	30 November 2013
Drillsearch Energy Limited	10,000,000	Ordinary	\$0.06	30 September 2014
Drillsearch Energy Limited	10,000,000	Ordinary	\$0.09	15 March 2015

The holders of these options do not have the right, by virtue of the option, to participate in any share issue or interest issue of the company or of any other body corporate or registered scheme.

Details of shares or interests issued since the end of the financial year as a result of exercise of options are:

Issuing Entity	Number of shares issued	Class of shares	Amount paid for shares	Amount unpaid on shares
Drillsearch Energy Limited	10,000,000	Ordinary	\$0.05	\$nil

Indemnification of officers and auditors

During the financial year, the Company paid a premium in respect of a contract insuring the Directors of the Company (as named above), the Company secretary, Mr I.W. Bucknell, and all executive officers of the Company and of any related body corporate against a liability incurred as such a director, secretary or executive officer to the extent permitted by the Corporations Act 2001. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

The Company has not otherwise, during or since the end of the financial year, except to the extent permitted by law, indemnified or agreed to indemnify an officer or auditor of the Company or of any related body corporate against a liability incurred as such an officer or auditor.

Directors' meetings

The following table sets out the number of directors' meetings (including meetings of committees of directors) held during the financial year and the number of meetings attended by each director (whilst they were a director or committee member). During the financial year, 16 board meetings, 3 remuneration and nomination committee meetings and 4 audit and risk committee meetings were held.

Directors	Board of directors		Remuneration & Nomination committee		Audit & risk committee	
	Held	Attended	Held	Attended	Held	Attended
Mr J.D. McKerlie	16	16	3	3	4	4
Mr B.W. Lingo	16	16	0	0	0	0
Mr B.K. Choo	16	14	0	0	0	0
Mr P.A. Wicks	3	3	0	0	1	1
Mrs F.A. Robertson	13	12	3	3	3	3
Mr H.R.B. Wecker	13	13	3	3	3	3

Legal matters

Drillsearch has been involved in legal proceedings during the year (see Note 26 to the financial report) including those detailed below:

- i. The Company was involved in two sets of legal proceedings commenced in the Supreme Court of New South Wales concerning the Extraordinary General meeting held on 10 June 2009. Although substantially complete there are some unresolved issues arising from the proceedings which may result in the Company incurring further legal costs.
- ii. Drillsearch was involved in legal proceedings commenced in the Supreme Court of New South Wales, concerning a claim by Carling Capital Partners for advisory fees. On 29 July 2010, these proceedings were resolved.
- iii. On 12 May 2009, Odin Energy Limited announced that it had added Great Artesian Oil and Gas Limited, a subsidiary of Drillsearch, to legal proceedings brought by Odin against Kompliment Pty Limited and its holding company, Blue Energy Limited, relating to the termination of a sub-farm-in agreement between those parties, and loss and damage Odin claims to have suffered in the circumstances of that agreement. Odin is claiming damages from Kompliment and Blue Energy in the amount of approximately \$4.5 million. As part of the proceedings, it is alleged that heads of agreement between Great Artesian, Kompliment and Blue Energy have terminated. The proceedings therefore essentially involve a dispute between a farminee (Kompliment) and sub farminee (Odin), and no claim for damages is made against Great Artesian. Great Artesian has filed its defence, provided discovery and participated in mediation sessions involving all parties to the proceedings. The recent attempts to resolve the matter at mediation were unsuccessful and Great Artesian is continuing a dialogue with the other parties in an attempt to extricate itself from the proceedings.

There is no other litigation of a material nature against Drillsearch or its subsidiaries of which the Directors are aware.

Non-audit services

Amounts paid or payable to the auditor for non-audit services provided during the year by the auditor amount to \$14,704 (2009: \$nil) and are outlined in Note 33 to the financial statements.

The Directors are satisfied that the provision of non-audit services, during the year, by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001.

The Directors are of the opinion that the services as disclosed in Note 33 to the financial statements do not compromise the external auditor's independence, based on advice received from the Audit Committee, for the following reasons:

- all non-audit services have been reviewed and approved to ensure that they do not impact the integrity and objectivity of the auditor, and
- none of the services undermine the general principles relating to auditor independence as set out in Code of Conduct APES 110 Code of Ethics for Professional Accountants issued by the Accounting Professional & Ethical Standards Board, including reviewing or auditing the auditor's own work, acting in a management or decision-making capacity for the Company, acting as advocate for the Company or jointly sharing economic risks and rewards.

Auditor's independence declaration

The auditor's independence declaration is included on page 35 of the annual report.

Remuneration Report

This remuneration report, which forms part of the Directors' report, sets out information about the remuneration of Drillsearch Energy Limited's Directors and its key management personnel for the financial year ended 30 June 2010. The prescribed details for each person covered by this report are detailed below under the following headings:

- Director and key management personnel details
- Remuneration policy
- Relationship between the remuneration policy and company performance
- Remuneration of directors and key management personnel
- Key terms of employment contracts.

Director and key management personnel details

The following persons acted as Directors of the Company during or since the end of the financial year:

- Mr J.D. McKerlie (Chairman)
- Mr B.W. Lingo (Managing Director)
- Mr B.K. Choo
- Mr P.A. Wicks (resigned 14 September 2009)
- Mrs F.A. Robertson (appointed 6 October 2009)
- Mr H.R.B. Wecker (appointed 6 October 2009)

The term 'key management personnel' is used in this remuneration report to refer to the following persons. Except as noted, the named persons held their current position for the whole of the financial year and since the end of the financial year:

- Mr J.S. Whaley (Chief Commercial Officer, appointed 21 October 2009)
- Mr D. Evans (Chief Technical Officer, appointed 15 March 2010)
- Mr I.W. Bucknell (Chief Financial Officer & Company Secretary)
- Mr C.J. Carty (Chief Operating Officer, resigned 8 September 2009)

Remuneration policy

The Board of Director's policy for determining the nature and amount of remuneration for Board members and senior executives of the economic entity is as follows:

The remuneration policy, setting the terms and conditions for the executive directors and other senior executives, was developed by the Board. All executives receive a base salary (which is based on factors such as length of service and experience), superannuation, and potentially options and bonuses. The remuneration committee reviews executive packages annually by reference to the economic entity's performance, executive performance and comparable information from industry sectors and other listed companies in similar industries.

The executive directors and executives receive a superannuation guarantee contribution required by the government, which is currently 9%. Some individuals, however, have chosen to sacrifice part of their salary to increase payments towards superannuation.

The Board of Director's policy is to remunerate Non-Executive Directors at market rates for comparable companies for time, commitment and responsibilities. The remuneration committee determines payments to the Non-Executive Directors and reviews their remuneration annually, based on market practice, duties and accountability. The maximum aggregate amount of fees that can be paid to Non-Executive Directors is subject to approval by shareholders at the Annual General Meeting.

Relationship between the remuneration policy and company performance

The Directors' reviewed the remuneration policy for key management personnel and the Company's performance. There is no direct link currently between the remuneration policy and the Company's performance. To address this, the Company has engaged an external consultant to establish a link between the remuneration policy and the Company's performance. The only key management personnel eligible for a salary review was Mr I.W. Bucknell. No pay increases were made in the financial year ended 30 June 2009. Mr I.W. Bucknell received a pay increase in the current financial year after benchmarking his salary to peer companies.

The tables below set out summary information about the consolidated entity's earnings including earnings from discontinued operations and movements in shareholder wealth for the five years to 30 June 2010:

	30 June 2010 \$'000	30 June 2009 \$'000	30 June 2008 \$'000	30 June 2007 \$'000	30 June 2006 \$'000	30 June 2005 \$'000
Revenue	9,235,826	15,628,441	24,138,210	15,536,753	12,482,700	7,940,349
Net profit/(loss) before tax	(24,792,514)	(9,369,936)	(13,676,468)	3,227,616	3,975,374	1,419,249
Net profit/(loss) after tax	(24,758,052)	(9,486,380)	(13,467,387)	3,238,392	3,979,081	1,437,279
	30 June 2010	30 June 2009	30 June 2008	30 June 2007	30 June 2006	30 June 2005
Share price at start of year	\$0.0300	\$0.0580	\$0.1583	\$0.1250	\$0.0567	\$0.0325
Share price at end of year	\$0.0510	\$0.0300	\$0.0580	\$0.1583	\$0.1250	\$0.0567
Basic earnings per share	(1.2695)cps	(0.5884)cps	(2.12)cps	0.74cps	1.00cps	0.46cps
Diluted earnings per share	(1.2695)cps	(0.5884)cps	(2.12)cps	0.74cps	1.00cps	0.46cps

Remuneration of Directors and key management personnel

2010	Short-term employee benefits			Post employ- ment benefits		Share-based payment		
	Salary & fees \$	Bonus \$	Non- monetary \$	Other \$	Super- annuation \$	Other Long-term employee benefits \$	Options \$	Total \$
Non-Executive Directors								
Mr J.D. McKerlie	88,381	–	–	22,282	7,954	–	619,200	737,817
Mr B.K. Choo	47,664	–	–	–	2,336	–	412,800	462,800
Mr P.A. Wicks	10,252	–	–	–	–	–	–	10,252
Mrs F.A. Robertson	34,404	–	–	–	3,096	–	264,000	301,500
Mr H.R.B. Wecker	34,404	–	–	–	3,096	–	264,000	301,500
Executive officers								
Mr B.W. Lingo	357,056	–	–	22,282	21,642	–	182,400	583,380
Mr J.S. Whaley	190,348	–	–	–	12,151	–	402,000	604,499
Mr D. Evans	76,264	–	–	–	4,916	–	384,700	465,880
Mr I.W. Bucknell	224,219	–	–	–	16,194	–	74,000	314,413
Mr C.J. Carty	205,161	–	–	22,282	18,465	–	–	245,908
	1,268,153	–	–	66,846	89,850	–	2,603,100	4,027,949

2009	Short-term employee benefits			Post employ- ment benefits		Share-based payment		Total \$
	Salary & fees \$	Bonus \$	Non- monetary \$	Other \$	Super- annuation \$	Other Long-term employee benefits \$	Options \$	
Non-Executive Directors								
Mr J.D. McKerlie	7,645	–	–	–	33,778	–	84,756	126,179
Mr B.K. Choo	15,291	–	–	–	–	–	–	15,291
Mr P.A. Wicks	43,432	–	–	19,000	–	–	84,756	147,188
Mr P.P. Simpson	51,454	–	–	27,000	28,031	–	113,008	219,493
Mr D.A. Dixon	–	–	–	–	10,000	–	–	10,000
Mr W.M. Johnson	24,014	–	–	–	2,161	–	–	26,175
Mr M.J. Carling	9,205	–	–	–	–	–	–	9,205
Mr P.W. Hopkins	–	–	–	–	9,420	–	–	9,420
Mr R.D. Langusch	31,424	–	–	23,250	–	–	84,756	139,430
Executive Officers								
Mr B.W. Lingo	14,335	183,486	–	–	17,804	–	–	215,625
Mr L.D.H. Williams	160,000	–	–	50	70,000	–	–	230,050
Mr C.J. Carty	151,976	23,853	–	9,499	86,304	–	141,260	412,892
Mr I.W. Bucknell	157,492	16,514	–	771	15,661	–	113,008	303,446
Mrs E.S. Petrie	139,550	15,500	–	70	13,955	–	–	169,075
	805,818	239,353	–	79,640	287,114	–	621,544	2,033,469

Bonuses and share-based payments granted as compensation for the current financial year

Bonuses

No bonuses were granted during 2010.

Employee share option plan

The Drillsearch operates an ownership-based scheme for executives and senior employees of the consolidated entity. Each employee share option converts into one ordinary share of Drillsearch Energy Limited on exercise. No amounts are paid or payable by the recipient on receipt of the option. The options carry neither rights to dividends nor voting rights. Options immediately vested and may be exercised at any time from the date of vesting to the date of their expiry. The options granted expire within four years of their issue, or 90 days of the resignation of the Director or executive. There is no direct link currently between the remuneration policy and the Company's performance.

During the financial year, the following share-based payment arrangements were in existence:

Options series	Grant date	Expiry date	Grant date fair value	Vesting date
(8) Issued 28 November 2008	12/08/08	12/08/12	\$0.0289	Vests at date of grant
(9) Issued 28 November 2008	28/11/08	28/11/12	\$0.0141	Vests at date of grant
(10) Issued 11 November 2009	15/06/09	10/11/13	\$0.0152	Vests at date of grant
(11) Issued 1 December 2009	6/10/09	30/11/13	\$0.0330	Vests at date of grant
(12) Issued 1 December 2009	4/12/09	30/11/13	\$0.0516	Vests at date of grant
(13) Issued 1 December 2009	1/10/09	30/09/14	\$0.0402	Vests at date of grant
(14) Issued 3 March 2010	3/03/10	2/03/13	\$0.0370	Vests at date of grant
(15) Issued 16 March 2010	16/03/10	15/03/15	\$0.0385	Vests at date of grant

There are no further services or performance criteria that need to be met in relation to options granted under series (8) to (15) before the beneficial interest vests in the recipient.

The following grants of share-based payment compensation to Directors and key management personnel relate to the current financial year:

Name	Option series	During the financial year			% of compensation for the year consisting of options	
		No. granted	No. vested	% of grant vested		
Mr B.W. Lingo	(10) Issued 11 November 2009	12,000,000	12,000,000	100%	n/a	31.3%
Mr H.R.B. Wecker	(11) Issued 1 December 2009	8,000,000	8,000,000	100%	n/a	87.6%
Mrs F.A. Robertson	(11) Issued 1 December 2009	8,000,000	8,000,000	100%	n/a	87.6%
Mr J.D. McKerlie	(12) Issued 1 December 2009	12,000,000	12,000,000	100%	n/a	83.9%
Mr B.K. Choo	(12) Issued 1 December 2009	8,000,000	8,000,000	100%	n/a	89.2%
Mr J.S. Whaley	(13) Issued 1 December 2009	10,000,000	10,000,000	100%	n/a	66.5%
Mr I.W. Bucknell	(14) Issued 3 March 2010	2,000,000	2,000,000	100%	n/a	23.5%
Mr D. Evans	(15) Issued 16 March 2010	10,000,000	10,000,000	100%	n/a	82.6%
		70,000,000	70,000,000			

During the year, the following ex-Directors exercised options that were granted to them as part of their compensation. Each option converts into one ordinary share of Drillsearch.

Name	No. of options exercised	No. of ordinary shares of Drillsearch Energy Limited issued	Amount paid	Amount unpaid
Mr R.D. Langusch	6,000,000	6,000,000	\$300,000	\$nil
Mr P.P. Simpson	8,000,000	8,000,000	\$400,000	\$nil
Mr P.A. Wicks	6,000,000	6,000,000	\$400,000	\$nil

The following table summarises the value of options granted, exercised or lapsed during the year to Directors and key management personnel:

Name	Value of options granted at the grant date ⁱ \$	Value of options exercised at the exercise date \$	Value of options lapsed at the date of lapse ⁱⁱ \$
Mr J.D. McKerlie	619,200	—	—
Mr B.L. Lingo	182,400	—	—
Mr B.K. Choo	412,800	—	—
Mr P.A. Wicks	—	84,756	—
Mrs F.A. Robertson	264,000	—	—
Mr H.R.B. Wecker	264,000	—	—
Mr J.S. Whaley	402,000	—	—
Mr D. Evans	384,700	—	—
Mr I.W. Bucknell	74,000	—	—

i. The value of options granted during the period is recognised in compensation over the vesting period of the grant, in accordance with Australian accounting standards.

ii. The value of options lapsing during the period due to the failure to satisfy a vesting condition is determined assuming the vesting condition had been satisfied.

Key terms of employment contracts

The employment conditions of the Managing Director, Mr B.W. Lingo, and other key management personnel are formalised in contracts of employment. Other than the Managing Director, Mr J.S. Whaley, Chief Commercial Officer, and Mr D. Evans, Chief Technical Officer, all other key management personnel are permanent employees of Drillsearch Energy Limited or controlled entities. Mr B.W. Lingo is employed under a fixed term contract, which expires on 1 July 2012. Mr J.S. Whaley is employed under a fixed term contract, which expires on 30 September 2012. Mr D. Evans is employed under a fixed term contract, which expires on 14 March 2013.

The various employment contracts stipulate a range of resignation periods. The Company may terminate the various employment contracts without cause by providing written notice or making payment in lieu of notice, based on the individual's annual salary component with a range of notice periods between 1 – 12 months. Termination payments are generally not payable on resignation or dismissal for serious misconduct. In the instance of serious misconduct the Company can terminate employment at any time.

This Directors' report is signed in accordance with a resolution of Directors made pursuant to s.298(2) of the Corporations Act 2001.

On behalf of the Directors



J.D. McKerlie
Chairman
Sydney, 27 August 2010

Deloitte.

The Board of Directors
Drillsearch Energy Limited
Level 8, 16 Spring Street
Sydney NSW 2000

Deloitte Touche Tohmatsu
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27 August 2010

Dear Board Members

Drillsearch Energy Limited

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Drillsearch Energy Limited.

As lead audit partner for the audit of the financial statements of Drillsearch Energy Limited for the financial year ended 30 June 2010, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- (i) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
- (ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU



Jason Thorne
Partner
Chartered Accountants

Liability limited by a scheme approved under Professional Standards Legislation.

Member of
Deloitte Touche Tohmatsu



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Independent Auditor's Report to the member of the Drillsearch Energy Limited

Report on the Financial Report

We have audited the accompanying financial report of Drillsearch Energy Limited, which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, the statement of cash flows and the statement of changes in equity for the year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year as set out on pages 17 to 69.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 3, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that compliance with the Australian equivalents to International Financial Reporting Standards ensures that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting

policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

Auditor's Independence Declaration

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's Opinion

In our opinion:

- (a) the financial report of Drillsearch Energy Limited is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 3.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 9 to 13 of the directors' report for the year ended 30 June 2010. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's Opinion

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

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU



Jason Thorne
Partner
Chartered Accountants
Sydney, 27 August 2010

Directors' declaration

The Directors declare that:

- a. in the Directors' opinion, there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable;
- b. the attached financial statements are in compliance with International Financial Reporting Standards, as stated in Note 3 to the financial statements;
- c. in the Directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the consolidated entity; and
- d. the Directors have been given the declarations required by s.295A of the Corporations Act 2001.

Signed in accordance with a resolution of the Directors made pursuant to s.295(5) of the Corporations Act 2001.

On behalf of the Directors



J.D. McKerlie
Chairman
Sydney, 27 August 2010

For the financial year ended 30 June 2010	Notes	2010 \$	2009 \$
Continuing Operations			
Revenue	6	6,109,331	9,968,423
Changes in inventories		234,188	2,017,367
Direct operating expense		(3,262,477)	(5,657,493)
Employee benefits expense		(2,018,904)	(1,616,126)
Amortisation expense		(2,676,629)	(3,570,978)
Depreciation expense		(101,442)	(135,247)
Gross profit		(1,715,933)	1,005,946
Investment revenue	7	311,243	464,903
Other gains	8	204,581	–
Share based payments expense	30	(2,603,100)	(865,186)
Exploration and evaluation costs expensed	13b	(3,754,543)	(2,143,067)
Impairment of oil and gas assets	13b	(11,266,946)	(4,686,368)
Finance costs	9	(433,396)	(547,599)
Corporate activity costs	13b	(984,228)	(1,727,064)
General legal and professional costs		(2,017,957)	(538,273)
Foreign exchange gains/(losses)	8	46,528	(254,284)
Loss on investment	13b	(60,002)	–
Other expenses	13a	(1,776,427)	(826,063)
Loss before tax		(24,050,180)	(10,117,054)
Income tax expense	10	34,462	228,995
Loss for the year from continuing operations	13	(24,015,718)	(9,888,059)
Discontinued Operations			
(Loss)/profit from the year from discontinued operations	11	(742,334)	401,680
LOSS FOR THE YEAR		(24,758,052)	(9,486,380)
Other Comprehensive Income			
Gain on available for sale investments		–	4,000
Exchange differences arising on translation of foreign operations		324,847	167,193
Other comprehensive income for the year, net of tax		324,847	171,193
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		(24,433,205)	(9,315,187)
Loss attributable to:			
Owners of the parent		(24,604,908)	(9,728,253)
Non-controlling interests		(153,144)	241,873
		(24,758,052)	(9,486,380)
Total comprehensive income attributable to:			
Owners of the parent		(24,280,061)	(9,651,396)
Non-controlling interests		(153,144)	336,209
		(24,433,205)	(9,315,187)
Earnings per Share			
From continuing and discontinued operations:			
Basic (cents per share)	14	(1.2695)	(0.5884)
Diluted (cents per share)		(1.2695)	(0.5884)
From continuing operations:			
Basic (cents per share)		(1.2314)	(0.6133)
Diluted (cents per share)		(1.2314)	(0.6133)

Notes to the financial report are included on pages 43 to 77.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 30 June 2010	Notes	2010 \$	2009 \$
ASSETS			
Current Assets			
Cash and bank balances	28	4,361,222	8,141,877
Trade and other receivables	15	2,038,006	2,705,539
Other financial assets	16	–	26,001
Inventories	17	3,655,034	4,349,111
Other assets	18	219,036	521,261
		10,273,298	15,743,789
Assets classified as held for sale	12	10,481,710	–
Total current assets		20,755,008	15,743,789
Non-Current Assets			
Exploration and evaluation assets	19	29,039,354	30,278,365
Oil and gas assets	20	26,252,743	37,033,739
Property, plant and equipment	21	192,817	177,255
Other assets	18	183,615	919,233
Total non-current assets		55,668,529	68,408,592
TOTAL ASSETS		76,423,537	84,152,381
LIABILITIES			
Current Liabilities			
Trade and other payables	22	1,030,325	2,439,091
Current tax liabilities	10	3,411,308	4,178,130
Provisions	23	73,126	54,138
		4,514,759	6,671,359
Liabilities directly associated with assets classified as held for sale	12	2,892,794	–
Total current liabilities		7,407,553	6,671,359
Non-Current Liabilities			
Provisions	23	3,266,303	3,823,412
Total non-current liabilities		3,266,303	3,823,412
TOTAL LIABILITIES		10,673,856	10,494,771
NET ASSETS		65,749,681	73,657,610
EQUITY			
Capital and Reserves			
Issued capital	24	110,489,587	96,567,411
Reserves		3,755,429	827,482
Retained earnings		(50,600,114)	(25,995,206)
Equity attributable to owners of the parent		63,644,902	71,399,687
Non-controlling interests		2,104,779	2,257,923
TOTAL EQUITY		65,749,681	73,657,610

Notes to the financial report are included on pages 43 to 77.

at 30 June 2010	Share capital \$	Equity-settled employee benefits reserve \$	Foreign currency translation reserve \$	General reserve \$	Retained earnings \$	Attributable to owners of the parent \$	Non-controlling interests \$	Total \$
Balance at 1 July 2008	67,802,582	–	(1,550,343)	1,256,267	(16,058,273)	51,450,233	2,415,680	53,865,913
Loss for the year	–	–	–	–	(9,728,253)	(9,728,253)	241,873	(9,486,380)
Other comprehensive income for the year	–	–	72,857	4,000	–	76,857	94,336	171,193
Total comprehensive income	–	–	72,857	4,000	(9,728,253)	(9,651,396)	336,209	(9,315,187)
Reduction in non-controlling interest	–	–	–	493,966	–	493,966	(493,966)	–
Recognition of share-based payments	–	1,296,560	–	–	–	1,296,560	–	1,296,560
Transfer to retained earnings	–	–	–	208,680	(208,680)	–	–	–
Purchase of treasury shares	–	–	–	(2,347,614)	–	(2,347,614)	–	(2,347,614)
Sale of treasury shares	–	–	–	1,393,109	–	1,393,109	–	1,393,109
Shares issued during the year	28,789,880	–	–	–	–	28,789,880	–	28,789,880
Transaction costs of share issue	(25,051)	–	–	–	–	(25,051)	–	(25,051)
Balance at 30 June 2009	96,567,411	1,296,560	(1,477,486)	1,008,408	(25,995,206)	71,399,687	2,257,923	73,657,610
Balance at 1 July 2009	96,567,411	1,296,560	(1,477,486)	1,008,408	(25,995,206)	71,399,687	2,257,923	73,657,610
Loss for the year	–	–	–	–	(24,604,908)	(24,604,908)	(153,144)	(24,758,052)
Other comprehensive income for the year	–	–	324,847	–	–	324,847	–	324,847
Total comprehensive income	–	–	324,847	–	(24,604,908)	(24,280,061)	(153,144)	(24,433,205)
Recognition of share-based payments	–	2,603,100	–	–	–	2,603,100	–	2,603,100
Shares issued during the year	14,955,667	–	–	–	–	14,955,667	–	14,955,667
Transaction costs of share issue	(1,033,491)	–	–	–	–	(1,033,491)	–	(1,033,491)
Balance at 30 June 2010	110,489,587	3,899,660	(1,152,639)	1,008,408	(50,600,114)	63,644,902	2,104,779	65,749,681

Notes to the financial report are included on pages 43 to 77.

CONSOLIDATED STATEMENT OF CASH FLOW

For the year ended 30 June 2010	Note	2010	2009
		\$	\$
Cash flows from operating activities			
Receipts from customers		8,044,600	19,985,881
Payments to suppliers and employees		(11,906,178)	(18,295,302)
Cash (used in)/generated by operations		(3,861,578)	1,690,579
Interest received		311,243	528,834
Interest paid		(7,745)	(10,668)
Net cash (used in)/generated by operating activities	28b	(3,558,080)	2,208,745
Cash flows from investing activities			
Cash and cash equivalents acquired as part of a business combination		–	1,569,668
Payments for exploration & evaluation		(7,712,380)	(4,692,727)
Payment for property, plant and equipment – oil and gas assets		(4,935,921)	(3,727,742)
Payment for property, plant and equipment – other assets		(161,979)	(17,891)
Proceeds from sale of non-current asset		202,943	800
Proceeds from investments		33,660	–
Net cash (used in) investing activities		(12,573,677)	(6,867,892)
Cash flows from financing activities			
Proceeds from issues of equity shares		14,955,667	–
Sale of treasury shares		–	1,393,109
Payment for share issue costs		(1,033,491)	(25,051)
Net cash generated by financing activities		13,922,176	1,368,058
Net decrease in cash and cash equivalents		(2,209,581)	(3,291,089)
Cash and cash equivalents at the beginning of the year			
Effects of exchange rate changes on the balance of cash held in foreign currencies		8,141,877	11,914,442
Cash and cash equivalents at the end of the year	28a	6,520,983	8,141,877

Notes to the financial report are included on pages 43 to 77.

Notes to the financial statements

Note 1. General information

Drillsearch Energy Limited (the Company) is a public company listed on the Australian Securities Exchange (trading under the symbol 'DLS'), incorporated in Australia and operating in Australia, Canada and Papua New Guinea.

Drillsearch Energy Limited's registered office and its principal place of business are as follows:

Registered office

8th Floor
16 Spring Street
SYDNEY NSW 2000
Australia
Tel: +61 2 9241 4440

Principal place of business

8th Floor
16 Spring Street
SYDNEY NSW 2000
Australia
Tel: +61 2 9241 4440

The entity's principal activities are the exploration, development and production of oil and gas interests.

Note 2. Adoption of new and revised Accounting Standards

2.1 Standards and Interpretations affecting amounts in the current period (and/or prior periods)

The following new and revised Standards and Interpretations have been adopted in the current period and have affected the amounts reported in these financial statements.

Standards affecting presentation and disclosure

AASB 101 <i>Presentation of Financial Statements</i> (as revised in September 2007)	AASB 101 (September 2007) has introduced terminology changes (including revised titles for the financial statements) and changes in the format and content of the financial statements.
AASB 8 <i>Operating Segments</i>	AASB 8 is a disclosure Standard that has resulting in a redesignation of the Group's reportable segments (see Note 4).
Amendments to AASB 5 <i>Non-current Asset Held for Sale and Discontinued Operations</i> (adopted in advance of effective date of 1 January 2010)	Disclosure in these financial statements have been modified to reflect the clarification in AASB2009-5 <i>Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project</i> that the disclosure requirements in Standards other than AASB 5 do not generally apply to non-current assets classified as held for sale and discontinued operations.

AASB 3 *Business Combinations* (as revised in 2008)

AASB 3 (2008) has been adopted in the current year. Its adoption has affected the accounting for business combinations in the current period.

In accordance with the relevant transitional provisions, AASB 3(2008) has been applied prospectively to business combinations for which the acquisition date is on or after 1 July 2009. The impact of the adoption of AASB 3(2008) *Business Combinations* has been:

- to allow a choice on a transaction-by-transaction basis for the measurement of non-controlling interests (previously referred to as 'minority' interests) either at fair value or at the non-controlling interests' share of the fair value of the identifiable net assets of the acquiree.
- to change the recognition and subsequent accounting requirements for contingent consideration. Under the previous version of the Standard, contingent consideration was recognised at the acquisition date only if payment of the contingent consideration was probable and it could be measured reliably; any subsequent adjustments to the contingent consideration were recognised against goodwill. Under the revised Standard, contingent consideration is measured at fair value at the acquisition date; subsequent adjustments to the consideration are recognised against goodwill only to the extent that they arise from better information about the fair value at the acquisition date, and they occur within the 'measurement period' (a maximum of 12 months from the acquisition date). All other subsequent adjustments are recognised in profit or loss;
- where the business combination in effect settles a pre-existing relationship between the Group and the acquiree, to require the recognition of a settlement gain or loss; and
- to require that acquisition-related costs be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition.

AASB 127 *Consolidated and Separate Financial Statements* (as revised in 2008)

The revisions to AASB 127(2008) principally affect the accounting for transactions or events that result in a change in the Group's interests in its subsidiaries.

Note 2. Adoption of new and revised Accounting Standards (continued)

AASB 127(2008) has been adopted for periods beginning on or after 1 July 2009 and has been applied retrospectively (subject to specified exceptions) in accordance with the relevant transitional provisions. The revised Standard has affected the Group's accounting policies regarding changes in ownership interests in its subsidiaries that do not result in a change in control. In prior years, in the absence of specific requirements in A-IFRS, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised where appropriate; for decreases in interests in existing subsidiaries that did not involve a loss of control, the difference between the consideration received and the carrying amount of the share of net assets disposed of was recognised in profit or loss. Under AASB 127(2008), all such increases or decreases are dealt with in equity, with no impact on goodwill or profit or loss.

When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the revised Standard requires that the Group derecognise all assets, liabilities and non-controlling interests at their carrying amount. Any retained interest in the former subsidiary is recognised at its fair value at the date control is lost, with the gain or loss arising recognised in profit or loss.

The following new and revised Standards and Interpretations have also been adopted in these financial statements. Their adoption has not had any significant impact on the amounts reported in these financial statements but may affect the accounting for future transactions or arrangements.

AASB 2008-7 <i>Amendments to Australian Accounting Standards – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate</i>	The amendments deal with the measurement of the cost of investments in subsidiaries, jointly controlled entities and associates when adopting A-IFRS for the first time and with the recognition of dividend income from subsidiaries in a parent's separate financial statements.
AASB 2008-1 <i>Amendments to Australian Accounting Standard – Share-based Payments: Vesting Conditions and Cancellations</i>	The amendments clarify the definition of vesting conditions for the purposes of AASB 2, introduce the concept of 'non-vesting' conditions, and clarify the accounting treatment for cancellations.
AASB 123 Borrowing Costs (as revised in 2007) and AASB 2007-6 <i>Amendments to Australian Accounting Standards arising from AASB 123</i>	The principal change to AASB 123 was to eliminate the option to expense all borrowing costs when incurred. This change has had no impact on these financial statements because it has always been the Group's accounting policy to capitalise borrowing costs incurred on qualifying assets.

2.2 Standards and Interpretations in issue not yet adopted

At the date of authorisation of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective.

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
AASB 2009-5 <i>Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project</i>	1 January 2010	30 June 2011
AASB 2009-8 <i>Amendments to Australian Accounting Standards – Group Cash-Settled Share-based Payment Transactions</i>	1 January 2010	30 June 2011
AASB 2009-10 <i>Amendments to Australian Accounting Standards – Classification of Rights Issues</i>	1 February 2010	30 June 2011
AASB 124 <i>Related Party Disclosures</i> (revised December 2009), AASB 2009-12 <i>Amendments to Australian Accounting Standards</i>	1 January 2011	30 June 2012
AASB 9 <i>Financial Instruments, AASB 2009-11 Amendments to Australian Accounting Standards arising from AASB 9</i>	1 January 2013	30 June 2014
Interpretation 19 <i>Extinguishing Financial Liabilities with Equity Instruments</i>	1 July 2010	30 June 2011

Note 3. Significant accounting policies

Statement of compliance

These financial statements are general purpose financial statements which have been prepared in accordance with the Corporations Act 2001, Australian Accounting Standards and Interpretations, and comply with other requirements of the law.

The financial statements comprise the consolidated financial statements of the Group.

Accounting Standards include Australian equivalents to International Financial Reporting Standards ('A-IFRS'). Compliance with A-IFRS ensures that the financial statements and notes of the Group comply with International Financial Reporting Standards ('IFRS').

The financial statements were authorised for issue by the Directors on 27 August 2010.

Basis of preparation

The financial report has been prepared on the basis of historical cost, except for the revaluation of certain non-current assets and financial instruments. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars, unless otherwise noted.

The following significant accounting policies have been adopted in the preparation and presentation of the financial report:

Going concern

The Directors have prepared the financial report on a going concern basis, which contemplates the continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

For the year ended 30 June 2010, the Group incurred a net loss after tax of \$24,758,052 (2009: loss \$9,486,380) principally as a result of the non-cash impacts of the impairment of oil and gas assets and the amortisation and depreciation expenses. The net cash used in operating activities for the year ended 30 June 2010 was \$3,558,080 (2009: cash generated \$2,208,745). The Group's net asset position at 30 June 2010 was \$65,749,681 (2009: \$73,657,610) and its cash balance including discontinued operations amounted to \$6,520,983 (2009: \$8,141,877) at that date.

The Directors' cash flow forecasts project that the Group will continue to be able to meet their liabilities and obligations (including those contractual commitments as disclosed in Note 25 as and when they fall due for a period of at least 12 months from the date of signing of this financial report. The cash flow forecasts are dependent upon the generation of sufficient cash flows from operating activities to meet working capital requirements, and the ability of the Group to manage discretionary exploration and evaluation expenditure on non-core assets via the farm out of certain interests and/or a reduction in its future work programs.

The Directors are of the opinion that the use of the going concern basis of accounting is appropriate as they are satisfied as to the ability of the Group to implement the above.

Further, as an entity involved in oil and gas exploration, development and production activities the Directors continue to assess the financing and capital requirements of the Group, which may include the need to raise additional funds to meet future work programs. However, the Directors believe that the ability of the Group to continue to pay their liabilities and obligations as and when they fall due and to meet their contractual commitments is not dependent upon the raising of additional funds.

The financial report does not include adjustments, if any, relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Group not continue as going concerns.

Critical accounting judgements and key sources of estimation uncertainty

In the application of the Group's accounting policies, management is required to make judgments, estimates and assumptions about carrying values of 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 current and future periods. Refer to Note 4 for a discussion of critical judgements in applying the entity's accounting policies, and key sources of estimation uncertainty.

Significant accounting policies

a. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the entities (including special purpose entities) controlled by the Company (its subsidiaries) (referred to as 'the Group' in these financial statements). Control is achieved where the Company has the power to govern the financial and operating policies of an 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 statement of comprehensive income 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 their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation. Where the transaction value of common control transactions differ from their consolidated book value, the difference is recognised as a contribution by or distribution to equity participants by the transacting entities.

b. Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration for each acquisition is measured as the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Group 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 AASB 3 (2008) are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with AASB 5 'Non-current Assets Held for Sale and Discontinued Operations', which are recognised and measured at fair value less costs to sell.

Note 3. Significant accounting policies (continued)

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 interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) 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 interests 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.

The interest of non-controlling shareholders in the acquiree is initially measured at net fair value of the assets, liabilities and contingent liabilities recognised. 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.

c. Foreign currency

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each entity are expressed in Australian dollars ('\$'), which is the functional currency of Drillsearch Energy Limited and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recognised at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on 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 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 or likely to occur (therefore forming part of the net investment in the foreign operation), which are recognised in other comprehensive income and reclassified from equity to profit or loss on disposal or partial disposal of the net investment.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in Australian dollars using exchange rates prevailing at the end of the reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity (attributed to non-controlling interests as appropriate).

On the disposal of a foreign operation (i.e. a disposal of the Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, loss of joint control over a jointly controlled entity that includes a foreign operation, or loss of significant influence over an associate that includes a foreign operation), all of the accumulated exchange differences in respect of that operation attributable to the Group are reclassified to profit or loss. Any exchange differences that have previously been attributed to non-controlling interests are derecognised, but they are not reclassified to profit or loss.

In the case of a partial disposal (i.e. no loss of control) of a subsidiary that includes a foreign operation, the proportionate share of accumulated exchange differences are re-attributed to non-controlling interests and are not recognised in profit or loss. For all other partial disposals (i.e. of associates or jointly controlled entities not involving a change of accounting basis), the proportionate share of the accumulated exchange differences is reclassified to profit or loss.

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

d. Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except:

- i. where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- ii. for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

Cash flows are included in the cash flow statement on a gross basis. The GST component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority is classified within operating cash flows.

e. Revenue

Revenue is recognised in profit or loss when the significant risks and rewards of ownership have been transferred to the buyer. Revenue is recognised and measured at the fair value of the consideration or contributions received, net of goods and services tax, to the extent it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

Sales revenue

Sales revenue is recognised on the basis of the Group's interest in a producing field ("entitlements" method), when the physical product and associated risks and rewards of ownership pass to the purchaser, which is generally at the time of ship or truck loading, or on the product entering the pipeline.

Overriding royalties

Royalties recognised on farmed out operating lease rights are recognised as revenue as they accrue in accordance with the terms of the overriding royalty agreements.

Pipeline tariffs and processing tolls

Tariffs and tolls charged to other entities for use of pipelines and facilities owned by the Group are recognised as revenue as they accrue in accordance with the terms of the tariff and tolling agreements.

f. Share-based payments

Equity-settled share-based payments with employees and others providing similar services are measured at the fair value of the equity instrument at the grant date. Fair value is measured by use of a binomial model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations. Further details on how the fair value of equity-settled share-based transactions has been determined can be found in Note 30.

The fair value determined at the grant date 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 equity instruments that will eventually vest.

At the end of each reporting date, the Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss over the remaining vesting period, with corresponding adjustment to the equity settled employee benefits reserve.

The policy described above is applied to all equity-settled share based payments that were granted after 7 November 2002 that vested after 1 January 2005. No amount has been recognised in the financial statements in respect of the other equity-settled share-based payments.

Equity-settled share-based payment transactions with parties other than employees are measured at the fair value of the goods and services received, except where the fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders the service.

For cash-settled share-based payments, a liability is recognised for the good or services acquired, measured initially at the fair value of the liability. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with changes in fair value recognised in the profit or loss for the year.

g. Taxation

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

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and 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 end of the reporting period.

Deferred tax

Deferred tax is recognised on temporary 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. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with 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. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Note 3. Significant accounting policies (continued)

The carrying amount of deferred tax assets is reviewed at the end of each reporting period 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 assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

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.

Current and deferred tax for the period

Current and deferred tax are recognised as an expense or income in profit or loss, except when they relate to items that are recognised outside profit or loss, in which case the tax is also recognised outside profit or loss, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is included in the accounting for the business combination.

Tax consolidation

The Company and all its wholly-owned Australian resident entities are part of a tax-consolidated group under Australian taxation law. Drillsearch Energy Limited is the head entity in the tax-consolidated group. Tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'separate taxpayer within group' approach by reference to the carrying amounts in the separate financial statements of each entity and the tax values applying under tax consolidation. Current tax liabilities and assets and deferred tax assets arising from unused tax losses and relevant tax credits of the members of the tax-consolidated group are recognised by the Company (as head entity in the tax-consolidated group).

Due to the existence of a tax funding arrangement between the entities in the tax-consolidated group, amounts are recognised as payable to or receivable by the Company and each member of the group in relation to the tax contribution amounts paid or payable between the parent entity and the other members of the tax-consolidated group in accordance with the arrangement.

Further information about the tax funding arrangement is detailed in Note 10. Where the tax contribution amount recognised by each member of the tax-consolidated group for a particular period is different to the aggregate of the current tax liability or asset and any deferred tax asset arising from unused tax losses and tax credits in respect of that period, the difference is recognised as a contribution from (or distribution to) equity participants.

h. Cash and cash equivalents

Cash comprises cash on hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, which are subject to an insignificant risk of changes in value and have a maturity of three months or less at the date of acquisition.

i. Financial assets

Investments are recognised and derecognised on trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs except for those financial assets classified as at fair value through profit or loss which are initially measured at fair value.

Subsequent to initial recognition, investments in subsidiaries are measured at cost in the Company financial statements as described in Note 29.

Other financial assets are classified into the following specified categories: financial assets 'at fair value through profit or loss', 'held-to-maturity investments', 'available-for-sale' financial assets, and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Income is recognised on an effective interest rate basis for debt instruments other than those financial assets 'at fair value through profit or loss'.

Financial assets at fair value through profit or loss

Financial assets are classified as financial assets at fair value through profit or loss where the financial asset:

- has been acquired principally for the purpose of selling in the near future;
- is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- is a derivative that is not designated and effective as a hedging instrument.

Financial assets at fair value through profit or loss are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the 'other gains and losses'. Fair value is determined in the manner described in Note 29.

Available-for-sale financial assets

Certain shares and redeemable notes held by the Group are classified as being available-for-sale and are stated at fair value. Fair value is determined in the manner described in Note 29. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve, with the exception of impairment losses, interest calculated using the effective interest method and foreign exchange gains and losses on monetary assets which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is included in profit or loss.

Dividends on available-for-sale equity instruments are recognised in profit and loss when the Group's right to receive the dividends is established.

The fair value of available-for-sale monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at reporting period. The foreign exchange gains and losses that are recognised in the profit or loss are determined based on the amortised cost of the monetary asset. Other foreign exchange gains and losses are recognised in other comprehensive income.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For financial assets carried at amortised cost, the amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of financial assets including uncollectible trade receivables is reduced by the impairment loss 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.

When an available-for-sale financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

With the exception of available-for-sale equity instruments, 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 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.

In respect of available-for-sale equity securities, impairment losses previously recognised in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognised in other comprehensive income.

De-recognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when 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 amounts 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.

j. Inventories

Inventories are stated at the lower of cost and net realisable value. Costs, including an appropriate portion of fixed and variable overhead expenses, are assigned to inventories by the method most appropriate to each particular class of inventory, with all categories being valued on a first in first out basis. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

k. Non-current assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the non-current asset (or disposal group) is available for immediate sale in its present condition.

Note 3. Significant accounting policies (continued)

Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

When the Group is committed to a sale plan involving loss of control of a subsidiary, all of the assets and liabilities of the subsidiary are classified as held for sale when the criteria described above are met, regardless of whether the Group will retain a non-controlling interest in its former subsidiary after the sale.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of their previous carrying amount and fair value less costs to sell.

I. Property, plant and equipment

Each class of plant and equipment is carried at cost less, where applicable, any accumulated depreciation and impairment losses.

Plant and equipment are measured on the cost basis. The carrying amount of plant and equipment is reviewed annually by directors to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows that will be measured reliably. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Items of plant and equipment, including buildings and leasehold property but excluding freehold land, are depreciated and amortised over their estimated useful lives to the consolidated group. Leasehold improvements are amortised over the shorter of either the unexpired period of the lease or the estimated useful lives of the improvements. The straight line method is used. Assets are depreciated or amortised from the date of acquisition.

The depreciation rates used for each class of depreciable assets are:

Class of Fixed Asset	Depreciation Rate
Property Plant and Equipment	5-33%

The asset's residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

The gain or loss on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

m. Oil and gas assets

The Group follows the full cost method of accounting for oil and gas assets whereby all costs, less any incentives related to the acquisition, exploration and development of oil and gas reserves are capitalised. These costs include land acquisition costs, geological and geophysical expenses, the costs of drilling both productive and non-productive wells, non-producing lease rentals and directly related general and administrative expenses. Proceeds received from the disposal of properties are normally credited against accumulated costs.

When a significant portion of the properties is sold, a gain or loss is recorded and reflected in profit or loss.

With respect to oil and gas assets, depletion of oil and gas assets and amortisation of production facilities and equipment are calculated using the unit-of-production method based on estimated proven oil and gas reserves. For the purposes of the depletion calculation, proven oil and gas reserves before royalties are converted to a common unit of measure.

The estimated costs for developing proved undeveloped reserves, future decommissioning and abandonments, net of estimated salvage values, are provided for on the unit of production method included in the provision for depletion and amortisation.

In applying the full cost method of accounting, capitalised costs less accumulated depletion are restricted from exceeding an amount equal to the estimated discounted future net revenues, based on year end prices and costs, less the aggregate estimated future operating and capital costs derived from proven and probable reserves.

n. Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

o. Employee benefits

A liability is recognised for benefits accruing to employees in respect of wages and salaries, annual leave, long service leave, and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

Liabilities recognised in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Liabilities recognised in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to reporting date.

Defined contribution plans

Contributions to defined contribution superannuation plans are recognised as an expense when employees have rendered service entitling them to the contributions.

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 the 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 reporting date, taking into account the risks and uncertainties surrounding the obligation.

Contingent liabilities acquired in a business combination

Contingent liabilities acquired in a business combination are initially measured at fair value at the date of acquisition. At the end of subsequent reporting periods, such contingent liabilities are measured at the higher of the amount that would be recognised in accordance with AASB 137 'Provisions, Contingent Liabilities and Contingent Assets' and the amount initially recognised less cumulative amortisation recognised in accordance with AASB 118 'Revenue'.

q. Financial liabilities and equity instruments issued by the Group

Debt and equity instruments

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and subsequently at the higher of:

- the amount of the obligation under the contract, as determined in accordance with AASB 137 'Provisions, Contingent Liabilities and Contingent Assets'; and
- the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with AASB 118 'Revenue'.

Financial liabilities

Financial liabilities are classified as either financial liabilities 'at fair value through profit or loss' or other 'financial liabilities'.

Financial liabilities at fair value through profit or loss

Financial liabilities are classified as at fair value through profit or loss where the financial liability is either held for trading or it is designated as at fair value through profit or loss.

A financial liability is held for trading if:

- it has been acquired principally for the purpose of repurchasing in the near term; or
- on initial recognition it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading is designated as at fair value through profit or loss upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and AASB 139 'Financial Instruments: Recognition and Measurement' permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

Financial liabilities at fair value through profit or loss are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability and is included in the 'other gains and losses' line in the statement of comprehensive income. Fair value is determined in the manner described in Note 29.

Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Note 3. Significant accounting policies (continued)

Derecognition of financial liabilities

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

r. Provision for decommissioning

A provision for decommissioning is recognised when there is a present obligation as a result of exploration, development and production activities undertaken, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount of the provision can be measured reliably. The estimated future obligations include the costs of removing facilities, abandoning wells and restoring the affected areas.

The provision for future decommissioning costs is the best estimate of the present value of the expenditure required to settle the decommissioning obligation at the reporting date. Future decommissioning costs are reviewed annually and any changes in the estimate are reflected in the present value of the decommissioning provision at each reporting date.

The initial estimate of the decommissioning and rehabilitation provision relating to exploration, development and production facilities is capitalised into the cost of the related asset and amortised on the same basis as the related asset, unless the present obligation arises from the production of inventory in the period, in which case the amount is included in the cost of production for the period. Changes in the estimate of the provision for decommissioning are treated in the same manner, except that the unwinding of the effect of discounting on the provision is recognised as a finance cost rather than being capitalised into the cost of the related asset.

s. Exploration and evaluation

Exploration and evaluation expenditures in relation to each separate area of interest are recognised as an exploration and evaluation asset in the year in which they are incurred where the following conditions are satisfied:

- i. the rights to tenure of the area of interest are current; and
- ii. at least one of the following conditions is also met:
 - a. the exploration and evaluation expenditures are expected to be recouped through successful development and exploration of the area of interest, or alternatively, by its sale; or
 - b. exploration and evaluation activities in the area of interest have not, at the reporting date, reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the area of interest are continuing.

Exploration and evaluation assets are initially measured at cost and include acquisition of rights to explore, studies, exploratory drilling, trenching and sampling and associated activities and an allocation of depreciation and amortisation of assets used in exploration and evaluation activities. General and administrative costs are only included in the measurement of exploration and evaluation costs where they are related directly to operational activities in a particular area of interest.

Exploration and evaluation assets are assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. The recoverable amount of the exploration and evaluation asset (or the cash-generating unit(s) to which it has been allocated, being no larger than the relevant area of interest) is estimated to determine the extent of the impairment loss (if any). Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent 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 in previous years. Where a decision is made to proceed with development in respect of a particular area of interest, the relevant exploration and evaluation asset is tested for impairment and the balance is then reclassified to development.

t. Development

Development expenditure is recognised at cost less accumulated amortisation and any impairment losses. Where commercial production in an area of interest has commenced, the associated costs together with any forecast future capital expenditure necessary to develop proved and probable reserves are amortised over the estimated economic life of the field on a units-of-production basis.

Changes in factors such as estimates of proved and probable reserves that affect unit-of-production calculations are dealt with on a prospective basis.

u. Impairment

The carrying amounts of Drillsearch's assets are reviewed at the end of each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss, unless an asset has previously been re-valued through equity, in which case the impairment loss is recognised as a reversal to the extent of the previous revaluation with any excess recognised through profit or loss.

Calculation of recoverable amount

The recoverable amount of Drillsearch's investments in held to maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

The recoverable amount of other assets is the greater of their 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 assets. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

v. Jointly Controlled Operations

Exploration, development and production activities of the Group are carried on through Joint Ventures with other parties and the Group's interest in each Joint Venture is brought into account by including in the respective classifications, where material, the share of individual assets and liabilities.

Note 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 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 current and future periods.

Critical judgements in applying the entity's accounting policies

The following are the critical judgements that management has 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:

Exploration and evaluation assets

The Group's policy for exploration and evaluation is discussed in Note 3(s). The application of this policy requires management to make certain estimates and assumptions as to future events and circumstances. Any such estimates and assumptions may change as new information becomes available. If, after having capitalised exploration and evaluation expenditure, management concludes that the capitalised expenditure is unlikely to be recovered by future sale or exploitation, then the relevant capitalised amount will be written off through profit or loss.

Estimate of reserve quantities

The estimated quantities of proven and probable hydrocarbon reserves reported by the Group are integral to the calculation of amortisation (depletion) and depreciation expense and to assessments of possible impairment of assets. Estimated reserve quantities are based upon interpretations of geological and geophysical models and assessment of the technical feasibility and commercial viability of producing the reserves. Management prepare reserve estimates which conform to guidelines prepared by the Society of Petroleum Engineers. These estimates are then verified by independent technical experts.

These assessments require assumptions to be made regarding future development and production costs, commodity prices, exchange rates and fiscal regimes. The estimate of reserves may change from period to period as the economic assumptions used to estimate the reserves can change from period to period, and as additional geological data is generated during the course of operations.

Provision for decommissioning

The Group estimates the future removal and decommissioning costs of oil and gas production facilities, wells, pipelines and related assets at the time of installation of the assets. In most instances the removal of these assets will occur many years in the future. The estimate of future removal costs therefore requires management to make adjustments regarding the removal date, future environmental legislation, the extent of decommissioning activities and future removal technologies.

Impairment of oil and gas assets

The Group assesses whether oil and gas assets are impaired on a semi-annual basis. This requires an estimation of the recoverable amount of the cash generating unit to which each asset belongs. The recoverable amount is assessed on the basis of the expected net cash flows that will be received from the asset's employment and or subsequent disposal. The expected net cash flows are discounted to their present values in determining the recoverable amount.

Note 5. Segment information

Segment revenues and results

The following is an analysis of the Group's revenue and results from continuing operations by reportable business unit.

	Segment revenue		Segment profit (loss)	
	2010 \$	2009 \$	2010 \$	2009 \$
Mature Oil Projects	5,840,274	9,796,488	(11,023,758)	(952,768)
New Oil Projects	168,384	171,935	(320,416)	(757,532)
Wet Gas Projects	100,673	–	185,581	2,321
Divestment Assets	–	–	(3,180,139)	(2,377,358)
New Ventures	–	–	(1,913,748)	(855,671)
Total from continuing operations	6,109,331	9,968,423	(16,252,480)	(4,941,008)
Investment revenue			311,243	464,903
Central admin costs & directors salaries			(7,675,547)	(5,093,350)
Finance costs			(433,396)	(547,599)
Loss before tax (continuing operations)			(24,050,180)	(10,117,054)

Revenue reported above represents revenue generated from external customers.

The accounting policies of the reportable segments are the same as the Group's accounting policies described in Note 3. Segment profit represents the profit earned by each segment without allocation of central administration costs and directors' salaries, investment revenue, finance costs and income tax expense. This is the measure reporting to the chief operating decision maker for the purposes of resource allocation and assessment of segment performance.

Other segment information

	Amortisation and Depreciation		Additions to non-current assets	
	2010 \$	2009 \$	2010 \$	2009 \$
Mature Oil Projects	2,676,629	3,570,978	2,125,775	4,793,685
New Oil Projects	–	–	5,412,599	21,467,103
Wet Gas Projects	–	–	1,160,888	1,725,077
Divestment Assets	–	–	3,598,538	3,849,028
New Ventures	–	–	386,387	1,663,246
Other	101,442	135,247	126,092	192,120
	2,778,071	3,706,225	12,810,279	33,690,260
	Impairment losses		Exploration write off	
	2010 \$	2009 \$	2010 \$	2009 \$
Mature Oil Projects	11,028,264	3,833,504	3,949	(74,957)
New Oil Projects	238,682	852,864	68,358	–
Wet Gas Projects	–	–	(116,170)	–
Divestment Assets	–	–	3,119,836	2,180,890
New Ventures	–	–	678,570	37,134
	11,266,946	4,686,368	3,754,543	2,143,067

The Group operates in only one geographic segment being Australia and holds no significant customers.

Note 6. Revenue

The following is an analysis of the Group's revenue for the year, from continuing operations (excluding investment revenue – see Note 7).

	2010 \$	2009 \$
Revenue from the sale of oil and gas	5,962,145	9,303,850
Revenue from tariffs and royalties	147,186	664,573
	6,109,331	9,968,423

See Note 5 for an analysis.

Note 7. Investment revenue**Continuing operations**

	2010 \$	2009 \$
Interest revenue		
Bank deposits	311,035	461,773
Other	208	3,130
Total interest	311,243	464,903

Note 8. Other gains and losses**Continuing operations**

	2010 \$	2009 \$
Other gains		
Gain/(loss) on disposal of property, plant and equipment	191,160	(4,871)
Other	13,421	–
	204,581	(4,871)
Net foreign exchange gains/(losses)	46,528	(254,284)
	46,528	(254,284)
	251,109	(259,155)

Note 9. Finance costs**Continuing operations**

	2010 \$	2009 \$
Interest on bank overdrafts and loans	7,745	(28,352)
Other interest expense	166,664	346,352
Total interest expense	174,409	318,000
Unwinding of discount on provisions	258,987	229,599
	433,396	547,599

Note 10. Income taxes

Income tax recognised in profit or loss

	2010 \$	2009 \$
Tax expense comprises:		
Deferred tax income relating to the origination and reversal of temporary differences	(34,462)	(228,995)
	(34,462)	(228,995)
Total tax expense relating to continuing operations	(34,462)	(228,995)

The expense for the year can be reconciled to accounting profit as follows:

	2010 \$	2009 \$
Loss from continuing operations	24,050,180	10,117,054
Income tax benefit calculated at 30%	(7,215,054)	(3,035,116)
Effect of expenses that are not deductible in determining taxable profit	3,430,083	1,509,105
Unrecognised tax losses	3,750,509	1,297,016
	(34,462)	(228,995)
Adjustments recognised in the current year in relation to the current tax of prior years	–	–
	(34,462)	(228,995)

The tax rate used for the 2010 and 2009 reconciliations above is the corporate tax rate of 30% payable by Australian corporate entities on taxable profits under Australian tax law.

Current tax liabilities

In the previous financial year, Drillsearch Energy Canada Incorporated, a wholly owned subsidiary of Drillsearch, received a re-assessment for the 2000 taxation year. The liability including penalties and interest now stands at \$3,411,308 (2009: \$4,178,130) which is fully provided for. The Company has referred this matter to legal counsel and has formally objected to the re-assessment and is in settlement negotiations with the Canadian tax authorities.

	2010 \$	2009 \$
Current tax liabilities		
Income tax payable attributable to:		
Other (see note above)	3,411,308	4,178,130
	3,411,308	4,178,130

Tax consolidation

The Company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 1 July 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Drillsearch Energy Limited. The members of the tax-consolidated group are identified in Note 27.

Note 11. Discontinued operations**11.1 Disposal of Circumpacific Energy Corporation (CER)**

The Group has been actively marketing its subsidiary, Circumpacific Energy Corporation for disposal (equity interest 79.37%). Jennings Capital of Calgary, Canada has been engaged to facilitate the sale process; and negotiations are ongoing with a preferred bidder. The asset continues to be carried at its book value.

The disposal of CER is consistent with the Group's long term policy to focus its activities on the Cooper-Eromanga Basin.

11.2 Analysis of profit for the year from discontinued operations

The results of the discontinued operation included in the statement of comprehensive income are set out below. The comparative profit and cash flows from discontinued operations have been re-presented to include those operations classified as discontinued in the current period.

	2010 \$	2009 \$
Profit/(loss) for the year from discontinued operations		
Revenue	3,491,770	5,127,213
Other gains	8,394	67,902
	3,500,164	5,195,115
Direct operating expense	(1,639,682)	(2,443,110)
Amortisation expense	(941,866)	(763,722)
Depreciation expense	(7,319)	(18,422)
Other expenses	(1,653,631)	(1,222,742)
(Loss)/Profit before tax	(742,334)	747,119
Attributable income tax expense	–	(345,439)
(Loss)/profit for the year from discontinued operations (attributable to owners of the Group)	(742,334)	401,680
Cash flows from discontinued operations		
Net cash inflows from operating activities	897,904	1,059,185
Net cash (outflows)/inflows from investing activities	(1,378,927)	747,013
Net cash inflows/(outflows) from financing activities	449,277	(1,048,295)
Net cash (outflows)/inflows	(31,746)	757,902

CER has been classified and accounted for at 30 June 2010 as a disposal group held for sale (see Note 12).

Note 12. Assets classified as held for sale

	Notes	2010 \$
Assets		
Cash and bank balances	28a	2,159,761
Trade and other receivables		870,025
Exploration and evaluation assets	19	773,709
Oil and gas assets	20	5,644,894
Property, plant and equipment	21	24,096
Inventory		929,832
Other assets		79,393
Total assets		10,481,710
Liabilities		
Trade and other payables		1,465,293
Provisions	23	1,427,501
Total liabilities		2,892,794
Net assets		7,588,916

The net assets include both Naccowlah Block and Circumpacific Energy Corporation.

- i. On 16 August 2010, the Group agreed to sell its 2% Naccowlah Block Joint Venture interest and associated exploration permit ATP 259P and production licenses to Bounty Oil & Gas NL (ASX:BUY) for \$1.15 million comprised of \$950,000 in cash and \$200,000 in BUY common stock. The effective date of the sale is 1 April 2010.
- ii. The Group has been actively marketing its subsidiary, Circumpacific Energy Corporation for disposal (equity interest 79.37%). Jennings Capital of Calgary, Canada has been engaged to facilitate the sale process; and negotiations are ongoing with a preferred bidder. The asset continues to be carried at its book value.

Note 13. Loss for the year from continuing operations

	2010 \$	2009 \$
Owners of the Parent	(23,862,574)	(10,129,932)
Non controlling interests	(153,144)	241,873
(24,015,718)	(9,888,059)	

a. Other expenses

Loss from continuing operations has been arrived at after charging/(crediting):

	2010 \$	2009 \$
Accounting and audit fees	224,213	130,064
Consultancy fees	567,293	191,136
Office rent	173,107	285,663
IT maintenance and software	144,962	119,112
Allowance for doubtful debts	133,694	(60,660)
Director's fee and expenses	304,690	335,702
Share registry and listing fee	139,997	129,967
Capitalised and recouped expenses	(381,462)	(512,781)
Miscellaneous costs	469,933	207,860
	1,776,427	826,063

b. Significant items

	2010 \$	2009 \$
Corporate activity costs	984,228	1,727,064
Amortisation expense	2,676,629	3,570,978
Depreciation expense	101,442	135,247
Exploration and evaluation costs expensed	3,754,543	2,143,067
Loss on Investment	60,002	–
Impairment of oil and gas assets	11,266,946	4,686,368
Total significant items	18,843,788	12,262,724

During the year, the consolidated entity carried out a review of the recoverable amount of its oil and gas assets. The review led to the recognition of an impairment loss on the Australian oil and gas assets of \$11,266,946 (2009: \$4,686,368) that has been recognised in profit or loss (See Note 20 for additional information).

Note 14. Earnings per share

	2010 Cents per share	2009 Cents per share
Basic earnings per share from continuing operations	(1.2314)	(0.6133)
Basic earnings per share from discontinuing operations	(0.0381)	0.0249
Total basic earnings per share	(1.2695)	(0.5884)
Diluted earnings per share from continuing operations	(1.2314)	(0.6133)
Diluted earnings per share from discontinuing operations	(0.0381)	0.0249
Total diluted earnings per share	(1.2695)	(0.5884)

Note 14. Earnings per share (continued)

Basic and diluted earnings per share

The earnings and weighted average number of ordinary shares used in the calculation of basic and diluted earnings per share are as follows:

	2010 \$	2009 \$
Loss for the year attributable to owners of the Company	(24,758,052)	(9,486,380)
Earnings used in the calculation of total basic and diluted earning per share	(24,758,052)	(9,486,380)
Profit/(loss) for the year from discontinued operations used in the calculation of basic EPS from discontinued operations	742,334	(401,680)
Earnings used in the calculation of basic and diluted EPS from continuing operations	(24,015,718)	(9,888,059)
Weighted average number of ordinary shares for the purposes of basic and diluted earnings per share	1,950,348,333	1,612,304,181

Note 15. Trade and other receivables

	2010 \$	2009 \$
Trade receivables ⁱ	2,033,460	2,962,651
Allowance for doubtful debts	–	(389,203)
	2,033,460	2,573,448
Unsecured loans receivable from other parties	4,546	132,091
	4,546	132,091
	2,038,006	2,705,539

i. The average credit period on sales of goods is 30 days.

Ageing of past due but not impaired

	2010 \$	2009 \$
60–90 days	–	17,925
90–120 days	–	18,112
120+ days	794,936	375,467
Total	794,936	411,504

Movement in allowance for doubtful debts

	2010 \$	2009 \$
Balance at the beginning of the year	(389,203)	(247,714)
Reclassified as asset held for sale	389,203	–
Impairment losses recognised on receivables	–	(203,404)
Impairment losses reversed	–	61,915
Balance at the end of the year	–	(389,203)

In determining the recoverability of a trade receivable, the Group considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the reporting date.

Ageing of impaired trade receivables

	2010 \$	2009 \$
60–90 days	–	–
90–120 days	–	–
120+ days	–	389,203
Total	–	389,203

Note 16. Other financial assets**Investments**

	2010 \$	2009 \$
Current		
Australian listed equity shares	–	1
Shares	–	26,000
	–	26,001
Disclosed in the financial statements as:		
Current other financial assets	–	26,001
Non-current other financial assets	–	–
	–	26,001

Note 17. Inventories

	2010 \$	2009 \$
Petroleum (crude oil and condensate at cost)	3,655,034	4,183,138
Consumable supplies at cost	–	165,973
Total	3,655,034	4,349,111

Petroleum stocks on hand are the Company's share of oil produced from the Company's Joint Venture interests in Queensland, Australia.

Note 18. Other assets

	2010 \$	2009 \$
Current		
Prepayments	81,111	383,336
Security deposit	137,925	137,925
	219,036	521,261
Non-current		
Security deposit	128,332	863,950
Rental bond	55,283	55,283
	183,615	919,233
	402,651	1,440,494

Note 19. Exploration and evaluation assets

	Note	2010 \$	2009 \$
Exploration and evaluation assets			
Opening balance		30,278,365	3,120,972
Acquisition of subsidiary		–	23,421,690
Expenditure incurred during the year		7,712,380	4,127,198
Expenditure expensed during the year		(3,754,543)	(2,143,067)
Changes in decommissioning obligations		(54,207)	–
Reclassified from (to) oil and gas assets	20	(4,425,986)	1,652,557
Reclassified as asset held for sale	12	(773,709)	–
Foreign currency translation		57,054	99,015
Balance carried forward		29,039,354	30,278,365

Note 20. Oil and gas assets

	Note	2010 \$	2009 \$
Opening balance		37,033,739	41,224,199
Acquisition of subsidiary		–	1,010,000
Expenditure incurred during the year		4,920,932	4,902,213
Depletion and amortisation expense		(3,618,494)	(4,334,700)
Impairment charges		(11,266,946)	(4,686,368)
Changes in decommissioning obligations		614,129	498,495
Reclass from (to) exploration & evaluation assets	19	4,425,986	(1,652,557)
Reclass from (to) property plant and equipment	21	14,988	–
Reclassified as asset held for sale	12	(5,644,894)	–
Foreign currency translation		(226,697)	72,457
Balance carried forward		26,252,743	37,033,739

	2010 \$	2009 \$
Balance at cost	65,137,670	74,296,015
Accumulated depletion and amortisation	(11,848,035)	(21,492,331)
Impairment charges	(27,036,892)	(15,769,945)
Balance carried forward	26,252,743	37,033,739

There was no depreciation during the period that was capitalised as part of the cost of other assets.

During the year, the consolidated entity carried out a review of the recoverable amount of its oil and gas assets. The review led to the recognition of an impairment loss on the Australian oil and gas assets of \$11,266,946 (2009: \$4,686,368) that has been recognised in profit or loss. The recoverable amount of the relevant assets has been determined on the basis of a discounted cash flow of future production based on proven and probable reserves. The impairment was primarily the result of a revaluation of the Tintaburra block after the Company received for the first time a detailed 3 year forward budget (The pre-tax discount rate used was 11.5% per annum (2009: 9.5%). The Naccowlah block was written down to the market value realised on the sale of the asset to Bounty Oil and Gas NL.

Note 21. Property, plant and equipment

	Note	2010 \$	2009 \$
Opening balance		177,255	94,612
Acquisition of subsidiary		–	211,268
Expenditure incurred during the year		176,967	17,891
Depreciation expense		(108,760)	(153,669)
Disposals during year		(11,782)	(5,601)
Reclassified to oil and gas assets	20	(14,988)	–
Reclassified as asset held for sale	12	(24,096)	–
Foreign currency translation		(1,779)	12,754
Balance carried forward		192,817	177,255
<hr/>			
Balance at cost		469,746	732,789
Accumulated depreciation		(276,930)	(555,534)
Balance carried forward		192,817	177,255

Note 22. Trade and other payables

		2010 \$	2009 \$
Trade payables ⁱ		909,601	2,273,796
Goods and services tax payable		33,399	140,498
Other taxes and dues		87,325	24,797
		1,030,325	2,439,091

i. The average credit period on purchases of goods is 30 days. The Group seeks to ensure that all payables are paid within the credit timeframe.

Note 23. Provisions

		2010 \$	2009 \$
Current			
Employee benefits		73,126	33,538
Office rent		–	20,600
		73,126	54,138
Non-current			
Decommissioning costs		3,266,303	3,823,412
		3,266,303	3,823,412

Note 23. Provisions (continued)

Decommissioning costs

	Note	2010 \$	2009 \$
Opening balance		3,823,412	2,384,205
Acquisition of subsidiary		–	591,250
Additional provisions recognised		559,922	498,495
Payments made		6,726	(28,877)
Unwinding of discount		329,455	321,249
Reclassified as asset held for sale	12	(1,427,501)	–
Foreign currency translation		(25,711)	57,090
Balance carried forward		3,266,303	3,823,412

The provision for decommissioning costs represents the present value of the Directors' best estimate of the future sacrifice of economic benefits that will be required to remove the facilities and restore the affected areas at the Group's operation sites.

The decommissioning of the oil and gas properties is expected to be undertaken between 2 to 25 years from the date of this report.

Note 24. Issued capital

	2010 \$	2009 \$
2,027,544,930 fully paid ordinary shares (2009: 1,728,431,597)	110,489,587	96,567,411
	110,489,587	96,567,411

Changes to the then Corporations Law abolished the authorised capital and par value concept in relation to share capital from 1 July 1998. Therefore, the Company does not have a limited amount of authorised capital and issued shares do not have a par value.

	2010 No.	2010 \$
Fully paid ordinary shares		
Balance at beginning of financial year	1,728,431,597	96,567,411
Issue of shares during the year	299,113,333	14,955,667
Share issue costs	–	(1,033,491)
Balance at end of financial year	2,027,544,930	110,489,587

Fully paid ordinary shares carry one vote per share and carry the right to dividends.

Share options granted under the employee share option plan

As at 30 June 2010, directors (including retired), executives and senior employees have options over 94,000,000 ordinary shares (all of which are vested), in aggregate, with all of those options expiring between 2012 and 2015. As at 30 June 2009, executives and senior employees had options over 44,000,000 ordinary shares.

Share options granted under the employee share option plan carry no rights to dividends and no voting rights. Further details of the employee option plans are contained in Note 30 to the financial statements.

Other share options on issue

As at 30 June 2010, the Company has 1,500,000 share options on issue (2009: 1,500,000, exercisable on a 1:1 basis for 1,500,000 ordinary shares of the Company (2009: 1,500,000) at an exercise price of 4 cents. The options expire on 12 August 2012, and carry no rights to dividends and no voting rights.

Note 25. Commitments for expenditure

	2010 \$	2009 \$
Capital expenditure commitments		
<i>Oil and gas properties</i>		
Not longer than 1 year	17,870,680	3,240,490
Longer than 1 year and not longer than 5 years	13,178,944	945,850
Longer than 5 years	–	–
	31,049,624	4,186,340
Operating lease commitments (office rental)		
Not longer than 1 year	186,585	351,333
Longer than 1 year and not longer than 5 years	746,339	1,212,699
Longer than 5 years	–	–
	932,924	1,564,032

Note 26. Contingent liabilities

	2010 \$	2009 \$
Contingent liabilities		
Court proceedings ⁱ	–	452,000
Court proceedings ⁱⁱ	–	175,000
Court proceedings ⁱⁱⁱ	–	–

Drillsearch has been involved in legal proceedings during the year including those detailed below:

- i. The Company was involved in two sets of legal proceedings commenced in the Supreme Court of New South Wales concerning the Extraordinary General meeting held on 10 June 2009. Although substantially complete there are some unresolved issues arising from the proceedings which may result in the Company incurring further legal costs.
- ii. Drillsearch was involved in legal proceedings commenced in the Supreme Court of New South Wales, concerning a claim by Carling Capital Partners for advisory fees. On 29 July 2010, these proceedings were resolved.
- iii. On 12 May 2009, Odin Energy Limited announced that it had added Great Artesian Oil and Gas Limited, a subsidiary of Drillsearch, to legal proceedings brought by Odin against Kompliment Pty Limited and its holding company, Blue Energy Limited, relating to the termination of a sub-farm agreement between those parties, and loss and damage Odin claims to have suffered in the circumstances of that agreement. Odin is claiming damages from Kompliment and Blue Energy in the amount of approximately \$4.5 million. As part of the proceedings, it is alleged that heads of agreement between Great Artesian, Kompliment and Blue Energy have terminated. The proceedings therefore essentially involve a dispute between a farminee (Kompliment) and sub farminee (Odin), and no claim for damages is made against Great Artesian. Great Artesian has filed its defence, provided discovery and participated in mediation sessions involving all parties to the proceedings. The recent attempts to resolve the matter at mediation were unsuccessful and Great Artesian is continuing a dialogue with the other parties in an attempt to extricate itself from the proceedings.

There is no other litigation of a material nature against Drillsearch or its subsidiaries of which the Directors are aware.

Note 27. Subsidiaries

Name of venture	Country of Incorporation	Ownership interest	
		2010 %	2009 %
Drillsearch Energy (WA) Pty Limited ⁱⁱⁱ	Australia	–	100.0
Great Artesian Oil and Gas Limited	Australia	100.0	100.0
Transoceanic Securities Pty Limited ⁱⁱⁱ	Australia	–	100.0
Frontier Bonaparte Pty Limited ⁱⁱⁱ	Australia	–	100.0
Clean Gas Pty Limited	Australia	100.0	100.0
Drillsearch Energy Gas Pty Limited ^{iv}	Australia	100.0	–
Circumpacific Energy (Australia) Pty Limited ^{iv}	Australia	79.4	–
Drillsearch Energy (Canada) Incorporated	Canada	100.0	100.0
Circumpacific Energy Corporation	Canada	79.4	79.4
Kun Yick International Limited	Hong Kong	100.0	100.0
Drillsearch Energy (PNG) Limited	Papua New Guinea	100.0	100.0

i. Drillsearch Energy Limited is the head entity within the tax-consolidated group.

ii. These companies are members of the tax-consolidated group.

iii. Drillsearch Energy (WA) Pty Ltd, Transoceanic Securities Pty Ltd and Frontier Bonaparte Pty Ltd were wound up during the financial year.

iv. Drillsearch Energy (Gas) Pty Ltd was acquired during the year and Circumpacific Energy (Australia) Pty Ltd was incorporated as a 100% subsidiary of Circumpacific Energy Corporation.

Note 28. Cash and cash equivalents

a. Reconciliation of cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents includes cash on hand and in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash and cash equivalents at the end of the reporting period as shown in the statement of cash flows can be reconciled to the related items in the statement of financial position as follows:

	Note	2010 \$	2009 \$
Cash and bank balances		4,361,222	8,141,877
Cash and bank balances included in a disposal group held for sale	12	2,159,761	–
		6,520,983	8,141,877

b. Financing facilities

	2010 \$	2009 \$
Secured bank overdraft facility:		
Amount unused included in a disposal group held for sale	1,671,123	3,731,741
	1,671,123	3,731,741

The Group has access to financing facilities at reporting date as indicated above. The Group expects to meet its other obligations from operating cash flows, proceeds of divestment of non-core assets and new capital issues.

The above facility is available to the Canadian subsidiary Circumpacific Energy Corporation as a CAD\$1,500,000 (2009: CAD\$3,500,000) revolving credit facility with a Canadian Chartered Bank. Interest on the outstanding advances is calculated at prime +1.5% (2009: prime + 2%). Any unutilised portion of the credit facility is subject to a standby fee. The authorised limit is subject to a semi-annual, borrowing base review by the bank. The facility is secured by a CAD\$15,000,000 (2009: CAD\$15,000,000) floating charge debenture over the assets of the subsidiary. As at 30 June 2010 no amounts were drawn on the facility.

The facility is available to the subsidiary at its option until 30 October 2010. Non-scheduled, interim reviews may occur at the request of the subsidiary with a view to upgrading the borrowing base as new reserves are added through the subsidiary's drilling program or in the event of a significant acquisition. Notwithstanding any of the terms of the facility, all obligations are repayable to the Bank at any time upon its demand. The funds are restricted to development of reserves in Canada with a maximum one time expenditure of CAD\$300,000 (2009: CAD\$600,000) for international development of petroleum and natural gas reserves from cash on hand in the subsidiary.

Significant covenants which have been complied with during the year are:

- The Canadian subsidiary Circumpacific Energy Corporation must maintain a Working Capital Ratio of 1.0:1.0 at all times. The Working Capital Ratio shall be defined as Current Assets (including the undrawn availability under the Credit Facility A and excluding unrealised hedging gains) to Current Liabilities (excluding any current portion of Bank Debt and unrealised hedging losses).

c. Reconciliation of profit for the year to net cash flows from operating activities

	2010 \$	2009 \$
Net loss after income tax	(24,758,052)	(9,486,380)
Depreciation	101,442	153,669
Amortisation	2,676,629	4,334,700
Exploration and evaluation costs	3,754,543	2,143,067
Impairment of oil and gas assets	11,266,946	4,686,368
Bad debts written off	–	141,489
Share based payments	2,603,100	865,186
Foreign exchange (gain)/loss	(114,130)	28,627
Non cash flow items relating to discontinued operation	949,184	–
Non cash – interest accrued	161,022	–
(Profit)/loss on sale of fixed assets	(191,160)	4,871
Profit on sale of shares	(11,660)	–
Decrease in receivables	54,137	3,069,377
Increase/(decrease) in creditors	75,516	(2,294,963)
Increase in inventories	(235,756)	(2,177,218)
Unwinding of discount in provisions	258,987	321,249
Decrease/(Increase) in taxation balances	(226,023)	116,444
Other	77,195	302,259
Net cash (used in)/generated by operating activities	(3,558,080)	2,208,745

Note 29. Financial Instruments

a. 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 stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from 2009.

The capital structure of the Group consists of cash and bank balances and equity of the Group (comprising issued capital, reserves and retained earnings and non-controlling interests).

The Group operates globally. In the markets in which the Group trades, none of the Group's entities are subject to externally imposed capital requirements.

Operating cash flows are used to maintain and expand the Group's exploration and production assets, as well as to make the routine outflows of tax, and repayment of maturing debt.

The Group's policy is to use a variety of capital market issues and borrowing facilities, to meet anticipated funding requirements.

Note 29. Financial Instruments (continued)

b. Financial risk management objectives

The Group's financial instruments consist of deposits with banks, local money market instruments, short-term investments, account receivables and payables and loans to and from subsidiaries.

Exposure to currency risk, interest rate risk, commodity risk, and liquidity risk arises in the normal course of the business. The consolidated Group's overall financial risk management strategy is to seek to ensure that the consolidated Group is able to fund its business plans. The Group does not have derivative financial instruments as at 30 June 2010.

The Group uses various measures dependent on the types of risk to which it is exposed. These methods include cash flow at risk analysis in the case of interest rate, foreign currency and commodity price risk, and ageing analysis for credit risk.

c. Foreign currency risk management

The Group undertakes certain transactions denominated in foreign currencies; consequently, exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters.

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

	2010 \$	2009 \$
US Dollars	109,351	2,658,653
Canadian Dollars	15,803	2,215,656
	125,154	4,874,309

Foreign currency sensitivity analysis

The Group's main exposure is to US dollars (USD) in the Australian entities, which are Australian Dollar functional currency entities. The following table details the Group's sensitivity to a 10% increase and decrease in the Australian Dollar against the relevant foreign currencies. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates.

A positive number below indicates an increase in profit and other equity where the Australian dollar strengthens 10% against the relevant currency. For a 10% weakening of the Australian dollar against the relevant currency, there would be a comparable impact on the profit and other equity, and the balances below would be negative.

	USD Impact 2010 \$	2009 \$
Profit or loss	144,861	297,273

This is mainly attributable to the exposure outstanding on USD receivables, payables and cash balances at the end of the reporting period in the Australian entities.

d. Credit risk management

Substantially all of the accounts receivable are with customers and Joint Venture partners in the oil and gas industry and are subject to normal industry credit risks. The Group generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, counterparties and partners. Accounts receivable related to the sale of the Group's petroleum and natural gas production are from major marketing companies.

e. Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the board of directors, which has established an appropriate liquidity risk management process 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 reserves, banking facilities and reserve borrowing facilities, by continuously monitoring forecast and actual cash flows, and by matching the maturity profiles of financial assets and liabilities. Included in Note 28(b) is a listing of additional undrawn facilities that the Group has at its disposal to further reduce liquidity risk.

Liquidity and interest risk tables

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows.

	Weighted average effective interest rate %	0–3 months \$	3 months to 1 year \$	1–5 years \$	Total \$
2010					
Non-interest bearing	–	1,030,325	–	–	1,030,325
Total financial liabilities		1,030,325		–	1,030,325
Tax liabilities					3,411,308
Provisions					3,339,429
Assets classified as held for sale					2,892,794
Total liabilities					10,673,856
2009					
Non-interest bearing	–	2,439,091	–	–	2,439,091
Total financial liabilities		2,439,091		–	2,439,091
Tax liabilities					4,178,130
Provisions					3,877,550
Total liabilities					10,494,771

The following tables detail the Company's and the Group's remaining contractual maturity for its non-derivative financial assets. The tables have been drawn up based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those except where the Group anticipates that the cash flow will occur in a different period.

	Weighted average effective interest rate %	0–3 months \$	3 months to 1 year \$	1–5 years \$	Total \$
2010					
Non-interest bearing	–	2,684,600	–	183,615	2,868,215
Variable interest rate instruments	3.25%	933,664	–	–	933,664
Fixed interest rate instruments	5.50%	–	3,000,000	–	3,000,000
Total financial assets		3,618,264	3,000,000	183,615	6,801,879
Inventory					3,655,034
Other non-current assets					55,484,914
Assets classified as held for sale					10,481,710
Total assets					76,423,537
2009					
Non-interest bearing	–	8,040,164	–	919,233	8,959,397
Variable interest rate instruments	3.25%	2,354,514	–	–	2,354,514
Fixed interest rate instruments	4.26%	–	1,000,000	–	1,000,000
Total financial assets		10,394,678	1,000,000	919,233	12,313,911
Inventory					4,349,111
Other non-current assets					67,489,359
Total assets					84,152,381

Note 29. Financial Instruments (continued)

f. Fair value of financial instruments

The fair values of financial assets and financial liabilities are determined as follows:

- the fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices
- the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions
- the fair value of derivative instruments, are calculated using quoted prices. Where such prices are not available, discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optimal derivatives, and option pricing models for optional derivatives
- the fair value of financial guarantee contracts is determined using option pricing models where the main assumptions are the probability of default by the specified counterparty extrapolated from market-based credit information and the amount of loss, given the default.

The Directors consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values.

Note 30. Share-based payments

The Company had 44,000,000 options on issue at the start of the financial year. Drillsearch issued 70,000,000 options during the year, whilst 20,000,000 options were exercised.

Each employee share option converts into one ordinary share of Drillsearch Energy Limited on exercise. No amounts are paid or payable by the recipient on receipt of the option. The options carry neither rights to dividends nor voting rights. Options immediately vested and may be exercised at any time from the date of vesting to the date of their expiry.

The options granted expire within four years of their issue, or 90 days of the resignation of the Director or executive.

The total expense for the year was \$2,603,100 (2009: \$1,296,560) of which \$2,603,100 (2009: \$865,186) was expensed and \$nil (2009: \$431,374) was capitalised.

The following share-based payment arrangements were in existence during the current and comparative reporting periods:

Options series	Grant date	Expiry date	Grant date fair value	Vesting date
(8) Issued 28 November 2008	12/08/08	12/08/12	\$0.0289	Vests at date of grant
(9) Issued 28 November 2008	28/11/08	28/11/12	\$0.0141	Vests at date of grant
(10) Issued 11 November 2009	15/06/09	10/11/13	\$0.0152	Vests at date of grant
(11) Issued 1 December 2009	6/10/09	30/11/13	\$0.0330	Vests at date of grant
(12) Issued 1 December 2009	4/12/09	30/11/13	\$0.0516	Vests at date of grant
(13) Issued 1 December 2009	1/10/09	30/09/14	\$0.0402	Vests at date of grant
(14) Issued 3 March 2010	3/03/10	2/03/13	\$0.0370	Vests at date of grant
(15) Issued 16 March 2010	16/03/10	15/03/15	\$0.0385	Vests at date of grant

The weighted average fair value of the share options granted during the financial year is \$0.037 (2009: \$0.02). Options were priced using a binomial option pricing model. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, exercise restrictions (including the probability of meeting market conditions attached to the option), and behavioural considerations. Expected volatility is based on the historical share price volatility over the past 4 years.

Inputs into the model	Option series							
	Series 8	Series 9	Series 10	Series 11	Series 12	Series 13	Series 14	Series 15
Grant date share price	\$0.047	\$0.030	\$0.033	\$0.052	\$0.084	\$0.051	\$0.067	\$0.079
Exercise price	\$0.0400	\$0.0500	\$0.0400	\$0.0725	\$0.0725	\$0.0625	\$0.0850	\$0.0877
Expected volatility	64%	64%	67%	84%	89%	84%	89%	89%
Option life	4 year	4 year	4.4 year	4.2 year	4 year	5 year	3 year	5 year
Dividend yield	–	–	–	–	–	–	–	–
Risk-free interest rate	5.78%	5.67%	5.07%	5.12%	5.10%	5.17%	5.12%	5.36%

The following reconciles the outstanding share options granted under the employee share option plan at the beginning and end of the year:

	2010		2009	
	No. of options	Weighted average exercise price \$	No. of options	Weighted average exercise price \$
Balance at the beginning of the year	44,000,000	0.050	–	–
Granted during the year	70,000,000	0.056	73,250,000	0.056
Forfeited during the year	–	–	(29,250,000)	0.066
Exercised during the year	(20,000,000)	0.050	–	–
Balance at the end of the year	94,000,000	0.054	44,000,000	0.050
Exercisable at the end of the year	94,000,000	0.054	44,000,000	0.050

The share options outstanding at the end of the financial year had a weighted average exercise price of \$0.031 (2009:\$0.02), and an average remaining contractual life of 1,531 days (2009: 1,240 days).

Note 31. Key management personnel compensation

Details of key management personnel

The Directors and other members of key management personnel of the Group during the year were:

- Mr J.D. McKerlie (Chairman)
- Mr B.W. Lingo (Managing director)
- Mr B.K. Choo (Non-executive director)
- Mrs F.A Robertson (Non-executive director)
- Mr H.R.B Wecker (Non-executive director)
- Mr P.A. Wicks (Non-executive director)
- Mr I.W. Bucknell (Company secretary & Chief financial officer)
- Mr D. Evans (Chief technical officer)
- Mr J.S Whaley (Chief commercial officer)
- Mr C.J. Carty (Former chief operating officer)

Note 31. Key management personnel compensation (continued)

Key management personnel compensation

The aggregate compensation made to key management personnel of the Group is set out below:

	2010 \$	2009 \$
Short-term employee benefits	1,334,997	1,124,811
Post-employment benefits	89,850	287,114
Share-based payment	2,603,100	621,544
	4,027,947	2,033,469

Number of share options and fully paid ordinary shares held by Key Management Personnel

Number of share options held by Key Management Personnel

Directors	Share options Number
Mr J.D. McKerlie	18,000,000
Mr B.W. Lingo	12,000,000
Mr B.K. Choo	8,000,000
Mrs F.A. Robertson	8,000,000
Mr H.R.B. Wecker	8,000,000
Mr P.A. Wicks	6,000,000

Number of fully paid ordinary shares held by Key Management Personnel

Directors	Balance 1 July 2009	Shares purchased during the financial year	Balance 30 June 2010
Mr J.D. McKerlie	2,810,000	800,000	3,610,000
Mr B.W. Lingo	–	925,000	925,000
Mr B.K. Choo	10,420,000	950,000	11,370,000
Mrs F.A. Robertson	–	300,000	300,000
Mr H.R.B. Wecker	–	300,000	300,000

The compensation of each member of the key management personnel of the Group for the current and prior year is set out below:

	Short-term employee benefits			Post employ- ment benefits		Share-based payment		
	Salary & fees \$	Bonus \$	Non- monetary \$	Other \$	Super- annuation \$	Other Long-term employee benefits \$	Options \$	Total \$
2010								
Non-executive directors								
Mr J.D. McKerlie	88,381	–	–	22,282	7,954	–	619,200	737,817
Mr B.K. Choo	47,664	–	–	–	2,336	–	412,800	462,800
Mr P.A. Wicks	10,252	–	–	–	–	–	–	10,252
Mrs F.A. Robertson	34,404	–	–	–	3,096	–	264,000	301,500
Mr H.R.B. Wecker	34,404	–	–	–	3,096	–	264,000	301,500
Executive officers								
Mr B.W. Lingo	357,056	–	–	22,282	21,642	–	182,400	583,380
Mr J.S. Whaley	190,348	–	–	–	12,151	–	402,000	604,499
Mr D. Evans	76,264	–	–	–	4,916	–	384,700	465,880
Mr I.W. Bucknell	224,219	–	–	–	16,194	–	74,000	314,413
Mr C.J. Carty	205,161	–	–	22,282	18,465	–	–	245,908
	1,268,153	–	–	66,846	89,850	–	2,603,100	4,027,949
2009	Short-term employee benefits			Post employ- ment benefits		Share-based payment		
	Salary & fees \$	Bonus \$	Non- monetary \$	Other \$	Super- annuation \$	Other Long-term employee benefits \$	Options \$	Total \$
Non-executive directors								
Mr J.D. McKerlie	7,645	–	–	–	33,778	–	84,756	126,179
Mr B.K. Choo	15,291	–	–	–	–	–	–	15,291
Mr P.A. Wicks	43,432	–	–	19,000	–	–	84,756	147,188
Mr P.P. Simpson	51,454	–	–	27,000	28,031	–	113,008	219,493
Mr D.A. Dixon	–	–	–	–	10,000	–	–	10,000
Mr W.M. Johnson	24,014	–	–	–	2,161	–	–	26,175
Mr M.J. Carling	9,205	–	–	–	–	–	–	9,205
Mr P.W. Hopkins	–	–	–	–	9,420	–	–	9,420
Mr R.D. Langusch	31,424	–	–	23,250	–	–	84,756	139,430
Executive officers								
Mr B.W. Lingo	14,335	183,486	–	–	17,804	–	–	215,625
Mr L.D.H. Williams	160,000	–	–	50	70,000	–	–	230,050
Mr C.J. Carty	151,976	23,853	–	9,499	86,304	–	141,260	412,892
Mr I.W. Bucknell	157,492	16,514	–	771	15,661	–	113,008	303,446
Mrs E.S. Petrie	139,550	15,500	–	70	13,955	–	–	169,075
	805,818	239,353	–	79,640	287,114	–	621,544	2,033,469

Note 32. Related party transactions

a. Equity interests in related parties

Equity interests in subsidiaries

Details of the percentage of ordinary shares held in subsidiaries are disclosed in Note 27 to the financial statements.

b. Transactions with key management personnel

Key management personnel compensation

Details of key management personnel compensation are disclosed in Note 31 to the financial statements.

Share options of Drillsearch Energy Limited

	Balance at 1 July No.	Granted as compen- sation No.	Exercised No.	Net other change No.	Balance at 30 June No.	Balance vested at 30 June No.	Vested but not exercisable No.	Vested and exercisable No.	Options vested during year No.
2010									
Mr J.D. McKerlie	6,000,000	12,000,000	–	–	18,000,000	18,000,000	–	18,000,000	12,000,000
Mr I.W. Bucknell	8,000,000	2,000,000	–	–	10,000,000	10,000,000	–	10,000,000	2,000,000
Mr B. W. Lingo	–	12,000,000	–	–	12,000,000	12,000,000	–	12,000,000	12,000,000
Mr B. K. Choo	–	8,000,000	–	–	8,000,000	8,000,000	–	8,000,000	8,000,000
Mr R. Wecker	–	8,000,000	–	–	8,000,000	8,000,000	–	8,000,000	8,000,000
Mrs F. Robertson	–	8,000,000	–	–	8,000,000	8,000,000	–	8,000,000	8,000,000
Mr J. Whaley	–	10,000,000	–	–	10,000,000	10,000,000	–	10,000,000	10,000,000
Mr D. Evans	–	10,000,000	–	–	10,000,000	10,000,000	–	10,000,000	10,000,000
Mr P.A. Wicks	6,000,000	–	6,000,000	–	6,000,000	6,000,000	–	6,000,000	–
2009									
Mr J.D. McKerlie	–	6,000,000	–	–	6,000,000	6,000,000	–	6,000,000	6,000,000
Mr I.W. Bucknell	–	8,000,000	–	–	8,000,000	8,000,000	–	8,000,000	8,000,000
Mr P.A. Wicks	–	6,000,000	–	–	6,000,000	6,000,000	–	6,000,000	6,000,000
Mr P.P. Simpson	–	8,000,000	–	–	8,000,000	8,000,000	–	8,000,000	8,000,000
Mr R.D. Langusch	–	6,000,000	–	–	6,000,000	6,000,000	–	6,000,000	6,000,000
Mr C.J. Carty	–	10,000,000	–	–	10,000,000	10,000,000	–	10,000,000	10,000,000
Mr L.D.H. Williams	–	12,000,000	–	–	–	–	–	–	–

During the year, 20,000,000 options were exercised by Mr R.D. Langusch, Mr P.P. Simpson and Mr P.A. Wicks at an exercise price of \$0.05 per option for 20,000,000 ordinary shares in Drillsearch Energy Limited (2009: nil). No amounts remain unpaid on the options exercised since the financial year. Further details of the share options granted during the 2010 and 2009 financial years are contained in Notes 30 and 31 to the financial statements.

Transactions between Drillsearch Energy Limited and its related parties

During the financial year, the following transactions occurred between the Company and its other related parties:

- Drillsearch Energy Limited recognised tax payable in respect of the tax liabilities of its wholly-owned Australian subsidiaries. Payments to/from the Company are made in accordance with the terms of the tax funding arrangement.

	2010 \$	2009 \$
Financial advisory fee paid to Carling Capital Partners Pty Ltd. The non-executive director, Mr M. Carling (resigned 17th October 08) is a director of Carling Capital Partners Pty Ltd.	–	222,814
Legal fee paid on behalf of the chairman, Mr J.D. Mckerlie towards settlement of court proceedings	135,619	–
Legal fee paid on behalf of the non-executive director, Mr B.K. Choo towards settlement of court proceedings	76,153	–

During the year the Drillsearch settled an amount of \$24,750 owing to Carling Capital Partners Pty Ltd.

Between May and July 2009, the Company was involved in two sets of court proceedings commenced in connection with the Extraordinary General Meeting (EGM) held on 10 June 2009. The Company received claims from its chairman, Mr J.D McKerlie, and non-executive director, Mr B.K Choo, for costs they incurred in relation to the proceedings and the EGM. These costs were paid during the year. All other claims against the Company in relation to the proceedings have been resolved.

There were no related party balances outstanding at 30 June 2010.

Transactions and balances between the Company and its subsidiaries were eliminated in the preparation of consolidated financial statements of the Group.

c. Parent entities

The parent entity in the Group is Drillsearch Energy Limited.

Note 33. Remuneration of auditors

	2010 \$	2009 \$
Auditors of parent entity		
Audit or review of the financial report	161,295	111,000
Preparation of the tax return	–	–
	161,295	111,000
Related practice of the parent entity auditor		
Other non-audit services	14,704	–
	14,704	–
Other auditors		
Audit or review of the financial report	108,786	67,773
Preparation of the tax return	–	–
Other non-audit services	–	–
	108,786	67,773

The auditor of Drillsearch Energy Limited is Deloitte Touche Tohmatsu.

Note 34. Subsequent events

Subsequent to balance date the following material events have occurred:

- On 7 July 2010, preliminary testing results for the Canunda Wet Gas discovery in PEL 106B reported the production of exceptionally high levels of condensate or light oil. Drillsearch owns 50% of this discovery.
- On 13 July 2010, Drillsearch announced a new oil discovery in the Naccowlah block Watson West-1 exploration well. The discovery was cased and suspended as a future oil producer in the Basal Birkhead Formation.
- On 15 July 2010, the planned drilling of up to 5 exploration wells in PEL 91 in the Cooper-Eromanga Basin Western Flank Oil Fairway in South Australia were announced with an expected start date of December 2010 / January 2011.
- On 16 August 2010, the Group agreed to sell its 2% Naccowlah Block Joint Venture interest and associated exploration permit ATP 259P and production licenses to Bounty Oil & Gas NL (ASX:BUY) for \$1.15 million comprised of \$950,000 in cash and \$200,000 in BUY common stock. The effective date of the sale is 1 April 2010.
- On 26 August 2010, the Company and Circumpacific Energy Corporation (TSXV:CER) announced that it had entered into an Arrangement Agreement pursuant to which all of the outstanding shares of CER are to be acquired by Western Petroleum Commodities Inc. ("WPC"), a private Canadian oil and gas company, for approximately \$9.6 million, or \$0.18 per share, representing a 100% premium over CER's 12-month volume weighted average trading price. Following the completion of the Arrangement, Drillsearch has also agreed to purchase CER's Joint Venture interest in eight exploration tenements in South West Queensland, Australia (the "SWQ Blocks") for \$1.8 million. The completion of the Plan of Arrangement is subject to the approval of 66.6% of the shareholders of CER.

Note 35. Parent entity disclosures

35.1 Financial position

	2010 \$	2009 \$
Assets		
Current assets	9,370,138	11,238,755
Non-current assets	68,924,229	76,142,147
Assets classified as held for sale	2,835,849	–
Total assets	81,130,216	87,380,902
Liabilities		
Current liabilities	3,053,941	4,322,202
Non-current liabilities	1,448,164	1,608,817
Assets classified as held for sale	1,004,881	
Total liabilities	5,506,986	5,931,019
Equity		
Issued capital	110,489,587	96,567,411
Reserves	3,606,343	908,273
Retained earnings	(38,472,700)	(16,025,801)
Total equity	75,623,230	81,449,883

35.2 Financial performance

	2010 \$	2009 \$
Loss for the year	(22,446,899)	(7,200,028)
Other comprehensive income	–	–
Total comprehensive income	(22,446,899)	(7,200,028)

35.3 Commitments for expenditure

	2010 \$	2009 \$
Capital expenditure commitments		
<i>Oil and gas properties</i>		
Not longer than 1 year	4,209,653	171,250
Longer than 1 year and not longer than 5 years	5,226,417	206,250
Longer than 5 years	–	–
	9,436,070	377,500
Operating lease commitments (office rental)		
Not longer than 1 year	186,585	178,207
Longer than 1 year and not longer than 5 years	746,339	534,623
Longer than 5 years	–	–
	932,924	712,830

Additional securities exchange information as at 25 August 2010

Number of holders of equity securities

Ordinary share capital

2,037,544,930 fully paid ordinary shares are held by 4,969 individual shareholders.

All issued ordinary shares carry one vote per share; however, partly paid shares do not carry the rights to dividends.

Options

105,500,000 options are held by 10 individual option holders.

Options do not carry a right to vote.

Distribution of holders of equity securities

	Total holders	Fully paid ordinary shares	% of Issued Capital
1–1,000	262	42,638	0.00
1,001–5,000	387	1,334,009	0.06
5,001–10,000	498	4,145,472	0.20
10,001–100,000	2,497	112,766,039	5.55
100,001 and over	1,319	1,919,256,772	94.19
Total	4,963	2,037,544,930	100.00
Holding less than a marketable parcel	–	–	–

Twenty largest holders of quoted equity securities

Ordinary Shareholders	Fully paid ordinary shares Number	Fully paid ordinary shares Percentage
HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED	281,171,312	13.80
ANZ NOMINEES LIMITED <CASH INCOME A/C>	229,721,348	11.27
CITICORP NOMINEES PTY LIMITED	199,357,053	9.78
UOB KAY HIAN PRIVATE LIMITED <CLIENTS A/C>	169,026,075	8.30
PHILLIP SECURITIES PTE LTD <CLIENT ACCOUNT>	45,330,850	2.22
DMG & PARTNERS SECURITIES PTE LTD <CLIENTS A/C>	45,251,360	2.22
BOUNTY OIL & GAS NL	43,511,758	2.14
BELL POTTER NOMINEES LTD <BB NOMINEES A/C>	43,000,000	2.11
NATIONAL NOMINEES LIMITED	42,206,500	2.07
MR YEW MENG CHAY	39,129,475	1.92
NEFCO NOMINEES PTY LTD	37,312,065	1.83
CIMB SECURITIES (SINGAPORE) PTE LTD <CLIENT A/C>	31,079,093	1.53
MR SWEE POOK TEH	20,400,000	1.00
MERRILL LYNCH (AUSTRALIA) NOMINEES PTY LIMITED	17,823,960	0.87
DBS VICKERS SECURITIES (SINGAPORE) PTE LTD <CLIENT ACCOUNT>	14,445,996	0.71
HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED-GSCO ECA	13,950,000	0.68
MR KOCK KENG LIEM	12,500,000	0.61
MR CHEW LAI OOI	10,880,000	0.53
MR RAJENDRAN RAMASAMY	8,300,000	0.41
INTER PARK LIMITED	7,450,000	0.37
	1,311,846,845	64.37

SCHEDULE OF TENEMENTS

Name of Joint Venture	Operator	Principal activity	Ownership interest	
			2010 %	2009 %
Mature Oil				
PL 5 (Pickanjinnie)	Santos Limited	Gas production	75%	75%
ATP 259P & PPL's (Naccowlah) ¹	Santos Limited	Oil production	0%	2%
ATP 299P & PPL's (Tintaburra)	Santos Limited	Oil production	11%	11%
New Oil				
ATP 539P (Eromanga) ²	Great Artesian Oil & Gas Ltd	Exploration	50%	100%
ATP 549P (West Block)	Icon Energy Limited	Exploration	25%	25%
ATP 549P (Cypress Block)	Australian Gasfield Limited	Exploration	40%	40%
ATP 783P (Chandos Block)	Drillsearch Energy Limited	Exploration	100%	100%
ATP 917P (Eromanga)	Circumpacific Energy Corporation ³	Exploration	100%	100%
ATP 920P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 924P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 927P (Eromanga)	Drillsearch Energy Limited	Exploration	100%	100%
ATP 932P (Cooper)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 956P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
ATP 959P (Eromanga)	Circumpacific Energy Corporation	Exploration	100%	100%
PEL 91 (Cooper)	Beach Energy Limited	Exploration	60%	60%
Wet Gas				
PEL 106A (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%*	100%
PEL 106B (Cooper)	Beach Energy Limited	Exploration	50%	50%
PEL 107 (Cooper)	Beach Energy Limited	Exploration	60%	40%
PEL A513 (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%	0%
PPL 212 (Cooper)	Beach Energy Limited	Oil production	60%	30%
Unconventional				
PEL 106A (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%*	100%
PEL 106B (Cooper)	Beach Energy Limited	Exploration	50%	50%
PEL 107 (Cooper)	Beach Energy Limited	Exploration	60%	40%
PELA 513 (Cooper)	Great Artesian Oil & Gas Ltd	Exploration	100%	0%
ATP 940P (Cooper)	Circumpacific Energy Corporation	Exploration	100%	100%
Divestment				
VIC/P 63 (Gippsland)	Great Artesian Oil & Gas Ltd	Exploration	100%	100%
VIC/P 64 (Gippsland)	Great Artesian Oil & Gas Ltd	Exploration	100%	100%
T/46P (Gippsland)	Great Artesian Oil & Gas Ltd	Exploration	100%	100%
PPL 244 (Papua) ⁴	Talisman Oil Limited	Exploration	0%	5%
Talbot Lake (Canada)	Drillsearch Energy (Canada) Inc. ⁵	Gas production	100%	100%
Talbot Lake (Canada)	Energy Venture Inc.	Gas production	25%	25%
Circumpacific Energy Corp	Various	Oil production	N/A	N/A
Circumpacific Energy Corp	Various	Gas production	N/A	N/A

Notes:

1. Drillsearch announced the sale of Naccowlah to Bounty Oil on 16 August 2010.
2. Drillsearch farmed out 50% to Traditional Oil Exploration Pty Limited.
3. Circumpacific Energy Corporation is a 79.37% owned subsidiary of Drillsearch Energy Limited.
4. Drillsearch has relinquished its interest in PPL244.
5. Drillsearch Energy (Canada) Inc. is a 100% owned subsidiary of Drillsearch Energy Limited.

* Subject to farmin interests.

Board of Directors

Jim McKerlie (Chairman)
 Brad Lingo (Managing Director)
 Beng Kai Choo (Director)
 Fiona Robertson (Director)
 Ross Wecker (Director)

Company Secretary

Ian Bucknell

Management

Brad Lingo (Managing Director)
 John Whaley (Chief Commercial Officer)
 David Evans (Chief Technical Officer)
 Ian Bucknell (Chief Financial Officer)

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Circumpacific Energy Corporation

For information about Circumpacific please refer to their website and annual report.

www.circumpacific.com

