



Karoon Gas Australia Limited

A.B.N. 53 107 001 338

Financial Report

Period ending 30 June 2006

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Directors Report

The Directors present their report together with the Financial Report of Karoon Gas Australia Ltd ("Karoon") and subsidiaries for the financial year ended 30 June 2006 and the auditors' report thereon.

Board of Directors

The Directors of Karoon at any time during or since the end of the financial year are:

Mr Robert Michael Hosking

Managing Director & Chairman

Appointed 11 November 2003

Robert is the founding Director of Karoon and has more than 30 years of commercial experience in the administration of several companies. Robert has been involved in the oil and gas industry for nine years and was the founding Director/Shareholder of both Karoon and Nexus Energy. Robert was responsible for procuring PEP 162 and EL 4537 and managing all of the required work programs in relation to those permits, including raising funds and overseeing the geophysical and geological contractors.

Robert also has a background of more than 15 years' commercial experience in the steel industry. He jointly owned and managed businesses involved in the transglobal sourcing, shipping and distribution of steel-related products, with particular expertise gained in Europe and the Asia/Pacific Rim.

Member of the audit committee.

Mr Geoff Atkins

FIE Aust. RMIT Dip. Civ Eng.

Non-Executive Director

Appointed 22 February 2005

Geoff has over 34 years' experience in investigation, planning, design, documentation and project management of numerous significant port, harbour and maritime projects, including container terminals, LNG jetties, cement, coal, bauxite, iron ore and other bulk terminals and naval bases. Geoff has gained substantial overseas experience completing marine projects in Indonesia, Malaysia, Thailand, Vietnam, Sri Lanka, India, South Africa, Namibia, New Zealand and the United Kingdom. LNG, oil, gas, bulk ports and other large maritime infrastructure projects have included the design of Woodside's LNG Jetty, tender design of Darwin LNG Jetty and investigations of proposed LNG marine terminals in Taiwan, Iran and Israel for BHP Petroleum and the West Kingfish and Cobia oil drilling platforms for ESSO/BHP in Bass Strait.

Chairman of the Audit Committee

Mr Mark Alexander Smith

Dip. App. Geol, Bsc. (Geology)

Executive Director and Exploration manager

Appointed 1 December 2003.

Mark has over 25 years continuous experience as a geologist and exploration manager in petroleum exploration and development in Australia, Southeast Asia and North America. The bulk of this experience was gained while with BHP Petroleum. Mark has been directly involved with seven economic oil and gas discoveries.

Mark has geoscience skills in regional basin and tectonic studies, acreage evaluations and gazettal. His skills also include farm-ins/farm-outs, petroleum systems fairway assessments, prospect evaluations, risking and volumetric and fault seal prediction. Mark has project and management experience in well site operations and also management of onshore and offshore drilling operations.

Mr Stephen Power

B. Juris LLB

Non-Executive Director

Appointed 28 June 2005

Stephen Power is a commercial lawyer who has spent approximately 20 years providing advice to participants in the resources industry in Australia and overseas. Stephen is a partner in a boutique law firm that provides commercial advice to its predominantly listed client base. Stephen has extensive experience in all facets of commercial and resources law, including the oil and gas sector, both in an Australian and International context. Stephen regularly advises on farm-in arrangements, joint ventures, production agreements and other facets of resources-related commercial transactions. In addition to Stephen's experience in the resources area, Stephen has a significant practice advising on capital raisings, including the drafting of prospectuses, underwritings and related work, listing advice and the planning and implementation of mergers and acquisitions.

Mr Scott Hosking

B. Commerce

Company Secretary

Appointed 10th March 2006

Scott was appointed company secretary in 2006

Mr Hector Peeters resigned as Company Secretary 10th March 2006

Directors' Meetings

The number of Directors' meetings (including meetings of committees of Directors) and number of meetings attended by each of the Directors of Karoon during the financial year were:

Director	Board meetings		Audit Committee meetings	
	A	B	A	B
Mr Robert Hosking	6	6	3	3
Mr Mark Smith	6	6	-	-
Mr Geoff Atkins	6	6	3	1
Mr Stephen Power	6	5	-	-

A – Number of meetings held during the time the Director held office during the financial year.

B – Number of meetings attended.

Principal Activities

The principal activities of Karoon during the course of the financial year were the investment in energy-related projects in the Western Gippsland Basin, a sedimentary basin in Victoria's south-east and the acquisition of permits WA-314-P and WA-315-P in the Browse Basin.

There were no other significant changes in the nature of the activities of Karoon during the financial year other than disclosed in the Financial Report.

Review of Operations

Gippsland Basin

Karoon Gas (through its 100% owned subsidiary Karoon Gas Pty Ltd) has a 100% registered interest in PEP162 and EL4537, located within the Western on-shore Gippsland Basin of Victoria.

The 250 km West Gippsland 2D seismic survey in PEP162 and EL4537 has been processed and prospect and lead mapping is progressing. The seismic program was designed to map the extent of the updip Megascollides-1 structure (Drilled by Karoon in November 2004) and to define new structures at the oil bearing Top Crayfish Group equivalent level. The seismic was also designed to map the extent and quality of CBM black coals across the EL4537 license to locate optimal drilling targets.

A drilling program is being planned, and Century Drilling will be contracted to complete the drilling of two prospects starting late in the 4th quarter of 2006.

Browse Basin

Karoon Gas is a 100% interest holder in oil and gas exploration permits WA-314-P and WA-315-P in the offshore Browse Basin located in North-Western Australia. Karoon has earned 100% equity in the WA-314-P and WA-315-P permits by fulfilling the minimum Year-2 commitments which consists of 400 square km. of 3D seismic in each permit.

Interpretation of the first 3D seismic survey has commenced, with results expected during the 3rd quarter 2006. The 845km 2D seismic survey data is in the final stages of processing.

The final phase of seismic acquisition will cover 286 sq km over eastern WA-315-P and is expected to be complete in the 1st week of August 2006. Data processing and interpretation should be completed in the 4th quarter 2006. This seismic survey will fulfil Karoon's year 2 work program commitments on the WA-314-P and WA-315-P permits.

Karoon is currently seeking to farm out equity in the WA-314-P and WA-315-P permits. Karoon is moving forward with potential farminees with results expected in the near future. Karoon will continue to employ its best efforts to generate a successful Joint Venture so as to further develop the WA-314-P and WA-315-P permits in the most timely and cost efficient manner.

Any Joint Venture Agreements reached will be announced to the ASX at the appropriate time.

Likely Developments

Karoon will continue to pursue its farm out activities with a view to drilling in WA-314-P and WA-315-P in the first quarter of 2007. The consolidated entity's long-term objective is to achieve growth from exploration and development opportunities.

Karoon will be pursuing its strategy to gain access to quality assets with significant equity levels.

Further information about likely developments in the operations of Karoon and the expected results of those operations in future financial years has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to Karoon.

New ventures

Karoon conducted preliminary due diligence on a number of hydrocarbon assets and is continuing with investigations at balance date. Any projects that are taken up will be announced to the ASX at the appropriate time.

Operating Results

The consolidated loss of the Group for the financial year ended 30 June 2006 was \$2,835,982 (2005: loss \$865,366).

Financial Position

During the financial year Karoon has successfully completed \$18.25 million in new capital raisings:

- \$4.3 million in exercise of various options
- \$13.95 million placed with sophisticated and institutional investors

Significant Changes in State of Affairs

During August 2005, 7.75 million shares were placed at 180 cents each that raised \$13.95 million.

Between July 2005 and June 2006, 19.33 million listed options were exercised at 20 cents each that raised \$3.87 million.

Between July 2005 and June 2006, 345,000 unlisted Director and employee options were exercised at 125 cents that raised \$431,250.

During October 2005 British Gas withdrew from the farm-out agreement with Karoon Gas over the WA-314-P and WA-315-P permits. Karoon decided to move through the second year work commitments alone while attempting to find a more suitable farm out partner.

On April 13th 2006 pursuant to the Liberty Farm-in Agreement, Karoon acquired 100% equity in WA-314-P and WA-315-P from Liberty Petroleum.

In November 2005 Karoon successfully completed a 250 km 2D seismic survey over the PEP-162 permits in the on-shore Gippsland Basin.

During January 2006 a 845 sq km 3D seismic survey was completed over the WA-314-P and WA-315-P permits.

During March 2006 a 850km 2D seismic survey was completed over the WA-314-P and WA-315-P permits.

Dividends

No dividend has been paid or declared by the Company to members since the end of the previous financial year.

Remuneration Report

This section of the Directors' Report is prepared in accordance with Section 300A of the Corporations Act 2001. Where appropriate, information which is included in other parts of the Financial Report is included in this report by reference.

Remuneration policy

The Board regularly reviews remuneration of its senior executives and Directors. This also includes responsibility for the Employee Share Option scheme. The executive remuneration structure is based on a number of factors, including length of service, particular experience of the individual concerned and overall performance of Karoon, it also involves a balance between fixed and incentive pay, reflecting short and long-term performance objectives appropriate to Karoon's circumstances and objectives. A proportion of executive remuneration is structured in a manner designed to link rewards to corporate and individual performance. This is done by considering the following remuneration components:

- Fixed remuneration; and
- Equity-based remuneration within thresholds set by the Board.

The contracts for service between Karoon and specified executives are on a continuing basis the terms of which are not expected to change in the immediate future. Upon retirement specified executives are paid employee benefit entitlements accrued to date of retirement.

Options are also issued under the Executive and Employee Share Option scheme. Non-executive Directors do not receive any performance-related remuneration. Options are valued under the Black and Scholes option pricing model.

The Directors and executives receive a superannuation guarantee contribution as required by the Federal Government, which is currently 9% and do not receive any other retirement benefits. Individuals, however, may choose to sacrifice part of their salary to increase payments towards superannuation.

Details of existing contracts between Karoon and the executive administration are as follows;

Name	Term	Expiry	Notice/Termination	Incentive Option Eligible	Remuneration amounts
Mr Robert Hosking	3 years, 3 year option	06/10/2008	In writing 6 months	Yes	\$250,000
Mr Mark Smith	3 years, 3 year option	06/10/2008	In writing 6 months	Yes	\$250,000
Mr Scott Hosking	2 years, 1 year option	01/01/2008	In writing 3 months	Yes	\$105,000

Details of remuneration for the financial year ended 30 June 2006

This section of the Remuneration Report provides specific disclosures in relation to remuneration for the Managing Director (as an Executive Director), Mr Robert Hosking, and for the senior executives in Karoon with the greatest authority for strategic direction and management of Karoon. In this report these executives are referred to as "Specified Executives".

The remuneration for each Director and each of the Specified Executives during the financial year was as follows:

	Primary	Post Employment	Equity	Other		
	Salary, Fees & Commissions	Superannuation Contributions	Cash Bonus	Superannuation	Options	Total
	\$	\$	\$	\$	\$	\$
Directors						
Mr Robert Hosking	\$250,000	-	-	-	715,200	965,200
Mr Mark Smith	\$250,000	-	-	-	715,200	965,200
Mr Geoff Atkins	\$25,000	2,250	-	-	206,700	233,950
Mr Stephen Power	\$25,000	2,250	-	-	163,900	191,150

	\$550,000	5,000	-	-	1,801,000	-	2,355,500
Specified Executives							
Mr Scott Hosking	75,625	6,806			14,590		76,625
Total	625,625	11,806			1,815,590		2,432,125

Options issued as part of remuneration for the financial year ended 30 June 2006

Options are issued to Specified Executives as part of their remuneration to increase goal congruence between executives and shareholders. No options were issued during the financial year to any Specified Executives.

	Granted number	Options granted as part of remuneration \$	Total remuneration represented by Options %	Options Exercised \$	Options Lapsed \$	Total \$
Directors						
Mr Robert Hosking	2,250,000	715,200	74.10	-	-	715,200
Mr Mark Smith	2,250,000	715,200	74.10	-	-	715,200
	4,500,000	1,430,400		-	-	1,430,400

Options

During or since the end of the financial year, Karoon did not grant any options over unissued ordinary shares to any of the Directors.

Issue of Options to Employees

At the date of this report, the unissued ordinary shares of Karoon Gas Australia Ltd under option are as follows:

Grant Date	Date of Expiry	Exercise Price	Number under Option
21 st October 2005	30 th June 2007	1.35	500,000
21 st October 2005	31 st October 2007	1.65	500,000
21 st October 2005	30 th September 2008	1.75	1,500,000
21 st October 2005	30 th September 2008	2.00	1,500,000
21 st October 2005	30 th September 2008	2.25	1,500,000
			4,500,000

At 30 June 2006, nil options (30 June 2005: \$415,000 options) were outstanding as part of the Karoon Gas Employee Share Option Plan.

During the financial year ended 30 June 2006 the following ordinary shares were issued on the exercise of options granted under the Karoon Gas Employee Share Option Plan. No further shares have been issued since that date. No amounts are unpaid on any of the shares.

Grant Date	Exercise Price	Number of Shares Issued
9 th May 2006	125 cents	100,000
6 th June 2006	125 cents	40,000
20 th June 2006	125 cents	50,000
30 th June 2006	125 cents	155,000
		345,000

In addition, at 30 June 2006 70,000 options with an exercise price of 1.25 cents each, expired and were not paid up.

Directors' Interests

The relevant interest of each Director in the shares, debentures, interests in registered schemes and rights or options over such instruments issued by Karoon, as notified by the Directors to ASX in accordance with Section 205G(1) of the Corporations Act 2001, at the date of this report is as follows:

	Ordinary fully paid shares	Options Over Ordinary Shares
Mr Robert Hosking	12,311,087	2,750,000
Mr Mark Smith	1,830,000	2,750,000
Mr Geoff Atkins	227,500	500,000
Mr Stephen Power	15,000	500,000

Indemnification of Directors and Officers

An indemnity agreement has been entered into between an insurance company and the current Directors of Karoon named earlier in this Directors' Report and with the full time executive officers, directors and secretaries of all Australian group companies. Under this agreement, the insurance company has agreed to indemnify these Directors and officers against any claim or for any expenses or costs which may arise as a result of work performed in their respective capacities. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

Proceedings on Behalf of Company

No person has applied for leave of Court to bring proceedings on behalf of Karoon or to intervene in any proceedings to which Karoon is a party for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

Karoon was not a party to any such proceeding during the financial year.

Corporate Governance

In recognising the need for the highest standards of corporate governance and accountability, the Directors of Karoon support and have adhered to the principles of good corporate governance. The Statement of Corporate Governance Principles for Karoon Gas is listed on pages 45 – 50 of this Annual Report.

Environmental Regulation

The consolidated entity is subject to a range of environmental laws and regulations with the most signified being:

- The Petroleum (submerged lands) Act 1967
- The Petroleum Act 1998 (Vic) and the Petroleum Regulations 2000 (Vic);
- Environment Protection and Biodiversity Conservation Act 1999
- Mineral Resources Development Act 1990 (Vic)
- The Aboriginal and Torres Strait Islander Heritage and Protection Act 1994 (Cth)
- The Archaeological and Aboriginal relics Preservation Act 1972 (Vic)

The Board believes that Karoon has adequate systems in place for managing its environmental requirements and is not aware of any breach of those environmental requirements as they apply to Karoon. No circumstances arose during the year that resulted in an incident to be reported under environmental legislation.

Adoption of Australian Equivalents to International Financial Reporting Standards ("AIFRS")

The Financial Report has been prepared under Australian equivalents to International Financial Reporting Standards. A reconciliation of adjustments arising on the transition to AIFRS, between previous Australian GAAP and Australian equivalents to International Financial Reporting Standards, has been included in Note 25 of the Financial Report.

Statutory Auditors

Mitchell Wilson and Partners continues to act in its capacity as the statutory auditor of Karoon Gas Australia Ltd in accordance with Section 327 of the Corporations Act 2001.

Auditor's Independence Declaration

Auditor's Independence Declaration

No officer of Karoon has previously belonged to an audit practice auditing Karoon during the financial year.

The Directors have considered the position and, in accordance with advice received from the Audit Committee, are satisfied that the provision of these services is compatible with the standards of auditor independence imposed by the Corporations Act 2001. The services were subject to terms and conditions of engagement to ensure that auditor independence was not compromised.

A copy of the auditors' independence declaration for the financial year ended 30 June 2006 has been received as required under Section 207C of the Corporations Act 2001 is included on page 44.

This Directors' Report is made in accordance with a resolution of the Board of Directors made pursuant to Section 298(2) of the Corporations Act 2001. On behalf of the Directors:



Mr Robert Hosking
Managing Director

Dated Melbourne this 15th day of September 2006

Auditor's Independence Declaration under Section 307C of the Corporations Act 2001 to the directors of Karoon Gas Australia Limited

I declare that, to the best of my knowledge and belief during the year ended 30 June 2006 there have been:

- i. No contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit, and
- ii. No contraventions of any applicable code of professional conduct in relation to the audit.

Mitchell Wilson & Partners
Chartered Accountants
Melbourne,



Doug Mitchell
Partner
15th Day of September 2006

STATEMENT OF FINANCIAL PERFORMANCE

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Note	Consolidated Entity		Parent Entity	
		2006 \$	2005 \$	2006 \$	2005 \$
Revenues from ordinary activities	2	931,762	157,976	1,002,147	157,056
Net foreign currency gains		77,459	-	77,459	-
Accounting & Taxation Fees		(19,460)	(19,927)	(19,460)	(19,927)
Audit fees	4	(5,500)	(15,000)	(2,455)	(12,000)
Bank charges		(104,219)	(2,487)	(103,222)	(2,487)
Computer support		(24,783)	(8,994)	(24,783)	(8,994)
Consulting fees		(295,006)	(191,696)	(295,006)	(191,696)
Corporate promotion and annual report		(48,192)	(15,285)	(48,192)	(15,285)
Depreciation and Amortization Expense		(123,710)	(210,019)	(123,710)	(48,099)
Directors' Fees and Superannuation		(54,500)	(30,479)	(54,500)	(30,479)
Exploration and evaluation expenditure expensed or written off		(78,230)	-	-	-
Legal fees		(65,601)	(109,468)	(65,601)	(109,468)
Insurance		(95,322)	(4,984)	(95,322)	(4,984)
Other expenses from ordinary activities		(109,003)	(63,474)	(109,003)	(62,028)
Property costs		(73,060)	(76,166)	(72,960)	(76,066)
Employee Benefits Expense (net)		(2,530,923)	(144,337)	(2,603,547)	(144,337)
Share registry and listing fees		(91,396)	(59,797)	(91,020)	(59,797)
Travel and accommodation		(126,299)	(71,229)	(126,299)	(71,229)
Loss from ordinary activities before income tax expense	3	(2,835,982)	(865,366)	(2,755,474)	(699,820)
Income tax (expense)/benefit relating to ordinary activities	5		-		-
Net loss from ordinary activities after income tax					
Expense attributable to members of the parent entity		(2,835,982)	(865,366)	(2,755,474)	(699,820)
Total changes in equity other than those resulting from transactions with owners as owners		(2,835,982)	(865,366)	(2,755,474)	(699,820)
Basic earnings per share	7	(\$0.0564)	(\$0.0145)		
Diluted earning per share		(\$0.0442)	(\$0.0095)		

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 17 to 42

STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2006

	Note	Consolidated Entity		Parent Entity	
		2006	2005	2006	2005
		\$	\$	\$	\$
Current assets					
Cash assets	8	15,701,319	12,796,605	15,689,684	12,757,094
Receivables	9	113,894	131,895	46,872	96,045
Inventory	10	70,644	195,402	-	-
Total current assets		15,885,857	13,123,902	15,736,556	12,853,139
Non-current assets					
Receivables		-	-	17,222,647	3,204,948
Property, plant and equipment	12	88,992	97,670	88,992	97,670
Intangible assets	13	239,472	20,093	111,804	20,093
Exploration and evaluation expenditure carried forward	14	17,046,217	2,984,934	-	-
Other financial assets	15	-	2,267	150,212	152,267
Total non-current assets		17,374,681	3,104,964	17,573,655	3,474,978
Total assets		33,260,538	16,228,866	33,310,211	16,328,117
Current liabilities					
Payables	16	(148,245)	(154,733)	(83,623)	(94,949)
Provisions	17	(2,407)	(2,521)	(2,407)	-
Total current liabilities		(150,652)	(157,254)	(86,030)	(94,949)
Total liabilities		(150,652)	(157,254)	(86,030)	(94,949)
Net assets		33,109,886	16,071,612	33,224,181	16,233,168
Equity					
Contributed equity	18	34,267,889	16,990,949	34,267,689	16,990,849
Accumulated losses		(3,610,525)	(919,337)	(3,496,029)	(757,681)
Reserve		2,452,521	-	2,452,521	-
Total equity		33,109,886	16,071,612	33,224,181	16,233,168

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 17 to 42

STATEMENT OF CHANGES IN EQUITY

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	CONSOLIDATED ENTITY			Total Equity \$
	Issued Capital \$	Accumulated Losses \$	Share based payments reserve \$	
Balance as at 1 July 2004	4,726,731	(148,092)	-	4,578,639
Shares issued during the year	13,124,989	-	-	13,124,889
Transaction costs arising on share issues	(860,771)	-	-	(860,771)
Loss attributable to members of the parent entity	0	(626,451)	-	(626,451)
Balance as at 30 June 2005	16,990,949	(774,543)	-	16,216,406
Shares issued during the financial year	18,246,790	-	-	18,246,790
Transaction costs arising on share issues	(697,500)	-	-	(697,500)
Loss attributable to members of the parent entity	-	(2,835,982)	-	(2,835,982)
Exercise of Options (funds cleared 4 July 2006)	(272,350)	-	-	(272,350)
Share based payments	-	-	2,452,521	2,452,521
Balance as at 30 June 2006	34,267,889	(3,610,525)	2,452,521	33,109,885

	PARENT ENTITY			Total Equity \$
	Issued Capital \$	Accumulated Losses \$	Share based payments reserve \$	
Balance as at 1 July 2004	4,726,731	(151,983)	-	4,574,748
Shares issued during the year	13,124,889	-	-	13,124,889
Transaction costs arising on share issues	(860,771)	-	-	(860,771)
Loss attributable to members of the parent entity	-	(605,698)	-	(605,698)
Balance as at 30 June 2005	16,990,849	(757,681)	-	16,233,168
Shares issued during the financial year	18,246,690	-	-	18,246,690
Transaction costs arising on share issues	(697,500)	-	-	(697,500)
Loss attributable to members of the parent entity	-	(2,738,348)	-	(2,738,348)
Exercise of Options (funds cleared 4 July 2006)	(272,350)	-	-	(272,350)
Share based payments	-	-	2,452,521	2,452,521
Balance as at 30 June 2006	34,267,689	(3,496,029)	2,452,521	33,224,181

The accompanying notes form an integral part of these financial statements

STATEMENT OF CASH FLOW

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Note	Consolidated Entity		Parent Entity	
		2006 \$	2005 \$	2006 \$	2005 \$
Cash flows from Operating Activities					
Receipt from Customers (inclusive of goods and services tax)		1,540,011	443,780	224,887	147,253
Payments to suppliers (inclusive of goods and services tax)		(1,365,671)	(1,149,296)	(1,361,152)	(876,417)
Interest received		931,762	157,976	929,521	157,056
Net cash flows used in operating activities	22	1,106,102	(547,540)	(206,744)	(572,108)
Cash flows from Investing Activities					
Purchase of property, plant and equipment (inclusive of goods and services tax)		(189,617)	(119,067)	(189,617)	(119,067)
Purchase of investments		(8,966)	(40,437)	(7,436)	(1,055)
Payments for exploration and development expenditure		(15,357,204)	(2,986,202)	-	(59,894)
Net cash flows used in investing activities		(15,555,787)	(3,145,706)	(197,053)	(180,016)
Cash flows from Financing Activities					
Proceeds from issue of ordinary shares		17,276,940	12,264,218	17,276,841	12,264,118
Loans to Subsidiaries		-	-	(14,017,912)	(2,963,493)
Net cash flows from Financing Activities		17,276,940	12,264,218	3,258,929	9,300,625
Net decrease in cash held		2,827,255	8,570,972	2,855,132	8,548,501
Cash at the beginning of the year		12,796,605	4,225,633	12,757,093	4,208,592
Effects of exchange rate changes on the balance of cash and cash equivalents held in foreign currency		77,459	-	77,459	-
Cash at the end of the year		15,701,319	12,796,605	15,689,684	12,757,094

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 17 to 42

NOTES TO THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The financial report is a general purpose financial report that has been prepared in accordance with the requirements of the Corporations Act 2001, relevant Australian Accounting Standards, Urgent Issues Group Interpretations and other authoritative pronouncements of the Australian Accounting Standards Board.

The financial report includes separate financial statements for Karoon Gas Australia Limited as an individual entity and the Group consisting of Karoon Gas Australia Limited and its subsidiaries.

Karoon Gas Australia Limited is a publicly listed company limited by shares and is listed in Australia on the ASX. It is incorporated and domiciled in Australia. The registered office of Karoon Gas Australia Limited and the principal place of business is located at Office 7a, 34-38 Lochiel Avenue, Mount Martha VIC 3934. The technical office of Karoon Gas Australia Limited is located on the 9th Floor, 406 Collin Street, Melbourne VIC 3000.

As this is the first full-year financial report prepared under Australian equivalents to International Financial Reporting Standards, the accounting policies applied are inconsistent with those in the financial report for the previous financial year ended 30 June 2005 as that report was presented under previous Australian GAAP, refer Note 1(b) below.

The following is a summary of the material accounting policies adopted by the Group in the preparation of this financial report. The accounting policies have been consistently applied, unless otherwise stated.

Reporting Basis and Convention

The financial report has been prepared on an accrual basis and is based on historical costs modified, when relevant, by the revaluation of selected non-current assets, financial assets and financial liabilities for which the fair value basis of accounting has been applied.

(a) Principles of Consolidation

The consolidated financial statements comprise the financial statements of Karoon Gas Australia Limited ("Company") and its subsidiaries (the "Group").

A subsidiary is any entity controlled by Karoon Gas Australia Limited whereby Karoon Gas Australia Limited has the power to control the financial and operating policies of an entity so as to obtain benefits from its activities.

All subsidiaries have a June financial year-end.

All inter-company balances and transactions between subsidiaries in the Group, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistencies with those policies applied by the Company.

Where subsidiaries have entered or left the Group during the period, their operating results have been included/excluded from the date control was obtained or until the date control ceased.

(b) Statement of Compliance

This financial report complies with relevant Australian Accounting Standards, which include Australian equivalents to International Financial Reporting Standards ("AIFRS"). Compliance with AIFRS ensures that the financial report for the financial year ended 30 June 2006, comprising the consolidated and Company financial statements and notes thereto, complies with International Financial Reporting Standards.

This is the first full-year financial report prepared based on AIFRS and comparatives for the financial year ended 30 June 2005 have been restated accordingly.

Reconciliations of AIFRS equity and AIFRS loss for the financial year ended 30 June 2005 prepared under previous Australian GAAP are detailed in Note 25 below.

(c) Comparative Figures

When required by Australian Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Income Taxes

Current tax

The charge for current income tax expense is based on the profit or loss for the period adjusted for any non-assessable or disallowable items. It is calculated using tax rates that have been enacted or are substantively enacted at the balance sheet date.

Deferred tax

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred income tax assets are recognised to the extent that it is probable that future tax profits will be available against which deductible temporary differences can be utilised.

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the Group will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by law.

Tax consolidation

Karoon Gas Australia Limited and its wholly-owned Australian subsidiaries have formed an income tax consolidated group under the Tax Consolidation Regime from 1 July 2003. The tax consolidated group has entered a tax sharing agreement whereby each company in the group contributes to the income tax payable in proportion to their contribution to the net profit before tax of the tax consolidated group.

(e) Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts, when relevant, are shown within short-term borrowings in current liabilities on the balance sheet.

(f) Inventories

Inventories are measured at the lower of cost and net realisable value.

The cost of casing and oilfield inventory includes direct materials, direct labour and transportation costs relating to oilfield activities.

(g) Property, Plant and Equipment

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

Plant and equipment

Plant and equipment are measured on the cost basis less depreciation and, when relevant, impairment losses.

The carrying amount of plant and equipment is reviewed annually by the Directors to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows that will be received from the asset's employment and subsequent disposal. The expected net cash flows have been discounted to their present values in determining recoverable amounts.

The cost of plant and equipment constructed within the Group includes the cost of materials, direct labour, borrowing costs and an appropriate proportion of fixed and variable overheads.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Property, Plant and Equipment (Continued)

Depreciation and amortisation

All assets have limited useful lives and are depreciated/amortised using the straight line method over their estimated useful lives. The depreciation/amortisation rates and methods are reviewed annually to determine the most appropriate method.

The depreciation/amortisation rates used for each class of asset, for the current and previous years, are as follows:

Plant and equipment	25 – 50%
Goodwill	10 %

Assets are depreciated or amortised from the month following their acquisition.

(i) Intangibles

Computer software is recognised at cost of acquisition. Computer software costs have a finite life and are carried at cost less accumulated amortisation and any impairment losses. Computer software costs are amortised over their useful life ranging from 2 to 3 years.

(j) Exploration and Evaluation Expenditure

Exploration and evaluation expenditure incurred is accumulated in respect of each identifiable area of interest. These costs are only carried forward on the balance sheet where rights to tenure are current and to the extent that costs are expected to be recouped through either the successful development of the area or where activities in the area have not yet reached a stage that permits reasonable assessment of the existence of economically recoverable reserves and active and significant exploration activity in, or in relation to, the area is continuing.

A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest.

Accumulated costs in relation to an abandoned area are written off in full in the income statement during the period in which the decision to abandon the area is made.

Provision for restoration is recognized when there is a legal or constructive obligation to do so. A corresponding restoration asset amount (included in exploration and evaluation expenditure carried forward) of an amount equivalent to the provision is also created. The amount recognised is the estimated cost of restoration, discounted to its net present value and is reassessed each year in accordance with local conditions and requirements. Changes in the estimates of restoration cost estimates are dealt with prospectively by recording an adjustment to the provision and a corresponding adjustment to the restoration asset. The unwinding of the discount on the restoration provision is included in the income statement.

Where it is established that economically recoverable reserves exist in a particular area of interest, the carrying amount attributable to that discovery is reclassified as a development asset.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Provisions

Provisions are recognised when the Group has a legal or constructive obligation, as a result of past events, for which it is probable that an outflow of economic benefits will result and that outflow can be reliably measured. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date.

(l) Impairment of Assets

At each balance sheet date, the Group reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication of impairment exists, the Group makes an estimate of recoverable amount, being the higher of the asset's fair value less costs to sell and value in use. Where the carrying amount of the asset exceeds its recoverable amount any excess is expensed to the income statement.

Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

(m) Financial Instruments

Recognition

Financial instruments are initially measured at cost on trade date, which includes transaction costs, when the related contractual rights or obligations exist. Subsequent to initial recognition these instruments are measured as set out below.

Financial assets at fair value through the income statement

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by Management and within the requirement of AASB 139 'Recognition and Measurement of Financial Instruments'. Derivatives are also recognised as held for trading unless they are designated as hedges. Realised and recognised gains and losses arising from changes in the fair value of these assets are included in the income statement in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method.

Held-to-maturity investments

These investments have fixed maturities, and it is the Group's intention to hold these investments to maturity. Any held-to-maturity investments held by the Group are stated at amortised cost using the effective interest rate method.

Available-for-sale financial assets

Available-for-sale financial assets include any financial assets not included in the above categories. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity.

Financial liabilities

Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

Derivative instruments

Derivative instruments are measured at fair value. Gains and losses arising from changes in fair value are taken to the income statement unless they are designated as hedges.

Fair value

Fair value is determined based on current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arm's length transactions, reference to similar instruments and option pricing models.

Impairment

At each balance sheet date, the Group assesses whether there is objective evidence that a financial instrument has been impaired. In the case of available-for-sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether impairment has arisen. Impairment losses are recognised in the income statement.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Foreign Currency Transactions and Balances

Functional and presentation currency

The functional currency of each of the Group's entities is measured using the currency of the primary economic environment in which that entity operates. The consolidated financial statements are presented in Australian dollars which is the Company's functional and presentation currency.

Transaction and balances

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary items are translated at the balance sheet date exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are reported at the exchange rate at the date when fair values were determined.

Exchange differences arising on the translation of monetary items are recognised in the income statement, except where deferred in equity as a qualifying cash flow or net investment hedge.

Exchange differences arising on the translation of non-monetary items are recognised directly in equity to the extent that the gain or loss is directly recognised in equity, otherwise the exchange difference is recognised in the income statement.

(o) Revenue

Sales

Revenue from the sale of goods is recognised upon the delivery of goods to customers.

Revenue from the rendering of a service is recognised upon the delivery of the service. All revenue is stated net of the amount of goods and services tax.

Interest

Interest revenue is recognised on a proportional basis taking into account the interest rates applicable to the financial assets.

Dividends

Dividend revenue is recognised when the right to receive a dividend has been established. Dividends received from associates are accounted for in accordance with the equity method of accounting.

(p) Employee Benefits

Wages and salaries, leave entitlements

An accrual is made for the Group's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits that are expected to be settled within one year have been measured at the amounts expected to be paid when the liability is settled, plus related on-costs.

Employee benefits payable later than one year have been measured at the present value of the estimated future cash outflows to be made for those benefits. In calculating the present value of future cash outflows in respect of long service leave, the probability of long service leave being taken is based on historical data.

Share based payments

Share based compensation benefits are provided to employees via the Karoon Gas Australia Limited Employee Share Option Plan.

For share options granted after 7 November 2002 and vested after 1 January 2005, the fair value of options granted is recognised as a share based payments expense with a corresponding increase in equity (the share base payments reserve). The fair value is measured at grant date and recognised over the period during which the individual become unconditionally entitled to the options. Upon the exercise of options, the balance of the share base payments reserve relating to those options is transferred to issued capital.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) Goods and Services Tax ("GST")

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Tax Office ("ATO"). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or equity or as part of an item of expense.

Receivables and payables in the balance sheet are shown inclusive of GST.

The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the balance sheet.

Cash flows are included in the cash flow statement on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

(r) Going Concern

On the basis of the Group's present level of operations, the Directors are of the opinion that for the next 12-month period from the date of signing the Directors' Declaration the Group and Company both have the ability to:

- i. farm-out interests in permits for a carry in order to meet future exploration expenditure commitments; and
- ii. raise additional capital through the issue of additional new ordinary shares to meet working capital requirements and shortfalls in exploration expenditure commitments.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Note	Consolidated Entity		Parent Entity	
		2006	2005	2006	2005
		\$	\$	\$	\$
2. REVENUE					
Operating activities					
Interest income		931,762	157,976	929,521	157,056
Services revenue from subsidiaries		-	-	72,626	-
Total revenue		931,762	157,976	1,002,147	157,056
Non-operating activities					
Net foreign currency gains		77,459	-	77,459	-
Total other income		77,459	-	77,459	-
3. LOSS FROM ORDINARY ACTIVITIES BEFORE INCOME TAX					
Loss before income tax includes the following specific expenses:					
1. Depreciation of plant and equipment and amortization of software		106,584	65,225	106,584	48,099
2. Rental expense on operating leases		56,060	24,960	56,060	24,960
3. Exploration and evaluation expenses written off		78,230	-	78,230	-
4. Net foreign currency gain		77,459	-	77,459	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Note	Consolidated Entity		Parent Entity	
		2006 \$	2005 \$	2006 \$	2005 \$
4. AUDITORS' REMUNERATION					
Auditing or reviewing the financial report		5,500	15,000	2,455	12,000
Other non-audit services		-	-	-	-
Total auditor's remuneration		5,500	15,000	2,455	12,000
5. INCOME TAX					
(a) Income tax expense					
The prima facie tax on loss ordinary activities before income tax is reconciled to income tax as follows:		-	-	-	-
Prima facie tax payable on the loss from ordinary activities before income tax calculated at the Australian tax rate of 30% (2005: 30%)		(850,795)	(187,935)	(826,642)	(181,710)
Tax effect of amounts in calculating taxable income:					
Add:					
- Non-deductible write off of capital assets		-	-	-	-
- Accumulated losses not brought into account		5,065,816	1,002,742	823,278	181,075
- Other non-deductible items		4,414	1,100	4,414	1,100
		4,219,435	815,907	1,050	465
Less:					
- Exploration expenses deductible for tax purposes		(4,218,385)	(815,442)	-	-
- Other deductible items		(1,050)	(465)	(1,050)	(465)
		-	-	(1,050)	(465)
Income tax expense		-	-	-	-
(b) Tax consolidation					
Karooon Gas Australia Limited and its wholly-owned Australian subsidiaries are a tax consolidated group. Karooon Gas Australia Limited is the head entity within the tax consolidated group. The tax consolidated group has entered a tax sharing agreement whereby each company in the group contributes to the income tax payable in proportion to their contribution to the net profit before tax of the tax consolidated group. In addition, the agreement provides for the allocation of income tax liabilities between entities, should the head entity default on its tax payment obligations.					

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Consolidated Entity		Parent Entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
6. DIVIDENDS				
There were no ordinary dividends proposed/paid during the year ended 30 June 2006 by the Company. (2005:\$NIL)				
7. EARNINGS PER SHARE				
Earnings used in the calculation of basic and dilutive earnings per share				
(a) Basic loss per share	(\$0,0564)	(\$0.0145)	-	-
(b) Diluted loss per share	(\$0,0442)	(\$0.0095)	-	-
Weighted average number of ordinary shares used in the calculation of basic earnings per share	81,241,897	43,190,626	-	-
Weighted average number of options outstanding	7,000,000	22,101,700	-	-
Weighted average number of ordinary shares outstanding during the year used in calculating diluted earnings per share	-	-	-	-
Potential ordinary shares	88,241,897	65,689,663	-	-
Options outstanding at 30 June 2006 are considered to be potential ordinary shares for the purposes of determining diluted earnings per share.				

8. CASH AND CASH EQUIVALENTS

Cash at bank of hand	6,426,152	12,796,605	6,417,517	12,757,094
Bank deposits at call	9,272,167	-	9,272,167	-
Total cash and cash equivalents	15,701,319	12,796,605	15,689,684	12,757,094

(a) Cash at bank and on hand

The Australian dollar cash at bank and on hand balance is non-interest bearing. The United States dollar cash at bank had an interest rate of 4.25% as at 30 June 2006. The Professional Funds cash at bank and on hand balance had an interest rate of 5.65% as at 30 June 2006.

(b) Bank deposits at call

The weighted average interest rate on bank deposits as at 30 June 2006 was 5.25%. The Australian Term Deposit has a maturity of less than 30 days. The United States Dollar Term Deposit has a maturity of less than 60 days.

(c) Effective Interest Rates

Information concerning the weighted average interest rate for the prior year is set out in Note 20.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Consolidated Entity		Parent Entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
9. TRADE AND OTHER RECEIVABLES				
Current				
Trade debtors	48,348	131,895	16,064	12,837
Other receivables	65,545	-	30,808	83,208
Total current trade and other receivable	113,894	131,895	46,872	96,045
Non-Current				
Karoon Gas Pty Ltd	-	-	17,222,647	3,204,948
Less: Provision for doubtful debts	-	-	-	-
Total non-current trade and other receivables	-	-	17,222,647	3,204,948

(a) Trade debtors

Trade debtors are recognized initially at fair value and are due for settlement no more than 30 days from the date of recognition. Collectibility of trade debtors is reviewed on an ongoing basis.

(b) Other receivables

Includes GST receivables of \$65,545 (2005: \$88,304) and \$30,808 (2005: \$83,208) as at 30 June 2006 for the Group and Company respectively.

(c) Effective Interest Rates and Credit Risk

Information concerning the Group's exposure to interest rate changes and credit risk on both current and non-current receivables is set out in Note 20.

10. INVENTORIES

Current				
Inventory at cost	70,644	195,402	-	-
Total current inventories	70,644	195,402	-	-

Casing and oilfield inventory is expected to be realized or used in projects within 12 months

11. OTHER ASSETS

<i>Non-current</i>				
Exploration and evaluation costs carried forward in respect of areas of interest	17,046,217	2,984,934	-	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Consolidated Entity		Parent Entity	
	2006 \$	2005 \$	2006 \$	2005 \$
12. PROPERTY, PLANT AND EQUIPMENT				
Plant and equipment				
At cost	210,965	140,891	210,965	140,891
Accumulated depreciation	(121,973)	(43,221)	(121,973)	(43,221)
Total plant and equipment	88,992	97,670	88,992	97,670
Reconciliations of the carrying amounts for each class of property, plant and equipment are set out below:				
Plant and equipment				
Balance at beginning of financial year	97,670	46,370	97,670	46,370
Additions	70,074	92,450	70,074	92,450
Depreciation expense	(78,752)	(41,150)	(78,752)	(41,150)
Carrying amount at end of financial year	88,992	97,670	88,992	97,670
13. INTANGIBLE ASSETS				
Computer software				
At cost	146,670	27,127	146,670	27,127
Accumulated amortization	(34,866)	(7,034)	(34,866)	(7,034)
Net carrying value	111,804	20,093	111,804	20,093
Goodwill				
Goodwill on acquisition of Karoon Gas Pty Ltd	171,951	171,951	-	-
Accumulated amortization	(44,283)	(27,157)	-	-
Net carrying value	127,668	144,794	-	-
Total intangibles, at net book value	239,472	164,887	111,804	20,093
Reconciliation of the carrying amount for computer software is set out below:				
Balance at beginning of financial year	20,093	425	20,093	425
Additions	119,543	26,617	119,543	26,617
Amortization charge	(27,832)	(6,949)	(27,832)	(6,949)
Net carrying at end of financial year	111,804	20,093	111,804	20,093
Reconciliation of the carrying amount for goodwill is set out below:				
Balance at beginning of financial year	144,794	161,920	-	-
Amortisation charge	(17,126)	(17,126)	-	-
Net carrying at end of financial year	127,668	144,794	-	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Note	Consolidated Entity		Parent Entity	
		2006 \$	2005 \$	2006 \$	2005 \$
14. EXPLORATION AND EVALUATION EXPENDITURE CARRIED FORWARD					
Balance at beginning of financial year		2,984,934	266,796		
Expenditure incurred		14,139,514	2,696,582		
Amounts expensed to income statement		(78,230)	-		
Net carrying amount at end of financial year (refer note (b) below)		<u>17,046,217</u>	<u>2,984,934</u>		

Exploration and evaluation expenditure carried forward to the areas of interest in the exploration phase for petroleum exploration permits PEP162/EL4537 and WA314P and WA315P.

The expenditure is carried forward on the basis that exploration and evaluation expenditure activities in the areas have not reached a stage that permits reasonable assessment of the existence or otherwise of economically recoverable reserves and active and significant activity in, or in relation, to the areas is continuing.

The ultimate recovery of capitalised exploration and evaluation expenditure is dependent on the successful development and commercial exploitation or the commercial sale of the relevant areas of interest.

15. OTHER FINANCIAL ASSETS

Non-current					
Investment in subsidiary companies at cost	19	-	2,267	150,212	152,267
Total non-current other financial assets		<u>-</u>	<u>2,267</u>	<u>150,212</u>	<u>152,267</u>

(a) Effective interest rates and credit risk

Information concerning the Group's exposure to interest rate changes and credit risk on the security deposit is set out in Note 20

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Consolidated Entity		Parent Entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
16. TRADE AND OTHER PAYABLES				
Current-unsecured liabilities				
Trade payables	95,927	107,813	45,405	51,308
Sundry payables and accrued expenditure	52,318	46,920	38,218	43,641
Total trade and other payables	148,245	154,733	83,623	94,949

Effective Interest Rates and Credit Risk

Information concerning the weighted average interest rate other payables is set out in Note 24

17. PROVISIONS

Short-term				
Provision for Fringe Benefits Tax	1,918	1,050	1,918	1,050
Total short-term provision	1,918	1,050	1,918	1,050
Long Term				
Employee benefits (long service leave)	489	-	489	-
Total long-term provision	489	-	489	-

Movements in each class of provision during the financial year are set out below:

Consolidated and Company 2006	Short-term Provision for Fringe Benefits Tax	Long-term Employee Benefits
	\$	\$
Balance at beginning of financial year	1,050	-
Additional provisions	8,686	489
Amounts used	(7,818)	-
Balance at end of financial year	1,918	489

Fringe Benefits Tax Provision

Fringe benefits tax ("FBT") is a tax payable by the Company on the value of certain benefits, known as fringe benefits that have been provided to employees or to associates of those employees in respect of their employment during an FBT year ending 31 March. The Company's FBT liability is due and payable during May each year, along with lodgement of the annual FBT return. A provision is raised for the estimated FBT amount. The Company is required to pay the tax in quarterly 'notional tax' instalments.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

Consolidated Entity		Parent Entity	
2006	2005	2006	2005
\$	\$	\$	\$

18. ISSUED CAPITAL

(a) Share Capital

80,273,897 (2005: 53,819,697) fully paid ordinary shares

34,267,689	16,990,849	34,267,689	16,990,849
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Ordinary share participate in dividends as declared from time to time and the proceeds on winding up of the parent entity in proportion to the number of shares held.

At the shareholders meeting, on a show of hands every holder of ordinary shares present at a meeting in person or by proxy is entitled to one vote, and upon a poll each share is entitled to one vote.

(b) Movements in ordinary share capital

Date	Details	Notes	Number of shares	Issue Price	\$
1 July 2005	Opening balance		53,819,697		16,990,849
16 August 2005	Share Placement	(a)	7,750,000	\$1.80	13,950,000
	Less: Transaction costs arising on share issue				(697,500)
1/7/05 – 30/6/06	Exercise of options	(b)	19,327,200	\$0.20	3,865,440
1/7/05 – 30/6/06	Exercise of options	(c)	345,000	\$1.25	431,250
30 June 2006	Exercise of options				(272,350)
30 June 2006	Closing balance		81,241,897		34,267,689

(c) Share Placement

Funds raised by placement were planned for use in the 2D and 3D seismic surveys in the West Australian Permits WA-314-P and WA-315-P as well as further drilling and seismic surveys in PEP- 162.

(d) Employee share option plan

Information relating to the Karoon Employee Share Option Plan, including details of options issued, exercised and lapsed during the financial year and options outstanding at the end of the financial year, is set out in Note 29

19. SUBSIDIARIES

Name	Country of incorporation	Percentage of equity and voting interests held		Investment	
		2006 %	2005 %	2006 \$	2005 \$
Parent entity					
Karoon Gas Australia Limited	Australia				
Subsidiaries					
Karoon Gas Pty Ltd	Australia	100%	100%	150,000	150,000
Eastern Pacific Coal Pty Ltd	Australia	100%	100%	212	-
Karoon Gas Browse Basin Pty Ltd	Australia	100%	100%	-	-
Total				17,222,859	3,204,948

NOTES TO THE FINANCIAL STATEMENTS continued

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

20. FINANCIAL INSTRUMENTS DISCLOSURE

The main purpose of non-derivative financial instruments is to raise finance for Group operations. The Group's activities expose it primarily to the financial risk of changes in foreign exchange rate movements and interest rates. The Group may enter into various derivative financial instruments to manage its exposure to these risks. The Group does not enter into or trade in derivative financial instruments for speculative purposes. For the financial year ended 30 June 2006, the Group and Company did not enter into any derivative financial instruments.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised in respect of each class of financial asset and financial liability are disclosed in Note 1.

a) Credit risk

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance date to recognised financial assets is the carrying amount of those assets, net of any provisions for impairment, as disclosed in the balance sheet and notes to the financial statements.

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance date to recognise financial assets is the carrying amount of those assets, net of any provisions for impairment, as disclosed in the balance sheet and notes to the financial statements.

The Group does not have any material credit risk exposure to any single debtor or group of debtors under non-derivative financial instruments entered into by the Group.

b) Net fair values

The net fair values of listed investments will be valued at the quoted market bid price at balance date adjusted for transaction costs expected to be incurred. For other assets and other liabilities the net fair value approximates their carrying value. Financial assets and financial liabilities are not readily traded on organised markets in standardised form other than listed investments.

The aggregate net fair values and carrying amounts of financial assets and financial liabilities are disclosed in the balance sheet and in the notes to the financial statements.

c) Foreign exchange risk

The Group is exposed to fluctuations in foreign currencies arising from the purchase of goods and services in currencies other than Australian dollars. The main foreign currency exposure is United States dollars. The Group manages foreign exchange risk by monitoring forecast cash flows in currencies other than Australian dollars and ensuring that adequate United States dollar cash balances are maintained.

d) Interest rate risk

The Group's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates, and the weighted average interest rate for classes of financial assets and financial liabilities is set out below:

	Weighted interest rate	Floating interest rate	Fixed interest maturing 1 year or less	Non- interest- bearing	TOTAL
	%	\$	\$	\$	\$
2006					
Financial assets					
Cash and cash equivalents	5.33	5,757,242	9,272,167	671,910	15,701,319
Trade and other receivables					-
Other financial assets					-
Total financial assets		5,757,242	9,272,167	671,910	15,701,319
2005					
Financial assets					
Cash and cash equivalents	5.35	12,743,969	-	52,635	12,796,605
Trade and other receivables					-
Other financial assets					-
Total financial assets		12,743,969	-	52,635	12,796,605

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

21. Commitments for Expenditure (for disclosure in 2006 Financial Report)

As at 30 June 2006

a) Capital expenditure commitments

Description	Not later than 1 year	Later than 1 Year but not Later than 5 Years	Later than 5 Years
As at 30 June 2006			
Plant & equipment-100% Karoon	-	-	-
Seismic Acquisition-100% Karoon	4,236,111	-	-
Drilling-100% Karoon	-	-	-
Total	4,236,111	-	-

*see Veritas seismic contract and invoices

b) Operating lease rental commitments (list out separately)

Non-cancellable operating lease rental, not provided for in the financial statements and payable:

Description	Not later than 1 year	Later than 1 Year but not Later than 5 Years	Later than 5 Years
As at 30 June 2006			
(i) Office rent-Mt Martha	16,918		-
(ii) Office rent-Collins Street	85,000	275,949	-
Total	101,918	275,949	-

In respect of non-cancellable operating leases the following provisions have been recognised :

Note : Operating leasing arrangements

A general description about the lessees leasing arrangements should be disclosed, including:

- (i) The Company has an office lease with a primary 3-year term that expires on the 4th March 2007. Rent is payable monthly in advance. There is an option to extend for another 3 years.
- (ii) The Company has an office lease with a 4 year primary term and a 4% per annum increase, expiring 30 June 2009. Rent is payable monthly in advance. There is an option for a 4 year extension.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

(c) Other expenditure commitments (Firm Commitments only)

Commitments for exploration expenditure arising from obligations to government, to perform minimum exploration work and expend minimum amounts of money on such work in exploration licence areas. The commitments existing at balance date attributable to the consolidated entity, which are not provided for in the financial statements are expected to fall due as follows :

Description	Not later than 1 year	Later than 1 Year but not Later than 5 Years	Later than 5 Years
Gippsland Permits(PEP162 & EL4537)	270,000		
West Australian Permits (WA-314-P & WA-315-P)	45,000,000	45,000,000	
Total	45,270,000	45,000,000	-

Notes:

(a) Estimates for future exploration expenditure commitments are based on estimated well and seismic costs which will change as actual drilling locations and seismic surveys are organised and are determined in current dollars on an undiscounted basis.

b) Where exploration expenditure included in this category relates to an existing contract for expenditure and/or signed AFEs as at 30 June 2006, the amount will be included in both categories (a) and (b) above.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

	Consolidated Entity		Parent Entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
22. NOTES TO THE CASH FLOW STATEMENTS				
(a) Reconciliation of Loss after Income Tax to Cash Flow from Operations				
(Loss)/Profit after income tax	(2,835,982)	(626,451)	(2,738,348)	(605,698)
Add/(subtract) non-cash items				
Depreciation of plant and equipment and amortization of software	123,710	65,225	123,710	65,225
Share based payments expensed	2,452,521	-	2,452,521	-
Reversal of impairment losses for non-current receivables (subsidiaries)	-	-	-	-
Impairment losses for non-current receivables (subsidiaries)	-	-	-	-
Net foreign currency losses (gains)	(77,459)	-	(77,459)	-
Items classified as investing/financing activities:				
Exploration and evaluation expenditure expensed	78,230			
Change in operating assets and liabilities:				
(Increase)/Decrease in assets				
Trade and other receivables – current				
Other assets – current				
Trade and other receivables – non-current				
Other financial assets – non-current				
Increase/(decrease) in liabilities				
Trade and other payables – current				
Short-term provisions	31,397	(2,521)	31,397	(2,521)
Long-term provisions	489	-	489	-
Net cash used in operating activities	1,106,102	547,540	206,744	572,108

23. RELATED PARTY TRANSACTIONS

(a) Parent entity

The ultimate parent entity within the Group is Karoon Gas Australia Limited.

(b) Subsidiaries

Interests in subsidiaries are set out in Note 19

During the financial year, the Company provided accounting, administrative and technical services to subsidiaries at cost as set out in Note 2. Other transactions that occurred were advancement of intercompany loans at Nil interest rate and no fixed term for repayment. Loans are unsecured. These transactions are eliminated on consolidation. Loans advanced to and repayments from subsidiaries are set out in the Cash Flow Statements.

(c) Directors and Specified Executives

Disclosures relating to Directors and Specified Executives are set out in the Directors' Report. Apart from the details disclosed in this note, no Director or Specified Executive has entered into a material contract with the Company or the Group since the end of the previous financial year and there were no material contracts involving Directors' or Specified Executives' interests subsisting as at 30 June 2006.

(d) Other transactions with the Company

During the financial year Mr Robert Hosking had an interest in Ropat Nominees Pty Ld which provided rental premises to the Group. The value of the transactions during the financial year was : \$ 25,000 (2005 : \$25,000).

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

24. SHARE BASED PAYMENTS

(a) Share Option Plan

(i) Employee Share Option Plan

The Company has one Employee Share Option Plan ("ESOP"), which was approved by shareholders at the 2004 annual general meeting. Options expire two years after they are granted. The exercise price of options, issued during the financial year, is based on the weighted average price at which the Company's shares are traded on ASX during the two months of trading days before the options are granted. Options may be exercised after the date the option was granted. If there is a change of control of the Company, all unexercised options will become immediately exercisable. Options granted under ESOP carry no dividend or voting rights. When exercisable, each option is convertible into one ordinary share of the Company.

The following reconciles the outstanding share options granted under ESOP at the beginning and end of the financial year:

	Consolidated and Company 2006		Consolidated and Company 2005	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Balance at beginning of financial year	415,000	1.25	0	-
Granted during the financial year	-	-	415,000	1.25
Exercised during the financial year	(345,000)	(1.25)	0	-
Forfeited during the financial year	0	-	0	-
Expired during the financial year	(70,000)	(1.25)	0	-
Balance at end of financial year	0	0	415,000	1.25
Exercisable at end of financial year	0	0	415,000	1.25

The weighted average share price when the share options were exercised during 2006 was \$1.48.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

24. SHARE BASED PAYMENTS (Continued)

(ii) Other Options

The Company has granted five million other options during the financial year. These options expire within two years after they are granted. The exercise price of options is based on the weighted average price at which the Company's shares are traded on ASX during the two months of trading days before the options are granted. Options may be exercised after the date the option was granted. If there is a change of control of the Company, all unexercised options will become immediately exercisable. Options granted carry no dividend or voting rights. When exercisable, each option is convertible into one ordinary share of the Company.

The following reconciles the outstanding other share options granted at the beginning and end of the financial year:

	Consolidated and Company 2006		Consolidated and Company 2005	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Balance at beginning of financial year	20,849,200	\$0.20	22,331,750	\$0.20
Granted during the financial year	5,500,000	\$1.91	-	-
Exercised during the financial year	(19,327,200)	(\$0.20)	(1,482,550)	\$0.20
Forfeited during the financial year	-	-	-	-
Expired during the financial year	(22,000)	-	-	-
Balance at end of financial year	7,000,000	\$1.91	20,849,200	\$0.20
Exercisable at end of financial year	7,000,000	\$1.91	20,849,200	\$0.20

The weighted average share price when the share options were exercised during 2006 was \$1.66.

The options outstanding as at 30 June 2006 had a weighted average exercise price of \$1.91 with a weighted average remaining contractual life of 873 days.

b) Detail of other options outstanding at the end of the financial year:

Grant date	Expiry and exercise date	Exercise Price	Number
18 November 2005	30 September 2008	\$1.75	1,500,000
18 November 2005	30 September 2008	\$2.00	1,500,000
18 November 2005	30 September 2008	\$2.25	1,500,000
18 November 2005	30 June 2007	\$1.35	500,000
18 November 2005	30 October 2007	\$1.65	500,000
			<u>5,500,000</u>

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

24. SHARE BASED PAYMENTS (Continued)

Fair value of options

The weighed average fair value of the ESOP and other options granted during the financial year was \$0.33. The fair value of each option during the financial year was estimated on grant date using the Black & Scholes option pricing model. The Black & Scholes option pricing model takes into account the exercise price, the term of the option, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option. The Company has applied the following assumptions and inputs:

Weighted average exercise price	\$0.22 (2005: \$0.20)
Weighted average life of options	707 days (2005: 502 days)
Weighted average share price	\$1.48 (2005: \$0.48)
Expected share price volatility	39% (2005: 29%)
Risk-free interest rate	5.25% (2005: 5.23%)

Historical volatility has been the basis for determining expected share price volatility as it is assumed that this is indicative of future tender, which may not eventuate.

Included under employee benefits expense in the income statement is \$2,452,521 relating to the ESOP (2005: \$0.00), in full, to equity-settled share based payments transactions.

25. EMPLOYEE BENEFITS

(a) Employee share option plan

Information relating to the Karoon Gas Australia Limited Employee Share Option Plan, including details of options issued, exercised and expired during the financial year and options outstanding at the end of the financial year, is set out in Note 24.

(b) Superannuation plans

During the financial year, the Company contributed to accumulation type benefit funds administered by fund managers. The funds cover all Australian domiciled employees of the Company. Employee and employer contributions are based on a fixed percentage of cash salary. The current contribution is 9% (2005: 9%) of employee cash remuneration.

(c) Employees

The number of employees as at 30 June 2006 was 4 (2005: 2) for Karoon Gas Australia Limited and the Group. The number of employees includes both full time employees and part time employees measured on a full time equivalent basis.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

26. FIRST TIME ADOPTION OF AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

1. Impact on the statements of financial position as at 1 July 2004

	Consolidated			Parent Entity		
	Existing GAAP \$	Effect of change \$	AIFRS \$	Existing GAAP \$	Effect of change \$	AIFRS \$
Current assets						
Cash assets	4,225,633		4,225,633	4,208,593		4,208,593
Receivables	66,046		66,046	46,481		46,481
Total current assets	4,291,679		4,291,679	4,255,073		4,255,073
Non-current assets						
Other financial assets	1,212		1,212	151,212		151,212
Receivables	-		-	241,455		241,455
Property, plant and equipment	46,795		46,795	46,795		46,795
Intangible assets	161,920	(161,920)	-	-		-
Other assets	266,796		266,796	-		-
Total non-current assets	476,723	(161,920)	313,591	439,462		439,462
Total assets	4,768,402	(161,920)	4,606,482	4,694,535		4,694,535
Current liabilities						
Payables	(189,764)		(189,764)	(119,787)		(119,787)
Total current liabilities	(189,764)		(189,764)	(119,787)		(119,787)
Total liabilities	(189,764)		(189,764)	(119,787)		(119,787)
Net assets	4,578,638	(161,920)	4,416,718	4,574,748		4,574,748
Equity						
Contributed equity	4,726,731		4,726,731	4,726,731		4,726,731
Accumulated losses	(148,092)	(161,920)	(310,012)	(151,983)		(151,983)
Total equity	4,578,638	(161,920)	4,578,638	4,574,748		4,574,748

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

26. FIRST TIME ADOPTION OF AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS continued

1. Impact on the statements of financial position as at 30 June 2005

	Consolidated			Parent Entity		
	Existing GAAP \$	Effect of change \$	AIFRS \$	Existing GAAP \$	Effect of change \$	AIFRS \$
Current assets						
Cash assets	12,796,605	-	12,796,605	12,757,094	-	12,757,094
Receivables	131,895	-	131,895	96,045	-	96,045
Other	195,402	-	195,402	-	-	-
Total current assets	13,123,902		13,123,902	12,853,139		12,853,139
Non-current assets						
Other financial assets	2,267	-	2,267	152,267	-	152,267
Receivables	-	-	-	3,204,948	-	3,204,948
Property, plant and equipment	117,763	-	117,763	117,763	-	117,763
Intangible assets	144,794	(144,794)	-	-	-	-
Other assets	2,984,934	-	2,984,934	-	-	-
Total non-current assets	3,249,758	(144,794)	3,104,964	3,474,978		3,474,978
Total assets	16,373,660	(144,794)	16,228,866	16,328,117		16,328,117
Current liabilities						
Payables	(154,733)	-	(154,733)	(94,949)	-	(94,949)
Provisions	(2,521)	-	(2,521)	-	-	-
Total current liabilities	(157,254)		(157,254)	(94,949)		(94,949)
Total liabilities	(157,254)		(157,254)	(94,949)		(94,949)
Net assets	16,216,406	(144,794)	16,071,612	16,233,168		16,233,168
Equity						
Contributed equity	16,990,949	-	16,990,949	16,990,849	-	16,990,849
Accumulated losses	(774,543)	(144,794)	(919,337)	(757,681)	-	(757,681)
Total equity	16,216,406	(144,794)	16,071,612	16,233,168		16,233,168

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

26. FIRST TIME ADOPTION OF AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

2. Reconciliation of Income Statement for the Financial Year ended 30 June 2005

	Notes	Consolidated Entity			Parent Entity		
		Australian GAAP	Adjustments on introduction of AIFRS	AIFRS	Australian GAAP	Adjustments on introduction of AIFRS	AIFRS
		\$	\$	\$	\$	\$	\$
Revenue	D	599,821	-	599,821	598,020	451,942	1,049,962
Exploration and evaluation expenditure expensed or written off		(300,546)	-	(300,546)	-	-	-
Impairment losses		-	-	-	(12,707,836)	-	(12,707,836)
Finance costs		(3,216)	-	(3,216)	(3,216)	-	(3,216)
Consulting fees		(24,320)	-	(24,320)	(10,045)	-	(10,045)
Employee benefits expense (net)	C, D	(419,992)	(314,822)	(734,814)	(419,992)	(766,764)	(1,186,756)
Directors' fees and superannuation		(140,833)	-	(140,833)	(140,833)	-	(140,833)
Depreciation and amortisation expense		(88,858)	-	(88,858)	(88,858)	-	(88,858)
Travel and accommodation expenses		(71,119)	-	(71,119)	(69,239)	-	(69,239)
Property costs		(80,574)	-	(80,574)	(80,574)	-	(80,574)
Professional fees		(53,216)	-	(53,216)	(36,781)	-	(36,781)
Share registry and listing fees		(113,768)	-	(113,768)	(112,009)	-	(112,009)
Corporate promotion and annual report		(53,075)	-	(53,075)	(47,345)	-	(47,345)
Computer support costs		(73,397)	-	(73,397)	(73,397)	-	(73,397)
Accounting and taxation fees		(29,194)	-	(29,194)	(21,194)	-	(21,194)
Operating lease rental expense		(6,887)	-	(6,887)	(6,887)	-	(6,887)
Subscription fees		(17,498)	-	(17,498)	(17,498)	-	(17,498)
Other expenses		(164,302)	-	(164,302)	(144,347)	-	(144,347)
Loss before income tax	C	(1,040,974)	(314,822)	(1,355,796)	(13,382,031)	(314,822)	(13,696,853)
Income tax expense		-	-	-	-	-	-
Loss Attributable to Members of the Parent Entity	C	(1,040,974)	(314,822)	(1,355,796)	(13,382,031)	(314,822)	(13,696,853)
		Cents	Cents	Cents			
Basic loss per share	C	(0.47)	(0.15)	(0.62)			
Diluted loss per share		refer note (a)	refer note (a)	refer note (a)			

(a) Diluted loss per share was not disclosed as the amount did not materially reflect a less favourable result than basic loss per share.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

26. FIRST TIME ADOPTION OF AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (Continued)

Notes to the Reconciliations of Equity as at 1 July 2004 and 30 June 2005 and Income Statement for the Financial Year Ended 30 June 2005

Exploration and evaluation expenditure carried forward

A – Under AASB 6 'Exploration for and Evaluation of Mineral Resources', pre-exploration costs are expensed.

Accrued annual leave

B – Under AASB 137 'Provisions, Contingent Liabilities and Contingent Assets', amounts due to employees for accrued annual leave are reported as part of Trade and other payables rather than Provisions.

Share based payments

C – Under AASB 2 'Share Based Payments', from 1 July 2004 the Group is required to recognise an expense for those options that were issued to employees under the Karoon Gas Employee Share Option Plan after 7 November 2002 but that had not vested by 1 January 2005. Share based payments are expensed over the vesting period of the options based on fair value of the option at grant date.

The Group has elected to apply the exemption under AASB 1 'First-time Adoption of Australian Equivalents to International Financial Reporting Standards' in respect of equity-settled awards and has applied AASB 2 only to equity instruments granted after 7 November 2002 but that had not vested on or before 1 January 2005.

Services revenue from subsidiaries

D – The Company provides accounting, administrative and technical services to subsidiaries at cost. Under AASB 118 'Revenue', the Company recognises such services provided as revenue. This amount had previously been recovered against employee benefits expense in the income statement.

Cash Flow Statements

There was no material differences between the cash flow statements presented under previous Australian GAAP and Australian equivalents to International Financial Reporting Standards. However, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

27. SEGMENT REPORTING

Business segment

The Group operates exclusively in one segment, investment in energy related projects.

Geographic segment

The Group operates in one geographic segment, being Australia.

28. SUBSEQUENT EVENTS

Since the end of the financial year, the following material events have occurred:

Subsequent to the end of the financial year the economic entity completed a 286 sq km 3D seismic data acquisition over the permits WA-314-P and WA-315-P. Interpretation of the first 845 sq km 3D seismic survey over WA-314-P and WA-315-P has commenced, with results expected during the 3rd quarter 2006. The 845km 2D seismic survey data is in the final stages of processing.

Century Rig 11 has been contracted to drill three wells in the Gippsland Basin in November 2006.

DIRECTORS' DECLARATION

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006

The Directors of the company declare that:

1. The financial statements and notes, as set out on pages 17 to 42 are in accordance with the Corporations Act 2001:
 - (a) comply with Accounting Standards and the Corporations Regulations 2001; and
 - (b) give a true and fair view of the financial position as at 30 June 2006 and of the performance for the year ended on that date of the Company and consolidated entity;
2. In the Directors' opinion there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Board of Directors.

Dated at Melbourne this 15th day of September 2006



Robert Hosking
Director

INDEPENDENT AUDIT REPORT TO MEMBERS OF KAROON GAS AUSTRALIA LIMITED AND CONTROLLED ENTITIES FOR THE YEAR ENDED 30 JUNE 2006

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for both Karoon Gas Australia Limited (the company) and Karoon Gas Australia Limited and Controlled Entities (the consolidated entity), for the year ended 30 June 2006. The consolidated entity comprises both the company and the entities it controlled during that year.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

We conducted an independent audit in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards, in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

Audit opinion

In our opinion, the financial report of Karoon Gas Australia Limited and Karoon Gas Australia Limited and Controlled Entities is in accordance with:

(a) the Corporations Act 2001, including:

- (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2006 and of their performance for the year ended on that date; and
- (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and

(b) other mandatory financial reporting requirements in Australia.

Inherent Uncertainty Regarding Continuation as a Going Concern

Without qualification to the opinion expressed above, attention is drawn to the following matter. As indicated in Note 1(r) to the financial report, the Directors of Karoon Gas Australia Limited are of the opinion that the consolidated entity has the ability to farm-out its interest in its permits and seek additional sources of capital in order to meet future exploration expenditure commitments and working capital requirements. If the farm-outs do not occur or additional capital is not raised, there is uncertainty whether the company and the consolidated entity will be able to continue as a going concern and therefore whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts in the financial report.

Mitchell Wilson & Partners
Chartered Accountants
Melbourne,

Doug Mitchell
Partner
15th Day of September 2006

