Tethys Petroleum Limited

Consolidated Financial Statements
December 31, 2010

Management Report

The accompanying consolidated financial statements and all the information in the annual report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies described in the notes to the consolidated financial statements. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality and are in accordance with International Financial Reporting Standards, appropriate in the circumstances, as issued by the International Accounting Standards Board. The consolidated financial information contained elsewhere in the annual report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management has developed and maintains systems of internal accounting controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguarding of assets.

External auditors, appointed by the shareholders of the Company, have examined the consolidated financial statements and have expressed an opinion on the consolidated statements. Their report is included with the consolidated financial statements.

The Board of Directors of the Company has established an Audit Committee, consisting of independent non-management directors, to review consolidated financial statements with management and the auditors. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

"Dr. D. Robson"
Chief Executive

"B. Murphy"
Chief Financial Officer

March 18, 2011

PRICEWATERHOUSECOOPERS

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Independent Auditor's Report

To the Shareholders of Tethys Petroleum Limited

We have audited the accompanying consolidated financial statements of Tethys Petroleum Limited which comprise the consolidated statements of financial position as at December 31, 2010 and December 31, 2009 and the consolidated statements of comprehensive loss, changes in equity and cash flow for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, 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 consolidated financial statements 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 management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Tethys Petroleum Limited as at December 31, 2010 and December 31, 2009 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants

March 18, 2011
Calgary, Alberta

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity.

Tethys Petroleum Limited

Consolidated Statement of Financial Position
(in US dollars)

	Note	As at December 31	
		2010	**2009**
		$'000	**$'000**
Non-current assets			
Intangible assets	11	16,892	24,378
Property, plant and equipment	12	115,653	73,171
Investments	13	1,015	659
Other receivables	14	12,320	5,171
Loan receivable from jointly controlled entity	15	35,460	21,727
		181,340	125,106
Current assets			
Inventories	16	2,121	2,368
Trade and other receivables	14	3,680	2,311
Cash and cash equivalents	17	79,135	7,297
Derivative financial instruments – interest rate swap	18	1,472	-
		86,408	11,976
Total assets		267,748	137,082
Equity attributable to shareholders			
Share capital	21	26,063	13,455
Share premium	21	297,222	153,748
Other reserves		34,261	27,775
Accumulated deficit		(118,023)	(88,374)
Total equity		239,523	106,604
Non-current liabilities			
Deferred gain on sale of assets to jointly controlled entity	15	3,699	3,659
Financial liabilities - borrowings	18	2,853	9,324
Shares to be issued		-	3,750
Deferred taxation	9	4,070	598
Trade and other payables	19	721	808
Asset retirement obligations	20	192	206
		11,535	18,345
Current liabilities			
Financial liabilities - borrowings	18	5,047	1,086
Derivative financial instruments - warrants	18	405	1,053
Derivative financial instruments – interest rate swap	18	-	95
Deferred revenue		2,450	3,113
Trade and other payables	19	8,788	6,786
		16,690	12,133
Total liabilities		28,225	30,478
Total shareholders' equity and liabilities		267,748	137,082
Commitments and contingencies	25		

The notes on pages 1 to 47 form part of these consolidated financial statements. The financial statements were approved by the Board on 18 March 2011 and were signed on its behalf.

"Dr. D. Robson"
Chief Executive

"B. Murphy"
Chief Financial Officer

Tethys Petroleum Limited

Consolidated Statement of Comprehensive Loss
(in US dollars)

	Note	Year ended December 31, 2010 $'000	2009 $'000
Sales and other operating revenues	6	14,706	8,559
Finance income		61	76
Total revenue and other income		14,767	8,635
Production expenditures		(7,076)	(3,405)
Depreciation, depletion and amortization		(5,885)	(3,238)
Exploration and evaluation expenditure written off		-	(887)
Listing expenses		(1,288)	(1,652)
Administrative expenses	7	(25,511)	(16,880)
Foreign exchange loss - net		(337)	(2,397)
Fair value loss (net) on derivative financial instrument		(24)	(479)
Loss from jointly controlled entity	15	(634)	(1,000)
Finance costs		(190)	(203)
Loss before taxation		**(26,178)**	**(21,506)**
Taxation	9	(3,471)	(214)
Net loss and comprehensive loss for the year attributable to shareholders		**(29,649)**	**(21,720)**
Loss per share attributable to shareholders			
Basic and diluted	10	(0.15)	(0.20)

No dividends were paid or are declared for the year (2009 – $Nil).

The notes on pages 1 to 47 form part of these consolidated financial statements.

Tethys Petroleum Limited

Consolidated Statement of Changes in Equity
(in US dollars)

		Attributable to shareholders					
	Note	Share capital $'000	Share premium $'000	Accumulated deficit $'000	Option reserves $'000	Warrant reserves $'000	Total equity $'000
Balance at January 1, 2009	21	6,639	138,598	(66,654)	8,592	16,555	103,730
Comprehensive loss for the year		-	-	(21,720)	-	-	(21,720)
Transactions with shareholders							
Issue of share capital	21	6,816	17,245	-	-	-	24,061
Cost of share issue		-	(2,095)	-	-	-	(2,095)
Share-based payments		-	-	-	2,628	-	2,628
Total transactions with shareholders		6,816	15,150	-	2,628	-	24,594
Balance at January 1, 2010		13,455	153,748	(88,374)	11,220	16,555	106,604
Comprehensive loss for the year		-	-	(29,649)	-	-	(29,649)
Transactions with shareholders							
Issue of share capital	21	12,322	147,780	-	-	-	160,102
Cost of share issue		-	(8,274)	-	-	-	(8,274)
Share-based payments		-	-	-	6,585	-	6,585
Exercise of warrants		250	3,681	-	-	-	3,931
Exercise of options		36	287	-	(99)	-	224
Total transactions with shareholders		12,608	143,474	-	6,486	-	162,568
At December 31, 2010		**26,063**	**297,222**	**(118,023)**	**17,706**	**16,555**	**239,523**

The option reserve and warrant reserve are denoted together as "other reserves" on the consolidated statement of financial position. These reserves are non distributable.

The notes on pages 1 to 47 form part of these consolidated financial statements.

Tethys Petroleum Limited

Consolidated Statement of Cash Flows
(in US dollars)

	Note	Year ended December 31, 2010 $'000	2009 $'000
Cash flow from operating activities			
Loss before taxation		(26,178)	(21,506)
Adjustments for			
Share based payments	7	5,956	2,628
Net finance cost		112	127
Unsuccessful exploration and evaluation expenditures	11	-	887
Depreciation, depletion and amortization		5,885	3,238
Payment of royalties		(78)	-
Fair value loss on derivative financial instrument		24	479
Listing expenses		351	-
Net unrealised foreign exchange (gain)/loss		(75)	1,120
Loss from jointly controlled entity		634	1,000
Deferred revenue		(663)	3,113
Net change in non-cash working capital	24	(2,792)	(1,160)
Net cash used in operating activities		(16,824)	(10,074)
Cash flow from investing activities			
Interest received		61	76
Expenditure on exploration and evaluation assets		(31,688)	(22,648)
Expenditures on property, plant and equipment		(6,605)	(9,573)
Investment in restricted cash		(356)	(72)
Acquisition of subsidiary, net of cash received		-	532
Sale of subsidiaries, net of cash disposed		-	(112)
Payments made on behalf of jointly controlled entity		(14,070)	-
Movement in advances to construction contractors		(3,298)	829
Value added tax receivable		(4,148)	(670)
Net change in non-cash working capital	24	3,461	1,273
Net cash used in investing activities		(56,643)	(30,365)
Cash flow from financing activities			
Proceeds from issuance of short-term borrowings	18	-	2,500
Repayment of short-term borrowings		-	(2,500)
Proceeds from issuance of long-term borrowings	18	1,840	5,020
Repayment of long-term borrowings	18	(4,974)	(856)
Interest paid on long-term borrowings and other non-current payables		(1,036)	(152)
Other non-current liabilities	19	(296)	(109)
Proceeds related to shares to be issued		-	3,750
Proceeds from issuance of equity, net of issue costs	21	149,770	17,906
Net cash generated from financing activities		145,304	25,559
Effects of exchange rate changes on cash and cash equivalents		1	(23)
Net decrease in cash and cash equivalents		71,838	(14,903)
Cash and cash equivalents at beginning of the year		7,297	22,200
Cash and cash equivalents at end of the year		79,135	7,297

The notes on pages 1 to 47 form part of these consolidated financial statements.

1 General information

The principal executive offices of Tethys Petroleum Limited and its subsidiaries (collectively "Tethys" or "the Company") are in Guernsey, British Isles. The domicile of Tethys Petroleum Limited was moved from Guernsey, British Isles to the Cayman Islands on July 17, 2008, where it is incorporated. The address of the Company's registered office is 89 Nexus Way, Camana Bay, Grand Cayman, Cayman Islands. Tethys is an oil and gas company operating within the Republic of Kazakhstan, Republic of Uzbekistan and the Republic of Tajikistan. Tethys' principal activity is the acquisition of and development of crude oil and natural gas fields.

The Company has its primary listing on the Toronto Stock Exchange (TSX) and a secondary listing on the Kazakhstan Stock Exchange (KASE) in Almaty.

Statement of compliance

These consolidated financial statements have been prepared on a going concern basis under the historical cost convention except as modified by the revaluation of available for sale financial assets, and financial assets and financial liabilities at fair value through the statement of comprehensive loss and are in accordance with International Financial Reporting Standards ("IFRSs") and IFRIC interpretations issued by the IFRS Interpretations Committee and effective or issued and early adopted as at the time of preparing these consolidated financial statements.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Areas where estimates are significant to the consolidated financial statements are disclosed in note 4.

2 Summary of significant accounting policies

Basis of preparation

The consolidated financial statements for the year ended December 31, 2010 have been prepared in accordance with International Financial Reporting Standards ("IFRS") and IFRIC Interpretations. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

The consolidated financial statements are presented in United States Dollars. Foreign operations are included in accordance with the policies set out in this note.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Foreign Operations

Tethys' future operations and earnings will depend upon the results of Tethys' operations in the Republic of Kazakhstan, Uzbekistan and Tajikistan. There can be no assurance that Tethys' will be able to successfully conduct such operations, and a failure to do so would have a material adverse effect on Tethys' financial position, results of operations and cash flows. Also, the success of Tethys' operations will be subject to numerous contingencies, some of which are beyond management control. These contingencies include general and regional economic conditions, prices for crude oil and natural gas, competitions and changes in regulation. Since Tethys' is dependent on international operations, Tethys' will be subject to various additional political, economic and other uncertainties. Among other risks, Tethys' operations may be subject to the risks and restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

Changes in accounting policy and disclosures

(a) New and amended standards adopted by the Company

The following new and amended accounting standards are mandatory and relevant for the Company for the first time for these financial statements:

- IFRS 3 'Business Combinations' - the Company has adopted the revised version of this standard, with effect from January 1 2010. The revised standard still requires the purchase method of accounting to be applied to business combinations but introduces some changes to the accounting treatment. Assets and liabilities arising from business combinations that occurred before January 1, 2010 were not required to be re-stated and thus there was no effect on the company's reported income or net assets on adoption.

- IAS 27 'Consolidated and Separate Financial Statements' - the Company has adopted the amended version of IAS 27, also with effect from January 1, 2010. This requires the effects of all transactions with minority interests to be recorded in equity if there is no change in control. When control is lost, any remaining interest in the entity is re-measured to fair value and a gain or loss recognized in profit or loss. There was no effect on the Company's reported income or net assets on adoption.

- IAS 38 'Measurement of non-current assets (or disposal groups) classified as held for sale' – the Company has adopted the amendment to this standard, with effect from January 1, 2010, which clarifies guidance in measuring the fair value of an intangible asset acquired in a business combination and it permits grouping of intangible assets as a single asset if each asset has similar useful economic lives. There was no effect on the Company's reported income or net assets on adoption.

(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company

- IFRS 9 'Financial instruments' – issued in November 2009. This standard is the first step in the process to replace IAS39, 'Financial instruments: recognition and measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets and liabilities, which may affect the Company's accounting for its financial assets. The standard is not applicable until January 1 2013 but is available for early adoption. The Company is yet to assess the full impact of IFRS 9.

Basis of consolidation

Subsidiaries

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Company.

The acquisition method of accounting is used to account for business combinations. The cost of acquisition is measured at the fair value of assets given, equity instruments issued and debt incurred or assumed at the date of acquisition, being the date on which the Company gains control. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred. The excess of the cost over the fair value of the Company's share of identifiable net assets acquired is recorded as goodwill. If the cost is less than the fair value of net assets acquired, the difference is recognised directly in the statement of comprehensive loss. All subsidiaries, as listed in note 23, have been consolidated into the Company's consolidated financial statements.

Inter-Company transactions, balances and unrealised gains or losses between subsidiaries are eliminated. The financial statements of the subsidiaries are prepared using consistent accounting policies and reporting date as of the Company.

Joint ventures

The Company's interests in jointly controlled entities are accounted for using the equity method of accounting. Under the equity method, the investment in a jointly controlled entity is carried in the statement of financial position at cost plus post-acquisition changes in the Company's share of net assets of the jointly controlled entity, less distributions received and less any impairment in value of the investment. The Company's statement of comprehensive loss reflects the Company's share of the results after tax of the jointly controlled entity.

When the Company's share of losses in the jointly controlled entity equals or exceeds its interest in the entity, including any other unsecured receivables, the Company does not recognise further losses, unless it has incurred obligations or made payments on behalf of the jointly controlled entity. Financial statements of jointly controlled entities are prepared for the same reporting year as the Company.

The Company recognises the portion of gains or losses on the sale of assets by the Group to the joint venture that is attributable to the other parties in the joint venture. The Company does not recognise its share of profits

or losses that results from the purchase of assets by the Group from the joint venture until when the asset is resold or, where relevant, as the asset is depreciated by the jointly controlled entity.

In circumstances where the significant risks and rewards of ownership of non-monetary assets transferred have not been transferred to the jointly controlled entity, the associated gain or loss is unrealised and , thus, not recognised in profit or loss but recognised as a deferred gain on the statement of financial position. The deferred gain is recognised in the statement of comprehensive loss when the asset is resold or, where to relevant, as the asset is depreciated by the jointly controlled entity.

Accounting policies of the joint venture are consistent with accounting policies adopted by the Company.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-makers have been identified as the Executive Directors (i.e. Chief Executive Officer, Chief Financial Officer and Executive Vice President) that make strategic decisions.

Foreign currency translation

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). All entities within the Company have a USD functional currency. The consolidated financial statements are presented in USD dollars, which is the Company's presentation currency.

All monetary assets and liabilities denominated in foreign currencies are translated into US dollars at the rate of exchange in effect at the reporting date. Non-monetary assets are translated at historical exchange rates.

Revenue and expense items (excluding depreciation and amortization which are translated at the same rates as the related assets) are translated at the average rate of exchange.

Exchange gains and losses arising on translation are taken to the statement of comprehensive loss.

Oil and gas exploration and evaluation expenditure

Oil and natural gas exploration and evaluation expenditures are accounted for using a modified 'successful efforts' method of accounting. Costs are accumulated on a field-by-field basis. Exploration and evaluation expenditures, including license acquisition costs, are capitalised as exploration and evaluation assets when incurred. Expenditure directly associated with an exploration well is capitalised until the determination of reserves is evaluated. If reserves are not identified, these costs are charged to expense. All other associated exploration and evaluation expenditures are carried forward as an asset in the statement of financial position where the rights of tenure of the property are current and it is considered probable that the costs will be recouped through successful development of the property, or alternatively by its sale. Capitalised exploration and evaluation expenditure is written down to its recoverable amount where the above conditions are no longer satisfied.

If it is determined that a commercial discovery has not been achieved in relation to the property, all other associated costs are written down to their recoverable amount. If commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development tangible and intangible assets. No depreciation and/or amortisation is charged during the exploration and evaluation phase.

Oil and gas properties

Oil and gas properties are stated at cost, less accumulated depreciation and accumulated impairment losses.

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalised within oil and gas properties, as long as the facts and circumstances indicate that the field has commercially viable reserves.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the asset retirement obligation, and for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalised value of a finance lease is also included within property, plant and equipment.

Where commercial production in an area of interest has commenced, oil and gas properties are depleted on a unit-of-production basis over the proved and probable reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. Rights and concessions are depleted on the unit-of-production basis over the total proved and probable reserves of the relevant area. The unit-of-production rate for the depletion of field development costs takes into account expenditures incurred to date, together with future development expenditure to develop the proved and probable reserves. Changes in factors such as estimates of proved and probable reserves that affect unit-of-production calculations do not give rise to prior year financial period adjustments and are dealt with on a prospective basis.

Other property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation. Depreciation is charged so as to write off the cost of these assets less residual value over their estimated useful economic lives, for the following classes of assets:

Drilling rigs and related oil and gas equipment	Unit of production	3,650 operating days
Smaller rig related equipment	Straight line	6 – 8 years
Vehicles	Straight line	4 years
Computer equipment	Straight line	3 years
Office equipment	Straight line	5 years

Gains and losses on disposal are determined by comparing the proceeds with the carrying amount and are recognised within the statement of comprehensive loss.

Other intangible assets

Production enhancement contracts are stated at cost less accumulated amortisation and have a finite useful life. Amortization is calculated using a unit-of-production basis over the estimated incremental production entitlement expected to be received over the life of the contract.

Impairment of non-financial assets

Exploration and evaluation costs are tested for impairment when reclassified to oil and gas properties or whenever facts and circumstances indicate potential impairment. An impairment loss is recognised for the amount by which the exploration and evaluation expenditure's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the exploration and evaluation expenditure's fair value less costs to sell and their value in use.

Values of oil and gas properties and other property, plant and equipment are reviewed for impairment when indicators of such impairment exist. If any indication of impairment exists an estimate of the asset's recoverable amount is calculated. Individual assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. An asset group’s recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of an asset group exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are adjusted for the risks specific to the asset group and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the statement of comprehensive loss so as to reduce the carrying amount to its recoverable amount (i.e. the higher of fair value less costs to sell and value in use).

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Company makes an estimate of the recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years.

Asset retirement obligation (ARO)

Provision is made for the present value of the future cost of abandonment of oil and gas wells and related facilities. This provision is recognised when a legal or constructive obligation arises.

The estimated costs, based on engineering cost levels prevailing at the reporting date, are computed on the basis of the latest assumptions as to the scope and method of abandonment. Provisions are measured at the fair value of the expenditures expected to be required to settle the obligation using a pre-tax risk free rate, updated at each reporting date that reflects current market assessments of the time value of money and the risks specific to the obligation. The corresponding amount is capitalised as part of exploration and evaluation expenditure or oil and gas properties and is amortised on a unit-of-production basis as part of the depreciation, depletion and amortisation charge. Any adjustment arising from the reassessment of estimated cost of ARO is capitalised, whilst the charge arising from the accretion of the discount applied to the ARO is treated as a component of finance costs.

Financial instruments

Financial assets and financial liabilities are recognised on the Company's statement of financial position when the Company becomes party to the contractual provisions of the instrument. Financial assets are de-recognised when the contractual rights to the cashflows from the financial asset expire or when the contractual rights to those assets are transferred. Financial liabilities are de-recognised when the obligation specified in the contract is discharged, cancelled or expired.

Investments

Investments comprise restricted current balances that are held on deposit with banks in the Republic of Kazakhstan in respect of the Company's asset retirement obligations (ARO) in this country and are classified as non-current. They are carried at fair value with gains or losses taken to the statement of comprehensive loss.

Trade receivables, loans and other receivables

Trade receivables, loans and other receivables, which are non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the reporting date, which are classified as non-current assets. The Company's loans and receivables comprise trade and other receivables in the statement of financial position.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method, net of any impairment.

A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the statement of comprehensive loss. When a trade receivable is not collectable, it is written off against the allowance account for trade receivables.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less. These are carried at fair value with gains or losses recognized through statement of comprehensive loss.

Financial liabilities - borrowings

Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of comprehensive loss when the liabilities are derecognised as well as through the amortisation process.

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are measured at amortised cost using the effective interest method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received net of direct issue costs.

Derivative financial instruments

Derivative financial instruments are initially recognized at fair value on the date a derivative contract was entered into and are subsequently remeasured at their fair value with changes in the fair value immediately recognised in the statement of comprehensive loss.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract. Contracts are assessed for embedded derivatives when the Company becomes a party to them, including at the date of a business combination.

Derivative contracts qualifying for the 'own-use' treatment

An 'own-use' contract is one that was entered into and continues to be held for the purpose of the receipt or delivery of the non financial item in accordance with the entity's expected purchase, sale or usage requirements. Contracts that are for the Company's own use are exempt from the requirements of IAS 39.

Inventories

Inventories consist of refined oil products, spare parts and consumable materials and are shown at the lower of cost and net realisable value. Cost is determined on a weighted average cost method for refined oil products and the first-in-first-out method for spare parts and consumable materials inventories.

Taxation including deferred taxation

The tax expense represents current tax and deferred tax.

Current tax is based on the taxable profits for the year. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date in the countries where the Company and its subsidiaries operate and generate taxable income.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss. Deferred income tax assets are recognised to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilised and the carry forward of unused tax credits and unused tax losses can be utilised.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred tax asset is realised or the deferred income tax liability settled.

Share–based payments

The Company operates share-based compensation plans, under which the entity receives services from employees as consideration for equity instruments (options and warrants) of the Company. The fair value of the employee options and warrants granted in exchange for the employee services is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted, excluding the impact of any non-market service and performance vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. When options vest in instalments over the vesting period, each instalment is accounted for as a separate arrangement. At each reporting date, the entity revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the statement of comprehensive loss, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital and share premium when the options are exercised.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of comprehensive loss, net of any reimbursement. The increase in the provision due to passage of time is recognized as interest expense.

Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of natural gas and oil products in the ordinary course of the Company's activities and is recognized when the amount can be reliably measured, it is probable that future economic benefits will flow to the entity, and when specific criteria have been met for each of the Company's activities as described below. Revenue is shown after eliminating sales within the Company.

Revenue from natural gas sales is recognized when the gas has been lifted and the risk of loss transferred to a third-party purchaser and is shown net of royalties, Mineral Extraction Tax (MET) and value-added tax. Revenue from refined product sales is recognized upon delivery and is shown net of value-added tax. All payments received before delivery are recorded as deferred revenue until delivery has occurred.

The Company recognises finance income earned on the Company's cash and cash equivalents and short term investments on an accrual basis.

Barter transactions

Where goods or services are exchanged for goods or services of a dissimilar nature, the revenue is measured at the fair value of the goods or services received, adjusted by the amount of cash or cash equivalents received or paid. If the fair value of the goods or services received cannot be reliably measured, the revenue is measured at the fair value of the goods or services given up, again adjusted by the amount of cash or cash equivalents received.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying capital asset or project under construction are capitalised and added to the asset or project cost during construction until such time as the asset or project is substantially ready for its intended use. Where funds are specifically borrowed to finance an asset or project, the amount capitalised represents the actual amount of borrowing cost incurred. Where funds used to finance an asset or project form part of general borrowings, the amount capitalised is calculated by using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognised in the statement of comprehensive loss in the period in which they are incurred.

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive loss on a straight-line basis over the period of the lease.

Business combinations

Business combinations are accounted for using the acquisition method of accounting. The cost of an acquisition is measured as the cash paid and the fair value of other assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The

acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is recognized as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the statement of comprehensive loss. Acquisition related costs are expensed as incurred.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose identified according to operation segment.

Fair value

The fair value of investments, trade and other receivables, trade and other payables approximate their carrying amounts due to the short term maturity of the instruments. Derivative financial instruments are recorded at fair value with movements in fair value recognised in the statement of comprehensive loss. Loan receivables, long term debt and other non-current liabilities have been recorded at amortized cost using the effective interest rate method.

3 Financial risk management

The Company's activities expose it to a variety of financial risks: market risk, credit risk and liquidity risk. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

Risk management is carried out by senior management, in particular, the Executive Board of Directors.

a) Financial risk factors

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations. Credit risk arises from the Company's loan receivable from the jointly controlled entity, cash and cash equivalents and accounts receivable balances.

With respect to the Company's financial assets the maximum exposure to credit risk due to default of the counter party is equal to the carrying value of these instruments. The maximum exposure to credit risk as at the reporting date is:

	December 31 2010 $'000	December 31 2009 $'000
Trade receivables	1,661	905
Cash and cash equivalents	79,135	7,297
Investments	1,015	659
Loan receivable from jointly controlled entity	35,460	21,727
	117,271	30,588

Concentration of credit risk associated with the above trade receivable balances in Kazakhstan is as a result of contracted sales to three customers during the year. The Company does not believe it is dependent upon this customer for sales due to the nature of gas products and the associated market. The Company's sales in Kazakhstan commenced in December 2007 and the Company has not experienced any credit loss to date. At December 31, 2010 the trade receivable amounted to $1,661,015 (2009 - $905,000), none of which was greater than 30 days overdue. The Company has therefore not recorded a provision against this amount as it does not consider the balance to be impaired.

In Uzbekistan, the Company makes use of two customers. Full payment is required before delivery of the oil and therefore there is limited exposure to credit risk in this country.

Although a significant amount of the deposits at financial institutions are not covered by bank guarantees, the Company does not believe there to be a significant risk of credit loss as the counterparties are banks with high credit ratings (A- or equivalent) assigned by international ratings agencies (Fitch and Standard and Poors).

The Company is exposed to credit risk in relation to its loan receivable from a jointly controlled entity to the extent that the jointly controlled entity fails to meet its contractual obligations. The Company does not believe that the balance is impaired at the reporting date. The carrying amount of the loan receivable represents the maximum exposure to credit risk.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. This risk relates to the Company's ability to generate or obtain sufficient cash or cash equivalents to satisfy these financial obligations as they become due. Since inception, the Company has incurred significant consolidated losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2010.

The Company's processes for managing liquidity risk includes preparing and monitoring capital and operating budgets, co-ordinating and authorizing project expenditures and ensuring appropriate authorization of contractual agreements. The budget and expenditure levels are reviewed on a regular basis and updated when circumstances indicate change is appropriate. The Company seeks additional financing based on the results of these processes.

The timings of cash outflows relating to financial liabilities and commitments at the reporting date are summarized below.

	Less than 1 year $'000	1-3 years $'000	4-5 years $'000	Thereafter $'000	Total $'000
Trade and other payables	8,788	458	128	135	9,509
Financial liabilities - borrowings (note 17)	5,047	2,853	-	-	7,900
Commitments (note 25)	6,196	2,700	-	-	8,896
Operating lease commitments (note 25)	456	210	-	-	666
Total expected cash outflow	20,487	6,221	128	135	26,971

There can be no assurance that debt or equity financing will be available or sufficient to meet the Company's requirements or if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse impact on the Company's financial condition, results of operations and prospects.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as commodity prices, interest rate and foreign exchange rates.

Commodity price risk

Commodity price risk arises from the effect that fluctuations of future commodity process may have on the price received for sales of gas and refined oil products. The marketability and price of natural gas and oil that is produced and may be discovered by the Company will be affected by numerous factors that are beyond the control of the Company.

Natural gas prices are subject to wide fluctuations: the Company has therefore entered into a fixed price contract for sales of gas from the Kyzyloi field in Kazakhstan. However, any material decline in natural gas prices could result in a reduction of Tethys' future net production revenues and impact on the commercial viability of the Company's existing and future oil and gas discoveries. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in volumes and the value of Tethys' gas reserves, if the Company elected not to produce from certain wells at lower prices.

Any material decline in refined oil product prices could result in a reduction of the Company's Uzbekistan net production revenue.

All of these factors could result in a material decrease in the Company's net production revenue causing a reduction in its acquisition and development activities.

The impact of changes in commodity price is assessed in note 4.

(tabular amounts in thousands of US dollars)

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will be affected by changes in market interest rates. Existing long term debt is agreed at fixed interest rates and consequently has limited exposure to changes in market interest rates.

The Company is exposed to interest rate risk on short term deposits to the extent that the significant reductions in market interest rates would result in a decrease in the interest earned by the Company. A change of 1% in the interest rate would have had a change of $207,746 in the interest earned in the current year (2009 - $38,250).

As at the reporting date the Company's interest rate profile was:

At December 31, 2010	Fixed rate financial instruments $'000	Floating rate financial instruments $'000	Total $'000
Cash and cash equivalents	5,000	74,135	79,135
Financial liabilities - borrowings	(7,900)	-	(7,900)
Interest rate swap	1,472	-	1,472
	(1,428)	74,135	72,707

At December 31, 2009	Fixed rate financial instruments $'000	Floating rate financial instruments $'000	Total $'000
Cash and cash equivalents	-	7,297	7,297
Financial liabilities - borrowings	(10,410)	-	(10,410)
Interest rate swap	(95)	-	(95)
	(10,505)	7,297	(3,208)

Foreign exchange risk

The Company is exposed to risks resulting from fluctuations in foreign currency exchange rates. A material change in the value of any such foreign currency could result in a material adverse effect on the Company's cash flow and future profits. The Company is exposed to exchange rate risk to the extent that balances and transactions denominated in a currency other than the US dollar. In addition, a portion of expenditures in Kazakhstan and Tajikistan are denominated in local currency, the Tenge and Somoni, respectively. The Company is not currently using exchange rate derivatives to manage exchange rate risks but is attempting to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan.

The Company holds the majority of its cash and cash equivalents in US dollars. However, the Company does maintain deposits in other currencies, as disclosed in the following table, in order to fund ongoing general and administrative activity and other expenditure incurred in these currencies.

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

In US$ equivalent at December 31, 2010	**CAD ’000**	**GBP ’000**	**EUR ’000**	**SOMONI ’000**	**KZT ’000**
Cash and cash equivalents	1,201	1,123	60	7	492
Trade and other receivables	-	19	24	-	10,434
Trade and other payables	(1)	(131)	-	-	(4,402)
Financial liabilities - borrowings	-	(287)	-	-	-
Net exposure	**1,200**	**724**	**84**	**7**	**6,524**

In US$ equivalent at December 31, 2009	**CAD ’000**	**GBP ’000**	**EUR ’000**	**SOMONI ’000**	**KZT ’000**
Cash and cash equivalents	52	132	83	11	187
Trade and other receivables	-	34	2	-	5,393
Trade and other payables	(35)	(318)	-	-	(561)
Financial liabilities - borrowings	-	(383)	-	-	-
Net exposure	**17**	**(535)**	**85**	**11**	**5,019**

The following table details the Company's sensitivity to a 10% movement in US dollars against the respective foreign currencies, which represents management's assessment of a reasonably likely change in foreign exchange rates.

2010 Effect in US$’000	**CAD**	**GBP**	**EUR**	**SOMONI**	**KZT**
Profit or (loss) before tax	120	73	8	1	652
2009 Effect in US$’000					
Profit or (loss) before tax	-	(20)	10	-	500

A 10% strengthening of the US dollar against the currencies above at December 31, 2010 would have had an equal but opposite effect on the amounts shown above, assuming all other variables remained constant.

b) Capital risk management

The Company's capital structure is comprised of shareholders' equity and net debt.

The Company's objectives when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure of the Company is managed and adjusted to reflect changes in economic conditions.

The Company funds its expenditures on commitments from existing cash and cash equivalent balances, primarily received from issuances of shareholders equity and some debt financing. None of the outstanding debt is subject to externally imposed capital requirements.

Financing decisions are made by management and the Board of Directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet the Company's commitments and development plans. Factors considered when determining whether to issue new debt or to seek equity financing include the amount of financing required, the availability of financial resources, the terms on which financing is available and consideration of the balance between shareholder value creation and prudent financial risk management.

Net debt is calculated as total borrowings (including 'current and non-current borrowings' as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt.

At December 31	**2010**	**2009**
	$'000	**$'000**
Total financial liabilities - borrowings (Note 17)	7,900	10,410
Less: cash and cash equivalents	(79,135)	(7,297)
Net (funds) / debt	(71,235)	3,113
Total equity	323,285	167,203
Total capital	252,050	170,316

If the Company is in a net debt position, the Company will assess whether the projected cash flow is sufficient to service this debt and support ongoing operations. Consideration will be given to reducing the total debt or raising funds through an alternative route such as the issuing of equity.

c) Fair value estimation

Effective January 1, 2009, the Company adopted the amendment to IFRS 7 for financial instruments that are measured at the reporting date at fair value. This requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities. The Company does not have any assets or liabilities that require Level 1 inputs.

Level 2: Inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly. For the Company, Level 2 inputs include prices that can be corroborated with other observable inputs for substantially the complete term of the contract.

Level 3: Unobservable inputs. For the Company, Level 3 inputs include production and price assumptions that are not based on observable market data (unobservable inputs) or are reliant on adjustments or interpolations are made by management to an otherwise standard valuation model.

As at December 31, 2010 the Company's only financial instruments measured at fair value on a recurring basis were the warrant liability and interest rate swap described in Note 18.3, the measurement inputs of which is designated as Level 2 and Level 3 respectively.

At December 31, 2010, the interest rate swap described in Note 18.3 is classified as Level 3 in the fair value hierarchy. The inputs required to measure the fair value of the interest rate swap include production and price assumptions that are reliant on adjustments or interpolation made by management to an otherwise standard valuation model. A reconciliation of the movement in the balance of the interest rate swap has been included at Note 18.3.

4 Critical judgements and accounting estimates

The preparation of financial statements requires management to make certain judgements, accounting estimates and assumptions that affect the amounts reported for assets and liabilities as at the reporting date and the amounts reported for revenues and expenses during the year. The nature of estimation means that actual outcomes could differ from those estimates. Accordingly, the impact of these estimates, assumptions and judgments on the consolidated financial statements in future periods could be material. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities are discussed below.

Recoverability of asset carrying values

The Company assesses its property, plant and equipment, including intangible exploration and evaluation assets, for possible impairment if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable, or at least at every reporting date. Such indicators include changes in the Company's business plans, changes in commodity prices, evidence of physical damage and, for oil and gas properties, significant downward revisions of estimated recoverable volumes or increases in estimated future development expenditure.

If there are low oil prices or natural gas prices during an extended period the Company may need to recognize significant impairment charges. The assessment for impairment entails comparing the carrying value of the cash-generating unit with its recoverable amount, that is, value in use. Value in use is usually determined on the basis of discounted estimated future net cash flows. Determination as to whether and how much an asset is impaired involves management estimates on highly uncertain matters such as future commodity prices, the effects of inflation on operating expenses, discount rates, production profiles and the outlook for regional market supply-and-demand conditions for crude oil, natural gas and refined products.

At the reporting date, an impairment test was carried out on the Akkulka gas field in accordance with the accounting policy stated in note 2. The recoverable amount of the field has been determined based on value in use calculations. These calculations require the use of estimates. The present value of future cash flows was computed on an pre-tax basis by applying forecast prices of gas reserves to estimated future production of proved and probable gas reserves, less estimated future expenditures to be incurred in developing and producing the proved and probable reserves. The present value of estimated future net revenues is computed using a discount factor of 16%. The discount rate used is pre-tax and reflects the specific risks relating to the underlying cash generating unit.

The value in use calculation assumes natural gas sales prices in US$/Mcf as follows:

	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
	$	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Natural gas US$/Mcf													
Akkulka	0.95	0.95	2.22	2.75	3.25	3.74	4.09	4.42	4.72	5.03	5.30	5.57	5.82

The above price estimates are lower than those previously expected by the Company, which is a reflection of the current gas market uncertainty in Central Asia. As at the reporting date and at the date of approval of these consolidated financial statements, the gas price remains the subject of negotiations which have not been finalised. This is a source of measurement uncertainty in the Company's impairment test since there can be no assurance as to what price will be achieved.

If the forecast prices applied to the Akkulka impairment test were to reduce from 2013 per year by US$0.10 per Mcf below the assumed price, the excess of recoverable amount over the carrying value of the Akkulka gas field would be reduced by approximately $3.172m.

Oil and gas reserves

Proved and probable oil and gas reserves are used in the units of production calculation for depletion as well as the determination of the timing of well closure costs and impairment analysis. There are numerous uncertainties inherent in estimating oil and gas reserves. Assumptions that are valid at the time of estimation may change significantly when new information becomes available. Changes in the forecast prices of commodities, exchange rates, production costs or recovery rates may change the economic status of reserves and may ultimately result in the reserves being restated.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. Such estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Asset retirement obligation

Provisions for environmental clean-up and remediation costs associated with the Company's drilling operations are based on current legal or constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, prices, discovery and analysis of site conditions and changes in clean-up technology.

Income taxes

The Company is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which

the ultimate tax determination is uncertain. The Company recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

Fair value of derivative and other financial instruments

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

Other significant areas of judgement

The estimates, assumptions and judgments made in relation to the fair value of stock based compensation and warrants and the associated expense recognition are subject to measurement uncertainty. The estimated fair values of financial assets and liabilities, by their very nature, are subject to measurement uncertainty.

5 Segmental Reporting

Geographical segments

Management has determined the operating segments based on the reports reviewed by the executive directors that are used to make strategic decisions. Reports provided to the executive directors with respect to segment information are measured in a manner consistent with that of the financial statements. The assets and liabilities are allocated based on the operations of the segment and for assets, the physical location of the asset.

The executive directors consider the business from predominantly a geographic perspective and the Company currently operates in three geographical markets: Kazakhstan, Tajikistan and Uzbekistan.

In Kazakhstan, the Company is producing oil and gas from the Kyzyloi and Akkulka fields and is undertaking exploration and evaluation activity in the Kulbas fields. In Tajikistan, the Company is mainly undertaking exploration and evaluation activity and in Uzbekistan, the Company operates under the North Urtabulak Production Enhancement Contract, which gives incremental production rights to increase the production volume of oil from wells on the North Urtabulak Oil Field.

The Company also operates a corporate segment which acquired a number of drilling rigs and related oil and gas equipment which will be utilised in Kazakhstan, Tajikistan, and Uzbekistan and possibly throughout the rest of Central Asia.

(tabular amounts in thousands of US dollars)

The segment results for the year ended December 31, 2010 are as follows:

	Kazakhstan $'000	Tajikistan $'000	Uzbekistan $'000	Other and Corporate $'000	Consolidated $'000
Gas sales	3,767	-	-	-	3,767
Oil sales	748	-	-	-	748
Refined product sales	-	-	9,851	-	9,851
Other income	3,122	-	-	539	3,661
Finance income	1	1	-	59	61
Segment revenue and other income	**7,638**	**1**	**9,851**	**598**	**18,088**
Inter-segment revenue	(2,782)	-	-	(539)	(3,321)
Segment revenue and other income from external customers	**4,856**	**1**	**9,851**	**59**	**14,767**
Loss from jointly controlled entity	-	(634)	-	-	(634)
(Loss)/ profit before taxation	**(4,251)**	**(923)**	**3,350**	**(24,354)**	**(26,178)**
Taxation	(2,080)	-	(1,383)	(8)	(3,471)
Net (loss)/profit attributable to shareholders	**(6,331)**	**(923)**	**1,967**	**(24,362)**	**(29,649)**

Sales in the Kazakhstan segment were made to three customers. Sales to those customers representing greater than 10% of total segment revenue were $3,836,361 and $931,357. Sales in the Uzbekistan segment were to two customers. Sales to one of those customers representing greater than 10% of total segment revenue were $8,970,182.

Borrowing costs of $1,943,533 were incurred during the year. These borrowing costs were capitalised in the Kazakhstan segment.

Amortisation of $514,283 of assets held in the Corporate segment were capitalised in Kazakhstan.

Segment results for the year ended December 31, 2009 were as follows:

	Kazakhstan $'000	Tajikistan $'000	Uzbekistan $'000	Other and Corporate $'000	Consolidated $'000
Gas sales	3,828	-	-	-	3,828
Refined product sales	-	-	4,731	-	4,731
Other income	-	-	-	800	800
Finance income	29	2	-	45	76
Segment revenue and other income	**3,857**	**2**	**4,731**	**845**	**9,435**
Inter-segment revenue	-	-	-	(800)	(800)
Segment revenue and other income from external customers	**3,857**	**2**	**4,731**	**45**	**8,635**
Loss from jointly controlled entity	-	(1,000)	-	-	(1,000)
Loss before taxation	**(5,165)**	**(3,040)**	**478**	**(13,779)**	**(21,506)**
Taxation	(64)	-	(145)	(5)	(214)
Net loss attributable to shareholders	**(5,229)**	**(3,040)**	**333**	**(13,784)**	**(21,720)**

Sales in the Kazakhstan segment were made to a single customer. Sales in the Uzbekistan segment were to five customers. Sales to three of those customers representing greater than 10% of total segment revenue were $2,600,000, $763,000 and $712,000.

Borrowing costs of $2,100,503 were incurred during the year. These borrowing costs were capitalised in the Tajikistan segment ($1,387,702), Kazakhstan segment ($356,173) and Uzbekistan segment ($154,270). The remaining $202,358 was expensed through the statement of comprehensive loss.

Amortisation of $1,106,830 of assets held in the Corporate segment were capitalised in Kazakhstan: $460,451 and Tajikistan: $646,379.

(tabular amounts in thousands of US dollars)

The segment assets and liabilities as at December 31, 2010 and capital expenditures for the year then ended are as follows:

	Kazakhstan $'000	Tajikistan $'000	Uzbekistan $'000	Other and Corporate $'000	Consolidated $'000
Total assets	117,144	35,683	14,203	100,718	267,748
Total liabilities	8,543	(7,732)	6,478	20,936	28,225
Cash expenditure on exploration & evaluation assets, property, plant and equipment	33,058	2	4,937	296	38,293
Depreciation, depletion & amortization	2,929	69	1,570	1,317	5,885

Total assets for Tajikistan include the Company's investment in the joint venture (note 15).

Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of $546,982.

The segment assets and liabilities at December 31, 2009 and capital expenditures for the year then ended are as follows:

	Kazakhstan $'000	Tajikistan $'000	Uzbekistan $'000	Other and Corporate $'000	Consolidated $'000
Total assets	72,152	21,984	11,015	31,931	137,082
Total liabilities	1,914	3,759	6,992	17,813	30,478
Cash expenditure on exploration & evaluation assets, property, plant and equipment	8,553	16,942	3,709	3,017	32,221
Depreciation, depletion & amortization	2,497	138	603	-	3,238

Total assets for Tajikistan include the Company's investment in the joint venture (note 15).

Included in Kazakhstan liabilities are payables in relation to exploration and evaluation assets of $411,202.

6 Sales and other operating revenues

	Year ended	
	December 31, 2010 $'000	**December 31, 2009 $'000**
Gas sales	3,767	3,828
Oil sales	748	-
Refined product sales	9,851	4,731
Other revenue	340	-
	14,706	8,559

Revenue has been grossed up for non-monetary transactions, namely marketing commission of $nil (2009: $141,426) and utility services of $809,417 provided with respect to Uzbekistan (2009: $752,807). The corresponding expenses are shown within administrative and production expenses respectively.

7 Administrative expenses

Administrative expenses by nature	Year ended	
	December 31, 2010 $'000	**December 31, 2009 $'000**
Staff expenses	8,741	5,469
Share-based payments	5,956	2,628
Travel expenses	3,380	2,590
Professional fees	2,577	1,909
Office costs	2,080	1,835
Other administrative expenses	2,777	2,449
	25,511	16,880

Key management personnel have been identified as the Board of Directors and nine vice presidents. Details of key management remuneration are shown in note 23.

8 Share-based payments

The Company has adopted a stock incentive plan referred to as the "2007 Long Term Stock Incentive Plan" pursuant to which the Company may grant stock options to any director, employee or consultant of the Company, or any subsidiary or Vazon Energy Limited (collectively, "Service Providers").

The maximum number of Ordinary Shares reserved for issuance under the plan equals 12 % (2009: 12%) of the outstanding Ordinary Shares. The plan is administered by the Compensation and Nomination Committee of the Board of Directors. Options may be granted pursuant to recommendations of the Compensation and Nomination Committee. The Compensation and Nomination Committee may determine the vesting schedule and term, provided that options may not have a term exceeding ten years. Subject to any resolution passed by

the Compensation and Nomination Committee, options will terminate three months after an option holder ceases to be a Service Provider.

The exercise price of options granted under the plan may not be less than the closing price of Ordinary Shares on the principal stock exchange where the Ordinary Shares are listed as of the date of the option grant. The plan contains amendment provisions which allow amendments to the plan by the Board of Directors, without shareholder approval, for amendments of a "housekeeping" nature, changes to vesting or termination provisions, and discontinuance of the plan. The plan also provides that outstanding options will vest immediately on the occurrence of a "change of control" (as defined in the plan). Options granted under the plan are only assignable to certain related entities of an option holder or otherwise with the consent of the Company.

Under the plan, the options vest in three tranches with one third vesting immediately, one third after one year and one third after two years. These options are equity settled share based payment transactions.

Stock options

The following table summarizes the stock option activity under the 2007 Long Term Stock Incentive Plan.

	Number of options	**Weighted average exercise price $**
Outstanding at January 1, 2009	6,675,000	2.67
Granted	5,808,000	0.71
Forfeited	(281,000)	0.94
Exercised	-	n/a
Expired	(496,000)	2.43
Outstanding at December 31, 2009	11,706,000	1.75
Exercisable at December 31, 2009	7,325,666	2.20
Outstanding at January 1, 2010	11,706,000	1.75
Granted	11,100,000	1.49
Forfeited	(80,000)	0.65
Exercised	(360,000)	0.62
Expired	(103,000)	1.02
Outstanding at December 31, 2010	22,263,000	1.65
Exercisable at December 31, 2010	13,148,000	1.86

The weighted average share price at the date of exercise was $1.62.

The following table lists the options outstanding at December 31, 2010 by exercise price.

Exercise price $	Options outstanding	Weighted average remaining term (in years)	Options exercisable	Weighted average remaining term (in years)
0.60	4,603,000	3.60	2,982,000	3.60
0.80	3,428,000	4.00	1,116,000	4.00
0.88	120,000	3.84	80,000	3.84
C1.60	4,110,000	4.80	1,370,000	4.80
2.10	3,438,000	4.27	1,146,000	4.27
2.50	2,334,000	4.57	2,224,000	4.55
2.75	4,170,000	3.53	4,170,000	3.53
3.18	60,000	3.93	60,000	3.93
Total	22,263,000	4.08	13,148,000	3.96

The fair value of the share-based payment grants is estimated using the Black-Scholes pricing model using the following average assumptions:

	December 31, 2010	December 31, 2009
Weighted average fair value	$0.9242	$0.2841
Risk free rate	1.25%	1.74%
Expected term	3 years	3 years
Volatility	112.8%	97.9%
Dividend	Nil	Nil
Weighted average share price	C$1.45	C$0.51

In estimating expected volatility, the Company considers the historical volatility of its own share price over the most recent period that is commensurate with the expected option term.

Warrants

The following table summarizes the warrant activity for the years ended December 31, 2010 and December 31, 2009.

	Number of warrants	**Weighted average exercise price $**
Outstanding at January 1, 2009	11,636,956	4.44
Granted	2,500,000	0.60
Forfeited	-	n/a
Exercised	-	n/a
Expired	(1,353,501)	4.13
Outstanding at December 31, 2009	12,783,455	3.73
Exercisable at December 31, 2009	12,783,455	3.73
Outstanding at January 1, 2010	12,783,455	3.73
Granted	-	n/a
Forfeited	-	n/a
Exercised	(2,500,000)	0.60
Expired	-	n/a
Outstanding at December 31, 2010	10,283,455	4.48
Exercisable at December 31, 2010	10,283,455	4.48

During the year ended December 31, 2010, there were no further warrant issues. During the year ended December 31,2009 2,500,000 warrants were issued in connection with loan financing (note 18.2).

Of the warrants outstanding at the beginning of the year, 7,504,003 relate to warrants granted to the Company's executive officers. These warrants remain outstanding and exercisable at December 31, 2010.

There are no performance conditions attached to the warrants and all the granted warrants were immediately vested. Warrants are equity settled share based payment transactions.

In estimating expected volatility, the Company considers the historical volatility of its own share price over the most recent period that is commensurate with the expected warrant term.

The following table lists the warrants outstanding at December 31, 2010 by exercise price.

Exercise price $	Warrants outstanding	Weighted average remaining term (in years)	Warrants exercisable	Weighted average remaining term (in years)
1.25	638,298	1.21	638,298	1.21
2.50	3,436,154	4.18	3,436,154	4.18
3.25	795,000	0.27	795,000	0.27
5.50	2,255,835	0.49	2,255,835	0.49
6.88	3,158,168	1.99	3,158,168	1.99
Total	10,283,455	2.21	10,283,455	2.21

As at December 31, 2010, there was no unrecognized expense related to unvested warrants.

9 Taxation

Tethys is domiciled in the Cayman Islands which has no Company income tax.

The Company had the following balances of non-capital losses in respect of which no deferred tax asset has been recognized:

	Kazakhstan $'000	Netherlands $'000	United States $'000	December 31, 2010 $'000
Within one year	-	-	-	-
One to five years	125	-	-	125
After five years	-	3,456	4,329	7,785
No expiry date	-	-	-	-
	125	3,456	4,329	7,910

The temporary differences comprising the net deferred income tax liability as at December 31, 2010 are as follows:

	December 31, 2010 $'000	December 31, 2009 $'000
Capital assets	5,107	1,078
Tax losses	(1,048)	(325)
Other	11	(155)
Net deferred tax liability	4,070	598

The provision for income taxes is different from the expected provision for income taxes for the following reasons:

	Year ended December 31, 2010 $'000	Year ended December 31, 2009 $'000
Loss before income taxes	(26,178)	(21,506)
Income tax rate	20%	20%
Expected income tax (recovery)	(5,236)	(4,301)
Increase/ (decrease) resulting from:		
Non-deductible expenses	(17)	535
Impact of effective tax rates in other foreign jurisdictions	2,525	2,755
Reversal of tax losses recognised in prior periods	3,638	-
Losses and tax assets not utilised/recognised	2,466	1,155
Other	95	70
	3,471	214
Deferred tax expense	3,471	214

10 Loss per share

Basic and diluted loss per share

	Loss for the year $'000	Weighted average number of shares (thousands)	Per share amount $
Year ended December 31, 2010			
Loss attributable to ordinary shareholders – Basic and diluted	(29,649)	196,047	(0.15)
Year ended December 31, 2009			
Loss attributable to ordinary shareholders – Basic and diluted	(21,720)	106,450	(0.20)

Basic loss per share is calculated by dividing the loss attributable to shareholders of the Company by the weighted average number of ordinary shares in issue during the year. Diluted per share information is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares including share options and warrants, are considered to be anti-dilutive and have therefore been excluded from the diluted per share calculation.

(tabular amounts in thousands of US dollars)

11 Intangible assets

	Other intangible asset	Exploration and evaluation assets	Total
	$'000	$'000	$'000
Year ended December 31, 2009			
Opening net book amount	-	16,105	16,105
Additions through acquisition of subsidiary	5,553	-	5,553
Additions	-	23,289	23,289
Disposal of subsidiaries at book amount	-	(19,176)	(19,176)
Amounts written off to exploration and evaluation costs	-	(887)	(887)
Amortisation charge	(506)	-	(506)
Closing net book amount	5,047	19,331	24,378
At December 31, 2009			
Cost	5,553	19,331	24,884
Accumulated amortisation and impairment	(506)	-	(506)
Net book amount	5,047	19,331	24,378
Year ended December 31, 2010			
Opening net book amount	5,047	19,331	24,378
Additions	-	34,467	34,467
Transfers to property, plant and equipment	-	(41,466)	(41,466)
Amortisation charge	(487)	-	(487)
Closing net book amount	4,560	12,332	16,892
At December 31, 2010			
Cost	5,553	12,332	17,885
Accumulated amortisation and impairment	(993)	-	(993)
Net book amount	4,560	12,332	16,892

Transfers to property, plant & equipment consists of the transfer of exploration expenditure related to the Akkulka Deep oil field following the establishment of proved reserves at the year end.

Borrowing costs of $1,943,533 (2009 – $1,387,000) have been capitalised within exploration and evaluation assets during the year. The effective weighted average interest rate of the relevant borrowings was 17% (2009 – 22%).

The effective interest rate is higher than the nominal rate due to the cost of associated warrants (Note 18.2) and royalties (Note 18.3). For the year ended December 31, 2010 $273,535 (2009 - $779,389) was capitalised from staff costs and share-based payment expense.

(tabular amounts in thousands of US dollars)

12 Property, plant and equipment

	Oil and gas properties $'000	Oil and gas equipment $'000	Vehicles $'000	Office and computer equipment $'000	Total $'000
Year ended December 31, 2009					
Opening net book amount	43,442	19,968	1,201	811	65,422
Additions	6,908	4,853	98	155	12,014
Additions through acquisition of subsidiary	-	-	-	117	117
Disposal of subsidiaries at book amount	-	-	(162)	(140)	(302)
Depreciation charge	(2,823)	(1,033)	(117)	(107)	(4,080)
Closing net book amount	47,527	23,788	1,020	836	73,171
At December 31, 2009					
Cost	54,462	24,893	1,324	1,099	81,778
Accumulated depreciation	(6,935)	(1,105)	(304)	(263)	(8,607)
Net book amount	47,527	23,788	1,020	836	73,171
Year ended December 31, 2010					
Opening net book amount	47,527	23,788	1,020	836	73,171
Additions	5,420	278	476	730	6,904
Transfers from intangible assets	41,466	-	-	-	41,466
Disposals	-	-	(20)	(28)	(48)
Depreciation charge	(3,487)	(1,943)	(238)	(197)	(5,865)
Accumulated depreciation on disposal	-	-	10	15	25
Closing net book amount	90,926	22,123	1,248	1,356	115,653
At December 31, 2010					
Cost	101,349	25,171	1,780	1,801	130,101
Accumulated depreciation	(10,423)	(3,048)	(532)	(445)	(14,448)
Net book amount	90,926	22,123	1,248	1,356	115,653
Asset under construction at net book amount included in above					
At December 31, 2010	26,612	-	-	-	26,612
At December 31, 2009	25,858	-	-	-	25,858

Assets under construction as at December 31, 2010 includes the cost of developing the Akkulka oil concession and are not being depreciated until commencement of production. Assets under construction as at December 31, 2009 includes the cost of developing the Akkulka gas concession and tie-in pipeline and are not being depreciated until commencement of production.

Borrowing costs of $nil have been capitalised to oil and gas properties in the current year (2009 - $513,000). The effective weighted average interest rate of the relevant borrowing was 17%, (2009 19.58 %). The effective interest rate is higher than the nominal rate due to the cost of associated warrants (note 18.2). For the year ended December 31, 2010 $1,238,327 (2009 - $438,584) was capitalised from staff costs and share-based payment expense.

13 Investments

	December 31, 2010 $'000	December 31, 2009 $'000
Restricted cash	1,015	659

Restricted cash at December 31, 2010 and December 31, 2009 consisted of interest bearing bank deposits held in Kazakhstan. These deposits have been placed to satisfy local Kazakhstan requirements in respect of asset retirement obligations. Of the balance held at December 31, 2010 $929k was held on deposit in USD and the remaining balance held in KZT (2009 - $604k held on deposit in USD and the remaining balance held in KZT).

14 Trade and other receivables

	December 31, 2010 $'000	December 31, 2009 $'000
Current		
Trade receivables	1,661	905
Prepayments	1,092	502
Other receivables	927	904
	3,680	2,311
Other receivables - non-current		
Advances to construction contractors	3,631	333
Hong Kong Stock Exchange (HKSE) deferred offering costs	-	352
Value added tax receivable	8,689	4,486
	12,320	5,171
	16,000	7,482

Current trade and other receivables are unsecured and non-interest bearing. Normal payment terms for the Company are 30 days. Prepayments primarily relate to prepaid insurance and other corporate operating expense items.

There are no trade receivables overdue past thirty days (December 31, 2009 – $905,000). The other classes within trade and other receivables do not contain impaired assets.

Non-current advances to construction contractors relate to suppliers who were paid in advance for materials and services relating to both the Akkulka and the Kul-Bas contracts. For the Akkulka contract, the prepayments

relate to the drilling of a new well and payments on compressors, pipes and associated construction work that will constitute phase two of the Company's gas production plan. For Kul-Bas the prepayment related primarily to the drilling of a new well.

15 Investment in Joint Venture

The Company has a 51% interest in a jointly controlled entity, Seven Stars Energy Corporation Limited (SSEC). On December 30, 2009 the Company transferred ownership of its three Tajik subsidiaries to SSEC. At December 31, 2010 the Company's investment in the joint venture was $nil (2009: $nil).

The consideration received by Tethys from SSEC was a note receivable in the amount of $21,727,000, which represents Tethys' book value of assets transferred plus an amount for certain costs previously expensed by Tethys which are recoverable from SSEC.

This transaction resulted in a gain of $4,699,000, which has been deferred on the statement of financial position. This amount has been recorded as a reduction of the investment account in the amount of $1,040,000 (which has reduced the investment account to $nil as at December 31, 2009), with the remaining balance of $3,659,000 being recorded as a deferred gain. The deferred gain will be recognised in the statement of comprehensive loss when realised.

The following amounts represent the movements in the loan receivable

	Year ended	
	December 31, 2010 $'000	**December 31, 2009 $'000**
Balance, beginning of year	21,727	-
Share of loss	(634)	(1,000)
Movement in deferred gain	40	-
Contributions made on behalf of jointly controlled entity	14,327	22,727
Balance, end of year	35,460	21,727

The purpose of the loan, which is interest bearing, is to enable the jointly controlled entity to finance work programs and field development plans of any of its subsidiaries in Tajikistan. Repayments shall commence during the calendar quarter during which the first revenues are generated from production sharing oil and/or gas sales under any production sharing contracts in Tajikistan. The majority of properties in Tajikistan are still currently in the exploration phase.

The following tables represent the assets and liabilities of the jointly controlled entity at the year end and its results for the year to December 31.

	December 31, 2010 $'000	December 31, 2009 $'000
Assets		
Non-current assets	44,446	24,173
Current assets	404	113
Total assets	44,850	24,286
Liabilities		
Non-current liabilities	(43,233)	(21,727)
Accruals	(820)	(519)
Total liabilities	(44,053)	(22,246)
Net assets	797	2,040

	December 31, 2010 $'000	December 31, 2009 $'000
Revenue	203	-
Expenses	(1,445)	(1,960)
Loss before tax	(1,242)	(1,960)
51% share of joint venture loss before tax	(634)	(1,000)

16 Inventories

	December 31, 2010 $'000	December 31, 2009 $'000
Raw materials	697	443
Finished goods	1,424	1,925
	2,121	2,368

17 Cash and cash equivalents

	December 31, 2010 $'000	December 31, 2009 $'000
Cash at bank and in hand	28,501	6,788
Short-term deposits	50,634	509
	79,135	7,297

Cash at bank balances earn interest at floating rates based on daily bank deposit rates. Short term deposits are made for varying periods of between one day and three months, depending on the cash requirements of the Company, and earn interest at the respective short term deposit rates.

18 Financial liabilities

18.1 Borrowings

	Effective interest rate %	Maturity date	December 31, 2010 $'000	December 31, 2009 $'000
Current				
Short-term portion of long-term loans	19 – 23 p.a.	2010	-	1,086
		2011	5,047	8,199
Non-current				
Long-term loans	19 – 23 p.a.	2012	2,853	1,125
			7,900	10,410

Financial borrowings relate to financing arrangements that were put in place to fund the acquisition of the Telesto deep drilling rig (Telesto) and the Tykhe drilling rig (Tykhe) in 2008 and the drilling of a new well in Uzbekistan in 2009. The Telesto loan was repaid early, in full at the end of 2010.

Principal repayments for the loans are as follows:

		Drilling rig loans $'000	Uzbekistan loans $'000	Total $'000
To December 31,	2011	1,164	4,100	5,264
	2012	-	3,408	3,408
Remaining principal payments		1,164	7,508	8,672
Less: unamortised debt discount		(164)	(608)	(772)
Balance, end of year		1,000	6,900	7,900
	Current	1,000	4,047	5,047
	Non-current	-	2,853	2,853

The loan to fund Telesto bears interest at a nominal rate of 12%. In addition 795,000 warrants to purchase Tethys shares at CAD$3.25 with a term of three years were issued to lenders. The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt, with the effective interest rate method being used to amortise the discount over the life of the loan. Lenders have security over the shares of Tethys Petroleum Inc. which has no other assets except the drilling rig. No corporate guarantees or security are being provided by Tethys. The debt was repaid, early, at the end of the financial year.

The loan to fund Tykhe bears interest at a nominal rate of 15%. In addition 638,298 warrants to purchase Tethys shares at CAD$1.25 with a term of three years were issued to lenders.

The fair value associated with the warrants issued has been recognised as a debt discount and presented as a direct reduction to the face value of the long-term debt, with the effective interest rate method being used to amortise the discount over the life of the loan. Lenders have security over the shares of AOE Tykhe BV which has no other assets except the drilling rig and in addition a corporate guarantee is being provided by Tethys.

Based on the borrowing rates currently available to the Company for long term borrowings with similar terms and average maturities (17%), the fair value of the financial borrowings in relation to the drilling rigs approximate their carrying value in both current and comparative years. With respect to the new well in Uzbekistan the fair value of the financial borrowings is $6,249,979 (2009 – approximates carrying value).

On October 19, 2009 Tethys closed a loan financing for $4.1 million with a group of investors in connection with the drilling of a new well in Uzbekistan. A coupon of 10% per annum is due for the first two months, which is the expected drilling time of the well. Thereupon the lenders will receive 6% per annum coupon and 6.25% of the revenue received by BHCL from sales of the net production from the new well for every $1.0 million invested, calculated monthly and payable quarterly in arrears over a period of up to 24 months. If the well does not produce the investor will receive only the 6% per annum coupon on the funds invested.

On December 14, 2009 in connection with the drilling of the above new well in Uzbekistan the Company further approved the issue of loan notes to a maximum value of $3,000,000 at an issue rate of $0.88 per note and redemption value of $1, resulting in an effective rate of 6.5%. By December 31, 2009, $1,000,000 loan notes had been placed. A further $2,000,000 loan notes were placed in February 2010. A royalty of 11.25% is payable to the loan note holders calculated on sales of net production from the new well. The royalty entitlement was identified as an embedded derivative and required to be separated from the loan note. The royalty entitlement has been accounted for as a derivative financial instrument – interest rate swap. Refer to note 18.

Issue of the loan notes was completed via a broker to whom a royalty commission is payable at 4.5% for every $1.0 million placed. The total fair value of the commission payable on these loan notes was $371,924. The Company measured the fair value of the commission payables by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the royalty entitlement. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the instrument and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows (5%). The fair value associated with the royalty entitlement has been recognised as a transaction cost and presented as a direct reduction to the face value of the borrowing with the effective interest rate method being used to amortise the cost over the life of the loan. By the end of 2010, the well associated with this loan was no longer producing and therefore the fair value of the commission liability is $nil at December 31, 2010 (2009 - $42,333).

18.2 Derivative financial instrument - warrants

	December 31, 2010 $'000	December 31, 2009 $'000
Balance, beginning of year	1,053	146
Issued during the year	-	422
Fair value loss / (gain)	1,815	485
Exercised during the year	(2,463)	-
Balance, end of year	405	1,053

The warrant liability represents the financial liability relating to share warrants that are denominated in a currency that is not the Company's functional currency. These warrants were issued in connection with the two rig loans described in note 18.1.

The liability was initially recognised at fair value. As the warrants are denominated in foreign currency, there is a written option for the holder to exchange the foreign currency denominated warrant for a fixed number of functional currency denominated shares. This option is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through income.

The fair value of the liability is estimated using the Black-Scholes pricing model using the following average assumptions:

	December 31, 2010	December 31, 2009
Weighted average fair value	$0.30	$0.29
Exercise price	C$2.36	$1.24
Risk free rate	1.66%	1.46%
Expected term	0.56 years	1.18 years
Volatility	57%	87%
Dividend	Nil	Nil

The weighted average share price of exercised warrants was $1.57.

18.3 Derivative financial instruments - interest rate swap

The interest rate swap represents the derivative financial instrument entered into in connection with the Uzbekistan loan financing disclosed in note 18.1 completed in the year. This instrument is a derivative financial instrument and was initially recognised at fair value and subsequently measured at fair value through income. The Company measured the fair value of the liability by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the instrument. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the instrument and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows (5%). During the year, a significant fluctuation occurred in the fair value of the interest rate swaps due to a

significant decline in expected production from well NUR 116, which resulted in a fair value gain as disclosed below. The asset balance at the end of the year represents the saving in interest expense.

	December 31, 2010 $'000	December 31, 2009 $'000
Balance, beginning of year	(95)	-
Derivative financial instrument entered into	(918)	(101)
Fair value (loss) / gain	2,407	6
Royalty payments	78	-
Balance, end of year	1,472	(95)

19 Trade and other payables

	December 31, 2010 $'000	December 31, 2009 $'000
Current		
Trade payables	5,672	4,236
Accruals	2,230	1,997
Payables to related parties	-	35
Other creditors	886	518
	8,788	6,786
Non-current		
Other non-current payables	721	808

Trade payables are non-interest bearing and are normally settled on 30 day terms. Accruals represent mainly fees outstanding to the drilling contractor in Uzbekistan and professional fees. Other current creditors consist mainly of local taxes in the Republic of Kazakhstan and the current portion of the Kyzyloi historical costs. All current trade and other payables are interest free and payable within 12 months.

Included within other non-current payables are accruals for historical costs due to the Government of Kazakhstan on the Kyzyloi and Akkulka contracts in Kazakhstan.

Kyzyloi

The principal amount of the historical cost liability outstanding at December 31, 2010 was $562,172 (2009 – $735,053) and this is to be repaid in quarterly instalments by March 2014. The liability is non-interest bearing. The liability is measured at amortised cost using the effective interest rate method, using an assumed market rate of interest (10%) on initial recognition. The carrying value of the liability is $474,957 (2009 – $510,455) of which $130,265 (2009 – $101,955) is current, leaving a non-current balance of $344,692 (2009 – $408,500). Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities (17%), the fair value of the liability relating to historic costs is $425,197 (2009 – $510,455).

Akkulka

Upon signature of the Akkulka gas production contract on December 23, 2009, the historical cost liability in relation to this field became due. The principal amount of the historical cost liability outstanding at December 31, 2010 was $823,597 (2009: $933,997) and this is to be repaid in quarterly instalments by June 2018. The liability is non-interest bearing. The liability is measured at amortised cost using the effective interest rate method, using an assumed market rate of interest (22%) on initial recognition. The carrying value of the liability is $400,248 (2009: $414,437) of which $24,258 (2009: $19,581) is current, leaving a non-current balance of $375,990 (2009: $394,856).

Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities (17%), the fair value of the liability relating to historic costs is $461,838 (2009 - approximates its carrying value).

Principal repayments for both contracts are as follows:

		$'000
To December 31,	2011	283
	2012	283
	2013	283
	2014	154
	2015 and thereafter	383
Remaining principal payments		1,386
Less: unamortised debt discount		(511)
Balance, end of year		875
	Current	154
	Non-current	721
		875

20 Asset retirement obligations

	Year ended December 31, 2010 $'000	Year ended December 31, 2009 $'000
At January 1	206	465
Additional obligations incurred	15	77
Change in estimated cash flow	(48)	(358)
Unwinding of discount due to passage of time	19	22
At December 31	192	206

The Company makes provision for the future cost of decommissioning oil and gas production facilities and pipelines on a discounted basis. These costs are expected to be incurred between 2012 and 2022. The provision has been estimated using existing technology at current prices, escalated at 10% (2009 – 10%) and discounted at 11% (2009 – 11%). The economic life and the timing of the asset retirement obligation are dependent on Government legislation, commodity prices and the future production profiles of the project. In addition, the estimated cash outflows are subject to inflationary and/or deflationary pressures in the cost of third party service provision. The undiscounted amount of liability at December 31, 2010 is $602,085 (2009 - $571,094).

(tabular amounts in thousands of US dollars)

21 Share capital

	Number	December 31, 2010 Number	December 31, 2009 Number
Authorized			
Ordinary shares with a par value of $0.10 each		700,000,000	700,000,000
Preference shares with a par value of $0.10 each		50,000,000	50,000,000

The preference shares have the rights as set out in the Memorandum and Articles of Association approved at

Ordinary equity share capital Allotted and fully paid	**Number**	**Share capital $'000**	**Share premium $'000**
At January 1, 2009	66,393,292	6,639	138,598
Issued during the year for purchase of oil and gas equipment	1,400,000	140	701
Issued during the year in connection with finance charges	81,477	8	226
Issued during the year for purchase of a subsidiary	15,000,000	1,500	1,487
Issued during the year for cash	51,680,000	5,168	12,736
At December 31, 2009	134,554,769	13,455	153,748
At January 1, 2010	134,554,769	13,455	153,748
Issued during the year in connection with the exercise of stock options	360,000	36	287
Issued during the year in connection with the exercise of warrants	2,500,000	250	2,711
Issued during the year for cash	123,215,000	12,322	140,476
At December 31, 2010	260,629,769	26,063	297,222

the AGM on April 24, 2008. Significant terms related to preference shares are summarised below:

- May be issued in one or more series;
- Are entitled to any dividends in priority to the ordinary shares;
- Confer upon the holders thereof rights in a winding-up priority to the ordinary shares;
- And may have such other rights, privileges and conditions (including voting rights) as the Board may determine prior to the first allotment of any series of preference shares, provided that if a series of preference shares has no or limited voting rights it shall be designated as such by the Board.

As at December 31, 2010 a total of 31,275,572 (December 31, 2009 – 24,489,455) ordinary shares are reserved under the Company's Long Term Stock Incentive Plan and Warrants granted by the Company. Details of the options and warrants are given in note 8.

There are currently no preference shares outstanding (2009 – None).

22 Business combination

During 2010 there were no business combinations.

On April 9, 2009 the Company acquired 100% of the issued share capital in Baker Hughes (Cyprus) Limited (BHCL), a Company incorporated in Cyprus, which operates under a production enhancement contract relating to the North Urtabulak field in Uzbekistan. Tethys issued 15,000,000 ordinary shares as purchase consideration in the acquisition. The acquisition agreement places a trading restriction on the shares as follows: 7,500,000 cannot be resold until 6 months from the date of issue and the remaining 7,500,000 cannot be resold until 12 months from the date of issue.

During 2009, the acquired business contributed revenues of $4,731,000 and a net profit before taxation of $477,000 to the Company for the period from April 9, 2009 to December 2009 (note 5). If the acquisition had occurred on January 1, 2009 the revenue of the Company would have been $1,017,371 higher (unaudited) and the net profit before taxation would have been $112,000 higher (unaudited). These amounts have been calculated using the Company's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had applied from January 1, 2009.

The fair value of the shares issued was based on the published price of the shares on the date of acquisition. As the shares were issued with a trading restriction, this resulted in a marketability discount being applied to the published price to arrive at the fair value. The marketability discount was valued using the Black Scholes Option Pricing Model using the following assumptions: dividend yield of 0%; expected term of 0.75 years; a risk free interest rate of 0.60% and expected volatility of 121%. This resulted in an adjustment of $2,344,484 to the purchase consideration.

	Fair value $
Consideration at April 9, 2009	
Equity instruments (15,000,000 ordinary shares)	2,987
Direct costs related to the acquisition	57
Total consideration transferred	3,044
Recognised amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	532
Trade and other receivables	502
Intangible asset	3,820
Property, plant and equipment	118
Inventory	-
Deferred revenue	-
Current trade and other payables	(1,928)
Deferred income tax liability	-
Total identifiable net assets	3,044

Assets and liabilities acquired in a business combination are required to be recognised at fair value. In the absence of an active market for the North Urtabulak Field Production Enhancement Contract, the Company measured the fair value of the asset by applying a valuation technique based on the discounted estimated future net cash flows expected to be derived from the asset. A discounted cash flow (DCF) method requires management to estimate future cash flows associated with the asset and then discount those amounts to present value at a rate of return that considers the relative risk of the cash flows.

(tabular amounts in thousands of US dollars)

23 Related party transactions

All subsidiaries, as listed below, have been consolidated into these financial statements A list of the investments in subsidiary undertakings (all of whose operations comprise one class of business, being Oil and Gas Exploration, Development and Production), including the name, proportion of ownership interest, country of operation and country of registration, is given below.

Subsidiaries	Percentage	Country of operation	Country of registration
Tethys Uzbekistan BV	100%	Netherlands	Netherlands
Tethys Petroleum Inc.	100%	USA	USA
Tethys Afghanistan Inc.	100%	Dormant	USA
Tethys Kazakhstan Limited	100%	Guernsey	Guernsey
Tethys Aral Gas LLP	100%	Kazakhstan	Kazakhstan
Kul-Bas LLP	100%	Kazakhstan	Kazakhstan
Tethys Munai Gaz LLP	100%	Dormant	Kazakhstan
Tethys Services Kazakhstan LLP	100%	Kazakhstan	Kazakhstan
Asia Oilfield Equipment BV	100%	Kazakhstan/ Tajikistan	Netherlands
Tethys Europa BV	100%	Dormant	Netherlands
AOE Telesto BV	100%	Dormant	Netherlands
AOE Tykhe BV	100%	Dormant	Netherlands
AOE Tykhe SA	100%	Dormant	Luxemburg
Tethys Services Limited	100%	United Kingdom	United Kingdom
Tethys Caspian Limited	100%	Dormant	Cyprus
Tethys Tajikistan Limited	100%	Tajikistan	Cayman Islands
Imperial Drilling Services Limited	100%	Cayman Islands	Cayman Islands
Amu Darya Petroleum Limited	100%	BVI	BVI
Tethyda Limited	100%	Dormant	Cyprus
Baker Hughes (Cyprus) Limited (t/a Tethys Production Uzbekistan Limited)	100%	Uzbekistan	Cyprus
Rosehill Energy Limited	100%	Uzbekistan	Cayman Islands
Jointly controlled entities			
Seven Stars Energy Corporation	51%	Tajikistan	BVI

The Company has an indirect shareholding of the following companies through its share of Seven Stars Energy Corporation:

Tethys Services Tajikistan Ltd.	51%	Tajikistan	Tajikistan
Kulob Petroleum Ltd.	51%	Tajikistan	Jersey
Sogdiana Petroleum Ltd.	51%	Tajikistan	Cayman Islands

Other

Vazon Energy Limited ("Vazon") is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director.

Tethys has a management services contract with Vazon that came into effect from June 27, 2007 whereby the services of Dr. Robson and other Vazon employees are provided to the Company. The total cost charged to Tethys for services from Vazon in the year ended December 31, 2010 was $2,525,885 (2009 – $1,677,113).

Oilfield Production Consultants (OPC) Limited and Oilfield Production Consultants (OPC) USA LLC, both of which have one common director with the Company, has charged Tethys a monthly retainer fee for engineering expertise, provided services relating to the optimization of the existing compressors and those to be installed as part of Phase 2 gas production from Akkulka, and has consulted on certain reservoir modelling work on projects in Tajikistan and Uzbekistan. Total fees for the year ended December 31, 2010 were $182,470 (2009 – $497,697).

The remuneration of the key management personnel of the Company is set out below in aggregate.

	Year ended	
	December 31, 2010 $'000	**December 31, 2009 $'000**
Salaries and short-term employee benefits	5,439	3,026
Share-based payments	5,642	2,071
	11,081	5,097

Transactions with affiliates or other related parties including management of affiliates are recorded at their exchange amount.

24 Changes in working capital

	Year ended December 31, 2010 $'000	December 31, 2009 $'000
Trade and other receivables	(1,368)	353
Inventories	249	(2,155)
Trade and other payables	2,002	4,051
Change in non-cash working capital	883	2,249
Non-cash transactions	(214)	(2,136)
Net changes in non-cash working capital	669	113

The principal non-cash transaction is related to the issue of shares as consideration for the acquisition discussed in note 22.

Net changes in non-cash working capital are categorized as follows:

	Year ended December 31, 2010 $'000	December 31, 2009 $'000
Operating activities	(2,792)	(1,160)
Investing activities	3,461	1,273
Balance	669	113

25 Commitments and contingencies

Kazakhstan

Kyzyloi Field and the Kyzyloi Field Licence and Production Contract

The Kyzyloi Field Licence and Production Contract grants TAG exploration and production rights over an area of approximately 70,967 acres (287.2 km^2) and extends down to the base of the Paleogene sequence. Pursuant to the contract, TAG must reimburse the Kazakh government for approximately $1,211,000 in historical costs, to be paid in equal quarterly instalments from the commencement of production until full reimbursement. Under the latest extension of the Kyzyloi Field Licence and Production Contract, TAG has committed to spending approximately $2.7 million for a workover program over the seven year period until 2014. In November 2009, the Company finalised and agreed the 2010 work program with a commitment of $136,350. As at December 31, 2010, this requirement had been satisfied by the expenditure of some $343,000. With respect to 2011, a work program amounting to $120,000 has been agreed.

Akkulka Exploration Licence and Contract

The Akkulka Exploration Licence and Contract was entered into between the Kazakh State Committee of Investments and TAG on September 17, 1998. On November 19, 2010, the Ministry of Oil and Gas approved an extension to the exploration period until March 10, 2013. Under the previous amendment agreement (to March 10,2011) TAG committed to spending an additional $850,000 over the 18 month period and the 2010 work program for Akkulka was agreed with a capital commitment of $676,700. As of March 2010, a revised Annual Work Program for Akkulka Exploration was approved which committed the Company to spend $11,190,000 in 2010 which has been satisfied through payments incurred by December 31, 2010 in excess of $33,000,000. With respect to 2011, a work program amounting to $3,210,000 has been agreed.

Akkulka Production Contract

On December 23, 2009, TAG and MEMR signed the Akkulka Production Contract giving TAG exclusive rights to produce gas from the Akkulka Block for a period of nine years. Contingent upon commencement of commercial production on the Akkulka contractual territory, a total amount of US$3,500,000 will be due to the Kazakhstan Government as a reimbursement of historical costs previously incurred by the Government in relation to the contractual territory. For that part of the contractual territory from which production will commence in 2010 staged payments over a period of nine years totalling approximately $933,997 will also be due to the Kazakh government for the reimbursement of historical costs (note 18). The 2010 minimum work program was agreed with a capital commitment of $90,900. As at December 31, 2010, this requirement had been satisfied by the expenditure of $109,300. There are no contractual commitments regarding production in 2011.

Kul-Bas Exploration and Production Contract

The Kul-Bas Exploration and Production Contract was signed between Kul-Bas and the MEMR on November 11, 2005. This contract, which is for a period of 25 years (unless extended by mutual agreement of the parties), with an initial six-year exploration period and a 19-year production period, grants Kul-Bas exploration and production rights over an original 2,688,695 acres (10,881 km^2) surrounding the Akkulka Block. Pursuant to the original contract, 20% of the area was to be relinquished at the end of the second year of the contract, with 20% to be relinquished annually thereafter up to the end of the six year exploration period. However, in response to an application on behalf of the Company, on April 27, 2009, Amendment 1 to the Kul-Bas Exploration and Production Contract was signed, according to which 20% is relinquished by the end of contract year 2 (completed), 0% in contract year 3 (2008), 10% by the end of contract year 4 (2009), 20% by the end of year 5 (2010) and all remaining contract area, outside commercial discovery areas, by the end of year 6 (2011). On December 23, 2010 an extension of the exploration period for a further 2 years to November 11, 2013 was agreed by the Ministry of Oil and Gas.

The work program on this area amounted to a total of approximately $7,773,500 over the initial six-year exploration period. The remaining commitment of $2,894,000 relating to the contractual territory is required to be satisfied by November 11, 2011 and is included within the 2010 work program of $3,045,150. As at December 31, 2010, this requirement had been satisfied by the expenditure of $3,039,150. In addition to the minimum work program commitments, the Kazakhstan Government is to be compensated for the historical costs related to the contractual territory in the amount of US$3,275,780. The Company has previously paid an amount of $49,137 in relation to this balance. If and when commercial production commences, $88,666 is due

in quarterly instalments until the remaining historical costs of $3,226,643 has been paid in full. With respect to 2011, a work program amounting to $273,000 has been agreed.

Uzbekistan

On August 11, 2010 a turnkey contract was signed for the provision of sidetracking equipment and associated services with a total commitment of $2,592,550, of which $388,883 had been accrued for work performed under this contract prior to the year end. The full commitment was paid on February 28, 2011.

Operating leases

Operating leases consist primarily of leases for offices. Lease commitments are as follows:

	Total $'000	**Less than 1 year $'000**	**1 – 3 years $'000**
Operating leases	666	456	210

2010 expenditure on lease commitments included in the statement of comprehensive loss amounted to $415,117 (2009 - $480,552).