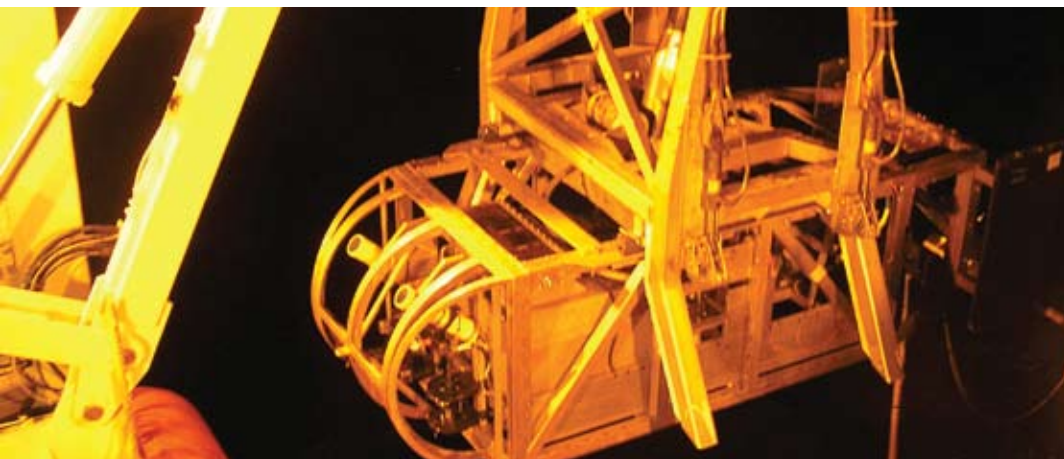




2010



ANNUAL REPORT




KAROON'S EXPLORATION AND APPRAISAL ASSETS IN AUSTRALIA, BRAZIL AND PERU PROVIDE GREAT OPPORTUNITIES AND SET THE STAGE FOR A VERY EXCITING UPCOMING FINANCIAL YEAR.



CONTENTS

03	2009-2010 Highlights Summary
04	Chairman's Report
07	2009-2010 Operations
12	Directors' Report
27	Auditor's Independence Declaration
28	Financial Statements
73	Directors' Declaration
74	Independent Auditor's Report
76	Statement of Corporate Governance
84	Additional Securities Exchange Information
86	Glossary of Terms
89	Corporate Directory



IT HAS BEEN A VERY ACTIVE YEAR FOR KAROON WITH THE DRILLING OF THREE WELLS AND ACQUISITION OF THREE LARGE 3D SEISMIC DATA SETS.

2009-2010 HIGHLIGHTS SUMMARY

During the financial year drilling and seismic work continued in the Browse Basin – Western Australia and geotechnical work was conducted in the Santos Basin – Brazil and the Tumbes Basin – Peru. Preparation for future works was also conducted in the Maranon Basin – Peru, and the Bonaparte Basin – Australia.

Australia

Following the Poseidon-1 success in 2009, Poseidon-2 was spudded in October 2009 and this well confirmed the presence of Plover sands in a down-dip location as anticipated. The well also penetrated what appears to be a reservoir quality Montara sand with possible indications of gas indicating a potential new shallower reservoir level. The Plover production test gave a low flow in Poseidon-2.

Concurrent with the drilling of the Poseidon-2 well in the Greater Poseidon structure, the Karoon/ConocoPhillips joint venture acquired a 2,828 square kilometre 3D seismic survey over the whole of the Greater Poseidon structure and surrounds. The seismic acquisition was completed early in 2010, and this, together with the data obtained from the three wells drilled to date, will be used to further evaluate the Poseidon structure and assist in planning further well locations in this structural complex.

Kronos-1 was drilled to 5,329mRT and production tested over the interval 4,999-5,052mRT. The maximum sustainable flow rate obtained during a multi-phase test was 26 million standard cubic feet per day (“mmscf/d”) through a 32/64 inch choke, with flowing well head pressure of 3,900psia.

Kontiki-1 exploration well was completed in October 2009 on a separate play and while logs gave some indications of hydrocarbons only low quality reservoir was penetrated at this location.

During August 2010 Karoon completed a Controlled Source Electro Magnetic (“CSEM”) geophysical survey on AC/P8. This survey was designed to test for indications of hydrocarbons by measuring the electrical resistivity of the subsurface remotely focusing on the leads within the acreage. Interpretation work is ongoing and expected to be completed later in 2010.

Peru

Early in 2010 a 1,500 square kilometre 3D seismic acquisition was conducted over Karoon’s Tumbes Basin Z-38 Block. The acquisition, using the CGG Veritas vessel ‘Geowave Endeavour’ is now being processed and early work on a fast track 3D seismic data set has confirmed the presence of a number of encouraging prospects. Interpretation is expected to be completed later in 2010.

Seabed Drop Cores in Karoon’s Tumbes Basin Z-38 Block were also acquired in July 2010. The seabed samples taken have been found to contain live oil from hydrocarbon seeps thought to migrate to surface through faults in the geological features.

Brazil

In early 2010 Karoon completed a 750 square kilometre wide azimuth 3D seismic acquisition program over its wholly owned Brazilian Blocks. The 3D seismic acquisition was completed by the WesternGeco vessel the ‘Western Patriot’. This seismic acquisition program, which covered all of the defined prospects and leads within the Blocks, is expected, once processed and interpreted, to allow vastly superior definition of structures beside and underneath salt bodies thereby allowing identification and better risk definition of new prospects and leads.

During August 2010, Karoon executed a farm-in Agreement with Petróleo Brasileiro SA (“Petrobras”) to acquire a 20% interest in Blocks BM-S-41/ S-M 1352 (Maruja Prospect) and BM-S-41/ S-M 1354 (Quasi Prospect) located in the offshore Santos Basin, Brazil. Subject to obtaining regulatory approvals in Brazil (including from the Brazilian Petroleum agency), Karoon will earn a 20% interest in both Blocks by funding 35% of a well in the Maruja Prospect, as part of a two well drilling program. Karoon will also pay its equity share of continued work and reimburse Petrobras for sunk costs.

CHAIRMAN'S REPORT

It has been a very active year for Karoon with the drilling of three wells and acquisition of three large 3D seismic data sets. Results from this work have contributed to the legitimacy of the Poseidon field in the Browse Basin and aided Karoon in its preparation for the commencement of drilling in Brazil and Peru in the coming financial year.

Karoon was delighted with the results of the Kronos-1 production test of 26mmscf/d through a 32/64 inch choke. The test indicates another culmination in the Greater Poseidon structure and this information will be crucial in future planning for drilling in 2011.

The Kronos-1 well followed the drilling of Poseidon-2 where a new reservoir was discovered over the target Plover reservoir and the Poseidon structure perimeter was confirmed. The Poseidon-2 test was, however, disappointing from the perspective of providing information about the quality of the reservoir at the Poseidon-2 location.

Karoon is looking forward to the re-commencement of exploration drilling on the Greater Poseidon structure, scheduled to begin in the first half of 2011. The objective of the new program is to explore untested fault block culminations within the Greater Poseidon structure, minimise risks in decision making on the development of the area, obtain information to assist with gas marketing and establish future financing.

Following the drilling of three wells in the past 12 months and commencement of seismic data interpretation, Karoon is satisfied with current results and maintains its most likely contingent resource estimate or P50 of 7TCF, with the potential for resource expansion.

The acquisition of seismic data in Brazil and Peru will provide Karoon with the data needed to prepare for future drilling campaigns. The seismic data has been structured to give Karoon optimal use of existing information, which will enable us to create an excellent geotechnical model of the source rocks, structures, leads and prospects along with direct comparisons to existing fields in the region. As more data is acquired and interpreted, Karoon will build greater knowledge of, and confidence in, the acreage acquired in South America.

Early data cubes from the Brazilian seismic acquisitions have provided further evidence of the prospectivity of Karoon's South American portfolio. In addition, continued discoveries in the Santos Basin by other companies is encouraging as shallow water regions have become a target area for good sized discoveries (for example, the Piracua Discovery which has 550 million boe in place, and is just five kilometres from the border of our Blocks). Karoon has now identified six prospects and one lead around three geological structures, all with prospective resource estimates of between 100 and 300 million boe in place.

Peruvian 3D seismic has provided additional clarity to the existing 2D data set acquired in early 2009. Karoon has further identified prospects and direct hydrocarbon indicators are present in the processed seismic. The work completed over this financial year provides Karoon with confidence in the prospectivity of its Tumbes Basin assets.

The Way Forward


Despite these positive results and strategic use of shareholder capital to conduct drilling and seismic acquisitions, Karoon, like all companies, has suffered at the hands of a turbulent year with volatile markets and fearful investors. While I was encouraged to see many new shareholders of all sizes entering the register, Karoon has traded below its previous high market capitalisation. This provided an opportunity for those with capital to invest and lament from others who had invested at higher prices. The Directors and management of Karoon are working diligently to capitalise on the Company's prospective value and prepare the Company for its significant global drilling campaign. The Company's goal is to grow into a serious LNG player and global production company. I am confident the work completed in 2009-2010 will put Karoon in a commanding position and provide for significant growth in the upcoming financial years.

Karoon's exploration and appraisal assets in Australia, Brazil and Peru provide great opportunities and set the stage for a very exciting upcoming financial year.

On behalf of the Board, I would like to thank all Karoon shareholders for their continued support.

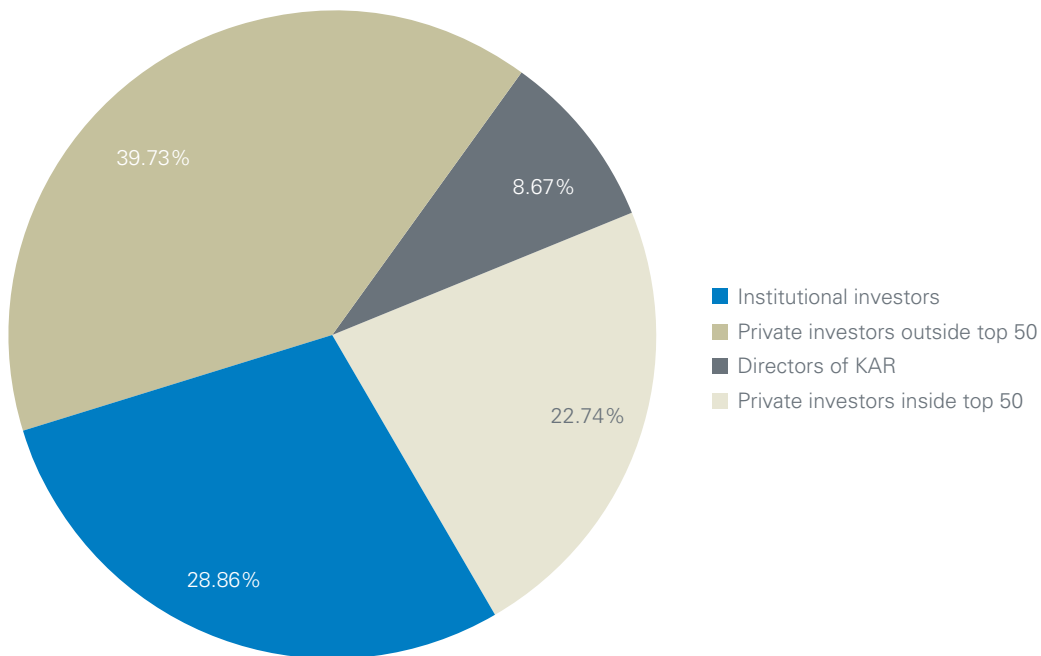


Mr Robert Hosking
Executive Chairman

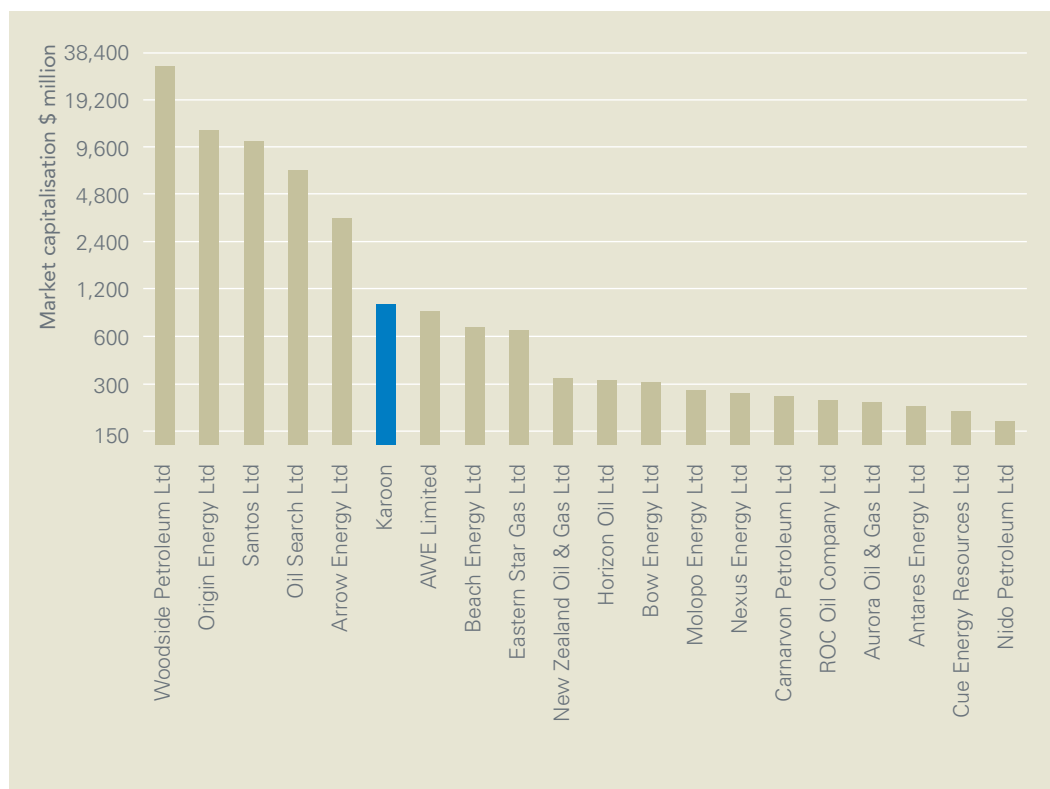
A photograph of an offshore oil rig at sunset. The sun is low on the horizon, creating a bright orange and yellow glow that reflects on the water. The rig's silhouette is dark against the bright sky. The image is partially obscured by a large white geometric shape on the left side.

**THE SUCCESS OF POSEIDON AND
KRONOS WILL HELP DEFINE THE SIZE
AND PRODUCTIVE CAPACITY OF THE
GREATER POSEIDON STRUCTURE AND
FORM THE BASIS FOR ANY FUTURE
DEVELOPMENT DECISION.**

Karoon Register by Investor Type as at 7 July 2010



Top 20 Australian Oil and Gas Companies by Market Capitalisation as at 30 June 2010

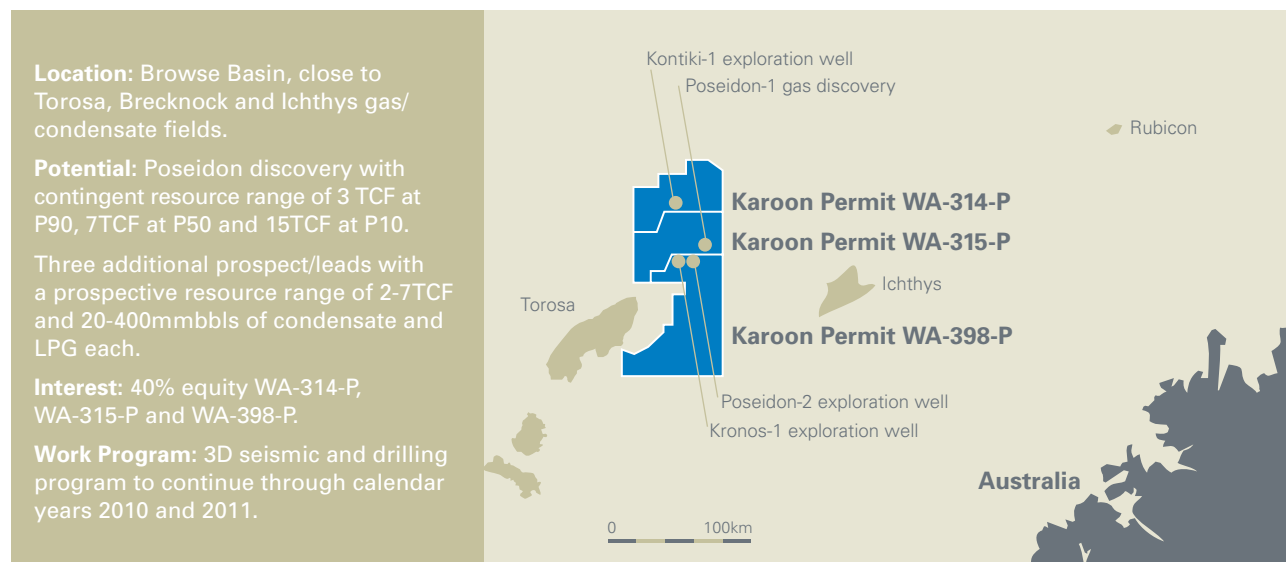


2009-2010 OPERATIONS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Australia

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



Karoon secured its Browse Basin permits, located 350km offshore from the north western Australian coastline during 2005. Including the Poseidon and Kronos discoveries, the Browse Basin cumulatively has the potential to contain up to six billion barrels of oil equivalent in condensate and gas. Together with our joint venture partner, ConocoPhillips, we are in the exploration phase of our Browse development with more drilling due to commence in 2011.

During the financial year, Karoon continued drilling in the Browse Basin with the drilling of the Kontiki-1 exploration well, the completion of the drilling, coring and testing of the Poseidon-2 exploration well, and the drilling, coring and testing of the Kronos-1 exploration well. These wells form part of a multiple exploration well program, which is designed to test prospects within the WA-314-P, WA-315-P and WA-315-P exploration permits.

The success of Poseidon and Kronos will help define the size and productive capacity of the Greater Poseidon structure and form the basis for any future development decision. The exploration program included wells designed to test the down dip extremities of the field, as was the case with Poseidon-2, and to test a structural high in the south with Kronos-1. The short-term forward program involves the completion of the processing and interpretation of the 2,828 square kilometre Poseidon 3D seismic survey, undertaken late in 2009 over the Greater Poseidon structure and surrounding prospective areas.

The new seismic data will form the basis for the planning of the next drilling program, which is expected to include a minimum of four wells with options for additional wells to commence in the first half of 2011.

The highlight of the financial year was the completion of the final exploration well in the first phase drilling campaign, Kronos-1. The Kronos-1 well was located on the south western high of the Greater Poseidon structure. Kronos-1 was spudded during February 2010, 15 kilometres to the south west of the Poseidon-1 exploration well and was drilled to 5,329mRT. This well was designed to test and evaluate the Plover reservoirs located high on a separate culmination of the Greater Poseidon structure. A key Kronos-1 objective was to define potential commercial production rates and gas composition on the crest of the Greater Poseidon structure.

Kronos-1 was production tested over the interval 4,999-5,052mRT. The maximum sustainable flow rate attained during a multi-phase test was 26mmscf/d through a 32/64 inch choke, with flowing well head pressure of 3,900psia. Significantly, the flow rate achieved was downhole equipment constrained. A condensate-gas ratio of 9.5bbl/mmscf was measured at the surface, along with a 10% carbon dioxide content taken from the gas flow on a volume basis.

2009-2010 OPERATIONS CONTINUED FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Based on the analysis of the well test data, Karoon believes that future possible production wells drilled adjacent to the Kronos-1 location could have the potential to flow at commercial rates well in excess of 100mmscf/d.

As planned, Kronos-1 was plugged and abandoned during early June 2010 following final well evaluation and production testing. The Kronos-1 exploration well also fulfilled one of the primary term well commitments for WA-398-P.

Early in the financial year, the Kontiki-1 exploration well was also drilled by the Transocean 'Legend'. The Kontiki-1 exploration well in exploration permit WA-314-P was drilled to a total depth of 4,600mRT. Karoon's interpretation is that the well penetrated approximately 40 metres of interbedded sands with complex lithologies over a gross interval of approximately 460 metres. Interpretation of mudlogging and petrophysical data indicated some possible gas saturation in poorly developed sands. This Kontiki-1 exploration well provided a greater understanding of the geology in WA-314-P and was plugged and abandoned.

The Poseidon-2 exploration well was spudded during October 2009 with the objective to test the extent, presence and quality of Plover reservoirs down-dip from the Poseidon-1 exploration well where the Plover formation was interpreted to thicken. Poseidon-2 was located in WA-398-P, on the southern flank of a north east trending structural high of the Greater Poseidon structure.

Prior to intersecting the Plover formation, Poseidon-2 penetrated a 20 metre gross hydrocarbon bearing sand interval in the Montara Formation not seen in Poseidon-1. This interval offers the potential for significant additional reserves and will be evaluated during the 2011 and 2012 drilling campaign.

After an initial Plover formation level Drill Stem Test ("DST") encountered technical difficulties, a subsequent DST was completed with a flow rate of 850 standard cubic feet per day on a 1 inch choke. Liquids volumes were not measured due to the low gas rates and a gas-liquids separator was not used.

Overall, the Poseidon-2 exploration well provided much needed data about the Greater Poseidon structure. Key highlights of Poseidon-2 were the discovery of a potential gas reservoir in the Montara sands above the targeted Plover formations, the penetration of three Plover formation sands as seen in Poseidon-1 and overall the confirmation of movable gas in this down-dip location on the perimeter of the Poseidon structure as previously mapped.

Poseidon-2 was drilled by the Transocean 'Legend' to a total depth of 5,356mRT and was plugged and abandoned as planned during February 2010. The Poseidon-2 exploration well fulfilled one of the primary term well commitments in WA-398-P.

During December 2009, subsequent to the completion of Poseidon-2, ConocoPhillips exercised its right to acquire an additional 9% equity in exploration permits WA-314-P and WA-315-P. To fulfil the exercise of the option, ConocoPhillips will pay 80% of the next US\$125 million in joint venture expenditure within exploration permits WA-314-P and WA-315-P.

Well data from the three wells to-date drilled over the Greater Poseidon structure is being analysed, integrating the interpretation of the new Poseidon 3D seismic data that is currently being processed. From this, further well locations will be identified in preparation for a second phase drilling program planned in the first half of 2011. That drilling program will run for at least one year. Karoon's assessment of the contingent and prospective resources of the Browse Basin permits will be independently verified when a full analysis of the drilled wells and the recent 3D seismic is completed.

Permit interests of the participants in WA-314-P, WA-315-P and WA-398-P are:

Karoon Gas (Browse Basin) Pty Ltd	40.00%
ConocoPhillips (Browse Basin) Pty Ltd (Operator)	60.00%

Bonaparte Basin Permit AC/P8



During the financial year, Karoon continued geological and geophysical interpretation of AC/P8 and made preparations for a CSEM survey. This survey was completed during August 2010, fulfilling a government work commitment. The results of the survey will be processed and interpreted later in 2010.

Karoon believes the AC/P8 permit offers good exploration potential due to its location in an existing oil and gas producing province and its proximity to several producing oilfields, including the Woodside Energy Ltd operated Laminaria and Corallina fields.

The AC/P8 permit contains two prospects and a number of leads that will need to be further defined by Karoon and its joint venture partner, Talisman.

Permit interests of the participants in AC/P8 are:

Karoon Energy International Ltd (Operator)	66.67%
Talisman Oil & Gas (Australia) Pty Limited	33.33%

South America

During August 2010, Karoon signed a farm-in agreement with Petrobras to acquire 20% of two Santos Basin exploration Blocks. Subject to obtaining regulatory approvals in Brazil (including from the Brazilian Petroleum agency), Karoon will earn a 20% interest in both Blocks by funding 35% of a well in the Maruja prospect, as part of a two well drilling program. Karoon will then pay its equity share of continued work and reimburse Petrobras for sunk costs.

During the financial year, Karoon investigated the potential for a listing of its South American assets in South America. As at the date of this report, work is continuing toward a final decision on the matter. In the meantime, Karoon has been preparing its South American business unit for a potential stock exchange listing. As part of the potential listing of the South American assets and in light of the new acreage acquisition from Petrobras, Karoon acquired a report from a leading independent engineering company, DeGolyer and MacNaughton. The report incorporated the results of newly acquired and processed 2D seismic in Peru and reprocessed 3D seismic in Brazil. The report stated that Karoon's Brazilian and Peruvian exploration assets had a risked net mean prospective resource of 589 million boe. The unrisked net mean prospective resource was 2,150 million boe.

2009-2010 OPERATIONS CONTINUED FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Brazil Blocks 1037, 1101, 1102, 1165 and 1166



During March 2008, Karoon was awarded offshore exploration Blocks 1037, 1101, 1102, 1165 and 1166. During August 2010 and as outlined above, Karoon agreed to acquire from Petrobras an interest in Blocks 1352 and 1354.

Karoon considers its Brazilian Blocks highly prospective and interpretation work to date has indicated the presence of several leads/prospects with a total DeGolyer and MacNaughton certified risked prospective resource estimate of 456 million barrels of oil and associated gas. There is currently one prospect, Pico de Jaragua, that is drill ready, and as work progresses it is expected that at least two more of these leads/prospects will mature to be drillable. Karoon's economic assessment of its Blocks indicate that this area could be rapidly brought into production due to the relatively shallow water depths and proximity to existing oil and gas infrastructure.

The Santos Basin Blocks are 220 kilometres off the coast from the Santa Catarina region of Brazil, just south of Rio de Janeiro, which has recently yielded multiple oil discoveries. Recent discoveries in the Santos Basin include the Tupi and Carioca oil fields, the Newton oil discovery, the Caravela and Coral fields and the Merluza field.

Most recently Petrobras announced the discovery of a 550 million boe in place resource at the Piracua field, just five kilometres to the north-east of Karoon's Blocks. Karoon is currently evaluating the technical information available from this discovery.

During the financial year, Karoon completed a 750 square kilometre wide azimuth 3D seismic acquisition program. The 3D seismic acquisition was completed by WesternGeco. This seismic acquisition program, which covered all of the defined prospects and leads within the Blocks, is expected, once processed and interpreted, to allow vastly superior definition of structures beside and underneath salt bodies thereby allowing identification and better risk definition of new prospects and leads. To the best of Karoon's knowledge, this was the first application of a wide azimuth 3D seismic acquisition in Brazil. WesternGeco has commenced processing of the survey, with results expected later in 2010. This seismic will fulfil the first period work program commitments for the Blocks and prepares Karoon for its future drilling campaign.

Initial research and planning for a drilling program also commenced during the financial year, with the environmental and regulatory approval process for future drilling operations underway. Drilling is expected to commence in late 2011 or early 2012.

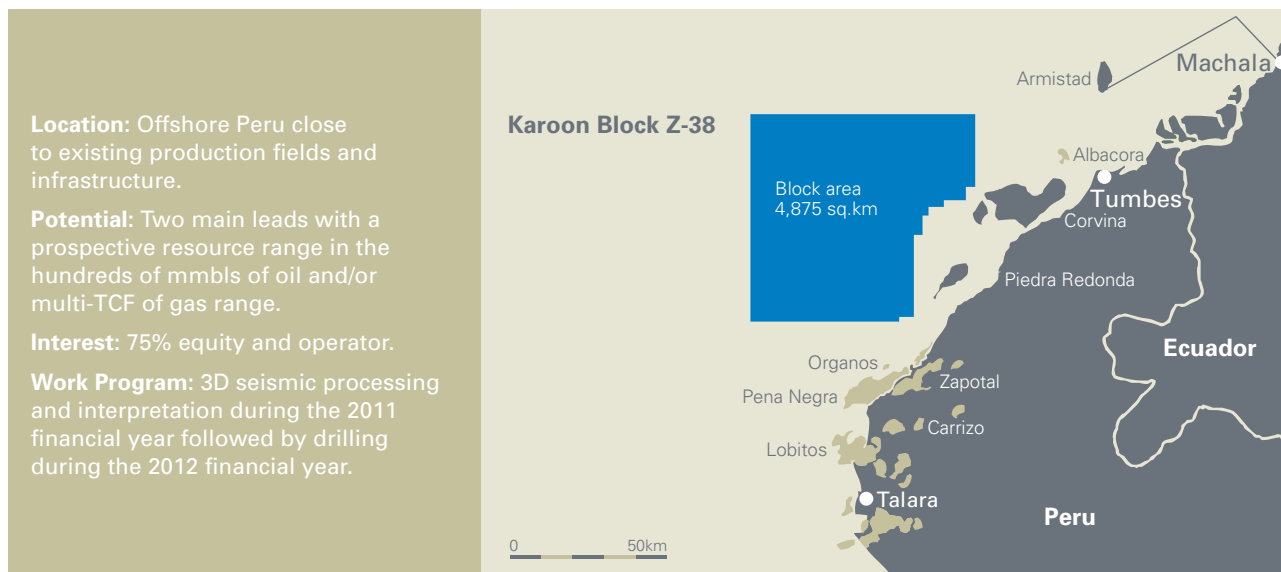
Karoon also continued its geotechnical work in its Santos Basin Blocks. Recent discoveries in the area immediately around Karoon's Blocks provided Karoon with additional information assisting with the delineation of prospects and leads.

Karoon is a 100% interest holder in Santos Basin Blocks 1037, 1101, 1102, 1165 and 1166.

Block interests of the participants in Santos Basin Blocks 1352 and 1354 are (subject to regulatory approvals):

Petroleo Brasileiro SA (Operator)	80%
Karoon Petróleo & Gas Ltda	20%

Peru Block Z-38



During 2008, Karoon signed a farm-in agreement to acquire an initial 20% interest in Block Z-38. Block Z-38 is located in the Tumbes Basin, offshore in the northwest of Peru. It is a region that is experiencing renewed activity after a series of successful exploration programs by BPZ Energy, the operator of Z1 Block which is adjacent to Block Z-38. The Talara Basin, to the south of the Tumbes Basin, has produced more than one billion barrels of oil.

Subject to obtaining relevant regulatory approvals and completion and funding of second and third year work commitments, including drilling two exploration wells, Karoon's ownership interest will increase to 75%.

Environmental impact assessment preparation and related approval applications commenced during the financial year for future drilling campaigns. Drilling in the Block is expected to commence during the 2012 financial year.

Interpretation of new 2D seismic data acquired earlier during 2009 was completed and subsequently a new 1,500 square kilometre 3D seismic acquisition program was completed.

Karoon contracted CGG Veritas for the use of the 'M/V Geowave Endeavour' for the 3D seismic survey. CGG Veritas was also contracted for the processing of the data. Processing will continue through to the end of 2010. Early work on a fast track 3D seismic data set has confirmed the presence of a number of encouraging leads. Prospect and lead evaluation work is ongoing and needs to be completed before drillable prospects can be firmed up.

Karoon also began preparations for carrying out a sea bed coring program, in order to investigate the presence and characteristics of any hydrocarbon seeps. The survey was successfully completed in July 2010 and the results are expected in the first quarter of 2011.

After completion of third year work commitments and subject to regulatory approvals, equity interests in Block Z-38 will be:

KEI (Peru Z38) Pty Ltd, Sucursal del Peru (Operator)	75.00% *
Vietnam American Exploration Company LLC	25.00%

* Equity interests stated are based on the post farm-in ownership.

Peru Block 144

Block 144 in Peru is located within the onshore Marañon Basin, on the eastern side of the Andes mountain range. The Block was awarded during April 2009.

Karoon continued its geotechnical, social and environmental work in the Block and has now completed the reprocessing of 1,000 kilometres of existing 2D seismic data. Geophysical interpretation using the reprocessed data has identified the presence of a four way dip closed structure in the southern portion of the Block. This prospect is considered substantial with a prospective resource potential of 120 million barrels. The prospect is located in proximity to a navigable river and an underutilised oil export pipeline from the Marañon Basin to the Pacific Ocean, offering potential lower cost development opportunities. Karoon has a 100% equity interest in 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 2010 (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 below:



Mr Robert M Hosking
Executive Chairman

Appointed 11 November 2003.

Robert is the founding Director of the Company and has more than 30 years of commercial experience in the administration of several companies. Robert has been involved in the oil and gas industry for 14 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.

Member of the Audit Committee.



Mr Mark A Smith
Dip. App. Geol, Bsc. (Geology)
Executive Director and Exploration Manager

Appointed 20 November 2003.

Mark has 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.

Member of the Remuneration Committee.



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, including 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'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 Audit Committee.
Chairman of the Remuneration



Committee.

Mr Stephen Power B. Juris LLB

Non-Executive Director

Appointed 28 June 2005.

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

Member of the Audit Committee and Remuneration Committee.



Company Secretary

Mr Scott Hosking B. Commerce

Appointed as Company Secretary of the Company 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 12 years with experience in international trade, finance and internal 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.

DIRECTORS' REPORT CONTINUED

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	
	A	B	A	B	A	B
Mr Robert Hosking	7	7	4	3	-	-
Mr Mark Smith	7	7	-	-	1	1
Mr Geoff Atkins	7	7	4	4	1	1
Mr Stephen Power	7	7	4	4	1	1

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 as follows:

Director	Ordinary Shares, Fully Paid	Unlisted Other Share Options
Mr Robert Hosking	12,102,320	1,750,000
Mr Mark Smith	2,572,037	1,500,000
Mr Geoff Atkins	412,500	1,000,000
Mr Stephen Power	300,000	1,000,000

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

During the financial year, the Company successfully completed \$34,104,259 in new equity capital raisings:

- 3,514,367 ordinary shares were issued during July 2009 to shareholders via a Share Purchase Plan at \$6.70 per ordinary share that raised gross proceeds of \$23,546,259; and
- 2,730,000 unlisted options were exercised during the financial year that raised gross proceeds of \$10,558,000.

Results

The consolidated result of the Group for the financial year was a loss after income tax of \$14,893,839 (2009: profit after income tax of \$4,452,766).

Financial Position

The net assets of the Group increased by \$27,044,732 from 30 June 2009 to \$361,703,571 during the financial year. This net increase was largely due to the following factor:

- Gross proceeds of \$34,104,259 raised from the issue of fully paid ordinary shares in the Company.

The Group's working capital, being current assets less current liabilities, has decreased from \$223,326,426 as at 30 June 2009 to \$91,010,773 as at 30 June 2010.

Review of Operations

Information on the operations of the Group is set out in the 2009-2010 Operations review on pages 7 to 11 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
ESOP options	27 November 2007	31 October 2010	\$2.95	205,000
Other share options	27 November 2007	31 October 2010	\$2.95	500,000
Other share options	22 January 2008	31 October 2010	\$2.95	500,000
Other share options	27 November 2008	30 April 2011	\$4.00	250,000
Other share options	1 August 2008	30 April 2011	\$4.50	750,000
Other share options	1 August 2008	30 April 2011	\$5.00	750,000
ESOP options	3 November 2008	30 October 2010	\$4.00	90,000
ESOP options	3 November 2008	30 April 2011	\$5.00	905,000
Other share options	27 November 2008	30 April 2011	\$4.50	750,000
Other share options	27 November 2008	30 April 2011	\$5.00	750,000
ESOP options	28 November 2008	30 April 2011	\$5.00	100,000
ESOP options	29 June 2009	30 October 2011	\$6.84	200,000
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	1,700,000
ESOP options	25 March 2010	18 November 2013	\$11.50	100,000
				9,080,000

During the financial year, the following ordinary shares of the Company were issued on the exercise of options granted. No amounts are unpaid on any of the ordinary shares issued:

Type of Option	Grant Date	Amount Paid Per Ordinary Share	Number of Ordinary Shares Issued
Other share options	1 August 2008	\$4.00	750,000
Other share options	27 November 2008	\$4.00	500,000
ESOP options	27 November 2007	\$2.95	440,000
ESOP options	20 August 2008	\$4.00	100,000
ESOP options	3 November 2008	\$4.00	640,000
ESOP options	28 November 2008	\$4.00	200,000
ESOP options	28 November 2008	\$5.00	100,000
			2,730,000

No fully paid ordinary shares have been issued since 30 June 2010 as a result of the exercise of Employee Share Option Plan ("ESOP") options or other share options since that date.

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

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 28 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 10 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 principles of good corporate governance. The Company's Statement of Corporate Governance is set out on pages 76 to 83 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:

- Petroleum (Submerged Lands) Act 1967 (Cth);
- Petroleum (Submerged Lands) (Management of Environment) Regulations 1999 (Cth);
- Environment Protection and Biodiversity Conservation Act 1999 (Cth);
- 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);
- 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.

Greenhouse Gas and Energy Data Reporting Requirements

A Carbon Pollution Reduction Scheme (“CPRS”), or similar regime, has not yet been introduced by the Australian Federal Government. However, greenhouse gas emissions, energy consumption and energy production reporting obligations under the *National Greenhouse and Energy Reporting Act 2007* (“NGER Act”) apply.

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 the specified Australian territory between 1 July 2009 and 30 June 2010.

Similarly, the Group’s current exploration, as the operator of AC/P8, is not expected to result in it meeting one of the thresholds under the NGER Act for the next reporting period and, therefore, it is not expected that it will be required to register and report under the NGER Act for the next reporting period.

However, the Company is in the process of assessing a cost effective, reliable and environmentally efficient method of dealing with its future greenhouse gas emissions, energy consumption and energy production reporting obligations.

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:

- 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
- 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 27.

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

Matters Arising Subsequent to the End of the Financial Year

Other than the matters disclosed in Note 32 of the consolidated financial statements, there has not been any matter or circumstance which has arisen since 30 June 2010 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.

Remuneration Report (Audited)

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 Law 2001*.

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

- A. Remuneration policy (used to determine the nature and amount of remuneration).
- B. Details of remuneration.
- C. Service agreements.
- D. Share-based remuneration.
- E. 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

The Board of Directors annually reviews remuneration of its Directors and employees aided by the Remuneration Committee. Remuneration includes base salaries and equity-based bonuses and incentive schemes.

The Board of Directors has established a Remuneration Committee which provides overview and recommendations on recruitment, retention and termination policies and procedures for senior executives and the remuneration framework for Directors. The Statement of Corporate Governance provides further information on the role of this committee.

Non-Executive Directors' fees are determined within an aggregate Directors' fee pool limit, which is periodically recommended for approval by shareholders. The maximum currently stands at \$200,000p.a., including superannuation contribution, and was approved by shareholders at the Annual General Meeting held on 3 November 2006.

Non-Executive Directors do not receive any performance-related remuneration.

The remuneration structure is based on a number of factors including length of service, particular experience, responsibilities of the individual and the overall performance of the Company. Remuneration involves a balance between fixed and incentive pay, reflecting short and long-term performance objectives appropriate to the Company's circumstances and objectives. A proportion of senior executive remuneration is structured in a manner designed to align the success of the Company with the employees who contributed.

This is done by considering the following remuneration components:

- fixed base remuneration; and
- equity-based remuneration within limits set by the Board of Directors.

Options are issued under either the Company's ESOP (to employees) or via other share options (to Directors).

The Directors and other key management personnel receive a superannuation contribution as required by the Australian Federal Government, which is currently 9%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.

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

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 net foreign currency gains), the Company believes this policy was effective in increasing shareholder wealth over the past five years through share price appreciation.

The tables below set out summary information about the Group's earnings and movements in shareholder wealth to 30 June 2010:

	30 June 2006	30 June 2007	30 June 2008	30 June 2009	30 June 2010
Financial Year Ended	\$	\$	\$	\$	\$
Revenue	931,762	2,878,695	5,320,930	4,868,541	6,459,623
Profit (loss) before income tax	(2,835,982)	(14,642,257)	(6,055,339)	4,452,766	(14,893,839)
Profit (loss) for financial year	(2,835,982)	(14,642,257)	(6,055,339)	4,452,766	(14,893,839)
Net assets at end of financial year	33,109,886	81,136,721	130,742,056	334,658,839	361,703,571

	30 June 2006	30 June 2007	30 June 2008	30 June 2009	30 June 2010
Financial Year Ended	\$	\$	\$	\$	\$
Share price at beginning of financial year	1.71	1.45	2.38	4.54	9.09
Share price at end of financial year	1.45	2.38	4.54	9.09	5.95
Basic profit (loss) per ordinary share	(0.0564)	(0.2035)	(0.0485)	0.0302	(0.0842)
Diluted profit (loss) per ordinary share	(0.0564)	(0.2035)	(0.0485)	0.0300	(0.0842)

DIRECTORS' REPORT CONTINUED

Remuneration Report (Audited) (continued)

B. Details of Remuneration

This section of the Remuneration Report provides specific disclosures in relation to remuneration for the Directors and other key management personnel listed below. In addition to the Directors of the Company, key management personnel are identified in accordance with AASB 124 'Related Party Disclosures' as those who had authority for planning, directing and controlling the Group and/or Company activities during the financial year.

The remuneration for each Director and other key management personnel during the financial year and previous financial year was as follows:

Ended 30 June 2010	Short-Term Benefits		Post-Employment Benefits	Long-Term Benefits	Share-Based Payments Expense		
Name	Cash Salary and Fees \$	Non-Monetary Benefits \$	Superannuation Contributions \$	Long Service Leave Provision \$	Options \$	Remuneration Consisting of Options* %	Total Remuneration \$
Executive Directors							
Mr Robert Hosking	400,000	9,925	-	-	305,607	42.7	715,532
Mr Mark Smith	366,972	5,780	33,027	-	281,778	41.0	687,557
Non-Executive Directors							
Mr Geoff Atkins	55,000	-	4,950	-	263,836	81.5	323,786
Mr Stephen Power	55,000	-	4,950	-	263,836	81.5	323,786
Total Directors' remuneration	876,972	15,705	42,927	-	1,115,057		2,050,661
Other key management personnel							
Mr Scott Hosking	229,358	3,934	20,642	-	720,000	73.9	973,934
Mr Tim Hosking	201,835	3,141	18,165	-	552,000	71.2	775,141
Mr Lino Barro	275,229	-	24,771	-	324,611	52.0	624,611
Mr David Ormerod	247,706	-	22,294	-	167,020	38.2	437,020
Mr Jorg Bein	243,119	-	21,881	-	324,611	55.1	589,611
Total other key management personnel remuneration	1,197,247	7,075	107,753	-	2,088,242		3,400,317
Total key management personnel remuneration	2,074,219	22,780	150,680	-	3,203,299		5,450,978

Ended 30 June 2009	Short-Term Benefits		Post-Employment Benefits	Long-Term Benefits	Share-Based Payments Expense		
Name	Cash Salary and Fees \$	Non-Monetary Benefits \$	Superannuation Contributions \$	Long Service Leave Provision \$	Options \$	Remuneration Consisting of Options* %	Total Remuneration \$
Executive Directors							
Mr Robert Hosking	403,030	7,300	-	-	1,374,393	77.0	1,784,723
Mr Mark Smith	366,972	10,509	33,027	16,454	1,810,722	80.9	2,237,684
Non-Executive Directors							
Mr Geoff Atkins	54,800	-	3,600	-	-	-	58,400
Mr Stephen Power	40,000	-	3,600	-	-	-	43,600
Total Directors' remuneration	864,802	17,809	40,227	16,454	3,185,115		4,124,407
Other key management personnel							
Mr Scott Hosking	202,447	3,934	18,220	22,763	212,000	46.2	459,364
Mr Lino Barro	252,294	-	22,706	11,737	77,710	21.3	364,447
Mr David Ormerod	240,826	-	21,674	8,862	155,420	36.4	426,782
Mr Jorg Bein	228,593	-	20,573	9,715	77,710	23.1	336,591
Total other key management personnel remuneration	924,160	3,934	83,173	53,077	522,840		1,587,184
Total key management personnel remuneration	1,788,962	21,743	123,400	69,531	3,707,955		5,711,591

* 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.

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 vesting criteria, the impact of dilution, the non-tradeable nature of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option.

The options have been granted subject to continued employment with the Company but are not subject to the individual meeting pre-determined performance criteria (for example, profitability and sales targets), given the Company is still in the exploration and evaluation phase of activities.

Options have vesting periods of zero to four 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 28 of the consolidated financial statements.

Remuneration Report (Audited) (continued)

The Board has prepared a policy in relation to an individual limiting his or her exposure to risk in relation to securities (including options).

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 including 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 below.

Details of existing contracts between the Company 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 Superannuation) Amount
Executive Directors							
Mr Robert Hosking	Three years	1 May 2011	In writing six months	-	Ropat Nominees Pty Ltd Hosking Superannuation Fund	Yes	\$400,000
Mr Mark Smith	Three years	1 May 2011	In writing three months	Redundancy: one year Change of control: one year	IERS (Australia) Pty Ltd Bonnie Doon Superannuation Fund	Yes	\$400,000
Other key management personnel							
Mr Scott Hosking	Ongoing	Ongoing	In writing three months	Redundancy: one year Change of control: one year		Yes	\$250,000
Mr Tim Hosking	Ongoing	Ongoing	In writing three months	Redundancy: one year Change of control: one year		Yes	\$220,000
Mr Lino Barro	Ongoing	Ongoing	In writing three months	Redundancy: one year Change of control: one year	Barro Superannuation Fund	Yes	\$300,000
Mr David Ormerod	Ongoing	Ongoing	In writing three months	Redundancy: three months Change of control: one year		Yes	\$270,000
Mr Jorg Bein	Ongoing	Ongoing	In writing three months	Redundancy: one year Change of control: one year	The J. Bein Superannuation Fund	Yes	\$265,000

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.

D. Share-based Remuneration

The Company has one ESOP, which was approved by shareholders at the 2009 Annual General Meeting.

Options are issued to other key management personnel as part of their remuneration to increase goal congruence between senior executives and shareholders in accordance with the Senior Executive Remuneration Policy.

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 2,230,000 options over unissued ordinary shares of the Company were issued to Directors and other key management personnel (refer to Note 29(c) of the consolidated financial statements).

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					
3 November 2008	30 April 2010	30 April 2011	\$5.00	\$0.63	100.0
29 June 2009	30 June 2010	30 October 2011	\$6.84	\$4.33	100.0
23 November 2009	23 November 2009	12 November 2013	\$14.07	\$2.40	100.0
9 December 2009	13 September 2011	18 November 2013	\$11.50	\$3.32	-
Other share options					
1 August 2008	1 May 2010	30 April 2011	\$5.00	\$0.79	100.0
27 November 2008	1 May 2010	30 April 2011	\$5.00	\$0.69	100.0
23 November 2009	12 November 2012	12 November 2013	\$14.07	\$2.40	-

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 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 20 days of trading before the ESOP options were granted.

The exercise price of other share options is based on the weighted average price at which the Company's ordinary shares traded on the ASX during the twenty days of trading before the options were granted.

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 the ASX Listing Rule 6.22.2.

Options granted carry no dividend or voting rights.

Further information on options is set out in Note 28 of the consolidated financial statements.

DIRECTORS' REPORT CONTINUED

Remuneration Report (Audited) (continued)

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
Executive Directors			
Mr Robert Hosking	-	-	-
Mr Mark Smith	-	-	-
Non-Executive Directors			
Mr Geoff Atkins	500,000	\$1,200,000	-
Mr Stephen Power	500,000	\$1,200,000	-
Other key management personnel			
Mr Scott Hosking	300,000	\$720,000	300,000
Mr Tim Hosking	230,000	\$552,000	230,000
Mr Lino Barro	300,000	\$996,000	-
Mr David Ormerod	100,000	\$332,000	-
Mr Jorg Bein	300,000	\$996,000	-
Total key management personnel	2,230,000	\$5,996,000	530,000

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

No options over unissued ordinary shares in the Company lapsed during the financial year.

Shares Issued on the Exercise of Options Provided as Remuneration

Details of fully paid ordinary shares in the Company issued as a result of the exercise of remuneration options to each Director and other key management personnel during the financial year are set out below:

Name	Grant Date of Option	Date of Exercise of Options	Number of Ordinary Shares Issued	Value at Exercise Date*	Amount Paid Per Ordinary Share
Executive Directors					
Mr Robert Hosking	27 November 2008	10 August 2009	500,000	\$3,300,000	\$4.00
Mr Mark Smith	1 August 2008	10 August 2009	750,000	\$4,950,000	\$4.00
Non-Executive Directors					
Mr Geoff Atkins	-	-	-	-	-
Mr Stephen Power	-	-	-	-	-
Other key management personnel					
Mr Scott Hosking	28 November 2008	23 March 2010	100,000	\$431,000	\$4.00
Mr Tim Hosking	20 August 2008	27 July 2009	200,000	\$1,424,000	\$4.00
	28 November 2008	27 July 2009	100,000	\$612,000	\$5.00
Mr Lino Barro	27 November 2007	14 July 2009	100,000	\$652,000	\$2.95
	3 November 2008	28 October 2009	100,000	\$373,000	\$4.00
Mr David Ormerod	3 November 2008	7 July 2009	50,000	\$223,000	\$4.00
	3 November 2008	14 July 2009	100,000	\$547,000	\$4.00
Mr Jorg Bein	27 November 2007	21 July 2009	100,000	\$725,000	\$2.95
	3 November 2008	21 July 2009	100,000	\$620,000	\$4.00

* The value at exercise date of options that were granted as part of their remuneration and were exercised during the financial year has been determined as the intrinsic value of the options at that date.

No amounts are unpaid on any ordinary shares issued on the exercise of the above options.

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 criteria 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	2009	100.0	-	-	-
Mr Mark Smith	2009	100.0	-	-	-
Non-Executive Directors					
Mr Geoff Atkins	2010	-	-	30 June 2013	\$936,164
Mr Stephen Power	2010	-	-	30 June 2013	\$936,164
Other key management personnel					
Mr Scott Hosking	2010	100.0	-	-	-
Mr Tim Hosking	2010	100.0	-	-	-
Mr Lino Barro	2009	100.0	-	-	-
	2010	-	-	30 June 2012	\$706,679
Mr David Ormerod	2009	100.0	-	-	-
	2010	-	-	30 June 2012	\$235,560
Mr Jorg Bein	2009	100.0	-	-	-
	2010	-	-	30 June 2012	\$706,679

No options will vest if the service criteria 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 30 of the consolidated financial statements for other transactions with Directors and other key management personnel during the financial year.


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

On behalf of the Directors:



Mr Robert Hosking
Executive Chairman

17 September 2010
Melbourne



KAROON WAS DELIGHTED WITH THE RESULTS OF THE KRONOS-1 EXPLORATION WELL PRODUCTION TEST, INDICATING ANOTHER CULMINATION IN THE GREATER POSEIDON STRUCTURE.

AUDITOR'S INDEPENDENCE DECLARATION



PricewaterhouseCoopers
ABN 52 780 433 757

Freshwater Place
2 Southbank Boulevard
SOUTHBANK VIC 3006
GPO Box 1331
MELBOURNE VIC 3001
DX 77
Telephone 61 3 8603 1000
Facsimile 61 3 8603 1999
Direct Phone +61 (3) 8603 3130
Direct Fax +61 (3) 8613 2059
Website: www.pwc.com/au

As lead auditor for the audit of Karoon Gas Australia Ltd for the financial year ended 30 June 2010, I declare that to the best of my knowledge and belief, there have been:

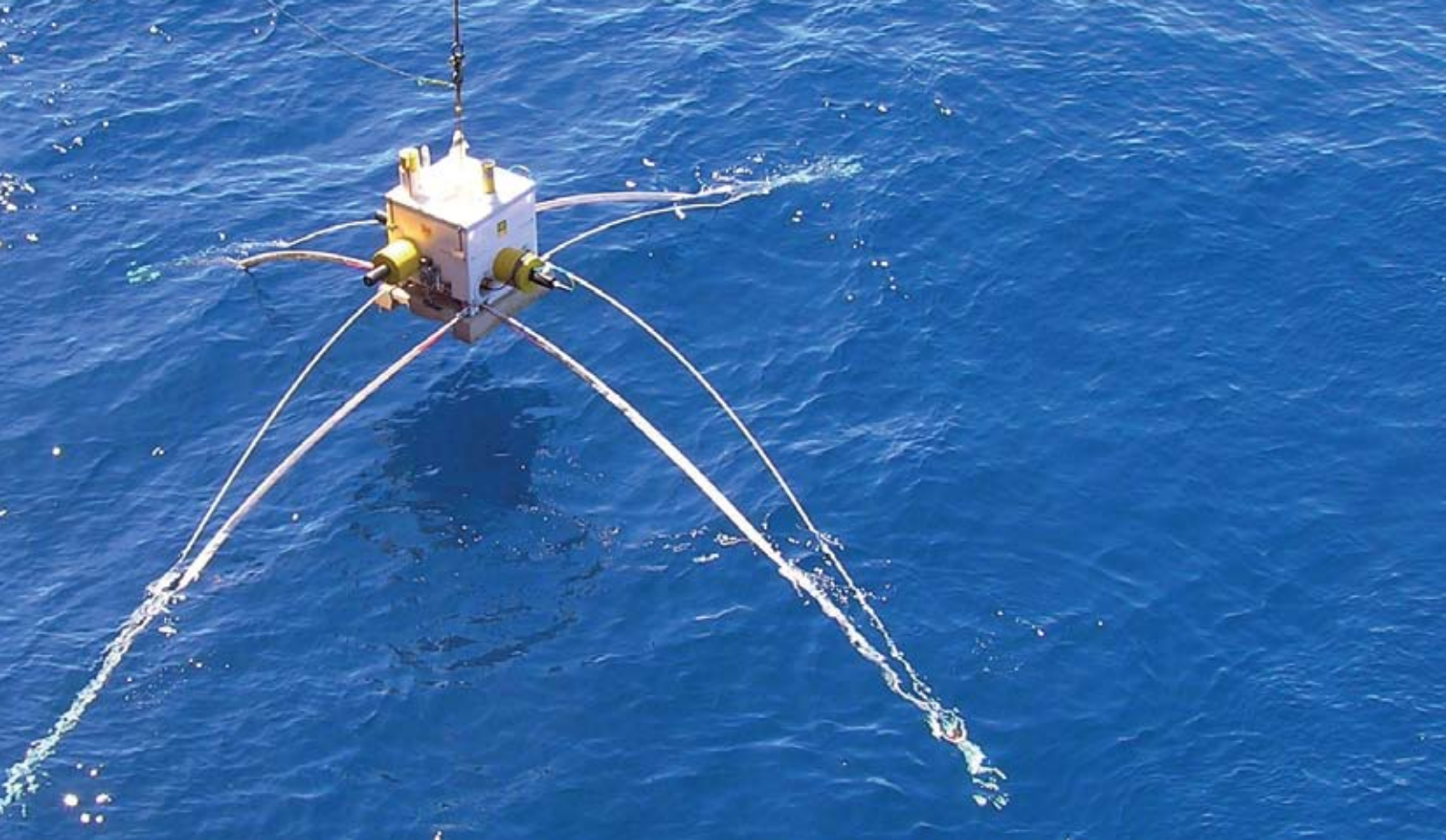
- (a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

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
17 September 2010



FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

- 29 Consolidated Statement of Comprehensive Income
- 30 Consolidated Statement of Financial Position
- 31 Consolidated Statement of Changes in Equity
- 32 Consolidated Statement of Cash Flows
- 33 Notes to the Financial Statements

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

		Consolidated	
	Note	2010	2009
		\$	\$
Revenue	4	6,459,623	4,868,541
Other income	4	914	9,787,639
Total revenue and other income		6,460,537	14,656,180
Computer support		(489,646)	(367,657)
Consulting fees		(822,971)	(929,587)
Corporate promotion and annual report		(28,810)	(70,853)
Depreciation and amortisation expense	5	(415,667)	(396,488)
Employee benefits expense (net)		(6,719,729)	(5,431,983)
Exploration and evaluation expenditure expensed or written off	5	(136,812)	(1,075,643)
Finance costs	5	(244,275)	(218,173)
Legal fees		(452,202)	(164,223)
Net foreign currency losses	5	(8,514,337)	-
Property costs		(321,221)	(237,873)
Share registry and listing fees		(485,285)	(334,559)
Travel and accommodation expenses		(842,774)	(331,606)
Other expenses		(1,651,825)	(644,769)
Total expenses		(21,125,554)	(10,203,414)
Profit (loss) before income tax		(14,665,017)	4,452,766
Income tax expense	6	(228,822)	-
Profit (loss) for financial year		(14,893,839)	4,452,766
Other comprehensive income (loss):			
Exchange differences arising from the translation of financial statements of foreign subsidiaries		2,833,583	(845,891)
Income tax relating to components of other comprehensive income (loss)		-	-
Other comprehensive income (loss) for financial year, net of tax		2,833,583	(845,891)
Total comprehensive income (loss) for financial year		(12,060,256)	3,606,875
Earnings per share for profit (loss) attributable to equity holders of the Company:			
Basic profit (loss) per ordinary share	9	(0.0842)	0.0302
Diluted profit (loss) per ordinary share	9	(0.0842)	0.0300

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 2010

		Consolidated	
	Note	2010	2009
		\$	\$
Current assets			
Cash and cash equivalents	10	87,122,836	228,238,280
Receivables	11	4,873,578	1,785,266
Inventories	12	360,081	1,448,793
Security deposits	13	12,091,872	3,172,610
Other assets	14	710,376	299,002
Total current assets		105,158,743	234,943,951
Non-current assets			
Plant and equipment	15	607,552	618,562
Intangible assets	16	354,922	240,689
Exploration and evaluation expenditure carried forward	17	265,243,372	100,235,662
Security deposits	13	4,547,690	10,331,455
Total non-current assets		270,753,536	111,426,368
Total assets		375,912,279	346,370,319
Current liabilities			
Trade and other payables	18	13,912,243	7,105,297
Funds held in escrow	19	-	4,512,228
Income tax liability	6	235,727	-
Total current liabilities		14,147,970	11,617,525
Non-current liabilities			
Provisions	20	60,738	93,955
Total non-current liabilities		60,738	93,955
Total liabilities		14,208,708	11,711,480
Net assets		361,703,571	334,658,839
Equity			
Issued capital	21	381,147,212	347,331,271
Accumulated losses		(34,710,440)	(19,816,601)
Share-based payments reserve		13,279,107	7,990,060
Foreign currency translation reserve		1,987,692	(845,891)
Total equity		361,703,571	334,658,839

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 2010

	Consolidated				
	Issued Capital \$	Accumulated Losses \$	Share-based Payments Reserve \$	Foreign Currency Translation Reserve \$	Total Equity \$
Balance as at 1 July 2008	151,335,352	(24,269,367)	3,676,071	-	130,742,056
Profit for financial year	-	4,452,766	-	-	4,452,766
Exchange differences arising from the translation of financial statements of foreign subsidiaries	-	-	-	(845,891)	(845,891)
Total comprehensive income for financial year	-	4,452,766	-	(845,891)	3,606,875
Transactions with owners in their capacity as owners:					
Ordinary shares issued	204,795,308	-	-	-	204,795,308
Transaction costs arising on ordinary shares issued	(8,799,389)	-	-	-	(8,799,389)
Share-based payments expense	-	-	4,313,989	-	4,313,989
	195,995,919	-	4,313,989	-	200,309,908
Balance as at 30 June 2009	347,331,271	(19,816,601)	7,990,060	(845,891)	334,658,839
Loss for financial year	-	(14,893,839)	-	-	(14,893,839)
Exchange differences arising from the translation of financial statements of foreign subsidiaries	-	-	-	2,833,583	2,833,583
Total comprehensive loss for financial year	-	(14,893,839)	-	2,833,583	(12,060,256)
Transactions with owners in their capacity as owners:					
Ordinary shares issued	34,104,259	-	-	-	34,104,259
Transaction costs arising on ordinary shares issued	(288,318)	-	-	-	(288,318)
Share-based payments expense	-	-	5,289,047	-	5,289,047
	33,815,941	-	5,289,047	-	39,104,988
Balance as at 30 June 2010	381,147,212	(34,710,440)	13,279,107	1,987,692	361,703,571

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 2010

		Consolidated	
	Note	2010	2009
		\$	\$
Cash flows from operating activities			
Receipts from customers (inclusive of GST refunds)		571,428	526,211
Payments to suppliers and employees (inclusive of GST)		(6,951,002)	(5,525,364)
Interest received		4,954,195	4,627,077
Interest and other costs of finance paid		(244,275)	(218,173)
Net cash flows used in operating activities	27(a)	(1,669,654)	(590,249)
Cash flows from investing activities			
Purchase of plant and equipment		(235,204)	(562,020)
Purchase of computer software		(283,677)	(195,470)
Payments for exploration and evaluation expenditure		(157,556,856)	(52,086,188)
Payment of security deposits		(1,767,942)	(3,905,681)
Net cash flows used in investing activities		(159,843,679)	(56,749,359)
Cash flows from financing activities			
Funds held in escrow	19	-	4,512,228
Proceeds from issue of ordinary shares		29,592,031	202,170,307
Payments for transaction costs arising on ordinary shares issued		(800,819)	(8,298,410)
Net cash flows provided by financing activities		28,791,212	198,384,125
Net increase (decrease) in cash and cash equivalents		(132,722,121)	141,044,517
Cash and cash equivalents at beginning of financial year		228,238,280	77,423,254
Effect of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies		(8,393,323)	9,770,509
Cash and cash equivalents at end of financial year	10	87,122,836	228,238,280

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

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 406 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, unless otherwise stated.

(a) Basis of Preparation

These general purpose consolidated financial statements have been prepared in accordance with the requirements of the *Corporations Act 2001*, relevant Australian Accounting Standards, Urgent Issues Group Interpretations and other authoritative pronouncements of the Australian Accounting Standards Board ("AASB").

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.

Compliance with International Financial Reporting Standards

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

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
- (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.

Financial Statement Presentation

The Group has applied the revised *AASB 101 'Presentation of Financial Statements'*, which became effective on 1 January 2009. The revised standard requires the separate presentation of a statement of comprehensive income and a statement of changes in equity. All non-owner changes in equity must now be presented in the statement of comprehensive income. As a consequence, the Group had to change the presentation of its consolidated financial statements.

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

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 1. Summary of Significant Accounting Policies (continued)

(b) Principles of Consolidation

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 22.

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.

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

The Group has applied *AASB 8 'Operating Segments'* from 1 July 2009. AASB 8 requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes. Previously, operating segments were determined and presented in accordance with *AASB 114 'Segment Reporting'* that required the Group to identify two sets of segments (geographical and business), using a risk and rewards approach, with the Group's system of internal reporting only the starting point of such segments.

As a result, following the adoption of AASB 8, the identification of the Group's reportable segments has changed to be in a manner consistent with the internal reporting provided to the chief operating decision maker. Reconciliations of such internal reporting information to the statutory information contained in the consolidated financial statements have been included in Note 23.

Comparative segment information has been re-presented in conformity with the transitional requirements of AASB 8. Since the change in accounting policy only impacts presentation and disclosure aspects, there is no impact on earnings per share.

(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.

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 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 tax 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 1. Summary of Significant Accounting Policies (continued)

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 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.

(g) Cash and Cash Equivalents

Cash and cash equivalents in the consolidated statement of financial position 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 included in current assets, except for those with maturities greater than one year after the end of the reporting period which are classified as non-current assets.

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 and 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 one year after the end of the reporting period which are classified as non-current assets.

Security deposits are derecognised when the terms and conditions attached to the relevant exploration permit agreements or operating rental lease 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 10 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 1. Summary of Significant Accounting Policies (continued)

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 both amounts expensed and amounts capitalised) are classified as investing 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.

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 carried at amortised cost. Due to their short-term nature they are not discounted. They 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 included in current liabilities, except for those with maturities greater than one year after the end of the reporting period which are classified as non-current liabilities.

(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.

Share-based Payments

Share-based remuneration benefits are provided to employees via the Company's ESOP and Directors via other share options (refer Note 28).

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 and the impact of any non-vesting conditions. Non-market performance vesting conditions are included in assumptions about the number of options that are expected to vest.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 1. Summary of Significant Accounting Policies (continued)

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

The provision for long service leave is recognised and measured as the present value of expected future payments to be made in respect of services provided by employees up to the end of the reporting period using the projected unit credit method. Consideration is given to expected future wage and salary levels, related on-costs, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the end of the reporting period on Australian government bonds with terms to maturity and currency that match, as closely as possible, the estimated future 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) Issued Capital

Ordinary shares are classified as equity.

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.

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.

(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 24.

(t) Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

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 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 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 assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

(v) Parent Company Financial Information

The financial information for the Parent Company, Karoon Gas Australia Ltd, disclosed in Note 31 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).

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 1. Summary of Significant Accounting Policies (continued)

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 2009-8 'Amendments to Australian Accounting Standards – Group Cash-Settled Share-based Payment Transactions [AASB 2]' (effective from 1 January 2010)

The amendments made by the AASB to AASB 2 confirm that an entity receiving goods or services in a Group share-based payment arrangement must recognise an expense for those goods or services regardless of which subsidiary in the Group settles the transaction or whether the transaction is settled in shares or cash. They also clarify how the Group share-based payment arrangement should be measured, that is, whether it is measured as an equity or a cash-settled transaction. The Group will apply these amendments retrospectively for the reporting period commencing on 1 July 2010. There will be no impact on the Group's financial statements.

(ii) AASB 9 'Financial Instruments' and AASB 2009-11 'Amendments to Australian Accounting Standards Arising from AASB 9' (effective from 1 January 2013)

AASB 9 'Financial Instruments' addresses the classification and measurement of financial assets and may affect the Group's accounting for its financial assets. The Group will apply the amendments from 1 July 2013 but is available for early adoption. The Group is yet to assess its full impact. However, initial indications are that it will have limited impact as equity investments are not held for trading. The Group will not early adopt AASB 9.

(iii) AASB 2009-5 'Further Amendments to Australian Accounting Standards Arising from the Annual Improvements Project' (effective from 1 January 2010)

The AASB made a number of amendments to Australian Accounting Standards as a result of the International Accounting Standard Board's annual improvements project. The Group will apply the amendments from 1 July 2010. The Group is yet to assess its full impact. However, initial indications are that transaction costs related to business combinations will, prospectively, be classified as operating cash flows in the consolidated statement of cash flows. In addition, only exploration and evaluation expenditure that is capitalised may be presented as cash flows from investing activities. Under the Group's current policy all cash flows associated with exploration and evaluation expenditure (comprising both amounts expensed and capitalised) are classified as cash flows from investing activities. The change in accounting policy would increase net cash outflows from operating activities and decrease net cash outflows from investing activities by \$136,812 (2009: \$1,049,943).

(iv) Revised AASB 124 'Related Party Disclosures' and AASB 2009-12 'Amendments to Australian Accounting Standards' (effective from 1 January 2011)

During December 2009, the AASB issued a revised AASB 124 'Related Party Disclosures'. It is effective for accounting periods beginning on or after 1 January 2011 and must be applied retrospectively. The Group will apply the amended standard from 1 July 2011. When the amendments are applied, the Group will need to disclose all transactions between its subsidiaries, including commitments. The Group is yet to assess its full impact. However, initial indications are that it will have limited impact.

(v) 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.

(vi) AASB 2010-3 'Amendments to Australian Accounting Standards Arising from the Annual Improvements Project' and AASB 2010-4 'Further Amendments to Australian Accounting Standards Arising from the Annual Improvements Project' (effective from 1 July 2010)

During June 2010, the AASB made a number of amendments to Australian Accounting Standards as a result of the International Accounting Standard Board's annual improvements project. The Group does not expect that any adjustments will be necessary as the result of applying the revised rules.

The Group has not early adopted any of the above reporting requirements.

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 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 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. The 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 2. Significant Accounting Estimates, Assumptions and Judgements (continued)

(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 cooperation 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 and funds held in escrow.

The Group had no off-statement of financial position financial assets or financial liabilities at either 30 June 2010 or 30 June 2009.

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

	Note	Consolidated	
		2010 \$	2009 \$
Financial assets			
Cash and cash equivalents	10	87,122,836	228,238,280
Receivables	11	4,873,578	1,785,266
Security deposits	13	16,639,562	13,504,065
Total financial assets		108,635,976	243,527,611
Financial liabilities			
Trade and other payables (refer Note (a) below)		13,672,624	7,023,179
Funds held in escrow	19	-	4,512,228
Total financial liabilities		13,672,624	11,535,407

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	13,912,243	7,105,297
Less: leave liabilities		(239,619)	(82,118)
		13,672,624	7,023,179

(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 predominately 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 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 3. Financial Risk Management (continued)

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	2010				2009			
	AUD \$	USD \$	REAL \$	Total \$	AUD \$	USD \$	REAL \$	Total \$
Financial assets								
Cash and cash equivalents	63,389,400	22,987,761	745,675	87,122,836	156,124,409	71,399,811	714,060	228,238,280
Receivables	735,344	4,138,234	-	4,873,578	913,587	871,679	-	1,785,266
Security deposits	93,727	4,810,814	11,735,021	16,639,562	89,858	3,130,591	10,283,616	13,504,065
	64,218,471	31,936,809	12,480,696	108,635,976	157,127,854	75,402,081	10,997,676	243,527,611
Financial liabilities								
Trade and other payables	1,175,245	12,127,933	369,446	13,672,624	1,915,909	4,173,026	934,244	7,023,179
Funds held in escrow	-	-	-	-	4,512,228	-	-	4,512,228
	1,175,245	12,127,933	369,446	13,672,624	6,428,137	4,173,026	934,244	11,535,407

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	
	2010 \$	2009 \$
Change in profit (loss)		
- Improvement in AUD to USD by 10.0%	(2,737,438)	(6,405,963)
- Decline in AUD to USD by 10.0%	3,345,757	7,829,510
Change in financial assets		
- Improvement in AUD to USD by 10.0%	(4,037,382)	(6,854,735)
- Decline in AUD to USD by 10.0%	4,934,578	8,378,009
Change in financial liabilities		
- Improvement in AUD to USD by 10.0%	1,102,539	379,366
- Decline in AUD to USD by 10.0%	(1,347,548)	(463,670)
Change in foreign currency translation reserve		
- Improvement in AUD to USD by 10.0%	197,405	69,406
- Decline in AUD to USD by 10.0%	(241,273)	(84,829)

(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 2010 and 30 June 2009, 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. Surplus cash is invested in short term bank deposits due to uncertainty of 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:

2010	Weighted Average Interest Rate % P.A.	Floating Interest Rate \$	Consolidated		Fair Value \$	Carrying Amount \$
			Fixed Interest Rate \$	Non-interest Bearing \$		
Financial assets						
Cash and cash equivalents	4.0	24,894,805	61,171,587	1,056,444	87,122,836	87,122,836
Receivables	-	-	-	4,873,578	4,873,578	4,873,578
Security deposits	8.2	4,100	16,635,462	-	16,639,562	16,639,562
		24,898,905	77,807,049	5,930,022	108,635,976	108,635,976
Financial liabilities						
Trade and other payables	-	-	-	13,672,624	13,672,624	13,672,624
		-	-	13,672,624	13,672,624	13,672,624

2009	Weighted Average Interest Rate % P.A.	Floating Interest Rate \$	Consolidated		Fair Value \$	Carrying Amount \$
			Fixed Interest Rate \$	Non-interest Bearing \$		
Financial assets						
Cash and cash equivalents	3.0	38,117,425	183,081,923	7,038,932	228,238,280	228,238,280
Receivables	-	-	-	1,785,266	1,785,266	1,785,266
Security deposits	8.9	3,231	13,500,834	-	13,504,065	13,504,065
		38,120,656	196,582,757	8,824,198	243,527,611	243,527,611
Financial liabilities						
Trade and other payables	-	-	-	7,023,179	7,023,179	7,023,179
Funds held in escrow	-	-	-	4,512,228	4,512,228	4,512,228
		-	-	11,535,407	11,535,407	11,535,407

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	
	2010 \$	2009 \$
Change in profit (loss)		
- Increase of interest rate by 1.0% p.a.	248,989	381,207
- Decrease of interest rate by 1.0% p.a.	(55,377)	(108,531)
Change in financial assets		
- Increase of interest rate by 1.0% p.a.	248,989	381,207
- Decrease of interest rate by 1.0% p.a.	(55,377)	(108,531)

(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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 3. Financial Risk Management (continued)

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. The Group does not have any material credit risk exposure to any single debtor or group of debtors entered into by the Group. 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 'AA-' are accepted. Where commercially practical, the Group seeks to limit the amount of credit exposure to any one bank or financial institution. Cash and cash equivalents and security deposits are spread amongst a number of AA and AAA rated banks and financial institutions to minimise the risk of default of counterparties.

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.

As at 30 June 2010, there were \$Nil (30 June 2009: \$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 \$25,951,249 (30 June 2009: \$40,644,129) 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.

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

	Consolidated					Total \$
	Less than 6 Months \$	6-12 Months \$	Between 1 and 2 Years \$	Between 2 and 5 Years \$	Over 5 Years \$	
2010						
Financial liabilities						
Trade and other payables	13,672,624	-	-	-	-	13,672,624
	13,672,624	-	-	-	-	13,672,624

2009	Consolidated					Total \$
	Less than 6 Months \$	6-12 Months \$	Between 1 and 2 Years \$	Between 2 and 5 Years \$	Over 5 Years \$	
Financial liabilities						
Trade and other payables	7,023,179	-	-	-	-	7,023,179
Funds held in escrow	4,512,228	-	-	-	-	4,512,228
	11,535,407	-	-	-	-	11,535,407

(d) Fair Value Estimation

For disclosure purposes only, the fair values of financial assets and financial liabilities as at 30 June 2010 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/Funds Held in Escrow

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

	Consolidated	
	2010 \$	2009 \$
Note 4. Revenue		
Interest income from unrelated entities	6,459,623	4,868,541
Total revenue	6,459,623	4,868,541
Net foreign currency gains	-	9,770,509
Sundry income	914	17,130
Total other income	914	9,787,639

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

	Note	Consolidated	
		2010 \$	2009 \$
Note 5. Expenses			
Profit (loss) before income tax includes the following specific expenses:			
Depreciation and amortisation expense:			
- depreciation of plant and equipment	15	246,223	277,317
- amortisation of computer software	16	169,444	119,171
Total depreciation and amortisation expense		415,667	396,488
Exploration and evaluation expenditure expensed or written off:			
- exploration and evaluation expenditure expensed		136,812	1,049,943
- exploration and evaluation expenditure written off	17	-	25,700
Total exploration and evaluation expenditure expensed or written off		136,812	1,075,643
Finance costs:			
- bank charges		244,275	218,173
Total finance costs		244,275	218,173
Net foreign currency losses		8,514,337	-
Share-based payments expense	28(d)	5,289,047	4,313,989
Costs associated with potential listing of South American assets		407,317	-
Rental expense on operating leases – minimum lease payments		228,395	158,723

		Consolidated	
		2010 \$	2009 \$

Note 6. Income Tax

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

Tax expense comprises:

Current income tax		228,822	-
Deferred income tax		-	-
Total income tax expense		228,822	-

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

Prima facie tax payable on profit (loss) before income tax, calculated at the Australian tax rate of 30% (2009: 30%)		(4,399,505)	1,335,830
Add (subtract) tax effect of:			
Share-based payments expense		1,586,714	1,294,197
Other non-deductible items		732,205	592,827
Prior financial year's income tax expense on foreign operations		228,822	-
Tax losses and temporary tax differences not recognised		3,126,480	(2,042,078)
Other items		(1,045,894)	(1,180,776)
Total income tax expense		228,822	-

	Consolidated	
	2010	2009
	\$	\$
(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	480,814	114,836
- Tax losses:		
- operating losses	7,025,051	4,227,861
Potential tax benefit at the Australian tax rate of 30% (2009: 30%)	7,505,865	4,342,697

(c) Current Tax Liabilities

Income tax payable	(235,727)	-
Total current tax liabilities	(235,727)	-

(d) Deferred Tax Liabilities

Temporary tax differences relating to deferred tax liabilities	(57,200,549)	(21,563,114)
Offset by deferred tax assets relating to operating losses	57,200,549	21,563,114
Total deferred tax liabilities	-	-

Note 7. Remuneration of External Auditors

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

Audit and review of financial statements	144,228	100,909
Non-audit services (review of accounting policy and procedure manual)	-	900
Total remuneration of external auditors	144,228	101,809

Note 8. Dividends

There were no ordinary dividends declared or paid during the financial year by the Group (2009: \$Nil).

Dividend franking account

Balance of franking account at end of financial year	-	-
--	---	---

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

	Consolidated	
	2010	2009
	\$	\$
Note 9. Earnings Per Share		
Profit (loss) for financial year used to calculate basic and diluted profit (loss) per ordinary share:	(14,893,839)	4,452,766
(a) Basic profit (loss) per ordinary share	(0.0842)	0.0302
(b) Diluted profit (loss) per ordinary share	(0.0842)*	0.0300

* Diluted loss per ordinary share equates to basic loss per ordinary share because a loss per 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 profit (loss) per ordinary share:	176,786,841	147,643,691
Weighted average number of potential ordinary shares:	2,991,254	679,956
Weighted average number of ordinary shares and potential ordinary shares used in calculating diluted profit per ordinary share (excluding anti-dilutive options outstanding):	179,778,095	148,323,647
Weighted average number of anti-dilutive options:	1,124,139	424,417

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 profit per ordinary share to the extent to which they are dilutive. The options have not been included in the determination of basic profit (loss) per ordinary share.

Note 10. Cash and Cash Equivalents

Cash at banks and on hand	25,951,249	45,156,356
Short term bank deposits	61,171,587	183,081,924
Total cash and cash equivalents	87,122,836	228,238,280

(a) Cash at Banks and on Hand

Cash at banks included funds held in escrow of \$Nil (30 June 2009: \$4,512,228). Refer to Note 19 for further details.

(b) Short Term Bank Deposits

Short term bank deposits are made for varying periods of between one day and three months, 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.

	Consolidated	
	2010	2009
	\$	\$
Note 11. Receivables		
Current		
Other receivables	4,873,578	1,785,266
Total current receivables	4,873,578	1,785,266

Financial Risk Management

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

	Consolidated	
	2010	2009
	\$	\$

Note 12. Inventories

Current

Casing and other drilling inventory, at cost	360,081	1,448,793
Total current inventories	360,081	1,448,793

Note 13. Security Deposits

Current

Karoon Gas Australia Ltd (refer Note (a) below)	-	3,130,591
Karoon Petróleo & Gas Ltda (refer Note (b) below)	11,723,326	-
Karoon Gas Australia Ltd (refer Note (c) below)	40,107	42,019
Karoon Gas Australia Ltd (refer Note (d) below)	293,324	-
Karoon Gas Pty Ltd (refer Note (e) below)	35,115	-
Total current security deposits	12,091,872	3,172,610

Non-current

Karoon Gas Australia Ltd (refer Note (a) below)	4,517,490	-
Karoon Petróleo & Gas Ltda (refer Note (b) below)	-	10,283,616
Karoon Gas Australia Ltd (refer Note (c) below)	30,200	13,824
Karoon Gas Pty Ltd (refer Note (e) below)	-	34,015
Total non-current security deposits	4,547,690	10,331,455

(a) Performance Guarantee

Performance guarantees (via letters of credit) were provided to Peru Petro SA for Block Z-38 and Block 144 by the Group (refer Note 25) for first and second year work commitments (2009: for first year 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.

(b) Performance Bonds

The Group has provided Agencia Nacional do Petroleo a letter of credit (refer Note 25) to carry out minimum work programs in relation to the Group's exploration permits in the Santos Basin, Brazil (Santos Basin Blocks 1037, 1101, 1102, 1165 and 1166). The letter of credit is fully funded by way of payment of a security deposit to Banco BNP Paribas Brasil SA, which will be released once the work programs are met.

(c) Bank Guarantees

Cash deposits are held as security against bank guarantee facilities for bank guarantees (refer Note 25) 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 Rio de Janeiro.

(d) Performance Guarantee

A performance guarantee (via a letter of credit) was provided to a third party supplier by the Group for exploration work to be undertaken in Peru (refer Note 25). The letter of credit is fully funded by way of payment of a security deposit, which will be released once the Group's obligation under the contract is satisfied.

(e) Bond

Cash was held as security deposit for the relinquished exploration licence EL4537.

(f) Financial Risk Management

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

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

	Note	Consolidated	
		2010	2009
		\$	\$
Note 14. Other Assets			
Current			
Prepayments		710,376	299,002
Total current other assets		710,376	299,002

Note 15. Plant and Equipment

Plant and equipment			
At cost		1,591,884	1,359,531
Accumulated depreciation		(984,332)	(740,969)
Total plant and equipment, at net book value		607,552	618,562

Reconciliation

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

Balance at beginning of financial year		618,562	333,859
Additions	23	235,213	562,020
Disposals (at cost)		(2,860)	-
Disposals (accumulated depreciation)		2,860	-
Depreciation expense	5	(246,223)	(277,317)
Net carrying amount at end of financial year		607,552	618,562

Note 16. Intangible Assets

Computer software			
At cost		825,904	542,227
Accumulated amortisation		(470,982)	(301,538)
Total intangibles, at net book value		354,922	240,689

Reconciliation

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

Balance at beginning of financial year		240,689	164,390
Additions	23	283,677	195,470
Amortisation expense	5	(169,444)	(119,171)
Net carrying amount at end of financial year		354,922	240,689

Note 17. Exploration and Evaluation Expenditure Carried Forward

Deferred geological, geophysical, drilling and other exploration and evaluation expenditure, including directly attributable general administrative costs		265,243,372	100,235,662
---	--	-------------	-------------

Reconciliation

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

Balance at beginning of financial year		100,235,662	51,597,114
Additions	23	165,145,066	49,785,695
Net foreign currency difference on translation of financial statements of foreign subsidiaries		(137,356)	(1,121,447)
Exploration and evaluation expenditure written off	5	-	(25,700)
Total exploration and evaluation expenditure carried forward (refer Note (a) below)		265,243,372	100,235,662
Tangible		-	-
Intangible		265,243,372	100,235,662
Total exploration and evaluation expenditure carried forward		265,243,372	100,235,662

(a) 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 1037, Block 1101, Block 1102, Block 1165, Block 1166, Block Z-38, Block 144 and AC/P8 (30 June 2009: WA-314-P, WA-315-P, WA-398-P, Block 1037, Block 1101, Block 1102, Block 1165, Block 1166, Block Z-38, Block 144 and AC/P8).

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	
	2010	2009
	\$	\$
Note 18. Trade and Other Payables		
Current (unsecured)		
Trade payables	477,260	1,064,165
Sundry payables and accrued expenditure	13,434,983	6,041,132
Total current trade and other payables	13,912,243	7,105,297

Financial Risk Management

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

Note 19. Funds Held in Escrow

Current (unsecured)		
Funds held in escrow	-	4,512,228
Total current funds held in escrow	-	4,512,228

(a) Share Purchase Plan

Funds held in escrow in the previous financial year represented a Share Purchase Plan offered to eligible Australian and New Zealand shareholders registered as at the close of business on 10 June 2009. That offering, to all eligible shareholders to acquire ordinary shares in the Company at \$6.70 each, closed on 17 July 2009. As at 30 June 2009, \$4,512,228 had been paid by shareholders taking up the offer and held in an escrowed bank account pending close of the offer and issue of fully paid ordinary shares (refer Note 10).

(b) Financial Risk Management

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

	Consolidated	
	2010	2009
	\$	\$
Note 20. Provisions		
Non-current		
Provision for long service leave	60,738	93,955
Total non-current provisions	60,738	93,955

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).

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

	Consolidated		Consolidated	
	2010 Number	2009 Number	2010 \$	2009 \$
Note 21. Issued Capital and Reserves Within Equity				
(a) Share Capital				
Ordinary shares, fully paid	177,546,198	171,301,831	381,147,212	347,331,271

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 2008	Opening balance in previous financial year		132,277,897		151,346,874
16 July 2008	Exercise of ESOP options	(i)	40,000	\$2.03	81,200
21 July 2008	Exercise of ESOP options	(i)	20,000	\$2.03	40,600
7 August 2008	Share placement	(ii)	14,000,000	\$3.50	49,000,000
19 August 2008	Exercise of ESOP options	(i)	30,000	\$2.03	60,900
18 September 2008	Exercise of ESOP options	(i)	75,000	\$2.03	152,250
19-25 September 2008	Exercise of other share options	(i)	750,000	\$2.00	1,500,000
19-25 September 2008	Exercise of other share options	(i)	1,500,000	\$2.35	3,525,000
31 October 2008	Exercise of ESOP options	(i)	100,000	\$2.03	203,000
1 June 2009	Exercise of ESOP options	(i)	100,000	\$2.95	295,000
16 June 2009	Share placement	(ii)	22,333,934	\$6.70	149,637,358
29 June 2009	Exercise of ESOP options	(i)	75,000	\$4.00	300,000
	Less: Transaction costs arising on ordinary shares issued during previous financial year				(8,810,911)
30 June 2009	Balance at end of previous financial year		171,301,831		347,331,271
2 July 2009	Exercise of ESOP options	(i)	30,000	\$2.95	88,500
7 July 2009	Exercise of ESOP options	(i)	50,000	\$4.00	200,000
14 July 2009	Exercise of ESOP options	(i)	100,000	\$2.95	295,000
14 July 2009	Exercise of ESOP options	(i)	100,000	\$4.00	400,000
17 July 2009	Exercise of ESOP options	(i)	100,000	\$2.95	295,000
21 July 2009	Exercise of ESOP options	(i)	100,000	\$4.00	400,000
21 July 2009	Exercise of ESOP options	(i)	130,000	\$2.95	383,500
22 July 2009	Exercise of ESOP options	(i)	30,000	\$4.00	120,000
24 July 2009	Share Purchase Plan	(ii)	3,514,367	\$6.70	23,546,259
27 July 2009	Exercise of ESOP options	(i)	200,000	\$4.00	800,000
27 July 2009	Exercise of ESOP options	(i)	100,000	\$5.00	500,000
30 July 2009	Exercise of ESOP options	(i)	10,000	\$4.00	40,000
10 August 2009	Exercise of other share options	(i)	1,250,000	\$4.00	5,000,000
28 October 2009	Exercise of ESOP options	(i)	100,000	\$4.00	400,000
16 February 2010	Exercise of ESOP options	(i)	20,000	\$2.95	59,000
16 February 2010	Exercise of ESOP options	(i)	42,500	\$4.00	170,000
11 March 2010	Exercise of ESOP options	(i)	50,000	\$4.00	200,000

Date	Details	Note	Number of Ordinary Shares	Issue Price Per Ordinary Share	\$
16 March 2010	Exercise of ESOP options	(i)	60,000	\$2.95	177,000
18 March 2010	Exercise of ESOP options	(i)	85,000	\$4.00	340,000
23 March 2010	Exercise of ESOP options	(i)	165,000	\$4.00	660,000
26 March 2010	Exercise of ESOP options	(i)	7,500	\$4.00	30,000
	Less: Transaction costs arising on ordinary shares issued during financial year				(288,318)
30 June 2010	Balance at end of financial year		177,546,198		381,147,212

(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 28.

(ii) Share Placement and Share Purchase Plan

The purpose of the share placement to sophisticated and professional investors during June 2009 and the Share Purchase Plan during July 2009 was to provide the Group with a strong cash position for its continued exploration and appraisal program in the Browse Basin, along with upcoming exploration programs in Peru and Brazil.

Funds raised by the share placement to sophisticated and professional investors during August 2008 provided the Group with funds for its drilling program in the Browse Basin, along with exploration programs in Peru and Brazil.

(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 payment reserve is used to recognise the 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). The Group has elected to retain all amounts originally recognised in the share-based payments reserve, regardless of whether the associated options are exercised or lapse unexercised.

(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 FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 22. 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	Percentage of Equity and Voting Interests Held			
	Country of Incorporation or Registration	Business Activities Carried on in	2010 %	2009 %
Parent Company:				
Karoon Gas Australia Ltd	Australia	Australia		
Unlisted subsidiaries of Karoon Gas Australia Ltd:				
Eastern Pacific Coal Pty Ltd	Australia	Australia	100.0	100.0
Karoon Energy International Ltd	Australia	Australia	100.0	100.0
Karoon Gas (Browse Basin) Pty Ltd	Australia	Australia	100.0	100.0
Karoon Gas Pty Ltd	Australia	Australia	100.0	100.0
Unlisted subsidiaries of Karoon Energy International 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 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

Note 23. 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 Manager (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 four offshore permit areas within the Browse Basin, Australia: WA-314-P, WA-315-P, WA-398-P and AC/P8;
- (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 1037, Block 1101, Block 1102, Block 1165 and Block 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 monthly basis:

- interest income;
- net foreign currency gains (losses);
- finance costs;
- net employee benefits expense (including non-cash share-based payments expense of \$5,289,047 (2009: \$4,313,989));
- administration and other operating expenses;
- 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.

(b) Operating Segments

Segment Performance	Australia	Brazil	Peru	All Other	Consolidated
	\$	\$	\$	Segments	\$
				\$	\$
Revenue for financial year ended 30 June 2010					
Segment revenue	-	-	-	-	-
Interest income from unrelated entities					<u>6,459,623</u>
Total revenue					<u>6,459,623</u>
Result for financial year ended 30 June 2010					
Segment result	<u>(70,705)</u>	<u>(12,207)</u>	<u>(3,001)</u>	<u>(49,985)</u>	<u>(135,898)</u>
Interest income from unrelated entities					6,459,623
Net foreign currency losses					(8,514,337)
Finance costs					(244,275)
Employee benefits expense (net)					(6,719,729)
Administration and other operating expenses					(4,773,513)
Depreciation and amortisation expense					(415,667)
Property costs					<u>(321,221)</u>
Loss before income tax					<u>(14,665,017)</u>
Income tax expense					<u>(228,822)</u>
Loss for financial year					<u>(14,893,839)</u>

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 23. Segment Information (continued)

Segment Performance	Australia \$	Brazil \$	Peru \$	All Other Segments \$	Consolidated \$
Revenue for financial year ended 30 June 2009					
Segment revenue	-	-	-	-	-
Interest income from unrelated entities					4,868,541
Total revenue					4,868,541
Result for financial year ended 30 June 2009					
Segment result	(253,096)	(64,990)	(370,165)	(370,262)	(1,058,513)
Interest income from unrelated entities					4,868,541
Net foreign currency gains					9,770,509
Finance costs					(218,173)
Employee benefits expense (net)					(5,431,983)
Administration and other operating expenses					(2,843,254)
Depreciation and amortisation expense					(396,488)
Property costs					(237,873)
Profit before income tax					4,452,766
Income tax					-
Profit for previous financial year					4,452,766
Segment Assets					
	Australia \$	Brazil \$	Peru \$	All Other Segments \$	Consolidated \$
As at 30 June 2010					
Segment asset information					
Cash and cash equivalents	10,230,163	1,965,638	223,434	74,703,601	87,122,836
Exploration and evaluation expenditure carried forward	190,077,406	52,024,240	23,141,726	-	265,243,372
Security deposits	35,115	11,723,326	4,810,814	70,307	16,639,562
Inventories	360,081	-	-	-	360,081
Other	1,339,515	28,487	3,343,996	1,834,430	6,546,428
Segment assets	202,042,280	65,741,691	31,519,970	76,608,338	375,912,279
As at 30 June 2009					
Segment asset information					
Cash and cash equivalents	1,657,233	752,041	40,890	225,788,116	228,238,280
Exploration and evaluation expenditure carried forward	61,865,072	31,728,583	6,642,007	-	100,235,662
Security deposits	34,015	10,283,616	3,130,591	55,843	13,504,065
Inventories	1,448,793	-	-	-	1,448,793
Other	147,381	8,277	896,076	1,891,785	2,943,519
Segment assets	65,152,494	42,772,517	10,709,564	227,735,744	346,370,319

(c) Other Segment Information

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

	Australia \$	Brazil \$	Peru \$	All Other Segments \$	Consolidated \$
Financial year ended 30 June 2010					
Plant and equipment	-	-	-	235,213	235,213
Intangible assets	-	-	-	283,677	283,677
Exploration and evaluation expenditure carried forward	128,212,334	20,525,118	16,407,614	-	165,145,066
Financial year ended 30 June 2009					
Plant and equipment	-	-	-	562,020	562,020
Intangible assets	-	-	-	195,470	195,470
Exploration and evaluation expenditure carried forward	36,181,513	6,402,420	7,201,762	-	49,785,695

Note 24. Joint Venture Operations

The Group had an interest in the following joint venture operations as at 30 June 2010 as follows:

Exploration Permit	Unincorporated Interest 2010 %	Unincorporated Interest 2009 %	Principal Activities	Operator of Joint Venture Operation
WA-314-P	40.00	49.00	Exploration and evaluation	ConocoPhillips
WA-315-P	40.00	49.00	Exploration and evaluation	ConocoPhillips
WA-398-P	40.00	40.00	Exploration and evaluation	ConocoPhillips
AC/P8	66.67	66.67	Exploration and evaluation	Karoon Energy International Ltd
Block Z-38	75.00*	20.00	Exploration and evaluation	KEI (Peru Z38) Pty Ltd, Sucursal del Peru

* The Group's 75% ownership interest is subject to obtaining regulatory approvals and completion of second and third year work commitments.

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	
	2010 \$	2009 \$
Cash and cash equivalents	10,217,259	1,655,114
Other receivables	872,986	143,234
Inventories	360,081	1,488,793
Total current assets	11,450,326	3,287,141
Exploration and evaluation expenditure carried forward	212,525,349	68,421,167
Total non-current assets	212,525,349	68,421,167
Trade payables	19,130	31,890
Sundry payables and accrued expenditure	10,651,597	3,799,504
Total current liabilities	10,670,727	3,831,394
Share of net assets employed in joint venture operations	213,304,948	67,876,914

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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 24. Joint Venture Operations (continued)

Contingent liabilities in respect of joint venture operations are set out in Note 25. Exploration expenditure commitments and capital commitments in respect of joint venture operations are set out in Note 26.

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	
	2010	2009
	\$	\$

Note 25. Contingent Liabilities and Contingent Assets

(a) Contingent Liabilities

The Group had contingent liabilities as at 30 June 2010 that may become payable in respect of:

(i) The Group has provided Agencia Nacional do Petróleo a letter 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 commitments will be satisfied. The letter of credit is fully funded by way of payment of a security deposit (refer Note 13) to Banco BNP Paribas Brasil SA, which will be released once the work programs are met.	11,723,326	10,283,616
(ii) Performance guarantees (via letters of credit) were provided to Peru Petro SA for Block Z-38 and Block 144 by the Group for first and second year work commitments (2009: first year 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.	4,517,490	3,130,591
(iii) A performance guarantee (via a letter of credit) was provided to a third party supplier by the Group for exploration work to be undertaken in Peru. The Directors are of the opinion that the Group's obligation under the contract will be satisfied. The letter of credit is fully funded by way of payment of a security deposit (refer Note 13), which will be released once the Group's obligation under the contract is satisfied.	293,324	-
(iv) 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).	70,307	55,843
(v) 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.

No material losses are anticipated in respect of any of the above contingent liabilities.

(b) Contingent Assets

The Group had no contingent assets as at 30 June 2010 (30 June 2009: \$Nil).

Consolidated

2010	2009
\$	\$

Note 26. Commitments**(a) Capital Expenditure Commitments**

Contracts for capital expenditure in relation to assets not provided for in the consolidated financial statements and payable:

(i) Drilling operations (joint venture operations)		
Not later than one year	-	19,837,934
	-	19,837,934
(ii) Seismic (non-joint venture operations)		
Not later than one year	-	926,978
	-	926,978
Total capital expenditure commitments	-	20,764,912

(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	294,144	147,046
Later than one year but not later than five years	443,945	69,213
Total operating lease rental commitments	738,089	216,259

The Group has an office lease for Office 6 & 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.

The Group also has an office lease at Level 10, 406 Collins Street, Melbourne with a five year term that expires 31 May 2012 and a 4%p.a. rental increase. Rent is payable monthly in advance. There is an option for a five year extension.

Overseas, the Group has an office lease at R. Farme de Amoedo 56, s 501, Ipanema, Rio de Janeiro, Brazil with a primary three year term that expires on 31 July 2013. Rent is payable monthly in advance. There is an option to extend for a further term of three years, on essentially the same terms and conditions, except that a market review of rent will be triggered on renewal.

Also overseas, the Group has an office lease at Av. Victor Andres Belaunde 147 Via Principal 120, Edificio Real 6 Piso 6 Sam Isidro, Peru with a primary term that expires on 30 April 2011. 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Consolidated
2010 2009
\$ \$

Note 26. Commitments (continued)

(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 1037, Block 1101, Block 1102, Block 1165, Block 1166, Block Z-38, Block 144 and AC/P8 (30 June 2009: WA-314-P, WA-315-P, WA-398-P, Block 1037, Block 1101, Block 1102, Block 1165, Block 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 \$175,918,961 (30 June 2009: \$190,678,235) of commitments that relate to the non-guaranteed work commitments:

Not later than one year	40,061,235	84,419,775
Later than one year but not later than five years	215,123,116	234,928,576
Total exploration expenditure commitments	255,184,351	319,348,351

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

Not later than one year	40,061,235	84,173,287
Later than one year but not later than five years	156,618,029	174,187,866
Total joint venture operation exploration expenditure commitments	196,679,264	258,361,153

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, the amount will be included in both categories (a) and (c) above.

Consolidated

2010 2009
\$ \$

Note 27. Notes to the Consolidated Statement of Cash Flows

(a) Reconciliation of Profit (Loss) For Financial Year to Net Cash Flows Used in Operating Activities

Profit (loss) for financial year	(14,893,839)	4,452,766
Add (subtract):		
Depreciation of plant and equipment and amortisation of computer software	415,667	396,488
Net foreign currency losses (gains)	8,393,323	(9,770,509)
Non-cash share-based payments expense	5,289,047	4,313,989
Items classified as investing/ financing activities:		
Exploration and evaluation expenditure expensed or written off	136,812	1,075,643
Net foreign currency losses	121,005	-
Change in operating assets and liabilities		
(Increase) decrease in assets:		
Receivables – current	93,443	(1,623,510)
Other assets	(1,594,174)	(80,740)
Increase (decrease) in liabilities:		
Trade and other payables – current	173,457	558,296
Provisions	(33,217)	87,328
Income tax liability	228,822	-
Net cash flows used in operating activities	(1,669,654)	(590,249)

Note 28. 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 two and a half and 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 20 trading days before the ESOP options are granted. 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	
	2010 Number	2010 Weighted Average Exercise Price	2009 Number	2009 Weighted Average Exercise Price
Balance at beginning of financial year	3,010,000	\$4.36	1,220,000	\$2.95
Granted during financial year	2,330,000	\$12.08	2,440,000	\$4.72
Exercised during financial year	(1,480,000)	\$3.76	(440,000)	\$2.57
Cancelled during financial year	(30,000)	\$6.84	-	-
Forfeited during financial year	-	-	-	-
Expired during financial year	-	-	(210,000)	\$2.03
Balance at end of financial year	3,830,000	\$9.27	3,010,000	\$4.36
Exercisable at end of financial year	2,030,000	\$7.30	1,475,000	\$3.54

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 28. Share-based Payments (continued)

The weighted average fair value of ESOP options granted during the financial year was \$3.31 (2009: \$1.00).

The weighted average share price when the ESOP options were exercised during the financial year was \$9.38 (2009: \$4.98).

ESOP options outstanding as at 30 June 2010 had a range of exercise prices from \$2.95 to \$14.07 (30 June 2009: \$2.95 to \$6.84) with a weighted average remaining contractual life of 866 days (30 June 2009: 519 days).

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

Grant Date	Expiry Date	Exercise Price Per Option	Number
27 November 2007	31 October 2010	\$2.95	205,000
3 November 2008	30 October 2010	\$4.00	90,000
3 November 2008	30 April 2011	\$5.00	905,000
28 November 2008	30 April 2011	\$5.00	100,000
29 June 2009	30 October 2011	\$6.84	200,000
23 November 2009	12 November 2013	\$14.07	530,000
9 December 2009	18 November 2013	\$11.50	1,700,000
25 March 2010	18 November 2013	\$11.50	100,000
Total			3,830,000

(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 is based on the weighted average price at which the Company's ordinary shares are traded on the ASX during the 20 trading days before the options are granted. 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	
	2010 Number	2010 Weighted Average Exercise Price	2009 Number	2009 Weighted Average Exercise Price
Balance at beginning of financial year	5,500,000	\$4.22	3,250,000	\$2.45
Granted during financial year	1,000,000	\$14.07	4,500,000	\$4.50
Exercised during financial year	(1,250,000)	\$4.00	(2,250,000)	\$2.23
Forfeited during financial year	-	-	-	-
Expired during financial year	-	-	-	-
Balance at end of financial year	5,250,000	\$6.15	5,500,000	\$4.22
Exercisable at end of financial year	4,250,000	\$4.28	4,000,000	\$3.93

The weighted average fair value of other share options granted during the financial year was \$2.40 (2009: \$0.84).

The weighted average share price when other share options were exercised during the financial year was \$10.60 (2009: \$4.08).

Other share options outstanding as at 30 June 2010 had a range of exercise prices from \$2.95 to \$14.07 (30 June 2009: \$2.95 to \$5.00) with a weighted average remaining contractual life of 446 days (30 June 2009: 636 days).

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

Grant Date	Expiry Date	Exercise Price Per Option	Number
27 November 2007	31 October 2010	\$2.95	500,000
22 January 2008	31 October 2010	\$2.95	500,000
27 November 2008	30 April 2011	\$4.00	250,000
1 August 2008	30 April 2011	\$4.50	750,000
1 August 2008	30 April 2011	\$5.00	750,000
27 November 2008	30 April 2011	\$4.50	750,000
27 November 2008	30 April 2011	\$5.00	750,000
23 November 2009	12 November 2013	\$14.07	1,000,000
Total			5,250,000

(c) Fair Value of Options

The fair value of each option during the financial year was estimated on grant date using the Black-Scholes option pricing model. The Black-Scholes option pricing model takes into account the exercise price, the term of the option, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option.

The Group applied the following assumptions and inputs in estimating the weighted average fair value:

	2010	2009
Weighted average exercise price	\$12.98	\$4.58
Weighted average life of options	1,408 days	595 days
Weighted average share price	\$8.21	\$2.95
Expected share price volatility	55%	64%
Risk free interest rate	5.44%	6.09%
Weighted average option value	\$2.90	\$0.90

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 \$5,289,047 (2009: \$4,313,989).

Note 29. Remuneration of Key Management Personnel

Directors and other key management personnel of Karoon Gas Australia Ltd 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 Manager
Mr Geoff Atkins	Independent Non-Executive Director
Mr Stephen Power	Non-Executive Director
Other key management personnel	
Mr Scott Hosking	Company Secretary and Chief Financial Officer
Mr Tim Hosking	South American General Manager
Mr Lino Barro	Engineering Manager
Mr David Ormerod	South America Exploration Manager
Mr Jorg Bein	Geophysical Manager

All of the above persons were also Directors or other key management personnel during the previous financial year, except for Mr Tim Hosking.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 29. Remuneration of Key Management Personnel (continued)

(a) Directors and Other Key Management Personnel Remuneration

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

	Consolidated	
	2010 \$	2009 \$
Short-term employee benefits	2,096,999	1,810,705
Post-employment benefits	150,680	123,400
Long-term employee benefits (non-cash)	-	69,531
Share-based payments expense (non-cash)	3,203,299	3,707,955
Total key management personnel remuneration	5,450,978	5,711,591

Detailed remuneration disclosures are provided in Sections A-D of the audited Remuneration Report on pages 18 to 24.

(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 28.

(c) Options Over Unissued Ordinary Shares in the Company

During the financial year 2,230,000 (2009: 5,500,000) options over unissued ordinary shares in the Company were issued to Directors and other key management personnel.

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

	Balance as at 1 July 2009	Granted As Remuneration	Options Exercised	Net Change Other	Balance as at 30 June 2010	Total Vested as at 30 June 2010	Exercisable as at 30 June 2010	Total Unexercisable as at 30 June 2010
Executive Directors								
Mr Robert Hosking	2,250,000	-	(500,000)	-	1,750,000	1,750,000	1,750,000	-
Mr Mark Smith	2,250,000	-	(750,000)	-	1,500,000	1,500,000	1,500,000	-
Non-Executive Directors								
Mr Geoff Atkins	500,000	500,000	-	-	1,000,000	500,000	500,000	500,000
Mr Stephen Power	500,000	500,000	-	-	1,000,000	500,000	500,000	500,000
Other key management personnel								
Mr Scott Hosking	300,000	300,000	(100,000)	-	500,000	500,000	500,000	-
Mr Tim Hosking	300,000	230,000	(300,000)	-	230,000	230,000	230,000	-
Mr Lino Barro	300,000	300,000	(200,000)	-	400,000	100,000	100,000	300,000
Mr David Ormerod	350,000	100,000	(150,000)	-	300,000	200,000	200,000	100,000
Mr Jorg Bein	300,000	300,000	(200,000)	-	400,000	100,000	100,000	300,000
Total key management personnel	7,050,000	2,230,000	(2,200,000)	-	7,080,000	5,380,000	5,380,000	1,700,000

	Balance as at 1 July 2008	Granted As Remuneration	Options Exercised	Net Change Other	Balance as at 30 June 2009	Total Vested as at 30 June 2009	Exercisable as at 30 June 2009	Total Unexercisable as at 30 June 2009
Executive Directors								
Mr Robert Hosking	1,125,000	2,250,000	(1,125,000)	-	2,250,000	1,500,000	1,500,000	750,000
Mr Mark Smith	1,125,000	2,250,000	(1,125,000)	-	2,250,000	1,500,000	1,500,000	750,000
Non-Executive Directors								
Mr Geoff Atkins	500,000	-	-	-	500,000	500,000	500,000	-
Mr Stephen Power	500,000	-	-	-	500,000	500,000	500,000	-
Other key management personnel								
Mr Scott Hosking	200,000	200,000	(100,000)	-	300,000	300,000	300,000	-
Mr Lino Barro	200,000	200,000	-	(100,000)	300,000	200,000	200,000	100,000
Mr David Ormerod	200,000	400,000	(200,000)	(50,000)	350,000	150,000	150,000	200,000
Mr Jorg Bein	100,000	200,000	-	-	300,000	200,000	200,000	100,000
Total key management personnel	3,950,000	5,500,000	(2,550,000)	(150,000)	6,750,000	4,850,000	4,850,000	1,900,000

(d) Shareholdings

The number of ordinary shares held by Directors and other key management personnel, including their personally-related entities, as at 30 June 2010 and 30 June 2009 was as follows:

	Balance as at 1 July 2009	Received as Remuneration	Options Exercised	Ordinary Shares Purchased	Ordinary Shares Sold	Other	Balance as at 30 June 2010
Executive Directors							
Mr Robert Hosking	12,388,820	-	500,000	-	(811,500)	25,000	12,102,320
Mr Mark Smith	2,405,000	-	750,000	-	(600,000)	17,037	2,572,037
Non-Executive Directors							
Mr Geoff Atkins	427,500	-	-	-	(10,000)	-	417,500
Mr Stephen Power	300,000	-	-	-	-	-	300,000
Other key management personnel							
Mr Scott Hosking	160,979	-	100,000	124,840	(218,469)	-	167,350
Mr Tim Hosking	149,943	-	300,000	38,070	(208,100)	-	279,913
Mr Lino Barro	-	-	200,000	-	(200,000)	-	-
Mr David Ormerod	25,000	-	150,000	-	(175,000)	-	-
Mr Jorg Bein	12,000	-	200,000	1,492	(210,746)	-	2,746
Total key management personnel	15,869,242	-	2,200,000	164,402	(2,433,815)	42,037	15,841,866

	Balance as at 1 July 2008	Received as Remuneration	Options Exercised	Ordinary Shares Purchased	Ordinary Shares Sold	Other	Balance as at 30 June 2009
Executive Directors							
Mr Robert Hosking	12,251,820	-	1,125,000	12,000	(1,000,000)	-	12,388,820
Mr Mark Smith	2,280,000	-	1,125,000	-	(1,000,000)	-	2,405,000
Non-Executive Directors							
Mr Geoff Atkins	427,500	-	-	-	-	-	427,500
Mr Stephen Power	300,000	-	-	-	-	-	300,000
Other key management personnel							
Mr Scott Hosking	146,676	-	100,000	140,935	(226,632)	-	160,979
Mr Lino Barro	-	-	-	-	-	-	-
Mr David Ormerod	-	-	200,000	-	(175,000)	-	25,000
Mr Jorg Bein	42,000	-	-	-	(30,000)	-	12,000
Total key management personnel	15,447,996	-	2,550,000	152,935	(2,431,632)	-	15,719,299

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 29. Remuneration of Key Management Personnel (continued)

(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 30 for other transactions with Directors and other key management personnel during the financial year.

Note 30. 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 22.

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 (2009: 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 24.

A bank guarantee provided by the Parent Company to a third party, guaranteeing a subsidiary's performance under an operating lease rental agreement, is set out in Note 25.

(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 29.

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 2010 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. The funds cover all Australian domiciled employees and Directors of the Company. The current contribution is 9% p.a. (2009: 9% 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 \$284,771 (2009: \$205,815).

(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 \$376,960 (2009: \$181,386).

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.

Company

2010 2009
\$ \$

Note 31. 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	75,836,959	223,890,905
Non-current assets	283,387,194	115,560,501
Total assets	359,224,153	339,451,406
Current liabilities	750,024	5,781,787
Non-current liabilities	60,738	93,955
Total liabilities	810,762	5,875,742
Net assets	358,413,391	333,575,664
Equity		
Issued capital	381,147,212	347,331,271
Accumulated losses	(36,012,928)	(21,745,667)
Share-based payments reserve	13,279,107	7,990,060
Total equity	358,413,391	333,575,664
Loss for financial year	(14,267,261)	(12,781,663)
Total comprehensive loss for financial year	(14,267,261)	(12,781,663)

(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 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). | 58,612 | 55,843 |
| (ii) Performance guarantees (via letters of credit) were provided to Peru Petro SA for Block Z-38 and Block 144 by the Company for first and second year work commitments (2009: first year 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. | 4,517,490 | 3,130,591 |
| (iii) A performance guarantee (via a letter of credit) was provided to a third party supplier by the Parent Company for exploration work to be undertaken in Peru. The Directors are of the opinion that the obligation under the contract will be satisfied. The letter of credit is fully funded by way of payment of a security deposit (refer Note 13), which will be released once the obligation under the contract is satisfied. | 293,324 | - |
| (iv) 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. | | |

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2010

Note 31. Parent Company Financial Information (continued)

(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 24.

A bank guarantee provided by the Parent Company to a third party, guaranteeing a subsidiary's performance under an operating lease rental agreement, is set out in Note 25.

Note 32. Subsequent Events

Since 30 June 2010, the following material events have occurred:

(a) Petrobras Farm-in

During August 2010, Karoon Petróleo & Gas Ltda, a wholly owned subsidiary of the Company, executed a farm-in agreement with Petrobras to acquire a 20% interest in Blocks 1352 (Maruja Prospect) and 1354 (Quasi Prospect) located in the offshore Santos Basin, Brazil.

Subject to obtaining regulatory approvals, Karoon Petróleo Gas Ltda will earn a 20% interest in both blocks by funding 35% of the costs of drilling an exploration well in the Maruja Prospect and funding 20% of an exploration well in the Quasi Prospect, as part of a two well drilling program. Karoon Petróleo & Gas Ltda will then pay its equity share of continued work and reimburse Petrobras for sunk costs.

(b) Block 1354 Exploration Well

Drilling the Quasi Prospect in Block 1354 commenced in August 2010 and the well reached a total depth of 2011 metres on 7 September 2010. Wireline tests were completed and no commercial hydrocarbons were encountered. The well is expected to be permanently plugged and abandoned and the rig released on or about 18 September 2010.

(c) Potential Brazilian Stock Exchange Listing

On 9 September 2010, Karoon Petróleo & Gas Ltda filed a draft prospectus and reference form with the Comissão de Valores Mobiliários (the "CVM"), the Brazilian securities regulator. This was the first step in the process to conduct an initial public offering of Karoon Petróleo & Gas Ltda's common shares on the BM&FBOVESPA, in São Paulo, Brazil to the public. The prospectus and reference form are subject to a one month period of review by the CVM. The Group will assess the merits of a BM&FBOVESPA listing during this period but is under no obligation to proceed to list. In the event that the Group proceeds with the offering, the Company expects to retain an ownership interest of approximately 70% to 75% in Karoon Petróleo & Gas Ltda.

Unless otherwise indicated, the financial effect of these events has not been recognised in either the consolidated financial statements or notes for the financial year.

The Annual Report was authorised for issue by the Board of Directors on 17 September 2010. The Board of Directors has the power to amend and reissue the consolidated financial statements.

(d) Share Placement

On 16 September 2010, the Company completed a successful share placement to sophisticated and professional investors of 26,631,929 fully paid ordinary shares at \$7 per share to raise total gross proceeds of \$186,423,503.

DIRECTORS' DECLARATION

In the Directors' opinion:

- (a) the consolidated financial statements and notes, set out on pages 29 to 72, 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 2010 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 Board of Directors.

On behalf of the Directors:



Mr Robert Hosking
Executive Chairman

17 September 2010
Melbourne

INDEPENDENT AUDITOR'S REPORT



PricewaterhouseCoopers
ABN 52 780 433 757

Freshwater Place
2 Southbank Boulevard
SOUTHBANK VIC 3006
GPO Box 1331L
MELBOURNE VIC 3001
DX 77
Website: www.pwc.com/au
Telephone 61 3 8603 1000
Facsimile 61 3 8603 1999

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 comprise the consolidated statement of financial position as at 30 June 2010, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the 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 "consolidated entity". The consolidated entity comprises the Company and the subsidiaries it controlled at the financial 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 and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1 the Directors also state, in accordance with Australian Accounting Standard *AASB 101 Presentation of Financial Statements*, that compliance with the Australian equivalents to International Financial Reporting Standards ensures that the financial report, comprising the consolidated financial statements and notes, complies 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.

Our audit did not involve an analysis of the prudence of business decisions made by Directors or management.

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

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 consolidated entity's financial position as at 30 June 2010 and of its performance for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 1(a).

Matters Relating to the Electronic Presentation of the Audited Financial Report

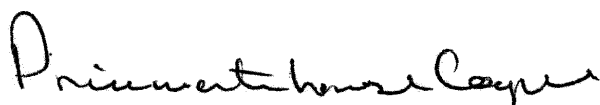
This auditor's report relates to the financial report of the Company for the year ended 30 June 2010 included on the Company's web site. The Company's Directors are responsible for the integrity of the Company's web site. We have not been engaged to report on the integrity of this web site. The auditor's report refers only to the financial report named above. It does not provide an opinion on any other information which may have been hyperlinked to/from the financial report. If users of this report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the audited financial report to confirm the information included in the audited financial report presented on this web site.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 18 to 25 of the Directors' Report for the financial year ended 30 June 2010. 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 2010 complies with Section 300A of the *Corporations Act 2001*.



PricewaterhouseCoopers



Charles Christie
Partner

Melbourne
17 September 2010

STATEMENT OF CORPORATE GOVERNANCE

The revised ASX Corporate Governance Council Principles and Recommendations published during August 2007 (revised Corporate Governance Council Principles) established the framework for how the Board of Directors oversees the Company and performs its functions on behalf of shareholders. The Company's objective is to achieve best practice in corporate governance and the Company's Directors, senior management and employees are committed to achieving this objective.

This statement summarises the Company's main corporate governance principles and practices.

Role of the Board of Directors

The roles and responsibilities of the Board of Directors 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 that there are adequate plans and procedures for succession planning;
- reviewing and approving the remuneration of the Executive Chairman and senior management;
- approving and monitoring the progress of major capital expenditure, capital management, acquisitions and divestitures; and
- approving and monitoring financial and other reporting.

The Company's Board Charter can be found on the Company's website at www.karooogas.com.au.

Composition of the Board of Directors

The Board of Directors is constituted by four 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 Non-Executive Directors of the Company are Mr Geoff Atkins and Mr Stephen Power. Mr Geoff Atkins is an Independent Director. The Company considers Mr Stephen Power to be a Non-Independent Director, due to Napier Legal Pty Ltd, a law firm in which Mr Power has an interest, providing legal services to the Company. These services are provided by Napier Legal Pty Ltd on normal commercial terms and conditions and at market rates.

Recommendation 2.1 of the revised Corporate Governance Council Principles provides that a majority of the Board of Directors should be Independent Directors. The Company does not currently comply with this Recommendation. 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.

A Non-Executive Director is independent under ASX Corporate Governance Principles and Recommendations if he or she does not fall within any of the following materiality thresholds:

- less than 10% of Company shares are held by the Director and any entity or individual directly or indirectly associated with the Director; or
- none of the Director's income or the income of an individual or entity directly or indirectly associated with the Director is derived from a contract with the Company other than income derived as a Director of the Company.

Recommendation 2.2 of the revised Corporate Governance Council Principles provides that the Chairman should be an Independent Director. Also, Recommendation 2.3 of the revised Corporate Governance Council Principles provides that the roles of the Chairman and the Chief Executive Officer should not be exercised by the same individual. The Company's Chairman also acts as its Chief

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

Meeting Schedule

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

Advice to Directors

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

Board Committees

The Board of Directors may establish appropriate committees to assist in its roles and responsibilities at appropriate points in the Company's evolution.

The Board of Directors has established an Audit Committee.

The Board of Directors has established a Remuneration Committee.

The Board of Directors has not established a nomination committee, but proposes to establish a nomination committee at the appropriate time.

Audit Committee

The role of the Audit Committee is to advise on the establishment and maintenance of a framework of internal control and the appropriate ethical standards for the management of the Group. The Company has formally adopted an Audit Committee Charter. A copy of the Audit Committee Charter can be found on the Company's website at www.karoongas.com.au.

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

The Audit Committee consists of:

Mr Geoff Atkins (Chairman)

Mr Robert Hosking

Mr Stephen Power

Recommendation 4 of the revised Corporate Governance Council Principles recommends that the Audit Committee be structured so that it:

- consists only of Non-Executive Directors;
- consists of a majority of Independent Directors;
- is chaired by an Independent Chairman, who is not Chairman of the Board of Directors; and
- has at least three members.

The recommendation is to ensure that the Audit Committee is of sufficient size, independence and technical expertise to discharge its mandate effectively. The Company has not fully complied with this recommendation. The Company has appointed two Non-Executive Directors to the Audit Committee, one of which acts as its Chairman. However, due to the current structure of the Board, the Company is unable to fully comply with Recommendation 4 in that an Executive Director sits on the Audit Committee. The Company proposes to replace the Executive Director of the Audit Committee with a Non-Executive Director when an additional Non-Executive Director is appointed to the Board of Directors.

STATEMENT OF CORPORATE GOVERNANCE CONTINUED

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 of Directors for approval of the annual financial report;
- reviewing treasury recommendations and making necessary recommendations to the Board of Directors for approval; and
- reviewing and reporting on any special reviews deemed necessary by the Board of Directors.

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

External Auditors

Recommendation 4.4 of the revised Corporate Governance Council Principles provides that the Company should make publicly available information on procedures for the selection and appointment of the external auditor and the rotation of external audit engagement partners.

The Company appointed the current external auditors, PricewaterhouseCoopers, during the financial year ended 30 June 2009. The Company has prepared a Selection and Appointment of External Auditor Policy, whereby the Company reviews every three years and assesses performance and potentially rotates the external auditor. The External Auditor Selection Policy is available on the Company's website at www.karoongas.com.au.

Nomination Committee

Recommendation 2.4 of the revised Corporate Governance Council Principles provides that a Board of Directors should establish a nomination committee. Given the size of the Board of Directors, the Board of Directors considers that the same efficiencies that may be derived from a nomination committee with respect to a larger board may not, in the current circumstances, be derived from a formal nomination committee structure. However, the Board of Directors has processes in place which address the issues that would otherwise be considered by a nomination committee.

The Company's Constitution provides that, at each Annual General Meeting of the shareholders, one third of the Directors (excluding the Managing Director) must resign, with Directors resigning by rotation based on the date of their appointment. Directors resigning by rotation may offer themselves for re-election. This procedure ensures that no Director can serve for more than three years without being re-elected.

No new Directors were appointed during the financial year. The Board of Directors proposes adopting a Selection and Appointment of Directors Policy prior to the appointment of any new Directors. Once adopted, the Selection and Appointment of Directors Policy will be made available on the Company's website.

Remuneration Committee

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

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

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

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

The Remuneration Committee consists of:

Mr Geoff Atkins (Chairman)

Mr Mark Smith

Mr Stephen Power

Recommendation 8.1 of the revised Corporate Governance Council Principles recommends that the Remuneration Committee be structured so that it:

- consists of a majority of Independent Directors;
- is chaired by an Independent Director; and
- has at least three members.

The Company does not fully comply with all of this Recommendation due to the current structure of the Board. However, the composition of the Remuneration Committee will be reviewed when new Directors are appointed to the Board of Directors.

A copy of the Remuneration Committee Charter can be found on the Company's website at www.karoongas.com.au.

Remuneration Policy

As an overall policy, the Company will 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 control framework that demonstrates a clear relationship between key executive performance and remuneration. The Remuneration Committee is responsible for executive remuneration and making recommendations to the Board of Directors.

Executive remuneration is set by the Board of Directors and may contain salary, bonuses and ESOP options.

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 aggregate Directors' fee pool to Non-Executive Directors is set and may not be increased without prior approval of the shareholders at a general meeting.

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 prepared a policy restricting the hedging of ESOP options over unissued ordinary shares of the Company, including unvested entitlements, under the Company's ESOP and other share options, and will make this available on the Company's website once adopted.

The Company has not established any schemes for retirement benefits, other than superannuation, for Non-Executive Directors.

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.

STATEMENT OF CORPORATE GOVERNANCE CONTINUED

Performance Review

Recommendation 2.5 of the revised Corporate Governance Council Principles provides that companies should disclose the process for evaluating the performance of the Board of Directors, its committees and individual Directors.

During the financial year, performance evaluation of the Executive Directors was undertaken and submitted to the Remuneration Committee. Non-Executive Directors did not receive a formal evaluation. Due to the nature and stage of the Company's operations and its evolution, the Board of Directors was of the view that a formal performance review of the Non-Executive Directors was not necessary.

The Board Performance Review Policy for senior executives and the Board of Directors is available on the Company's website at www.karoongas.com.au.

Management Performance Review

Recommendation 1.2 of the revised Corporate Governance Council Principles provides that the performance of senior executives should be reviewed regularly against appropriate measures.

Performance evaluation for senior executives has taken place during the financial year.

Role of the Company Secretary

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

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

The Company Secretary supports the effectiveness of the Board of Directors by monitoring compliance with Board policy and procedures and coordinating the completion and dispatch of the Board agenda and briefing materials.

Ethical Standards, Compliance with Obligations and Responsible Decision Making

The Directors, senior executives, employees and consultants are required to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of the Group. The Company also strives to comply with legal and other obligations to stakeholders.

The Company has developed a Code of Conduct for the Board of Directors, senior management and employees of the Company. The Company's Code of Conduct can be found on the Company's website at www.karoongas.com.au. 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.

Fair Dealings and Related Party Transactions

A Director, or entities in which a Director has a significant interest and/or influence, who enters 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 of Directors.

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 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.

Policy and Procedure for Share Trading

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

Directors, officers, employees and consultants are prohibited from dealing in securities of the Company during any embargo period declared by the Chairman or Company Secretary. Embargo periods may typically include the period of two weeks prior to the release of the Company's half year results and final results to the ASX.

These restrictions in dealing in securities of the Company are subject to discretion exercised by the Chairman.

Prior to dealing in securities of the Company, Directors and officers (including employees and consultants) must:

- advise a Director or the 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 Director or Company Secretary that he or she is not aware of any price sensitive information that has not been released to the ASX.

Directors and officers (including employees and consultants) 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 on the Company's website at www.karoongas.com.au.

Environment

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

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

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 the compliance of the Company with the various laws and ASX Listing Rule obligations in relation to disclosure of information to the market and to ensure accountability at a senior executive level for that compliance.

The Company's Continuous Disclosure Policy can be found at www.karoongas.com.au.

The Role of Shareholders

The Board of Directors aims to ensure that all shareholders are informed of all major developments affecting the Company's state of affairs. Information is communicated to shareholders as follows:

- the Annual Report is distributed to any shareholders who request a copy. The Board of Directors ensures that the Annual Report includes relevant information about the operations of the Group during the financial year, changes in the state of affairs of the Group and other disclosures required by the *Corporations Act 2001*;
- 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;

STATEMENT OF CORPORATE GOVERNANCE CONTINUED

- 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.karooogas.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 will ensure that the Annual General Meeting is held in a manner that 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 about the conduct of the audit, preparation and content of the independent auditor's report.

The Chairman of the Annual General Meeting will allow a reasonable opportunity for shareholders to ask questions about the Company's performance and operations and ask questions of the external auditor concerning the conduct of the audit, preparation and content of the independent auditor's report.

Risk Assessment and Management

Recommendation 7.1 of the revised Corporate Governance Council Principles provides that companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies. The Board of Directors has overall responsibility for monitoring compliance and oversight of these policies along with ensuring that they are efficient and effective.

Currently, as part of the Group's strategy to implement an integrated framework of control, the Board of Directors continually identifies and monitors the key business and financial risks that could jeopardise the Group achieving its objectives. The Board of Directors has and continues to develop appropriate controls to effectively manage those risks. These include:

- financial controls are set in place by the use of an authority matrix, general purchasing principles and approvals procedures. All expenditure is closely monitored by the Audit Committee on behalf of the Board of Directors and reported on a quarterly 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 of Directors. Management accounts are prepared monthly for the Board of Directors to ensure information congruence between management and the Board of Directors;
- the Company offsets the risk of 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 of a Health, Safety and Environment Policy and travel insurance for periods where employees are out of state or out of country, along with membership to emergency assistance and management for an employee overseas; and
- operational reporting is submitted to the Board of Directors at every Board meeting to ensure decisions are made in an efficient and effective manner. Reports include reviews of current assets, potential acquisitions and general operational issues and/or opportunities.

Management Accountability

In compliance with Recommendation 7.3, the Board of Directors encourages management accountability for the Company's annual financial report by requiring the Executive Chairman and Chief Financial Officer to state in writing to the Board of Directors that:

- the Company's annual financial report presents a true and fair view, in all material respects, of the Company's financial condition and operational results and is in accordance with relevant Australian Accounting Standards; and
- the annual financial report is compiled in accordance with best practice and is properly monitored using the Audit Committee and the external auditors to ensure a sound system of risk management and control.

Recommendation 7.2 of the revised Corporate Governance Council Principles provides that the Board of Directors should require management to design and implement the risk management and internal control system to manage the Company's material business risks and report to it on whether those risks are being managed effectively. Throughout the financial year, Karoon has reviewed and where required improved its risk management and internal compliance and control systems. The Company will continue to review and improve its risk management systems over the coming financial period.

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 7 September 2010.

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	3,973	2,026,883
1,001 to 5,000	3,383	8,493,155
5,001 to 10,000	888	6,596,189
10,001 to 100,000	956	25,402,615
More than 100,000	108	135,027,356
Total	9,308	177,546,198

There were 74 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
Talbot Group Holdings Pty Ltd	26,317,356	14.82
Wellington Management Group, LLP and its related bodies corporate	24,856,467	14.00
Mr Robert Hosking	12,102,320	6.82
Total	63,276,143	35.64

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	33,478,308	18.86
2 Talbot Group Holdings Pty Ltd <Talbot Equities A/C>	15,317,043	8.63
3 ANZ Nominees Limited <Cash Income A/C>	11,894,302	6.70
4 Talbot Group Investments Pty Ltd	11,000,313	6.20
5 Ropat Nominees Pty Ltd	10,477,880	5.90
6 JP Morgan Nominees Australia Limited	8,649,990	4.87
7 Woodross Nominees Pty Ltd	5,124,564	2.89
8 National Nominees Limited	4,771,742	2.69
9 Citicorp Nominees Pty Limited	3,923,902	2.21
10 IERS (Australia) Pty Ltd <Smith Family Investment A/C>	1,591,500	0.90
11 HSBC Custody Nominees (Australia) Limited – GSCO ECA	1,165,946	0.66
12 Mrs Mara Spong	1,125,746	0.63
13 UBS Wealth Management Australia Nominees Pty Ltd	1,011,534	0.57
14 Mr Donald James Erskine <Erskine Invest Super A/C>	1,000,000	0.56
15 Warbont Nominees Pty Ltd <Settlement Entrepot A/C>	998,833	0.56
16 Rose Burton Pty Ltd	815,000	0.46
17 Mrs Pauline Frolley	765,746	0.43
18 Mr Mark Smith	750,000	0.42
19 Brian Dunn Investments Pty Ltd	704,258	0.40
20 Penelope Baldick	702,912	0.40
Total	115,269,519	64.92

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	30	3,830,000
Other share options issued	4	5,250,000
Total	34	9,080,000

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
AC/P8	Bonaparte, Australia	66.67
WA-314-P	Browse, Australia	40.00
WA-315-P	Browse, Australia	40.00*
WA-398-P	Browse, Australia	40.00*
Block 1037	Santos, Brazil	100.00
Block 1101	Santos, Brazil	100.00
Block 1102	Santos, Brazil	100.00
Block 1165	Santos, Brazil	100.00
Block 1166	Santos, Brazil	100.00
Block 1352	Santos, Brazil	20.00 [^]
Block 1354	Santos, Brazil	20.00 [^]
Block 144	Maranon, Peru	100.00
Block Z-38	Tumbes, Peru	75.00 [#]

* 1.5% ORR for first five years, going to 2% thereafter.

The Group's 75% ownership interest is subject to obtaining regulatory approvals and completion of second and third year work commitments.

[^] The Group's 20% ownership interest is subject to obtaining regulatory approvals and satisfying farm-in obligations.

GLOSSARY OF TERMS

Term	Definition
2D seismic	Two-dimensional seismic.
3D seismic	Three-dimensional seismic.
\$ or cents	Units of Australian currency.
AASB	Australian Accounting Standards Board.
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	Australian Securities Exchange or ASX Limited (ABN: 98 008 624 691).
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.
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.
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.
CPRS	Carbon Pollution Reduction Scheme.
CSEM	Controlled Source Electro Magnetic (survey).
Director	A Director of Karoon Gas Australia Ltd.
Discovery well	The first successful well on a new prospect.
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.
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.

Term	Definition
FBT	Fringe Benefits Tax in Australia.
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 2010.
Karoon or Group	Karoon Gas Australia Ltd and its subsidiaries.
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.
Company or Parent Company	Karoon Gas Australia Ltd.
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.
m	Metres.
market capitalisation	The product of the 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.
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	<i>National Greenhouse and Energy Reporting Act 2007.</i>
operator	One joint venture participant that has been appointed to carry out all operations on behalf of all the joint venture participants.
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 2009.

GLOSSARY OF TERMS CONTINUED

Term	Definition
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.
prospectivity	Referring to the likelihood of finding commercial hydrocarbons.
prospective resource	The term used to describe undiscovered volumes in an exploration prospect yet to be drilled.
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.
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.
Talisman	Talisman Oil & Gas (Australia) Pty Limited.
TCF	Trillion cubic feet (1,000,000,000,000 cubic feet).
unrisked	A risk value has not been applied to an estimate of hydrocarbon volume either in place or recoverable.
USD	United States dollars.

This report does not constitute an offer of securities for sale in the United States by the company or any of its affiliates, nor may the Company's securities, or those of its affiliates, be offered or sold in the United States absent registration or an exemption from registration as provided in the US Securities Act of 1933, as amended, and the rules and regulations thereunder. Neither the company nor any of its affiliates has registered their respective securities in the United States, nor does the Company or any of its affiliates have any such intention to register their respective securities. The information contained in this report shall not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the company's securities, or those of its affiliates, in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration, exemption from registration or qualification under the securities laws of any such jurisdiction.

CORPORATE DIRECTORY

Board of Directors

Mr Robert Hosking – Executive Chairman
Mr Mark Smith – Executive Director
Mr Geoff Atkins – Independent Non-Executive Director
Mr Stephen Power – Non-Executive Director

Company Secretary

Mr Scott Hosking

Audit Committee Members

Mr Geoff Atkins (Chairman of Committee)
Mr Robert Hosking
Mr Stephen Power

Remuneration Committee Members

Mr Geoff Atkins (Chairman of Committee)
Mr Mark Smith
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
Email info@karoongas.com.au
Website www.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

Bankers

National Australia Bank Limited
271 Collins Street
Melbourne VIC 3000
Australia

HSBC Bank Australia Limited
Level 12, 140 William Street
Melbourne VIC 3000
Australia

Share Registrar

Computershare Investor Services Pty Limited
Yarra Falls
452 Johnston Street
Abbotsford VIC 3067
Australia

Telephone 1300 850 505 (investors within Australia)
+61 3 9415 4000

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 Room 3 at the Crown Towers
Level 1, Crown Towers, 8 Whiteman Street
Southbank VIC 3006

Time 11am (registration from 10am)

Date Thursday 18 November 2010



Karoon Gas Australia Ltd

ACN 107 001 338 | ABN 53 107 001 338

Office 7A, 34-38 Lochiel Avenue, Mount Martha VIC 3934 Australia

Telephone 61 3 5974 1044 | Facsimile 61 3 5974 1644

info@karoongas.com.au | www.karoongas.com.au