Registered No: SC255303

CAIRN ENERGY KARNALI LIMITED

REPORT & FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2010

Cairn Energy Karnali Limited

Directors:

W B B Gammell
J M Brown
M S Thoms
S J Thomson
M J Watts

Secretary:

D A Wood

Auditors:

Ernst & Young LLP
Ten George Street
Edinburgh EH2 2DZ

Solicitors:

Shepherd and Wedderburn LLP
1 Exchange Crescent
Conference Square
Edinburgh EH3 8UL

Registered Office:

50 Lothian Road
Edinburgh EH3 9BY

Registered No:

SC255303

Cairn Energy Karnali Limited

Directors' Report

The directors present their report and financial statements for the year ended 31 December 2010.

Principal Activities and Business Review

Cairn Energy Karnali Limited's ("the Company") principal activity is the exploration for oil and gas.

The Company has signed a petroleum agreement (PA) for Nepal blocks 1 and 2 where it will explore for oil and gas.

The Company carried out an impairment review of intangible exploration/appraisal assets and concluded that indicators of impairment did not exist. Refer to note 1 (e) for details of the assumptions used in the impairment calculations.

During the year the Company made a profit of $27,889 mainly due to foreign exchange (2009: loss $89,016). No dividend has been paid or declared in respect of the year ended 31 December 2010 (2009: $nil).

Principal Risks and Uncertainties

The Company is subject to a variety of risks which derive from the nature of the oil and gas exploration business.

The Company's future depends significantly upon its success in finding or acquiring and developing oil and gas reserves. If the Company is unsuccessful, it would adversely affect the results of its operations and financial condition.

The cost of drilling, completing and operating wells is often uncertain. As a result, the Company may incur cost overruns or may be required to curtail, delay or cancel drilling operations because of many factors, including unexpected drilling conditions, pressure or irregularities in geological formations, equipment failures or accidents, adverse weather conditions, the need for compliance with environmental regulations, governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment.

The security situation in Nepal continues to be monitored closely. Contractual force majeure was invoked on 9 August 2005 and it continued until it was revoked on 30 December 2009. Refer to note 14 for further details.

Financial Instruments

For details of the Company's financial risk management policy see note 11.

Directors

The directors who held office during the year and subsequently are as follows:
W B B Gammell
J M Brown
M S Thoms
S J Thomson
M J Watts

Charitable and Political Donations

The Company did not make any charitable or political contributions during the year (2009: $nil).

Cairn Energy Karnali Limited

Directors' Report (continued)

Creditors Payment Policy

It is the Company's payment policy to ensure settlement of suppliers' services in accordance with the terms of the applicable contracts. In most circumstances, settlement terms are agreed prior to business taking place.

Disclosure of Information to Auditors

The directors of the Company who held office at 31 December 2010 confirm, as far as they are aware, there is no relevant audit information of which the Company's auditors are unaware. In making this confirmation, the directors have taken appropriate steps to make themselves aware of the relevant audit information and that the Company's auditors are aware of this information.

BY ORDER OF THE BOARD

Duncan Wood

Duncan Wood
Secretary

50 Lothian Road
Edinburgh EH3 9BY

31 May 2011

Cairn Energy Karnali Limited

Directors' Responsibility Statement

The directors are responsible for preparing the Annual Report and the Company financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

Under Company Law the directors must not approve the Company financial statements unless they are satisfied that they present fairly the financial position, financial performance and cash flows of the Company for that period. In preparing the Company financial statements the directors are required to:

- Select suitable accounting policies in accordance with IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- State that the Company has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

Each of the directors, whose names are listed in the Board of Directors on page 1 confirms to the best of his knowledge that:

- The financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- The Directors' Report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

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

Independent Auditors' Report

To the members of Cairn Energy Karnali Limited (registered number SC255303)
We have audited the financial statements of Cairn Energy Karnali Limited for the year ended 31 December 2010 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Cash Flows, the Statement of Changes in Equity and the related notes 1 to 16. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of directors and auditors
As explained more fully in the Directors' Responsibilities Statement set out on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the report and financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatement or inconsistencies, we consider the implications for our report.

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Ernst & Young LLP

Ian James McDowall (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Glasgow
31 May 2011

Cairn Energy Karnali Limited
Income Statement
For the year ended 31 December 2010

Continuing Activities	Notes	**2010**	2009
		$	$
Administrative expenses		**(446)**	(1,705)
Operating loss	2	**(446)**	(1,705)
Finance income	4	**28,335**	-
Finance costs	5	**-**	(87,311)
Profit/(loss) before taxation		**27,889**	(89,016)
Taxation on profit/(loss)	6	**-**	-
Profit/(loss) for the year		**27,889**	(89,016)

Cairn Energy Karnali Limited

Statement of Comprehensive Income

For the year ended 31 December 2010

	2010	2009
	$	$
Profit/(loss) for the year	**27,889**	(89,016)
Total comprehensive income for the year	**27,889**	(89,016)

Cairn Energy Karnali Limited

Balance Sheet

As at 31 December 2010

	Notes	2010 $	2009 $
Non-current assets			
Intangible exploration/appraisal assets	7	**489,065**	186,438
		489,065	186,438
Current assets			
Cash and cash equivalents	8	**916**	916
		916	916
Total assets		**489,981**	187,354
Current liabilities			
Trade and other payables	9	**1,879,348**	1,604,610
Total liabilities		**1,879,348**	1,604,610
Net liabilities		**(1,389,367)**	(1,417,256)
Equity			
Called-up share capital	10	**2,002**	2,002
Retained earnings		**(1,391,369)**	(1,419,258)
Total equity		**(1,389,367)**	(1,417,256)

Signed on behalf of the Board on 31 May 2011.

Jann Brown
Director

Cairn Energy Karnali Limited

Statement of Cash Flows

For the year ended 31 December 2010

	Notes	2010 $	2009 $
Cash flows from operating activities			
Profit/(loss) before taxation		**27,889**	(89,016)
Finance income		**(28,335)**	-
Finance costs		-	87,311
Net cash generated used in operating activities		**(446)**	(1,705)
Cash flows from investing activities			
Expenditure on exploration/appraisal assets		**(1,749)**	1,705
Net cash (used in)/from investing activities		**(1,749)**	1,705
Cash flows from financing activities			
Payment from group companies		**2,195**	-
Bank charges		-	-
Net cash flows from financing activities		**2,195**	-
Net decrease in cash and cash equivalents		-	-
Opening cash and cash equivalents at beginning of year		**916**	916
Closing cash and cash equivalents	8	**916**	916

Cairn Energy Karnali Limited

Statement of Changes in Equity

For the year ended 31 December 2010

	Equity share capital $	Retained earnings $	**Total Equity $**
At 1 January 2009	2,002	(1,330,242)	**(1,328,240)**
Loss for the year	-	(89,016)	**(89,016)**
Total comprehensive income for the year	-	(89,016)	**(89,016)**
At 1 January 2010	2,002	(1,419,258)	**(1,417,256)**
Profit for the year	-	**27,889**	**27,889**
Total comprehensive income for the year	-	**27,889**	**27,889**
At 31 December 2010	**2,002**	**(1,391,369)**	**(1,389,367)**

1 Accounting Policies

a) Basis of preparation

The financial statements of Cairn Energy Karnali Limited ("the Company") for the year ended 31 December 2010 were authorised for issue in accordance with a resolution of the directors on 31 May 2011. The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review on page 2. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are presented in the financial statements and supporting notes. In addition, note 11 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

Although the Company holds net liabilities as at 31 December 2010, the Company's ultimate parent company, Cairn Energy PLC, has confirmed it will make available sufficient funds to allow the Company to meet its liabilities as they fall due for the next twelve months. Hence these accounts have been prepared on a going concern basis.

The Company is a limited company incorporated and domiciled in the United Kingdom. The registered office is located at 50 Lothian Road, Edinburgh, Scotland.

The Company prepares its accounts on a historical cost basis. Where there are assets and liabilities calculated on a different basis, this fact is disclosed in the relevant accounting policy.

b) Accounting standards

The Company prepares its accounts in accordance with applicable International Financial Reporting Standards ("IFRS") as adopted by the EU. The Company's financial statements are also consistent with IFRS as issued by the International Accounting Standards Board ("IASB") as they apply to accounting periods ended 31 December 2010.

For the year ending 31 December 2010, the Company has adopted the following standards and interpretations:

Title	Change to accounting policy	Impact on initial application
IAS 7 'Statement of Cash Flows'	Explicitly states that only expenditure that results in a recognised asset can be classified as investing activities.	No impact on the financial position or performance of the Company.

Other amendments to IFRS effective during the year but with no impact on the accounting policies, financial position or performance of the Company were as follows:

- IFRS 2 'Group-settled Share-based Payment Arrangements';
- IFRS 3 'Business Combinations (Revised)';
- IFRS 5 'Non-current Assets Held-for-sale and Discontinued Operations';
- IFRS 8 'Operating Segments';
- IAS 1 'Presentation of Financial Statements';
- IAS 17 'Leases';
- IAS 18 'Revenue;
- IAS 27 'Consolidated and Separate Financial Statements (amended)';
- IAS 38 'Intangible assets';
- Amendment to IAS 39 'Financial Instruments: Recognition and Measurement';
- IFRIC 12 'Service Concession Arrangements';
- IFRIC 15 'Agreements for the Construction of Real Estate';
- IFRIC 17 'Distributions of Non-cash Assets to Owners'; and
- IFRIC 18 'Transfers of Assets from Customers'

1 Accounting Policies (continued)

b) Accounting standards (continued)

The following new standards and interpretations, which are not yet effective and which are not expected to impact the Company's financial position or performance, have been issued by the IASB:

- Improvements to IFRS 7 'Transfers of financial assets';
- IFRS 9 'Financial Instruments: Classification and Measurement';
- IFRS 10 'Consolidation';
- IFRS 11 'Joint Arrangements';
- IFRS 12 'Disclosure of Interests in Other Entities';
- IFRS 13 'Fair Value Measurement';
- Amendment to IAS 12 'Deferred tax: Recovery of underlying assets';
- IAS 24 (Revised) 'Related Party Disclosures';
- Amendment to IAS 32 'Classification of rights issues'; and
- IFRIC 19 'Extinguishment of financial liabilities with equity instruments'

c) Presentation currency
The functional and presentation currency of the Company is US Dollars ($). The Company's policy on foreign currencies is detailed in note 1(i).

d) Joint ventures
The Company participates in several unincorporated Joint Ventures which involve the joint control of assets used in the Company's oil and gas exploration and producing activities. The Company accounts for its share of assets, liabilities, income and expenditure of Joint Ventures in which the Company holds an interest, classified in the appropriate Balance Sheet and Income Statement headings. The Company's principal licence interests are jointly controlled assets.

The company has interests in the following unincorporated joint ventures:

	Working interest
Block 1, Nepal	50.0%
Block 2, Nepal	50.0%

e) Intangible exploration/appraisal assets and property, plant and equipment – development/producing assets
The Company follows a successful efforts based accounting policy for oil and gas assets.

Costs incurred prior to obtaining the legal rights to explore an area are expensed immediately to the Income Statement.

Expenditure incurred on the acquisition of a licence interest is initially capitalised on a licence-by-licence basis. Costs are held, un-depleted, within intangible exploration/appraisal assets until such time as the exploration phase on the licence area is complete or commercial reserves have been discovered.

Exploration expenditure incurred in the process of determining oil and gas exploration targets is capitalised initially within intangible exploration/appraisal assets and subsequently allocated to drilling activities. Exploration/appraisal drilling costs are initially capitalised on a well–by-well basis until the success or otherwise of the well has been established. The success or failure of each exploration/appraisal effort is judged on a well-by-well basis. Drilling costs are written off on completion of a well unless the results indicate that hydrocarbon reserves exist and there is a reasonable prospect that these reserves are commercial.

Following appraisal of successful exploration wells, if commercial reserves are established and technical feasibility for extraction demonstrated, then the related capitalised intangible exploration/appraisal costs are transferred into a single field cost centre within property, plant and equipment - development/producing assets after testing for impairment (see below). Where results of exploration drilling indicate the presence of hydrocarbons which are ultimately not considered commercially viable, all related costs are written off to the Income Statement.

All costs incurred after the technical feasibility and commercial viability of producing hydrocarbons has been demonstrated are capitalised within property, plant and equipment - development/producing assets on a field-by-field basis. Subsequent expenditure is capitalised only where it either enhances the economic benefits of the development/producing asset or replaces part of the existing development/producing asset. Any remaining costs associated with the part replaced are expensed.

Net proceeds from any disposal of an intangible exploration/appraisal asset are initially credited against the previously capitalised costs. Any surplus proceeds are credited to the Income Statement. Net proceeds from any disposal of development/producing assets are credited against the previously capitalised cost. A gain or loss on disposal of a development/producing asset is recognised in the Income Statement to the extent that the net proceeds exceed or are less than the appropriate portion of the net capitalised costs of the asset.

1 Accounting Policies (continued)

e) Intangible exploration/appraisal assets and property, plant and equipment – development/producing assets (continued)

Depletion
The Company depletes separately, where applicable, any significant components within property, plant and equipment - development/producing assets, such as fields, processing facilities and pipelines, which are significant in relation to the total cost of a development/producing asset.

The Company depletes expenditure on property, plant & equipment - development/producing assets on a unit-of-production basis, based on proved and probable reserves on a field-by-field basis. In certain circumstances, fields within a single development area may be combined for depletion purposes.

Impairment
Intangible exploration/appraisal assets are reviewed regularly for indicators of impairment following the guidance in IFRS 6 'Exploration for and Evaluation of Mineral Resources' and tested for impairment where such indicators exist. In such circumstances the exploration/appraisal asset is allocated to property, plant and equipment - development/producing assets within the same operating segment and tested for impairment. Any impairment arising is recognised in the Income Statement for the year. Where there are no development/producing assets within an operating segment, the exploration/appraisal costs are charged immediately to the Income Statement.

Impairment reviews on property, plant and equipment - development/producing assets are carried out on each cash-generating unit identified in accordance with IAS 36 'Impairment of Assets'. The Company's cash generating units are those assets which generate largely independent cash flows and are normally, but not always, single development areas.

At each reporting date, where there are indicators of impairment, the net book value of the cash generating unit is compared with the associated expected discounted future net cash flows. If the net book value is higher, then the difference is written off to the Income Statement as impairment. Discounted future net cash flows for IAS 36 purposes are calculated using an estimated short and long term oil price of $75/bbl (2009: short and long term oil price of $65/bbl), or the appropriate gas price as dictated by the relevant gas sales contract, escalation for prices and costs of 3%, and a pre-tax discount rate of 10% (2009: 3% and 10% respectively). Forecast production profiles are determined on an asset-by-asset basis, using appropriate petroleum engineering techniques.

Where there has been a charge for impairment in an earlier period that charge will be reversed in a later period where there has been a change in circumstances to the extent that the discounted future net cash flows are higher than the net book value at the time. In reversing impairment losses, the carrying amount of the asset will be increased to the lower of its original carrying value or the carrying value that would have been determined (net of depletion) had no impairment loss been recognised in prior periods.

f) Financial instruments
A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets are categorised as financial assets held at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. The Company holds financial assets which are classified as either available for sale financial assets or loans and receivables, with the exception of derivative financial instruments which are held at fair value through profit or loss.

Financial liabilities generally substantiate claims for repayment in cash or another financial asset. Financial liabilities are categorised as either fair value through profit or loss or held at amortised cost. All of the Company's financial liabilities are held at amortised cost, with the exception of derivative financial instruments which are held at fair value through profit or loss.

Financial instruments are generally recognised as soon as the Company becomes party to the contractual regulations of the financial instrument.

Cash and cash equivalents
Cash and cash equivalents comprise cash at bank and short-term deposits with an original maturity of three months or less.

For the purposes of the consolidated Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Trade payables and other non derivative financial liabilities
Trade payables and other creditors are non-interest bearing and are measured at cost.

1 Accounting Policies (continued)

g) Equity

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs, allocated between share capital and share premium.

h) Taxation

The tax expense represents the sum of current tax and deferred tax.

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit.

Deferred income tax liabilities are recognised for all taxable temporary differences except in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in Joint Ventures where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future. A deferred income tax liability is not recognised if a temporary difference arises on initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, carry forward of unused tax assets and unused tax losses can be utilised, except where the deferred income tax asset relating to the deductible temporary timing difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss. In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in Joint Ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profits will be available against which the temporary differences can be utilised.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the periods in which the asset is realised or the liability is settled, based on tax rates and laws enacted or substantively enacted at the Balance Sheet date.

Deferred tax assets and liabilities are only offset where they arise within the same entity and tax jurisdiction and the group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

i) Foreign currencies

The Company translates foreign currency transactions into the functional currency at the rate of exchange prevailing at the transaction date. Monetary assets and liabilities denominated in foreign currency are translated into the functional currency at the rate of exchange prevailing at the Balance Sheet date. Exchange differences arising are taken to the Income Statement except for those incurred on borrowings specifically allocable to development projects, which are capitalised as part of the cost of the asset.

j) Significant accounting judgements, estimates and assumptions

Key estimations and assumptions

The Company has used estimates and assumptions in arriving at certain figures within the financial statements. The resulting accounting estimates may not equate with the actual results which will only be known in time. Those areas believed to be key areas of estimation are noted below, with further details of the assumptions contained in the relevant note.

Impairment testing

Discounted future net cash flows for IAS 36 purposes are calculated using commodity price, cost and discount rate assumptions on forecast production profiles. See notes 1(f) and 1(g) for further details.

2 Operating Loss

The Company's auditors' remuneration of $4,638 (2009: $4,697) has been borne by the intermediate holding company Capricorn Energy Limited. Auditors' remuneration for other services is disclosed in the financial statements of Cairn Energy PLC, the ultimate parent undertaking. The Company has a policy in place for the award of non-audit work to the auditors which, in certain circumstances, requires Audit Committee approval.

3 Directors' Emoluments

The directors of the company are also directors of the ultimate parent company, Cairn Energy PLC. The directors received remuneration for the year of $5.6m (2009: $5.2m) and pension contributions of $0.5m (2009: $0.5m), all of which was paid by its ultimate parent company. The directors do not believe that it is practicable to apportion this amount between their services as directors of the Company and their services as directors of Cairn Energy PLC and fellow subsidiary companies.

4 Finance Income

	2010	2009
	$	$
Exchange gain	**28,335**	-
	28,335	-

5 Finance Costs

	2010	2009
	$	$
Exchange loss	-	87,311
	-	87,311

6 Taxation on Profit/(Loss)

Factors affecting tax expense for year

A reconciliation of income tax expense applicable to profit/(loss) before income tax at the applicable tax rate to income tax expense at the Company's effective income tax rate is as follows:

	2010	2009
	$	$
Profit/(loss) before taxation	**27,889**	(89,016)
Tax at the weighted average rate of corporation tax of 28% (2009: 28%)	**7,809**	(24,924)
Effects of:		
Deferred tax movement not recognised	**125**	477
Group relief surrendered	**(7,934)**	24,447
Total tax expense	**-**	-

There is a deferred tax asset of $439,923 as at 31 December 2010 (2009: $456,091) in relation to fixed assets, tax losses, and other temporary differences. This asset has not been recognised as there is insufficient evidence that it will reverse in the foreseeable future. This asset will be recovered if the Company generates sufficient taxable income in the future.

7 Intangible Exploration/Appraisal Assets

	South Asia $	**Total $**
Cost		
At 1 January 2009	1,627,194	**1,627,194**
Additions	186,438	**186,438**
At 1 January 2010	1,813,632	**1,813,632**
Additions	302,627	**302,627**
At 31 December 2010	**2,116,259**	**2,116,259**
Impairment		
At 1 January 2009, 1 January 2010 and 31 December 2010	**1,627,194**	**1,627,194**
Net book value at 31 December 2010	**489,065**	**489,065**
Net book value at 31 December 2009	186,438	186,438
Net book value at 1 January 2009	-	-

Impairment of exploration/appraisal assets
Exploration/appraisal assets were reviewed for indicators of impairment at year end and indicators of impairment were not found. Refer to note 1(e) for further details. In 2010 and 2009 no impairment of exploration/appraisal assets was required.

8 Cash and Cash Equivalents

	31 December 2010 $	31 December 2009 $
Cash and cash equivalents	**916**	916
	916	916

9 Trade and other payables

	31 December 2010 $	31 December 2009 $
Amounts owed to Group companies	**34,264**	33,014
Joint Venture creditors	**106**	-
Joint Venture accruals	**1,844,978**	1,571,596
	1,879,348	1,604,610

10 Issued Capital and Reserves

	2010 Number £1 Ordinary	2009 Number £1 Ordinary
Authorised ordinary shares		
At 1 January and 31 December	**5,000,000**	5,000,000

	2010 £1 Ordinary Number	2009 £1 Ordinary Number	2010 £1 Ordinary $	2009 £1 Ordinary $
Allotted, issued and fully paid ordinary shares				
At 1 January and 31 December	**1,300**	1,300	**2,002**	2,002

11 Financial Risk Management: Objectives and Policies

The main risks arising from the Company's financial instruments are liquidity risk, interest rate risk, foreign currency risk, and credit risk. The Board of the Company's ultimate parent company, Cairn Energy PLC reviews and agrees policies for managing each of these risks and these are summarised below.

The Company's treasury functions at Cairn Energy PLC and local operational offices are responsible for these risks for their respective businesses, in accordance with the policy set by the Board. Management of these risks is carried out by monitoring of cash flows, investment and funding requirements using a variety of techniques. These potential exposures are managed whilst ensuring that the Company have adequate liquidity at all times in order to meet their immediate cash requirements.

There are no significant concentrations of risks unless otherwise stated.

The primary financial instruments comprise cash, intra-group loans, and other receivables and financial liabilities held at amortised cost. The Company's strategy is managed as part of a wider strategy undertaken by the Board for the various companies of the Group - mainly to finance its operations through a mixture of retained profits and bank borrowings. Other alternatives such as equity and other forms of non investment-grade debt finance are reviewed by the Board, when appropriate, to fund substantial acquisitions or oil and gas projects.

Liquidity risk
On 28 March 2008, the Company's ultimate parent undertaking, Cairn Energy PLC, entered into a £30.0m revolving credit facility to fund its working capital. The facility was jointly provided by The Royal Bank of Scotland PLC and the Bank of Scotland and was to expire on 31 January 2013. Interest was charged at floating rates determined by LIBOR plus an applicable margin. The facility was cancelled on 20 January 2010.

On 15 September 2010 Cairn Energy PLC entered into a £200m revolving credit facility to fund its working capital. The facility was provided by Standard Chartered Bank Plc and was to expire on 30 September 2011. Interest was charged at floating rates determined by LIBOR plus an applicable margin.

On 15 December 2010 the above facility was refinanced. Cairn Energy PLC entered into a stand-by secured revolving credit of $900m to extend the working capital available to enable commitments to made for the 2011 Greenland drilling campaign and for other general corporate purposes. The facility is provided by Standard Chartered Bank, Bank of Scotland Plc, Crédit Agricole Corporate and Investment Bank, HSBC Bank PLC and Société Générale and expires on 30 September 2012. Security, in the form of a pledge over a number of shares in Cairn Energy UK Holdings Limited, would be provided prior to first drawdown. Interest is charged at floating rates determined by LIBOR plus an applicable margin. No sums were drawn at 31 December 2010.

In addition, Cairn Energy PLC and the Capricorn Group have $35m of facilities (2009: $35m) in place to cover the issue of performance guarantees. Fixed rates of bank commission and charges apply to these. $0.7m was utilised as at 31 December 2010 (2009: $5.9m).

The Cairn Energy PLC Group currently has surplus cash which it has placed in a combination of money market liquidity funds, fixed term deposits and mutual funds with a number of International and Indian banks and financial institutions, ensuring sufficient liquidity to enable the Group to meet its short/medium-term expenditure requirements.

11 Financial Risk Management: Objectives and Policies (continued)

Liquidity risk (continued)
The Group is conscious of the current environment and constantly monitors counterparty risk. Policies are in place to limit counterparty exposure. The Group monitors counterparties using published ratings and other measures where appropriate.

Interest rate risk
Surplus funds are placed on short/medium-term deposits at floating rates. It is Group policy to deposit funds with banks or other financial institutions that offer the most competitive interest rate at time of issue. The requirement to achieve an acceptable yield is balanced against the need to minimise liquidity and counterparty risk.

Short/medium-term borrowing arrangements are available at floating rates. The treasury functions may from time to time opt to manage a proportion of the interest costs by using derivative financial instruments like interest rate swaps. At this time, however, there are no such instruments (2009: none).

Foreign currency risk
The Company manages exposures that arise from non-functional currency receipts and payments by matching receipts and payments in the same currency and actively managing the residual net position.

Where residual net exposures do exist and they are considered significant the Company may from time to time, opt to use derivative financial instruments to minimise its exposure to fluctuations in foreign exchange and interest rates.

Credit risk
Investment credit risk for investments with banks and other financial institutions is managed by the Treasury function in accordance with the Board approved policies of Cairn Energy PLC. Investments of surplus funds are only made with approved counterparties who meet the appropriate rating and/or other criteria, and are only made within approved limits. The Board continually re-assesses the Group's policy and update as required. The limits are set to minimise the concentration of risks and therefore mitigate financial loss through counterparty failure.

PLC and Capricorn Group limit the placing of deposits, certificates of deposit and other investments to banks or financial institutions that have at least 2 AA- or above ratings from Moody's, Standard & Poor's or Fitch unless a Sovereign Guarantee is available from a AAA rated Government. The counterparty limit is $100m and a maximum of 5% of a fund. Investments in international money market liquidity funds are only made with AAA rated funds and where the investment policy is limited to money market instruments.

At the year end the Company does not have any significant concentrations of bad debt risk.

The maximum credit risk exposure relating to financial assets is represented by the carrying value as at the Balance Sheet date.

Capital Management
The objective of the Company's capital management structure is to ensure that there remains sufficient liquidity within the Company to carry out committed work programme requirements. The Board monitors the long term cash flow requirements of the business in order to assess the requirement for changes to the capital structure to meet that objective and to maintain flexibility.

The Board manages the capital structure and makes adjustments to it in light of changes to economic conditions. To maintain or adjust the capital structure, the Board may adjust the dividend payment to shareholders, return capital, issue new shares for cash, repay debt, put in place new debt facilities or other such restructuring activities as appropriate.

No significant changes were made in the objectives, policies or processes during the year ended 31 December 2010.

11 Financial Risk Management: Objectives and Policies (continued)

Company capital and net debt were made up as follows:

	31 December 2010 $	31 December 2009 $
Trade and other payables	**1,879,348**	1,604,610
Less cash and cash equivalents	**(916)**	(916)
Net debt	**1,878,432**	1,603,694
Equity	**(1,389,367)**	(1,417,256)
Company capital and net debt	**489,065**	186,438
Gearing Ratio	**384%**	860%

12 Financial Instruments

The Company calculates the fair value of assets and liabilities by reference to amounts considered to be receivable or payable on the Balance Sheet date. The Company's financial assets and liabilities, together with their fair values are as follows:

Financial assets	**Carrying amount**		**Fair value**	
	31 December 2010 $	31 December 2009 $	**31 December 2010 $**	31 December 2009 $
Cash and cash equivalents	**916**	916	**916**	916
	916	916	**916**	916

All of the above financial assets are current and unimpaired.

Financial liabilities	**Carrying amount**		**Fair value**	
	31 December 2010 $	31 December 2009 $	**31 December 2010 $**	31 December 2009 $
Amount owed to Group companies	**34,264**	33,014	**34,264**	33,014
Joint Venture creditors	**106**	-	**106**	-
	34,370	33,014	**34,370**	33,014

The fair value of financial assets and liabilities has been calculated by discounting the expected future cash flows at prevailing interest rates.

Maturity analysis
The following table sets out the amount, by maturity, of the Company's financial liabilities:

At 31 December 2010

	Total $	Less than one year $	One to two years $	Two to three years $	Three to four years $	Four to five years $	More than five years $
Amount owed to Group companies	**34,264**	34,264	-	-	-	-	-
Joint Venture creditors	**106**	106	-	-	-	-	-
	34,370	**34,370**	-	-	-	-	-

12 Financial Instruments (continued)

At 31 December 2009

	Total $	Less than one year $	One to two years $	Two to three years $	Three to four years $	Four to five years $	More than five years $
Amount owed to Group companies	33,014	33,014	-	-	-	-	-
	33,014	33,014	-	-	-	-	-

13 Capital Commitments

	2010 $	2009 $
Oil and gas expenditure:		
Intangible exploration/appraisal assets	**416,761**	719,350
Contracted for	**416,761**	719,350

The above capital commitments represent the Company's share of obligations in relation to its interests in Joint Ventures. As all Company joint ventures are jointly controlled assets, these commitments also represent the Company's share of the capital commitments of the Joint Ventures themselves.

14 Force Majeure

In accordance with Article 72.3 of the Petroleum Agreement (effective 11 August 2004), the Company has notified the Department of Mines and Geology that force majeure had been lifted on the Company's Nepalese acreage, with effect from 30 December 2009. Force majeure had been in place due to events that had prevented the Company from fulfilling its commitments under the Petroleum Agreement namely, civil disorder, terrorist acts, strikes and blockages. Improved security in the area of the Company's interests will allow, on an initially limited scale, field operations to proceed safely.

15 Related Party Transactions

The following table provides the Company's balances which are outstanding with subsidiary companies at the Balance Sheet date:

	At 31 December 2010 $	At 31 December 2009 $
Amounts owed to Group companies	**34,264**	33,014
	34,264	33,014

The amounts outstanding are unsecured, repayable on demand and will be settled in cash. Interest, where charged, is at market rates. No guarantees have been given.

Remuneration of key management personnel
The remuneration of directors, who are the key management personnel of the Company, is set out in Note 3. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report included in the parent company's annual accounts on pages 76 to 83.

16 Ultimate Parent Company

The Company is a wholly-owned subsidiary of Cairn Energy Nepal Holdings Limited. The results of the Company are consolidated into those of the ultimate parent company, Cairn Energy PLC, registered in Scotland, whose principal place of business is at 50 Lothian Road, Edinburgh, EH3 9BY.

Copies of Cairn Energy PLC's financial statements are available to the public and may be obtained from the above mentioned address.