



## **NEXEN EXPLORATION U.K. LIMITED**

**DIRECTORS' REPORT AND FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED 31 DECEMBER 2008**



A company Registered in England and Wales, No. 04323945  
Registered Office: Charter Place, Vine Street, Uxbridge, Middlesex UB8 1JG

## **DIRECTORS' REPORT**

The directors of Nexen Exploration U.K. Limited ("Nexen" or the "company") present their report on the affairs of the company together with the financial statements for the year ended 31 December 2008. The company's immediate parent is Nexen Petroleum U.K. Limited, and its ultimate parent undertaking and controlling party at 31 December 2008 is Nexen Inc., a company incorporated in Canada. This directors' report has been prepared in accordance with the special provisions relating to small companies under section 246(4) of the Companies Act 1985.

### **Principal activities**

The company is in the business of exploration and production of crude oil, natural gas and natural gas liquids. The company has no production at present.

The company holds interests in one offshore exploration licence (P244) encompassing three blocks (21/2NJR, 21/2NCR and 21/2S).

Nexen acquired a package of prospective Coal Bed Methane (CBM) licences in the U.K. in December 2005 and embarked on an exploration and appraisal programme to evaluate their potential. After three years, five exploration wells and two production wells have been drilled and £13.2m has been spent including acquisition costs. One of the production wells has tested gas from a short lateral for a period of nearly 200 days, and the other used as a monitoring well. Longer laterals are currently being added to the pilot production well to improve the production rate. The programme has been encouraging so far, demonstrating that CBM is technically viable in the U.K.

A Field Development Plan for an extended well test on Doe Green was approved in January 2009 by Department of Energy and Climate Change (DECC). In 2009, it is proposed that the pilot well is tested and the gas used to generate electricity. It is planned to drill another pilot producer at a different location and to prepare for a third elsewhere to be drilled in 2010. It is expected that by the end of this three well pilot programme, we will be in a position to decide whether to move to CBM development in the U.K. or to monetise the assets.

### **Future developments**

The company will continue to investigate its offshore areas and to develop the business plans for CBM onshore developments.

As discussed in note 1(a), the directors continue to adopt the going concern basis in preparing the annual report and accounts.

### **Results and dividends**

The loss for the year amounts to £6,581,854 (2007: £66,005). The directors do not recommend the payment of a dividend for the current year (2007: £nil).

## DIRECTORS' REPORT

### Directors

The directors of the company during the year and since the year end are as listed below:

Name	Date of Appointment	Date of Resignation
P. Addy		
E.W. Bogle		
I.R. Habke		28 August 2008
L.T. Harvey	30 May 2008	
R.G. Jensen	11 June 2008	
A. O'Brien		
D. O'Driscoll		05 March 2009
P. Oldham		
M. J. Schonberger	28 August 2008	
D.O. Tudor		

The Office of Company Secretary during the year ended 31 December 2008 was held by S. Kaul. L. L. White resigned as Company Secretary on 1 August 2008.

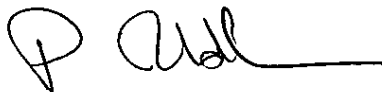
### Auditors

Each of the persons who is a director at the date of the approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- the director has taken all the steps that he/she ought to have taken as director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of the information.

This information is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

The company has passed an elective resolution in accordance with the Companies Act 1985 to dispense with the annual re-appointment of auditors. Deloitte LLP will, accordingly, continue in office as auditors of the company pursuant to section 386 of the Companies Act 1985.



By order of the Board:  
P. Oldham, Director

Date: 7 April 2009

## **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The directors are responsible for preparing the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company as at the end of the financial year and of its profit or loss for the period then ended. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NEXEN EXPLORATION U.K. LIMITED**

We have audited the financial statements of Nexen Exploration U.K. Limited for the year ended 31 December 2008 which comprise the profit and loss account, the balance sheet and the related notes 1 to 18. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements within it.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NEXEN EXPLORATION U.K. LIMITED**

### **Opinion**

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2008 and of its loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

*Deloitte LLP*

Deloitte LLP  
Registered Auditors and Chartered Accountants  
London

*7 April*, 2009

## PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	2008 £	2007 £
Exploration expenses	5 & 8	(3,166,051)	(48,618)
Administrative expenses		<u>(1,363)</u>	<u>(31,902)</u>
<b>OPERATING LOSS</b>		<u>(3,167,414)</u>	<u>(80,520)</u>
Net finance (charges)/income	6	<u>(1,812,435)</u>	<u>71,335</u>
<b>LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION</b>		<u>(4,979,849)</u>	<u>(9,185)</u>
Tax credit/(charge) on loss on ordinary activities	7	<u>(1,602,005)</u>	<u>(56,820)</u>
<b>LOSS ON ORDINARY ACTIVITIES AFTER TAXATION AND RETAINED FOR THE FINANCIAL YEAR</b>	15	<u>(6,581,854)</u>	<u>(66,005)</u>

All items dealt with in the above profit and loss account relate to continuing operations.

There were no recognised gains or losses in either the current or prior years other than the loss for the year. Accordingly no statement of total recognised gains and losses is required.

## BALANCE SHEET AT 31 DECEMBER 2008

	Notes	2008 £	2007 £
<b>FIXED ASSETS</b>			
Intangible assets	8	20,214,584	15,348,491
Investments	9	<u>1,137</u>	<u>-</u>
		<u>20,215,721</u>	<u>15,348,491</u>
<b>CURRENT ASSETS</b>			
Inventory	10	499,379	274,658
Debtors	11	5,380,833	2,060,769
Cash at bank		<u>-</u>	<u>896</u>
		<u>5,880,212</u>	<u>2,336,323</u>
<b>CREDITORS – amount falling due within one year</b>	12	<u>(32,747,025)</u>	<u>(19,329,071)</u>
<b>NET CURRENT LIABILITIES</b>		<u>(26,866,813)</u>	<u>(16,992,748)</u>
<b>PROVISION FOR LIABILITIES</b>			
Deferred tax liability	7	(1,522,823)	-
Abandonment and decommissioning	13	<u>(787,677)</u>	<u>(735,481)</u>
<b>NET LIABILITIES</b>		<u>(8,961,592)</u>	<u>(2,379,738)</u>
<b>CAPITAL AND RESERVES</b>			
Called up share capital	14	894,060	894,060
Profit and loss account	15	<u>(9,855,652)</u>	<u>(3,273,798)</u>
<b>SHAREHOLDER'S DEFICIT</b>	16	<u>(8,961,592)</u>	<u>(2,379,738)</u>

The financial statements were approved on behalf of the Board of Directors and authorised for issue on 7 April 2009. They were signed on its behalf by:

M. Schonberger, Director



## NOTES TO THE ACCOUNTS – 31 DECEMBER 2008

### 1 ACCOUNTING POLICIES

A summary of the principal accounting policies, all of which have been applied consistently throughout the current and preceding year, is set out below:

#### (a) Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

The company's financial statements fall within the scope of the UK Oil Industry Accounting Committee's Statement of Recommended Practice (SORP), "Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities" and have been prepared in accordance with provisions thereof.

The company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Directors' report on page 1. The financial position of the company and borrowings are described in the balance sheet on page 7 and note 12 on page 13. The company obtains insurance cover to reduce the potential risks associated with the exploration and production activities. In addition, business interruption cover is purchased for a proportion of the cash flow from producing fields.

The company is in a net liability and net current liability position at the balance sheet date and remains dependent of continued financial support from Nexen Petroleum U.K. Limited, its immediate parent company, given the funding requirements for the ongoing exploration of its assets. The directors are in receipt of support from Nexen Petroleum U.K. Limited that confirms appropriate group support will continue to be available to enable the company to trade in the ordinary course of activities for the foreseeable future.

After making enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

#### (b) Taxation

Current Corporation Tax is provided on the basis of amounts to be paid or recovered using tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Full provision is made for deferred taxation on all timing differences that have arisen but not reversed at the balance sheet date. Deferred tax assets are only recognised to the extent that it is more likely than not that they will be recovered. Amounts related to deferred taxation are undiscounted.

#### (c) Joint ventures

Exploration activities are conducted as co-licensee in joint ventures with other companies. The financial statements reflect the relevant proportions of capital and operating expenditures applicable to the company's interests.

#### (d) Intangible fixed assets and oil and gas property related tangible fixed assets

Expenditures on pre-licence, licence acquisition, exploration and appraisal activities are initially capitalised as intangible fixed assets until the discovery or otherwise of commercial reserves has been established and development consent is received. The recoverability of such intangible assets is dependent on future successful drilling results and successful development of commercial reserves. Intangible assets are held undepreciated, but are reviewed annually for impairment.

## **NOTES TO THE ACCOUNTS – 31 DECEMBER 2008**

### **Intangible fixed assets and oil and gas property related tangible fixed assets (continued)**

Where it is determined that no commercial reserves exist, in the absence of a producing pool, the related intangible assets are written off to the profit and loss account as exploration expenses.

#### **(e) Inventory**

Inventory is recorded at the lower of cost and net realisable value.

#### **(f) Foreign currencies**

Transactions denominated in currencies other than pounds sterling are translated into sterling at the rates of exchange prevailing at the dates of the transactions. Monetary assets and liabilities denominated in such currencies are translated into sterling at the rates of exchange prevailing at the balance sheet date. All exchange differences arising are taken to the profit and loss account for the year.

#### **(g) Abandonment and decommissioning**

Provision is made for the present value of the future cost of abandonment of exploration wells where additional work is required for their abandonment. The estimated costs, based upon engineering cost levels estimated as at the balance sheet date, are computed on the basis of the latest assumptions as to the scope and method of abandonment. The corresponding amount is capitalised as part of tangible assets. The unwinding of the discount applied to the abandonment provision is treated as a component of the interest charge.

#### **(h) Investments**

Fixed asset investments are shown at cost less provision for impairment.

#### **(i) Cash flow statement**

The company has taken advantage of the exemptions in Financial Reporting Standard (FRS) 1 from the requirement to prepare a cash flow statement for the company on the grounds that its results are consolidated in the financial statements of its ultimate holding company, Nexen Inc., a company incorporated in Canada, which are publicly available (see note 18).

#### **(j) Related parties**

In accordance with the exemption allowed by paragraph 3(c) of FRS 8, no disclosure is made of transactions with other member companies of Nexen Inc. or any of its subsidiaries.

### **2 DIRECTORS' EMOLUMENTS**

Directors' emoluments were £Nil for the year (2007: £Nil).

### **3 STAFF COSTS**

The company did not employ any staff for the year (2007: None).

## NOTES TO THE ACCOUNTS – 31 DECEMBER 2008

### 4 AUDITORS' REMUNERATION

Audit fees were borne by the immediate parent undertaking. The audit fee in respect of the audit of the company's annual accounts is £4,600 (2007: £4,400).

### 5 EXPLORATION EXPENSES

	<u>2008</u>	<u>2007</u>
	£	£
Exploration costs written off (see note 8)	<u>3,166,051</u>	<u>48,618</u>

The charge for exploration costs in the profit and loss account represents capitalised costs that have been impaired prior to the commencement of commercial production, on determination that no commercial reserves have been discovered.

### 6 NET FINANCE CHARGES/(INCOME)

	<u>2008</u>	<u>2007</u>
	£	£
<b>Interest receivable and similar income</b>		
Net gain on foreign exchange	-	113,006
<b>Interest payable and similar charges</b>		
Net loss on foreign exchange	(1,768,505)	-
Interest payable - joint venture partners	(229)	(260)
Interest on unwinding of discount on provision for abandonment and decommissioning	(43,701)	(41,411)
	<u>(1,812,435)</u>	<u>71,335</u>

### 7 TAXATION

(a) Analysis of corporation tax charge for the year:

	<u>2008</u>	<u>2007</u>
	£	£
Current tax on profits in the year	-	33,824
Adjustments in respect of previous years	79,182	22,996
Total current tax charge	<u>79,182</u>	<u>56,820</u>
Deferred tax:		
Origination and reversal of timing differences		
- UK corporation tax	701,446	-
- UK supplementary charge	821,377	-
Total deferred tax charge	<u>1,522,823</u>	<u>-</u>
Total tax on loss on ordinary activities	<u>1,602,005</u>	<u>56,820</u>

## NOTES TO THE ACCOUNTS – 31 DECEMBER 2008

### TAXATION (continued)

(b) Factors affecting the corporation tax charge for the year:

The difference between the total current corporation tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	<u>2008</u>	<u>2007</u>
	£	£
<b>Loss on ordinary activities before tax</b>	<u>(4,979,849)</u>	<u>(38,534)</u>
Loss on ordinary activities multiplied by average 2007 UK corporation tax rate of 50% (2007: 30%)	(2,489,925)	(11,560)
<b>Effects of:</b>		
Pre-trading expenditure not deductible for tax purposes	-	45,384
Prior year adjustment	79,182	22,996
Other originating timing differences	<u>2,489,925</u>	<u>-</u>
<b>Current tax charge for the year</b>	<u>79,182</u>	<u>56,820</u>

### PROVISION FOR DEFERRED TAX LIABILITY

	<u>2008</u>	<u>2007</u>
	£	£
<b>Deferred corporation tax:</b>		
- Accelerated capital allowances	5,854,349	-
- Tax losses	(4,916,600)	-
- Other timing differences	<u>(236,303)</u>	<u>-</u>
	<u>701,446</u>	<u>-</u>
<b>Deferred supplementary charge:</b>		
- Accelerated capital allowances	3,902,900	-
- Tax losses	(2,923,988)	-
- Other timing differences	<u>(157,535)</u>	<u>-</u>
	<u>821,377</u>	<u>-</u>
<b>Total provision for deferred tax liability</b>	<u>1,522,823</u>	<u>-</u>

A net deferred tax liability of £1,522,823 (2007: nil) has been recognised. This net liability relates primarily to trading losses and timing differences on capital expenditure. During the year, the CBM project received development consent and based on forecasts, trading taxable profits from 2010 onwards are expected to exceed the taxable losses incurred to date.

## NOTES TO THE ACCOUNTS – 31 DECEMBER 2008

### 8 FIXED ASSETS

	Intangible £
<b>Cost</b>	
At 1 January 2008	18,297,897
Additions	<u>8,032,144</u>
At 31 December 2008	<u>26,330,041</u>
<b>Impairment</b>	
At 1 January 2008	2,949,406
Impairment charge	<u>3,166,051</u>
At 31 December 2008	<u>6,115,457</u>
<b>Net book value</b>	
At 31 December 2008	<u>20,214,584</u>
At 31 December 2007	<u>15,348,491</u>

Intangible assets are comprised of licence acquisition costs and exploration expenditure.

The net book value of the abandonment and decommissioning asset included in the above tangible assets is £700,084 (2007: £691,588).

### 9 INVESTMENTS

During the year, the company invested \$2,000 in Nexen Oil and Gas U.K. Developments LP, a limited partnership.

	<u>2008</u> £	<u>2007</u> £
Nexen Oil and Gas U.K. Developments LP	<u>1,137</u>	<u>-</u>

### 10 INVENTORY

	<u>2008</u> £	<u>2007</u> £
Materials and consumables	<u>499,379</u>	<u>274,658</u>

## NOTES TO THE ACCOUNTS – 31 DECEMBER 2008

### 11 DEBTORS: Amounts falling due within one year

	<u>2008</u> £	<u>2007</u> £
Amounts owed by group undertaking	4,965,960	1,740,659
VAT recoverable	200,919	26,966
Other debtors	213,254	292,444
Accrued receivables from co-venturers	700	700
	<u>5,380,833</u>	<u>2,060,769</u>

### 12 CREDITORS: Amounts falling due within one year

	<u>2008</u> £	<u>2007</u> £
Trade creditors	603,403	4,569
Amounts owed to immediate parent undertaking	30,938,775	17,986,539
Accruals	1,204,847	1,281,142
Corporation tax	-	56,820
	<u>32,747,025</u>	<u>19,329,070</u>

Amounts due to the parent undertaking are interest free, with no fixed repayment date.

### 13 ABANDONMENT AND DECOMMISSIONING

	<u>2008</u> £	<u>2007</u> £
At 1 January	735,481	751,662
Additions and changes in assumptions	8,495	(57,592)
Interest on unwinding of discount	43,701	41,411
At 31 December	<u>787,677</u>	<u>735,481</u>

The provision is based on the net present value of Nexen's estimated future cost of £108,217 for restoring Block 29/6a in 2015, £731,850 for restoring the Doe Green CBM field location in 2010 and £51,250 for the Fradley CBM field location in 2009.

### 14 CALLED UP SHARE CAPITAL

	<u>2008</u> £	<u>2007</u> £
<b>Attributable to equity interests:</b>		
Ordinary shares		
Authorised: 10,000,000 shares of £1 each	<u>10,000,000</u>	<u>10,000,000</u>
Allotted, called up and fully paid:		
894,060 of £1 each	<u>894,060</u>	<u>894,060</u>

## NOTES TO THE ACCOUNTS – 31 DECEMBER 2008

### 15 RESERVES

	<u>Profit and loss account £</u>
At 31 December 2007	(3,273,798)
Loss for the year	<u>(6,581,854)</u>
At 31 December 2008	<u>(9,855,652)</u>

### 16 RECONCILIATION OF MOVEMENTS IN SHAREHOLDER'S FUNDS

	<u>2008 £</u>	<u>2007 £</u>
Loss for the year	<u>(6,581,854)</u>	<u>(66,005)</u>
Net decrease in shareholder's deficit	<u>(6,581,854)</u>	<u>(66,005)</u>
Opening shareholder's deficit	<u>(2,379,738)</u>	<u>(2,313,733)</u>
Closing shareholder's deficit	<u>(8,961,592)</u>	<u>(2,379,738)</u>

### 17 CAPITAL COMMITMENTS

At 31 December 2008, capital expenditures contracted but not provided for were £500,000 (2007: £4,586,000).

### 18 ULTIMATE PARENT COMPANY AND CONTROLLING PARTY

The immediate parent undertaking at 31 December 2008 is Nexen Petroleum U.K. Limited.

The ultimate parent undertaking and controlling party at 31 December 2008 is Nexen Inc., a company incorporated in Canada, which is the largest corporate entity to prepare consolidated group financial statements incorporating these accounts. Copies may be obtained from the Corporate Secretary, Nexen Inc., 801-7th Avenue S.W., Calgary, Alberta, Canada T2P 3P7. The smallest group to consolidate these financial statements is Nexen Petroleum U.K. Holdings Limited. Copies of the financial statements may be obtained from the company secretary, Nexen U.K. Holdings Limited, Charter Place, Vine Street, Uxbridge, Middlesex, UB8 1JG, UK.