

Karoon Gas Australia Limited

ABN 53 107 001 338
and Controlled Entities



Financial Report 2004



2004 FINANCIAL REPORT

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Chairmans report

Dear Fellow Shareholders,

On behalf of the board of Directors, I take great pleasure in presenting to you the first annual report from Karoon Gas Australia Ltd ("Karoon Gas").

When Karoon Gas completed its public offer in June of this year, the primary purpose was to raise funds to focus applying the many years of geotechnical and geophysical experience of its directors to create a "greenhouse friendly" energy source and provide profitable operations for shareholders. Following this goal the Company has focused on analysis and drilling of the company's permits in the Narracan Trough, part of the Western Gippsland Basin in Victoria's Southeast. Over the preceding months much work has been completed to finish this geotechnical analysis and begin drilling with the aim of discovering CBM and Natural Gas reserves. At this time the analysis of PEP 162 and EL 4537 is complete and drilling is expected to take place in late October 2004. As the initial exploration program is coming to fruition it is a very exciting time for all parties involved.

Currently all permits are owned 100% by Karoon Gas through its subsidiary Karoon Gas Australia Pty. Ltd., this in turn assures that Karoon Gas is in a position to apply its years of Geotechnical and Geophysical Analysis while maintaining full control of all its operations and its shareholders benefit from produced income.

Over the coming year Karoon Gas aims to complete up to three successful wells in PEP 162 and EL 4537, and grow organically through further exploration and development opportunities. Karoon Gas aims to invest further into the Oil and Gas sector using its expertise in financial and geotechnical analysis to yield positive results which the company believes will lead to greater self-sufficiency, enhance value and shareholder returns.

The Karoon Gas share price has remained steady since the IPO and is expected to strengthen as we come closer to the drilling of Megascoides #1, the first well to be drilled in the Narracan Trough, and move into the coming year with new prospects for growth.

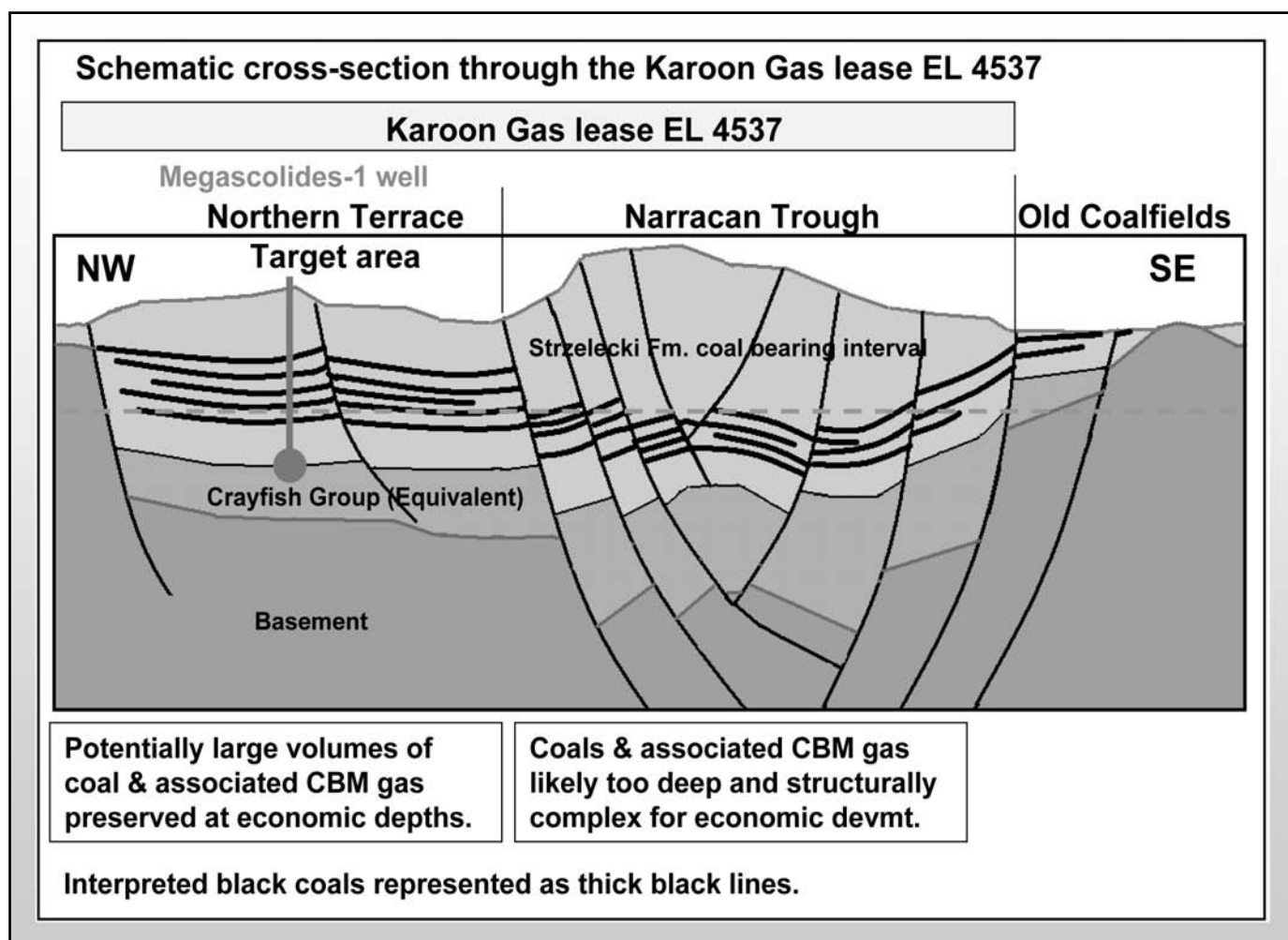
The board of directors is pleased with progress that has been made thus far with development of permits and market reception. The prospectivity of permits is expected to lead to significant growth potential through the coming years, allowing Karoon Gas the development of high profitability and ability to continue its growth into more exploration activities and graduation into a substantial CBM/ Natural Gas Producer.

Corporate Governance issues continue to be an important issue which is always of consideration in all board decisions and agendas. The Company aims to maintain the highest standards and follow the strictest guidelines in relation to adherence of Corporate Governance policies set out in the corporate governance section of this Annual Report.

The board and I are very pleased with the accomplishments of Karoon Gas so far this year and look forward to a productive 2005. A year that sees the unfolding of projects which will lead to increased growth and development of both the company and its shareholder value. I would like to thank the Shareholders for their support of Karoon Gas Australia Ltd



Robert Hosking
Executive Chairman





Karoon Gas Australia Ltd (KGAL) : Activities Update

- The date for drilling the 1st well in PEP 162 and EL 4537 in West Gippsland called Megascoides - 1 is expected to commence (spud) on approximately the 29th October 2004. Well total depth is planned to be 2000 metres. The intervals of interest are the black coal horizons and the deeper Crayfish Group equivalent sandstones.
- The 2nd well called Invermay-1 is expected to commence drilling in early December 2004. Well depth is expected to be 1400 metres.
- A new subsidiary company called Eastern Pacific Coal Pty Ltd has been formed to accommodate the existing Brown Coal reserves of Karoon Gas Australia Ltd. This new subsidiary is 100% owned by KGAL. During the quarter, an audit of EL 4537 identified a potentially commercial brown coal resource. This resource was drilled and evaluated by ESSO in the early 1980's as a candidate for a coal to liquids project. The ESSO field work that defined the resource included seismic acquisition and interpretation and the drilling of 77 bores in and around the resource. This extensive data base, retained by Victorian state government has been used to re-evaluate the deposit. To establish this brown coal as a defined resource Karoon commissioned an independent evaluation by GHD Pty Ltd. GHD is an international engineering and professional services company.

The GHD report has determined that a Coal In-situ Resource Estimate in EL 4537 as follows:

Measured	50	Million tonnes
Indicated	210	Million tonnes
Inferred	80	Million tonnes

Total *340 Million tonnes

* contains coal and inferior coal.

The deposit is located in the Yarragon area under a thin cover of sands and clays.

- For the purposes of company expansion and risk management, Karoon Gas has begun to review other energy business opportunities for consideration as additions to Karoon's asset portfolio.



The Western Gippsland Basin Assets

Karoon Gas (through its 100% owned subsidiary Karoon Gas Pty Ltd) has a 100% registered interest in PEP162 and EL4537, within the Western on-shore Gippsland Basin of Victoria (see page 6). The area of PEP162 is extensive, covering some 2950 sq. km. and overlays EL4537, which covers 800 sq. km. The permits are 100 kms east of Melbourne, and are close to existing oil and gas pipelines and infrastructure moving oil and gas from Bass Strait to the Melbourne area.

Karoon Gas Pty Ltd has previously conducted exploration activities on its own behalf. Additional work was needed to prove any potential resource. After further analysis by Karoon Gas it has been interpreted that there are large sections of interbedded black coal sequences present in the Narracan Trough. Based on a comparison with key criteria from producing CBM fields the conditions appear favourable for the development of a potential CBM resource.

The proposed wells are being designed to collect the remaining data required to define gas reserves and gauge their ability to produce. Specifically the wells will determine the number, depth and thickness of any coal seams present. Cores cut through the coal will be analysed to determine gas content, while saturation and other testing will define coal permeability in these wells.

This information will allow optimal forward evaluation and development plans to be developed.

Karoon Gas Petroleum Tenements

Petroleum Exploration Permit 162

On 25 May 2001, the State Government of Victoria granted Bass Petroleum (Victoria) Pty Ltd (A.C.N. 056 976 642) (now Karoon Gas Pty Ltd) Petroleum Exploration Permit 162 ("PEP 162") for a period of five (5) years with effect from 14 May 2001 in respect of an area on-shore Victoria in the Gippsland Basin. The grant of PEP 162 was based on the following work programme.

Year Work Program

- 1 60 Km Seismic Survey
- 2 Geological and geophysical studies
- 3 40 Km Seismic Survey
- 4 Drill one well
- 5 Data Review

Year 1 and 3 of the approved work programme are declared to be key objects of the work program for the purpose of Section 27 of Petroleum Act 1998 (Vic). The permit holder must complete as a minimum the key objects of the work program during the five (5) years of PEP162.

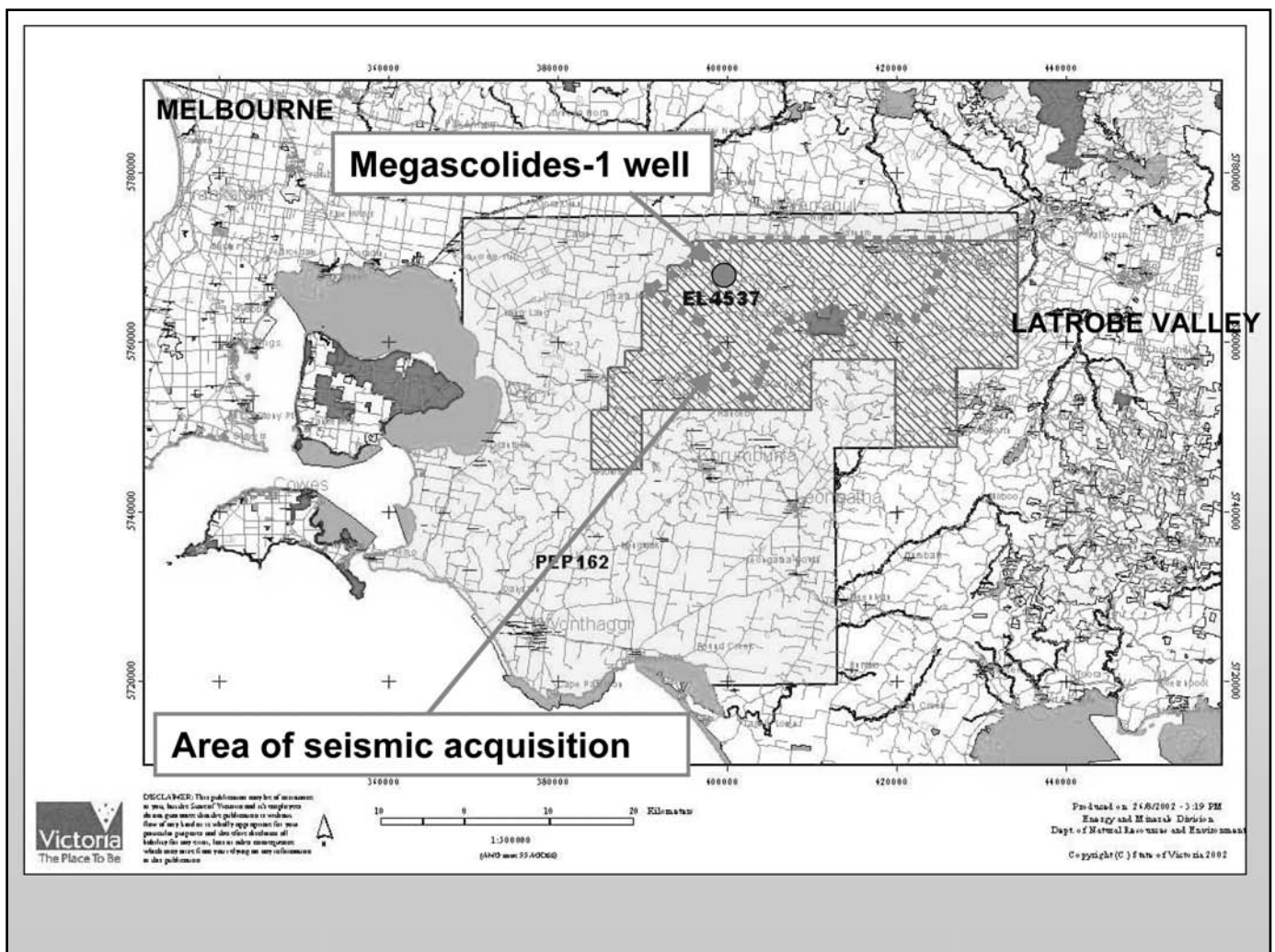
An application has been made by the permit holder to vary the work program by drilling one (1) well in year three and carrying out the 40 Km Seismic Survey in year four.

Exploration Licence 4537

On the 10th September 2004 the Exploration Licence 4537 was officially transferred into the name of Karoon Gas Pty Ltd a wholly owned subsidiary of Karoon Gas Australia Ltd. Exploration Licence 4537 ("EL4537") for all minerals and coal (brown or black) in respect of an area on shore Victoria in the Narracan Trough Gippsland Basin.

The licensee of EL4537 must expend in connection with its exploration a minimum of :

- \$81,600 in the first year of the term of the licence
- \$103,800 in the second year of the term of the licence
- \$121,500 in the third year of the term of the licence
- \$121,500 in the fourth year of the term of the licence
- \$148,200 in the fifth year of the term of the licence



DIRECTORS' REPORT

FOR THE YEAR ENDED 30 JUNE 2004

The Directors present their report together with the financial report of Karoon Gas Australia Limited ("the Company") for the year ended 30 June 2004 and the auditors' report thereon.

Directors

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

Mr Robert Michael Hosking

Executive Chairman

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

Robert also has a background of more than 15 years commercial experience in the steel industry. He jointly owned and managed businesses involved in the trans-global 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 Alexander Smith

Executive Director and Exploration manager

Dip. App. Geol, Bsc. (Geology)

Mark is a geologist with over 23 years of international and managerial experience in the petroleum exploration and development industry, with particular emphasis in Australia, Southeast Asia and North America. The bulk of this experience was gained whilst with BHP Petroleum. Mark has been directly involved with seven economic oil and gas discoveries.

Mark's geoscience skills cover regional basin and tectonic studies, acreage evaluations and gazettals, farmins/farmouts, petroleum systems fairway assessments, prospect evaluations, risking and volumetrics and fault seal prediction.

Mark also has project and operations management experience in wellsite operations and management of onshore and offshore drilling operations.

Mr Edward Munks

B. Bus, FCPA, MAICD

Non-Executive Director and Company Secretary

Edward has a finance and commercial background with over 20 years' international experience with a range of industrial and resource companies. He has had experience in a range of financial and business matters, from gas marketing, capital raisings to restructuring of corporate enterprises. He also has had experience as a Chief Financial Officer in various listed companies in the past.

Member of the audit committee.

Mrs Patricia Hosking

Non-Executive Director

Resigned 1 March 2004

DIRECTORS' REPORT continued

FOR THE YEAR ENDED 30 JUNE 2004

Directors' meetings

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

Director	Board meetings		Audit Committee meetings	
	A	B	A	B
Mr Robert Hosking	8	8	2	2
Mr Mark Smith	6	6		
Mr Edward Munks	8	8	2	2
Mrs Patricia Hosking	5	5		

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

B – Number of meetings attended.

Principal activities

The principal activities of the Company during the course of the financial year were the investment in energy related projects in particular the exploration of the Western Gippsland Basin, a sedimentary basin in Victoria's south east, using existing seismic information to assist in proving a potential commercial reserve of Coal Bed Methane (CBM).

There were no other significant changes in the nature of the activities of the Company during the year other than disclosed in this financial report.

Review of operations

Karoon has conducted further geotechnical analysis of the company's exploration permits and also commenced preparation for the drilling of the Megascollides #1 well, which is anticipated to spud in late October 2004.

The company's exploration permits are relatively unexplored by industry standards and is located in an area close to major infrastructure and markets.

Operating results

The consolidated loss of the consolidated entity for the year ended 30 June 2004 was \$178,301 (2003:\$nil).

Significant changes in state of affairs

In December 2003 the Company acquired Karoon Gas Pty Ltd, with the consideration being the issue of 15 million shares to Ropat Nominees Pty Ltd. Karoon Gas Pty Ltd holds the petroleum exploration permit PEP 162 and the minerals exploration licence EL 4537 in the onshore Western Gippsland Basin.

Karoon Gas Australia Ltd (Karoon) was listed in the Australian Stock on the 8th June 2004, following a successful Initial Public Offering (IPO). The IPO was oversubscribed and raised \$4.7 million.

Dividends

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

Issue of options to employees

At 30 June 2004, there were no options outstanding as part of the Executive and Employee Options scheme.

All options that are granted under the Employee Share Option scheme expire on their expiry date or on termination of the employee's employment. Options may be exercised at any time by employees.

These options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

During the year the following options were issued to directors or their related parties;

1,500,000	Issued on 27 May 2004 to the directors of the Company with an exercise price of \$0.25 each to acquire one ordinary fully paid share in the Company; expiry date 30 June 2007.
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DIRECTORS' REPORT continued

FOR THE YEAR ENDED 30 JUNE 2004

Environmental regulation

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

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

The Board believes that the Company has adequate systems in place for the management of its environmental requirements and is not aware of any breach of those environmental requirements as they apply to the Company.

No circumstances arose during the year which resulted in an incident to be reported under environmental legislation.

Events subsequent to balance date

Subsequent to the end of the financial year the economic entity has signed a contract with Hunt Energy & Mineral Co Australia Pty Ltd for the company's forthcoming drilling programme in the Western Onshore Gippsland Basin.

The Hunt Energy Rig has been contracted to drill the Megascolides #1 well with an option to drill 2 additional wells back to back.

Site and access work for the Megascolides #1 drilling location has commenced.

Likely developments

The Company will continue to pursue its policy of investing in the energy sector during the next financial year. The consolidated entity's long-term objective is to achieve organic growth from exploration and development opportunities. The Company will be pursuing its strategy to gain access to quality assets with significant equity levels.

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

Directors' and senior executives' emoluments Remuneration policy

The Board regularly reviews remuneration of its senior executives and Directors. This also includes responsibility for the Employee Share Option scheme. Executive remuneration levels are competitively set with regard to the level of seniority, responsibility and effectiveness in carrying out these duties. Directors' remuneration levels are competitively set.

DIRECTOR'S REPORT continued

FOR THE YEAR ENDED 30 JUNE 2004

Options are also issued under the Executive and Employee Share Option scheme.

Directors' and senior executives' emoluments

Details of the nature and amount of each major element of the emoluments of each Director of the Company and each of the named executive officers of the Company and the consolidated entity receiving the highest emolument are detailed in the notes to the accounts.

Directors' interests

The relevant interest of each Director in the shares, debentures, interests in registered schemes and rights or options over such instruments issued by the Company, as notified by the Directors to the Australian Stock Exchange in accordance with S205G(1) of the Corporations Act, at the date of this report is as follows:

	Ordinary fully paid shares	Options
Mr Robert Hosking	8,188,334	4,594,167
Mr Mark Smith	1,200,000	1,100,000
Mr Edward Munks	250,000	625,000

Corporate governance

In recognising the need for the highest standards of corporate governance and accountability, the Directors of the parent entity support and have adhered to the principles of corporate governance. The consolidated entity's corporate governance statement is on pages 36 - 39 of this annual report.

Auditors

Mitchell Wilson & Partners continue in accordance with Section 327 of the Corporations Act.

Dated Melbourne this 30th day of September 2004.

Signed in accordance with a resolution of the Directors:



Robert Hosking
Chairman



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STATEMENT OF FINANCIAL PERFORMANCE

FOR THE YEAR ENDED 30 JUNE 2004

	Note	Consolidated Entity		Parent Entity	
		2004 \$	2003 \$	2004 \$	2003 \$
Revenues from ordinary activities	2	34,015	-	34,015	-
Travel and accommodation		(8,878)	-	(6,210)	-
Directors benefits		(2,083)	-	(2,083)	-
Consulting fees		(114,789)	-	(114,789)	-
Property costs		(8,435)	-	(8,361)	-
Operating lease rental expense		(8,320)	-	(8,320)	-
Audit fees		(7,000)	-	(5,000)	-
Legal fees		(1,650)	-	(1,650)	-
Corporate promotion and annual report		(20,000)	-	(20,000)	-
Depreciation of plant and equipment		(2,156)	-	(2,156)	-
Amortisation of goodwill on acquisition of Karoon Gas Pty Ltd		(10,031)	-	-	-
Share registry and listing fees		(6,859)	-	(7,772)	-
Other expenses from ordinary activities		(22,115)	-	(9,657)	-
Loss from ordinary activities before income tax expense		(178,301)	-	(151,983)	-
Income tax (expense)/benefit relating to ordinary activities		-	-	-	-
Net loss from ordinary activities after income tax					
Expense attributable to members of the parent entity		(178,301)	-	(151,983)	-
Total changes in equity other than those resulting from transactions with owners as owners		(178,301)	-	(151,983)	-
Basic earnings per share		(\$0.016)	-		
Diluted earning per share		(\$0.011)	-		

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 15 to 33.

STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2004

		Consolidated Entity		Parent Entity	
	Note	2004	2003	2004	2003
		\$	\$	\$	\$
Current assets					
Cash assets		4,225,633	-	4,208,593	-
Receivables	8	66,046	-	46,481	-
Other	13		-		-
Total current assets		4,291,679	-	4,255,073	-
Non-current assets					
Other financial assets	9	1,212	-	151,212	-
Receivables	8	-	-	241,455	-
Property, plant and equipment	10	46,795	-	46,795	-
Intangible assets	11	161,920	-	-	-
Other assets	12	266,796	-	-	-
Total non-current assets		476,723	-	439,462	-
Total assets		4,768,402	-	4,694,535	-
Current liabilities					
Payables	13	(189,764)	-	(119,787)	-
Total current liabilities		(189,764)	-	(119,787)	-
Total liabilities		(189,764)	-	(119,787)	-
Net assets		4,578,638	-	4,574,748	-
Equity					
Contributed equity	15	4,726,731	-	4,726,731	-
Accumulated losses		(148,092)	-	(151,983)	-
Total equity		4,578,638	-	4,574,748	-

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 15 to 33.

STATEMENT OF CASH FLOW
FOR THE YEAR ENDED 30 JUNE 2004

		Consolidated Entity		Parent Entity	
	Note	2004	2003	2004	2003
		\$	\$	\$	\$
Cash flows from operating activities					
Tax refund		12,865	-	5,156	-
Payments to suppliers		(144,128)	-	(116,904)	-
Interest received		34,015	-	34,015	-
Net cash flows used in operating activities		(97,248)	-	(77,733)	-
Cash flows from investing activities					
Purchase of property, plant and equipment		(48,951)	-	(48,951)	-
Purchase of investments		-	-	-	-
Payments for exploration and development expenditure		(204,899)	-	-	-
Net cash flows used in investing activities		(253,850)	-	(48,951)	-
Cash flows from financing activities					
Proceeds from issue of ordinary shares		4,576,731	-	4,576,731	-
Repayment of loans to parent entity		-	-	(241,455)	-
Net cash flows from financing activities		4,576,731	-	4,335,276	-
Net decrease in cash held		4,225,633	-	4,208,592	-
Cash at the beginning of the year		-	-	-	-
Cash at the end of the year		4,225,633	-	4,208,592	-

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 15 to 33.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2004

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

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

The financial report covers the consolidated entity of Karoon Gas Australia Limited and controlled entities, and Karoon Gas Australia Limited as an individual parent entity. Karoon Gas Australia Limited is a listed public company, incorporated and domiciled in Australia.

The financial report has been prepared on an accruals basis and is based on historical costs and does not take into account changing money values or, except where stated, current valuations of non-current assets. Cost is based on the fair values of the consideration given in exchange for assets.

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

a) Principles of consolidation

The consolidated accounts of the consolidated entity comprise the accounts of the parent entity, Karoon Gas Australia Limited and its controlled entity Karoon Gas Pty Ltd. Information on the controlled entity is contained in Note 23. All intercompany balances and transactions between the parent entity and controlled entity have been eliminated.

When a controlled entity has been disposed of or is acquired during the year, its operating results have been included to the date of disposal or from the date of acquisition as appropriate.

b) Revenue recognition

Revenues are recognised at fair value of the consideration received net of the amount of goods and services tax. Exchanges of goods or services of the same nature and value without any cash consideration are not recognised as revenues.

Rendering of services

Revenue from rendering services is recognized in the period in which the service is provided, having regard to the stage of completion of the contract.

Interest revenue

Interest revenue is recognised as it accrues.

c) Goods and services tax

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

Receivables and payables are stated with the amount of GST included.

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

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

d) Income tax

The consolidated entity adopts the income statement liability method of tax effect accounting.

Income tax expense is calculated on operating profit adjusted for permanent differences between taxable and accounting income. The tax effect of timing differences, which arise from items being brought to account in different periods for income tax and accounting purposes, is carried forward in the statement of financial position as a future income tax benefit or a provision for deferred income tax. Future income tax benefits are not brought to account unless realization of the asset is assured beyond reasonable doubt. Future income tax benefits relating to tax losses are only brought to account when their realization is virtually certain. The tax effects of capital losses are not recorded unless realisation is virtually certain.

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

e) Acquisition of assets

All assets acquired including property, plant and equipment and intangibles other than goodwill are initially recorded at their cost of acquisition at the date of acquisition, being fair value of the consideration provided plus incidental costs directly attributable to the acquisition.

Expenditure (including that on internally generated assets other than research and development costs) is only recognised as an asset when the entity controls future economic benefits as a result of the costs incurred, it is probable that those future economic benefits will eventuate, and the costs can be measured reliably. Costs attributable to feasibility and alternative approach assessments are expensed as incurred.

f) Non-current assets

The carrying amounts of non-current assets are reviewed to determine whether they are in excess of their recoverable amount at balance date. If the carrying amount of a non-current asset exceeds its recoverable amount, the asset is written down to the lower amount.

g) Receivables

Trade debtors

Trade debtors to be settled within 60 days are carried at amounts due. The collectibility of debts is assessed at balance date and specific provision is made for any doubtful accounts.

h) Inventories

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

i) Investments

Associates

Investments in unlisted shares of associates are recognised in the financial statements by applying the equity method of accounting.

Controlled entities

Investments in controlled entities are valued in the parent entity's accounts at cost, less, where appropriate, a provision for diminution in value where the annual review by Directors has determined that cost is in excess of the recoverable amount from these assets.

j) Operating leases

Payments made under operating leases are expensed on a straight line basis over the term of the lease, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased property.

k) Property, plant and equipment

Depreciation and amortisation

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

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

Plant and equipment	25 – 50%
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Assets are depreciated or amortised from the month following their acquisition.

l) Payables

Liabilities are recognised for amounts to be paid in the future for goods or services received, whether or not billed to the Company. Trade accounts payable are normally settled within 30 days.

m) Employee entitlements

Provision is made for the Company's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits expected to be settled within one year together with entitlements arising from wages and salaries, annual leave and sick leave which will be settled after one year, have been measured at the amounts expected to be paid when the liability is settled, plus related on-costs. Other employee benefits payable later than one year have been measured at the present value of the estimated future cash outflows to be made for those benefits.

Contributions are made by the consolidated entity to employee superannuation funds and are charged as expenses when incurred.

n) Cash and cash equivalents

Cash and cash equivalents includes deposits held at call with a bank or financial institution and highly liquid investments with short periods to maturity which are readily convertible to cash on hand at the consolidated entity's option and are subject to insignificant risk of changes in value.

o) Adoption of Australian Equivalents to International Financial Reporting Standards

Australia is currently preparing for the introduction of International Financial Reporting Standards (IFRS) effective for financial years commencing 1 January 2005. This requires the production of accounting data for future

NOTES TO THE FINANCIAL STATEMENTS continued

FOR THE YEAR ENDED 30 JUNE 2004

The consolidated entity's management and directors, are assessing the significance of these changes and preparing for their implementation. We will seek to keep stakeholders informed as to the impact of these new standards as they are finalised.

The directors are of the opinion that the key differences in the economic entity's accounting policies which will arise from the adoption of IFRS are:

Impairment of Assets

The consolidated entity currently determines the recoverable amount of an asset on the basis of undiscounted net cash flows that will be received from the assets use and subsequent disposal. In terms of pending AASB 136: Impairment of Assets, the recoverable amount of an asset will be determined as the higher of fair value less costs to sell and value in use. It is likely that this change in accounting policy will lead to impairments being recognised more often than under the existing policy.

Income Tax

Currently, the consolidated entity adopts the liability method of tax-effect accounting whereby the income tax expense is based on the accounting profit adjusted for any permanent differences.

Timing differences are currently brought to account as either a provision for deferred income tax or future income tax benefit. Under the pending AASB 112: Income Taxes, the consolidated entity will be required to adopt a balance sheet approach under which temporary differences are identified for each asset and liability rather than the effects of the timing and permanent differences between taxable income and accounting profit.

p) Exploration and development expenditure

Exploration, evaluation and development expenditure incurred is accumulated in respect of each identifiable area of interest. These costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area or where activities in the area have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves.

Accumulated costs in relation to an abandoned area are written off in full against profit in the year in which the decision to abandon the area is made.

When production commences, the accumulated costs for the relevant area of interest are amortised over the life of the area according to the rate of depletion of the economically recoverable reserves.

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

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

	Note	Consolidated Entity		Parent Entity	
		2004	2003	2004	2003
		\$	\$	\$	\$
2. REVENUE FROM ORDINARY ACTIVITIES					
Rendering of services revenue from operating activities		-	-	-	-
Other revenues from operating activities					
Interest		34,015	-	34,015	-
Other revenue from outside operating activities					
Other revenue		-	-	-	-
Total other revenues		-	-	-	-
Total revenue from ordinary activities		34,015	-	34,015	-
3. LOSS FORM ORDINARY ACTIVITIES BEFORE INCOME TAX EXPENSE					
Loss from ordinary activities before income tax expense has been arrived at after charging/(crediting) the following items:					
Depreciation of plant and equipment		2,156	-	2,156	-
Amortisation of goodwill		10,031	-	-	-
Total depreciation and amortisation		12,187	-	2,156	-
Operating lease rental expense		8,320	-	8,320	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

		Consolidated Entity		Parent Entity	
	Note	2004 \$	2003 \$	2004 \$	2003 \$
4. AUDITORS' REMUNERATION					
Audit services		7,000	-	5,000	-
Other services		-	-	-	-
		7,000	-	5,000	-
5. TAXATION					
(a) Income tax expense					
Prima facie income tax expense/(benefit) calculated at 30% on the profit from ordinary activities		(60,620)	-	(45,595)	-
Increase in income tax expense due to:					
- Other non-deductible items		3,009	-	-	-
- Current year losses not brought to account		57,611	-	45,595	-
Income tax expense attributable to ordinary activities		-	-	-	-
The potential future income tax benefit arising from tax losses and timing differences has not been recognised as an asset because recovery of tax losses is not virtually certain and recovery of timing differences is not assured beyond any reasonable doubt.					
Tax losses carried forward at a rate of 30%		57,611	-	45,595	-
Timing differences		-	-	-	-
		-	-	-	-
The potential future income tax benefit will only be obtained if:					
(i) the Company derives future assessable income of a nature and of an amount sufficient to enable the benefit from the deductions for the losses to be realised;					
(ii) the Company continues to comply with the conditions for deductibility imposed by tax legislation; and					
(iii) no changes in tax legislation adversely affect the Company in realizing the benefit from the deductions for the losses.					

NOTES TO THE FINANCIAL STATEMENTS continued
 FOR THE YEAR ENDED 30 JUNE 2004

	Consolidated Entity		Parent Entity	
	2004	2003	2004	2003
	\$	\$	\$	\$
6. DIVIDENDS				
There were no ordinary dividends proposed/paid during the year ended 30 June 2004 by the Company.				
7. EARNINGS PER SHARE				
Earnings used in the calculation of basic and dilutive earnings per share	(178,301)	-		
(a) Basic loss per share	(\$0.016)	-		
(b) Diluted loss per share	(\$0.011)	-		
Weighted average number of ordinary shares used in the calculation of basic earnings per share	11,307,908	-		
Weighted average number of options outstanding	5,653,953	-		
Weighted average number of ordinary shares outstanding during the year used in calculating diluted earnings per share	16,861,861	-		
Potential ordinary shares				
Options outstanding at 30 June 2004 are considered to be potential ordinary shares for the purposes of determining diluted earnings per share.				
8. RECEIVABLES				
<i>Current</i>				
Trade debtors	66,046	-	46,481	-
Less: Provision for doubtful trade debts	-	-	-	-
Other debtors		-	-	-
Total current receivable	66,046	-	46,481	-
<i>Non-current</i>				
Karoon Gas Pty Ltd	-	-	241,455	-
Less: provision for doubtful debts	-	-	-	-
Total non-current receivables	-	-	241,455	-

NOTES TO THE FINANCIAL STATEMENTS continued
 FOR THE YEAR ENDED 30 JUNE 2004

	Consolidated Entity		Parent Entity	
	2004	2003	2004	2003
	\$	\$	\$	\$
9. OTHER FINANCIAL ASSETS				
<i>Non-current</i>				
Investment in subsidiary companies at cost	-	-	150,000	-
Formation Costs	1,212	-	1,212	-
10. PROPERTY, PLANT AND EQUIPMENT				
<i>Plant and equipment</i>				
At cost	48,951	-	48,951	-
Accumulated depreciation	(2,156)	-	(2,156)	-
Total property, plant and equipment net book value	46,795	-	46,795	-
<i>Reconciliations</i>				
Reconciliations of the carrying amounts for each class of property, plant and equipment are set out below:				
<i>Plant and equipment</i>				
Carrying amount at beginning of year	-	-	-	-
Additions	48,951	-	48,951	-
Disposals	-	-	-	-
Depreciation	(2,156)	-	(2,156)	-
Carrying amount at end of year	46,795	-	46,795	-
11. INTANGIBLE ASSETS				
Goodwill on acquisition of Karoon Gas Pty	171,951	-	-	-
Less: amortisation of Goodwill	(10,031)	-	-	-
Total	161,920	-	-	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

	Consolidated Entity		Parent Entity	
	2004	2003	2004	2003
	\$	\$	\$	\$
12. OTHER ASSETS				
<i>Non-current</i>				
Exploration and evaluation costs carried forward in respect of areas of interest	266,796	-	-	-
Exploration and evaluation expenditure relates to the areas of interest in exploration phase for petroleum exploration permits VIC/P54 and NT/P66. The expenditure is carried forward provided that:				
- Costs are expected to be recouped through successful development of the area or alternatively by its sale or;				
- Exploration and development expenditure activities in the specific areas have not reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves and active and subsequent operations in or in relation to the area are continuing.				
13. PAYABLES				
<i>Current</i>				
Trade creditors	156,404	-	92,427	-
Other creditors and accruals	33,360	-	27,360	-
	189,764	-	119,787	-
14. PROVISIONS				
<i>Non-current</i>				
Employee entitlements	-	-	-	-
Number of employees at year end	2	-	2	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

	Consolidated Entity		Parent Entity	
	2004	2003	2004	2003
	\$	\$	\$	\$
15. CONTRIBUTED EQUITY				
Issued and paid-up share capital				
41,663,505 (nil: 2003) fully paid ordinary shares	5,127,703	-	5,127,703	-
Less: equity raising costs	(400,972)	-	(400,972)	-
	4,726,731	-	4,723,731	-
<i>Movements in share capital</i>				
Balance at the beginning of the financial year			-	-
<i>Shares issued</i>				
41,663,505 fully paid ordinary shares			5,127,703	-
Less: equity raising costs			(400,972)	-
			4,726,731	-
			No.	No.
At the beginning of the reporting period			-	-
Shares issued during year			41,663,505	-
At reporting date			41,663,505	-
Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings. In the event of winding up of the Company, ordinary shareholders rank after all other creditors and are fully entitled to any proceeds of liquidation.				
16. ACCUMULATED LOSSES				
(Accumulated losses) retained profits at beginning of year	-	-	-	-
Retained profits acquired with purchase of Karoon Gas Pty Ltd	30,209	-	-	-
Net loss	(178,301)	-	(151,983)	-
Accumulated losses at end of year	(148,092)	-	(151,983)	-
17. TOTAL EQUITY RECONCILIATION				
Total equity at beginning of year	-	-	-	-
Net loss recognised in the statement of financial performance	(148,092)	-	(151,983)	-
Contributions of equity	4,726,731	-	4,726,731	-
	4,578,639	-	4,578,639	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

17. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE

a) Credit risk

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

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

b) Net fair values

The net fair values of listed investments will be valued at the quoted market bid price at balance date adjusted for transaction costs expected to be incurred. For other assets and other liabilities the net fair value approximates their carrying value. No financial assets and financial liabilities are readily traded on organised markets in standardised form other than listed investments. Financial assets where the carrying amount exceeds net fair values have not been written down as the consolidated entity intends to hold these assets to maturity.

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

c) Interest rate risk

Interest rate risk exposures

The consolidated entity's exposure to interest rate risk and the effective weighted average interest rate for classes of financial assets and financial liabilities is set out below:

Note	Weighted Average Interest rate %	Floating Interest Rate \$	Fixed interest maturing in 1 year or less \$	Non-interest- bearing \$	Total \$
2004					
<i>Financial assets</i>					
Cash	5.15	4,225,633	-	-	4,225,633
Receivables		-	-	66,046	66,046
		4,225,633	-	66,046	4,291,679
<i>Financial liabilities</i>					
Payables		-	-	189,764	189,764
		-	-	-	-
2003					
<i>Financial assets</i>					
		-	-	-	-
		-	-	-	-
<i>Financial liabilities</i>					
		-	-	-	-
		-	-	-	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

	Consolidated Entity		Parent Entity	
	2004	2003	2004	2003
	\$	\$	\$	\$
18. COMMITMENTS				
Operating lease commitments				
Future operating lease rentals not provided for in the financial statements and payable:				
Within one year	25,000	-	25,000	-
Later than one year but not later than five years	50,000	-	50,000	-
	75,000	-	75,000	-

Finance lease commitments

The consolidated entity does not have any finance leases at balance date.

Capital expenditure commitments

Capital commitments for petroleum exploration permits payable

- Not later than 1 year	1,603,800	-	-	-
- Not later than 1 year but not later than 5 years	391,200	-	-	-
- Later than 5 years	-	-	-	-
	1,995,000	-	-	-

Capital expenditure commitments relate to work commitments pursuant to the award of petroleum exploration permit PEP 162 and mineral exploration licence EL 4537, the economic entity has a 100% interest in both permits.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

	Consolidated Entity		Parent Entity	
	2004	2003	2004	2003
	\$	\$	\$	\$
19. NOTES TO THE STATEMENT OF CASH FLOWS				
(a) Reconciliation of cash				
For the purposes of the statement of cash flows, cash includes cash on hand and at bank, short-term deposits and short-term commercial bills. Cash as at the end of the financial year as shown in the statement of cash flows is as disclosed in the statement of financial position as "Cash Assets".				
(b) Reconciliation of loss from ordinary activities after income tax net cash provided by operating activities				
Loss from ordinary activities after income tax	(178,301)	-	(151,983)	-
Add/(less) non-cash items				
Write off of exploration expenditure	1,417	-	-	-
Amortisation	10,031	-	-	-
Depreciation	2,156	-	2,156	-
Cash flows excluded from loss from profit from ordinary activities attributable to operating activities:				-
Formation expenses of company	-		(1,212)	
Change in assets and liabilities				
Decrease/(Increase) in receivables	(66,046)	-	(46,481)	-
Decrease/(Increase) in tax refundable	7,728	-	-	-
(Decrease)/Increase in payables	125,767	-	119,787	-
Net cash flow from operating activities	(97,248)	-	(77,733)	

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

20. DIRECTORS' and EXECUTIVE REMUNERATION

(a) Names and positions held of parent entity directors and specified executives in office at any time during the financial year are:

Parent Entity Directors

Mr Robert Hosking	Chairman – Executive
Mr Mark Smith	Director – Executive
Mr Edward Munks	Director – Non Executive / Company Secretary
Mrs Patricia Hosking	Director – resigned 1 March 2004

Specified Executives

Mr Robert Hosking	Chairman – Executive
Mr Mark Smith	Director – Executive

(b) Parent Entity Directors Remuneration

		Primary		Post Employment	Equity	Other	
	Salary, Fees & Commissions	Superannuation Contributions	Cash Bonus	Superannuation	Options		Total
	\$	\$	\$	\$	\$	\$	\$
2004							
Mr Robert Hosking	91,000	-	-	-	-	-	91,000
Mr Mark Smith	29,596	-	-	-	-	-	29,596
Mr Edward Munks	2,083	-	-	-	-	-	2,083
Mrs Patricia Hosking	-	-	-	-	-	-	-
	122,679	-	-	-	-	-	122,679
2003							
	-	-	-	-	-	-	-

The company was formed in November 2003 and as such there were no directors in 2003.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

20. DIRECTORS' and EXECUTIVE REMUNERATION continued

(c) Specified Executives Remuneration

		Primary		Post Employment	Equity	Other	
	Salary, Fees & Commissions	Superannuation Contributions	Cash Bonus	Superannuation	Options		Total
	\$	\$	\$	\$	\$	\$	\$
2004							
Mr Robert Hosking	91,000	-	-	-	-	-	91,000
Mr Mark Smith	29,596	-	-	-	-	-	29,596
	120,596	-	-	-	-	-	120,596
2003							
	-	-	-	-	-	-	-
	-	-	-	-	-	-	-

The company was formed in November 2003 and as such there were no directors in 2003.

Directors options were issued prior to the company's IPO. The fair value of each option issued to Directors during the year is estimated on grant date using the Black & Scholes option pricing model. Currently, these fair values are not recognised as expenses in the financial statements. However, should these grants be expensed they would be amortised over the vesting periods resulting in an increase in employee benefits expense of \$nil for 2004 financial year. (\$nil for 2003 financial year).

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

(d) Remuneration Options – Options granted as remuneration

	Vested number	Granted number	Grant date	Value per option at grant date \$	Exercise Price \$	First exercise date	Last exercise date
Specified executives							
Mr Robert Hosking	-	-	-	-	-	-	-
Mr Mark Smith	-	-	-	-	-	-	-

(e) Option holdings

Number of options held by specified directors and executives

	Balance 1/7/03	Granted as remuneration	Options exercised	Balance 30/6/04	Total vested 30/6/04	Total exercisable 30/6/04	Total unexercisable 30/6/04
Parent Entity Directors							
Mr Robert Hosking	-	-	-	4,594,167	4,594,167	4,594,167	-
Mr Mark Smith	-	-	-	1,100,000	1,100,000	1,100,000	-
Mr Edward Munks	-	-	-	625,000	625,000	625,000	-

Specified Executives

Mr Robert Hosking	-	-	-	4,594,167	4,594,167	4,594,167	-
Mr Mark Smith	-	-	-	1,100,000	1,100,000	1,100,000	-

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

(f) Shareholdings

Number of shares held by specified directors and executives

	Balance 1/7/03	Received as remuneration	Options exercised	Net change other	Balance 30/6/04
Parent Entity Directors					
Mr Robert Hosking	-	-	-	8,188,334	8,188,334
Mr Mark Smith	-	-	-	1,200,000	1,200,000
Mr Edward Munks	-	-	-	250,000	250,000
	-	-	-	9,638,334	9,638,334
Specified Executives					
Mr Robert Hosking	-	-	-	8,188,334	8,188,334
Mr Mark Smith	-	-	-	1,200,000	1,200,000
	-	-	-	9,388,334	9,388,334

(g) Remuneration practices

The company's policy for determining the nature and amount of emoluments of board members and senior executives of the company is as follows:

Executives

The executive remuneration structure is based on a number of factors, including length of service, particular experience of the individual concerned and overall performance of the company.

Non-executives

- Non-executive Directors are remunerated by way of fees in the form of cash and superannuation contributions,
- Non-executive Directors are not provided with retirement benefits other than statutory superannuation.

No Director has entered into a material contract with the Company since the end of the previous financial year, however there were 2 material contracts involving Directors' interests subsisting at the end. The Company has engaged Ropat Nominees Pty Ltd, a company in which Robert Hosking is a director and shareholder to procure that Mr Hosking provides the services of managing director to the company. The consultancy fee is \$195,000 per annum. The company has also entered into a lease with Ropat Nominees Pty Ltd in relation to an office for the Company's use. An annual rent of \$25,000 is payable by the Company. The term of both agreements is 3 years.

The company has also engaged IERS (Australia) Pty Ltd, a company in which Mark Smith is a director and shareholder, to procure that Mr Smith provide the services of exploration manager to the company. Under the terms of the agreement Mr Smith is required to devote 50% of his working time to the affairs of the company. The consultancy fee is \$100,000 per annum. The term of the agreement is 3 years.

Other transactions with the Company

During the year, a Director, Mr M Smith had an interest in IERS (Australia) Pty which incurred operating, expenses on behalf of the company. The value of transactions during the year was \$3,026 (2003: \$nil).

During the year, a Director, Mr R Hosking, had an interest in Ropat Nominees Pty Ltd (Ropat) which incurred operating, expenses on behalf of the company. The value of transactions during the year was \$3,514 (2003: \$nil). The Company also paid \$173,623 for outstanding creditor liabilities amounts to Ropat. (2003: \$nil).

Other transactions with the Company

	Consolidated Entity		Parent Entity	
	2004	2003	2004	2003
	\$	\$	\$	\$
Loans to related entities				
Non-current				
Controlled entities				
- Karoon Gas Australia Pty Ltd	-	-	241,455	-
	-	-	241,455	-

21. CONTINGENT LIABILITIES

The Directors are not aware of any contingent liabilities that are likely to have a material effect on the results of the consolidated entity except as disclosed in the final statements.

22. EVENTS SUBSEQUENT TO BALANCE DATE

Subsequent to the end of the financial year the economic entity has signed a contract with Hunt Energy & Mineral Co Australia Pty Ltd for the company's forthcoming drilling programme in the Western Onshore Gippsland Basin. The Hunt Energy Rig has been contracted to drill the Megascoldes #1 well with an option to drill 2 additional wells back to back. Site and access work for the Megascoldes #1 drilling location has commenced.

NOTES TO THE FINANCIAL STATEMENTS continued
FOR THE YEAR ENDED 30 JUNE 2004

Name	Country of incorporation	Percentage of equity Interest held by the Consolidated entity		Investment		Contribution to Group profit	
		2004	2003	2004	2003	2004	2003
		%	%	\$	\$	\$	\$
23. CONTROLLED ENTITIES							
Karoon Gas Pty Ltd	Australia	100%	nil	151,212	nil	178,301	nil

24. SEGMENT REPORTING

Business segments

The consolidated entity comprise the following main business segments, based on the consolidated entity's management reporting system:
Investment in energy related projects. This segment is involved in the exploration of petroleum and CBM in Australia.

	Energy Investments \$	Consolidated \$
Primary reporting – business segments		
2004		
External revenue	34,015	34,015
Other segments	-	-
Total revenue		34,015
Total segment revenue		34,015
Unallocated revenue		-
Revenue from ordinary activities		-
Segment result	(178,301)	(178,301)
Unallocated expenses net of unallocated revenue		-
Loss from ordinary activities before income tax expense		(178,301)
Income tax expense		-
Loss from ordinary activities after income tax expense		(178,301)
Assets		
Segment assets	4,468,402	4,468,402
Total assets		4,468,402
Segment liabilities		(189,764)
Total liabilities		(189,764)
Other		
Depreciation and amortisation of segment assets	12,187	12,187

NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED 30 JUNE 2004

25. EMPLOYEE BENEFITS

Employee share option arrangement

During the year there no options were granted to employees under the Karoon Gas Australia Ltd Share Option

The closing share market price of an ordinary share of Karoon Gas Australia Limited on the Australian Stock Exchange at 30 June 2004 was \$0.165

	Economic Entity		Parent Entity	
	2004	2003	2004	2003
	No.	No.	No.	No.
a) Movements in the number of share options held by employees are as follows:				
Opening balance	-	-	-	-
Granted during the year	-	-	-	-
Exercised during the year	-	-	-	-
Lapsed during the year	-	-	-	-
Closing balance	-	-	-	-

DIRECTORS' DECLARATION
FOR THE YEAR ENDED 30 JUNE 2004

The Directors of the company declare that:

1. The financial statements and notes, as set out on pages 15 to 33 are in accordance with the Corporations Act 2001:
 - (a) comply with Accounting Standards and the Corporations Regulations 2001; and
 - (b) give a true and fair view of the financial position as at 30 June 2004 and of the performance for the year ended on that date of the Company and consolidated entity;
2. In the Directors' opinion there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

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

Dated at Melbourne this 30th day of September 2004.

A handwritten signature in black ink, appearing to read 'R Hosking', with a stylized flourish at the end.

Robert Hosking
Director

INDEPENDENT AUDIT REPORT TO MEMBERS OF KAROON GAS AUSTRALIA LIMITED AND CONTROLLED ENTITIES

FOR THE YEAR ENDED 30 JUNE 2004

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for both Karoon Gas Australia Limited (the Company) and Karoon Gas Australia Limited and controlled entities (the consolidated entity), for the year ended 30 June 2004. The consolidated entity comprises both the company and the entities it controlled during that year.

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

Audit approach

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

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

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

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

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

Independence

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

Audit opinion

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

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2004 and of their performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.

Mitchell Wilson & Partners
Chartered Accountants

Douglas Mitchell
Melbourne, 30th September 2004

STATEMENT OF CORPORATE GOVERNANCE PRINCIPLES

The Statement of Corporate Governance Principles establishes the framework for how the Board oversees the Company and performs its functions on behalf of shareholders. Karoons' objective is to achieve best practice in corporate governance, the Company's Directors and employees are committed to achieve this objective.

Structure of the Board of Directors

The Board is elected by shareholders to represent all shareholders. It is a Director's responsibility, in all decisions he or she is called upon to make concerning the consolidated entity's affairs, to conscientiously weigh the interests of shareholders in light of the circumstances and to consider the effects of such decisions on the interests of all shareholders.

The Company recognises the importance of having a Board comprising of Directors with an appropriate range of background, skills and experience to suit the Company's current and future strategies and requirements.

Role of the Board

The Board is to oversee and direct the management of the Company with a view to increasing shareholder wealth 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 consolidated entity'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
- the Board will, from time to time, review and monitor the management and Company performance
- appoint and appraise the Chief Executive Officer (CEO) and any other executive Director. Ensure that there are adequate plans and procedures for succession planning
- review and approve the remuneration of the CEO and senior management

Composition of the Board

The Board of Directors is to be constituted by three members, with one non-executive Director. At this relatively early stage of the development of the Company the Board is comprised of people who understand the consolidated entity's business in depth and who are prepared to be actively involved in the Company and work closely with management. 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 director's report.

The name of the independent director of the company is Edward Munks.

When determining whether a non-executive director is independent the director must not fail 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;
- none of the directors income or the income of an individual or entity directly or indirectly associated with the director is derived from a contract with any member of the economic entity other than income derived as a director of the entity.

The Board's composition will be reviewed from time to time having regard to the growth of the consolidated entity's business with a view to having a majority of independent Directors.

Under the Company's constitution, at each Annual General Meeting of 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.

Chairman of the Board

The Chairman of the Board shall ideally be independent, but at this relatively early stage of the development of the Company the chairman is an executive. .

Meeting schedule

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

Relationship of Board with management

The management of the day-to-day business of the Company is conducted by or under the supervision of the executive chairman and is designated by the Board of Directors which has clearly defined the limits of management's responsibilities. The Board will approve the corporate objectives which will be developed and implemented by the executive chairman and management. The Board will adopt appropriate structures and procedures to ensure that the Board functions independently of management.

Board committees

The Board may establish appropriate committees to assist in its role at appropriate points in the Company's evolution.

The Board has established the following committee:

- Audit Committee

Composition of committees

A committee will be chaired by a non-executive Director appointed by the Board and will be comprised of a majority of Directors.

Other members, as appointed by the Chairman of the Committee, may comprise Directors, senior executives and/or external professionals who possess skills and expertise suitable for carrying out the functions of the Committee.

Audit Committee

The role of the 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 consolidated entity. The Company has formally adopted an Audit Committee charter.

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

The Audit Committee presently consists of:

Mr R Hosking
Mr H Peeters
Mr E Munks

The responsibilities of the Audit Committee include:

liaising with external auditors and ensuring that the annual and half yearly statutory audits are conducted in an effective manner

- reviewing internal controls and recommending improvements

- the review of the half year financial statements prior to lodgement of these documents with the Australian Stock Exchange, and any significant adjustments required as a result of the audit
- to review the draft financial statements and the audit report and to make the necessary recommendations to the Board for approval of the financial statements
- to review treasury recommendations and make necessary recommendations to the Board for approval
- to review and report on any special reviews deemed necessary by the Board

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

Internal control

The Board acknowledges that it is responsible for the overall internal control framework. To assist in discharging this responsibility the Company has an established internal framework, this can be described as follows:

- Financial reporting – there is a comprehensive budgeting system with an annual budget approved by the Directors. Monthly actual results are reported against budget and revised forecasts for the year. A revised budget is prepared half yearly and approved by the Directors
- Functional specialty reporting – the Company has identified a number of key areas which are subject to regular reporting to the Board such as treasury, legal and self insurance matters
- Investment appraisal – the Company has clearly defined guidelines for capital expenditure. These include annual budgets and review procedures
- Surplus funds – a policy of conservative and secure investment of surplus funds is applied

Advice to Directors

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

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.

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 to the Company:

- 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
- 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 Committee must absent them self from the meeting and not participate in any vote to approve such contract.

Disclosure of information

The Company has an objective of honest and open disclosure of information in dealing with stakeholders, subject to appropriate commercial considerations associated with competitive and sensitive information. Such disclosure may, in appropriate circumstances, exceed statutory requirements.

The Company has developed a draft Market Disclosure policy to ensure the compliance of the Company with the various laws and Australian Stock Exchange Limited listing rules obligations in relation to disclosure of information to the market.

Share dealings

The Board of Directors has adopted a policy and procedure on dealing in Company securities by Directors and senior management, which provides that Directors and any employee who from time to time possess information that is inside information should never deal in the Company's securities.

It also provides guidance on the periods when securities can be dealt.

Policy and procedure for share trading

Directors, employees, any consultants and their respective associates who, from time to time, possess information that could be considered to be inside information:

- Should never engage in short term trading of any Karoon securities;

- Should never deal in any Nexus securities whilst in possession of inside information;
- Should never communicate, directly or indirectly, any information or cause the information to be communicated, to another person the insider knows, or ought reasonable to know would or would likely to deal in Karoon securities.

In addition the Chairman or in his absence the Company Secretary or in his absence the Exploration Manager will, from time to time, declare an embargo period on restricting dealings in Karoon securities.

The embargo periods may typically include periods of one month prior to the date of the release of:

- The half yearly announcement to the ASX
- The yearly announcement to the ASX
- Disclosure documents to acquire equity securities in Karoon

If in doubt notify the Chairman / Secretary before commencing any transaction.

Ethical standards and responsible decision making

The Directors, senior executives and employees are required to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of the consolidated entity.

The Company has developed a draft code of conduct for Directors and Officers of the Company.

Environment

The Company has an environmental policy and is committed to conducting all its activities in an environmentally responsible manner.

The role of shareholders

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

- The annual report is distributed to all shareholders. The Board ensures that the annual report includes relevant information about the operations of the consolidated entity during the year, changes in the state of affairs of the consolidated entity and other disclosures required by the Corporations Law
- Half yearly financial statements prepared in accordance with the requirements of the Corporations Law are subject

to an audit review. The financial statements are sent to any shareholder who requests them

- Proposed major changes in the consolidated entity which may impact on share ownership rights are submitted to a vote of shareholders
- Shareholder newsletters are distributed to shareholders at least twice per year
- The Company posts all reports, Australian Stock Exchange and media releases and copies of significant presentations on the Company's website – www.karoongas.com.au

In addition, news announcements and other information are sent by email to all persons who have requested their details be added to the Company's electronic mailing list. If requested, the Company, where appropriate, will provide general information by email, facsimile or post.

Risk assessment and management

As part of the consolidated entity's strategy to implement an integrated framework of control, the Board continually identifies and monitors the key business and financial risks which could jeopardise the consolidated entity achieving its objectives. The Board is continually developing appropriate controls which would effectively manage those risks. These include:

- business plan
- regular budgeting and financial reporting
- procedures to manage financial exposures
- commitment and expenditure levels exceeding certain levels are submitted to the Board for approval

Management accountability

The Board encourages management accountability for the Company's financial reports by requiring the Executive Chairman to state in writing to the Board that:

- a) the Company's financial reports present a true and fair view, in all material respects, of the Company's financial condition and operational results and are in accordance with relevant accounting standards
- b) the statement given above is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board; and

- c) the Company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects

Role of the Company Secretary

Under the Corporate Governance principles 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 as a whole.

The Company Secretary supports the effectiveness of the Board by monitoring that Board policy and procedures are followed, and co-ordinating the completion and dispatch of Board agenda and briefing materials.

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

Annual general meeting

The Company will ensure that the Annual General Meeting (AGM) is held in a manner that enables as many shareholders as possible to attend and encourages effective participation by shareholders.

The Company will request that its external auditor attend the Company's AGM and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report. The Chairperson of that meeting will allow a reasonable opportunity for members to ask questions about the Company's performance and operations and ask questions of the external auditor concerning the conduct of the audit and the preparation and content of the auditor's report.

Remuneration

As an overall policy, the Company will remunerate in such a way that it:

- motivates Directors and management to pursue the long-term growth and success of the Company within an appropriate control framework
- demonstrates a clear relationship between key executive performance and remuneration.

Non-executives

- Non-executive Directors are remunerated by way of fees (in the form of cash and superannuation contributions).

Non-executive Directors are not provided with retirement benefits other than statutory superannuation

SHAREHOLDER INFORMATION

Shareholdings as at 24 September 2004

Substantial shareholders

The number of shares held by substantial shareholders are:

	Fully paid Ordinary shares	Options expiry 31 July 2004 exercise price \$0.18
Ropat Nominees Pty Ltd	8,188,334	4,094,167

Twenty largest shareholders

Name of holder	Number of ordinary Shares held	Percentage of Shares held
Ropat Nominees Pty Ltd	8,188,334	19.65
J P Morgan Nominees Australia Limited	1,250,000	3.00
IERS (Australia) Pty Ltd	1,210,000	2.90
Echo Beach Pty Ltd	800,000	1.92
Summerlea Nominees Pty Ltd	800,000	1.92
Pressure Drop Pty Ltd	750,000	1.80
Doug Spong & Mare Spong	750,000	1.80
MF Custodians Ltd	690,420	1.66
Beck Corporation Pty Ltd	575,000	1.38
Delregal Pty Ltd	550,000	1.32
EBANC.Com Pty Ltd	550,000	1.32
J P Morgan Nominees Australia Ltd	500,000	1.20
National Nominees Limited	500,000	1.20
Accbell Nominees Pty Ltd	496,500	1.19
Mrs Sue Purser	432,400	1.04
Mandies Meats Pty Ltd	400,000	0.96
Rornik Capital Pty Ltd	400,000	0.96
Alimoc Pty Ltd	383,333	0.92
Tricom Nominees Pty Ltd	375,000	0.90
Vista Blue Limited	375,000	0.90
	19,975,987	47.94
Total shares on issue	41,663,503	100.00

Twenty largest quoted option holders (options expiring 30 June 2006, exercisable at \$0.20)

Name of holder	Number of Options held	Percentage of Options held
Ropat Nominees Pty Ltd	4,094,167	19.65
Rose Burton Pty Ltd	750,000	3.60
Summerlea Nominees Pty Ltd	685,000	3.29
J P Morgan Nominees Australia Limited	625,000	3.00
IERS (Australia) Pty Ltd	605,000	2.90
Westpac Custodian Nominees Limited	500,000	2.40
Echo Beach Pty Ltd	400,000	1.92
Pressure Drop Pty Ltd	375,000	1.80
Doug Spong & Mare Spong	375,000	1.80
Malarch Pty Ltd	300,000	1.44
Beck Corporation Pty Ltd	287,500	1.38
Delregal Pty Ltd	275,000	1.32
Citicorp Nominees Pty Limited	250,000	1.20
J P Morgan Nominees Australia Ltd	250,000	1.20
Mr William Alexander Morrison	250,000	1.20
National Nominees Limited	250,000	1.20
Rornik Capital Pty Ltd (Rornik Capital Fund A/c)	200,000	0.96
Alimoc Pty Ltd	191,667	0.92
Trocom Nominees Pty Ltd (Nominee A/c)	187,500	0.90
Vista Blue Limited	187,500	0.90
	11,038,334	52.98
Total Options on issue	20,831,750	100.00

SHAREHOLDER INFORMATION continued

AS AT 24 September 2004

Distribution of share and option holdings

Number of holders by size of holdings at 24 September 2004 were as follows:

	Ordinary fully paid shares	Options expiry 31/06/06 exercisable @ 20 cents	Director options expiry 30/06/07 exercisable @ 25 cents
1 - 1,000	3	-	-
1,001 - 5,000	20	141	-
5,001 - 10,000	158	49	-
10,001 - 100,000	297	204	-
100,001 and above	56	36	3
Total	534	430	3

Issued capital

(a) At 24 September 2004, the following securities in the parent entity were on issue:

	Number of Securities issued	Number of holders
Fully paid ordinary shares	41,663,503	534
Options Exercisable at \$0.20 by 30 June 2006	20,831,750	430
Options Exercisable at \$0.25 by 30 June 2007 – Unquoted	1,500,000	3

(b) At 24 September 2004, 6 shareholders held less than a marketable parcel of fully paid ordinary shares and 146 option holders held less than a marketable parcel of options.

Voting rights

On a show of hands every member present in person or by proxy shall have one vote and upon a poll each share shall have one vote.

ADDITIONAL INFORMATION REQUIRED FOR LISTED COMPANIES

Schedule of interests

As at 24 September 2004	Interest
Exploration Permits	%
PEP 162 Gippsland Basin	100
EL 4537 Gippsland Basin	100

The above interests are held by Karoon Gas Australia Pty Ltd.

CORPORATE DIRECTORY

Directors

Mr R Hosking – Executive Chairman
Mr M Smith – Executive Director
Mr E Munks – Non – Executive Director

Company Secretary

Mr E Munks

Audit Committee

Mr R Hosking
Mr H Peeters
Mr E Munks

Auditors

Mitchell Wilson & Partners
261 -271 Wattletree Road
Malvern VIC 3144
Telephone: (03) 9500 0533
Facsimile: (03) 9500 0633

Bankers

National Australia Bank Limited
271 Collins Street
MELBOURNE VIC 3000
Telephone: (03) 9659 7600
Facsimile: (03) 9659 7902

Registered Office and Head Office

Suite 7A, 34 Lochiel Avenue
Mt Martha VIC 3934
Telephone: (03) 5974 1044
Facsimile: (03) 5974 1644
Email: basspetrol@hotmail.net.au
Website: www.karoongas.com.au

Location of Share Registry

Computershare Investor Services Pty Ltd
Reserve Bank Building
Level 2, 45 St George's Terrace
PERTH WA 6000
Telephone: (08) 9323 2023
Website: www.computershare.com

Stock Exchange

The Company is listed on the Australian Stock Exchange.
The Home Exchange is Melbourne, Victoria.

Other Information

Karoon Gas Australia Limited, incorporated and domiciled in Australia, is a publicly listed company limited by shares.

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