

ANNUAL REPORT 2012



CONTENTS

2	2011-2012 Highlights Summary
3	Chairman's Report
7	2011-2012 Operations
14	Directors' Report
36	Auditor's Independence Declaration
37	Financial Statements
84	Directors' Declaration
85	Independent Auditor's Report
87	Statement of Corporate Governance
99	Additional Securities Exchange Information
101	Glossary of Terms
104	Corporate Directory

2011-2012 HIGHLIGHTS SUMMARY

Australia

- // Received key environmental approval for the phase-2 drilling campaign in the Browse Basin permits.
- // Contracted the 'Transocean Legend' semi-submersible drilling rig and commenced drilling of a five to eight well program as part of the phase-2 drilling campaign in the Browse Basin.
- // Spudded the Boreas-1 exploration well. Subsequent to the end of the financial year, commenced coring operations after reaching the primary reservoir objective.
- // Completion of regulatory approval to acquire an additional 50% interest in WA-314-P.
- // Interpretation of 2,828 square kilometres of 3D seismic data acquired over the greater Poseidon structure continued, resulting in better definition of the Poseidon structure and several surrounding prospects.

Brazil

- // Contracted the 'Blackford Dolphin' semi-submersible drilling rig and preparations made to drill three wells in Karoon's wholly owned Santos Basin Blocks.
- // Reprocessing of recently acquired 3D seismic data using alternative methodology to better define prospect interpretation, resulting in drilling target selection.
- // Farm-out of Karoon's wholly owned Santos Basin Blocks commenced and negotiations with interested parties continues.

Peru

- // Commencement of preparations for drilling in the Tumbes Basin, Peru, with long lead items ordered.
- // Block Z-38 prospects defined in preparation for a minimum two well drilling campaign during calendar year 2013.
- // Early tender work indicating the availability of several drilling rigs for the anticipated drilling campaign in Karoon's preferred time frame during calendar year 2013.
- // Interpretation of 1,500 square kilometres of new 3D seismic data continued through the financial year. Results have allowed for prospect oriented interpretation indicating the presence of up to 15 prospects and leads.
- // In Block 144, preparations to acquire 300 kilometres of 2D seismic data commenced.

The 2012 financial year provided Karoon and its stakeholders with another year of turbulent financial markets, drilling delays and the eventual commencement of drilling in Australia. During the new financial year, Karoon has moved forward operationally and commercially with the progression of a potential farm-out in Brazil and re-commencement of drilling in Australia, with Brazilian drilling expected in the coming months.

The Group's third campaign, in Peru, is anticipated to take place during calendar year 2013. Results from all three drilling campaigns are expected throughout calendar year 2013.

Karoon has maintained a sufficient financial position to maintain the Board's comfort regarding the Company's ability to manage through uncertain market conditions and delays to operations, whilst being able to progress its operational plans. Karoon has, however, endured significant drilling delays caused by unpredictable external factors.

After maintenance and servicing of the 'Transocean Legend' in Dampier WA, the Boreas-1 well commenced drilling on 5 April 2012. After drilling to a depth of 4,009 mRT, problems became evident in the routine function testing with the BOP requiring repairs, which were completed successfully during August 2012. During September 2012, the well intersected the primary reservoir objective and coring operations commenced.

The Browse joint venture has approved three well locations for the commencement of exploration and appraisal of the greater Poseidon structure, Boreas-1, Zephyros-1 and Proteus-1. Additional targets will be incorporated into the firm work program once drilling results from these initial wells are available. The end result will be a better understanding of the hydrocarbon volumes and characteristics of the greater Poseidon structure. This will in turn allow optimal development planning for commercialisation.

One exploration well is scheduled for the WA-314-P drilling in calendar year 2013, the Grace-1 well. Karoon currently holds a 90% interest in WA-314-P and is in the process of farming out equity in the permit. The intent is to complete a farm-out in early calendar year 2013, in preparation for drilling the Grace-1 well in calendar year 2013.

In Brazil, the 'Blackford Dolphin' drilling rig was scheduled to commence during the financial year, however, problems with an earlier well for another operator caused significant delays. The rig is now drilling the preceding well to Karoon's three well campaign. Drilling is scheduled to commence in the coming months.

Exploration well targets are expected to be on the Kangaroo, Bilby and Emu/Cassowary prospects. Each of these locations has a prospective resource in the hundreds of millions of barrels of hydrocarbons, across multiple target zones.

A process to farm-out the Santos Basin Blocks commenced during the financial year. Significant interest was received from several parties and negotiations with interested parties continued. Karoon anticipates finalising the farm-out documentation in the very near future.

The operator of the neighbouring blocks to the west of Karoon's Santos Basin S-M-1101 and S-M-1037 Blocks, Pan Atlantic, has recently commenced drilling wells in Blocks S-M-1035 and S-M-1036. The second well in the campaign will be targeting the prospect known to Pan Atlantic as Canario and to Karoon as Kookaburra. This prospect has a potential prospective resource of approximately 440 million barrels of hydrocarbons and a large portion of the prospect is within Karoon's Blocks.

Regulatory approval for Karoon's 20% participating interest in Block S-M-1352 in Brazil is expected during the last quarter of calendar year 2012. Karoon's participating interest in the Block will provide access to the Maruja discovery and involvement in the decision making process for a potential development.

In Peru, recent 3D seismic has identified the potential for 12 additional prospects and leads. This brings the total prospects within Karoon's Block Z-38 to 15. The immediate area around Block Z-38 has discoveries of oil and gas that have produced 1.6 billion barrels of oil, but it is considered to be a frontier area due to its lack of meaningful exploration in the areas further offshore.

During the financial year, Karoon commenced works to acquire a drilling rig for its Peruvian prospects and made preparations for drilling during calendar year 2013. These rig negotiations were slowed due to the work involved and level of interest in the Brazil farm-out and Karoon's desire to offset costs before committing to additional financial exposure in such an unpredictable financial climate. The drilling rig procurement process is currently underway with well targets being in the recoverable prospective resource range of 200-400 million barrels of hydrocarbons.

This drilling will give Karoon shareholders exposure to a third exploration campaign during calendar year 2013.

Karoon intends to farm-out equity in Block Z-38 and has opened a data room after additional interpretation of seismic data and geotechnical analysis was generated. Interest is strong and bookings to review new information are presently being made.

Revision of Remuneration Framework

Karoon has proposed restructuring its remuneration framework from the alignment of early stage growth and reward through providing market consistent base salaries and option plans to Directors and executives, to more contemporary share-based remuneration schemes involving operational and relative performance based targets. Changes to the share-based remuneration schemes are subject to shareholder approval at the 2012 Annual General Meeting. Further information on the proposed new remuneration framework is set out in the Directors' Report.

Starting 1 July 2012, Karoon proposes issuing performance based remuneration, based on personal performance and achievement of operational goals in the short-term while rewarding long-term incentives based on Karoon's relative performance to the S&P ASX 200 Energy Index.


The Board of Karoon believes that by setting personal, operational and relative market performance goals and issuing share-based incentives, it is aligning the inherent interests of shareholders and employees.

On behalf of the Directors and management of Karoon, I would like to thank shareholders for their continuing support and patience and offer our assurance that we are working diligently to capitalise on the Company's prospective value and to prepare the Company for the upcoming global drilling campaign and growth into a LNG player and global production company.



Mr Robert Hosking
Executive Chairman

14 September 2012
Melbourne



KAROONS FIRST BRAZILIAN OFFSHORE SANTOS BASIN DRILLING CAMPAIGN TO COMMENCE NOVEMBER 2012



5-8 WELL BROWSE BASIN DRILLING CAMPAIGN COMMENCED WITH BOREAS-1 EXPLORATION WELL

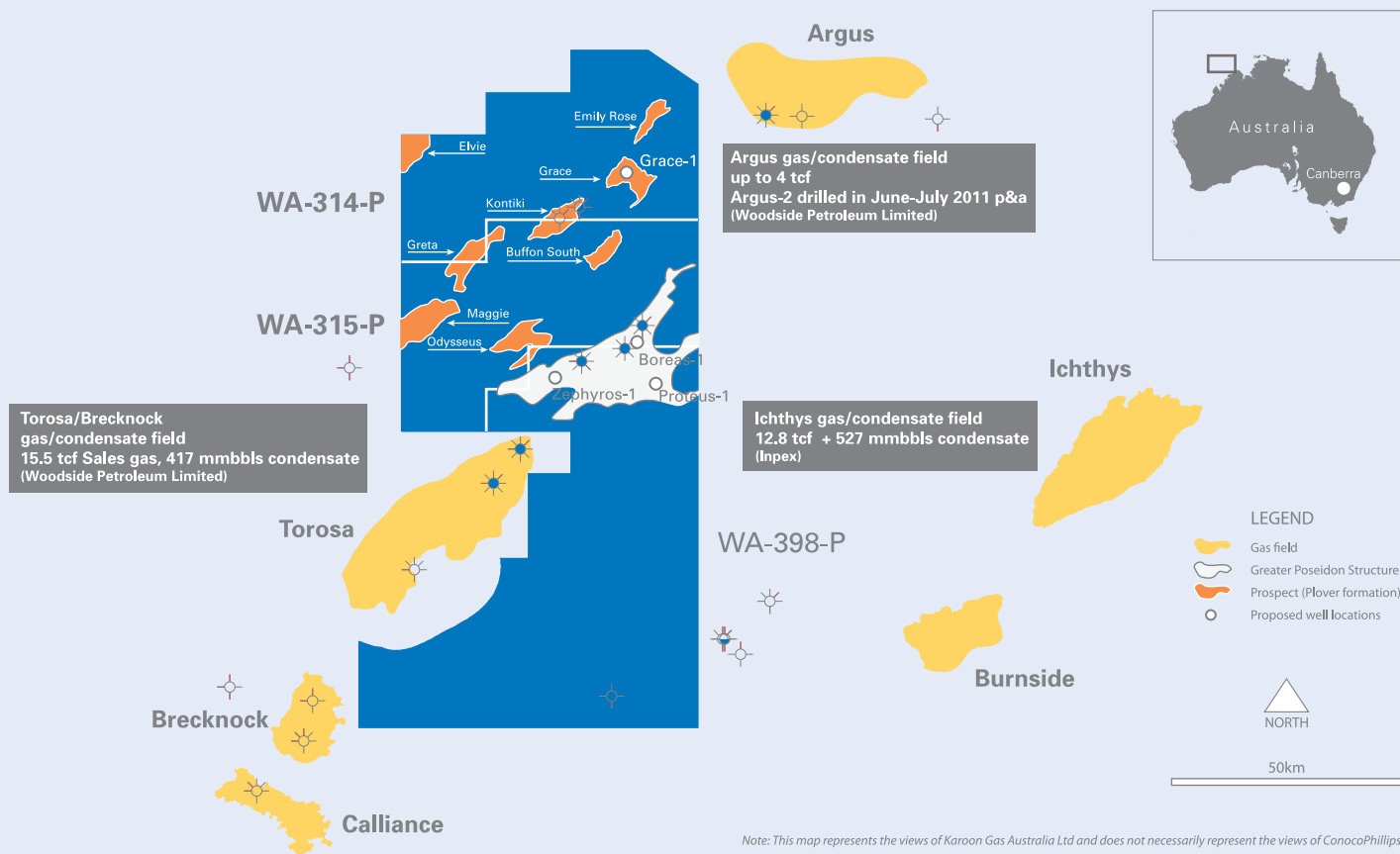
2011-2012 OPERATIONS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

7

Australia

Browse Basin Permits WA-314-P, WA-315-P and WA-398-P



Karoon acquired its interest in exploration permits WA-314-P and WA-315-P in the Browse Basin during 2005, adding WA-398-P through a co-operative agreement to joint bid with ConocoPhillips (Browse Basin) Pty Ltd (ConocoPhillips) during 2007. The permits are located in the Browse Basin, 350 kilometres offshore from the northwestern Australian coast and have a combined area of 7,828 square kilometres.

Karoon and its co-venturer, ConocoPhillips, drilled the Poseidon-1 gas discovery during 2009 with follow-up discoveries at Poseidon-2 and Kronos-1 drilled between July 2009 and June 2010. The Poseidon-2 well test provided necessary and critically important information from the deeper areas of the Poseidon structure. The Kronos-1 well discovered a separate accumulation of hydrocarbons deeper than that seen at Poseidon-1 and a good gas and condensate flow rate during drill stem testing, which provided confidence in the potential of the greater Poseidon structure.

The Browse Basin now has several gas discoveries, the most advanced of which are at the final investment decision ('FID') stage, preparing to commence development. The FID on the first LNG plants to be operated by Inpex, in the case of the Darwin based development of the Ichthys field and Shell in the floating LNG development of Prelude and surrounding fields.

Value has also been established for undeveloped fields generally in the Browse Basin, as in the case of the sale of 15% of the Woodside Petroleum Limited operated Torosa/Brecknock gas field to Mitsubishi and Mitsui for a reported \$2 billion. Market valuation metrics put this Browse Basin sale at approximately \$800-\$900 million per trillion cubic feet plus the costs of development.

The Browse drilling campaign is expected to continue for a period of up to two years. The drilling campaign has been designed to define more precisely the size and quality of the contingent gas resource base contained within the Poseidon structure, allowing the joint venture to move forward with development planning, concept selection and project design.

2011-2012 OPERATIONS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Karooon anticipates that at the completion of the phase-2 Browse drilling campaign, the Karoon/ConocoPhillips joint venture will have better assessed the resource base in the greater Poseidon area, advancing the joint venture's understanding of options to develop the gas and condensate held on our Browse Basin permits.

Drilling

Early in the financial year, the 'Transocean Legend' semi-submersible drilling rig was contracted by ConocoPhillips to commence the phase-2 drilling campaign on behalf of the Karoon/ConocoPhillips joint venture. The contract accommodated drilling of five to eight wells in the Browse Basin permits. The 'Transocean Legend' was scheduled to commence drilling in the fourth quarter 2011, but during mechanical acceptance inspections, critical equipment did not meet the operating standards of the joint venturers. Specifically this required the BOP to be sent for mechanical servicing, with parts being sent for refurbishment to manufacturers in the United States. Late in the first quarter 2012, the BOP was rebuilt and passed all functional tests resulting in the rig being accepted to go on contract.

During April 2012, the 'Transocean Legend' commenced drilling the Boreas-1 exploration well. Boreas-1 is located approximately four kilometres south of Poseidon-1, in WA-315-P, on a large tilted fault block, which is part of the northeast trending structural high of the greater Poseidon structure. The objective of the well is to test the extent, presence and quality of reservoirs within the Boreas-1 fault block.

During May 2012, after drilling the Boreas-1 exploration well to 4,009 mRT, problems became evident in the routine function testing of the BOP. Repairs and diagnostic testing culminated in a further delay to drilling with final repair and successful function testing being completed during August 2012. The Boreas-1 well recommenced drilling on 17 August 2012 and during September 2012 the well intersected the primary reservoir objective and coring operations commenced.

The second well, Zephyros-1, is the next well in the drilling campaign and will be drilled in permit WA-398-P on a large tilted fault block, approximately eight kilometres southwest of the Kronos-1 discovery location.

The third well, Proteus-1 in permit WA-398-P and will be drilled on a large tilted fault block, approximately 14 kilometres southeast of the Poseidon-1 discovery location.

Seismic Processing and Interpretation

During the financial year, well data acquired from the 2009/2010 drilling campaign was further analysed and integrated with the previously acquired Endurance 3D seismic. This interpretation is an integral part of the planning and decision making process during the phase-2 Browse drilling campaign.

The joint venture also reprocessed 2D and 3D seismic data in WA-314-P to improve the quality of the sub-surface imaging over the key exploration trends. The data has been reinterpreted with the objective of determining potential well locations, one of which, Grace-1, is expected to be drilled during calendar year 2013, as part of the phase-2 Browse drilling campaign.

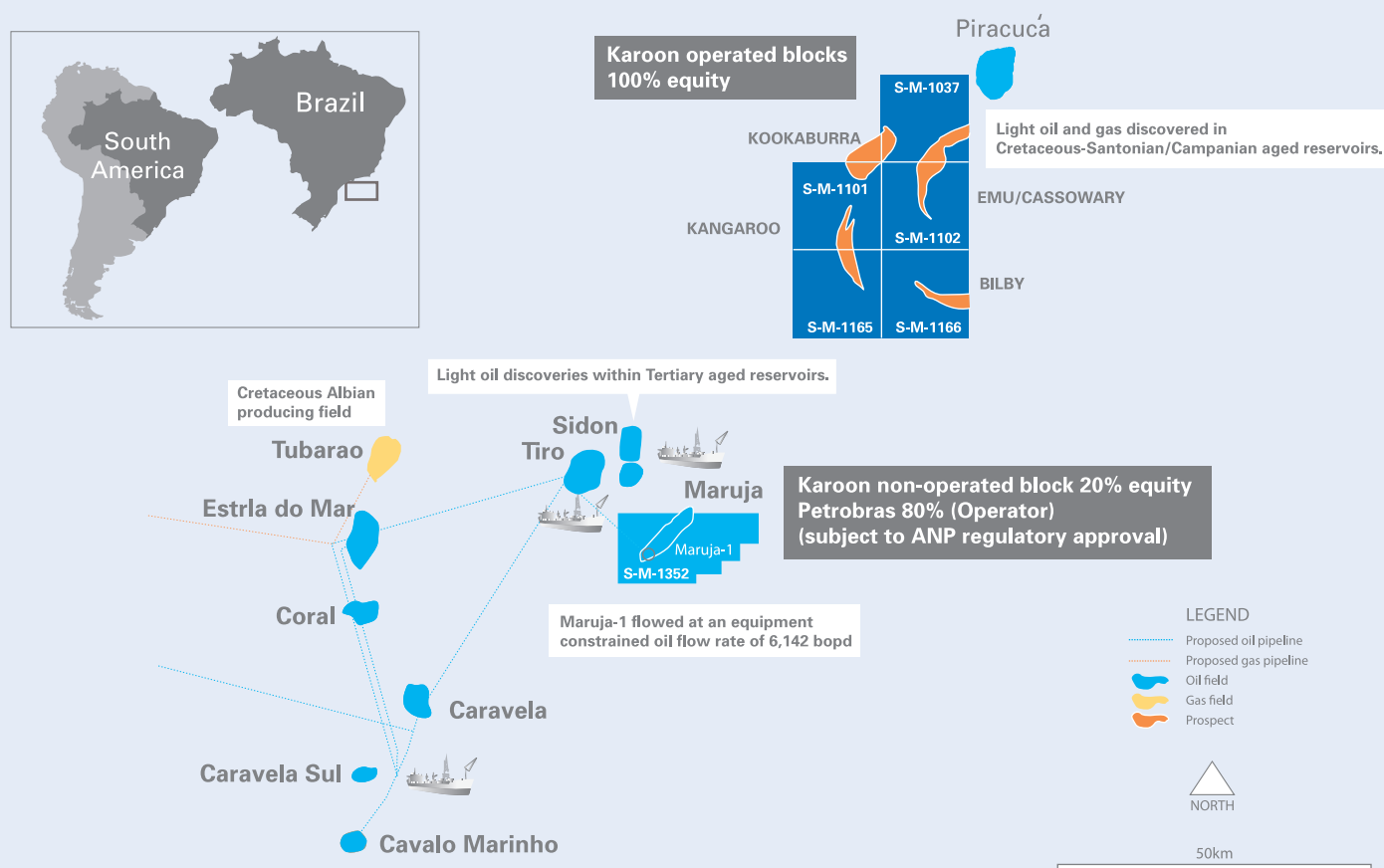
Equity Interests

Karooon holds 40% of both WA-315-P and WA-398-P, with ConocoPhillips retaining the other 60% interest as operator.

Karooon currently holds 90% of WA-314-P, with ConocoPhillips retaining the remaining 10% interest and operatorship. Karoon is currently preparing relevant information for inclusion in a data room, with the intent to farm-out part of its 90% interest.

Brazil

Santos Basin Blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165 and S-M-1166



Karoon's Santos Basin Blocks are located 112 kilometres off the coast of the Santa Catarina region of Brazil, south of Rio de Janeiro. The Santos Basin has recently yielded multiple oil discoveries and is becoming an exciting area for exploration. Karoon was awarded 100% participation in five offshore exploration Blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165 and S-M-1166 in the Santos Basin, Brazil during 2008. The five Blocks total 865 square kilometres.

Discoveries announced in the period since Karoon acquired the first of its Santos Basin Block interests include the Deepwater pre-salt fields, including the original Tupi discovery, which contains an estimated 40 billion barrels of oil equivalent in-place.

In the shallow water Santos Basin, several recent discoveries have also been made which have similar geological characteristics to Karoon's Santos Blocks, such as the Piracua, Tiro, Sidon, Guaiama, Panoramix and Vampira fields all in the same trend as the previously discovered Merluza, Mexilhao and Caravela fields. These fields have collective resources in the billions of barrel of oil equivalent in-place.

Farm-out

Karoon has now narrowed the farm-out process to a limited group of potential partners and negotiations are continuing. Documentation is progressing, with results expected in the very near future.

2011-2012 OPERATIONS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Drilling

The 'Blackford Dolphin' semi-submersible drilling rig has commenced drilling the final well before Karoon takes possession of the rig. Karoon anticipates commencing drilling in its Blocks during November 2012. Karoon has a firm commitment to drill three wells. The Karoon drilling team has now completed engineering and drilling preparations and subject to final approvals from the relevant authorities, including the ANP and the environmental regulator ('IBAMA'), is ready to start drilling. Supply bases are operational and well infrastructure is on site and ready for deployment. Final targets have been identified and well locations on the prospects are currently being finalised.

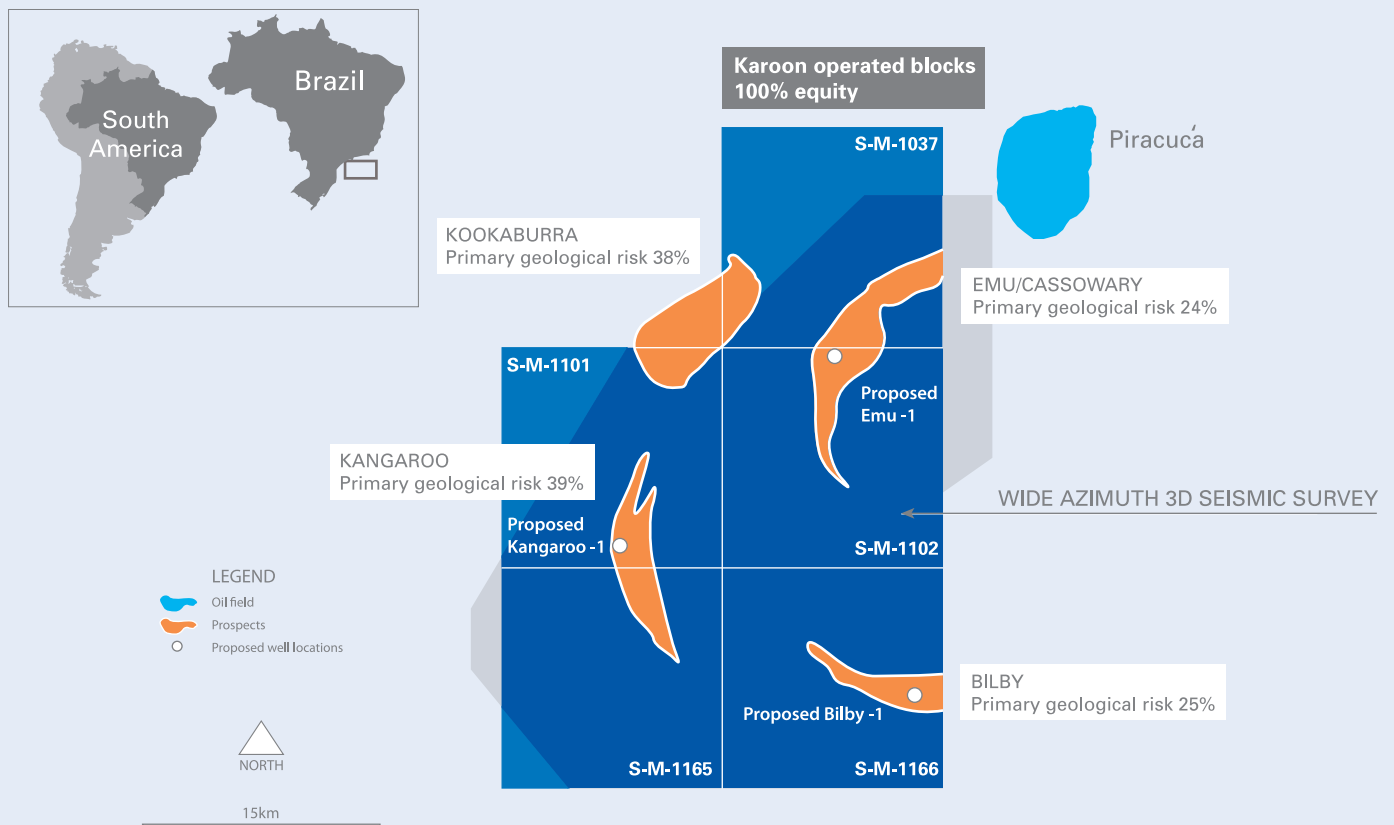
Drilling is set to commence with the drilling of Kangaroo-1, to be followed by Emu-1/Cassowary-1 and Bilby-1. Each of these wells target between 100-300 million barrels of hydrocarbons and will satisfy the secondary term minimum work commitments to the regulator and the farm-in commitments of Pacific Rubiales Energy Corp.

In addition, the operator neighboring Karoon's Blocks, Pan Atlantic, will be drilling the Canario-1 well in late calendar year 2012. The Canario prospect is known as Kookaburra to Karoon, as it straddles the border of Karoon's Block.

Effectively, the Canario-1 well will be testing the Kookaburra prospect, at no cost to Karoon.

Kangaroo-1 is the first well in the Santos Basin exploration drilling campaign. It is located within Blocks S-M-1101 and S-M-1165 and has multiple targets at several geological levels, including the Campanian, Maestrichtian, Eocene and Miocene aged rocks. Each target carries its own independent prospective resource and probability of success. Targets for Kangaroo-1 total hundreds of millions of barrels of hydrocarbons. Completion of this well will satisfy the minimum work commitments for Blocks S-M-1101 and S-M-1165.

Emu-1/Cassowary-1 is expected to be the second well in the Santos Basin exploration drilling campaign. It is located within Blocks S-M-1102 and S-M-1137 and has multiple targets at several geological levels, including the Santonian, Campanian, Maestrichtian, Eocene and Miocene aged rocks. Each target carries its own independent prospective resource and probability of success. Targets for Emu-1 total hundreds of millions of barrels of hydrocarbons. Completion of the Emu-1 well will satisfy the minimum work commitments for Blocks S-M-1102 and S-M-1037. Emu is 8 kilometres from the Piracuca field, which is currently being appraised by Petróleo Brasileiro SA ('Petrobras').



Bilby-1 is expected to be the third well in the Santos Basin exploration drilling campaign. It is located within Block S-M-1166 and has multiple targets at several geological levels, including the Santonian, Campanian, Maestrichtian and Eocene aged rocks. Each target carries its own independent prospective resource and probability of success. Targets for Bilby-1 total hundreds of millions of barrels of hydrocarbons. Completion of this well will satisfy the minimum work commitments for Block S-M-1166.

Geology

During the financial year, Karoon re-processed the proprietary seismic datasets with excellent technical results, especially for the pre-salt section. This re-processed data provides excellent imaging of structure and amplitude plays, that will provide Karoon with a higher chance of success in the upcoming drilling campaign.

Results are very encouraging on the new seismic datasets. Interpretation has confirmed the main post-salt amplitude supported prospects, as well as the presence of similar prospects as those found in the immediate region around Karoon's Blocks that were defined on earlier 3D data, providing validation and better definition.

An anomaly at the Santonian level on the west flank of the Kangaroo prospect salt diapir was seen in a dataset purchased during 2008 and remains very well developed on the new data. The amplitudes show the same strong concordance to depth, which is interpreted to be the result of a hydrocarbon fluid contact and a direct indication of hydrocarbons (DHI). This relationship with amplitude to depth provides strong DHI support, which helps to reduce risk and allow better quantification of potential volumes ahead of drilling.

Equity Interests

Karoon currently has a 100% participating interest in Blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165 and S-M-1166.

Santos Basin Block S-M-1352

Karoon entered into agreements with Petrobras to farm-in to a 20% interest in two contiguous Blocks S-M-1352 and S-M-1354 on 23 August 2010. S-M-1354 was subsequently relinquished during early 2011. Karoon is currently awaiting regulatory approval from the ANP of its interest in S-M-1352. During the financial year, Petrobras continued assessment of well results at Maruja-1 and Maruja-2, in the context of Maruja's position in the southern Santos Basin when grouped with other discoveries at Tiro and Sidon.

Maruja-1, drilled in Block S-M-1352, late in calendar year 2010, discovered high quality light oil of 38 gravity API within a Oligocene aged sandstone reservoir. A full wire-line and pressure sampling program concluded that the reservoir was of high quality with excellent porosity and permeability. This reservoir interval was drill stem tested (DST), which although constrained by surface tubing, flowed oil at a maximum stabilised rate of 4,675 barrels of oil per day and 0.8 million cubic feet of gas per day through a ½ inch choke, with a flowing well head pressure of 1,050 psia. The well was then suspended after testing and may be used as part of a longer production test in preparation for any eventual development that may occur.

During February 2011, Petrobras commenced the drilling of an appraisal well, Maruja-2, with a location designed to intersect the reservoir at over 80 metres down dip and 4.5 kilometres from the initial discovery well. This well found good quality reservoirs contained below the oil/water contact at this location, with no hydrocarbons recovered.

An evaluation, using all acquired well data, is underway and reprocessing of the existing 3D seismic has commenced to better define and evaluate this discovery.

Equity Interests

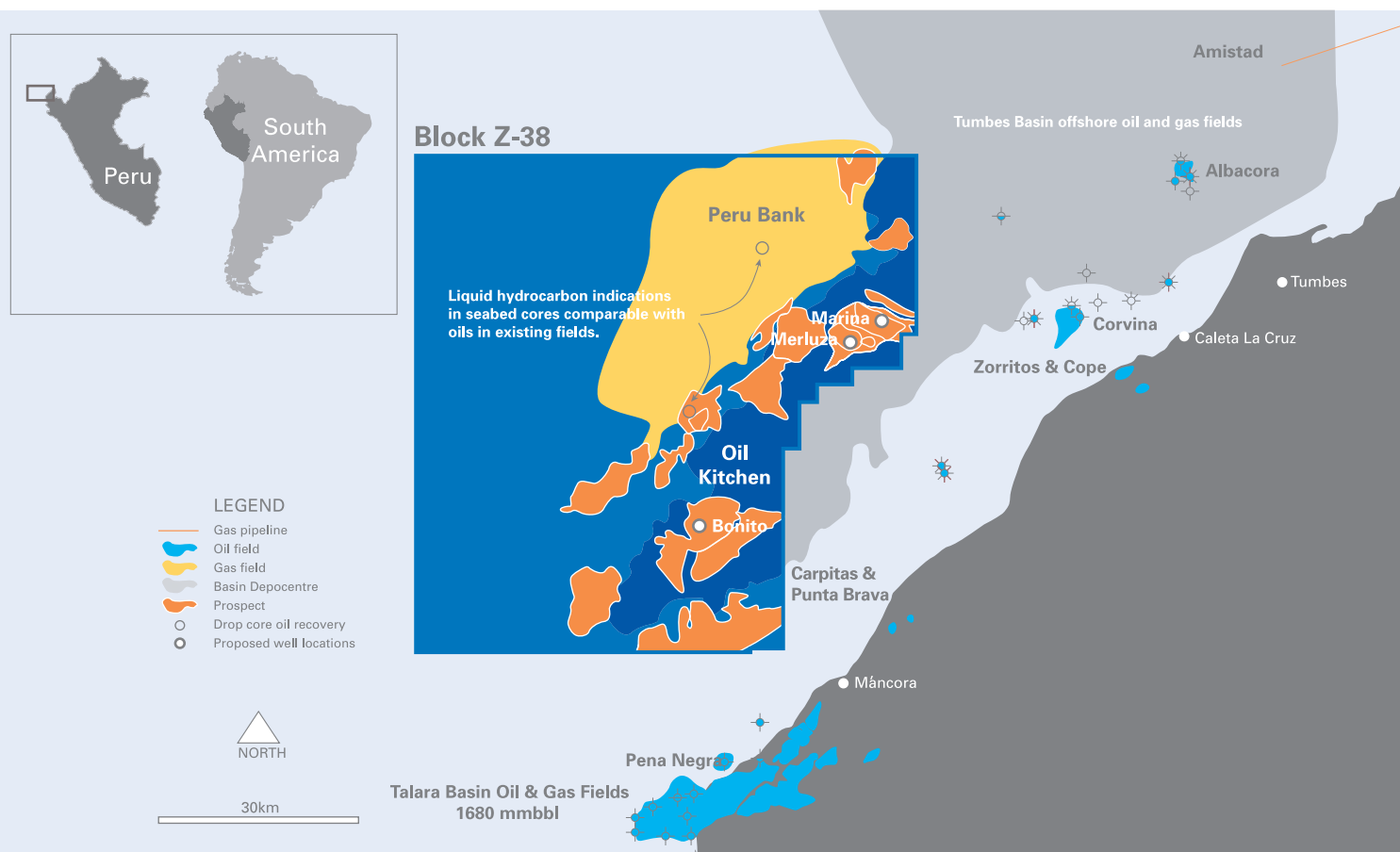
Karoon has a 20% participating interest in Block S-M-1352, with Petrobras holding the remaining 80% equity interest.

2011-2012 OPERATIONS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

PERU

Peru Block Z-38



Block Z-38 is an offshore block of 4,750 square kilometres located in the Tumbes Basin, 10 kilometres from the northwest coast of Peru and 25 kilometres north of the prolific Talara Basin. The Talara Basin continues to produce oil and gas with over 1.6 billion barrels produced to date. This region has historically been very productive, with the first oil discoveries made in the late 1800s. However, much of the offshore parts of the basin remain unexplored.

During January 2008, Karoon signed a farm-in agreement to acquire a 20% participating interest in Block Z-38. During October 2009, Karoon was approved by the regulator as Operator of the Block and negotiated to increase its participating interest in Block Z-38 to 75%, subject to completion of farm-in obligations. Karoon subsequently received regulatory approval to increase its interest to 75%.

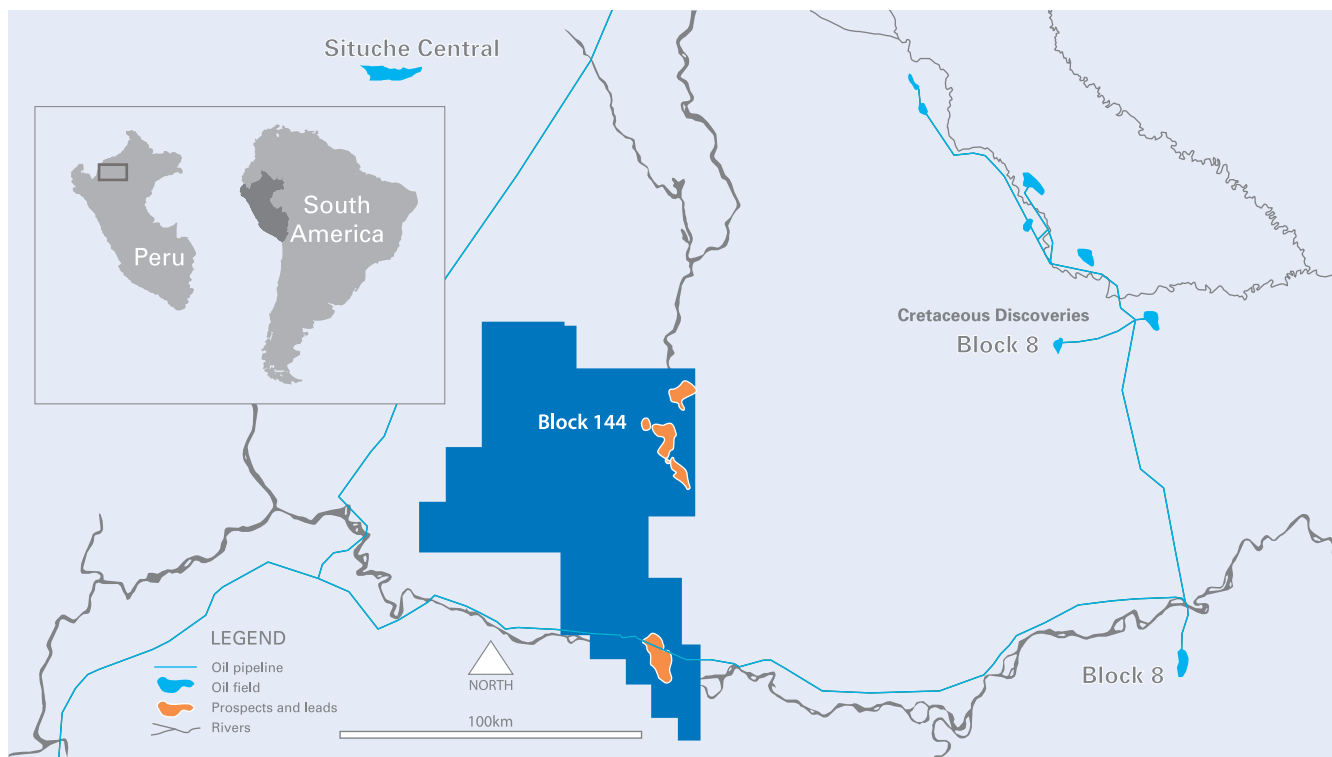
Karoon completed a 3D seismic survey over the Block during calendar year 2010 and planning is now underway for a minimum two well exploration drilling campaign, to satisfy the third year work commitments and farm-in obligations.

A recent US\$362million deal between Pacific Rubiales and BPZ Energy in the adjacent permit, demonstrates the potential value to new entrants in the region.

Geological Data Acquisition, Processing and Interpretation

Interpretation of the 1,500 square kilometre 3D seismic survey indicates a wide variety of play types in the Block. 15 prospects and leads have now been mapped with several prospects containing multiple target zones. The prospects vary significantly in size, with each of the four largest having a mean unrisks prospective resource of over 250 million barrels of oil plus significant volumes of gas. Prospect evaluation is continuing, with well location selection being the main aim.

A regional geological model has been constructed to support the assumptions Karoon makes around the prospectivity of Block Z-38. This model is based on information from wells that have been drilled in the area, results of a seabed coring program conducted around Block Z-38, re-processed and interpreted 2D and 3D seismic, gravity data and magnetic surveys.



Block Z-38 is interpreted to contain thick sections of Miocene aged rocks, of which the two main regional reservoir depositional cycles in the Zorritos and Tumbes sequences are interpreted to be well developed. Reservoirs at both these levels in Block Z-38 are interpreted to be turbidite sands, likely to offer better reservoir quality than the sands seen in the Corvina field which are poorer quality by comparison.

Drill Planning

During the financial year, the Environmental Impact Assessment ('EIA') report was submitted, long lead items were ordered, expressions of interest for drilling rigs were sent and regulatory approvals were submitted for the upcoming drilling campaign. Drilling in the Block is expected to commence during the second half of calendar year 2013, with two firm exploration commitment wells, with an additional optional well likely.

Karoon has received and evaluated tenders for the provision of various drilling related items such as the drilling rig and long lead items. Current rig availability indicates that a rig will be available in the required timeframe for drilling. Karoon expects to proceed with final tendering and contracting in the short-term. Karoon is continuing dialogue with other offshore Peruvian operators to form a 'rig club' with the aim of providing a more cost effective and attractive contract for the drilling rig operator.

Karoon will be utilising its existing South American drilling team, who have already commenced drilling preparations and will assume full scale planning at the appropriate time.

Equity Interests

Karoon is currently the Operator of Block Z-38, with an equity interest of 75%, subject to completion of farm-in obligations. The remaining 25% equity interest is held by Pitkin Petroleum Peru Z-38 SRL (formerly Vietnam American Exploration Company LLC).

Subsequent to the end of the financial year, preparations were being made to re-commence the farm-out of a portion of Block Z-38. A data room is being prepared for potential farm-in partners. On completion of the Brazil Santos Block's farm-out process, Karoon will recommence the Block Z-38 farm-out discussions.

Peru Block 144

Block 144 is located within the onshore Marañón Basin, on the eastern side of the Andes mountain range. The Block was awarded to Karoon during April 2009. During the financial year, Karoon continued its geotechnical, social, EIA application and planning for the seismic acquisition program in the Block.

Work Program

Karoon is now in early stage planning for future work programs within the Block. As part of the second term work commitments, Karoon is required to acquire 300 kilometres of 2D seismic and conduct geological studies. Block 144 is now in the second year work commitment phase and a new 2D seismic acquisition program will be planned. There are two areas of interest, one in the southern area (the Patria prospect) and another in the northeast of the Block (the Ungumayo prospect).

Prospective Areas

Geophysical interpretation using reprocessed 2D seismic data has identified the presence of two separate four-way dip closed structures in the northeast and southern portion of the Block. The Patria prospect is located in proximity to a navigable river and an underutilised oil export pipeline from the Marañón Basin to the Pacific Ocean, offering potential lower cost development opportunities on success of any exploration drilling. The Ungumayo prospect lies in the northeast of Block 144 and will be the focus of new geotechnical activities in the Block.

Equity Interest

Karoon currently has a 100% equity interest in Peru Block 144.

DIRECTORS' REPORT

The Board of Directors submits its Directors' Report on Karoon Gas Australia Ltd and its subsidiaries (the 'Group') for the financial year ended 30 June 2012 (the 'financial year').

Board of Directors

Under the Company's Constitution, the minimum number of Directors that may comprise the Board of Directors is currently three and the maximum number of Directors is 10. Directors are elected and re-elected at annual general meetings of the Company.

The names of the Directors of Karoon Gas Australia Ltd (the 'Company') during the financial year and up to the date of this Directors' Report are set out beside:



Mr Robert M. Hosking

Executive Chairman

Appointed 11 November 2003.

Robert is the founding Director and shareholder of the Company and has more than 30 years of commercial experience in the management of several companies. Robert has been involved in the oil and gas industry for 16 years and was the founding director/shareholder of Nexus Energy Limited.

Robert also has a background of more than 17 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.



Mr Mark A. Smith

Dip. App. Geol, Bsc. (Geology)

**Executive Director and
Exploration Director**

Appointed 20 November 2003.

Mark has more than 30 years experience as a geologist and exploration manager in petroleum exploration and development in Australia, South East Asia and North America. The bulk of this experience was gained while working with BHP Petroleum. Mark has been directly involved with 11 economic oil and gas discoveries.

Mark has geosciences skills in regional basin and tectonic studies, petroleum systems fairway assessments, prospect evaluations, risking and volumetrics, fault seal prediction and well-site operations. His management skills cover general and human resources management, acreage evaluation and acquisition projects, farm-ins/farm-outs, well site operations management and management of onshore and offshore drilling operations.



Mr Geoff Atkins
FIE Aust. RMIT Dip. Civ Eng.

**Independent Non-Executive
Director**

Appointed 22 February 2005.

Geoff has over 40 years experience in investigation, planning, design, documentation and project management of numerous significant port, harbour and maritime projects. These include container terminals, LNG jetties, heavy lift wharves, 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 that Geoff has been involved in have included the design of Woodside Petroleum Ltd's LNG Jetty, tender design of ConocoPhillips' Darwin LNG Jetty and concept designs for the Sunrise LNG Jetty. Geoff has also been involved in 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 Nomination
Committee.

Chairman of the Remuneration
Committee.

Member of the Audit Committee.



Mr Clark Davey
B. Commerce, FTIA, MAICD

**Independent Non-Executive
Director**

Appointed 1 October 2010.

Clark has over 30 years experience in the Australian natural resources industry as a taxation consultant to oil and gas and mining companies. Clark was a partner at Price Waterhouse and PricewaterhouseCoopers specialising in the natural resources industry. For a number of years he held resource industry leadership roles within both firms. Clark is a member of the Taxation Institute of Australia and the Australian Institute of Company Directors.

Clark brings a wealth of taxation and business advisory knowledge and experience to the Company, including experience with company income tax, petroleum resource rent taxation in Australia and assisting with accounting and capital management. He has assisted many Australian companies with tax management of their joint venture interests and has had considerable experience with merger and acquisition transactions. He has also assisted companies expand their resource industry interests internationally.

Chairman of the Audit Committee.

Member of the Nomination
Committee and Remuneration
Committee.



Mr Stephen Power
B. Juris LLB

Non-Executive Director

Appointed 28 June 2005.

Stephen is a commercial lawyer who has spent over 25 years providing advice to participants in the resources industry in Australia and overseas. Stephen was previously a partner in a boutique law firm that provided commercial advice to a 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 including farm-in arrangements, joint ventures, production agreements and other facets of resources related commercial transactions as well as capital raisings and the planning and implementation of mergers and acquisitions.

Current directorships of other listed companies include Antipa Minerals Limited since 1 November 2010.

Member of the Audit Committee,
Nomination Committee and
Remuneration Committee.

DIRECTORS' REPORT CONTINUED



Mr Jose Coutinho Barbosa
Bsc. (Geology) Msc. (Geophysics)
Non-Executive Director

Appointed 31 August 2011.

Jose Coutinho spent 38 years with Petrobras, beginning his career in a number of technical and management positions, culminating in his appointment as Acting President and CEO of Petróbras, now the world's fifth largest petroleum exploration and production company.

Earlier in his career, Jose Coutinho was Executive Vice-President and CEO of Petróbras International SA (otherwise known as Braspetro) and was Managing Director for Exploration and Production of Petrobras until his retirement during February 2003. Since then, he has managed his own independent consulting firm, Net Pay Óleo & Gás Consultoria Ltda, headquartered in Rio de Janeiro, Brazil, operating in areas of the petroleum industry. Jose Coutinho brings knowledge and experience to the Company, including experience with geology, exploration and production and local knowledge of the oil and gas industry in Brazil and internationally.

Current directorships of other listed companies include Lupatech SA (director from 24 March 2008 to 29 April 2011 and re-appointed 4 May 2012).



Mr Scott Hosking
B. Commerce
Company Secretary

Appointed on 10 March 2006.

Scott has a significant international financial and commercial management background with expertise in equity capital raisings. He has been involved with several commercial ventures over the past 15 years with experience in international trade, finance and corporate management. He has previously held support positions to Company Secretaries of listed companies and was involved in the listing of Karoon Gas Australia Ltd.

Meetings

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

Director	Board Meetings		Audit Committee Meetings		Remuneration Committee Meetings		Nomination Committee Meetings	
	A	B	A	B	A	B	A	B
Mr Robert Hosking	8	8	-	-	-	-	-	-
Mr Mark Smith	8	8	-	-	-	-	-	-
Mr Geoff Atkins	8	8	5	5	2	2	1	1
Mr Clark Davey	8	8	5	5	2	2	1	1
Mr Stephen Power	8	8	5	5	2	2	1	1
Mr Jose Coutinho Barbosa	6	6	-	-	-	-	-	-

A. The number of meetings held during the time the Director held office during the financial year.

B. The number of meetings attended during the time the Director held office during the financial year.

Directors' Interests in the Company's Shares and Options

As at the date of this Directors' Report, the Directors held the following number of ordinary shares and options over unissued ordinary shares in the Company:

Director	Ordinary Shares, Fully Paid	Unlisted Other Share Options
Mr Robert Hosking	12,524,462	2,325,000
Mr Mark Smith	3,002,037	2,325,000
Mr Geoff Atkins	696,784	500,000
Mr Clark Davey	13,144	500,000
Mr Stephen Power	602,142	500,000
Mr Jose Coutinho Barbosa	-	300,000

Principal Activities

The principal activity of the Company during the course of the financial year continued to be investment in hydrocarbon exploration and evaluation in Australia, Brazil and Peru.

Significant Changes in State of Affairs

There was no significant change in the state of affairs of the Company during the financial year.

Results

The consolidated result of the Group for the financial year was a loss after income tax expense of \$3,287,382 (2011: \$23,304,914). The loss for the financial year included employee benefits expense (net), which recognised share-based payments expense of \$5,969,470. The loss for the financial year also included exploration and evaluation expenditure expensed, in accordance with the Group's accounting policy, of \$1,219,720 from reviewing new exploration ventures (predominantly in Australia).

Partially offsetting the loss for the financial year was interest income of \$13,601,653 earned on interest bearing cash assets and security deposits and net foreign currency gains of \$4,388,118. The net foreign currency gains were almost entirely attributable to the appreciation in the United States dollar against the Australian dollar (from AUD1:USD1.0739 as at 30 June 2011 to AUD1:USD1.0191) on cash assets and security deposits held in United States dollars.

Financial Position

At the end of June 2012, the Group had a cash balance of \$227,802,316 (2011: \$266,839,144) and no debt.

During the financial year, total assets decreased from \$622,273,394 to \$612,081,847, total liabilities increased from \$4,406,070 to \$11,481,926 and total equity decreased by \$17,267,403 to \$600,599,921. This net decrease was largely due to the following:

- adverse movement in the foreign currency translation reserve as a result of the depreciation of the Brazilian REAL against the Australian dollar from AUD1:REAL1.6739 as at 30 June 2011 to AUD1:REAL2.0644 as at 30 June 2012.

Financial Position (continued)

The Group's working capital, being current assets less current liabilities, decreased from \$311,643,637 as at 30 June 2011 to \$276,593,251 as at 30 June 2012 predominantly as a result of expenditure on exploration and evaluation assets.

Exploration expenditure of \$44,659,227 (2011: \$22,242,534) was incurred during the financial year, with major expenditure in the following operating segments:

- Australia, the Group commenced drilling of the Boreas-1 exploration well in the Browse Basin, including mobilisation costs, along with 3D seismic interpretation, at a total cost of \$25,283,375;
- Brazil, the Group undertook preparatory work and planning for the scheduled three well exploration drilling campaign, along with 3D seismic processing and interpretation, at a total cost of \$16,133,669; and
- Peru, the Group undertook preparatory work and planning for the anticipated two well exploration drilling campaign, along with 3D seismic interpretation, at a total cost of \$3,242,183.

The contributed equity of the Company was unchanged during the financial year at \$664,894,335.

Review of Operations

Information on the operations of the Group is set out in the 2011-2012 Operations on pages 7-13 of this Annual Report.

Future Developments, Business Strategies and Prospects, and Expected Results of Operations

Other than the matters included in this Directors' Report or elsewhere in the Annual Report, future developments, business strategies and prospects of the Company and the expected results of those operations have not been disclosed as the Directors believe that their inclusion would most likely result in unreasonable prejudice to the Company and/or the Group.

Dividends

No dividend has been paid or declared by the Company to shareholders since the end of the previous financial year. The Company intends to pay future dividends during financial periods when appropriate to do so.

Options

As at the date of this Directors' Report, the details of options over unissued ordinary shares in the Company were as follows:

Type of Option	Grant Date	Date of Expiry	Exercise Price Per Option	Number Under Option
Other share options	23 November 2009	12 November 2013	\$14.07	1,000,000
ESOP options	23 November 2009	12 November 2013	\$14.07	530,000
ESOP options	9 December 2009	18 November 2013	\$11.50	1,500,000
ESOP options	3 September 2010	31 October 2014	\$9.77	805,000
ESOP options	12 January 2011	31 October 2014	\$9.77	300,000
Other share options	18 November 2010	18 November 2014	\$9.48	500,000
ESOP options	18 November 2010	18 November 2014	\$9.77	100,000
ESOP options	10 November 2011	31 October 2015	\$7.30	800,000
ESOP options	10 October 2011	31 October 2015	\$7.30	1,460,000
Other share options	10 November 2011	1 May 2014	\$8.92	850,000
Other share options	10 November 2011	1 May 2015	\$9.95	1,200,000
Other share options	10 November 2011	1 May 2016	\$10.98	2,600,000
				11,645,000

For details of options issued to Directors and other key management of the Group as remuneration, refer to the Remuneration Report in this Directors' Report.

No fully paid ordinary shares have been issued since 1 July 2011 as a result of the exercise of Employee Share Option Plan (ESOP) options and other share options since that date.

Information relating to the Company's ESOP and other share options, including details of options granted, exercised, cancelled, forfeited and expired during the financial year and options outstanding at the end of the financial year, is set out in Note 27 of the consolidated financial statements.

No option holder has any right under the options to participate in any other share issue of the Company or any other entity.

Indemnification of Directors and Officers

An indemnity agreement has been entered into between an insurance company and the Directors of the Company named earlier in this Directors' Report and with the full time executive officers, directors and secretaries of all Australian subsidiaries. Under this agreement, the insurance company has agreed to indemnify these Directors, full time executive officers, directors and secretaries 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.

As approved by shareholders at the Annual General Meeting held on 12 November 2009, the Company will continue to pay those Director insurance premiums for a period of ten years following termination of their directorships of the Company and will provide each Director with access, upon ceasing for any reason to be a Director of the Company and for a period of 10 years following cessation, to any Company records which are either prepared or provided to the Director during the time period they were a Director of the Company.

Proceedings on Behalf of the Company

No person has applied to the Court under Section 237 of the *Corporations Act 2001* for leave to bring proceedings on behalf of the Company, or to intervene in any proceedings to which the Company is a party, for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

The Company 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 support the ASX Corporate Governance Council Principles and Recommendations. The Company's Statement of Corporate Governance is set out on pages 87-98 of this Annual Report.

Environmental Regulation

The Company and its subsidiaries are subject to a range of relevant Commonwealth, State and International environmental laws including:

- *Environment Protection and Biodiversity Conservation Act 1999 (Cth)*;
- *Offshore Petroleum and Greenhouse Gas Storage Act 2006 (Cth)*;
- *Petroleum (Submerged Lands) Act 1967 (WA)*;
- *The Aboriginal and Torres Strait Islander Heritage and Protection Act 1994 (Cth)*;

- *The Brazilian Federal Constitution (Brazil)*;
- *The Brazilian Petroleum Law (Law No. 9,478, of August 6, 1997) (Brazil)*;
- *The Brazilian Civil Code (Law No. 10,406, of January 19, 2002) (Brazil)*;
- *The Brazilian Corporations Law (Law No. 6,404, of December 15, 1976) (Brazil)*;
- *The Brazilian Bid Law (Law No. 8,666, of June 21, 1993) (Brazil)*;
- *The Brazilian Federal Environmental Law (Law No. 6,938, of August 31, 1981) (Brazil)*;
- *The Brazilian Law of Environmental Practise (Law No. 9,605, of February 12, 1998) (Brazil)*;
- *National – Ministry of Energy and Mines – Supreme Decree No. 042-2005-EM – Unique Comprised Text of the Organic Law of Hydrocarbons (which text of the law was approved by Law No. 26221) (Peru)*;
- *National – Congress of the Republic – Law No. 28611 – General Environmental Law (Peru)*;
- *National – Ministry of Energy and Mines – Supreme Decree No. 015-2006-EM – Regulations for Environmental Protection in Hydrocarbon Activities (Peru)*;
- *National – Ministry of Energy and Mines – Supreme Decree No. 043-2007-EM – Safety Rules for Hydrocarbon Activities (Peru)*;
- *National – Ministry of Energy and Mines – Supreme Decree No. 032-2004-EM Rules of Hydrocarbon Exploration and Exploitation Activities (Peru)*; and
- *National – Ministry of Energy and Mines – Supreme Decree No. 052-93-EM – Safety Rules for Hydrocarbon Storage (Peru)*.

The Board of Directors believes the Company has adequate systems in place for managing its environmental obligations and is not aware of any breach of those environmental obligations as they apply to the Company and/or Group. No circumstances arose during the financial year that required an incident to be reported by the Company and/or Group under environmental legislation.

Carbon Pricing and Reporting Requirements

The carbon pricing mechanism, established under the *Clean Energy Act 2011 (Cth)*, commenced on 1 July 2012. Under the carbon pricing mechanism, liable entities have to pay a price for every tonne of carbon pollution, or the equivalent amount of certain other greenhouse gas, that is emitted. The Company is not a liable entity and therefore has no direct obligations under the carbon pricing mechanism.

Carbon Pricing and Reporting Requirements (continued)

In addition to the carbon pricing mechanism, greenhouse gas emissions, energy consumption and energy production reporting obligations arise under the *National Greenhouse and Energy Reporting Act 2007 (Cth)* ('NGER Act'). The Group was not required to register and report greenhouse gas emissions, energy consumption and energy production under the NGER Act for this financial year as it did not meet any of the relevant thresholds from activities conducted within Australia for the relevant period. However, the Company continues to assess cost effective, reliable and environmentally efficient methods of dealing with its future greenhouse gas emissions and energy consumption.

Non-Audit Services

The Company may decide to engage its external auditor, PricewaterhouseCoopers, on assignments additional to its statutory audit duties where the external auditor's expertise and experience with the Company and/or Group are important.

Details of the amounts paid or payable to the external auditor for non-audit services provided during the financial year are set out in Note 7 of the consolidated financial statements.

The Board of Directors has considered the position and, in accordance with written advice received from the Audit

Committee, is satisfied that the provision of non-audit services is compatible with the general standard of independence for external auditors imposed by the *Corporations Act 2001*. The Board of Directors is satisfied that the provision of non-audit services by the external auditor did not compromise the external auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- (a) all non-audit services have been reviewed by the Audit Committee to ensure they do not impact the impartiality and objectivity of the external auditor; and
- (b) none of the services undermine the general principles relating to external auditor independence as set out in APES 110 'Code of Ethics for Professional Accountants', including reviewing or auditing the external auditor's own work, acting in a management or a decision making capacity for the Group, acting as advocate for the Group or jointly sharing economic risk and reward.

External Auditor's Independence Declaration

A copy of the external Auditor's Independence Declaration for the financial year, as required under Section 307C of the *Corporations Act 2001*, is set out on page 36 of this Annual Report.

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

Remuneration Report (Audited)

The Directors are pleased to provide the Company's Remuneration Report, which sets out remuneration information for Karoon Gas Australia Ltd Executive Directors, Non-Executive Directors and other key management personnel of the Group and Company. The Remuneration Report forms part of this Directors' Report.

The information provided in the Remuneration Report has been audited by the external auditor as required by Section 308(3C) of the *Corporations Act 2001*.

The Directors and executives disclosed in the Remuneration Report during the financial year are as follows:

Name	Position
Directors	
Mr Robert Hosking	Executive Chairman
Mr Mark Smith	Executive Director and Exploration Director
Mr Geoff Atkins	Independent Non-Executive Director
Mr Clark Davey	Independent Non-Executive Director
Mr Stephen Power	Non-Executive Director
Mr Jose Coutinho Barbosa	Non-Executive Director
Other key management personnel (Group)	
Mr Scott Hosking	Company Secretary and Chief Financial Officer (Group)
Mr Tim Hosking	General Manager South America
Mr Lino Barro	Engineering Manager
Mr Edward Munks	Chief Operating Officer

All of the above persons were also Directors or other executives during the previous financial year, except for Mr Jose Coutinho Barbosa who was appointed as a Non-Executive Director on 31 August 2011.

The Remuneration Report is set out under the following main headings:

- Remuneration policy and objectives (used to determine the nature and amount of remuneration).
- Details of remuneration.
- Service agreements.
- Share-based remuneration.
- Additional information.

Where appropriate, information which is included in other parts of the consolidated financial statements is included in this Directors' Report by reference.

A. Remuneration Policy and Objectives

The Board of Directors, aided by the Remuneration Committee, annually reviews remuneration of its Directors, senior executives and employees.

The Board of Directors has established a Remuneration Committee that provides overview and recommendations on recruitment, retention and termination policies and procedures for senior executives and the remuneration framework for Directors. The objective of the Remuneration Committee is to ensure that remuneration is competitive, fair and aligned with industry market practice.

The Remuneration Committee is responsible for the review of and recommendation to the Board on:

- the Group's recruitment, retention and termination policies and procedures for senior executives;
- senior executive and Director remuneration; and
- the remuneration framework, including superannuation arrangements, performance conditions and the operation of share-based remuneration schemes.

The Statement of Corporate Governance provides further information on the role of the Remuneration Committee.

A performance evaluation process has also been created to monitor the performance of the Board and senior executives.

Share Trading Policy

The trading of ordinary shares issued to Directors, officers and other key management personnel under any of the Company's share-based remuneration schemes is subject to, and conditional upon, compliance with the Company's Share Trading Policy.

Under the Company's Share Trading Policy, an individual may not limit his or her exposure to risk in relation to securities (including unlisted options). Directors and executives are prohibited from entering into any hedging arrangements over unvested options under the Company's share-based remuneration schemes.

Remuneration Report (Audited) (continued)

A. Remuneration Policy and Objectives (continued)

Executive Remuneration Framework

Karoon aims to align the interests of executives with those of shareholders by remunerating executives through performance and equity-based incentive schemes in addition to their fixed remuneration.

Consequently, executive remuneration consists of the following elements:

- fixed base salary;
- short-term incentive bonus based on performance;
- share-based remuneration; and
- other benefits including superannuation.

Remuneration and other terms of employment for executives are formalised in service agreements or employment contracts. Section C (Service Agreements) in this Remuneration Report outlines the remuneration and other key terms of employment specifically for the other key management personnel.

Fixed Base Salary

The cash salary of executives is determined from a review of peer companies and reflects core performance requirements and expectations. In addition, the Group considers the following:

- scope of the individual's role;
- length of service of the individual with Karoon;
- individual's level of skill, experience and qualifications;
- their location of employment;
- labour market conditions; and
- size and complexity of the Group's business.

Performance-Based Remuneration

The purpose of performance-based remuneration is to reward actual achievement by the individual executive of performance objectives and for improved Company performance. Consequently, performance-based remuneration is paid where a clear contribution to successful outcomes for the Company is demonstrated and the individual attains and excels against pre-agreed key performance indicators during a performance period.

During the financial year, no performance-based remuneration was paid.

Share-Based Remuneration

The Directors of the Company seek to reward past contributions of executives and provide an incentive for future performance. An Employee Share Option Plan provides such a mechanism for the Company by giving it the ability to issue options to executives.

The Company has an Employee Share Option Plan ('ESOP'), which has been operating since the Company was listed on the Australian Securities Exchange (ASX), in which executives may participate. The 2006 and 2009 Karoon Gas Australia Employee Share Option Plans were approved by shareholders in general meetings of shareholders on 3 November 2006 and 12 November 2009, respectively.

Unlisted options are currently issued to eligible employees, via the ESOP, as part of their remuneration to increase goal congruence between eligible employees with shareholders.

ESOP options have historically been issued annually, without the use of performance conditions. All issued options have, however, been issued at a premium to share trading prices at issue, with zero to two year vesting periods and three to four year expiry dates. The Company is of the opinion that the issue of ESOP options has represented a cost effective means of properly remunerating experienced professionals at an appropriate level.

Using a premium to the market price ensures rewards to executives from options granted as part of their remuneration is only available when value has been created for shareholders through share price appreciation. During the previous two financial years, the growth in shareholder value through share price appreciation has varied considerably. As such, no ordinary shares of the Company have been issued since 2 May 2011 from the exercise of ESOP options since that date.

Non-Monetary Benefits

Executives are entitled to health insurance, motor vehicle allowances and certain memberships depending on their respective employment agreements.

Superannuation

The Australian executives of the Company receive a superannuation contribution as required by the Australian Federal Government, which is currently 9.0% p.a. and do not receive any other retirement benefits. Individuals, however, may choose to sacrifice part of their salary to increase payments towards superannuation. It is at their discretion to seek individual financial advice concerning each of their own personal superannuation funds.

Termination Payments

Termination payments, if any, for executives, are agreed by the Remuneration Committee in advance of employment and are stated in the relevant employment contracts.

The Remuneration Committee reviews senior executive remuneration annually and makes its recommendations to the Board. When assessing individual fixed base salary, the Remuneration Committee assesses past performance and overall responsibilities of each senior executive. The Company obtains market-based comparisons through internal reviews of peer remuneration from public data and through an industry wide survey of salary levels.

Upon retirement, executives are paid employee benefit entitlements accrued to the date of retirement.

Executive Director Remuneration Framework

Executive Directors Mr Robert Hosking and Mr Mark Smith each receive an annual base salary, non-monetary benefits and participation in a share-based remuneration scheme, which now includes performance conditions before vesting.

Annually, the Remuneration Committee reviews Executive Director remuneration and makes recommendations to the Board. When assessing remuneration, the Remuneration Committee takes into account various issues, which in the Company's opinion, result in a high level of responsibility and commensurate risk being attached to the position of an Executive Director of the Company. The issues considered included the:

- market capitalisation of the Company and the scope and value of its activities;
- Company's geographical footprint into international activities, including South America;
- size and level of the day to day operations of the Company;
- complexity and importance of the strategic decisions facing the Company; and
- level of responsibility attaching to the office of an Executive Director.

During the previous financial year, the Company investigated market levels of remuneration, including an internal assessment of relative market capitalisation, salary levels of peer companies and participation in an industry wide salary and benefits survey.

Section C ('Service Agreements') in this Remuneration Report outlines the remuneration and other key terms of employment specifically for the Executive Directors.

Annual Base Salary

Annual base salary (including superannuation contribution) was assessed on a market comparison of peer companies of similar size to Karoon Gas Australia Ltd. It was found that the current remuneration levels of both Executive Directors were falling behind the market and a revised remuneration package was formulated in the previous financial year.

The annual base salary of each Executive Director is currently \$550,000. Executive Director contract terms each specify annual base salaries of \$600,000 commencing 1 July 2013.

Superannuation contributions are paid in accordance with Australian superannuation guarantee legislation.

Share-based Remuneration

The Company considers that the issue of unlisted other share options an essential part of Executive Director remuneration because the:

- issue of options to Directors creates an inherent alignment of interests between the Board and shareholders generally at no financial cost to the Company;
- Group is not yet in the development or production phase of activities and all expenses incurred are currently predominantly funded from the proceeds of Company ordinary share issues. Any cash component of Executive Directors' remuneration will, therefore, involve the issue of equity which has, in the past, been carried out at prices which are below the market price of the Company's ordinary shares at the time; and
- issue of options at an exercise price which is set at a premium to the market price at the time of setting the price, means a smaller dilutive effect of such an issue on other shareholders.

Current share-based remuneration for each Executive Director is considered by the Remuneration Committee to be appropriate considering there are performance conditions set to reward outperformance of peer companies of like size, along with inherent alignment of interests between Executive Directors and shareholders through the use of ascending premiums when originally pricing the unlisted options.

Remuneration Report (Audited) (continued)

A. Remuneration Policy and Objectives (continued)

The recent three year share-based remuneration package of Executive Directors was approved by shareholders at the 2011 Annual General Meeting of the Company.

Each of the Executive Directors' share-based remuneration was divided into three components:

- base options, not subject to performance conditions;
- bonus options, subject to key performance indicators; and
- a single long-term component, subject to a 'Company Milestone' performance condition.

Base Options

Each of the Executive Directors were issued a total of 600,000 unlisted other share options. The 600,000 unlisted other share options were issued in three 200,000 option tranches vesting in each of the financial years ending 2012, 2013 and 2014, at exercise prices of \$8.92, \$9.95 and \$10.98 respectively. These exercise prices reflect a 30%, 45% and 60% premium to the share price at the pricing determination date, respectively.

Bonus Options (excluding 'Company Milestone' Options)

Each of the Executive Directors were also issued with 1,300,000 unlisted other share options, that are subject to performance conditions before vesting, as summarised below:

- relative total shareholder return ('TSR') as judged by share value appreciation that outperforms the S&P ASX 200 Energy Index in the performance period (weighting 50%);
- absolute TSR to exceed 10% p.a. in the performance period (weighting 25%); and
- maintenance of a zero incident safety record in the performance period (weighting 25%).

The 1,300,000 unlisted other share options were issued in option tranches of 300,000 options, 400,000 options and 600,000 options vesting (subject to the above performance conditions) in each of the financial years ending 2012, 2013 and 2014, at exercise prices of \$8.92, \$9.95 and \$10.98 respectively. These exercise prices reflect a 30%, 45% and 60% premium to the share price at the pricing determination date, respectively.

During the performance period from 1 May 2011 to 1 May 2012, the Company outperformed the S&P ASX 200 Energy Index and a zero incident safety record was maintained. However, the Company TSR did not increase by 10% or more over the performance period. Out of the 300,000 unlisted other share options, subject to performance conditions assessed to 1 May 2012, 225,000 unlisted other share options vested and 75,000 other share options were forfeited for each Executive Director.

'Company Milestone' Options

A third bonus option component of 500,000 unlisted other share options with an exercise price of \$10.98, at a 60% premium to the share price at the pricing determination date, vesting in the financial year ending 2014 was issued to each Executive Director, subject to satisfaction of a single performance condition, the 'Company Milestone', being the outperformance of the S&P ASX 200 Energy Index by 50% or more over the period beginning 1 May 2011 and ending 1 May 2014.

In the case where a particular performance condition was out of the control of the Executive Director and not achieved, the Remuneration Committee may nevertheless allow the Bonus Options (including Company Milestone Options) to vest and be exercised.

Non-Executive Director Remuneration Framework

Fees and payments to Non-Executive Directors reflect the demands which are placed on, and the responsibilities of, the Directors. The Company reviews Director remuneration annually and assesses the change to the Company's activities and overall responsibilities of each Non-Executive Director. Non-Executive Directors' fees are reviewed annually by the Remuneration Committee. To assist the Remuneration Committee, the Company obtains both market-based comparisons through publicly available information about peer non-executive director fees and a review of the S&P ASX 200 non-executive director remuneration levels.

Non-Executive Directors do not ordinarily receive performance-related remuneration. However, to promote an inherent alignment of interests between Non-Executive Directors and shareholders, Non-Executive Directors have in the past been issued with unlisted other share options and are also encouraged to purchase ordinary shares in the Company on market. Options issued to Non-Executive Directors are approved, on a case-by-case basis, by shareholders at relevant general meetings.

Non-Executive Directors' Fees

Non-Executive Directors' fees were last reviewed during October 2011. Non-Executive Directors' fees are determined within an aggregate directors' fee pool limit, which is periodically recommended for approval by shareholders. As approved by shareholders at the Annual General Meeting held on 18 November 2010, the maximum aggregate amount, including superannuation contribution, that may be paid to Non-Executive Directors of the Company from the Group is \$900,000 p.a.

	From 1 July 2012	From 1 July 2011
Base Fee		
Non-Executive Directors	\$100,000	\$100,000
Committee Member Fees		
Audit Committee	\$10,000	\$10,000
Nomination Committee	\$10,000	\$10,000
Remuneration Committee	\$10,000	\$10,000

Superannuation contributions are paid, in accordance with Australian superannuation guarantee legislation, on directors' fees paid to Australian resident Non-Executive Directors.

Retirement Allowance for Directors

Karoon does not provide any Non-Executive Director with a retirement allowance.

Voting and Comments at the Company's 2011 Annual General Meeting

The Company received more than 81% of 'yes' votes on its Remuneration Report for the previous financial year. The Company did not receive any specific feedback at the Company's 2011 Annual General Meeting but did receive specific feedback during the financial year on its remuneration practices.

Proposed Changes to the Company's Share-based Remuneration Schemes, Commencing 1 July 2012

The Board has proposed restructuring the Director, executive and employee remuneration framework from 1 July 2012 to one that is both market competitive and complementary to the reward strategy of the Group. The new remuneration framework proposes a mix of fixed base remuneration and a blend of short and long-term share-based remuneration incentives.

The objective of the Group's new remuneration framework is to ensure the following key criteria are achieved:

- remuneration is reasonable and competitive in order to attract and retain talented and motivated employees and executives to Karoon;

- there is a clear relationship between responsibility, performance, results delivered and remuneration;
- it is acceptable to shareholders;
- to facilitate capital management; and
- transparency.

The key elements of the new remuneration framework are:

(a) alignment to shareholders' interests:

- attract and retain high calibre executives capable of managing the Group's diverse international operations;
- focus on sustained growth in shareholder value; and

(b) alignment to executives' and employees' interests:

- reward capability and experience;
- reflect competitive reward for contribution to growth in shareholder wealth;
- provide a clear structure for earning rewards; and
- provide recognition of contribution.

Given the Group is still in the exploration and evaluation phase of activities, the Board believes linkage of the share-based remuneration framework to Company share price performance rather than its earnings and/or sales revenue is seen as the most sensible method of incentivising Directors, executives and employees. Any increase in the share price of the Company has a positive effect on shareholder wealth. The use of both one to three year term incentives and three to five year term incentives is designed to align the performance and interests of employees with the interests of the Company.

Remuneration of senior executives is proposed to be allocated in the following manner from 1 July 2012:

- fixed base salary, superannuation and non-monetary benefits, 60-70% p.a.;
- short-term incentive based on individual and Company-wide performance measures under the proposed Karoon Gas Australia Ltd Performance Rights Plan 2012 ('PRP'), 15-20% p.a.; and
- long-term incentive based on Company-wide performance conditions under the proposed Karoon Gas Australia Ltd Employee Share Option Plan 2012 15-20% p.a.

The following proposed share-based remuneration plans are subject to shareholder approval at the 2012 Annual General Meeting of the Company.

Remuneration Report (Audited) (continued)

A. Remuneration Policy and Objectives (continued)

Short-Term Incentive ('STI')

Directors and employees will have the opportunity to earn an annual short-term incentive, provided personal performance and Company-wide measures are achieved. This STI will be payable in Performance Rights (Rights), to be issued under the PRP.

The purpose of the proposed PRP is to:

- attract and retain quality eligible employees;
- motivate eligible employees by enabling them to share in any Company growth creation and encouraging them to improve the short/medium term performance of the Company and, in turn, returns to shareholders;
- advance the interests of all shareholders by motivating the eligible employees;
- provide a mechanism for eligible employees to share the rewards of the success of the Company through the issuance of options; and
- facilitate capital management by enabling the Company to preserve cash reserves for expenditure on principal activities.

The PRP is subject to shareholder approval at the 2012 Annual General Meeting of the Company.

The issue of Rights rather than cash is considered appropriate by the Company because the Company is still in the exploration and evaluation phase of activities and is not currently generating earnings and/or sales revenue.

Vesting of Rights intended to be issued under the PRP in 2012 is conditional on the achievement of the following performance measures, over the relevant one year performance period, and provided the employee remains employed by the Company for an additional year:

- personal performance as assessed during the annual performance review period. The Group conducts annual performance reviews, measured against an individual's job description and role within the Group as assessed by senior management and the Remuneration Committee where appropriate (weighting 50% p.a.); and
- Company-wide operational objectives, as reviewed annually by the Remuneration Committee by reviewing the Company's operational work plans for the upcoming financial year and assessing the relevant individual's involvement. For example, during the financial year ending 30 June 2013 the predominant work plan involves the commencement of drilling campaigns. Operational success could be measured by successful target selection, adherence to time and cost budgeting,

compliant health, safety and environment record and/or efficient operations (weighting 50% p.a.).

The quantum of Rights will be based on the pre-determined percentage of total salary that is allocated to the STI portion divided by the Company's share price in the period leading up to the first day of the performance period, nominally 1 July annually. The portion of total salary to be allocated to the STI will be determined at the commencement of the performance period.

STI vesting is based on a one year performance period followed by a one year retention period, after such time each Right can be converted to one fully paid ordinary share of the Company. In each case, the Remuneration Committee will be responsible for assessing whether the performance measures have been achieved.

The rules, terms and conditions of the proposed PRP will be set out in the notice of meeting for the 2012 Annual General Meeting.

Long-Term Incentive ('LTI')

The Company currently has one ESOP, the 2009 Karoon Gas Australia Employee Share Option Plan, which was approved by shareholders at the 2009 Annual General Meeting.

As it is coming up to three years from the last shareholder approval of the ESOP, and in accordance with rule 13.3 of the ESOP rules and Exception 9 of ASX Listing Rule 7.2, the Company will submit a new ESOP to shareholders of the Company to approve its continued operation and the issue of securities from time to time under the new ESOP, as an exception to ASX Listing Rule 7.1. The Directors have taken the opportunity to review the ESOP rules and have amended the rules to take into account the current operations, changes to government legislation, industry market practice and size of the Company.

The purpose of the proposed Karoon Gas Australia Ltd Employee Share Option Plan 2012 is to:

- attract and retain quality eligible employees;
- motivate eligible employees by enabling them to share in any Company growth creation and encouraging them to improve the performance of the Company and, in turn, its returns to shareholders;
- advance the interests of all shareholders by motivating and incentivising the eligible employees;
- provide a mechanism for eligible employees to share the rewards of the success of the Company through the issuance of unlisted options; and
- facilitate capital management by enabling the Company to preserve cash reserves for expenditure on principal activities.

The Karoon Gas Australia Ltd Employee Share Option Plan 2012 is subject to shareholder approval at the 2012 Annual General Meeting of the Company.

Issues under the Karoon Gas Australia Ltd Employee Share Option Plan 2012 will provide unlisted options to employees with the intent of rewarding long-term performance and superior shareholder returns. Under the Karoon Gas Australia Ltd Employee Share Option Plan 2012 employees may be granted options that only vest if the Company-wide performance measures are achieved, provided the employee remains employed by the Company.

Participation in the Karoon Gas Australia Ltd Employee Share Option Plan 2012 is at the discretion of the Board (on the recommendation of the Remuneration Committee and/or senior executives) and no employee has a contractual right to receive a LTI.

In all new issues under the proposed Karoon Gas Australia Ltd ESOP 2012, it is intended that vesting of any LTI be subject to the Company's TSR exceeding the relative TSR of companies (weighted by company size) in the S&P ASX 200 Energy Index over a three year period.

Vesting will occur in proportion to the Company's performance measures, as follows:

TSR Rank	Proportion of Proposed Unlisted Options to Vest
Less than 50 th percentile	0%
At 50 th percentile	50%
Between 50 th and 75 th percentile	50% plus 2% for each additional percentile ranking above 50 th percentile
At or above 75 th percentile	100%

Once vested, the options will be exercisable for a period of up to two years and will be granted for \$Nil consideration.

The rules, terms and conditions of the proposed Karoon Gas Australia Ltd Employee Share Option Plan 2012 will be set out in the notice of meeting for the 2012 Annual General Meeting.

Relationship between the Remuneration Policy and Company Performance

Notwithstanding that the Group is still in the exploration and evaluation phase of activities and is still incurring operating losses (excluding foreign currency gains and losses), the Company believes its current policy was effective in increasing long-term shareholder wealth through share price appreciation, strengthening the Group's asset base and prospective resources.

The tables below set out summary information about the Group's earnings and movements in shareholder wealth to 30 June 2012:

Financial Year Ended	30 June 2008 \$	30 June 2009 \$	30 June 2010 \$	30 June 2011 \$	30 June 2012 \$
Revenue	5,320,930	4,868,541	6,459,623	14,225,048	13,601,653
Profit (loss) before income tax	(6,055,339)	4,452,766	(14,665,017)	(23,304,914)	(3,287,382)
Profit (loss) for financial year	(6,055,339)	4,452,766	(14,893,839)	(23,304,914)	(3,287,382)
Net assets at end of financial year	130,742,056	334,658,839	361,703,571	617,867,324	600,599,921

Financial Year Ended	30 June 2008 \$	30 June 2009 \$	30 June 2010 \$	30 June 2011 \$	30 June 2012 \$
Share price at beginning of financial year	2.38	4.54	9.09	5.95	5.23
Share price at end of financial year	4.54	9.09	5.95	5.23	4.03
Basic profit (loss) per ordinary share	(0.0485)	0.0302	(0.0842)	(0.1119)	(0.0148)
Diluted profit (loss) per ordinary share	(0.0485)	0.0300	(0.0842)	(0.1119)	(0.0148)

DIRECTORS' REPORT CONTINUED

Remuneration Report (Audited) (continued)

B. Details of Remuneration

Details of the remuneration of the Directors and other key management personnel of the Group (as identified in accordance with the *Corporations Act 2001* and *AASB 124 'Related Party Disclosures'* as those who had authority and responsibility for planning, directing and controlling the Group and/or Company activities) for the financial year and previous financial year are set out in the following tables.

Ended 30 June 2012	Short-Term Benefits		Post-Employment Benefits		Long-Term Benefits	Share-based Payments Expense		
	Cash Salary And Fees	Non-Monetary Benefits	Superannuation Contributions	Social Security & Indemnity Fund Contributions	Long Service Leave Provision	Options*/***	Remuneration Consisting of Options**	Total Remuneration
Name	\$	\$	\$	\$	\$	\$	%	\$
Executive Directors								
Mr Robert Hosking	458,716	43,874	41,284	-	1,300	1,085,457	66.6	1,630,631
Mr Mark Smith	458,716	24,790	41,284	-	19,385	1,085,457	66.6	1,629,632
Non-Executive Directors								
Mr Geoff Atkins	130,000	891	11,700	-	-	399,635	73.7	542,226
Mr Clark Davey	130,000	891	11,700	-	-	457,915	76.3	600,506
Mr Stephen Power	130,000	-	11,700	-	-	399,635	73.8	541,335
Mr Jose Coutinho Barbosa (appointed 31 August 2011)	83,333	-	-	-	-	-	-	83,333
Total Directors' remuneration	1,390,765	70,446	117,668	-	20,685	3,428,099		5,027,663
Other key management personnel (Group)								
Mr Scott Hosking	290,000	15,767	26,100	-	19,277	80,049	18.6	431,193
Mr Tim Hosking	313,087	5,547	-	104,404	-	80,049	15.9	503,087
Mr Lino Barro	297,966	-	26,817	-	12,992	329,649	49.4	667,424
Mr Edward Munks	459,175	2,393	36,000	-	922	331,946	40.0	830,436
Total other key management personnel remuneration (Group)	1,360,228	23,707	88,917	104,404	33,191	821,693		2,432,140
Total key management personnel remuneration (Group)	2,750,993	94,153	206,585	104,404	53,876	4,249,792		7,459,803

* Remuneration in the form of options includes negative amounts for options forfeited during the financial year.

** The percentage of total remuneration consisting of options, based on the value of options expensed in the consolidated statement of comprehensive income during the financial year.

*** During the financial year, Mr Robert Hosking and Mr Mark Smith were each issued share-based payments subject to performance conditions. For both Mr Robert Hosking and Mr Mark Smith this represented 24% of total share-based payments received. Share based payments are provided exclusively by way of options, percentages disclosed are based on the value of options expensed during the financial year subject to performance conditions. Mr Robert Hosking and Mr Mark Smith received no further remuneration subject to performance conditions and no other Directors or other key management personnel were granted performance based remuneration. No performance based remuneration was granted during the previous financial year.

Ended 30 June 2011	Short-Term Benefits		Post-Employment Benefits		Long-Term Benefits	Share-based Payments Expense		
	Cash Salary And Fees	Non-Monetary Benefits	Superannuation Contributions	Social Security & Indemnity Fund Contributions	Long Service Leave Provision	Options	Remuneration Consisting of Options*	Total Remuneration
Name	\$	\$	\$	\$	\$	\$	%	\$
Executive Directors								
Mr Robert Hosking	409,786	28,895	6,881	-	-	-	-	445,562
Mr Mark Smith	382,263	17,143	34,404	-	13,780	-	-	447,590
Non-Executive Directors								
Mr Geoff Atkins	73,395	2,005	6,606	-	-	399,635	83.0	481,641
Mr Clark Davey (appointed 1 October 2010)	55,046	2,005	4,954	-	-	282,381	82.0	344,386
Mr Stephen Power	73,394	-	6,606	-	-	399,635	83.3	479,635
Total Directors' remuneration	993,884	50,048	59,451	-	13,780	1,081,651		2,198,814
Other key management personnel (Group)								
Mr Scott Hosking	252,294	13,462	22,706	-	6,035	267,000	47.6	561,497
Mr Tim Hosking**	309,516	12,700	11,043	51,695	-	-	-	384,954
Mr Lino Barro	284,862	-	25,638	-	5,833	590,410	65.1	906,743
Mr Edward Munks (appointed 1 January 2011)	126,580	1,648	-	-	-	105,341	45.1	233,569
Total other key management personnel remuneration (Group)	973,252	27,810	59,387	51,695	11,868	962,751		2,086,763
Total key management personnel remuneration (Group)	1,967,136	77,858	118,838	51,695	25,648	2,044,402		4,285,577

* The percentage of total remuneration consisting of options, based on the value of options expensed in the consolidated statement of comprehensive income during the previous financial year.

** Mr Tim Hosking was appointed Chief Executive Officer South America on 1 December 2010. Before this appointment he was the Company's South American General Manager. Amounts shown above include all Mr Tim Hosking's remuneration during the previous financial year.

Remuneration Report (Audited) (continued)

B. Details of Remuneration (continued)

The amounts disclosed for the remuneration of Directors and other key management personnel include the assessed fair values of options granted during the financial year, at the date they were granted. The value attributable to options is allocated to particular financial periods in accordance with AASB 2 '*Share-based Payment*', which requires the value of an option at grant date to be allocated equally over the period from grant date to vesting date, adjusted for not meeting the vesting condition. For options that vest immediately, the value is disclosed as remuneration immediately, in accordance with the accounting policy described in Note 1(p) of the consolidated financial statements.

Fair values of options are assessed under the Black-Scholes option pricing model. The Black-Scholes option pricing model takes into account the exercise price, the term 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.

Current ESOP options have been granted subject to continued employment with the Company but are not subject to the individual meeting pre-determined performance conditions.

Other share options, issued during the financial year to Executive Directors, in addition to continued employment with the Company, are subject to meeting pre-determined performance conditions. For example, total shareholder return expansion to equal or outperform the S&P ASX 200 Energy Index in the tranche period (weighting 50%); TSR to exceed 10% p.a. in the tranche period (weighting 25%); and the maintenance of a zero incident safety record in the tranche period (weighting 25%).

Options have vesting periods of zero to three years, dependent upon the tranche of options being granted and the time elapsed between formal approval and issue of options.

Further information on options is set out in Note 27 of the consolidated financial statements.

Amounts disclosed for remuneration of Directors and other key management personnel exclude insurance premiums paid by the Company in respect of directors' and officers' liability insurance contracts, as the contracts do not specify premiums paid in respect of individual Directors and officers. Information relating to insurance contracts is set out in this Directors' Report.

C. Service Agreements

Remuneration and other terms of employment for the Executive Chairman, Executive Director, Chief Financial Officer and other key management personnel are formalised in either service agreements or employment contracts. Each of these agreements provide for the provision of benefits such as health insurance, car allowances and participation, when eligible, in the Company's ESOP or other share options. Other major provisions of the agreements relating to remuneration are set out on page 31.

Details of existing contracts between the Group and the Executive Directors, and other key management personnel are as follows:

Name	Term	Expiry	Notice/ Termination Period	Termination Payments	Related Entity	Share Option Eligible	Base Salary (Including Post Employment Benefit Entitlements) Amount
Executive Directors							
Mr Robert Hosking	From 1 May 2011, ongoing	Ongoing	In writing 6 months	Change of control: one year	Ropat Nominees Pty Ltd Hosking Superannuation Fund	Yes	\$550,000 ^
Mr Mark Smith	From 1 May 2011, ongoing	Ongoing	In writing 6 months	Change of control: one year	IERS (Australia) Pty Ltd Bonnie Doon Superannuation Fund	Yes	\$550,000 ^
Other key management personnel (Group)							
Mr Scott Hosking	Ongoing	Ongoing	In writing 3 months	Change of control: one year		Yes	\$366,470
Mr Tim Hosking	From 1 December 2010, ongoing	Ongoing	In writing 1 month	Change of control: one year		Yes	\$442,061
Mr Lino Barro	Ongoing	Ongoing	In writing 3 months	Change of control: one year	Barro Superannuation Fund	Yes	\$339,398
Mr Edward Munks	From 1 January 2011, ongoing	Ongoing	In writing 6 months	Change of control: one year		Yes	\$466,470

^ Employment contract terms specify annual base salaries of \$600,000 commencing 1 July 2013.

The contracts for service between the Company and other key management personnel are on a continuing basis. The terms of which are not expected to change in the immediate future.

Remuneration Report (Audited) (continued)

D. Share-based Remuneration

The Company currently has one ESOP, which was approved by shareholders during the 2009 Annual General Meeting. It is currently proposed that new share-based remuneration plans will be presented to shareholders for approval at the 2012 Annual General Meeting. These plans will include the Karoon Gas Australia Ltd Employee Share Option Plan 2012 and the introduction of a Performance Rights Plan (see Section A – Remuneration Policy and Objectives on page 21).

The Company also grants other share options to Directors. Options issued to Directors are approved, on a case-by-case basis, by shareholders at relevant general meetings.

During the financial year 5,400,000 options over unissued ordinary shares of the Company were issued to the above Directors and other key management personnel.

The terms and conditions of each grant of options over unissued ordinary shares in the Company affecting remuneration in the current or a future financial year are as follows:

Grant Date	Date Vested and Exercisable	Expiry Date	Exercise Price Per Option	Fair Value Per Option at Grant Date	% Vested
ESOP options					
9 December 2009	13 November 2011	18 November 2013	\$11.50	\$3.32	100
3 September 2010	31 October 2012	31 October 2014	\$9.77	\$1.92	-
12 January 2011	31 October 2012	31 October 2014	\$9.77	\$2.03	-
10 November 2011	31 October 2013	31 October 2015	\$7.30	\$1.44	-
10 October 2011	31 October 2013	31 October 2015	\$7.30	\$1.65	-
Other share options					
23 November 2009	12 November 2012	12 November 2013	\$14.07	\$2.40	-
18 November 2010	18 November 2013	18 November 2014	\$9.48	\$2.75	-
10 November 2011	1 May 2012	1 May 2014	\$8.92	\$0.87	85
10 November 2011	1 May 2013	1 May 2015	\$9.95	\$1.07	-
10 November 2011	1 May 2014	1 May 2016	\$10.98	\$1.30	-

Options are granted for no consideration. When exercisable, each option is convertible into one ordinary share of the Company.

ESOP options expire between two and a half and four and a half years after they are granted. The exercise price of ESOP options, issued during the financial year, was based on the volume weighted average price at which the Company's ordinary shares traded on the ASX during the 90 days of trading days before the ESOP options were offered plus a premium to the market price.

The exercise price of other share options, issued during the financial year, is based on the weighted average price at which the Company's ordinary shares traded on the ASX during the 90 days of trading days before the options were offered plus a premium to the market price.

If there is a change of control in the Company, all unexercised options become immediately exercisable.

The option exercise prices are subject to adjustment in certain circumstances as per ASX Listing Rule 6.22.2.

Options granted carry no dividend or voting rights.

Further information on options is set out in Note 27 of the consolidated financial statements.

Number of Options Provided as Remuneration during the Financial Year

Details of options over unissued ordinary shares in the Company provided as remuneration to each Director and each of the other key management personnel are set out below:

Name	Number of Options Granted During Financial Year	Value of Options at Grant Date*	Number of Options Vested During Financial Year	Value of Options Forfeited**
Executive Directors				
Mr Robert Hosking	500,000	\$435,000	425,000	\$(65,250)
	600,000	\$642,000	-	-
	1,300,000	\$1,690,000	-	-
Mr Mark Smith	500,000	\$435,000	425,000	\$(65,250)
	600,000	\$642,000	-	-
	1,300,000	\$1,690,000	-	-
Non-Executive Directors				
Mr Geoff Atkins	-	-	-	-
Mr Clark Davey	-	-	-	-
Mr Stephen Power	-	-	-	-
Mr Jose Coutinho Barbosa	-	-	-	-
Other key management personnel (Group)				
Mr Scott Hosking	150,000	\$247,500	-	-
Mr Tim Hosking	150,000	\$247,500	-	-
Mr Lino Barro	100,000	\$144,000	300,000	-
Mr Edward Munks	200,000	\$330,000	-	-
Total key management personnel (Group)	5,400,000	\$6,503,000	1,150,000	\$(130,500)

* The value at grant date, calculated in accordance with AASB 2, of options granted during the financial year as part of their remuneration.

** The value, calculated in accordance with AASB 2, of options forfeited during the financial year reducing their remuneration.

No options over unissued ordinary shares in the Company, held by any Director or other key management personnel, lapsed during the financial year, except for 75,000 other share options that were forfeited for each Executive Director.

Shares Issued on the Exercise of Options Provided as Remuneration

No options were exercised by any Director and other key management personnel during the financial year.

Remuneration Report (Audited) (continued)

E. Additional Information

Details of Remuneration – Options

For each grant of options in current or previous financial years which results in an amount being disclosed in the Remuneration Report as a share-based payment expense in the financial year to Directors and other key management personnel, the percentage of the grant that vested in the financial year and the percentage that was forfeited because the individual did not meet the service and/or performance conditions is set out below:

Name	Financial Year End Granted	Vested %	Forfeited %	Financial Years in Which Options May Vest	Maximum Total Value of Grant Yet to Vest
Executive Directors					
Mr Robert Hosking	30 June 2012	85	15	-	-
	30 June 2012	-	-	30 June 2013	\$363,209
	30 June 2012	-	-	30 June 2014	\$1,253,084
Mr Mark Smith	30 June 2012	85	15	-	-
	30 June 2012	-	-	30 June 2013	\$363,209
	30 June 2012	-	-	30 June 2014	\$1,253,084
Non-Executive Directors					
Mr Geoff Atkins	30 June 2010	-	-	30 June 2013	\$136,894
Mr Clark Davey	30 June 2011	-	-	30 June 2014	\$634,704
Mr Stephen Power	30 June 2010	-	-	30 June 2013	\$317,352
Other key management personnel (Group)					
Mr Scott Hosking	30 June 2012	-	-	30 June 2014	\$167,451
Mr Tim Hosking	30 June 2012	-	-	30 June 2014	\$167,451
Mr Lino Barro	30 June 2010	100	-	-	-
	30 June 2011	-	-	30 June 2013	\$29,161
	30 June 2012	-	-	30 June 2014	\$93,459
Mr Edward Munks	30 June 2011	-	-	30 June 2013	\$75,446
	30 June 2012	-	-	30 June 2014	\$223,267

No options will vest if the service and/or performance conditions are not met, therefore the minimum value of the option yet to vest is \$Nil.

The maximum value of options yet to vest was determined as the amount of the grant date fair value of the options that is yet to be expensed in the consolidated statement of comprehensive income.

Loans to Directors and Other Key Management Personnel

There were no loans to Directors or other key management personnel during the financial year.

Other Transactions with Directors and Other Key Management Personnel

Refer to Note 29 of the consolidated financial statements for other transactions with Directors and other key management personnel during the financial year.

Matters Arising Subsequent to the End of the Financial Year

Other than the matters disclosed in Note 31 of the consolidated financial statements, no other matter or circumstance has arisen since 30 June 2012 that has significantly affected, or may significantly affect:

- (a) the Group's operations in future financial years;
- (b) the results of those operations in future financial years; or
- (c) the Group's state of affairs in future financial years.

This Directors' Report, incorporating the Remuneration Report, is made in accordance with a resolution of the Directors.

On behalf of the Directors:



Mr Robert Hosking
Executive Chairman

14 September 2012
Melbourne

AUDITOR'S INDEPENDENCE DECLARATION



As lead auditor for the audit of Karoon Gas Australia Ltd for the financial year ended 30 June 2012, I declare that to the best of my knowledge and belief, there have been:

- (a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Karoon Gas Australia Ltd and the subsidiaries it controlled during the financial year.

A handwritten signature in black ink, appearing to read 'Charles Christie'.

Charles Christie
Partner
PricewaterhouseCoopers

Melbourne
14 September 2012

PricewaterhouseCoopers
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FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

37

38	Consolidated Statement of Comprehensive Income
39	Consolidated Statement of Financial Position
40	Consolidated Statement of Changes in Equity
41	Consolidated Statement of Cash Flows
42	Notes to the Consolidated Financial Statements

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

		Consolidated	
	Note	2012 \$	2011 \$
Revenue	4	13,601,653	14,225,048
Other income	4	4,396,073	-
Total revenue and other income		17,997,726	14,225,048
Computer support		(982,706)	(623,097)
Consulting fees		(552,451)	(985,930)
Depreciation and amortisation expense	5	(948,676)	(531,245)
Employee benefits expense (net)		(11,460,468)	(8,529,761)
Exploration and evaluation expenditure expensed or written off	5	(1,219,720)	(4,662,554)
Farm-out costs		(340,321)	(258,385)
Finance costs	5	(256,321)	(456,290)
Insurance expense		(1,396,641)	(575,172)
Legal fees		(214,205)	(349,722)
Net foreign currency losses		-	(10,440,658)
Property costs		(1,058,828)	(775,632)
Share registry and listing fees		(210,357)	(518,330)
Telephone and communication expenses		(274,987)	(286,075)
Travel and accommodation expenses		(1,199,922)	(754,146)
Brazilian initial public offering expenses		(88,474)	(5,673,914)
Other expenses		(1,081,031)	(2,109,051)
Total expenses		(21,285,108)	(37,529,962)
Loss before income tax		(3,287,382)	(23,304,914)
Income tax expense	6	-	-
Loss for financial year attributable to equity holders of the Company		(3,287,382)	(23,304,914)
Other comprehensive income (loss):			
Exchange differences arising from the translation of financial statements of foreign subsidiaries		(19,949,491)	(9,347,931)
Income tax relating to components of other comprehensive loss		-	-
Other comprehensive income (loss) for financial year, net of tax		(19,949,491)	(9,347,931)
Total comprehensive loss for financial year attributable to equity holders of the Company		(23,236,873)	(32,652,845)
Loss per share attributable to equity holders of the Company:			
Basic loss per ordinary share	9	(0.0148)	(0.1119)
Diluted loss per ordinary share	9	(0.0148)	(0.1119)

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2012

39

		Consolidated	
	Note	2012 \$	2011 \$
Current assets			
Cash and cash equivalents	10	227,802,316	266,839,144
Receivables	11	3,362,813	4,003,566
Inventories	12	13,051,792	279,892
Security deposits	13	35,090,209	41,301,743
Current tax asset	6	503,416	-
Other assets	14	8,058,487	3,525,878
Total current assets		287,869,033	315,950,223
Non-current assets			
Plant and equipment	15	2,036,567	2,216,532
Intangible assets	16	679,426	480,041
Exploration and evaluation expenditure carried forward	17	313,884,275	276,465,002
Security deposits	13	7,470,369	26,058,837
Other assets	14	142,177	1,102,759
Total non-current assets		324,212,814	306,323,171
Total assets		612,081,847	622,273,394
Current liabilities			
Trade and other payables	18	11,275,782	4,306,586
Total current liabilities		11,275,782	4,306,586
Non-current liabilities			
Provisions	19	206,144	99,484
Total non-current liabilities		206,144	99,484
Total liabilities		11,481,926	4,406,070
Net assets		600,599,921	617,867,324
Equity			
Contributed equity	20	664,894,335	664,894,335
Accumulated losses		(61,302,736)	(58,015,354)
Share-based payments reserve		24,318,052	18,348,582
Foreign currency translation reserve		(27,309,730)	(7,360,239)
Total equity		600,599,921	617,867,324

The above consolidated statement of financial position should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

	Contributed Equity \$	Accumulated Losses \$	Consolidated Share-based Payments Reserve \$	Foreign Currency Translation Reserve \$	Total Equity \$
Balance as at 1 July 2010	381,147,212	(34,710,440)	13,279,107	1,987,692	361,703,571
Loss for financial year	-	(23,304,914)	-	-	(23,304,914)
Exchange differences arising from the translation of financial statements of foreign subsidiaries	-	-	-	(9,347,931)	(9,347,931)
Total comprehensive loss for financial year	-	(23,304,914)	-	(9,347,931)	(32,652,845)
Transactions with owners in their capacity as owners:					
Ordinary shares issued	292,461,747	-	-	-	292,461,747
Transaction costs arising on ordinary shares issued	(8,714,624)	-	-	-	(8,714,624)
Share-based payments expense	-	-	5,069,475	-	5,069,475
	283,747,123	-	5,069,475	-	288,816,598
Balance as at 30 June 2011	664,894,335	(58,015,354)	18,348,582	(7,360,239)	617,867,324
Loss for financial year	-	(3,287,382)	-	-	(3,287,382)
Exchange differences arising from the translation of financial statements of foreign subsidiaries	-	-	-	(19,949,491)	(19,949,491)
Total comprehensive loss for financial year	-	(3,287,382)	-	(19,949,491)	(23,236,873)
Transactions with owners in their capacity as owners:					
Ordinary shares issued	-	-	-	-	-
Transaction costs arising on ordinary shares issued	-	-	-	-	-
Share-based payments expense	-	-	5,969,470	-	5,969,470
	-	-	5,969,470	-	5,969,470
Balance as at 30 June 2012	664,894,335	(61,302,736)	24,318,052	(27,309,730)	600,599,921

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

41

		Consolidated	
	Note	2012 \$	2011 \$
Cash flows from operating activities			
Receipts from customers (inclusive of GST refunds)		3,089,442	1,669,745
Payments to suppliers and employees (inclusive of GST)		(14,077,730)	(16,636,777)
Payments for exploration and evaluation expenditure expensed		(1,286,879)	(683,108)
Interest received		16,074,369	10,324,046
Interest and other costs of finance paid		(256,321)	(456,290)
Income taxes paid		(560,717)	(220,227)
Net cash flows provided by/(used in) operating activities	26(a)	2,982,164	(6,002,611)
Cash flows from investing activities			
Purchase of plant and equipment		(382,725)	(2,058,087)
Purchase of computer software		(580,025)	(320,991)
Payments for exploration and evaluation expenditure capitalised		(56,631,948)	(34,129,282)
Repayment (payment) of security deposits		11,665,842	(51,875,314)
Proceeds from disposal of non-current assets		24,545	31,374
Net cash flows used in investing activities		(45,904,311)	(88,352,300)
Cash flows from financing activities			
Proceeds from issue of ordinary shares		-	292,461,747
Payments for transaction costs arising on ordinary shares issued		-	(8,714,624)
Net cash flows provided by financing activities		-	283,747,123
Net increase (decrease) in cash and cash equivalents		(42,922,147)	189,392,212
Cash and cash equivalents at beginning of financial year		266,839,144	87,122,836
Effect of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies		3,885,319	(9,675,904)
Cash and cash equivalents at end of financial year	10	227,802,316	266,839,144

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 1. Summary of Significant Accounting Policies

Karoon Gas Australia Ltd (the 'Company') is a public company limited by shares and is listed on the ASX. It is incorporated and domiciled in Australia. The registered office of Karoon Gas Australia Ltd and the principal place of business is Office 7A, 34-38 Lochiel Avenue, Mount Martha, VIC, 3934. The technical office is located at Level 25, 367 Collins Street, Melbourne, VIC, 3000.

The financial statements are for the consolidated entity consisting of Karoon Gas Australia Ltd and its subsidiaries (the 'Group').

The nature of the operations and principal activities of the Group are described in the Directors' Report.

The following is a summary of significant accounting policies adopted by the Group in the preparation of these consolidated financial statements. The accounting policies have been consistently applied to all the financial years presented, unless otherwise stated.

(a) Basis of Preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board (the 'AASB') and the *Corporations Act 2001*. Karoon Gas Australia Ltd is a for-profit entity for the purpose of preparing financial statements.

Where necessary, comparative information has been reclassified to achieve consistency in disclosure with financial year amounts and other disclosures.

Historical Cost Convention

The consolidated financial statements have been prepared on an accrual basis under the historical cost convention as modified, when relevant, by the revaluation of selected financial assets and financial liabilities for which the fair value basis of accounting has been applied.

Going Concern

On the basis of the present level of operations and after consideration of the Group's ability to:

- (i) farm-out its interests in exploration permits/Blocks in order to fund future exploration expenditure commitments;
- (ii) raise capital through the issue of new ordinary shares in the Company to meet working capital requirements and/or shortfalls in exploration expenditure commitments; and/or
- (iii) manage its existing cash and future cash flows to meet its current obligations and future plans,

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 will have sufficient liquidity to meet their existing commitments and accordingly present the consolidated financial statements on a going concern basis.

Significant Accounting Estimates, Assumptions and Judgements

The preparation of financial statements requires the use of certain significant accounting estimates. It also requires management to exercise its judgement in the process of applying Group accounting policies. The areas involving a high degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 2.

Compliance with International Financial Reporting Standards

The consolidated financial statements comply with International Financial Reporting Standards as issued by the International Accounting Standards Board (the 'IASB').

New and Amended Australian Accounting Standards Adopted by the Group

None of the new Australian Accounting Standards and amendments to Australian Accounting Standards that were mandatory for the first time for the financial year beginning 1 July 2011 affected any amounts recognised in the financial year or previous financial year and are not likely to affect future financial periods. However, the adoption of the revised *AASB 124 'Related Party Disclosures'* resulted in the disclosure of additional related party transactions and required the restatement of some comparative information in Note 28 and Note 29.

Early Adoption of Australian Accounting Standards

The Group has not elected to apply any pronouncements before their operative date in the financial year beginning 1 July 2011.

(b) Principles of Consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Karoon Gas Australia Ltd as at 30 June 2012 and the results of all subsidiaries for the financial year then ended.

A subsidiary is any entity controlled by Karoon Gas Australia Ltd whereby it has the power to control the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Interests in subsidiaries are set out in Note 21.

The acquisition of subsidiaries is accounted for using the acquisition method of accounting. The acquisition method of accounting involves allocating the cost of the business combination to the fair value of the assets acquired, liabilities and contingent liabilities assumed at the date of acquisition. Acquisition related costs are expensed as incurred and the associated cash flows are classified as operating activities in the consolidated statement of cash flows.

All subsidiaries have a financial year end of June, with the exception of: Karoon Petróleo & Gas Ltda; KEI (Peru 112) Pty Ltd, Sucursal del Peru; and KEI (Peru Z38) Pty Ltd, Sucursal del Peru. These subsidiaries and branches have a financial year end of December in accordance with relevant Brazilian and Peruvian tax and accounting regulations respectively.

Accounting policies of subsidiaries have been changed, where necessary, to ensure consistency with the policies applied by the Group.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated on consolidation. Unrealised losses are also eliminated, unless the transaction provides evidence of the impairment of the asset transferred.

Where subsidiaries have entered or left the Group during the financial year, their operating results are included or excluded from the date control was obtained or until the date control ceased respectively.

(c) Segment Information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for assessing performance and in determining the allocation of resources of the operating segments, has been identified as the Executive Chairman and the Executive Director/Exploration Director.

(d) Revenue

Revenue is recognised and measured at the fair value of the consideration received or receivable to the extent it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Sales Revenue

Revenue from the sale of goods is recognised upon the delivery of goods to the buyer and all significant risks and rewards of ownership are transferred. Revenue from the rendering of a service is recognised upon the delivery of the service. All revenue is stated net of the amount of GST.

Dividend Revenue

Dividend revenue is recognised when the right to receive a dividend has been established.

Interest Income

Interest income is recognised using the effective interest rate method, which, for floating rate financial assets, is the rate inherent in the relevant financial asset.

(e) Foreign Currency Transactions and Balances

Functional and Presentation Currency

Items included in the financial statements of each of the Group's subsidiaries are measured using the currency of the primary economic environment in which the subsidiary or branch operates (the 'functional currency'). The consolidated financial statements are presented in Australian dollars, which is the Company's functional and presentation currency.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 1. Summary of Significant Accounting Policies (continued)

(e) Foreign Currency Transactions and Balances (continued)

Transactions and Balances

Foreign currency transactions are translated into the functional currency using the foreign exchange rates prevailing at the dates of the transactions. Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at financial year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of comprehensive income.

Non-monetary items measured at historical cost continue to be carried at the foreign exchange rate at the date of transaction. Foreign 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 foreign exchange differences are recognised in the consolidated statement of comprehensive income.

Group Companies

The results and financial position of foreign subsidiaries that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities are translated at end of reporting period foreign exchange rates prevailing at the end of each reporting period;
- income and expenses are translated at average foreign exchange rates for the financial period; and
- all resulting foreign exchange differences are recognised in other comprehensive income.

On consolidation, foreign exchange differences arising on translation of foreign subsidiary financial statements are transferred directly to the foreign currency translation reserve in the consolidated statement of financial position. The relevant differences are recognised in the consolidated statement of comprehensive income during the financial period when the investment in a foreign subsidiary is disposed.

(f) Income Taxes and Other Taxes

Current Tax

Current income tax expense is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or loss for the financial period. It is calculated using income tax rates that have been enacted or are substantively enacted by the end of each reporting period. Current tax for current and prior financial periods is recognised as a liability (or asset) to the extent that it is unpaid or (refundable).

Deferred Tax

Deferred tax is accounted for using the statement of financial position liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. The tax base of an asset or liability is the amount attributed to that asset or liability for income taxation purposes.

No deferred 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 financial period when the asset is realised or liability is settled. Deferred tax is credited in the consolidated statement of comprehensive income 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 tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary tax differences or unused tax losses and tax offsets can be utilised.

Deferred tax assets and tax liabilities are offset when there is a legally enforceable right to offset current tax assets and tax liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the Group has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

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.

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 Taxation 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 consolidated statement of financial position are shown inclusive of GST.

The net amount of GST recoverable from, or payable to, the ATO is included as current other receivables or sundry payables respectively in the consolidated statement of financial position.

Cash flows are included on a gross basis in the consolidated statement of cash flows. 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.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the ATO.

Petroleum Resource Rent Tax ('PRRT')

PRRT is accounted for as income tax under AASB 112 'Income Taxes'.

(g) Cash and Cash Equivalents

Cash and cash equivalents in the consolidated statement of financial position and for presentation in the consolidated statement of cash flows comprise cash at banks and on hand (including share of joint venture operation cash balances) and short-term bank deposits that are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

(h) Receivables

Receivables, which generally have 30 day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less any accumulated impairment losses. They are presented as current assets unless collection is not expected for more than 12 months after the reporting date.

Cash flows relating to receivables are not discounted if the effect of discounting would be immaterial.

Collectability of receivables is reviewed on an ongoing basis. Individual receivables that are known to be uncollectible are written off when identified.

Receivables are tested for impairment in accordance with the accounting policy described in Note 1(n). An impairment provision is recognised when there is objective evidence that the Group will not be able to collect the receivable. The amount of the impairment loss is the receivable's carrying amount compared to the present value of estimated future cash flows, discounted when material, at the original effective interest rate.

(i) Inventories

Inventories are measured at the lower of cost and net realisable value. Inventories are represented by assets acquired from third parties, in the form of casing and other drilling inventory to be consumed or used in exploration and evaluation activities.

The cost of casing and other drilling inventory includes direct materials, direct labour and transportation costs.

(j) Security Deposits

Certain financial assets have been pledged as security for performance guarantees, performance bonds and bank guarantees related to exploration permits and operating lease rental agreements. Their realisation may be restricted subject to terms and conditions attached to the relevant exploration permit agreements or operating lease rental agreements.

Security deposits are non-derivative financial assets that are not quoted in an active market. Security deposits are initially recognised at cost. Such assets are subsequently carried at amortised cost using the effective interest method. They are included in current assets, except for those with maturities greater than 12 months after the end of the reporting period which are classified as non-current assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 1. Summary of Significant Accounting Policies (continued)

(j) Security Deposits (continued)

Security deposits are derecognised when the terms and conditions attached to the relevant exploration permit agreements or operating lease rental agreements have expired or been transferred.

Security deposits are tested for impairment in accordance with the accounting policy described in Note 1(n).

(k) Plant and Equipment

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing parts that are eligible for capitalisation when the cost of replacing the parts is incurred. Similarly, when each major inspection is performed, its cost is recognised in the carrying amount of the plant and equipment as a replacement only if it is eligible for capitalisation. All other repairs and maintenance are recognised as an expense in the consolidated statement of comprehensive income as incurred.

Commencing from the time the plant and equipment is held ready for use, depreciation expense is calculated on a straight-line basis to allocate their cost amount, net of their residual values, over their estimated useful lives ranging from two to ten years.

Plant and equipment residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at the end of each reporting period.

Gains and losses on disposals are determined by comparing proceeds with the net carrying amount. These gains and losses are included in the consolidated statement of comprehensive income.

Plant and equipment are tested for impairment in accordance with the accounting policy described in Note 1(n).

(l) Intangibles

Computer Software

Computer software is stated at cost less accumulated amortisation and any accumulated impairment losses. Computer software costs have a finite life.

Commencing from the time the computer software is held ready for use, amortisation expense is calculated on a straight-line basis to allocate their cost amount, net of their residual values, over their estimated useful lives ranging from two to two and half years.

The assets' residual values, useful lives and amortisation methods are reviewed, and adjusted if appropriate, at the end of each reporting period.

Computer software is tested for impairment in accordance with the accounting policy described in Note 1(n).

Goodwill

Goodwill recognised in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is not amortised.

Impairment of Goodwill

For the purpose of impairment testing at the end of each reporting period, goodwill recognised in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates.

An impairment loss is recognised as an expense in the consolidated statement of comprehensive income for the amount by which the asset's carrying amount exceeds its estimated recoverable amount.

Any impairment loss recognised for goodwill is not subsequently reversed.

(m) Exploration and Evaluation Expenditure

Expenditure on exploration and evaluation activities is accounted for in accordance with the 'area of interest' method of *AASB 6 'Exploration for and Evaluation of Mineral Resources'*. Exploration and evaluation expenditure is capitalised at cost, as an intangible, provided the right to tenure of the area of interest is current and either:

- the exploration and evaluation activities are expected to be recouped through successful development and exploitation of the area of interest or, alternatively, by its sale; or
- exploration and evaluation activities in the area of interest have not at the end of the reporting period reached a stage that permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the area of interest are continuing.

Otherwise, exploration and evaluation expenditure is expensed as incurred.

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

As capitalised exploration and evaluation expenditure is not available for use, it is not amortised.

Cash flows associated with exploration and evaluation expenditure (comprising amounts capitalised) are classified as investing activities in the consolidated statement of cash flows. Whereas, cash flows associated with exploration and evaluation expenditure expensed are classified as operating activities in the consolidated statement of cash flows.

When the technical feasibility and commercial viability of extracting economically recoverable reserves have been demonstrated, any related capitalised exploration and evaluation expenditure is reclassified as development expenditure in the consolidated statement of financial position. Prior to reclassification, capitalised exploration and evaluation expenditure is assessed for impairment.

Farm-out

The Group does not record any exploration and evaluation expenditure made by a farmee. It also does not recognise any gain or loss on its exploration and evaluation farm-out arrangements but redesignates any exploration and evaluation expenditure previously capitalised in relation to the whole area of interest as relating to the partial interest retained.

Any cash consideration received on sale or farm-out of an area within an exploration area of interest is offset against the carrying value of the particular area involved. Where the total carrying value of an area of interest has been recouped in this manner, the balance of the proceeds is brought to account in the consolidated statement of comprehensive income as a gain on disposal.

Impairment of Capitalised Exploration and Evaluation Expenditure

The carrying value of capitalised exploration and evaluation expenditure is assessed for impairment at the asset or cash-generating unit level (which usually is represented by an exploration permit) whenever facts and circumstances (as defined in AASB 6) suggest that the carrying amount of the asset may exceed its recoverable amount. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

An impairment loss exists when the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. The asset or cash-generating unit is then written-down to its recoverable amount. Impairment losses are recognised as an expense in the consolidated statement of comprehensive income.

Capitalised exploration and evaluation expenditure that suffered impairment are tested for possible reversal of the impairment loss whenever facts or changes in circumstances indicate that the impairment may have reversed.

(n) Impairment of Assets (Other than Goodwill and Capitalised Exploration and Evaluation Expenditure)

All other current and non-current assets (other than inventories and deferred tax assets) are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

At the end of each reporting period, the Group conducts an internal review of asset values, which is used as a source of information to assess for any indicators of impairment. External factors, such as changes in economic conditions, are also monitored to assess for indicators of impairment. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 1. Summary of Significant Accounting Policies (continued)

(n) Impairment of Assets (Other than Goodwill and Capitalised Exploration and Evaluation Expenditure) (continued)

An impairment loss exists when the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount. The asset is then written-down to its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets (cash-generating units).

Impairment losses are recognised as an expense in the consolidated statement of comprehensive income.

Assets that suffered impairment are tested for possible reversal of the impairment loss whenever events or changes in circumstances indicate that the impairment may have reversed.

(o) Trade and Other Payables

Trade and other payables are initially recognised at their fair value and subsequently measured at amortised cost using the effective interest method. These amounts represent liabilities for goods and services provided to the Group prior to the end of the reporting period that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of goods and services. The amounts are unsecured and are usually paid within 30 days of recognition. They are presented as current liabilities unless payment is not due within 12 months from the reporting date.

(p) Employee Benefits

Wages, Salaries, Annual Leave and Personal Leave

Liabilities for wages and salaries, including non-monetary benefits, annual leave and accumulating personal leave expected to be settled within one year after the end of the reporting period in which the employees render the related services are recognised in respect of employees' services up to the end of the reporting period. They are measured at the amounts expected to be paid when the liabilities are settled plus related on-costs. Expenses for non-accumulating personal leave are recognised when the leave is taken and are measured at the rates paid or payable.

The obligations are presented as current liabilities in the consolidated statement of financial position if the Group does not have an unconditional right to defer settlement for at least 12 months after the reporting date, regardless of when the actual settlement is expected to occur.

Share-based Payments

Share-based remuneration benefits are provided to employees via the Company's ESOP and Directors via other share options (refer Note 27).

The fair value of options granted is recognised as a share-based payments expense in the consolidated statement of comprehensive income with a corresponding increase in the share-based payments reserve in equity. The total amount to be expensed is determined by reference to the fair value of the options granted, which includes any market performance conditions but excludes the impact of any service and non-market performance vesting conditions. Non-market performance vesting conditions are included in assumptions about the number of options that are expected to vest.

The fair value is measured at grant date. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the end of each reporting period, the Group revises its estimates of the number of options that are expected to vest based on the non-market performance vesting conditions. It recognises the impact of the revision to original estimates, if any, in the consolidated statement of comprehensive income, with a corresponding adjustment to equity. For options that vest immediately, the value is expensed immediately.

The fair value at grant date is independently determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, 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 Group has elected to retain any amounts originally recognised in the share-based payments reserve, regardless of whether the associated options are exercised or lapse unexercised.

(q) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are not recognised for future operating losses.

When it is expected that some or all of a provision is to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is included in the consolidated statement of comprehensive income, net of any reimbursement.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period using a discounted cash flow methodology. If the effect of the time value of money is material, provisions are discounted using a pre-tax rate that reflects the time value of money and the risks specific to the obligation. The increase in the provision resulting from the passage of time is recognised as finance costs in the consolidated statement of comprehensive income.

Long Service Leave

A provision has been recognised for employee entitlements relating to long service leave measured at the present value of estimated future cash outflows. In determining the provision, consideration is given to employee wage increases and the probability that the employee may satisfy vesting requirements. The cash outflows are discounted using market yields on Australian government bonds with terms of maturity that match the expected timing of cash outflows.

Restoration

Restoration costs incurred during exploration and evaluation activities are provided when the obligation to incur such costs arises, a corresponding restoration asset (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 present value, and is reassessed at the end of each reporting period in accordance with local conditions and requirements. Expected future payments are discounted using market yields at the end of each reporting period on Australian government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows. Changes in the estimates of restoration costs 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 within finance costs in the consolidated statement of comprehensive income.

(r) Contributed Equity

Ordinary shares are classified as equity.

Transaction costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of any related income tax benefit, from the proceeds. Transaction costs are the costs that are incurred directly in connection with the issue of new ordinary shares and which would not have been incurred had those ordinary shares not been issued. These directly attributable transaction costs include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and marketing costs.

The costs of an equity raising that is abandoned are recognised as an expense in the consolidated statement of comprehensive income.

Cash received from shareholders and investors at the end of the reporting period, pending allotment and issue of fully paid ordinary shares, is held as funds in escrow in the consolidated statement of financial position.

(s) Interests in Joint Venture Operations

The proportionate interests in the assets, liabilities, revenue and expenses of a joint venture operation are incorporated in the consolidated financial statements under the appropriate headings.

The Group's share of assets and liabilities employed in joint venture operations is set out in Note 23.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 1. Summary of Significant Accounting Policies (continued)

(t) Leases

Group as a Lessee

Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Group as lessee are classified as operating leases. Operating lease payments (net of any incentives received from the lessor) are recognised as an expense in the consolidated statement of comprehensive income on a straight-line basis over the financial period of the lease.

(u) Earnings Per Share

Basic Earnings Per Share

Basic earnings per ordinary share is calculated by dividing the profit or loss attributable to owners of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for any bonus elements in ordinary shares issued during the financial year.

Diluted Earnings Per Share

Diluted earnings per ordinary share adjusts the figures used in the determination of basic earnings per ordinary share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

(v) Parent Company Financial Information

The financial information for the Parent Company, Karoon Gas Australia Ltd, disclosed in Note 30 has been prepared on the same basis as the consolidated financial statements, except as set out below:

Investments in Subsidiaries

Investments in subsidiaries are accounted for at cost in the financial statements of Karoon Gas Australia Ltd.

The Parent Company does not designate any investments in subsidiaries as being subject to the requirements of Australian Accounting Standards specifically applicable to financial instruments. They are held for strategic and not trading purposes.

Investments in subsidiaries and receivables from subsidiaries are tested for impairment in accordance with the accounting policy described in Note 1(n).

Share-based Payments

The grant by the Company of options over its ordinary shares to the employees of subsidiary companies in the Group is treated as a capital contribution to that subsidiary company. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investments in subsidiaries, with a corresponding credit to equity.

Tax Consolidation

The Parent Company and its wholly owned Australian subsidiaries are part of an income tax-consolidated group under Australian taxation law. Karoon Gas Australia Ltd is the head entity in the income tax-consolidated group. Tax expense/income, deferred liabilities and deferred assets arising from temporary tax differences of the members of the income tax-consolidated group are recognised in the separate financial statements of the members of the income tax-consolidated group using the 'stand alone taxpayer' approach by reference to the carrying amounts in the separate financial statements of each company and the tax values applying under tax consolidation. Current tax liabilities and tax assets and deferred tax assets arising from unused tax losses and tax credits of members of the income tax-consolidated group are recognised by the Parent Company (as head entity of the income tax-consolidated group).

Due to the existence of a tax funding agreement between the companies in the income tax-consolidated group, each company contributes to the income tax payable or receivable in proportion to their contribution to the income tax-consolidated group's taxable income. Differences between the amounts of net tax assets and tax liabilities derecognised and the net amounts recognised pursuant to the funding agreement are recognised as either a contribution by, or distribution to, the head entity.

(w) New Australian Accounting Standards and Interpretations for Application in Future Financial Years

Certain new Australian Accounting Standards and Interpretations have been published that are not mandatory for this financial year. The Group's assessment of the impact of the relevant new Australian Accounting Standards and Interpretations is set out below:

(i) *AASB 9 'Financial Instruments', AASB 2009-11 'Amendments to Australian Accounting Standards arising from AASB 9' and AASB 2010-7 'Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)'* (effective for annual reporting periods beginning on or after 1 January 2013)

AASB 9 'Financial Instruments' addresses the classification, measurement and de-recognition of financial assets and financial liabilities. The standard is not applicable until 1 January 2013 but is available for early adoption. The Group is yet to assess AASB 9's full impact. The Group does not intend to adopt the new standard before its operative date, which means that it would be first applied in the financial year ending 30 June 2014.

(ii) *AASB 1053 'Application of Tiers of Australian Accounting Standards' and AASB 2010-2 'Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements'* (effective 1 July 2013)

On 30 June 2010, the AASB officially introduced a revised differential reporting framework in Australia. Under this framework, a two-tier differential reporting regime applies to all entities that prepare general purpose financial statements. Karoon Gas Australia Ltd is listed on the ASX, as such it is ineligible to adopt these two new Australian Accounting Standards. As a consequence, there will be no impact on the consolidated financial statements.

(iii) *AASB 10 'Consolidated Financial Statements', AASB 11 'Joint Arrangements', AASB 12 'Disclosure of Interests in Other Entities', revised AASB 127 'Separate Financial Statements', AASB 128 'Investments in Associates and Joint Ventures' and AASB 2011-7 'Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards'* (effective 1 January 2013)

During August 2011, the AASB issued a suite of five new and amended standards which address the accounting for joint arrangements, consolidated financial statements and associated disclosures.

AASB 10 replaces all of the guidance on control and consolidation in AASB 127 'Consolidated and Separate Financial Statements', and Interpretation 12 'Consolidation – Special Purpose Entities'. The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single economic entity remains unchanged, as do the mechanics of consolidation. However, the standard introduces a single definition of control that applies to all entities. It focuses on the need to have both power and rights or exposure to variable returns before control is present. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both. There is also new guidance on participating and protective rights and on agent/principal relationships. The Group does not expect the new standard to have any impact on its composition.

AASB 11 introduces a principles based approach to accounting for joint arrangements. The focus is no longer on the legal structure of joint arrangements but rather on how rights and obligations are shared by the parties to the joint arrangement. Based on the assessment of rights and obligations, a joint arrangement will be classified as either a joint operation or joint venture. Joint ventures are accounted for using the equity method, the choice to proportionately consolidate will no longer be permitted. Parties to a joint operation will account for their share of revenues, expenses, assets and liabilities in much the same way as under the previous standard. AASB 11 also provides guidance for parties that participate in joint arrangements but do not share joint control. The Group has considered the impact of AASB 11, as it is a participant in joint venture operations. Currently, the Group does not expect this standard to have any impact on its consolidated financial statements.

AASB 12 sets out the required disclosures for entities reporting under the above two new standards, AASB 10 and AASB 11, and replaces the disclosure requirements currently found in AASB 127 and AASB 128. Application of this standard by the Group will not affect any of the amounts recognised in the consolidated financial statements.

AASB 127 is renamed 'Separate Financial Statements' and is now a standard dealing solely with separate financial statements. Application of this standard by the Group will not affect any of the amounts recognised in the consolidated financial statements.

Amendments to AASB 128 provide clarification that an entity continues to apply the equity method and does not remeasure its retained interest as part of ownership changes where a joint venture becomes an associate, and vice versa. The amendments also introduce a partial disposal concept. Application of this standard by the Group will not affect any of the amounts recognised in the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 1. Summary of Significant Accounting Policies (continued)

(w) New Australian Accounting Standards and Interpretations for Application in Future Financial Years (continued)

The Group does not intend to adopt the relevant new standards before their operative date, which means that they would first be applied in the financial year ending 30 June 2014.

(iv) AASB 13 'Fair Value Measurement' and AASB 2011-8 'Amendments to Australian Accounting Standards arising from AASB 13' (effective 1 January 2013)

AASB 13 was released during September 2011. AASB 13 explains how to measure fair value and aims to enhance fair value disclosures. The Group does not use fair value measurements extensively. It is therefore unlikely that the new rules will have a significant impact on any of the amounts recognised in the consolidated financial statements or disclosed in the notes to the consolidated financial statements. The Group does not intend to adopt the new standard before its operative date, which means that it would be first applied in the financial year ending 30 June 2014.

(v) AASB 2011-9 'Amendments to Australian Accounting Standards-Presentation of Items of Other Comprehensive Income' (effective 1 July 2012)

During September 2011, the AASB made an amendment to AASB 101 'Presentation of Financial Statements'. The amendment requires entities to separate items presented in other comprehensive income into two groups, based on whether they may be recycled to profit or loss in the future. It will not affect the measurement of any of the items recognised in the statement of comprehensive income. The Group will adopt the new standard from 1 July 2012.

(vi) AASB 2011-4 'Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements' (effective 1 July 2013)

During July 2011, the AASB decided to remove the individual key management personnel disclosure requirements from AASB 124 'Related Party Disclosures', to achieve consistency with the international equivalent standard and remove a duplication of the requirements with the *Corporations Act 2001*. While this will reduce the disclosures that are currently required in the notes to the consolidated financial statements, it will not affect any of the amounts recognised in the consolidated financial statements. The amendments apply from 1 July 2013 and cannot be adopted early.

(vii) AASB 2012-5 'Amendments to Australian Accounting Standards arising from Annual Improvements 2009-2011 Cycle' (effective for annual reporting periods beginning on or after 1 January 2013)

During June 2012, the AASB approved a number of amendments to Australian Accounting Standards as a result of the 2009-2011 annual improvements project. The Group does not expect that any adjustments will be necessary as the result of applying the revised rules. The Group does not intend to adopt the new standard before its operative date, which means that it would be first applied in the financial year ending 30 June 2014.

There are no other Australian Accounting Standards that are not yet effective and that are expected to have a material impact on the Group in the current or future financial years and on foreseeable future transactions.

Note 2. Significant Accounting Estimates, Assumptions and Judgements

Revenues and expenses and the carrying amounts of certain assets and liabilities are often determined based on estimates and assumptions of future events. In applying the Group's significant accounting policies, the Board of Directors and management evaluate estimates and judgements based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data obtained both externally and within the Group.

Significant estimates, assumptions and/or judgements made by the Board of Directors and management in the preparation of the consolidated financial statements were:

(a) Capitalised Exploration and Evaluation Expenditure

The future recoverability of capitalised exploration and evaluation expenditure is dependent on a number of factors, including whether the Group decides to exploit the related exploration permit itself or, if not, whether it successfully recovers the related exploration and evaluation asset through sale. Factors that could affect the future recoverability include the level of economically recoverable reserves, future technological changes which could impact the cost of development, future legal changes (including changes to environmental and restoration obligations) and changes to commodity prices. To the extent that capitalised exploration and evaluation expenditure is determined not to be recoverable in the future, financial results and net assets will be reduced during the financial period in which this determination is made.

In addition, exploration and evaluation expenditure is carried forward on the basis that exploration and evaluation activities in the areas of interest have not at the end of the reporting period reached a stage that permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the areas of interest are continuing. To the extent it is determined in the future this capitalised expenditure should be written off, financial results and net assets will be reduced during the financial period in which this determination is made.

Information on the reasonable existence or otherwise of economically recoverable reserves is progressively gained through geological analysis and interpretation, drilling activity and prospect evaluation during a normal exploration permit term. A reasonable assessment of the existence or otherwise of economically recoverable reserves can generally only be made, therefore, at the conclusion of those exploration and evaluation activities.

(b) Share-based Payments

The Group measures the cost of share-based payment transactions with Directors and employees by reference to the fair value of the options at the date they were granted. Fair value is ascertained using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. The accounting estimates and assumptions relating to share-based payments would have no impact on the carrying amounts of assets and liabilities within the next reporting period but may impact expense and equity.

(c) Income Tax

The Group is subject to income taxes in Australia and jurisdictions where it has foreign operations. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The Group estimates its tax liabilities based on the Group's understanding of the tax law. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax balances in the financial period in which such determination is made.

The Group has not recognised deferred tax assets in respect of tax losses and temporary tax differences as the future utilisation of these losses and temporary tax differences is not considered probable at this point in time. Assessing the future utilisation of tax losses and temporary tax differences requires the Group to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws. To the extent that future utilisation of these tax losses and temporary tax differences becomes probable, this could result in significant changes to deferred tax assets recognised, which would in turn impact future financial results.

Note 3. Financial Risk Management

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and interest rate risk); credit risk; and liquidity risk. The Group's overall financial risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Group. The Group uses different methods to measure the different types of financial risk to which it is exposed. These methods include sensitivity analysis in the case of foreign exchange and interest rates.

The overall financial risk management strategy of the Group is governed by the Board of Directors and is primarily focused on ensuring that the Group is able to finance its business plans, while minimising potential adverse effects on financial performance. The Board of Directors provides written principles for overall financial risk management, as well as written policies covering specific areas, such as mitigating foreign exchange, interest rate and credit risks, use of derivative financial instruments and investment of excess cash. Financial risk management is carried out by the Company's finance function under policies approved by the Board of Directors. The finance function identifies, evaluates and if necessary hedges financial risks in close co-operation with the Executive Chairman. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and Group activities.

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.

The Group's financial instruments consist of cash and cash equivalents, receivables, security deposits, trade and other payables.

The Group had no off-statement of financial position financial assets or financial liabilities at either 30 June 2012 or 30 June 2011.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 3. Financial Risk Management (continued)

The totals for each category of financial instruments in the consolidated statement of financial position are as follows:

	Note	Consolidated 2012 \$	2011 \$
Financial assets			
Cash and cash equivalents	10	227,802,316	266,839,144
Receivables	11	3,362,813	4,003,566
Security deposits	13	42,560,578	67,360,580
Total financial assets		273,725,707	338,203,290
Financial liabilities			
Trade and other payables (refer note (a) below)		10,654,343	3,809,100
Total financial liabilities		10,654,343	3,809,100

Note:

(a) Trade and other payables above exclude amounts relating to leave liabilities, which are not considered a financial instrument. The reconciliation to the amount in the consolidated statement of financial position is as follows:

Trade and other payables	18	11,275,782	4,306,586
Less: Leave liabilities		(621,439)	(497,486)
		10,654,343	3,809,100

(a) Market Risk

(i) Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Foreign exchange risk arises when future commercial transactions and recognised financial assets and financial liabilities are denominated in a currency that is not the Company's functional currency.

The Group operates internationally and is exposed to foreign exchange risk arising from currency exposures to predominantly United States dollar expenditures and cash and deposits held in United States dollars. The Group manages foreign exchange risk at the corporate level by monitoring forecast cash flows in currencies other than Australian dollars and ensuring that adequate United States dollar cash balances are maintained.

United States dollars are bought on the spot market in excess of immediate requirements. Where currencies are purchased in advance of requirements, these balances do not usually exceed three months requirements.

Regular sensitivity analysis is conducted to evaluate the potential impact of unfavourable exchange rates on the Group's future financial position. The results of this evaluation are used to determine the most appropriate risk mitigation tool to be used. The Group will hedge when it is deemed the most appropriate risk mitigation tool to be used.

Foreign currency hedging transactions were not entered into during the financial year or previous financial year.

An analysis of the Group's exposure to foreign exchange risk for financial instruments, expressed in Australian dollars, at the end of the financial year is set out below:

Consolidated	2012				2011			
	AUD \$	USD \$	REAL \$	Total \$	AUD \$	USD \$	REAL \$	Total \$
Financial assets								
Cash and cash equivalents	132,453,044	94,257,036	1,092,236	227,802,316	192,445,470	73,556,394	837,280	266,839,144
Receivables	1,631,469	1,017,127	714,217	3,362,813	1,722,844	2,280,722	-	4,003,566
Security deposits	344,385	7,018,383	35,197,810	42,560,578	359,509	10,027,347	56,973,724	67,360,580
Total financial assets	134,428,898	102,292,546	37,004,263	273,725,707	194,527,823	85,864,463	57,811,004	338,203,290
Financial liabilities								
Trade and other payables	997,393	6,220,348	3,436,602	10,654,343	1,393,545	1,420,761	994,794	3,809,100
Total financial liabilities	997,393	6,220,348	3,436,602	10,654,343	1,393,545	1,420,761	994,794	3,809,100

Foreign Exchange Sensitivity Analysis

The following table details the Group's sensitivity to a 10.0% increase or decrease in the Australian dollar against the United States dollar, with all other variables held constant. The sensitivity analysis includes only outstanding foreign currency denominated amounts at the end of the financial year and adjusts their translation for a 10.0% change in the relevant foreign exchange rate.

The sensitivity analysis is not fully representative of the inherent foreign exchange risk, as the financial year end exposure does not necessarily reflect the exposure during the course of a financial year. These sensitivities should not be used to forecast the future effect of movements in United States dollar exchange rates on future cash flows.

	Consolidated	
	2012 \$	2011 \$
Change in profit (loss)		
– Improvement in AUD to USD by 10.0%	(8,690,056)	(7,479,610)
– Decline in AUD to USD by 10.0%	10,621,179	9,141,745
Change in financial assets		
– Improvement in AUD to USD by 10.0%	(9,299,322)	(7,807,288)
– Decline in AUD to USD by 10.0%	11,365,838	9,542,240
Change in financial liabilities		
– Improvement in AUD to USD by 10.0%	565,486	129,160
– Decline in AUD to USD by 10.0%	(691,150)	(157,862)
Change in foreign currency translation reserve		
– Improvement in AUD to USD by 10.0%	43,780	198,518
– Decline in AUD to USD by 10.0%	(53,509)	(242,633)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 3. Financial Risk Management (continued)

(a) Market Risk (continued)

(ii) Interest Rate Risk

Interest rate risk is the risk that the fair value of future cash flows of financial assets and financial liabilities will fluctuate because of changes in market interest rates. Interest rate risk is managed on a Group basis at the corporate level.

As at 30 June 2012 and 30 June 2011, there was no borrowing outstanding and there was no interest rate hedging in place.

The Group's interest rate risk arises from relevant financial assets, primarily cash and cash equivalents deposited at variable rates of interest and security deposits held in Brazil. Surplus cash is invested in short-term bank deposits due to uncertainty of the timing of major cash outflows. Whilst some of the invested cash is in United States dollars, the primary exposure is to Australian interest rates.

An analysis of the Group's exposure to interest rate risk for financial assets and financial liabilities at the end of the financial year is set out below:

	Weighted Average Interest Rate % P.A.	Floating Interest Rate \$	Consolidated Fixed Interest Rate \$	Non-interest Bearing \$	Fair Value \$	Carrying Amount \$
2012						
Financial assets						
Cash and cash equivalents	3.4	92,145,235	129,525,115	6,131,966	227,802,316	227,802,316
Receivables	-	-	-	3,362,813	3,362,813	3,362,813
Security deposits	8.9	35,193,756	7,336,088	30,734	42,560,578	42,560,578
Total financial assets		127,338,991	136,861,203	9,525,513	273,725,707	273,725,707
Financial liabilities						
Trade and other payables	-	-	-	10,654,343	10,654,343	10,654,343
Total financial liabilities		-	-	10,654,343	10,654,343	10,654,343

	Weighted Average Interest Rate % P.A.	Floating Interest Rate \$	Consolidated Fixed Interest Rate \$	Non-interest Bearing \$	Fair Value \$	Carrying Amount \$
2011						
Financial assets						
Cash and cash equivalents	4.3	80,585,111	184,939,247	1,314,786	266,839,144	266,839,144
Receivables	-	-	-	4,003,566	4,003,566	4,003,566
Security deposits	9.4	44,959,458	22,384,825	16,297	67,360,580	67,360,580
Total financial assets		125,544,569	207,324,072	5,334,649	338,203,290	338,203,290
Financial liabilities						
Trade and other payables	-	-	-	3,809,100	3,809,100	3,809,100
Total financial liabilities		-	-	3,809,100	3,809,100	3,809,100

Interest Rate Sensitivity Analysis

The following table details the Group's sensitivity to a 1.0% p.a. increase or decrease in interest rates, with all other variables held constant. The sensitivity analysis is based on the balance of floating interest rate amounts held at the end of the financial year.

The sensitivity analysis is not fully representative of the inherent interest rate risk, as the financial year end exposure does not necessarily reflect the exposure during the course of a financial year. These sensitivities should not be used to forecast the future effect of movements in interest rates on future cash flows.

	Consolidated	
	2012	2011
	\$	\$
Change in profit (loss)		
– Increase of interest rate by 1.0% p.a.	1,273,390	1,255,446
– Decrease of interest rate by 1.0% p.a.	(295,976)	(536,744)
Change in financial assets		
– Increase of interest rate by 1.0% p.a.	1,273,390	1,255,446
– Decrease of interest rate by 1.0% p.a.	(295,976)	(536,744)

(b) Credit Risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. Credit risk arises from cash and cash equivalents and security deposits held with banks, financial institutions and joint venture operators, as well as credit exposures to customers, including outstanding receivables.

Credit risk is managed on a Group basis at the corporate level. Management monitors credit risk on an ongoing basis within the Group.

To minimise credit risk, the Group has adopted a policy of only dealing with recognised and creditworthy third parties. Receivable balances are monitored on an ongoing basis with the result being the Group's exposure to bad debts is minimised. The Group does not hold collateral, nor does it securitise its receivables.

The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history.

Cash and cash equivalents and security deposit counterparties are limited to high credit quality banks and financial institutions. For banks and financial institutions, only independently rated counterparties with a minimum rating of A are accepted. Where commercially practical, the Group seeks to limit the amount of credit exposure to any one bank or financial institution.

The maximum exposure to credit risk at the end of the financial year is the carrying amount of the financial assets as disclosed in the consolidated statement of financial position and notes to the consolidated financial statements. There are no significant concentrations of credit risk, whether through exposure to individual counterparties, specific industry sectors and/or geographical regions.

As at 30 June 2012, there were \$Nil (30 June 2011: \$Nil) financial assets past due.

(c) Liquidity Risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities.

At the end of the financial year, the Group held cash and cash equivalents at call of \$98,277,201 (30 June 2011: \$81,899,897) that are expected to readily generate cash inflows for managing liquidity risk.

The Group manages liquidity risk by ensuring that there are sufficient funds available to meet financial obligations on a day-to-day basis and to meet unexpected liquidity needs in the normal course of business. Emphasis is placed on ensuring there is sufficient funding in place to meet the ongoing requirements of the Group's exploration and evaluation activities.

The following mechanisms are utilised:

- preparing and maintaining rolling forecast cash flows in relation to operational, investing and financing activities;
- maintaining a reputable credit profile;
- managing credit risk related to financial assets;
- investing surplus cash only in high credit quality banks and financial institutions; and
- comparing the maturity profile of financial liabilities with the realisation profile of financial assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 3. Financial Risk Management (continued)

(c) Liquidity Risk (continued)

An analysis of the Group's financial liability maturities at the end of the financial year is set out below:

		Consolidated				
	Less than 6 Months \$	6-12 Months \$	Between 1 and 2 Years \$	Between 2 and 5 Years \$	Over 5 Years \$	Total \$
2012						
Financial liabilities						
Trade and other payables	10,654,343	-	-	-	-	10,654,343
Total financial liabilities	10,654,343	-	-	-	-	10,654,343
2011	\$	\$	\$	\$	\$	\$
Financial liabilities						
Trade and other payables	3,809,100	-	-	-	-	3,809,100
Total financial liabilities	3,809,100	-	-	-	-	3,809,100

(d) Fair Value Estimation

For disclosure purposes only, the fair values of financial assets and financial liabilities as at 30 June 2012 are presented in the table under Note 3(a)(ii) and can be compared to their carrying values as presented in the consolidated statement of financial position. Fair values are those amounts at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values estimated for disclosure purposes are based on information that is subject to judgement, where changes in assumptions may have a material impact on the amounts estimated.

The following summarises the significant methods and assumptions used in estimating fair values of financial assets and financial liabilities for disclosure purposes:

Cash And Cash Equivalents

The carrying amount is fair value due to the liquid nature of these assets.

Receivables

The carrying amounts of receivables are assumed to approximate their fair values due to their short-term nature.

Security Deposits

The carrying amounts of security deposits are assumed to represent their fair values based on their likely realisability profile.

Trade and Other Payables

Due to the short-term nature of these financial liabilities, their carrying amounts are assumed to represent their fair values.

		Consolidated	
	Note	2012 \$	2011 \$

Note 4. Revenue

Interest income from unrelated entities		13,601,653	14,225,048
Total revenue		13,601,653	14,225,048

Net foreign currency gains		4,388,118	-
Net gain on disposal of plant and equipment		7,955	-
Total other income		4,396,073	-

Note 5. Expenses

Loss before income tax includes the following specific expenses:

Depreciation and amortisation expense:

- depreciation of plant and equipment	15	559,759	335,347
- amortisation of computer software	16	388,917	195,898
Total depreciation and amortisation expense		948,676	531,245

Exploration and evaluation expenditure expensed or written off:

- exploration and evaluation expenditure expensed		1,219,720	780,662
- exploration and evaluation expenditure written off	17	-	3,881,892
Total exploration and evaluation expenditure expensed or written off		1,219,720	4,662,554

Finance costs:

- bank charges		256,321	447,592
- interest expense to unrelated entities		-	8,698
Total finance costs		256,321	456,290

Share-based payments expense	27(d)	5,969,470	5,069,475
Rental expense on operating leases – minimum lease payments		802,170	668,041
Net loss on disposal of subsidiaries		427	-
Net loss on disposal of plant and equipment		-	82,945

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

	Consolidated	
	2012	2011
	\$	\$

Note 6. Income Tax

(a) Income Tax Recognised in the Consolidated Statement of Comprehensive Income

Tax expense comprises:

Current income tax	-	-
Deferred income tax	-	-
Total income tax expense	-	-

The prima facie tax on loss before income tax is reconciled to income tax expense as follows:

Prima facie tax payable on loss before income tax, calculated at the Australian tax rate of 30% (2011: 30%)	(986,215)	(6,991,474)
Add (subtract) tax effect of:		
Share-based payments expense	1,790,841	1,520,843
Other non-deductible items	1,550,780	2,422,961
Tax losses and temporary tax differences not recognised	(2,355,406)	3,047,670
Total income tax expense	-	-

(b) Unrecognised Deferred Tax Assets

A deferred tax asset has not been recognised in the consolidated statement of financial position as the benefits of which will only be realised if the conditions for deductibility set out in Note 1(f) occur:

– Unrecognised temporary tax differences relating to deferred tax assets	1,155,116	5,500,782
– Tax losses:		
– Australian operating losses at a rate of 30%	10,206,442	8,150,065
– Brazilian operating losses at a rate of 34%	367,777	334,002
Potential tax benefit	11,729,335	13,984,849

(c) Current Tax Asset

Income tax refund receivable	503,416	-
Total current tax asset	503,416	-

(d) Deferred Tax Liabilities

Temporary tax differences relating to deferred tax liabilities	(75,605,449)	(67,609,198)
Offset by deferred tax assets relating to operating losses	75,605,449	67,609,198
Total deferred tax liabilities	-	-

PRRT

PRRT applies to all the Group's Australian petroleum projects in offshore areas under the Petroleum Resource Rent Tax Assessment Act 1987, other than some specific production licences. PRRT is assessed on a project basis or production licence area and will be levied on the taxable profits of a relevant petroleum project at a rate of 40%. Certain specified undeducted expenditures are eligible for compounding. The expenditures can be compounded annually at set rates and the compounded amount can be deducted against assessable receipts in future financial years.

The Group estimates that it has incurred compounded carried forward undeducted PRRT expenditure in excess of accounting carrying values as at 30 June 2012 of \$89,948,514 (2011: \$73,042,033). The resulting deferred tax asset calculated at an effective tax rate of 28%, that has not been recognised in the consolidated financial statements, was \$25,185,584 (2011: \$20,451,769).

In order for the Group to utilise undeducted expenditures for PRRT purposes from previous financial years, it will be required to substantiate eligible expenditure in relation to respective Australian offshore permits since the date of their granting to the Group. Any amount that the Group is not able to substantiate will not be able to be utilised against assessable receipts in future financial years. Interests in undeducted PRRT expenditure can be transferred between projects within the Group or to other third parties on acquisitions of interests in the Group's Australian offshore permits.

	Consolidated	
	2012	2011
	\$	\$

Note 7. Remuneration of External Auditors

Remuneration received or due and receivable by the external auditor of Karoon Gas Australia Ltd for:

(a) PricewaterhouseCoopers Australia

(i) Audit and Other Assurance Services

Audit and review of financial statements	121,500	195,320
Non-audit services (2011: due diligence services for Brazilian initial public offering)	-	135,600
Total remuneration for audit and other assurance services	121,500	330,920

(ii) Other Services

International tax advice	3,000	-
Benchmarking services	-	10,000
Total remuneration of PricewaterhouseCoopers Australia	124,500	340,920

(b) Related Practices of PricewaterhouseCoopers Australia

(i) Audit and Other Assurance Services

Audit and review of financial statements	51,053	37,186
Non-audit services (2011: due diligence services for Brazilian initial public offering)	-	449,657
Total remuneration for audit and other assurance services of related practices	51,053	486,843
Total remuneration external auditors	175,553	827,763

Note 8. Dividends

There were no ordinary dividends declared or paid during the financial year by the Group (2011: \$Nil).

Dividend franking account

Balance of franking account at end of financial year	-	-
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

	Consolidated	
	2012	2011
	\$	\$
Note 9. Earnings Per Share		
Loss for financial year used to calculate basic and diluted loss per ordinary share:	(3,287,382)	(23,304,914)
(a) Basic loss per ordinary share	(0.0148)	(0.1119)
(b) Diluted loss per ordinary share*	(0.0148)	(0.1119)
* Diluted loss per ordinary share equates to basic loss per ordinary share because a loss per ordinary share is not considered dilutive for the purposes of calculating earnings per share pursuant to AASB 133 'Earnings per Share'.		
Weighted average number of ordinary shares on issue during the financial year used in calculating basic loss per ordinary share:	221,420,769	208,328,055
Weighted average number of potential ordinary shares:	-	1,188,898
Weighted average number of ordinary shares and potential ordinary shares used in calculating diluted loss per ordinary share (excluding anti-dilutive options outstanding):	221,420,769	209,516,898
Weighted average number of anti-dilutive options:	9,731,486	2,829,263

Potential ordinary shares

Options over unissued ordinary shares of the Company outstanding at the end of the financial year are considered to be potential ordinary shares and have been included in the determination of diluted loss per ordinary share to the extent to which they are dilutive. The options have not been included in the determination of basic loss per ordinary share.

Note 10. Cash and Cash Equivalents

Cash at banks and on hand	98,277,201	81,899,897
Short-term bank deposits	129,525,115	184,939,247
Total cash and cash equivalents	227,802,316	266,839,144

(a) Cash at Banks and On Hand

Cash at banks and on hand includes share of joint venture operation cash balances. Refer to Note 23 for further details.

(b) Short-Term Bank Deposits

Short-term bank deposits are made for varying periods of between one day and 91 days, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term bank deposit rates.

(c) Financial Risk Management

Information concerning the Group's exposure to financial risks on cash and cash equivalents is set out in Note 3.

Note 11. Receivables

Current

Other receivables	3,362,813	4,003,566
Total current receivables	3,362,813	4,003,566

(a) Financial Risk Management

Information concerning the Group's exposure to financial risks on receivables is set out in Note 3.

	Consolidated	
	2012	2011
	\$	\$

Note 12. Inventories

Current

Casing and other drilling inventory, at cost	13,051,792	279,892
Total current inventories	13,051,792	279,892

Note 13. Security Deposits

Current

Karooon Petróleo & Gas Ltda (refer Note (a) below)	35,058,685	37,870,543
Karooon Gas Australia Ltd (refer Note (b) below)	-	3,400,231
Karooon Gas Australia Ltd, KEI (Peru Z38) Pty Ltd, Sucursal del Peru (refer Note (c) below)	4,279	30,969
Karooon Petróleo & Gas Ltda, KEI (Peru Z38) Pty Ltd, Sucursal del Peru (refer Note (d) below)	27,245	-
Total current security deposits	35,090,209	41,301,743

Non-current

Karooon Petróleo & Gas Ltda (refer Note (a) below)	-	18,941,299
Karooon Gas Australia Ltd (refer Note (b) below)	6,995,982	6,611,416
Karooon Gas Australia Ltd, Karooon Petróleo & Gas Ltda (refer Note (c) below)	474,387	506,122
Total non-current security deposits	7,470,369	26,058,837

(a) Performance Bonds

The Group has provided Agencia Nacional do Petróleo (the Brazilian Petroleum Agency) insurance bonds (2011: insurance bonds and letters of credit) (refer Note 24) to carry out minimum work programs in relation to the Group's exploration permits in the Santos Basin, Brazil (Santos Basin Blocks S-M-1037, S-M-1101, S-M-1102, S-M-1165 and S-M-1166). The insurance bonds have been part funded to 50% of the value of the total bonds provided to Agencia Nacional do Petróleo by establishment of an escrow account. The funds deposited in escrow are invested on term deposit and quarterly interest earned is released from escrow after the end of each quarter. The principal funds held in escrow will be released as work is undertaken to satisfy the work programs. The letters of credit provided were fully funded by way of payment of security deposits and were released during the financial year having satisfied first period work programs.

(b) Performance Guarantees

Performance guarantees (via letters of credit) were provided to Peru Petro SA for Block Z-38 and Block 144 by the Group (refer Note 24) for second and third period work commitments (30 June 2011: for second and third period work commitments). The letters of credit are fully funded by way of payment of a security deposit, which will be released once the work commitments are met.

(c) Bank Guarantees

Cash deposits are held as security against bank guarantee facilities for bank guarantees (refer Note 24) given to lessors for the Group's compliance with its obligations in respect of operating lease rental agreements for office premises at Melbourne, Mount Martha and Brazil (2011: Melbourne, Mount Martha, Peru and Brazil).

(d) Bonds

Cash deposits are held as bonds for the Group's compliance with its obligations in respect of agreements for various accommodation in Brazil and Peru.

(e) Financial Risk Management

Information concerning the Group's exposure to financial risks on security deposits is set out in Note 3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

		Consolidated	
	Note	2012 \$	2011 \$

Note 14. Other Assets

Current

Prepayments		8,058,487	3,525,878
Total current other assets		8,058,487	3,525,878

Non-current

Prepayments		142,177	1,102,759
Total non-current other assets		142,177	1,102,759

Note 15. Plant and Equipment

Plant and equipment

At cost		3,546,780	3,284,993
Accumulated depreciation		(1,510,213)	(1,068,461)
Total plant and equipment, at net book value		2,036,567	2,216,532

Reconciliation

The reconciliation of the carrying amount for plant and equipment is set out below:

Balance at beginning of financial year		2,216,532	607,552
Additions	22	382,725	2,058,646
Disposals		(16,591)	(114,319)
Net foreign currency difference on translation of financial statements of foreign subsidiaries		13,660	-
Depreciation expense	5	(559,759)	(335,347)
Net carrying amount at end of financial year		2,036,567	2,216,532

Note 16. Intangible Assets

Computer software

At cost		1,724,577	1,144,552
Accumulated amortisation		(1,045,151)	(664,511)
Total intangibles, at net book value		679,426	480,041

Reconciliation

The reconciliation of the carrying amounts for computer software is set out below:

Balance at beginning of financial year		480,041	354,922
Additions	22	580,025	321,017
Net foreign currency difference on translation of financial statements of foreign subsidiaries		8,277	-
Amortisation expense	5	(388,917)	(195,898)
Net carrying amount at end of financial year		679,426	480,041

		Consolidated	
		2012	2011
	Note	\$	\$
Note 17. Exploration and Evaluation Expenditure Carried Forward			
Deferred geological, geophysical, drilling and other exploration and evaluation expenditure, including directly attributable general administrative costs		313,884,275	276,465,002

Reconciliation

The reconciliation of exploration and evaluation expenditure carried forward is set out below:

Balance at beginning of financial year		276,465,002	265,243,372
Additions	22	44,659,227	22,242,534
Net foreign currency difference on translation of financial statements of foreign subsidiaries		(7,239,954)	(7,139,012)
Exploration and evaluation expenditure written off (refer Note (a) below)	5	-	(3,881,892)
Total exploration and evaluation expenditure carried forward (refer Note (b) below)		313,884,275	276,465,002
Tangible		-	-
Intangible		313,884,275	276,465,002
Total exploration and evaluation expenditure carried forward		313,884,275	276,465,002

(a) Exploration and evaluation expenditure written off during the previous financial year related to the AC/P8 exploration permit, following a decision by the Board of Directors to surrender the permit in good standing having satisfied all firm commitments.

(b) Exploration and evaluation expenditure carried forward relates to areas of interest in the exploration and evaluation phase for exploration permits WA-314-P, WA-315-P, WA-398-P, Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165, Block S-M-1166, Block Z-38 and Block 144.

The expenditure is carried forward on the basis that exploration and evaluation activities in the areas of interest 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 future recoverability of the carrying amount of capitalised exploration and evaluation expenditure is dependent on successful development and commercial exploitation or, alternatively, the sale of the respective areas of interest.

	Consolidated	
	2012	2011
	\$	\$

Note 18. Trade and Other Payables

Current (unsecured)

Trade payables	3,945,978	1,149,991
Sundry payables and accrued expenditure	7,329,804	3,156,595
Total current trade and other payables	11,275,782	4,306,586

(a) Financial Risk Management

Information concerning the Group's exposure to financial risks on trade and other payables is set out in Note 3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

	Consolidated	
	2012	2011
	\$	\$
Note 19. Provisions		
Non-current		
Provision for long service leave	206,144	99,484
Total non-current provisions	206,144	99,484

(a) Provision for Long Service Leave

A provision was recognised for employee entitlements relating to long service leave. The measurement and recognition criteria relating to long service leave entitlements are as described in Note 1(q).

	Consolidated		Consolidated	
	2012	2011	2012	2011
	Number	Number	\$	\$
Note 20. Contributed Equity and Reserves within Equity				
(a) Share Capital				
Ordinary shares, fully paid	221,420,769	221,420,769	664,894,335	664,894,335
Total contributed equity			664,894,335	664,894,335

Ordinary shares have no par value and the Company does not have a limited amount of authorised capital.

Voting rights of shareholders are governed by the Company's Constitution. In summary, 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 such attending shareholder is entitled to one vote for every fully paid ordinary share held.

Ordinary shares participate in dividends as declared from time to time and the proceeds on winding up of the Company in proportion to the number of fully paid ordinary shares held.

(b) Movement in Ordinary Shares

Date	Details	Note	Number of Ordinary Shares	Issue Price Per Ordinary Share	\$
1 July 2010	Opening balance in previous financial year		177,546,198		381,147,212
22 September 2010	Share placement	(iii)	26,631,929	\$7.00	186,423,503
23 September 2010	Exercise of ESOP options	(i)	50,000	\$5.00	250,000
23 September 2010	Exercise of other share options	(i)	200,000	\$2.95	590,000
30 September 2010	Exercise of ESOP options	(i)	60,000	\$2.95	177,000
30 September 2010	Exercise of ESOP options	(i)	50,000	\$5.00	250,000
30 September 2010	Exercise of other share options	(i)	520,000	\$2.95	1,534,000
1 October 2010	Exercise of other share options	(i)	280,000	\$2.95	826,000
12 October 2010	Exercise of ESOP options	(i)	25,000	\$5.00	125,000
12 October 2010	Exercise of ESOP options	(i)	145,000	\$2.95	427,750
14 October 2010	Exercise of ESOP options	(i)	5,000	\$5.00	25,000
27 October 2010	Exercise of ESOP options	(i)	75,000	\$4.00	300,000
27 October 2010	Share purchase plan	(iii)	11,692,642	\$7.00	81,848,494
28 October 2010	Exercise of ESOP options	(i)	15,000	\$4.00	60,000
9 February 2011	Exercise of ESOP options	(i)	200,000	\$5.00	1,000,000
11 February 2011	Exercise of ESOP options	(i)	25,000	\$5.00	125,000
14 February 2011	Exercise of ESOP options	(i)	100,000	\$5.00	500,000
16 February 2011	Exercise of ESOP options	(i)	5,000	\$5.00	25,000
23 February 2011	Exercise of ESOP options	(i)	20,000	\$5.00	100,000
25 February 2011	Exercise of other share options	(i)	1,500,000	\$5.00	7,500,000

Date	Details	Note	Number of Ordinary Shares	Issue Price Per Ordinary Share	\$
25 February 2011	Exercise of other share options	(i)	1,500,000	\$4.50	6,750,000
25 February 2011	Exercise of ESOP options	(i)	30,000	\$5.00	150,000
28 February 2011	Exercise of ESOP options	(i)	50,000	\$5.00	250,000
4 March 2011	Exercise of ESOP options	(i)	25,000	\$5.00	125,000
9 March 2011	Exercise of ESOP options	(i)	20,000	\$5.00	100,000
16 March 2011	Exercise of ESOP options	(i)	10,000	\$5.00	50,000
22 March 2011	Exercise of ESOP options	(i)	225,000	\$5.00	1,125,000
25 March 2011	Exercise of ESOP options	(i)	40,000	\$5.00	200,000
11 April 2011	Exercise of ESOP options	(i)	65,000	\$5.00	325,000
2 May 2011	Exercise of ESOP options	(i)	60,000	\$5.00	300,000
2 May 2011	Exercise of other share options	(i)	250,000	\$4.00	1,000,000
	Less: Transaction costs arising on ordinary shares issued during previous financial year				(8,714,624)
30 June 2011 and 30 June 2012	Balance at end of financial year		221,420,769		664,894,335

(i) Employee Share Option Plan ('ESOP') and Other Share Options

Information relating to the Company's ESOP and other share options, including details of options granted, exercised, cancelled, forfeited and expired during the financial year and options outstanding at the end of the financial year, is set out in Note 27.

(ii) Share Placement and Share Purchase Plan

The purpose of the share placement to sophisticated and professional investors during September 2010 and the share purchase plan during October 2010 was to provide the Group with a strong cash position for its continued exploration and appraisal program in the Browse Basin, exploration in Brazil and Peru and general working capital.

(c) Capital Management

The Board of Directors controls the capital of the Company in order to ensure that the Group can fund its operations and continue as a going concern. The aim is to maintain a capital structure that ensures the lowest cost of capital to the Company.

The Executive Chairman manages the Company's capital by monitoring future rolling cash flows and adjusting its capital structure, as required, in consultation with the Board of Directors to meet Group business objectives.

There were no externally imposed capital management restrictions on the Group during the financial year.

(d) Reserves Within Equity

(i) Share-based Payments Reserve

The share-based payments reserve is used to recognise the grant date fair value of share-based payments to Directors, other key management personnel and employees as part of their remuneration, as described in Note 1(p).

(ii) Foreign Currency Translation Reserve

The foreign currency translation reserve is used to recognise exchange differences arising from the translation of financial statements of foreign subsidiaries, as described in Note 1(e). The relevant amounts included in the foreign currency translation reserve will be recognised in the consolidated statement of comprehensive income when each relevant investment in foreign subsidiary is disposed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 21. Subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in Note 1(b):

Name	Country of Incorporation or Registration	Business Activities Carried on In	Percentage of Equity and Voting Interests Held	
			2012 %	2011 %
Parent Company:				
Karoon Gas Australia Ltd	Australia	Australia		
Unlisted subsidiaries of Karoon Gas Australia Ltd:				
Karoon Energy International Pty Ltd	Australia	Australia	100.0	100.0
Karoon Gas (Browse Basin) Pty Ltd	Australia	Australia	100.0	100.0
Karoon Gas (FPSO) Pty Ltd	Australia	Australia	100.0	100.0
Karoon Gas Pty Ltd	Australia	Australia	-	100.0
Eastern Pacific Coal Pty Ltd	Australia	Australia	-	100.0
Unlisted subsidiaries of Karoon Energy International Pty Ltd:				
KEI (Brazil Santos) Pty Ltd	Australia	Australia	100.0	100.0
KEI (Peru 112) Pty Ltd	Australia	Australia	100.0	100.0
KEI (Peru Z38) Pty Ltd	Australia	Australia	100.0	100.0
Jointly owned unlisted subsidiary of Karoon Energy International Pty Ltd and KEI (Brazil Santos) Pty Ltd:				
Karoon Petróleo & Gas Ltda	Brazil	Brazil	100.0	100.0
Branch of KEI (Peru 112) Pty Ltd:				
KEI (Peru 112) Pty Ltd, Sucursal del Peru	Peru	Peru	100.0	100.0
Branch of KEI (Peru Z38) Pty Ltd:				
KEI (Peru Z38) Pty Ltd, Sucursal del Peru	Peru	Peru	100.0	100.0

Karoon Gas Pty Ltd and Eastern Pacific Coal Pty Ltd, both dormant companies, were deregistered on 2 May 2012.

Karoon Energy International Ltd converted to a proprietary company and changed its name to Karoon Energy International Pty Ltd during the financial year.

Karoon Petróleo & Gas SA changed its name to Karoon Petróleo & Gas Ltda during the financial year.

Note 22. Segment Information

(a) Description of Segments

The Group has identified its operating segments based on the internal reports that are reviewed and used by the Executive Chairman and Executive Director/Exploration Director (identified as the 'chief operating decision maker') in assessing performance and in determining the allocation of resources.

The operating segments identified are based on the Group's equity interest in each individual exploration permit. Discrete financial information (including expenditure on exploration and evaluation assets) is provided to the chief operating decision maker on a regular basis. In certain circumstances, individual exploration permits are aggregated into a single operating segment where the economic characteristics and long-term planning and operational considerations of the individual exploration permits are such that they are considered interdependent.

The Group has identified three operating segments:

- (i) Australia exploration – the Group is currently involved in the exploration and evaluation of hydrocarbons in three offshore permit areas within the Browse Basin, Australia: WA-314-P, WA-315-P, WA-398-P;
- (ii) Brazil exploration – the Group is currently involved in the exploration and evaluation of hydrocarbons in five offshore blocks within the Santos Basin, Brazil: Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165 and Block S-M-1166; and
- (iii) Peru exploration – the Group is currently involved in the exploration and evaluation of hydrocarbons in two blocks in Peru: Block 144 (onshore) and Block Z-38 (offshore).

'All other segments' include amounts of a corporate nature not specifically attributable to an operating segment.

The following items and associated assets and liabilities are not allocated to operating segments as they are not considered part of the core operations of any segment but are reviewed by the chief operating decision maker on a regular basis:

- interest income;
- net foreign currency gains (losses);
- finance costs;
- net employee benefits expense (including non-cash share-based payments expense of \$5,969,470 (2011: \$5,069,475));
- administration and other operating expenses (including Brazilian initial public offering expenses of \$88,474 (2011: \$5,673,914));
- depreciation and amortisation expense;
- property costs; and
- income tax expense.

Employee benefits expenses and other operating expenses, that are associated with the exploration and evaluation activities and specifically relate to an area of interest, are allocated to the area of interest and are capitalised as exploration and evaluation assets.

Segment revenues and results do not include transfers between segments as intercompany balances are eliminated on consolidation.

The amounts provided to the chief operating decision maker with respect to total assets are measured in a manner consistent with that of the consolidated financial statements. Reportable segment assets are equal to consolidated total assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 22. Segment Information (continued)

(b) Operating Segments

Segment Performance	Australia \$	Brazil \$	Peru \$	All Other Segments \$	Consolidated \$
Revenue for financial year ended 30 June 2012					
Segment revenue	-	-	-	-	-
Interest income from unrelated entities	-	-	-	13,601,653	13,601,653
Total revenue					<u>13,601,653</u>
Result for financial year ended 30 June 2012					
Segment result	(1,192,867)	(24,360)	(419)	(2,074)	(1,219,720)
Interest income from unrelated entities	-	-	-	13,601,653	13,601,653
Net foreign currency gains	-	-	-	4,388,118	4,388,118
Net gain on disposal of plant and equipment	-	-	-	7,955	7,955
Finance costs	-	-	-	(256,321)	(256,321)
Employee benefits expense (net)	-	-	-	(11,460,468)	(11,460,468)
Administration and other operating expenses	-	-	-	(6,341,095)	(6,341,095)
Depreciation and amortisation expense	-	-	-	(948,676)	(948,676)
Property costs	-	-	-	(1,058,828)	(1,058,828)
Loss before income tax					<u>(3,287,382)</u>
Income tax expense					-
Loss for financial year					<u>(3,287,382)</u>
Revenue for financial year ended 30 June 2011					
Segment revenue	-	-	-	-	-
Interest income from unrelated entities	-	-	-	14,225,048	14,225,048
Total revenue					<u>14,225,048</u>
Result for financial year ended 30 June 2011					
Segment result	(4,448,680)	(32,449)	(18,277)	(163,148)	(4,662,554)
Interest income from unrelated entities	-	-	-	14,225,048	14,225,048
Net foreign currency losses	-	-	-	(10,440,658)	(10,440,658)
Finance costs	-	-	-	(456,290)	(456,290)
Employee benefits expense (net)	-	-	-	(8,529,761)	(8,529,761)
Administration and other operating expenses	-	-	-	(12,133,822)	(12,133,822)
Depreciation and amortisation expense	-	-	-	(531,245)	(531,245)
Property costs	-	-	-	(775,632)	(775,632)
Loss before income tax					<u>(23,304,914)</u>
Income tax expense					-
Loss for previous financial year					<u>(23,304,914)</u>

Segment Assets	Australia \$	Brazil \$	Peru \$	All Other Segments \$	Consolidated \$
As at 30 June 2012					
Segment asset information					
Cash and cash equivalents	4,455,817	1,153,673	418,552	221,774,274	227,802,316
Exploration and evaluation expenditure carried forward	220,318,279	66,466,372	27,099,624	-	313,884,275
Security deposits	-	35,058,685	6,995,982	505,911	42,560,578
Inventories	932,223	12,119,569	-	-	13,051,792
Other	2,458,990	4,743,037	2,383,011	5,197,848	14,782,886
Segment assets	228,165,309	119,541,336	36,897,169	227,478,033	612,081,847

As at 30 June 2011

Segment asset information					
Cash and cash equivalents	343,869	848,356	85,553	265,561,366	266,839,144
Exploration and evaluation expenditure carried forward	195,034,904	58,519,082	22,911,016	-	276,465,002
Security deposits	-	56,811,842	10,011,647	537,091	67,360,580
Inventories	279,892	-	-	-	279,892
Other	188,091	4,150,819	2,263,013	4,726,853	11,328,776
Segment assets	195,846,756	120,330,099	35,271,229	270,825,310	622,273,394

(c) Other Segment Information

Additions to non-current assets, other than financial assets (refer Note 3), during the reporting periods were:

Financial year ended 30 June 2012

Plant and equipment	-	-	-	382,725	382,725
Intangible assets	-	-	-	580,025	580,025
Exploration and evaluation expenditure carried forward	25,283,375	16,133,669	3,242,183	-	44,659,227
Other assets (prepayments)	-	-	-	-	-

Financial year ended 30 June 2011

Plant and equipment	-	-	-	2,058,646	2,058,646
Intangible assets	-	-	-	321,017	321,017
Exploration and evaluation expenditure carried forward	8,839,390	9,595,443	3,807,701	-	22,242,534
Other assets (prepayments)	-	1,102,759	-	-	1,102,759

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 23. Joint Venture Operations

The Group had an interest in the following joint venture operations as at 30 June 2012 as follows:

Exploration Permit	Unincorporated Interest 2012 %	Unincorporated Interest 2011 %	Principal Activities	Operator of Joint Venture Operation
WA-314-P	90.00	90.00	Exploration and evaluation	ConocoPhillips
WA-315-P	40.00	40.00	Exploration and evaluation	ConocoPhillips
WA-398-P	40.00	40.00	Exploration and evaluation	ConocoPhillips
AC/P8	- [^]	66.67	Exploration and evaluation	Karoon Energy International Pty Ltd
Block Z-38	75.00 [#]	75.00 [#]	Exploration and evaluation	KEI (Peru Z38) Pty Ltd, Sucursal del Peru

[^] Following a decision by the Board of Directors in the previous financial year to surrender the permit in good standing, having satisfied all firm commitments, regulatory approval for the relinquishment was received during the financial year.

[#] The Group's 75.00% Block equity interest is subject to completion of farm-in obligations.

The following amounts represented the Group's share of assets and liabilities employed in joint venture operations. The amounts are included in the consolidated financial statements, in accordance with the accounting policy described in Note 1(s), under the following classifications:

	Consolidated	
	2012	2011
	\$	\$
Cash and cash equivalents	4,455,817	343,869
Other receivables	879,349	118,278
Inventories	932,223	279,892
Total current assets	6,267,389	742,039
Exploration and evaluation expenditure carried forward	245,369,544	216,828,377
Total non-current assets	245,369,544	216,828,377
Sundry payables and accrued expenditure	5,858,519	200,796
Total current liabilities	5,858,519	200,796
Share of net assets employed in joint venture operations	245,778,414	217,369,620

The future recoverability of the carrying amount of capitalised exploration and evaluation expenditure is dependent on successful development and commercial exploitation or, alternatively, the sale of the respective areas of interest.

Contingent liabilities in respect of joint venture operations are set out in Note 24. Exploration expenditure commitments and capital commitments in respect of joint venture operations are set out in Note 25.

Parent Company guarantees have been provided to ConocoPhillips guaranteeing Karoon Gas (Browse Basin) Pty Ltd's performance under the joint venture operating agreements covering the three Browse Basin permit interests. In addition, a deed of cross charge has been entered into with ConocoPhillips by Karoon Gas (Browse Basin) Pty Ltd covering its three Browse Basin permit interests.

	Consolidated	
	2012	2011
	\$	\$

Note 24. Contingent Liabilities and Contingent Assets

(a) Contingent Liabilities

The Group had contingent liabilities as at 30 June 2012 that may become payable in respect of:

(i) The Group has provided Agencia Nacional do Petróleo (the Brazilian Petroleum Agency) insurance bonds (2011: insurance bonds and letters of credit) to carry out minimum work programs in relation to the Group's exploration permits in the Santos Basin, Brazil. The Directors are of the opinion that the work programs will be satisfied. The letters of credit provided were fully funded by way of payment of security deposits (refer Note 13) and were released during the current financial year having satisfied first period work programs. The insurance bonds have been part funded to 50% of the value of the total bonds provided to Agencia Nacional do Petróleo by establishment of an escrow account. The principal funds held in escrow will be released as work is undertaken to satisfy the work programs.	35,058,685	56,811,842
(ii) Performance guarantees (via letters of credit) were provided to Peru Petro SA for Block Z-38 and Block 144 by the Group for second and third period work commitments (2011: second and third period work commitments). The Directors are of the opinion that the work commitments will be satisfied for both Blocks. The letters of credit are fully funded by way of payment of security deposits (refer Note 13), which will be released once the work commitments are met.	6,995,982	10,011,647
(iii) Bank guarantees were provided in respect of operating lease rental agreements for the Group. These guarantees may give rise to liabilities in the Group if obligations are not met under these guarantees. The bank guarantees given to lessors are fully funded by way of payment of security deposits (refer Note 13).	478,666	537,091
(iv) Cash deposits are held as bonds for the Group's compliance with its obligations in respect of agreements for various accommodation in Brazil and Peru. The cash deposits given to third party suppliers are fully funded by way of payment of security deposits (refer Note 13).	27,245	-
(v) On 23 August 2010, Karoon Petróleo & Gas Ltda, a wholly owned subsidiary of the Company, executed a farm-in agreement with Petróleo Brasileiro SA (Petrobras) to acquire a 20% interest in Block S-M-1352, which is part of BM-S-41 Concession located in the offshore Santos Basin, Brazil.	47,345,583	39,429,646

Under the farm-in agreement and subject to obtaining regulatory approvals from Agencia Nacional do Petróleo (the Brazilian Petroleum Agency), Karoon Petróleo & Gas Ltda will earn a 20% equity interest by funding a proportion of the cost of two exploration wells. Karoon Petróleo & Gas Ltda will then pay its equity share of continued work and reimburse Petrobras for sunk costs.

The two exploration wells included drilling of the Quasi Prospect in Block S-M-1354, which was subsequently plugged and abandoned during September 2010. The second well, the Maruja-1 exploration well, in Block S-M-1352 commenced drilling during September 2010 and was suspended following a completion of a production test during January 2011. Block S-M-1354 expired during November 2010 and was formally relinquished by Petrobras during January 2011. The farm-in area of S-M-1352 was reduced to an area retained around the Maruja discovery. The reduction includes the partial relinquishment of S-M-1352.

Continued work on the Block S-M-1352 included the drilling of a third well, the Maruja-2 appraisal well, which was completed and abandoned during March 2011.

Under the farm-in agreement with Petrobras, the Group's share of the costs incurred on both Blocks as at 30 June 2012 was \$44,622,592 (2011: \$39,429,646), that is payable upon obtaining regulatory approvals. An uplift fee of \$2,722,991 for a full licence to non-exclusive seismic data is also payable upon the completion of this farm-in and obtaining regulatory approval.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 24. Contingent Liabilities and Contingent Assets (continued)

(vi) Joint venture operations

In accordance with normal industry practice, the Group has entered into joint venture operations with other parties for the purpose of exploring and evaluating its permit interests. If a participant to a joint venture operation defaults and does not contribute its share of joint venture operation obligations, then the remaining joint venture participants are jointly and severally liable to meet the obligations of the defaulting participant. In this event, the interest in the exploration permit held by the defaulting participant may be redistributed to the remaining joint venture participants.

In the event of a default, a contingent liability exists in respect of expenditure commitments due to be met by the Group in respect of the defaulting joint venture participant.

(b) Contingent Assets

The Group had no contingent assets as at 30 June 2012 (30 June 2011: \$Nil).

	Consolidated
	2012
	2011
	\$
	\$

Note 25. Commitments

(a) Capital Expenditure Commitments

Contracts and/or signed Authorities for Expenditure for capital expenditure in relation to assets not provided for in the consolidated financial statements and payable:

Drilling operations

Not later than one year	122,162,003	12,965,882
Total capital expenditure commitments	122,162,003	12,965,882

(b) Operating Lease Rental Commitments

Non-cancellable operating lease rentals not provided for in the consolidated financial statements and payable:

Not later than one year	812,654	855,745
Later than one year but not later than five years	2,099,374	2,829,030
Later than five years	-	192,762
Total operating lease rental commitments	2,912,028	3,877,537

The Group has an office lease for Office 6 and 7, 34-38 Lochiel Avenue, Mount Martha with a primary three year term that expires on 31 January 2013. Rent is payable monthly in advance. Annually from the commencement date, the rent is adjusted by reference to the consumer price index. There is an option to extend for one further term of three years, except that a market review of rent will be triggered on renewal.

The Group has an office lease for Level 25, 367 Collins Street, Melbourne with a primary six year term that expires on 30 November 2016 and a 4% p.a. rental increase. Rent is payable monthly in advance. There is no option for renewal at the end of the term.

The Group has two office leases in Brazil. One at Rua Visconde de Pirajá, 303 – 9º Andar – Salas 904/912, Ipanema, Rio de Janeiro with a primary four year term that expires on 30 April 2015. Rent is payable monthly in advance. There is an option to extend for a further term, which is negotiable at the end of the lease. The second office lease is at Av Afonso Delambert Neto, 619 sala 5 Lagoa da Conceição, Florianópolis with a primary four year term that expires on 23 January 2014. Rent is payable monthly in advance. There is an option to extend for a further term, which is negotiable at the end of the lease.

The Group has an office lease at Antequera 777, 101, Sam Isidro, Peru with a primary term that expires on 31 July 2013. Rent is payable monthly in advance. There is an option to extend for a further term of 12 months, on essentially the same terms and conditions, except that a market review of rent will be triggered on renewal.

	Consolidated	
	2012	2011
	\$	\$
(c) Exploration Expenditure Commitments		
Some subsidiaries within the Group have commitments for exploration expenditure arising from obligations to government, to perform minimum exploration and evaluation work and expend minimum amounts of money pursuant to the award of exploration permits WA-314-P, WA-315-P, WA-398-P, Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165, Block S-M-1166, Block Z-38 and Block 144 (30 June 2011: WA-314-P, WA-315-P, WA-398-P, Block S-M-1037, Block S-M-1101, Block S-M-1102, Block S-M-1165, Block S-M-1166, Block Z-38, Block 144 and AC/P8) not provided for in the consolidated financial statements and payable. Included in exploration expenditure commitments are \$66,248,229 (30 June 2011: \$90,965,044) of commitments that relate to the non-guaranteed work commitments:		
Not later than one year	343,876,544	155,694,566
Later than one year but not later than five years	198,955,083	265,895,674
Total exploration expenditure commitments	542,831,627	421,590,240

The above commitments include exploration expenditure commitments relating to joint venture operations:

Not later than one year	95,593,201	155,694,566
Later than one year but not later than five years	198,955,083	146,836,168
Total joint venture operation exploration expenditure commitments	294,548,284	302,530,734

Estimates for future exploration expenditure commitments to government 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. The exploration and evaluation obligations may vary significantly as a result of renegotiations with relevant parties.

The commitments may also be reduced by the Group entering into farm-out agreements, which are typical of the normal operating activities of the Group.

Where exploration and evaluation expenditure included in this category relates to an existing contract for expenditure and/or signed Authorities for Expenditure, the amount will be included in both categories (a) and (c) above.

Note 26. Notes to the Consolidated Statement of Cash Flows

(a) Reconciliation of Loss for Financial Year to Net Cash Flows Provided by Operating Activities

	Consolidated	
	2012	2011
	\$	\$
Loss for financial year	(3,287,382)	(23,304,914)
Add (subtract):		
Depreciation of plant and equipment and amortisation of computer software	948,676	531,245
Net foreign currency (gains)/losses	(3,885,319)	9,675,904
Non-cash employee benefits expense: share-based payments expense	5,969,470	5,069,475
Items classified as investing/ financing activities:		
Exploration and evaluation expenditure written off	-	3,881,892
Net foreign currency (gains)/ losses	(502,799)	764,754
Net loss on disposal of subsidiaries	427	-
Net (gain)/ loss on disposal of plant and equipment	(7,955)	82,945

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 26. Notes to the Consolidated Statement of Cash Flows (continued)

(a) Reconciliation of Loss for Financial Year to Net Cash Flows Provided by Operating Activities (continued)

Change in operating assets and liabilities (Increase) decrease in assets:

Receivables – current	1,509,296	(959,099)
Security deposits	3,177,395	(2,855,838)
Current tax assets	(560,717)	-
Other assets	(43,944)	466,076

Increase (decrease) in liabilities:

Trade and other payables – current	(441,642)	826,430
Provisions	106,658	38,746
Income tax liability	-	(220,227)
Net cash flows provided by/ (used in) operating activities	2,982,164	(6,002,611)

Note 27. Share-based Payments

The share-based payments plan is described below. There has been no cancellation to the plan during the financial year. Amendments to the plan and its continuing operation were approved by shareholders at the 2009 Annual General Meeting.

(a) Employee Share Option Plan

The Group had an ESOP, which has been operating since the listing of the Company on the ASX. ESOP options expire up to four years after they are granted. The exercise price of ESOP options, issued during the financial year, is based on the volume weighted average price at which the Company's ordinary shares are traded on the ASX during the 90 trading days before the ESOP options were offered plus a premium to the market price. ESOP options may be exercised after the date the option was granted. If there is a change of control in the Company, all unexercised ESOP options will become immediately exercisable. Options granted under the ESOP carry no dividend or voting rights. When exercisable, each ESOP option is convertible into one ordinary share of the Company.

The following summary reconciles the outstanding ESOP options over unissued ordinary shares in the Company at the beginning and end of the financial year:

	Consolidated		Consolidated	
	2012 Number	2012 Weighted Average Exercise Price	2011 Number	2011 Weighted Average Exercise Price
Balance at beginning of financial year	3,775,000	\$11.00	3,830,000	\$9.27
Granted during financial year	2,420,000	\$7.30	1,445,000	\$9.77
Exercised during financial year	-	-	(1,300,000)	\$4.61
Cancelled during financial year	(500,000)	\$9.67	(200,000)	\$10.64
Forfeited during financial year	-	-	-	-
Expired during financial year	(200,000)	\$6.84	-	-
Balance at end of financial year	5,495,000	\$9.64	3,775,000	\$11.00
Exercisable at end of financial year	2,130,000	\$12.06	830,000	\$11.81

The weighted average fair value of ESOP options granted during the financial year was \$1.51 (2011: \$1.99).

The weighted average share price when the ESOP options were exercised during the previous financial year was \$7.66.

ESOP options outstanding as at 30 June 2012 had a range of exercise prices from \$7.30 to \$14.07 (30 June 2011: \$6.84 to \$14.07) with a weighted average remaining contractual life of 875 days (30 June 2011: 956 days).

Details of ESOP options outstanding at the end of the financial year are:

Grant Date	Expiry Date	Exercise Price Per Option	Number
23 November 2009	12 November 2013	\$14.07	530,000
9 December 2009	18 November 2013	\$11.50	1,500,000
3 September 2010	31 October 2014	\$9.77	805,000
12 January 2011	31 October 2014	\$9.77	300,000
18 November 2010	18 November 2014	\$9.77	100,000
10 November 2011	31 October 2015	\$7.30	800,000
10 October 2011	31 October 2015	\$7.30	1,460,000
Total ESOP options			5,495,000

(b) Other Share Options

The Group had granted other share options over unissued ordinary shares in the Company during the financial year to Directors. The exercise price of other share options, issued during the financial year, was based on the weighted average price at which the Company's ordinary shares are traded on the ASX during the 90 trading days before the options were offered plus a premium to the market price. Other share options may be exercised after the date the option was granted. If there is a change of control of the Company, all unexercised other share options will become immediately exercisable. Other share options granted carry no dividend or voting rights. When exercisable, each other share option is convertible into one ordinary share of the Company.

Options issued to Directors are approved on a case-by-case basis by shareholders at relevant general meetings.

The following summary reconciles the outstanding other share options over unissued ordinary shares in the Company at the beginning and end of the financial year:

	Consolidated		Consolidated	
	2012 Number	2012 Weighted Average Exercise Price	2011 Number	2011 Weighted Average Exercise Price
Balance at beginning of financial year	1,500,000	\$12.54	5,250,000	\$6.15
Granted during financial year	4,800,000	\$10.29	500,000	\$9.48
Exercised during financial year	-	-	(4,250,000)	\$4.28
Forfeited during financial year	(150,000)	\$8.92	-	-
Expired during financial year	-	-	-	-
Balance at end of financial year	6,150,000	\$10.87	1,500,000	\$12.54
Exercisable at end of financial year	850,000	\$8.92	-	-

The weighted average fair value of other share options granted during the financial year was \$1.15 (2011: \$2.75).

The weighted average share price when other share options were exercised during the previous financial year was \$7.17.

Other share options outstanding as at 30 June 2012 had a range of exercise prices from \$8.92 to \$14.07 (30 June 2011: \$9.48 to \$14.07) with a weighted average remaining contractual life of 1,039 days (30 June 2011: 990 days).

Details of other share options outstanding at the end of the financial year are:

Grant Date	Expiry Date	Exercise Price Per Option	Number
23 November 2009	12 November 2013	\$14.07	1,000,000
18 November 2010	18 November 2014	\$9.48	500,000
10 November 2011	1 May 2014	\$8.92	850,000
10 November 2011	1 May 2015	\$9.95	1,200,000
10 November 2011	1 May 2016	\$10.98	2,600,000
Total other share options			6,150,000

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 27. Share-based Payments (continued)

(c) Fair Value of Options

The fair value of each option issued 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 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 Group applied the following assumptions and inputs in estimating the weighted average fair value:

	2012	2011
Weighted average exercise price	\$9.29	\$9.70
Weighted average life of options	1,418 days	1,481 days
Weighted average share price	\$4.56	\$7.13
Expected share price volatility	58%	42%
Risk free interest rate	4.24%	5.21%
Weighted average option value	\$1.27	\$2.19

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

(d) Share-based Payments Expense

Total expenses arising from share-based payment transactions recognised during the financial year, included as part of employee benefits expense in the consolidated statement of comprehensive income, was \$5,969,470 (2011: \$5,069,475).

Note 28. Remuneration of Key Management Personnel

Directors and other key management personnel at any time during the financial year were as follows:

Name	Position
Directors	
Mr Robert Hosking	Executive Chairman
Mr Mark Smith	Executive Director and Exploration Director
Mr Geoff Atkins	Independent Non-Executive Director
Mr Clark Davey	Independent Non-Executive Director
Mr Stephen Power	Non-Executive Director
Mr Jose Coutinho Barbosa	Non-Executive Director
Other key management personnel	
Mr Scott Hosking	Company Secretary and Chief Financial Officer (Group)
Mr Tim Hosking	General Manager South America
Mr Lino Barro	Engineering Manager
Mr Edward Munks	Chief Operating Officer

All of the above persons were also Directors or other key management personnel during the previous financial year, except for Mr Jose Coutinho Barbosa who was appointed as a Non-Executive Director on 31 August 2011.

(a) Directors and Other Key Management Personnel Remuneration

Directors and other key management personnel remuneration was summarised as follows:

	Consolidated	
	2012	2011
	\$	\$
Short-term employee benefits	2,845,146	2,044,994
Post-employment benefits	310,989	170,533
Long-term employee benefits (non-cash)	53,876	25,648
Share-based payments expense (non-cash)	4,249,792	2,044,402
Total key management personnel remuneration	7,459,803	4,285,577

Detailed remuneration disclosures are provided in Sections A-D of the audited Remuneration Report on pages 21 to 33.

(b) Employee Share Option Plan and Other Share Options

Information relating to the Company's ESOP and other share options, including details of options granted, exercised, cancelled, forfeited and expired during the financial year and options over unissued ordinary shares in the Company outstanding at the end of the financial year to Directors, other key management personnel and others, is set out in Note 27.

(c) Options Over Unissued Ordinary Shares in the Company

During the financial year 5,540,000 (2011: 900,000) options over unissued ordinary shares in the Company were issued to Directors and other key management personnel, including their personally related parties.

The movement of options over unissued ordinary shares in the Company held by Directors and other key management personnel, including their personally related parties, during the financial year and previous financial year was as follows:

	Balance as at 1 July 2011	Granted as Remuneration	Options Exercised	Options Forfeited	Balance as at 30 June 2012	Total Vested as at 30 June 2012	Total Exercisable as at 30 June 2012	Total Unexercisable as at 30 June 2012
Executive Directors								
Mr Robert Hosking	-	2,400,000	-	(75,000)	2,325,000	425,000	425,000	1,900,000
Mr Mark Smith	-	2,400,000	-	(75,000)	2,325,000	425,000	425,000	1,900,000
Non-Executive Directors								
Mr Geoff Atkins	500,000	-	-	-	500,000	-	-	500,000
Mr Clark Davey	500,000	-	-	-	500,000	-	-	500,000
Mr Stephen Power	500,000	-	-	-	500,000	-	-	500,000
Mr Jose Coutinho Barbosa (appointed 31 August 2011)	300,000	70,000	-	-	370,000	300,000	300,000	70,000
Other key management personnel								
Mr Scott Hosking	400,000	150,000	-	-	550,000	400,000	400,000	150,000
Mr Tim Hosking	230,000	220,000	-	-	450,000	230,000	230,000	220,000
Mr Lino Barro	400,000	100,000	-	-	500,000	300,000	300,000	200,000
Mr Edward Munks	200,000	200,000	-	-	400,000	-	-	400,000
Total key management personnel	3,030,000	5,540,000	-	(150,000)	8,420,000	2,080,000	2,080,000	6,340,000

	Balance as at 1 July 2010	Granted as Remuneration	Options Exercised	Net Change Other	Balance as at 30 June 2011	Total Vested as at 30 June 2011	Total Exercisable as at 30 June 2011	Total Unexercisable as at 30 June 2011
Executive Directors								
Mr Robert Hosking	1,750,000	-	(1,750,000)	-	-	-	-	-
Mr Mark Smith	1,500,000	-	(1,500,000)	-	-	-	-	-
Non-Executive Directors								
Mr Geoff Atkins	1,000,000	-	(500,000)	-	500,000	-	-	500,000
Mr Clark Davey (appointed 1 October 2010)	-	500,000	-	-	500,000	-	-	500,000
Mr Stephen Power	1,000,000	-	(500,000)	-	500,000	-	-	500,000
Other key management personnel								
Mr Scott Hosking	500,000	100,000	(200,000)	-	400,000	400,000	400,000	-
Mr Tim Hosking	230,000	-	-	-	230,000	230,000	230,000	-
Mr Lino Barro	400,000	100,000	(100,000)	-	400,000	-	-	400,000
Mr Edward Munks (appointed 1 January 2011)	190,000	200,000	(190,000)	-	200,000	-	-	200,000
Total key management personnel	6,570,000	900,000	(4,740,000)	-	2,730,000	630,000	630,000	2,100,000

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 28. Remuneration of Key Management Personnel (continued)

(d) Shareholdings

The number of ordinary shares held by Directors and other key management personnel, including their personally related parties, as at 30 June 2012 and 30 June 2011 was as follows:

	Balance as at 1 July 2011	Received as Remuneration	Options Exercised	Ordinary Shares Purchased	Ordinary Shares Sold	Other	Balance as at 30 June 2012
Executive Directors							
Mr Robert Hosking	12,882,122	-	-	2,000	(26,400)	-	12,857,722
Mr Mark Smith	3,002,037	-	-	-	-	-	3,002,037
Non-Executive Directors							
Mr Geoff Atkins	712,176	-	-	2,500	-	-	714,676
Mr Clark Davey	13,144	-	-	-	-	-	13,144
Mr Stephen Power	602,142	-	-	-	-	-	602,142
Mr Jose Coutinho Barbosa (appointed 31 August 2011)	-	-	-	-	-	-	-
Other key management personnel							
Mr Scott Hosking	270,727	-	-	16,882	(6,950)	-	280,659
Mr Tim Hosking	242,055	-	-	-	(2,000)	-	240,055
Mr Lino Barro	-	-	-	-	-	-	-
Mr Edward Munks	942,885	-	-	-	-	-	942,885
Total key management personnel	18,667,288	-	-	21,382	(35,350)	-	18,653,320

	Balance as at 1 July 2010	Received as Remuneration	Options Exercised	Ordinary Shares Purchased	Ordinary Shares Sold	Other	Balance as at 30 June 2011
Executive Directors							
Mr Robert Hosking	12,442,820	-	1,750,000	54,005	(1,364,703)	-	12,882,122
Mr Mark Smith	2,572,037	-	1,500,000	-	(1,070,000)	-	3,002,037
Non-Executive Directors							
Mr Geoff Atkins	431,500	-	500,000	286,426	(505,750)	-	712,176
Mr Clark Davey (appointed 1 October 2010)	10,746	-	-	2,398	-	-	13,144
Mr Stephen Power	300,000	-	500,000	2,142	(200,000)	-	602,142
Other key management personnel							
Mr Scott Hosking	167,350	-	200,000	148,377	(245,000)	-	270,727
Mr Tim Hosking	279,913	-	-	2,142	(40,000)	-	242,055
Mr Lino Barro	-	-	100,000	-	(100,000)	-	-
Mr Edward Munks (appointed 1 January 2011)	884,317	-	190,000	248,568	(380,000)	-	942,885
Total key management personnel	17,088,683	-	4,740,000	744,058	(3,905,453)	-	18,667,288

(e) Loans to Directors and Other Key Management Personnel

There were no loans to Directors or other key management personnel during the financial year or previous financial year.

(f) Other Transactions with Directors and Other Key Management Personnel

Refer to Note 29 for other transactions with Directors and other key management personnel during the financial year.

Note 29. Related Party Transactions

Transactions between related parties are on normal commercial terms and conditions, no more favourable than those available to other parties, unless otherwise stated.

(a) Parent Company

The ultimate Parent Company within the Group is Karoon Gas Australia Ltd.

(b) Subsidiaries

Interests in subsidiaries are set out in Note 21.

During the financial year, the Group provided accounting, administrative and technical services to subsidiaries at cost. This allocation was based on costs recharged on a relevant time allocation of employees and consultants and associated office charges.

Other transactions that occurred were advancement of intercompany loans at Nil% interest rate (2011: Nil%) and no fixed term for repayment as it was used for funding the intercompany operations and therefore will not be repaid within 12 months. Loans are unsecured and are repayable in cash.

The above transactions are eliminated on consolidation.

Parent Company guarantees provided to third parties guaranteeing a subsidiary's performance under joint venture operating agreements are set out in Note 23.

(c) Directors and Other Key Management Personnel

Disclosures relating to Directors and other key management personnel are set out in the Directors' Report and Note 28.

Apart from the details disclosed in this note, no Director or other key management personnel has entered into a material contract with the Group since the end of the previous financial year and there were no material contracts involving Directors' or other key management personnel interests subsisting as at 30 June 2012 other than as stated in the Directors' Report (Remuneration Report, Section C).

(d) Superannuation Contributions

During the financial year, the Group contributed to accumulation type benefit funds administered by external fund managers or an employee's self-managed superannuation fund. The funds cover all Australian domiciled employees and Directors of the Company. The current contribution rate is 9.0% p.a. (2011: 9.0% p.a.) of employee cash remuneration. Contributions to superannuation funds, on behalf of Directors and employees, during the financial year by the Group amounted to \$456,309 (2011: \$324,730).

(e) Other Related Party Transactions Within the Group

During the financial year, Mr Stephen Power, a Director, had an interest in Napier Legal Pty Ltd which provided legal services to the Group. The value of transactions during the financial year in the Group was \$57,043 (2011: \$593,034).

During the financial year, Mr Clark Davey, a Director, had an interest in Anderson Park Tax Pty Ltd which provided taxation services to the Group. The value of transactions during the financial year in the Group was \$7,140 (2011: \$Nil).

During the financial year, Mr Jose Coutinho Barbosa, a Director, had an interest in Net Pay Óleo & Gás Consultoria Ltda which provided business and geology consulting services to the Group. The value of transactions, for the time since he was a Director, during the financial year in the Group was \$198,249.

During the financial year, Ms Flavia Barbosa, the daughter of a Director, was employed by the Group as the in-house Legal Advisor in Brazil. As an eligible employee since 2010, 70,000 ESOP options, with an exercise price of \$7.30 expiring 31 October 2015, were issued to her during the financial year. The total value of her remuneration (including share-based payments expense), for the time since her father was a Director, during the financial year was \$223,581.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2012

Note 29. Related Party Transactions (continued)

(e) Other Related Party Transactions Within the Group (continued)

During the current and previous financial year, Ms Marina Sayao, the wife of Mr Tim Hosking (a key management person), was employed by the Group as the Community Relations and Social Projects Manager in Peru. As an eligible employee, 70,000 ESOP options (2011: Nil), with an exercise price of \$7.30 expiring 31 October 2015, were issued to her during the financial year. The total value of her remuneration (including share-based payments expense) during the financial year was \$208,111 (2011: \$144,113).*

During the financial year and the previous financial year, Mr Mark Smith, a Director, had an interest in IERS (Australia) Pty Ltd, which has an ongoing agreement with the Group to provide geophysical fault seal analysis software. This contract had been negotiated at commercial terms and does not include monetary compensation. Instead, the Group provides testing and ongoing development of the geophysical fault seal analysis software in return for its use.

* Following the adoption of AASB 124 'Related Party Transactions' (effective for the financial year beginning 1 July 2011) this transaction is now identified as a related party transaction. A comparative has been provided accordingly.

	Company	
	2012	2011
	\$	\$

Note 30. Parent Company Financial Information

(a) Summary Financial Information

The individual financial statements for Karoon Gas Australia Ltd show the following aggregate amounts:

Statement of financial position

Current assets	221,733,111	270,071,493
Non-current assets	376,968,977	348,672,866
Total assets	598,702,088	618,744,359

Current liabilities	1,089,303	765,990
Non-current liabilities	206,144	99,486
Total liabilities	1,295,447	865,476
Net assets	597,406,641	617,878,883

Equity

Contributed equity	664,894,335	664,894,335
Accumulated losses	(91,805,746)	(65,364,034)
Share-based payments reserve	24,318,052	18,348,582
Total equity	597,406,641	617,878,883

Loss for financial year	(26,441,712)	(29,351,106)
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Total comprehensive loss for financial year	(26,441,712)	(29,351,106)
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	Company	
	2012	2011
	\$	\$
(b) Contingent Liabilities of Parent Company		
(i) Bank guarantees were provided in respect of operating lease rental agreements at Melbourne and Mount Martha for the Company (2011: Melbourne and Mount Martha for the Company and a subsidiary). These guarantees may give rise to liabilities in the Parent Company if obligations are not met under these guarantees. The bank guarantees given to lessors are fully funded by way of payment of security deposits (refer Note 13).	344,386	359,509
(ii) Performance guarantees (via letters of credit) were provided to Peru Petro SA for Block Z-38 and Block 144 by the Company for second and third period work commitments (2011: second and third period work commitments). The Directors are of the opinion that the work commitments will be satisfied under both Blocks. The letters of credit are fully funded by way of payment of security deposits (refer Note 13), which will be released once the work commitments are met.	6,995,982	10,011,647
(iii) The Company's present intention is to provide the necessary financial support for all Australian incorporated subsidiaries, whilst they remain wholly owned subsidiaries, as is necessary for each company to pay all debts as and when they become due.		

(c) Guarantees Entered into by Parent Company

Parent Company guarantees provided to third parties guaranteeing a subsidiary's performance under joint venture operating agreements are set out in Note 23.

A bank guarantee, provided by the Parent Company to a third party guaranteeing a subsidiary's performance under an operating lease rental agreement, was released during the financial year as the operating lease rental agreement had expired.

Note 31. Subsequent Events

The Annual Report was authorised for issue by the Board of Directors on 14 September 2012. The Board of Directors has the power to amend and reissue the consolidated financial statements and notes.

Since 30 June 2012, the following material events have occurred:

Browse Drilling Campaign

As at 6 September 2012, the Boreas-1 well in WA-315-P had intersected the primary reservoir objective and preparations were being made to commence coring operations.

The well intersected a sand interval characterised by a rate of penetration increase, sandy drill cuttings and an increase in the mudlog gas readings indicating a potential gas bearing reservoir. Coring operations are being undertaken to allow more extensive analysis of the rock properties in potential reservoir intervals in the Boreas-1 well.

On completion of coring and drilling operations, wireline logging, pressure and sampling programs will be used to define the thickness and properties of any sands penetrated and the presence and characteristics of any movable hydrocarbons. Production testing may be undertaken should hydrocarbon bearing sands be encountered and confirmed by the wireline logging and the pressure and sampling programs.

DIRECTORS' DECLARATION

In the Directors' opinion:

- (a) the consolidated financial statements and notes, set out on pages 38 to 83, are in accordance with the *Corporations Act 2001*, including:
 - (i) complying with relevant Australian Accounting Standards and the *Corporations Regulations 2001*; and
 - (ii) giving a true and fair view of the Group's financial position as at 30 June 2012 and of its performance for the financial year ended on that date; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Note 1(a) confirms that the consolidated financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The Directors have been given the declarations by the Executive Chairman and Chief Financial Officer required by Section 295A of the *Corporations Act 2001*.

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

On behalf of the Directors:



Mr Robert Hosking
Executive Chairman

14 September 2012
Melbourne



Independent Auditor's Report to the Members of Karoon Gas Australia Ltd

Report on the Financial Report

We have audited the accompanying financial report of Karoon Gas Australia Ltd (the 'Company'), which comprises the consolidated statement of financial position as at 30 June 2012, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and consolidated statement of cash flows for the financial year ended on that date, a summary of significant accounting policies, other explanatory notes and the Directors' Declaration for the Karoon Gas Australia Ltd Group (the 'Group'). The Group comprises the Company and the subsidiaries it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the Financial Report

The Directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the Directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the Directors also state, in accordance with *Australian Accounting Standard AASB 101 'Presentation of Financial Statements'*, that the financial statements comply with International Financial Reporting Standards.

Auditor's Responsibility

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

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

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

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

PricewaterhouseCoopers
ABN 52 780 433 757

Freshwater Place, 2 Southbank Boulevard, SOUTHBANK VIC 3006, GPO Box 1331, MELBOURNE VIC 3001, DX 77
T: +61 3 8603 0000 F: +61 3 8603 1999 www.pwc.com.au

Liability limited by a scheme approved under Professional Standards Legislation.

Independence

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

Auditor's Opinion

In our opinion:

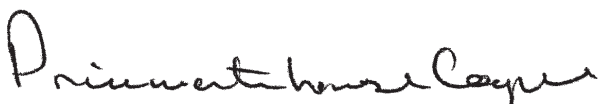
- (a) the financial report of Karoon Gas Australia Ltd is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the Group's financial position as at 30 June 2012 and of its performance for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and
- (b) the financial report and notes also comply with International Financial Reporting Standards, as disclosed in Note 1.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 21 to 34 of the Directors' Report for the financial year ended 30 June 2012. The Directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's Opinion

In our opinion, the Remuneration Report of Karoon Gas Australia Ltd for the financial year ended 30 June 2012, complies with section 300A of the *Corporations Act 2001*.



PricewaterhouseCoopers



Charles Christie
Partner

Melbourne
14 September 2012

The Company is committed to a high level of corporate governance and fostering a culture that values ethical behaviour, integrity and respect. It believes that adopting and operating in accordance with high standards of corporate governance is essential for sustainable long-term performance and value creation. This statement reports on the Company's key governance principles and practices.

The Company, as a listed entity, must comply with the *Corporations Act 2001*, the Australian Securities Exchange ('ASX') Listing Rules ('ASX Listing Rules') and other Australian and international laws. The ASX Listing Rules require the Company to report on the extent to which it has followed the Corporate Governance Recommendations contained in the ASX Corporate Governance Council's ('ASXCGC') second edition of its Corporate Governance Principles and Recommendations (August 2007 as amended in 2010).

A checklist cross-referencing the ASXCGC Recommendations to the relevant sections of this statement and the Annual Report is set out below. The Company's website contains copies of Board and Committee charters and copies of many of the policies and documents referred to in this statement.

ASXCGC Recommendations	Company's Practice	Compliance
Principle 1 – Lay solid foundations for management and oversight		
Establish and disclose the functions reserved to the board and those delegated to senior executives.	Paragraph 1.1 discloses the separation of responsibilities between the Board and senior executives. The Board Charter is disclosed on the Company's website.	✓
Disclose the process for evaluating the performance of senior executives.	Paragraph 1.5 discusses the process for evaluating senior executive performance. The Board Performance Review Policy is disclosed on the Company's website.	✓
Principle 2 – Structure the Board to add value		
A majority of the board should be independent directors.	Paragraphs 1.2 and 1.3 confirm that the Board currently consists of two Non-Executive Independent Directors, two Non-Executive but not Independent Directors and two Executive Directors. As discussed in paragraph 1.2 , the Company has a view to appointing a majority of Independent Directors in the future.	x
The chair should be an independent director.	Paragraph 1.2 identifies that the Chairman is currently the Executive Chairman and sets out why the Board considers it acceptable at this time.	x
The roles of chairperson and chief executive officer should not be exercised by the same individual.	Paragraph 1.2 identifies that the Chairman is currently the Executive Chairman and sets out why the Board considers it acceptable at this stage.	x
Establish a nomination committee consisting of a minimum of three members, with the majority being independent directors.	Paragraphs 1.4 and 3.2 detail the role and membership of the Nomination Committee.	✓
Disclose the processes for evaluating the performance of the board, its committees and individual directors.	Paragraph 1.5 details the process for evaluating the performance of the Board and its committees. The Board Performance Review Policy is disclosed on the Company's website.	✓

STATEMENT OF CORPORATE GOVERNANCE CONTINUED

ASXCGC Recommendations	Company's Practice	Compliance
Principle 3 – Promote ethical and responsible decision-making		
<p>Establish a code of conduct and disclose the code or a summary of the code as to:</p> <ul style="list-style-type: none"> the practices necessary to maintain confidence in the Company's integrity; the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders; and the responsibility and accountability of individuals for reporting and investigating unethical practices. 	<p>Paragraph 7.1 confirms that the Company has adopted a Code of Conduct. A copy of the Code of Conduct is disclosed on the Company's website.</p>	✓
<p>Establish a diversity policy and disclose the policy or a summary. The diversity policy should include a requirement for the board to establish measurable objectives for achieving gender diversity for the board to assess annually both the objectives and the progress in achieving them.</p>	<p>Paragraph 7.2 confirms that the Company has adopted and disclosed its Diversity Policy.</p>	✓
<p>Disclose in each annual report the measurable objectives for achieving gender diversity and progress towards achieving them.</p>	<p>Paragraph 7.2 sets out the measurable objectives to achieve gender diversity that the Board has set and the progress in achieving them.</p>	✓
<p>Disclose in each annual report the proportion of women employees in the Company, in senior executive positions and on the board.</p>	<p>Paragraph 7.2 discloses the proportion of women employees and women in senior management positions.</p> <p>Paragraph 1.2 indicates that there are currently no women on the Board.</p>	✓
Principle 4 – Safeguard integrity in financial reporting		
<p>Establish an audit committee.</p>	<p>Paragraph 3.1 confirms that the Board has established an Audit Committee.</p>	✓
<p>Structure the audit committee so that it:</p> <ul style="list-style-type: none"> consists only of non-executive directors; consists of a majority of independent directors; is chaired by an independent chair who is not chair of the board; and has at least three members. 	<p>Paragraph 3.1 describes the structure of the Audit Committee.</p>	✓
<p>The audit committee should have a formal charter.</p>	<p>Paragraph 3.1 confirms the Company has adopted a formal Audit Committee Charter which is disclosed on the Company's website.</p>	✓
Principle 5 – Make timely and balanced disclosure		
<p>Establish and disclose written policies designed to:</p> <ul style="list-style-type: none"> ensure compliance with ASX Listing Rule disclosure requirements; and ensure accountability at a senior executive level for that compliance. 	<p>Paragraph 7.6 describes the Company's approach to disclosure and confirms that the Company has established a written Continuous Disclosure Policy which is available on the Company's website.</p>	✓

ASXCGC Recommendations	Company's Practice	Compliance
Principle 6 – Respect the rights of shareholders		
Design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings. Disclose the policy or a summary of that policy.	A summary of the Company's policy for communicating with shareholders is disclosed at paragraph 9 .	✓
Principle 7 – Recognise and manage risks		
Establish policies for the oversight and management of material business risks and disclose a summary of those policies.	Paragraph 5 describes the Company's approach to risk management and confirms the Company's adoption of a formal Risk Management Policy.	✓
Require management to design and implement the risk management and internal control system to manage the company's material business risks and report to the board on whether those risks are being managed effectively. Disclose that management has reported to the board as to the effectiveness of the company's management of its material business risks.	Paragraphs 4 and 5 describe the Company's approach to risk management, internal controls and senior management's responsibility for implementing and reporting on effective risk management.	✓
Disclose whether the board has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of the <i>Corporations Act 2001</i> is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.	Paragraph 4 confirms that the Board has received this assurance from the Executive Chairman and Chief Financial Officer.	✓
Principle 8 – Remunerate fairly and responsibly		
Establish a remuneration committee.	Paragraph 3.3 confirms that the Board has established a Remuneration Committee.	✓
Structure the remuneration committee so that it: <ul style="list-style-type: none"> • consists of a majority of independent directors; • is chaired by an independent chair; and • has at least three members. 	Paragraph 3.3 describes the structure of the Remuneration Committee.	✓
Clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.	Paragraph 9 describes the Company's approach to the remuneration of Executive and Non-Executive Directors. Further information regarding the remuneration of Directors and other key management personnel is set out in the Directors' Report (Remuneration Report section) of this Annual Report.	✓

1. Board of Directors

1.1 Role of the Board

The role and responsibilities of the Board are to oversee and direct the senior management of the Company by:

- defining and monitoring the strategic direction of the Company;
- defining policies and procedures to ensure the Company operates within the legal, ethical and social requirements of its environment;
- establishing control and accountability systems within the Group's operations to conform to the legal requirements and the expectations of shareholders and other stakeholders;
- defining and monitoring the management of an effective risk assessment strategy;
- securing funds to develop the Company's assets;
- driving Company performance;
- from time to time, reviewing and monitoring management and Company performance;
- appointing and appraising the Executive Chairman and any other Executive Director;
- ensuring there are adequate plans and procedures for succession planning;
- reviewing and approving the remuneration of the Executive Chairman, any other Executive Director and senior executives;
- approving and monitoring the progress of major capital expenditure, capital management, acquisitions and divestitures; and
- approving and monitoring financial and other reporting.

The Executive Chairman is responsible for managing the Company in accordance with the strategy, plans and policies approved by the Board. The Executive Directors and other key management personnel are responsible for the day to day management and administration of the Company. The Board has policies and procedures in place to assess the performance of the Executive Directors.

The role and responsibilities of the Board are listed in the Company's Board Charter, which can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

1.2 Composition of the Board

The Board is currently constituted by six Directors, the skills, experience and expertise relevant to the position of each Director who is in office at the date of the Annual Report and their term of office are detailed in the Directors' Report.

The Company's Chairman also acts as its Chief Executive Officer. The Company's Chairman was also the Company's founding Director and is one of the Company's substantial shareholders. Given the stage of the Company's growth, the Board considers it acceptable for the Chairman to be an Executive Director and not independent.

The composition of the Board is reviewed on an ongoing basis having regard to the growth of the Company's business, with a view to appointing a majority of Independent Directors in the future.

The Board considers that collectively its current composition is appropriate for the size and activities of the Company. Directors have the range of skills, knowledge and experience necessary to direct the Company effectively. The Non-Executive Directors contribute operational and international experience, an understanding of the industry in which the Company operates, knowledge of financial markets and an understanding of the health, safety, environmental and community matters that are important to the Company. The Executive Directors bring an additional perspective to the Board through a thorough understanding of the Group's business as a whole.

While the directors on the Board represent a diverse range of nationalities and backgrounds, the Board recognises the current gender imbalance and the need to address it in the future as the Company and Board evolve. The Board has assessed the benefits of electing a lead Independent Director but considers such an appointment to be unwarranted at this time considering the Company's current size and activities.

1.3 Independence of Directors

When determining the independent status of a Director, the Board has adopted the definition of independence as set out in the Corporate Governance Principles. Accordingly, the Board considers a Director not to be independent if he or she:

- is a substantial shareholder of the Company or an officer of, or otherwise associated directly with, a substantial shareholder of the Company;
- is employed, or has previously been employed in an executive capacity by the Company or another Group company, and there has not been a period of at least three years between ceasing such employment and serving on the Board;
- has within the last three years been a principal of a material professional adviser or a material consultant to the Company or another Group company, or an employee materially associated with the service provided; or
- is a material supplier or customer of the Company or other Group company, or an officer of or otherwise associated directly or indirectly with a material supplier or customer who has a material contractual relationship with the Company or another Group company other than as a Director.

The test of whether a relationship or business is material is based on the nature of the relationship or business and on the circumstances and activities of the Director. Materiality is considered from the perspective of the Company and its Group companies, the persons or organisations with which the Director has an affiliation and from the perspective of the Director.

Mr Geoff Atkins and Mr Clark Davey are considered to be Independent Non-Executive Directors based on the above.

The Non-Executive Directors of the Company are Mr Geoff Atkins, Mr Clark Davey, Mr Stephen Power and Mr Jose Coutinho Barbosa. The Board has had an equal number of Independent and Non-Independent Non-Executive Directors since the appointment of Mr Jose Coutinho Barbosa on 31 August 2011.

The Company considers Mr Stephen Power and Mr Jose Coutinho Barbosa to be Non-Independent Directors, due to companies in which Mr Power and Mr Barbosa each have an interest, providing significant services to the Group. Services rendered are, however, provided by the relevant related party companies on normal commercial terms and conditions and at market rates. In practice, both of these Non-Executive Directors act in a capacity of oversight and advice in a fashion that is considered by the Company to be as de-facto Independent Directors.

1.4 Selection and Appointment of Directors

The ongoing composition of the Board is overseen by the Nomination Committee which has specific responsibility for:

- identifying and recommending to the Board nominees for membership of the Board, including the position of Chief Executive Officer;
- identifying and assessing the necessary and desirable competencies and characteristics for Board membership and regularly assessing the extent to which those competencies and characteristics are represented on the Board;
- developing and implementing processes to identify and assess necessary and desirable competencies and characteristics for Board members and reviewing the size of the Board;
- developing and implementing processes to evaluate the performance of the Board, its committees and Directors, including an evaluation of time required from Non-Executive Directors and whether such time requirements are being met;
- establishing succession plans to maintain an appropriate balance of skills and diversity on the Board and reviewing those plans;
- regularly assessing and reviewing the Selection and Appointment of Directors Policy; and
- recommending the removal or re-election of Directors.

The procedure for selecting and recommending candidates for appointment or re-appointment as Directors can be found in the Nomination Committee Charter, which can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

1. Board of Directors (continued)

1.5 Review of Board, Director and Senior Executive Performance

During the financial year, performance evaluation of the Executive Directors was undertaken in accordance with the Performance Review Policy and submitted to the Remuneration Committee. Non-Executive Directors also received a formal evaluation.

The Board, in consultation with the Executive Directors, establish the Executive Directors' performance targets for each performance period. The performance targets for senior executives are set in consultation with his or her superior on an annual basis.

Performance evaluations for senior executives have taken place during the financial year, in accordance with the process described in the Performance Review Policy.

The Performance Review Policy for the Board and senior executives can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

2. Operation of the Board

2.1 Board Meetings

The Board meets at least every two months with additional committee meetings, if and when required, to discuss specific matters.

2.2 Independent Advice

Subject to the approval of the Board, an individual Director may engage an independent professional adviser, at the Company's expense, in appropriate circumstances.

2.3 Role of the Company Secretary

All Directors have access to the Company Secretary. The appointment and removal of the Company Secretary is a matter for decision by the Board.

The Company Secretary is accountable to the Board, through the Chairman, on all corporate governance matters.

The Company Secretary supports the effectiveness of the Board by monitoring compliance with Board policy and procedures and coordinating the completion and despatch of the Board papers.

3. Board Committees

The Board has the ability under the Company's Constitution to delegate its process and responsibilities to committees of the Board. The Board has established three standing committees to assist it in effectively exercising its responsibilities. These are the:

- Audit Committee;
- Nomination Committee; and
- Remuneration Committee.

3.1 Audit Committee

The role of the Audit Committee is to advise on the establishment and maintenance of a framework of internal financial control and the appropriate ethical standards for the financial management of the Group. The Company has formally adopted an Audit Committee Charter.

The Audit Committee also reviews the quality and reliability of financial information prepared for use by the Board in determining policies or for inclusion in financial statements.

The responsibilities of the Audit Committee include:

- reviewing the integrity of the Company's financial reporting and overseeing the independence of external auditors;
- liaising with external auditors and ensuring that the annual statutory audits and half year auditor reviews are conducted in an effective manner;
- reviewing internal controls and recommending improvements;
- reviewing the half year financial report prior to lodgement of this document with the ASX, and any significant adjustments required as a result of the review;
- reviewing the draft annual financial report and the independent auditor's report and making the necessary recommendations to the Board for approval of the annual financial report;
- reviewing treasury recommendations and making necessary recommendations to the Board for approval; and
- reviewing and reporting on any special reviews deemed necessary by the Board.

The Audit Committee reports to the Board after each Committee Meeting and minutes of meetings are provided to all Directors.

A full description of the role and responsibilities of the Audit Committee is contained in the Audit Committee Charter, which can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

The Audit Committee consists of three Non-Executive Directors, a majority of whom are Independent Directors and is chaired by an Independent Director.

The Audit Committee consists of:

- Clark Davey (Chairman of the Committee);
- Geoff Atkins; and
- Stephen Power.

The record of attendance for each of the members of the Audit Committee is set out in the Directors' Report of the Annual Report.

3.2 Nomination Committee

The role of the Nomination Committee is described above at paragraph 1.4.

The Nomination Committee consists of a majority of Independent Directors and is chaired by an Independent Director.

The Nomination Committee consists of:

- Geoff Atkins (Chairman of the Committee);
- Clark Davey; and
- Stephen Power.

A full description of the role and responsibilities of the Nomination Committee, together with the Company's Selection and Appointment of Directors Policy, is contained in the Nomination Committee Charter, which can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

The record of attendance for each of the members of the Nomination Committee is set out in the Directors' Report of the Annual Report.

3. Board Committees (continued)

3.3 Remuneration Committee

The Remuneration Committee is responsible for the review of and recommendation to the Board on:

- the Group's recruitment, retention and termination policies and procedures for senior executives;
- senior executives' and Executive Directors' remuneration and incentives;
- superannuation arrangements; and
- the remuneration framework for Non-Executive Directors.

The Company's remuneration policy is designed to ensure that:

- remuneration is competitive in order to attract and retain talented and motivated employees and Directors to the Group;
- there is a clear relationship between performance, responsibility, results delivered and remuneration; and
- a performance evaluation process is created to monitor the Board and senior executives.

A full description of the role and responsibilities of the Remuneration Committee is contained in the Remuneration Committee Charter, which can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

The Remuneration Committee consists of a majority of Independent Directors and is chaired by an Independent Director.

The Remuneration Committee consists of:

- Geoff Atkins (Chairman of the Committee);
- Clark Davey; and
- Stephen Power.

The record of attendance for each of the members of the Remuneration Committee is set out in the Directors' Report of the Annual Report.

4. Executive Chairman and Chief Financial Officer Assurance

The Board requires accountability for the Company's annual financial report by requiring both the Executive Chairman and Chief Financial Officer to confirm in writing to the Board that:

- the financial records of the Company for the financial year ended 30 June have been properly maintained in accordance with Section 286 of the *Corporations Act 2001*;
- the consolidated financial statements and notes for the financial year ended 30 June comply with relevant Australian Accounting Standards;
- the consolidated financial statements and notes for the financial year ended 30 June give a true and fair view; and
- any other matters that are prescribed by the regulations for the purposes of Section 295A(2)(d) of the *Corporations Act 2001* in relation to the consolidated financial statements and the notes for the financial year ended 30 June are satisfied.

The Executive Chairman and Chief Financial Officer have provided written confirmation to the Board in respect of the matters referred to above.

5. Risk Assessment and Management

The Company adopted a formal Risk Management Policy during the financial year, with the Board responsible for reviewing the policy and its implementation. The Board has overall responsibility for monitoring compliance and oversight of the Risk Management Policy along with ensuring that it is relevant and effective.

Currently, as part of the Group's strategy to implement an integrated framework of control, the Board continually identifies and monitors the material business and financial risks. The Board has and continues to develop appropriate controls to effectively manage those risks. Throughout the financial year, the Company has reviewed and, where required, improved risk management and internal compliance and control systems following reports from senior management. The Company will continue to review and improve its risk management systems in conjunction with senior management over the coming financial periods.

A summary of the Company's policies for the oversight and management of material business and financial risks follows:

- financial controls are set in place by the use of an authority matrix, general purchasing principles and approval procedures. All material expenditure is closely monitored by the Audit Committee on behalf of the Board and reported on a periodic basis. The Chairman of the Audit Committee also works closely with the Company's finance personnel prior to Board meetings in order to understand financial risks and report such risks to the Board. Management accounts are prepared regularly for the Board to ensure information congruence between senior management and the Board;
- the Company offsets the risk of catastrophic operational failures using appropriate insurance, with covers for third party liability, well control, day-to-day office and business insurance and operator's extra expense;
- the Company protects its employees through the adoption and application of a Health, Safety and Environment Policy, global medivac membership program and travel insurance for periods where employees are travelling on business, along with membership to emergency assistance and management for all employees in overseas locations; and
- operational reporting is submitted to the Board at each Board meeting to ensure decisions are made in an efficient and effective manner. Reports include reviews of operational assets, potential exploration, new ventures and general operational issues and/or opportunities.

The Company's Risk Management Policy can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

6. External Auditors

The Company appointed the current external auditors, PricewaterhouseCoopers, during the financial year ended 30 June 2009.

The Audit Committee oversees the co-ordination of the external auditors and monitors the effectiveness and independence of the external auditor.

Furthermore, the Company has prepared an External Auditor Selection Policy, pursuant to which the External Auditor is required to rotate its audit partner so that no partner is responsible for the Company's accounts for a period of more than five consecutive years.

The Company's External Auditor Selection Policy can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

7. Ethical Standards and Responsible Decision Making

The Directors, officers, employees and consultants of the Company are required to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of the Group.

7.1 Code of Conduct

The Company has developed a Code of Conduct for the Board, senior management and employees of the Company.

The Code includes:

- the practices necessary to maintain confidence in the Company's integrity;
- the practices necessary to take into account their legal obligations and the reasonable expectations of stakeholders; and
- the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

A copy of the Company's Code of Conduct can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

7. Ethical Standards and Responsible Decision Making (continued)

7.2 Diversity

The Board recognises the importance of diversity and has adopted a Diversity Policy in accordance with the ASXCGC Recommendations. The Company has introduced measureable objectives for achieving gender diversity and the Board assesses the objectives and progress towards achieving them on an annual basis. The measurable objectives for achieving gender diversity set by the Board for the financial year and the Company's progress towards achieving them are:

Measurable Objective	Company's Progress
Undertake an assessment of the current diversity of the Karoon workforce and diversity issues that Karoon employees face.	An assessment has been conducted and management is aware of issues concerning diversity.
Provide equal opportunity with respect to recruitment, compensation and promotion, including promotion to senior management or Board positions.	Karoon considers itself an equal opportunity employer, see table below.
Structure the Board, senior management, and employee annual performance evaluations in a manner to ensure the Diversity Policy is considered.	All performance and remuneration evaluation practices take into account the Company's Diversity Policy and all employees are evaluated equally.
Promote equal pay for equal work for all employees and senior executives at all levels.	Karoon's remuneration practices are conducted on a position and performance basis only. Equal pay for equal work is established.
Develop a culture which takes account of domestic responsibilities of employees.	Karoon provides flexible work schedules for those that require them from time to time.

See the table below setting out the Karoon workforce gender profile:

	Female	Female %
Group (includes administration/technical/specialists)	20	44%
Senior management	-	0%
Board	-	0%

The Company's Diversity Policy can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

7.3 Fair Dealings and Related Party Transactions

A Director, or entities in which a Director has a significant interest and/or influence, who proposes to enter into a transaction with the Company, must make full disclosure of all material elements of the transaction to the Chairman, or, if the Director involved is the Chairman, to the Board.

In addition, contracts with Directors, or entities in which Directors have a significant interest and/or influence, must be approved by the Audit Committee in advance of committing the Company to:

- contracts for the supply of goods and/or services which extend beyond one year, or where the total value of goods and/or services supplied under the contract will, in any one year, exceed \$25,000;
- all agreements to lease and/or leases of property; and
- all agreements for the acquisition or disposal of property, except by way of public auction.

Any Director who is a member of the Audit Committee and who has a significant interest and/or influence in relation to a contract to be approved by the Audit Committee must absent themselves from the meeting and not participate in any vote to approve such contract.

7.4 Policy and Procedure for Share Trading

Directors, officers, employees and consultants are prohibited from dealing in securities of the Company if they are in possession of information concerning the Group which, if made public, a reasonable person would expect to have a material impact on the price or value of the Company's securities ('insider information').

Directors, officers, key management personnel and other designated persons are prohibited from dealing in securities of the Company during any embargo period declared by the Chairman or Company Secretary. Embargo periods include the period of two weeks prior to the release of the Company's half year results and final results to the ASX and the period from the close of trading 10 days before the Company's Annual General Meeting.

These restrictions in dealing in securities of the Company are subject to the discretion of the Chairman, to be exercised in exceptional circumstances.

Prior to dealing in securities of the Company, Directors, officers, key management personnel and other designated persons must:

- seek written clearance from the Chairman or Company Secretary of the proposed dealing to ensure that there is not any imminent ASX announcement that contains price sensitive information; and
- confirm to the Chairman or Company Secretary that he or she is not aware of any insider information that has not been released to the ASX.

Directors, officers, key management personnel and other designated persons must advise the Company Secretary of any dealing in securities of the Company within two days of such dealing.

The Company's Share Trading Policy can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

7.5 Environment

The Company has a Health, Safety and Environment Policy and is committed to conducting all of its activities in an environmentally responsible manner.

The Company's Health, Safety and Environment Policy can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

7.6 Disclosure of Information

The Company aims to provide honest and open disclosure of information in dealing with stakeholders, subject to appropriate commercial considerations associated with competitive and sensitive information.

The Company has developed a Continuous Disclosure Policy to ensure compliance by the Company with the *Corporations Act 2001* and the ASX Listing Rules obligations in relation to disclosure of information to the market and to ensure accountability at a senior management level for that compliance.

The Company's Continuous Disclosure Policy can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

8. Remuneration Policy

The Company seeks to remunerate in such a way that it motivates Directors and employees to pursue the long-term growth and success of the Company within an appropriate remuneration framework that demonstrates a clear relationship between performance and remuneration. The Remuneration Committee is responsible for senior executive remuneration and making recommendations to the Board.

Executive Director remuneration is set by the Board and may contain salary, bonuses and other share-based incentives.

Non-Executive Directors are remunerated by way of Directors' fees in the form of cash and superannuation contribution at market levels, as well as non-performance related share option incentives. The Company has not established any schemes for retirement benefits, other than superannuation, for Non-Executive Directors.

The aggregate Directors' fee pool to Non-Executive Directors is set and may not be increased without the prior approval of shareholders at a general meeting.

Unlisted options over unissued ordinary shares of the Company issued to Directors are approved on a case-by-case basis by shareholders at relevant general meetings.

The Company has a policy restricting recipients of ESOP and other share options from:

- dealing at any time in financial products such as options, warrants, futures or other financial products issued over the Company's securities by third parties such as banks and other institutions. An exception may apply where the Company's securities form a component of a listed portfolio or index product; and/or
- entering into transactions in products associated with the Company's securities which operate to limit the economic risk of their security holding in the Company over unvested entitlements (including hedging arrangements).

These restrictions are set out in the Company's Share Trading Policy, which can be found under the Corporate Policies tab on the Company's website at www.karoongas.com.au.

Further information on the remuneration of the Directors and other key management personnel can be found in the Remuneration Report section of the Directors' Report.

9. Communication with Shareholders

The Board aims to ensure that shareholders are informed of all major developments affecting the Company in accordance with its legal obligations. Information is communicated to shareholders as follows:

- the Annual Report is distributed to shareholders who request a copy. The Board ensures that the Annual Report includes relevant information about the operations of the Group during the relevant financial year, changes in the state of affairs of the Group and other disclosures required by the *Corporations Act 2001* and the ASX Listing Rules;
- the half year financial report, prepared in accordance with the requirements of the *Corporations Act 2001*, is subject to an external auditor's review. The half year financial report is sent to any shareholder who requests a copy;
- proposed major changes in the Company which may impact on share ownership rights are submitted to a vote of shareholders; and
- the Company posts all reports, ASX and media releases and copies of significant presentations on the Company's website at www.karoongas.com.au.

In addition, news announcements and other information are sent by email to all persons who have requested their details be added to the Company's electronic mailing list. If requested, the Company, where appropriate, will provide general information by email, facsimile or post.

The Company ensures that the Annual General Meeting is held in a manner which enables as many shareholders as possible to attend and encourages effective participation by shareholders at the Annual General Meeting.

The Company will arrange to have its external auditor attend the Company's Annual General Meeting and be available to answer shareholder questions concerning the conduct of the audit and preparation and content of the Independent Auditor's Report.

The Chairman will allow a reasonable opportunity at the Annual General Meeting for shareholders to ask questions of the Directors about the Company's performance and operations.

ADDITIONAL SECURITIES EXCHANGE INFORMATION

Additional information required by ASX Listing Rules and not disclosed elsewhere in the Annual Report is set out below. The information was applicable for the Company as at 6 September 2012.

Distribution of Shareholding

The number of shareholders ranked by size of holding is set out below:

Size of Holding	Number of Holders	Number of Ordinary Shares on Issue
Less than 1,000	3,350	1,607,407
1,001 to 5,000	4,219	11,276,574
5,001 to 10,000	1,290	9,478,540
10,001 to 100,000	1,189	29,883,317
More than 100,000	124	169,174,931
Total	10,172	221,420,769

There were 725 shareholders holding less than a marketable parcel of ordinary shares to the value of \$500.

Substantial Shareholders

The number of ordinary shares held by substantial shareholders and their associates (who held 5% or more of total fully paid ordinary shares on issue), as disclosed in substantial holder notices given to the Company, is set out below:

Shareholder	Fully Paid Ordinary Shares	
	Number Held	% of Issued Ordinary Shares
Wellington Management Group, LLP and its related bodies corporate	28,476,840	12.86
Talbot Group Holdings Pty Ltd	26,358,356	11.90
Mr Robert Hosking	12,524,462	5.66
FMR Corp. and FIL	11,215,573	5.07
Total	78,575,231	35.49

Twenty Largest Shareholders

The names of the 20 largest shareholders of the Company's ordinary shares are listed below:

Shareholder	Fully Paid Ordinary Shares	
	Number Held	% of Issued Ordinary Shares
1 HSBC Custody Nominees (Australia) Limited	39,368,646	17.78
2 JP Morgan Nominees Australia Limited	28,536,650	12.89
3 Talbot Group Holdings Pty Ltd <Talbot Equities A/C>	15,317,043	6.92
4 Talbot Group Investments Pty Ltd	11,000,313	4.97
5 National Nominees Limited	10,304,695	4.65
6 Ropat Nominees Pty Ltd	9,210,022	4.16
7 JP Morgan Nominees Australia Limited <Cash Income A/C>	7,099,040	3.21
8 Citicorp Nominees Pty Limited	6,200,771	2.80
9 UBS Wealth Management Australia Nominees Pty Ltd	2,886,855	1.30
10 HSBC Custody Nominees (Australia) Limited-GSCO ECA	2,316,457	1.05
11 Mr Robert Hosking	2,250,000	1.02
12 HSBC Custody Nominees (Australia) Limited – A/C 2	2,092,620	0.95
13 Mr Mark Smith	1,500,000	0.68
14 IERS (Australia) Pty Ltd <Smith Family Investment A/C>	1,271,500	0.57
15 AMP Life Limited	1,174,900	0.53
16 Mrs Mara Spong	1,127,888	0.51
17 T A G Constructions Pty Ltd	1,000,000	0.45
18 Citicorp Nominees Pty Limited <Colonial First State INV A/C>	997,188	0.45
19 Erskine Super Company Pty Ltd <Erskine Invest Staff S/F A/C>	819,842	0.37
20 Rose Burton Pty Ltd	796,692	0.36
Total	145,271,122	65.61

ADDITIONAL SECURITIES EXCHANGE INFORMATION CONTINUED

Unlisted Equity Securities: Options

The following options over unissued ordinary shares of the Company were unquoted:

	Number of Holders	Number of Unlisted Options on Issue
Options issued pursuant to Company's ESOP	49	5,495,000
Other share options issued	5	6,150,000
Total	54	11,645,000

Voting Rights

(a) Ordinary Shares, Fully Paid

Voting rights of shareholders are governed by the Company's Constitution. In summary, 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 such attending shareholder is entitled to one vote for every fully paid ordinary share held.

(b) Unlisted Options

No voting rights.

Other Information

The Company was incorporated as a public company on 11 November 2003.

The Company was admitted to the ASX official list during June 2004 and quotation of its ordinary shares commenced on 8 June 2004.

The register of securities is held at Computershare Investor Services Pty Limited, Yarra Falls, 452 Johnston Street, Abbotsford VIC 3067 Australia. Investor enquiries can be made via telephone on 1300 850 505 (within Australia).

Schedule of Interests

Exploration Permit	Basin	% Interest Held
WA-314-P	Browse, Australia	90.00*
WA-315-P	Browse, Australia	40.00*
WA-398-P	Browse, Australia	40.00
Block S-M-1037	Santos, Brazil	100.00
Block S-M-1101	Santos, Brazil	100.00
Block S-M-1102	Santos, Brazil	100.00
Block S-M-1165	Santos, Brazil	100.00
Block S-M-1166	Santos, Brazil	100.00
Block S-M-1352	Santos, Brazil	20.00^
Block 144	Maranon, Peru	100.00
Block Z-38	Tumbes, Peru	75.00#

* 1.5% ORR for first five years of production, going to 2% thereafter.

^ The Group's 20% participating interest in the Block is subject to satisfying farm-in obligations and obtaining regulatory approvals from ANP.

The Group's 75.00% Block equity interest is subject to completion of farm-in obligations.

Term	Definition
2D seismic	Two-dimensional seismic.
3D seismic	Three-dimensional seismic.
\$ or cents	Units of Australian currency.
AASB	Australian Accounting Standards Board.
ANP	Agencia Nacional do Petróleo.
API	American Petroleum Institute's inverted scale for denoting the 'lightness' or 'heaviness' of crude oils and other liquid hydrocarbons.
appraisal well	A well drilled to confirm the size or quality of a hydrocarbon discovery.
associated gas	Natural gas found in association with oil, dissolved either in the oil or as a cap of free gas above the oil.
ASX	ASX Limited (ACN 008 624 691), trading as Australian Securities Exchange.
ATO	Australian Taxation Office.
AUD	Australian currency.
barrel or bbl	Barrel of oil, inclusive of condensate. A quantity of 42 United States gallons; equivalent to approximately 159 litres.
basin	An ancient natural depression on the earth's surface in which sediments, eroded from higher surrounding ground levels, accumulated and were preserved.
BCF	Billion cubic feet (1,000,000,000 cubic feet); equivalent to approximately 28.3 million cubic metres.
block	A licence or concession area. It may be almost any size or shape, although usually part of a grid pattern.
boe	Barrel of oil equivalent. The factor used to convert gas to oil equivalent is based upon an approximate energy value of 6,000 standard cubic feet per barrel and not price equivalence at the time.
BOP	Blowout preventer.
BTU	British Thermal Unit. The unit of measurement of the quantity of heat required to raise the temperature of one pound of water by one degree fahrenheit, equivalent to 1055.056 joules.
Company or Parent Company	Karoon Gas Australia Ltd.
condensate	Hydrocarbons which are predominantly pentane and heavier compounds which are in a gas phase in the reservoir and which separate out from natural gas at the well head and condense to liquid at lower pressures and temperatures.
ConocoPhillips	ConocoPhillips (Browse Basin) Pty Ltd.
contingent resources	Quantities of hydrocarbons which are estimated, on a given date, to be potentially recoverable from known accumulations, but which are not yet currently considered to be commercially recoverable for lack of market or suitable price.
Director	A Director of Karoon Gas Australia Ltd.
DHI	Direct hydrocarbon indicator.
discovery well	The first successful well on a new prospect.
DSEWPac	Department of Sustainability, Environment, Water, Population and Communities.
DST	Drill stem test.
economically recoverable reserves	The estimated quantity of hydrocarbons in an area of interest that can be expected to be profitably extracted, processed and sold under current and foreseeable economic conditions.
EDT	Eastern Daylight Time, being the time in Melbourne, Victoria.
EIA	Environmental Impact Assessment. A report on the study of the effect of proposed works on the local people and environment.

Term	Definition
ESOP	The Karoon Gas Australia Employee Share Option Plan.
exploration	The process of identifying, discovering and testing prospective hydrocarbon regions and structures, mainly by interpreting regional and specific geochemical, geological, geophysical survey data and drilling.
farm-in and farm-out	A commercial agreement in which an incoming joint venture participant (the farmee) earns an interest in an exploration permit by funding a proportion of exploration and evaluation expenditures, while the participant owning the interest in the exploration permit (the farmor) pays a reduced contribution. The interest received by a farmee is a farm-in while the interest transferred by the farmor is a farm-out.
FBT	Fringe Benefits Tax in Australia.
FID	Final Investment Decision.
field	An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature or stratigraphic condition. The field name refers to the surface area although it may refer to both the surface and underground productive formation.
financial year	Financial year ended 30 June 2012.
GST	Goods and Services Tax in Australia.
hydrocarbon	A compound of the elements hydrogen and carbon, in either liquid or gaseous form. Natural gas and petroleum are mixtures of hydrocarbons.
IASB	International Accounting Standards Board.
Karoon or Group	Karoon Gas Australia Ltd and its subsidiaries.
lead	A potential hydrocarbon target which has been identified but requires further evaluation before it is drill ready, at which point it becomes a prospect.
LNG	Liquefied natural gas.
LPG	Liquid petroleum gas.
LTi	Long-term incentive.
m	Metres.
market capitalisation	The product of a company's share price multiplied by the total number of ordinary shares issued by the company.
migration	Hydrocarbons are often found in formations other than those in which their organic source was deposited. This movement often covers considerable distances and is known as migration.
mm	Million.
mmbbls	Millions of barrels (1,000,000 barrels).
mmscf/d	Millions of standard cubic feet per day; equivalent to 28,317 cubic metres per day.
MMtpa	Million tonne per annum. A common measurement of LNG facility production capacity.
Monte Carlo simulation	Where there is uncertainty in the variables used in the calculation of economically recoverable reserves, the ranges of possible values of each variable can be incorporated in a Monte Carlo simulation calculation to produce a range of probabilistic outcomes that reflect that uncertainty. The 'mean' is the expected outcome. The P10 (probability greater than 10%) is often used as the maximum case, the P50 (probability of 50%) the mid case and the P90 (probability greater than 90%) the minimum case.
mRT	Metres rotary table.
NGER Act	National Greenhouse and Energy Reporting Act 2007.
operator	One joint venture participant that has been appointed to carry out all operations on behalf of all the joint venture participants.

Term	Definition
ordinary shares	The ordinary shares in the capital of Karoon Gas Australia Ltd.
ORR	Over-riding royalty.
p.a.	Per annum.
permit	A hydrocarbon tenement, lease, licence, concession or Block.
Petrobras	Petróleo Brasileiro SA.
play	A trend within a prospective basin that has common geologic elements containing one or more fields, prospects or leads with common characteristics.
previous financial year	Financial year ended 30 June 2011.
PRP	Karoon Gas Australia Ltd Performance Rights Plan 2012 (proposed).
prospect	A geological or geophysical anomaly that has been surveyed and defined, usually by seismic data, to the degree that its configuration is fairly well established, and on which further exploration such as drilling can be recommended.
prospective resource	The term used to describe undiscovered volumes in an exploration prospect yet to be drilled.
prospectivity	Referring to the likelihood of finding commercial hydrocarbons.
PRRT	Petroleum Resource Rent Tax.
psia	Pounds per square inch absolute.
REAL	Brazilian currency.
recoverable gas	An estimated measure of the total amount of gas which could be brought to surface from a given reservoir. In a good quality reservoir this is usually in the order of 70-80% of the estimated gas-in-place.
reserves	Quantities of economically recoverable hydrocarbons estimated to be present within a trap.
reservoir	A porous and permeable rock formation to store and transmit fluids such as hydrocarbons and water.
rig	The equipment needed for drilling a well. It includes the onshore and offshore vehicles, mobile platforms or vessel on which the equipment is stored.
rights	Performance Rights.
risk	Prospect risk or geologic risk is the assessed chance that the drilling of the prospect will be successful in finding significant volumes of hydrocarbons. The risk is calculated by multiplying the chance of success of each of the petroleum system elements involved in the prospect.
seismic survey	A type of geophysical survey where the travel times of artificially created seismic waves are measured as they are reflected in a near vertical plane back to the surface from subsurface boundaries. This data is typically used to determine the depths and form of stratigraphic units and in making subsurface structural contour maps and ultimately in delineating prospective structures.
spud	To start drilling a new well.
STI	Short-term incentive.
TCF	Trillion cubic feet (1,000,000,000,000 cubic feet).
TSR	Total shareholder return.
unrisked	A risk value has not been applied to an estimate of hydrocarbon volume either in place or recoverable.
USD	United States dollars.

CORPORATE DIRECTORY

Board of Directors

Mr Robert Hosking – Executive Chairman
 Mr Mark Smith – Executive Director
 Mr Geoff Atkins – Independent Non-Executive Director
 Mr Clark Davey – Independent Non-Executive Director
 Mr Stephen Power – Non-Executive Director
 Mr Jose Coutinho Barbosa – Non-Executive Director

Company Secretary

Mr Scott Hosking

Audit Committee Members

Mr Clark Davey (Chairman of Committee)
 Mr Geoff Atkins
 Mr Stephen Power

Nomination Committee Members

Mr Geoff Atkins (Chairman of Committee)
 Mr Clark Davey
 Mr Stephen Power

Remuneration Committee Members

Mr Geoff Atkins (Chairman of Committee)
 Mr Clark Davey
 Mr Stephen Power

Registered Office and Head Office

Office 7A, 34-38 Lochiel Avenue
 Mount Martha VIC 3934
 Australia

ACN 107 001 338
ABN 53 107 001 338
Telephone + 61 3 5974 1044
Facsimile + 61 3 5974 1644
Website www.karoongas.com.au
Email info@karoongas.com.au

External Auditor

PricewaterhouseCoopers Australia
 Freshwater Place
 2 Southbank Boulevard
 Southbank VIC 3006
 Australia

Telephone + 61 3 8603 1000
Facsimile + 61 3 8603 1999

Share Registrar

Computershare Investor Services Pty Limited
 Yarra Falls
 452 Johnston Street
 Abbotsford VIC 3067
 Australia

Telephone 1300 850 505 (within Australia)
 + 61 3 9415 5000 (outside Australia)
Facsimile + 61 3 9473 2500
Website www.computershare.com

Securities Exchange Listing

The Company's ordinary shares are listed on the ASX.
 The home exchange is Melbourne VIC.

ASX code KAR

Notice of Annual General Meeting

The Annual General Meeting of Karoon Gas Australia Ltd will be held at:

River Rooms 2 and 3 at the Crown Towers
 Level 1, 8 Whiteman Street
 Southbank VIC 3006

Time 11.00am EDT
 (registration opens at 10.00am EDT)
Date Thursday 25 October 2012

