K2 ENERGY LIMITED

A.C.N. 106 609 143

Annual Report

2009

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MANAGING DIRECTOR'S LETTER TO SHAREHOLDERS

Dear Shareholder,

During the past year the company focussed on continuing its evaluation of it assets in the Bad Creek project in Oklahoma that include behind pipe resource potential from existing wells, development well drilling, conventional oil and gas drilling targets, and evaluation of the Woodford and Caney Shale gas potential of the acreage. During 2008 ten workovers of existing wells were completed, 3 new wells were drilled and an independent evaluation of the potential reserves of the company's Bad Creek project acreage was also completed. Gas prices in the USA declined by more than 50% to under $4 per mcf, which makes drilling uneconomic.

During 2009 the results of the workovers and new wells drilled in 2008 were evaluated and overall the results of this activity was disappointing, with the workovers of existing wells not yielding an appreciable increase in production. The wells drilled in May 2007, the Patriot #1 and Priegel #1 achieved impressive initial production rates of 1.8mmcfgd but the Priegel well declined rapidly and watered out after several months. The Patriot #1 produced at 500 mcfgd for many months before slowly declining. Both wells were worked over during the past year but commercial production was not restored and other potentially productive zones in the wells were completed but failed to produce commercially.

In late 2008 the company encountered difficulties with the operator of the Bad Creek Project, Metro Energy Group related to financial accountability and reporting, project and operations management that resulted in legal action being taken against Metro Energy Group seeking termination of all contractual arrangements, as well as an audit of wells drilled by Metro Energy for K2 Energy and its predecessor Tomahawk Energy. In addition the company became increasingly frustrated by Metro Energy's inability to generate drilling units on the priority targets identified in Bad Creek, due to continual problems with prosecuting the acreage pooling process for drilling units in Oklahoma. The necessity for legal action is unfortunate but in the circumstances the company could not continue to allow Metro Energy to operate the project. An overview of the legal issues with Metro Energy Group appears below.

The Bad Creek project remains highly prospective but on hold pending resolution of the accounting and legal issues and I provide the following recap of the project.

Update - Woodford and Caney Shale Project – up to 81 BCF net to KTE

During 2008 the company retained a leading third party consulting engineering group Netherland Sewell & Associates (NSA) to evaluate the potential of the company's Bad Creek leases and the outstanding results of that report, as well as the significant activity and success of major players shifted the company's focus to the Woodford and Caney Shale opportunity. NSA returned a resource estimate of up to 81 billion cubic feet (BCF) of gas net to K2 Energy on its Bad Creek acreage with a best estimate of 47 BCF.

The Jones #1-5 Well (KTE 32%) is a horizontal Woodford shale well was drilled by the project operator Metro Energy Group in 2008/9. The well was a technical success in that it produced gas at a sustained rate of ~40 mcfd from the Woodford shale prior to being shut in. The well supported the prospectivity of the Woodford shale however the flow rate was limited as the fracture treatment of the well was only partially successful with only 2 of the 4 stages of fracture treatment achieving penetration. The conclusion is that while the Jones well produced gas and supported the potential of the Woodford Shale on the Bad Creek Project, the engineering problems encountered with the drilling and completion process most probably affected the commercial viability of the well. The second planned horizontal Woodford well, the Sears #1 has been deferred pending resolution of legal and financial issues with the Bad Creek Project Operator Metro Energy Group.

The NSA report has identified the potential of the Woodford and Caney Shale plays in the Bad Creek project acreage, which covers more than 5,000 acres and the Jones well drilled to test the Woodford Shale provided further evidence that the Woodford shale is highly prospective.

Metro Energy Group

After drilling the Jones well the company requested financial reconciliation statements from Metro Energy Group in respect of the 5 wells drilled by Metro Energy in the Bad Creek area since the merger of K2 Energy and Tomahawk Energy in May 2007. Metro Energy could not produce the financial reconciliations requested. K2 Energy then requested an Audit of all of the 5 wells drilled since May 2007. The partners in all of these wells including Irvine Energy, Williams Petroleum and Gas Rock Capital all agreed to participate in the audit. The audit to date has revealed in excess of $400,000 in exceptions and overcharges that Metro Energy Group cannot rectify at this time. While the audit was being conducted Metro Energy withdrew co-operation with the auditor and an application was made to the District Court of Okfuskee County to Compel Metro Energy to produce all financial documents and other relevant material on both the post merger wells and all wells drilled by Tomahawk Energy from 2004. The Judge recently granted the Motion to Compel and directed Metro Energy to produce all relevant documents to enable the auditor to complete his audit of the 5 post merger wells. In addition the Judge made an Order to Compel Metro Energy to produce all financial records relating to all wells by Tomahawk Energy from 2004 to may 2007 when the merger with K2 Energy was completed. The company proposes to audit a selection of the wells drilled between 2004 and 2007.

New Projects

With the decline in US gas prices and onset of the Global Financial Crisis in late 2008 and the issues with Metro Energy Group outlined above, the company resolved to cut overheads and expenses as much as possible and adopted a strategy of preserving capital and seeking new opportunities for the company in the oil and gas and natural resources sector that may emerge as a result of the GFC. The company has reviewed many opportunities in the first 6 months of 2009 without identifying a suitable project. The Board has several new opportunities under review at this time and hopes to be in a position to announce a new direction for the company in the next few months.

Several oil and gas opportunities in the US have been reviewed in the past months however the very low natural gas prices in the United States of between $3 and $4 per mcf have rendered many of these projects less desirable. Also the Australian stock market continues to undervalue the assets of Australian junior explorers in the US and exhibits lukewarm interest in most of the juniors operating in the US, which is most probably due to the lack of success of many these companies with their US projects.

The company is seeking a project or projects that have potential upside that is capable of restoring shareholder value for KTE shareholders.

Conclusion

While it has been a disappointing and difficult year for the company, with the impact of the GFC and the breakdown of relations with the Operator of the Bad Creek project, the company remains optimistic that it is in a good position to take advantage of its stable cash position to secure new projects.

During the year John Thompson and Robert Rosenthal retired as Directors of the company and I thank them for their respective contributions as Directors of the company.

I also thank shareholders for their patience and support through what has been as testing year for K2 Energy Limited.

Yours faithfully,

PETER MOORE
Managing Director

DIRECTORS' REPORT

The Directors submit their report for the financial year ended 30 June 2009.

DIRECTORS

The names and details of the Company's directors in office during the financial year and until the date of this report are as follows. Directors were in office for the entire period unless otherwise stated.

Names, qualifications, experience and special responsibilities
Samuel Gazal, BEc,

Non-executive Chairman

Sam has more than 35 years experience as a director of public and private companies. He graduated from Sydney University with a Bachelor of Economics. He has been a director and significant shareholder in a number of successful companies including Gazal Industries Limited, Winthrop Investments Limited, Country Television Services Limited and Sunshine Broadcasting Network Limited. He is the major shareholder and chairman of the Roslyndale group of companies.

Peter Moore, BA LLB.

Managing Director

Peter was formerly a commercial lawyer and is a director of Geoflite Inc. He has worked in the resource exploration industry since 1987, and has wide commercial experience in the oil and gas exploration industry in the United States.

Michael Reed, BSc, (Hons) CPG,AAPG
Non-executive Director

Michael is a 1982 honours graduate in geology from the University of Kentucky and a Certified Petroleum Geologist with the American Association of Petroleum Geologists. He has 25 years' experience in oil and gas exploration and investment, currently as President of Aspen Energy, Inc. and formerly as Vice President of Tenexco Inc. based in Louisville, Kentucky, USA. Mike has overseen in excess of 350 oil and gas drilling ventures, investing more than $50,000,000 over the past 10 years throughout the main oil and gas producing regions of the USA. He has highly specialized expertise in screening and evaluating drilling opportunities.

Robert Kenneth (Ken) Gaunt- Non-executive Director
Non-executive Director

Ken has enjoyed significant commercial success since founding Electronic Banking Solutions Pty Ltd in 1998. As Managing Director, Ken developed the business before merging with Cash Card Australia Limited in 2003. Ken has been director of Cash Card Australia Limited and is an investor in many successful businesses in Australia and elsewhere. Ken was a board member and Australia's representative of the ATM industry association and was a member of the customer advisory board of National Cash Register Company Limited.

John Thompson, B.Com
Non-executive Director (resigned 31st October 2008)

John has strong experience in general management of resources and scientific companies. Most recently he led the Geochemistry Division of an international testing and verification business. He has also had general management responsibility for oil services companies. He has been a Director of Bank of Western Australia and at one time led the Stock Exchange in Perth. He is now a Director of several private and public companies involved in oil and mineral services. He has concentrated on private equity situations and has led successful buyout opportunities in the past. He was educated at University of Western Australia in Accounting and Commercial law.

Bob Rosenthal B Sc, M Sc
Non-executive Director (resigned 1st December 2008)

Mr Rosenthal graduated from the University of Southern California in 1974 with a B.Sc. in Geology and then in 1977 completed a M.Sc. in Geology and Geophysics from the same University.

In his 30 year career, he has worked on oil and gas projects in the Gulf of Mexico, Offshore Atlantic Margin, and North Slope of Alaska. In 1985, Bob was seconded to BP in Aberdeen Scotland and within a year he became Technical Leader of Northern and Central North Sea Lead Group who successfully bid in UK Licensing round. In 1988, he became senior advisor to Chief Geophysicist, then Global Consultant for Exploration reporting to Chief Geologist and General Manager of Exploration, worldwide.

For 15 years, he held various positions including senior exploration geophysicist with Sohio Petroleum (a subsidiary of BP) in San Francisco, California. Since 1999, Mr Rosenthal has run a successful consulting business and lives in both Ojai California and London, England. During the past three years, Mr Rosenthal has not served as a director for any other listed Australian company.

Company Secretary
Terence Flitcroft B Comm. CA SFIN
Mr Flitcroft is company secretary for a number of public and private companies.

CORPORATE INFORMATION

Corporate Structure
K2 Energy Limited is a public company listed on the Australian Stock Exchange (ASX Code: KTE).

Nature of operations and principal activities
K2 Energy is an oil and gas exploration and production company whose primary purpose is to secure, find, develop, produce and sell hydrocarbons.

Employees
K2 currently has only one employee being the Managing Director of the company. The field operations of the Oklahoma project are outsourced to the Operator of the project, Metro Energy Group Inc.

OPERATING AND FINANCIAL REVIEW

In response to changed market conditions in the US oil and gas industry during 2009 K2 Energy curtailed expenditure on the Bad Creek AMI (Oklahoma) and shut in a number of uneconomic wells. Due to this the company adopted a conservative approach and sought to conserve capital and substantially reduce expenditures resulting in a reduction in expenses and operating costs for the year. During the year the company suspended its drilling activity in the Bad Creek project area in Oklahoma, due to the ongoing legal and accounting dispute with the operator of the project Metro Energy Group.

The company recorded a loss of $1.977 million for 2009, which includes amortisation and depreciation of $1.298 million.

Revenue from Oil and Gas production has declined due to declining production rates from some existing wells, very low gas prices and the shut in of a number of uneconomic wells. Production revenue from the Oklahoma wells is currently being held in escrow pending the resolution of litigation with the Metro Energy Group.

The company continued to evaluate the unconventional gas potential of the Caney and Woodford Shales during the year and will re-evaluate its drilling activity once the legal issues with the Metro Energy Group have been resolved.

At year end the company had cash of $3.5m and is in a good position to take advantage of new commercial opportunities going forward. The company has reviewed a number of new oil and gas and corporate opportunities in the USA and Australia, without yet identifying an appropriate project for the company.

FINANCIAL POSITION

The Company had cash funds on hand of approximately $3.5 million at year-end.

PRINCIPAL ACTIVITY

K2 Energy participates in the exploration and production of oil and gas in the United States of America.

FINANCIAL RESULT

The operating result for the financial year ended 30 June 2009 for the Consolidated Entity and the Company was an after tax loss of $1,977,303 (2008: $4,058,417).

DIVIDENDS PAID OR RECOMMENDED

The directors do not recommend the payment of a dividend and no amount has been paid or declared by way of a dividend to the date of this report.

SIGNIFICANT CHANGES IN STATE OF AFFAIRS

There were no significant changes in the state of affairs of the Consolidated Entity during the financial year, other than as detailed in this directors' report and the Managing Director's Report accompanying this report.

AFTER BALANCE DATE EVENTS

The directors are not aware of any matter or circumstance that has arisen since the end of the period to the date of this report that has significantly affected or may affect:

- (i) The operations of the company and the entities that it controls
- (ii) The results of those operations
- (iii) The state of affairs of the company in subsequent years, other than as set out below.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

The company will continue to invest in oil and gas exploration prospects in the United States. Future performance will depend on the results of future drilling.

ENVIRONMENTAL REGULATIONS AND PROCEEDINGS

K2 Energy is aware of its environmental obligations with regards to its exploration activities and ensures that it complies with all regulations when carrying out any exploration work.

REMUNERATION REPORT

Remuneration Policy

The remuneration policy of K2 Energy Limited has been designed to align director objectives with shareholder and business objectives by providing a fixed remuneration component, which is assessed on an annual basis in line with market rates. The Board of K2 Energy Limited, the majority of whom are non-executive directors, believes the remuneration policy to be appropriate and effective in its ability to attract and retain the best directors to run and manage the company, as well as to create goal congruence between directors and shareholders. The Board will assess the appropriateness of the nature and amount of emoluments of such officers on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality Board and executive team.

The Board's policy for determining the nature and amount of remuneration for board members is as follows:

The remuneration policy, setting the terms and conditions for the executive director was developed and approved by the Board after seeking professional advice from independent external consultants.

In determining competitive remuneration rates, the Board seeks independent advice on local and international trends among comparative companies and industry generally. It examines terms and conditions for employee incentive schemes, benefit plans and share plans. Independent advice is obtained to confirm that executive remuneration is in line with market practice and is reasonable in the context of Australian executive reward practices.

The Managing Director receives a base salary and superannuation.

The Company is currently an exploration and emerging production entity, and therefore speculative in terms of performance. Consistent with attracting and retaining talented executives, directors and the senior executive are paid market rates associated with individuals in similar positions within the same industry. Options and performance incentives may be issued particularly as the Company moves from an exploration to a producing entity and key performance indicators such as profit and production and reserves growth are able to be used as measurements for assessing executive performance.

All remuneration paid to directors is valued at the cost to the company and expensed. Options are valued using the Black-Scholes methodology.

The Board policy is to remunerate non-executive directors at market rates for comparable companies for time, commitment and responsibilities. The Remuneration Committee determines payments to the non-executive directors and reviews their remuneration annually, based on market practice, duties and accountability. The Remuneration Committee consists of Messrs Gazal, Gaunt and Thompson. The maximum aggregate amount of fees that can be paid to non-executive directors is subject to approval by shareholders. Fees for non-executive directors are not linked to the performance of the Company. However, to align directors' interests with shareholder interests, the directors are encouraged to hold shares in the company.

(a) Directors' and Key Management Personnel Remuneration

(i) Directors

Samuel Gazal -Non-Executive Director
Peter Moore- Managing Director
Ken Gaunt - Non-Executive Director
Mike Reed- Non-Executive Director
John Thompson- Non-Executive Director (resigned 31st October 2008)
Bob Rosenthal – Non-Executive Director (resigned 15th December 2008)

(ii) Executives

There are no executives other than Peter Moore.

Directors' remuneration and other terms of employment are reviewed annually by the Remuneration Committee having regard to performance against goals set at the start of the year, relative comparative information and independent expert advice.

Except as detailed in Notes (b) – (d) to the remuneration report, no director has received or become entitled to receive, during or since the financial year, a benefit because of a contract made by the Company or a related body corporate with a director, a firm of which a director is a member or an entity in which a director has a substantial financial interest. This statement excludes a benefit included in the aggregate amount of emoluments received or due and receivable by directors and shown in Notes (b) – (d) to the remuneration report, prepared in accordance with the Corporations regulations, or the fixed salary of a full time employee of the Company.

(b) Directors' and Key Management Personnel Remuneration (continued)

The following table discloses the remuneration of Directors of the company for the year ended 30 June 2009, as specified for disclosure by AASB 124. The information contained in this table is audited.

	Short Term		Equity Compensation	Post-employment	
Directors	**Base Salary and Fees $**	**Bonus and Non Monetary Benefits $**	**Value of Options $**	**Superannuation Contributions $**	**TOTAL $**
Frank Brophy (resigned 20.7.07)					
30 June 2008	14,583	-	-	-	14,583
30 June 2009	-	-	-	-	-
Sam Gazal **					
30 June 2008	41,250	-	-	3,712	44,962
30 June 2009	41,264	-	-	3,714	44,978
Peter Moore *					
30 June 2008	133,792	-	-	12,041	145,833
30 June 2009	137,615	-	-	12,385	150,000
Ken Gaunt					
30 June 2008	26,250	-	-	2,362	28,612
30 June 2009	26,674	-	-	2,401	29,075
John Thompson (resigned 31.10.08)					
30 June 2008	35,000	-	-	3,150	38,150
30 June 2009	11,667	-	-	1,050	12,717
Total 2008	250,875	-	-	21,265	272,140
Total 2009	217,220	-	-	19,550	236,770

* Mr Moore's salary and superannuation contribution was paid by K2 Energy Investments Pty Limited. During the year fees were paid to Geoflite Technology Inc – a company associated with Peter Moore.
** During the year fees were paid to Winchester Associates Pty Limited – a company associated with Sam Gazal.

All transactions were entered into on normal commercial terms.

(i) In accordance with AASB 2, options issued to Directors and during the previous year and in previous years have been valued using a Black-Scholes option pricing model, which takes account of factors such as the option exercise price, the current level and volatility of the underlying share price and the time to maturity of the option. Although a value is ascribed and included in total Directors Remuneration, it should be noted that the Directors have not received this amount and the option may have no actual financial value unless the options achieve their exercise price.

(c) Directors' and Key Management Personnel Remuneration by Category

	CONSOLIDATED ENTITY		THE COMPANY	
	30 June 2009 $	30 June 2008 $	30 June 2009 $	30 June 2008 $
Short-term	217,220	250,875	79,605	117,083
Other long-term	-	-	-	-
Post employment benefits	19,550	21,265	7,165	9,224
Share based payments	-	-	-	-
	236,770	272,140	86,770	126,307

(d) Compensation Options: Granted and vested during and since the financial year ended 30 June 2009

During and since the financial year ended 30 June 2009, no options relating to compensation were granted to directors and a total of 2,500,000 (2008-400,000) options exercisable at between $0.40 and $0.70 lapsed. No shares were issued on exercise of compensation options during the financial year or previous financial year.

The following table discloses the value of options granted, exercised or lapsed during the 2009 year:

	Options Granted	Options Exercised	Options Lapsed	Total value of options granted, exercised and lapsed		Value of options included in remuneration for the year	Percentage of total remuneration for the year that consists of options
	Value at grant date	Value at exercise date	Value at time of lapse				
Director	$	$	$	$		$	%
R. Rosenthal	-	-	-	-		-	-

The following table discloses the value of options granted, exercised or lapsed during the 2008 year:

	Options Granted	Options Exercised	Options Lapsed	Total value of options granted, exercised and lapsed		Value of options included in remuneration for the year	Percentage of total remuneration for the year that consists of options
	Value at grant date	Value at exercise date	Value at time of lapse				
Director	$	$	$	$		$	%
F Brophy	-	-	26,000	26,000		-	-

(e) Options issued as Part of Remuneration

Options are issued from time to time to directors and executives as part of their remuneration. The options are not issued based on performance criteria, but are issued to increase goal congruence between executives, directors and shareholders.

(f) Employment Contracts of Directors and Senior Executives

Peter Moore is the only director who is currently a permanent employee of the Company. Mr Moore has an employment agreement with K2 Energy Investments Pty Limited. The contract is not for a fixed term. The contract states he can be terminated by the company by giving up to three months notice and by paying a redundancy of three months. Previously Mr Brennan was employed as an Executive.

MEETINGS OF DIRECTORS

The number of directors' meetings (including committees) held during the financial year and the number of meetings attended by each director are:

	DIRECTORS' MEETINGS		COMMITTEE MEETINGS			
			AUDIT COMMITTEE		REMUNERATION COMMITTEE	
	Number eligible to attend	Number Attended	Number eligible to attend	Number Attended	Number eligible to attend	Number Attended
Bob Rosenthal (resigned 15 December 2008)	2	2	-	-	-	-
Samuel Gazal	3	3	1	1	1	1
Peter Moore	3	3	-	-	-	-
Ken Gaunt	3	2	-	-	1	1
John Thompson (resigned 31 October 2008)	1	1	1	1	-	-
Mike Reed	3	1	-	-	-	-

OPTIONS

At the date of this report the following options over ordinary shares in the Company were on issue.

Type	No. Issued	No. Quoted	Exercise Price	Expiry Date
Listed Options	29,997,500	29,997,500	20 cents	30 September 2009

Directors' holdings of shares and share options have been disclosed in the Remuneration Report.

BOARD MEMBERS DIRECTORSHIPS

Listed below are details of listed public company directorships held by Board Members over the last three years.

Director	Directorship of	Date Appointed	Date Resigned
Samuel Gazal	K2 Energy Investments Pty Limited *	29th August 2005	-
Peter Moore	K2 Energy Investments Pty Limited *	29th August 2005	-
Bob Rosenthal	None	-	-
Mike Reed	K2 Energy Investments Pty Limited *	18th October 2005	-
Robert Kenneth Gaunt	K2 Energy Investments Pty Limited *	18th October 2005	-
John Thompson	Pharmaust Limited	4th July 2005	27 Sept 2006
	K2 Energy Investments Pty Limited *	20th July 2006	-

* K2 Energy Investments Pty Limited was previously known as K2 Energy Limited

DIRECTORS' INTERESTS IN SECURITIES

All equity dealings with directors have been entered into with terms and conditions no more favourable than those that the entity would have adopted if dealing at arm's length. The relevant interests of each director in share capital at the date of this report are as follows:-

	Number of Shares	Number of Options
Samuel Gazal *	1,950,000	1,125,000
Peter Moore *	11,100,000	9,250,000
Ken Gaunt *	2,550,000	1,187,500
Mike Reed *	1,800,000	1,500,000
	17,400,000	13,062,500

* Held by an entity associated with the Director and in which he has a financial interest.

INDEMNIFYING OFFICERS OR AUDITOR

In accordance with the constitution, except as may be prohibited by the Corporations Act 2001, every officer, auditor or agent of the Company shall be indemnified out of the property of the Company against any liability incurred by him in his capacity as officer, auditor or agent of the Company or any related corporation in respect of any act or omission whatsoever and howsoever occurring or in defending any proceedings, whether civil or criminal. The Company currently has no insurance in respect of directors' and officers' liability.

PROCEEDINGS ON BEHALF OF COMPANY

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

The Company was not a party to any such proceedings during the year.

AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration for the year ended 30 June 2009 has been received and can be found on page 47 of the annual report.

NON AUDIT SERVICES

The board of directors, in accordance with advice from the audit committee, is satisfied that the provision of non-audit services during the year is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The directors are satisfied that the services disclosed below did not compromise the external auditor's independence for the following reasons:

- all non-audit services are reviewed and approved by the audit committee prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and
- the nature of the services provided do not compromise the general principles relating to auditor independence in accordance with APES 110: Code of Ethics for Professional Accountants set by the Accounting Professional and Ethical Standards Board.

The following fees for non-audit services were paid/payable to the external auditors during the year ended 30 June 2009:
- Taxation services $2,000

This report is made in accordance with a resolution of the directors.

Samuel Gazal
Chairman
30 September 2009

Corporate Governance Statement

Principle 1:

Lay solid foundations for management and oversight

The Board of Directors is responsible for the overall Corporate Governance of the company including its strategic direction, establishing goals for management and monitoring the achievement of these goals.

The primary responsibilities of the Board include responsibility for:

- oversight of the company, including its control and accountability systems,
- appointing and removing the chief executive officer (or equivalent),
- ratifying the appointment and, where appropriate, the removal of the chief financial officer (or equivalent) and the company secretary,
- input into and final approval of management's development of corporate strategy and performance objectives,
- reviewing and ratifying systems of risk management and internal compliance and control, codes of conduct, and legal compliance,
- monitoring senior management's performance and implementation of strategy, and ensuring appropriate resources are available,
- approving and monitoring the progress of major capital expenditure, capital management, and acquisitions and divestitures,
- approving and monitoring financial and other reporting.

Directors consider that the company's procedures comply with Principle 1 of the Principles of Good Corporate Governance.

Principle 2:

Structure the board to add value

2.1: A majority of the board should be independent directors.

The names of the Directors of the Company in office at the date of this Statement are set out in the Directors' Report.
Directors are appointed based on their experience and on independence of their decision-making and judgement.
In considering the status of directors as independent directors the company has regard to the following
An independent director is a non-executive director (ie is not a member of management) and:

- is not a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company
- within the last three years has not been employed in an executive capacity by the company or another group member, or been a director after ceasing to hold any such employment
- within the last three years has not been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
- is not a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
- has no material contractual relationship with the company or another group member other than as a director of the company
- has not served on the board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company
- is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company.

The majority of the directors are independent, therefore the company complies with principle 2.1.

2.2: The chairperson should be an independent director.

The Directors consider that the company complies with the principle 2.2.

2.3: The roles of chairperson and chief executive officer should not be exercised by the same individual.

The Directors consider the company complies.

2.4: The board should establish a nomination committee

The company does not have a formal nomination committee due to the scale and nature of the company's activities. The whole board meet to consider additional appointments to the Board.
Directors consider that the company complies with the intentions of Principle 2.4 of the Principles of Good Corporate Governance.

2.5: Provide the information indicated in Guide to reporting on Principle 2
The skills, experience and expertise relevant to the position of director held by each director in office at the date of the Annual Report are disclosed in the Directors' Report included in the Annual Report.
All of the directors are considered by the board to constitute independent directors, except for Peter Moore. The company does not have fixed materiality thresholds.
Each Director has the right to seek independent professional advice at the Company's expense. However, prior approval of the Chair is required, which is not unreasonably withheld.
No directors have fixed terms of office.
The company does not have a nomination committee for the reasons outlined in 2.4 above.
Any departures from best practice recommendations 2.1, 2.2, 2.3, 2.4 or 2.5 are included in those sections.
The Board will review its composition on an annual basis to ensure that the Board has the appropriate mix of expertise and experience. Where a vacancy exists, for whatever reason, or where it is considered that the Board would benefit from the services of a new Director with particular skills, the Board will select appropriate candidates with relevant qualifications, skills and experience.
Directors consider that the company complies with Principle 2.5 of the Principles of Good Corporate Governance.

Principle 3:

Promote ethical and responsible decision-making

3.1: Establish a code of conduct to guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to:
3.1.1 the practices necessary to maintain confidence in the company's integrity
3.1.2 the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.
The Board's policy for the Directors and management is to conduct themselves with the highest ethical standards. All Directors and employees will be expected to act with integrity and objectivity, striving at all times to enhance the reputation and performance of the Company.
The Company has not adopted a specific Code of Conduct due to the size of its operations and number of employees at this time.
The Directors consider the company complies.

3.2: Disclose the policy concerning trading in company securities by directors, officers and employees.
The policy is as follows:
Directors and senior executives (officers) must not buy or sell shares or securities in the company if they possess information which, if disclosed publicly, might have a material effect on the price or value of the company's shares.
Directors through the Company Secretary must notify the ASX of any change in their share holdings within 3 business days of the transaction taking place.
The Company maintains a policy that requires all directors to seek the chairman's approval prior to trading in the Company's securities.
No transaction should take place if the directors (or officers) are aware of any information which, if disclosed publicly, might have a material effect on the price or value of the company's shares.
Directors consider that the company complies with Principle 3.2 of the Principles of Good Corporate Governance.

3.3: Provide the information indicated in Guide to reporting on Principle 3.
This information is provided in this statement.
Directors consider that the company complies with Principle 3.3 of the Principles of Good Corporate Governance.

Principle 4:

Safeguard integrity in financial reporting

4.1: Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that 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.
The Directors consider the company complies.

4.2: The board should establish an audit committee.
The Directors consider the company complies.

4.3: Structure the audit committee so that it consists of:

- **only non-executive directors**
- **a majority of independent directors**
- **an independent chairperson, who is not chairperson of the board**
- **at least three members.**

Directors consider that Principle 4.3 of the Principles of Good Corporate Governance is not applicable given the size of the Board and two members is appropriate.

4.4: The audit committee should have a formal charter.
Directors consider that Principle 4.4 of the Principles of Good Corporate Governance is not applicable.

4.5: Provide the information indicated in Guide to reporting on Principle 4.
Directors consider that the company complies with Principle 4.5 of the Principles of Good Corporate Governance to the extent applicable to the Company.

Principle 5:

Make timely and balanced disclosure

5.1: Establish written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior management level for that compliance.

All directors are required to have a general understanding of the matters that are to be, or not to be disclosed in accordance with the ASX Listing Rules.

All matters concerning compliance with the listing rules are to be reported to the chairman.

The Chairman has primary responsibility for ensuring that the company complies with its disclosure obligations and is primarily responsible for deciding what information will be disclosed.

The Chairman and the Company Secretary are responsible for promoting understanding of compliance and monitoring compliance.

Directors are required to maintain confidentiality of corporate information to avoid premature disclosure

The Chairman is responsible for media contact and comment, external communications such as analyst briefings and responses to shareholder questions.

Directors consider that the company complies with Principle 5.1 of the Principles of Good Corporate Governance.

5.2: Provide the information indicated in Guide to reporting on Principle 5.
This information is provided in this statement.
Directors consider that the company complies with Principle 5.2 of the Principles of Good Corporate Governance.

Principle 6:

Respect the rights of shareholders

6.1: Design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings.

Information is communicated to shareholders as follows:

- notices of all meetings of shareholders;
- all documents that are released publicly are made available on the Company's website at www.K2energy.com.au

Directors consider that the company complies with Principle 6.1 of the Principles of Good Corporate Governance.

6.2: Request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.
Directors anticipate that the company will comply with Principle 6.2 of the Principles of Good Corporate Governance.

Principle 7:

Recognise and manage risk

7.1: The board or appropriate board committee should establish policies on risk oversight and management.

The Board monitors and if necessary receives advice on areas of operational and financial risk, and considers strategies for appropriate risk management arrangements.

Specific areas of risk, which are identified, will be regularly considered at Board meetings include performance of activities, human resources, the environment and continuous disclosure obligations.

7.2: The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that:

7.2.1 The statement given in accordance with best practice recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board.

7.2.2 The company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.
Matters of risk management and compliance are currently addressed by the board as a whole at this stage of the development of the company.
Directors consider that the company complies with the intentions of Principle 7.2 of the Principles of Good Corporate Governance.

7.3: Provide the information indicated in Guide to reporting on Principle 7.
This information is provided in this statement.
Directors consider that the company complies with Principle 7.3 of the Principles of Good Corporate Governance.

Principle 8:

Encourage enhanced performance

8.1: Disclose the process for performance evaluation of the board, its committees and individual directors, and key executives.
At this stage of the development of the company, the company does not have formal procedures in place for performance evaluation of the board, its committees and individual directors, and key executives.
Directors consider that the company does not comply with Principle 8.1 of the Principles of Good Corporate Governance although this non-compliance is not material.

Principle 9:

Remunerate fairly and responsibly

9.1: Provide disclosure in relation to the company's remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives and corporate performance.
At this stage of the development of the company, the company has formal remuneration policies in place.

9.2: The board should establish a remuneration committee.
The Directors consider the company complies.

9.3: Clearly distinguish the structure of non-executive directors' remuneration from that of executives.
The remuneration of each director is set out in the Directors' Report included in the Annual Report.
Directors consider that the company complies with Principle 9.3 of the Principles of Good Corporate Governance.

9.4: Ensure that payment of equity-based executive remuneration is made in accordance with thresholds set in plans approved by shareholders.
The company has equity-based executive remuneration that has been approved by shareholders on 29 December 2004.
Directors consider that Principle 9.4 of the Principles of Good Corporate Governance is not applicable.

9.5: Provide the information indicated in Guide to reporting on Principle 9.
This information is provided in this statement.
Directors consider that the company complies with Principle 9.5 of the Principles of Good Corporate Governance.

Principle 10:

Recognise the legitimate interests of stakeholders

10.1: Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders.
The Directors consider the company complies.

INCOME STATEMENTS
For the year ended 30 June 2009

	Note	CONSOLIDATED ENTITY 30 June 2009 $	CONSOLIDATED ENTITY 30 June 2008 $	THE COMPANY 30 June 2009 $	THE COMPANY 30 June 2008 $
Revenue	5	**513,776**	**669,522**	**-**	**-**
Lease operating expenses	6	(418,490)	(472,895)	-	-
Amortisation & depreciation		(1,298,788)	(917,219)	-	-
Other revenue	5	145,668	220,645	67,835	5,899
Administration, land management and corporate expenses		(598,602)	(1,308,574)	(55,921)	(105,739)
Directors' fees, salaries and employee benefits		(302,163)	(345,824)	(53,166)	(133,754)
Foreign exchange gains/(losses)	6	247,133	(527,786)		(1,090,210)
Work over costs written off		-	(180,454)	-	-
Interest paid		(4,573)	(24)	-	(17)
Impairment of oil and gas assets	6	-	(1,047,230)		
Provision for non recovery of intercompany loan			-	(1,505,719)	(2,828,323)
Goodwill on oil and gas assets written off	6	-	(148,578)	-	-
Provision for diminution of investment in subsidiary company		-	-	(433,346)	-
Loss on disposal and expiration of lease		(261,264)	-	-	
LOSS BEFORE INCOME TAX EXPENSE		**(1,977,303)**	**(4,058,417)**	**(1,980,317)**	**(4,152,144)**
Income Tax Benefit / (Expense)	7	-	-	-	-
NET LOSS ATTRIBUTABLE TO EQUITY HOLDERS OF K2 ENERGY LIMITED		**(1,977,303)**	**(4,058,417)**	**(1,980,317)**	**(4,152,144)**
Basic loss per share (cents)	19	(1.51)	(3.41)		

The accompanying notes form part of these financial statements.

BALANCE SHEETS
As at 30 June 2009

	Note	CONSOLIDATED ENTITY		THE COMPANY	
		30 June 2009 $	30 June 2008 $	30 June 2009 $	30 June 2008 $
CURRENT ASSETS					
Cash and cash equivalents	8	3,503,179	4,722,827	1,720,596	1,581,626
Trade and other receivables	9	26,857	17,714	-	-
TOTAL CURRENT ASSETS		3,530,036	4,740,541	1,720,596	1,581,626
NON-CURRENT ASSETS					
Property plant equipment	10	22,234	25,269	-	-
Other financial assets	11	-	-	7,093,692	9,032,757
Deferred exploration, evaluation and development costs	12	4,812,024	5,699,570	-	-
TOTAL NON-CURRENT ASSETS		4,834,258	5,724,839	7,093,692	9,032,757
TOTAL ASSETS		8,364,294	10,465,380	8,814,288	10,614,383
CURRENT LIABILITIES					
Trade and other payables	13	200,618	477,988	807,213	626,991
TOTAL CURRENT LIABILITIES		200,618	477,988	807,213	626,991
TOTAL LIABILITIES		200,618	477,988	807,213	626,991
NET ASSETS		**8,163,676**	**9,987,392**	**8,007,075**	**9,987,392**
EQUITY					
Equity attributable to equity holders of the parent					
Issued capital	14	42,934,768	42,934,768	42,934,768	42,934,768
Foreign currency translation reserve	16	1,678,053	1,524,466	-	-
Option reserve	16	2,489,100	2,489,100	2,489,100	2,489,100
Accumulated losses	15	(38,938,245)	(36,960,942)	(37,416,793)	(35,436,476)
TOTAL EQUITY		**8,163,676**	**9,987,392**	**8,007,075**	**9,987,392**

The accompanying notes form part of these financial statements.

STATEMENTS OF CHANGES IN EQUITY
For the year ended 30 June 2009

CONSOLIDATED ENTITY	**Minority Interest**	**Foreign Currency Translation Reserve**	**Option Reserve**	**Issued Capital**	**Accumulated Losses**	**Total**
	$	**$**	**$**	**$**	**$**	**$**
Balance at 1 July 2007	**332,943**	**1,285,250**	**2,489,100**	**40,883,347**	**(32,902,525)**	**12,088,115**
Loss attributable to members	-	-	-	-	(4,058,417)	(4,058,417)
Foreign translation revenue	-	239,216	-	-	-	239,216
Shares issued during the year	-	-	-	2,134,021	-	2,134,021
Purchase of minority interest	(332,943)	-	-	-	-	(332,943)
Capital raising costs	-	-	-	(82,600)	-	(82,600)
Balance at 30 June 2008	**-**	**1,524,466**	**2,489,100**	**42,934,768**	**(36,960,942)**	**9,987,392**
Loss attributable to members	-	-	-	-	(1,977,303)	(1,977,303)
Foreign translation revenue	-	153,587	-	-	-	153,587
Balance at 30 June 2009	**-**	**1,678,053**	**2,489,100**	**42,934,768**	**(38,938,245)**	**8,163,676**

THE COMPANY	**Option Reserve**	**Issued Capital**	**Accumulated Losses**	**Total**
	$	**$**	**$**	**$**
Balance at 1 July 2007	**2,489,100**	**40,883,347**	**(31,284,332)**	**12,088,115**
Loss attributable to members	-	-	(4,152,144)	(4,152,144)
Shares issued during the year	-	2,134,021	-	2,134,021
Capital raising costs	-	(82,600)	-	(82,600)
Balance at 30 June 2008	**2,489,100**	**42,934,768**	**(35,436,476)**	**9,987,392**
Loss attributable to members	-	-	(1,980,317)	(1,980,317)
Shares issued during the year	-	-	-	-
Capital raising costs	-	-	-	-
Balance at 30 June 2009	**2,489,100**	**42,934,768**	**(37,416,793)**	**8,007,075**

The accompanying notes form part of these financial statements.

CASH FLOW STATEMENTS
For the year ended 30 June 2009

		CONSOLIDATED ENTITY		THE COMPANY	
		30 June 2009 $	**30 June 2008 $**	**30 June 2009 $**	**30 June 2008 $**
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from customers		92,108	644,197	-	-
Payments for operations and employees		(1,188,675)	(2,024,720)	(139,865)	(289,476)
Interest received		145,668	220,645	67,835	12,398
NET CASH FLOWS FROM OPERATING ACTIVITIES	17 (a)	**(950,899)**	**(1,159,878)**	**(72,030)**	**(277,078)**
CASH FLOWS FROM INVESTING ACTIVITIES					
Payments for exploration expenditure		(822,296)	(1,547,845)	-	-
Cash acquired on acquisition of subsidiaries		-	-	-	-
Payments relating to acquisition of subsidiaries		306,414	-	-	-
NET CASH FLOWS USED IN INVESTING ACTIVITIES		**(515,882)**	**(1,547,845)**	**-**	**-**
CASH FLOWS FROM FINANCING ACTIVITIES					
Receipt of funds from related company		-	-	211,000	286,586
Proceeds from issue of shares and options		-	1,652,500	-	1,652,500
Transaction costs of issue of shares		-	(82,600)	-	(82,600)
NET CASH FLOWS FROM FINANCING ACTIVITIES		**-**	**1,569,900**	**211,000**	**1,856,486**
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**(1,466,781)**	**(1,137,823)**	**138,970**	**1,579,408**
Cash and cash equivalents at beginning of the year		4,722,827	6,388,436	1,581,626	2,218
Net foreign exchange difference on opening cash		247,133	(527,786)	-	-
CASH AND CASH EQUIVALENTS AT END OF YEAR	17(b)	**3,503,179**	**4,722,827**	**1,720,596**	**1,581,626**

The accompanying notes form part of these financial statements.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. REPORTING ENTITY

K2 Energy Limited is a company domiciled in Australia. The consolidated financial statements of the Company as at and for the year ended 30 June 2009 comprise the Company and its controlled entities (together referred to as the Consolidated Entity). The Consolidated Entity operates solely in Oil and Gas Exploration and Production, with interests in oil and gas in the USA.

2. BASIS OF PREPARATION

a. Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASBs) (including Australian Interpretations) adopted by the Australian Accounting Standards Board and the Corporations Act 2001. The financial report of the Consolidated Entity and the financial report of the Company comply with International Financial Reporting Standards and Interpretations adopted by the International Accounting Standards Board.

b. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis.

c. Functional and presentation currency

These consolidated financial statements are presented in Australian dollars, which is the Company's functional currency.

d . Use of judgments and estimates

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. In particular, information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is described in the following areas: Impairment and Financial instruments.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by all entities in the Consolidated Entity.

a. Basis of Consolidation

Controlled entities

Controlled entities are entities controlled by the Company. Control exists when the Company has power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of controlled entities are included in the consolidated financial statements from the date that control commences until the date that control ceases. Investments in controlled entities are carried at their cost of acquisition in the Company's financial statements.

Transactions eliminated on consolidation

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

b. Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured.
The following specific recognition criteria must also be met before revenue is recognised:

Interest
Control of the right to receive the interest payment.

c. Goods and Services Tax

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part 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 relevant taxation authority is included as a current asset or liability in the balance sheet. 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 relevant taxation authority are classified as operating cash flows.

d. Foreign Currency

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of controlled entities at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary transactions denominated in foreign currencies that are stated at historical cost are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at the foreign exchange rates ruling at the date the fair value was determined. Foreign exchange differences arising on translation are recognised in the income statement.

Financial statements of foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, generally are translated to the functional currency at foreign exchange rates ruling at the reporting date. The revenues and expenses of foreign operations are translated to the functional currency at rates approximating the foreign exchange rates ruling at the dates of transactions. Foreign currency differences arising from translation of controlled entities with a different functional currency to that of the Consolidated Entity are recognised in the foreign currency translation reserve (FCTR). When a foreign operation is disposed of, in part or in full, the relevant amount of its FCTR is transferred to profit or loss.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a foreign operation and are recognised directly in equity in the FCTR.

e. Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with an original maturity of three months or less.

f. Provisions

A provision is recognised in the balance sheet when the Consolidated Entity has a present legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

g. Impairment

The carrying amounts of the Consolidated Entity's assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated (see below). An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement unless the asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the income statement. Impairment losses recognised in respect of cash generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash generating unit or a group of units and then, to reduce the carrying amount of the other assets in the unit or a group of units on a pro-rata basis.

Calculation of recoverable amount

Receivables

The recoverable amount of the Consolidated Entity's investments in receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted. Impairment of receivables is not recognised until objective evidence is available that a loss event has occurred. Significant receivables are individually assessed for impairment. Impairment testing of significant receivables that are not assessed as impaired individually is performed by placing them into portfolios of significant receivables with similar risk profiles and undertaking a collective assessment of impairment. Non-significant receivables are not individually assessed. Instead, impairment testing is performed by placing non-significant receivables in portfolios of similar risk profiles, based on objective evidence from historical experience adjusted for any effects of conditions existing at each balance date. The allowance for impairment is calculated with reference to the profile of debtors in the Consolidated Entity's sales and marketing regions.

Other Assets

The recoverable amount of other assets is the greater of their fair value less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generate cash flows from continuing use that are largely independent of the cash flows of other assets or groups of assets (cash generating units). The goodwill acquired in a business combination, for the purpose of impairment testing is allocated to the cash generating units that are expected to benefit from the synergies of the combination. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Reversals of Impairment

An impairment loss in respect of a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. An impairment loss in respect of goodwill is not reversed. In respect of other assets, an impairment loss is reversed when there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

h. Property, Plant and Equipment

Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see accounting policy (g)). An asset's cost is determined as the consideration provided plus incidental costs directly attributable to the acquisition. Subsequent costs in relation to replacing a part of property, plant and equipment are recognised in the carrying amount of the item if it is probable that future economic benefits embodied within the part will flow to the Consolidated Entity and its cost can be measured reliably. All other costs are recognised in the income statement as incurred.

Leased assets - 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. Minimum lease payments include fixed rate increases.

Depreciation

Depreciation is recognised in the income statement on a straight-line basis. Items of property, plant and equipment, including leasehold assets, are depreciated using the straight-line method over their estimated useful lives, taking into account estimated residual values. Assets are depreciated from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use. Depreciation rates and methods, useful lives and residual values are reviewed at each balance sheet date. When changes are made, adjustments are reflected prospectively in current and future financial periods only.

The estimated useful lives in the current and comparative periods are as follows:

Plant & equipment	5 – 10 years

i Exploration, Evaluation and Development Expenditure

Exploration, evaluation and development expenditure incurred is accumulated in respect of each identifiable area of interest. These costs are carried forward only if they relate to an area of interest for which rights of tenure are current and in respect of which:

(i) such costs are expected to be recouped through successful development and exploitation or from sale of the area; or

(ii) exploration and evaluation activities in the area have not, at balance date, resulted in booking economically recoverable reserves, and active operations in, or relating to, this area are continuing.

Accumulated costs in respect of areas of interest which are abandoned are written off in full against profit in the year in which the decision to abandon the area is made.

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.

Amortisation is charged against individual wells currently based on a well life of 5 years as reserve estimates are not yet available. Amortisation is not charged on costs carried forward in respect of areas of interest in the development phase until production commences.

j. Restoration

Provisions for future environmental restoration are recognised where there is a present obligation as a result of exploration, development, production, transportation or storage activities having been undertaken, and it is probable that an outflow of economic benefits will be required to settle the obligation. The estimated future obligations include the costs of removing facilities, abandoning wells and restoring the affected areas.

The provision for future restoration costs is the best estimate of the present value of the expenditure required to settle the restoration obligation at the reporting date, based on current legal requirements and technology. Future restoration costs are reviewed annually and any changes in the estimate are reflected in the present value of the restoration provision at the end of the balance sheet date, with a corresponding change in the cost of the associated asset.

The amount of the provision for future restoration costs relating to exploration, development and production facilities is capitalized and depleted as a component of the cost of those activities.

The unwinding of the effect of discounting on the provision is recognised as a finance cost.

k. Goodwill

Goodwill represents the excess of the cost of the acquisition over the Group's interest in the net fair value of the identifiable assets liabilities and contingent liabilities of the acquiree. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

All goodwill on acquisition of controlled entities has been impaired.

l. Employee Benefits

Wages, salaries and annual leave

Liabilities for employee benefits for wages, salaries and annual leave expected to settle within 12 months of the year end represent present obligations resulting from employees' services provided up to reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that the Consolidated Entity expects to pay as at reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

Share based payments

The Company has granted options to certain directors and employees. The fair value of options and shares granted is recognised as an expense with a corresponding increase in equity. The fair value is measured at the date the options or shares are granted taking into account market based criteria and expensed over the vesting period after which the employees become unconditionally entitled to the options and shares. The fair value of the options granted is measured using the Black-Scholes method, taking into account the terms and conditions attached to the options. The fair value of the performance shares granted is measured using the weighted average share price of ordinary shares in the Company, taking into account the terms and conditions attached to the shares. The amount recognised as an expense is adjusted to reflect the actual number of options and shares that vest except where forfeiture is due to market related conditions.

m. Receivables

Trade and other receivables are stated at amortised cost less impairment losses (see accounting policy (g)).

n. Taxation

Income tax expense in the income statement for the periods presented comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences are not provided for the initial recognition of goodwill and other assets or liabilities in a transaction that affects neither accounting nor taxable profit, or differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based upon the laws that have been enacted at reporting date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised. Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend is recognised.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity or on a different tax entity but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

o. Payables

Trade and other payables are stated at amortised cost.

p. Finance income and expense

Interest income is recognised as it accrues in the income statement using the effective interest method.

q. Earnings per share

The Consolidated Entity presents basic and diluted earnings per share (EPS) for its ordinary shares. Basic EPS is calculated by dividing the net loss attributable to equity holders of the parent for the financial period, after excluding any costs of servicing equity (other than ordinary shares) by the weighted average number of ordinary shares of the Company, adjusted for any bonus issue.

Diluted EPS is calculated using the basic EPS earnings as the numerator. The weighted average number of shares used as the denominator is adjusted by the after-tax effect of financing costs associated with the dilutive potential ordinary shares and the effect on revenues and expenses of conversion to ordinary shares associated with dilutive potential ordinary shares adjusted for any bonus issue.

r. Segment Reporting

A segment is a distinguishable component of the Consolidated Entity that is engaged either in providing products or services within a particular economic environment (geographical segment), or in providing products or services (business segment), which is subject to risks and rewards that are different from those of other segments. The Consolidated Entity's primary format for segment reporting is based on geographical segments. The geographical segments are determined on the Consolidated Entity's management and internal reporting structure.

s. Share Capital

Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any income tax benefit.

t. New standards and interpretations not yet adopted

The following standards, amendments to standards and interpretations have been identified as those which may impact the entity in the period of initial application. They are available for early adoption at 30 June 2009, but have not been applied in preparing this financial report:

AASB 3 Business Combinations;

AASB 8 Operating Segments;

AASB 101 Presentation of Financial Statements (revised);

AASB 127 Consolidated and Separate Financial Statements; and

AASB 2008-1 Amendments to Australian Accounting Standard - Share-based Payments: Vesting Conditions and Cancellations.

AASB 2008-7 Amendments to Accounting Standards – Cost of Investments in a subsidiary, Jointly Controlled Entity or Associate.

The impact of these standards is yet to be determined but they will be applied by the Consolidated Entity on the relevant application date.

u. Other financial assets

Financial assets in the scope of AASB 139 Financial Instruments: Recognition and Measurement are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transactions costs. The Group determines the classification of its financial assets after initial recognition and, when allowed and appropriate, re-evaluates this designation at each financial year-end.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets under contracts that require delivery of the assets within the period established generally by regulation or convention in the marketplace.

(i) Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category ‘financial assets at fair value through profit or loss’. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on investments held for trading are recognised in profit or loss.

(ii) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. Investments that are intended to be held-to-maturity, such as bonds, are subsequently measured at amortised cost. This cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. This calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in profit or loss when the investments are derecognised or impaired, as well as through the amortisation process.

(iii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

(iv) Available-for-sale investments

Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified as any of the three preceding categories. After initial recognition available-for sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is recognised in profit or loss.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments with no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument that is substantially the same; discounted cash flow analysis and option pricing models.

4. FINANCIAL RISK MANAGEMENT

Overview

The Company and Consolidated Entity have exposure to the following risks from the use of financial instruments:

• Credit risk

• Liquidity risk

• Market risk

This note presents information about the Company's and the Consolidated Entity's exposure to each of above risks, their objectives, policies and processes for measuring and managing risk, and the management of capital. Further quantitative disclosures are included throughout these consolidated financial statements. The Board of directors has overall responsibility for the establishment and oversight of the risk management and monitors operational and financial risk management throughout the Consolidated Entity. Monitoring risk management includes ensuring appropriate policies and procedures are published and adhered to. The Management reports to the Audit Committee.

The Board aims to manage the impact of short-term fluctuations on the Company's and the Consolidated Entity's earnings. Over the longer term, permanent changes in market rates will have an impact on earnings.

The Company and the Consolidated Entity are exposed to risks from movements in exchange rates, commodity prices and interest rates that affect revenues, expenses, assets, liabilities and forecast transactions. Financial risk management aims to limit these market risks through ongoing operational and finance activities.

Exposure to credit, commodity prices, foreign exchange and interest rate risks arises in the normal course of the Company's and the Consolidated Entity's business. Derivative financial instruments are not used to hedge exposure to fluctuations in foreign exchange rates, interest rates or commodity prices.

The Audit Committee oversees adequacy of the company's risk management framework in relation to the risks faced by the Company and the Consolidated Entity.

Credit Risk

Credit risk is the risk of financial loss to the Company or the Consolidated Entity if a customer, controlled entity or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's and the Consolidated Entity's receivables from customers.

Trade and other receivables

The Company's and Consolidated Entity's exposure to credit risk is influenced mainly by the geographical location and characteristics of individual customers. The Consolidated Entity does not have a significant concentration of credit risk with a single customer.

Policies and procedures of credit management and administration of receivables are established and executed at a regional level.

In monitoring customer credit risk, the ageing profile of total receivables balances is reviewed by management by geographic region on a monthly basis.

The Company and the Consolidated Entity have established an allowance for impairment that represents their estimate of incurred losses in respect of trade and other receivables.

Liquidity Risk

Liquidity risk is the risk that the Consolidated Entity will not be able to meet its financial obligations as they fall due. The Consolidated Entity's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Consolidated Entity's reputation.

The Consolidated Entity monitors cash flow requirements and produces cash flow projections for the short and long term with a view to optimising return on investments. Typically, the Consolidated Entity ensures that it has sufficient cash on demand to meet expected operational net cash flows for a period of at least 30 days, including the servicing of financial obligations. This excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters.

Market Risk

Market risk is the risk that changes in market prices such as foreign exchange rates, commodity prices interest rates and equity prices will affect the Company's and the Consolidated Entity's net loss or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Currency Risk

The Consolidated Entity undertakes its exploration and production transactions denominated in US currency and is exposed to currency risk on the value of is exploration assets and sales and purchases that are denominated in United States dollars (USD).

Over 75% of the Consolidated Entity's revenues and over 85% of costs are denominated in currencies other than AUD. Risk resulting from the translation of assets and liabilities of foreign operations into the Consolidated Entity's reporting currency is not hedged.

Interest Rate Risk

The Consolidated Entity is exposed to interest rate risks in relation to the return earned its funds on deposit and invested. The Consolidated Entity does not have short or long term debt, and therefore this risk is minimal.

Capital Management

The Consolidated Entity's objectives when managing capital are to safeguard its ability to continue as a going concern, to provide returns to shareholders, to provide benefits to other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Board aims to maintain and develop a capital base appropriate to the Consolidated Entity. In order to maintain or adjust the capital structure, the Consolidated Entity can issue new shares. The Board of directors undertakes periodic reviews of the Consolidated Entity's capital management position to assess whether the capital management structure is appropriate to meet the Consolidated Entity's medium and long-term strategic requirements. Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements. There were no significant changes in the Consolidated Entity's approach to capital management during the year.

	CONSOLIDATED ENTITY		THE COMPANY	
	30 June 2009 $	**30 June 2008 $**	**30 June 2009 $**	**30 June 2008 $**
5. REVENUE				
Oil and gas sales	513,776	669,522	-	-
Other revenue				
Interest received	145,668	220,645	67,835	5,899
Total revenue	659,444	890,167	67,835	5,899

6. LOSS FOR THE YEAR

Net gains and expenses

Loss before related income tax expense includes the following net gains and expenses :

Lease operating expenses	418,490	472,895	-	-
Impairment of oil and gas assets	-	1,047,230	-	-
Goodwill written off	-	148,578	-	-
Net foreign currency losses/(gains)	(247,133)	527,786	-	1,090,210

7. INCOME TAXES	CONSOLIDATED ENTITY 30 June 2009 $	CONSOLIDATED ENTITY 30 June 2008 $	THE COMPANY 30 June 2009 $	THE COMPANY 30 June 2008 $
(a) Tax expense/(income)				
The prima facie income tax expense on pre-tax accounting profit from operations reconciles to the income tax expense in the financial statements as follows:				
Net loss for the year	(1,977,303)	(4,058,417)	(1,980,317)	(4,152,144)
Income tax expense calculated at 30% (2008: 30%)	(593,191)	(1,217,525)	(594,095)	(1,245,643)
Add/(less) tax effect of:				
Amortisation of exploration assets	1,444	269,728	-	-
Impairment of exploration assets	-	48,160	-	-
Goodwill write-off of exploration assets	-	44,573	-	-
Provision for diminution of investments	-	-	581,719	848,502
Provision for non-recovery of loan	-	-	-	-
Share based payments	-	-	-	-
Other non-allowable items	385,503	275,166	-	-
Capitalised exploration expenditure	209,325	(209,325)	-	-
Unrealised foreign exchange loss	(74,140)	158,336	-	327,063
Other temporary differences not recognised	(83,211)	61,439	(17,250)	(9,360)
Foreign tax losses not recognised as deferred tax assets	-	-	-	-
Unused tax losses not recognised as deferred tax assets	154,270	569,448	29,626	79,438
Income tax expense	-	-	-	-
(b) Deferred tax balances				
The following deferred tax balances at 30% (2008:30%) have not been recognised:				
Deferred tax assets:				
Revenue losses	971,675	816,379	596,117	583,741
Foreign losses	6,115,680	4,078,013	-	-
Capital raising costs	90,304	173,604	90,304	173,604
Unrealised loss /(gain) on impairment	(74,140)	1,043,754	8,676,314	7,892,998
Provisions and accruals	(5,513)	77,698	(10,351)	6,899
Other	-	-	-	-
	7,098,006	6,189,448	9,352,384	8,657,242

The prior year's deferred tax balances have been adjusted to reflect the income tax losses (realised and unrealised) not brought to account, following the completion of the merger of the USA subsidiaries and the merger of K2 Energy Limited and K2 Energy Investments Pty Limited.

	CONSOLIDATED ENTITY		THE COMPANY	
	As at 30 June 2009 $	**As at 30 June 2008 $**	**As at 30 June 2009 $**	**As at 30 June 2008 $**
8. CASH AND CASH EQUIVALENTS				
Cash at bank – A$ Accounts	2,966,850	2,991,645	1,720,596	1,581,626
Cash at bank – USD Accounts	536,329	1,731,182	-	-
	3,503,179	4,722,827	1,720,596	1,581,626

Cash at bank earns interest at floating rates based on daily bank deposit rate.

9. TRADE & OTHER RECEIVABLES

Current				
Oil sales receivable (a)	11,093	15,669	-	-
Other debtors (b)	15,764	2,045	-	-
	26,857	17,714	-	-

Terms and conditions relating to the above financial instruments:
(a) Oil sales receivable is non-interest bearing and generally on 60 day terms;
(b) Other debtors are non-interest bearing and generally on 30 day terms

10. PROPERTY, PLANT AND EQUIPMENT

Plant and equipment – at cost	40,482	34,292	-	-
Accumulated depreciation	(18,248)	(9,023)	-	-
	22,234	25,269	-	-
Movements in the carrying amounts of plant and equipment during the current financial year:				
Balance at the beginning of the year	25,269	16,176	-	-
Additions	-	15,170	-	-
Depreciation expense	(6,987)	(6,077)	-	-
Foreign exchange adjustment	3,952	-	-	-
Carrying amount at the end of the year	22,234	25,269	-	-

11. OTHER FINANCIAL ASSETS

Non current				
Advance related company	-	-	3,528,029	2,856,011
Less provision for diminution	-	-	(3,528,029)	(1,350,292)
Investment in subsidiaries	-	-	32,486,739	32,486,739
Less provision for diminution	-	-	(25,393,047)	(24,959,701)
	-	-	7,093,692	9,032,757

12. DEFERRED EXPLORATION, EVALUATION AND DEVELOPMENT EXPENDITURE	CONSOLIDATED ENTITY As at 30 June 2009 $	CONSOLIDATED ENTITY As at 30 June 2008 $	THE COMPANY As at 30 June 2009 $	THE COMPANY As at 30 June 2008 $
Exploration and evaluation costs carried forward in respect of oil and gas exploration areas of interest	**4,812,024**	**5,699,570**	-	-
Movement in carrying amounts				
Opening balance	5,699,570	5,886,051	-	-
Expenditure incurred and acquired during the year	102,814	1,771,891	-	-
Foreign exchange translation adjustment	308,428	-	-	-
Amortisation of areas under production	(1,298,788)	(911,142)	-	-
Impairment of assets	-	(1,047,230)	-	-
Closing balance	4,812,024	5,699,570	-	-

The ultimate recoupment of costs carried forward for exploration and evaluation phases is dependent on the successful development and commercial exploitation or sale of the oil and gas exploration areas of interest.

13. TRADE & OTHER PAYABLES

Current				
Trade creditors (a)	-	-	-	-
Accruals	200,618	477,988	18,458	49,236
Advance from related company	-	-	788,755	577,755
	200,618	477,988	807,213	626,991

Terms and conditions

Terms and conditions relating to the above financial instruments

(a) Trade creditors are non-interest bearing and are normally settled on 45 day terms.

14. SHARE CAPITAL

Issued and paid up capital				
130,654,903 (2008: 130,654,903) Ordinary shares fully paid	42,934,768	42,934,768	42,934,768	42,934,768

(a) Movements in paid up capital

At the beginning of the reporting period	42,934,768	40,883,347	42,934,768	40,883,347
- Issue of shares pursuant to merger with K2 Energy Investments Pty Limited at 25 cents	-	481,521	-	481,521
- Option exercise	-	500	-	500
- Placement at $0.14 per share	-	1,652,000	-	1,652,000
- Capital raising costs	-	(82,600)	-	(82,600)
At end of reporting period	42,934,768	42,934,768	42,934,768	42,934,768

14. SHARE CAPITAL (CONT'D)

(b) Movements in shares on issue	CONSOLIDATED ENTITY 2009 Number	CONSOLIDATED ENTITY 2008 Number	THE COMPANY 2009 Number	THE COMPANY 2008 Number
At the beginning of the reporting period	130,654,903	116,926,322	130,654,903	116,926,322
Shares issued during the period:				
- Issue of shares pursuant to merger with K2 Energy Investments Pty Limited at 25 cents	-	1,926,081	-	1,926,081
- Option exercise	-	2,500	-	2,500
- Placement at $0.14 per share	-	11,800,000	-	11,800,000
At end of reporting period	130,654,903	130,654,903	130,654,903	130,654,903

(i) 1,926,081 shares and 885,208 options were issued on 10 July 2007, following the completion of the compulsory acquisition of the remaining K2 Energy Investments Pty Limited shares and options not yet acquired as a result of the merger.

(ii) In July 2007 2500 options were exercised upon payment of 20 cents.

(iii) In June 2008 11,800,000 shares were issued pursuant to a placement which was approved subsequently by shareholders.

(c) Options

At the end of the reporting period, there are 29,997,500 options over unissued shares as follows

Type	No. Issued	No. Quoted	Exercise Price	Expiry Date
Listed Options	29,997,500	29,997,500	20 cents	30 September 2009

There were no ordinary shares (2008- 2,500) issued as a result of the exercise of options during the financial year. Following the completion of the compulsory acquisition of the remaining options in K2 Energy Investments Pty Limited a further 885,208 options were issued on 10 July 2007.

Terms and conditions of contributed equity

Ordinary shares
Holders of ordinary shares have the right to receive dividends as declared and, in the event of the winding up of the Company, to participate in the proceeds from the sale of all surplus assets in proportion to the number of and amounts paid up on shares held.

Ordinary shares entitle their holder to one vote, either in person or by proxy, at a meeting of the Company.

Options over ordinary shares
During the year ended 30 June 2009 nil (30 June 2008 - 885,208) options have been issued over ordinary shares, exercisable at varying prices and periods. During the financial year 200,000 (2008 – 400,000) options exercisable at $0.40 each and 500,000 options exercisable at $0.70 each lapsed. Further details of the terms and conditions of these options are provided in notes 20 and 28 and the Remuneration Report.

15. ACCUMULATED LOSSES

	CONSOLIDATED ENTITY		THE COMPANY	
	30 June 2009	**30 June 2008**	**30 June 2009**	**30 June 2008**
	$	**$**	**$**	**$**
Balance at beginning of the year	(36,960,942)	(32,902,525)	(35,436,476)	(31,284,332)
Net loss attributable to members	(1,977,303)	(4,058,417)	(1,980,317)	(4,152,144)
Balance at end of the year	(38,938,245)	(36,960,942)	(37,416,793)	(35,436,476)

16. RESERVES

OPTION RESERVE

Balance at beginning of the year	2,489,100	2,489,100	2,489,100	2,489,100
Balance at end of the year	2,489,100	2,489,100	2,489,100	2,489,100

Nature and purpose of reserve
The share based payment reserve is used to recognise the fair value of options issued.

FOREIGN CURRENCY TRANSLATION RESERVE

Balance at beginning of the year	1,524,466	1,285,250	-	-
Currency translation differences arising during the year	153,587	239,216	-	-
Balance at end of the year	1,678,053	1,524,466	-	-

Nature and purpose of reserve
The foreign currency translation reserve is used to record exchange differences arising from the translations of the financial statements of foreign subsidiaries.

MINORITY INTEREST

Balance at beginning of the year	-	332,943	**-**	**-**
Purchase of minority interests	-	(332,943)	-	-
Balance at end of the year	**-**	**-**	**-**	**-**

17. STATEMENT OF CASH FLOWS

	CONSOLIDATED ENTITY		THE COMPANY	
	Year Ended 30 June 2009 $	Year Ended 30 June 2008 $	Year Ended 30 June 2009 $	Year Ended 30 June 2008 $
(a) Reconciliation of loss after tax to the net cash flows from operations:				
Net loss	(1,977,303)	(4,058,417)	(1,980,317)	(4,152,144)
Non cash items				
Unrealised foreign currency (gains)/ losses	(247,133)	527,786	-	1,090,210
Goodwill on acquisition of minority interest	-	148,578	-	-
Loss on disposal and expiration of leases	261,264	-	-	-
Impairment	-	1,047,230	-	-
Amortisation	1,298,788	917,219	-	
Provision for diminution of investment in subsidiary company	-	-	433,346	-
Provision for non recovery of intercompany loan	-	-	1,505,719	2,828,323
Changes in assets and liabilities				
(Increase)/decrease in receivables	(9,143)	65,325	-	6,885
Increase/ (decrease) in payables and accruals	(277,372)	192,401	(30,778)	(50,352)
Net cash flows (used in) / from operating activities	(950,899)	(1,159,878)	(72,030)	(277,078)
(b) Reconciliation of cash:				
Cash balances comprises				
- Cash at bank	2,966,850	2,991,645	1,720,596	1,581,626
- US Dollar accounts	536,329	1,731,182	-	-
	3,503,179	4,722,827	1,720,596	1,581,626

(c) Non cash financing and investing activities

During the prior year the company issued 1,926,081 shares and 885,208 options to acquire the remaining shares and options resulting from the compulsory acquisition of the minorities in K2 Energy Investments Pty Limited.

18. KEY MANAGEMENT PERSONNEL COMPENSATION

(a) Details of Key Management Personnel

(i) Directors

Bob Rosenthal – Non-Executive Director (resigned 15 December 2008)
Samuel Gazal– Non-Executive Chairman
Ken Gaunt- Non-Executive Director
Mike Reed - Non-Executive Director
John Thompson- Non-Executive Director (resigned 31 October 2008)
Peter Moore – Managing Director

(b) Compensation Practices and Key Management Personnel Compensation

Details of compensation practices and key management personnel compensation are disclosed in the Directors' Report, which accompanies these financial statements.

Details of management personnel compensation shares and options are disclosed in the note 28.

(c) Other Transactions and Balances with Key Management Personnel

Disclosures relating to other transactions and balances with key management personnel during the financial year are set out in note notes 20, 22 and 28 and the Remuneration Report. There were no loans to key management personnel during the financial year.

		CONSOLIDATED ENTITY	
		30 June 2009 $	**30 June 2008 $**
19. LOSS PER SHARE			
Basic loss per share (cents per share)		(1.51)	(3.41)
Loss used in calculation of basic and diluted earnings per share		(1,977,305)	(4,058,417)
Weighted average number of ordinary shares on issue used in the calculation of basic EPS	(i)	130,654,903	118,992,920

(i) Share options are not considered dilutive, as their impact would be to decrease the net loss per share. Accordingly, diluted loss per share has not been disclosed.

20. SHARE BASED PAYMENTS

(a) Share and Option holdings

Details of options and shares held by key management personnel are set out below.

Shares held by Key Management Personnel

Year ended 30 June 2009

	Balance at beginning of year	Shares Issued	Options Exercised	Bought & (Sold)	Balance at date of retirement/ appointment	Balance at end of year
Directors						
Mike Reed	1,800,000	-	-	-	-	1,800,000
John Thompson (resigned 31.10.08)	750,000	-	-	-	(750,000)	-
Bob Rosenthal (resigned 15.12.08)	-	-	-	-	-	-
Samuel Gazal	1,950,000	-	-	-	-	1,950,000
Peter Moore	11,100,000	-	-	-	-	11,100,000
Ken Gaunt	2,550,000	-	-	-	-	2,550,000
Total	18,150,000	-	-	-	(750,000)	17,400,000

Year ended 30 June 2008

	Balance at beginning of year	Shares Issued	Options Exercised	Bought & (Sold)	Balance at date of retirement/ appointment	Balance at end of year
Directors						
Mike Reed	-	-	-	-	1,800,000	1,800,000
John Thompson	-	-	-	-	750,000	750,000
Frank Brophy	26,000	-	-	-	(26,000)	-
Bob Rosenthal	-	-	-	-	-	-
Samuel Gazal	1,950,000	-	-	-	-	1,950,000
Peter Moore	11,100,000	-	-	-	-	11,100,000
Ken Gaunt	2,550,000	-	-	-	-	2,550,000
Total	15,626,000	-	-	-	2,524,000	18,150,000

** Shares issued to shareholders pursuant to merger of K2 Energy Limited and K2 Energy Investments Pty Limited.

20. SHARE BASED PAYMENTS (continued)

Options held by Key Management Personnel

Year ended 30 June 2009

	Balance at 01.07.08	Received as Remuner-ation	Exercise of Options	Bought & (Sold)/ (Lapsed)	Balance at date of retirement/ appointment	Balance at 30.06.09	Total Vested	Total Exercisable
Directors								
John Thompson (resigned 31.10.08)	312,500	-	-	-	(312,500)	-	-	-
Mike Reed	1,500,000	-	-	-	-	1,500,000	1,500,000	1,500,000
Bob Rosenthal (resigned 15.12.08)	500,000	-	-	-	(500,000)	-	-	-
Samuel Gazal	1,125,000	-	-	-	-	1,125,000	1,125,000	1,125,000
Peter Moore	9,250,000	-	-	-	-	9,250,000	9,250,000	9,250,000
Ken Gaunt	1,187,500	-	-	-	-	1,187,500	1,187,500	1,187,500
Total	13,875,000	-	-	-	(812,500)	13,062,500	13,062,500	13,062,500

Year ended 30 June 2008

	Balance at 01.07.07	Received as Remuner-ation	Exercise of Options	Bought & (Sold)/ (Lapsed)	Balance at date of retirement/ appointment	Balance at 30.06.08	Total Vested	Total Exercisable
Directors								
John Thompson	-	-	-	-	312,500	312,500	312,500	312,500
Mike Reed	-	-	-	-	1,500,000	1,500,000	1,500,000	1,500,000
Frank Brophy	400,000	-	-	(400,000)	-	-	-	-
Bob Rosenthal	500,000	-	-	-	-	500,000	500,000	500,000
Samuel Gazal	1,125,000	-	-	-	-	1,125,000	1,125,000	1,125,000
Peter Moore	9,250,000	-	-	-	-	9,250,000	9,250,000	9,250,000
Ken Gaunt	1,187,500	-	-	-	-	1,187,500	1,187,500	1,187,500
Total	12,462,500	-	-	(400,000)	1,812,500	13,875,000	13,875,000	13,875,000

Options issued as Part of Remuneration for the year-ended 30 June 2009

No options were issued to directors and executives as part of their remuneration in the current year.

21. SEGMENT INFORMATION

(a) Primary Segment - Geographical Segments

The Consolidated Entity has the following geographical segments:

United States of America
The United States of America ("USA") is the location of the Company's exploration and production activities and licence interests held.

Australia
Australia is the location of the central management and control of K2 Energy, including where company secretarial services, accounting and cash management operations are performed.

30 June 2009 **Primary Reporting – Geographical Segments**	$ **USA**	$ **Australia**	$ **Consolidated**
Revenues from operations	514,316	145,128	659,444
Segment result (loss)	(1,868,010)	(109,293)	(1,977,303)
Segment assets	4,878,346	3,485,948	8,364,294
Segment liabilities	176,245	24,373	200,618
Acquisitions of plant and equipment, exploration and evaluation, and other non-current segment assets	102,814	-	102,814
Depreciation and amortisation	1,298,788	-	1,298,788
Other non-cash expenses	-	-	-

30 June 2008 **Primary Reporting – Geographical Segments**	**$** **USA**	**$** **Australia**	**$** **Consolidated**
Revenues from operations	688,821	201,346	890,167
Segment result (loss)	(2,895,355)	(1,163,062)	(4,058,417)
Segment assets	5,968,874	4,496,506	10,465,380
Segment liabilities	412,772	65,216	477,988
Acquisitions of plant and equipment, exploration and evaluation, and other non-current segment assets	697,749	-	697,749
Depreciation and amortisation	917,219	-	917,219
Other non-cash expenses	-	-	-

(b) Secondary Segment - Business Segments

Oil & Gas Exploration
The Consolidated Entity operates solely in the Oil and Gas Exploration and Production, with interests in oil and gas in the USA state of Oklahoma.

22. RELATED PARTY DISCLOSURES

Ultimate Parent
K2 Energy Limited is the ultimate Australian parent company.

Other Related Party Transactions

(i) Amount of $133,333 (2008-$133,333) was paid to Winchester Associates Pty Limited (a company associated with Mr Gazal) for financial advisory services provided to K2 Energy Limited.

(ii) Amounts of $59,330 (2008-$144,462) for advisory services and $9,493 (2008 - $16,002) for rent were paid to Aspen Energy Inc (a company associated with Mr Reed) for services and rent provided to K2 Energy USA Inc.

(iii) Amount of $184,582 (2008-$241,696) was paid to Geoflite Inc. (a company associated with Mr Moore) for technical and advisory services provided to K2 Energy USA Inc.

(iv) No amount (2008-$83,343) was paid to Geoflite Inc. (a company associated with Mr Moore) for licensing fees in relation to the Geoflite technology.

All the above payments were made on normal commercial terms and conditions.

23. COMMITMENTS FOR EXPENDITURE

K2 Energy currently assesses and drills wells on a well by well basis. The company is expecting to participate in other drilling prospects in Oklahoma, however at balance date there were no material commitments for future expenditure.

24. INTEREST IN SUBSIDIARIES

The following companies are subsidiaries of K2 Energy Limited.

Name	Country of Incorporation	Percentage of equity interest held by consolidated entity		Investment at cost	
		2009 %	**2008 %**	**2009 $**	**2008 $**
K2 Energy Investments Pty Limited	Australia	**100**	**100**	16,492,001	16,492,001
K2 Energy USA Inc.	United Sates of America	**100**	**100**	15,994,738	15,994,738

25. AUDITORS' REMUNERATION

	CONSOLIDATED ENTITY		THE COMPANY	
	30 June 2009 $	**30 June 2008 $**	**30 June 2009 $**	**30 June 2008 $**
Remuneration of auditors of the parent company:				
- auditing or reviewing the financial report	30,000	13,000	30,000	13,000
- taxation service	2,000	500	500	500
Remuneration of other auditors of subsidiary companies:				
- auditing or reviewing the financial report	27,686	29,003	-	-
Remuneration of previous auditors of the parent company:				
- auditing or reviewing the financial report	-	20,625	-	20,625
	59,686	63,128	30,500	34,125

26. CONTINGENT ASSETS AND LIABILITIES

The Consolidated Entity is not aware of any contingent liabilities, which existed as at the end of the financial year or have arisen as at the date of this report, other than as referred to below.

The Company is a defendant in a lawsuit styled Metro Energy Group, Inc. (Metro) vs. K2 Energy USA, Inc. Metro an operator of oil and gas properties, alleges it is entitled to recover unpaid charges and expenses attributable to 24 oil and gas wells in which the Company intends to vigorously defend against the claim. The Company has filed counterclaims against Metro for lost revenues, fraud, interest, and attorney's fees.

The Company has also been named as defendant in a lawsuit in which the plaintiff alleges that it was not paid for services performed on behalf of Metro for any potential liability. The Company intends to vigorously defend this claim.

These cases are in the discovery phase and no trial dates have been set. No amount has been accrued in these financial statements since the outcome of these is uncertain, and since the resulting liability, if any, cannot be determined.

27. EMPLOYEE BENEFITS

At 30 June 2009, K2 Energy Limited had 1 employee (2008: 2).

Employee Incentive Option Plan
The Company has an Employee Incentive Scheme approved at the general meeting held on 29 December 2004.

The plan provides for the Board to elect to offer Options to an employee having regard to the potential contribution of the employee to the group and any other matters the Board considers relevant.

Each option is convertible to one ordinary share. The exercise price of the options, determined in accordance with the Rules of the Scheme, is the price determined by the Board and advised to the employee when Options are offered to the employee.

All options expire on the earlier of their termination date or 30 days following termination of the employee's employment. Options vest on granting, however exercise can be conditional upon the consolidated entity achieving certain performance hurdles as determined by the Board of directors.

There are no voting or dividend rights attaching to the options.

Details of shares and options issued to Directors are included in the Remuneration Report and in note 20.

28. SHARE BASED PAYMENT PLANS

Options are issued to directors and executives as part of their remuneration under the company's Employee Incentive Option Plan as described in Note 27. The options are not issued based on performance criteria, but are issued to all directors of K2 Energy Limited and its subsidiaries to increase goal congruence between executives, directors and shareholders.

The following table illustrates the number and weighted average exercise prices (WAEP) of and movements in share options issued as share based payments during the year:

	CONSOLIDATED ENTITY		THE COMPANY	
2009	**Number of Options**	**Weighted Average Exercise Price $**	**Number of Options**	**Weighted Average Exercise Price $**
Outstanding at beginning of the year	4,500,000	0.34	4,500,000	0.34
Granted during the year	(2,500,000)	0.34	(2,500,000)	0.34
Lapsed during the year	-	-	-	-
Exercised during the year	-	-	-	-
Expired during the year	-	-	-	-
Outstanding at the end of the year	2,000,000	-	2,000,000	-
Exercisable at the end of the year	2,000,000	-	2,000,000	-

	CONSOLIDATED ENTITY		THE COMPANY	
2008	**Number of Options**	**Weighted Average Exercise Price $**	**Number of Options**	**Weighted Average Exercise Price $**
Outstanding at beginning of the year	4,900,000	0.35	4,900,000	0.35
Granted during the year	-	-	-	-
Lapsed during the year	(400,000)	0.40	(400,000)	0.40
Exercised during the year	-	-	-	-
Expired during the year	-	-	-	-
Outstanding at the end of the year	4,500,000	0.34	4,500,000	0.34
Exercisable at the end of the year	4,500,000	0.34	4,500,000	0.34

(i) There is no employee benefits expense in the income statement (2008: nil), which relates, to equity-settled share-based payment transactions.

(ii) There is no administrative land management and corporate expenses in the income statement (2008: $nil), which relates to equity-settled share-based payment transactions.

28. SHARE BASED PAYMENT PLANS (CONT.)

No options were issued to employees in 2009.
The weighted average remaining contractual life for the share options outstanding as at 30 June 2009 was 3 months (2008- 1 year)
The range of exercise prices for options outstanding at the end of the previous year was $0.20 (2008 between $0.20 – $0.70) The weighted average fair value of options granted during the year was N/A (2008: NA).

The fair value of the cash-settled options is measured at the grant date using the Black-Scholes options pricing model taking into account the terms and conditions upon which the instruments were granted. The services received and a liability to pay for those services are recognised over the expected vesting period. Until the liability is settled it is remeasured at each reporting date with changes in fair value recognised in profit or loss.

29. SUBSEQUENT EVENTS

The directors are not aware of any matter or circumstance that has arisen since the end of the period to the date of this report that has significantly affected or may affect:
(i) The operations of the company and the entities that it controls
(ii) The results of those operations
(iii) The state of affairs of the company in subsequent years.

30. FINANCIAL INSTRUMENTS

Credit Risk

Exposure to Credit Risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	CONSOLIDATED ENTITY		THE COMPANY	
	30 June 2009	**30 June 2008**	**30 June 2009**	**30 June 2008**
	$	**$**	**$**	**$**
Cash and equivalents	3,503,179	4,722,827	1,720,596	1,581,626
Trade receivables and other receivables	11,093	15,669	-	-
Other Receivables	15,764	2,045	-	-
Other financial assets (note 11)	-	-	-	1,505,719
	3,530,036	4,740,541	1,720,596	3,087,345
The maximum exposure to credit risk for trade receivables and other financial assets at the reporting date by geographic region was:				
United States	11,093	15,669	-	1,505,719
Australia	-	-	-	-
	11,093	15,669	-	1,505,719

Impairment Losses

The aging of the trade receivables at the reporting date was:

Gross receivables				
Not past due date	11,093	15,669	3,528,029	2,856,011
Past due 30- 90	-	-	-	-
Past due 90 days and over	-	-	-	-
	11,093	15,669	3,528,029	2,856,011
Impairment	-	-	(3,528,029)	(1,350,292)
Trade receivables net of impairment loss	11,093	15,669	-	1,505,719

There was no movement in the allowance for impairment in respect of trade receivables during the year.

Impairment losses recognised in the year relate to significant individual customers, which have been assessed as impaired under the Consolidated Entity’s accounting policy as detailed in Note 3(g).

Based upon past experience, the Consolidated Entity believes that no impairment allowance, other than as provided in these accounts is necessary in respect of trade receivables not past due.

The allowance accounts used in respect of trade receivables are used to record impairment losses unless the Consolidated Entity is satisfied that non -recovery of the amount owing is possible; at that point, the amount considered non-recoverable is written off against the financial asset directly.

30. FINANCIAL INSTRUMENTS (Continued)

Currency Risk

Consolidated Entity's exposure to foreign currency (USD) risk was as follows, based upon notional amounts:

Amounts local currency	CONSOLIDATED ENTITY		THE COMPANY	
	30 June 2009	**30 June 2008**	**30 June 2009**	**30 June 2008**
	$	**$**	**$**	**$**
Cash and equivalents	536,329	1,731,182	-	-
Investments *	-	-	-	-
Plant property and equipment	20,734	23,769	-	-
Deferred exploration expenditure	4,812,024	5,699,570	-	-
Trade receivables and other receivables	24,812	15,669	-	-
Amounts receivable from related entities *	-	-	-	1,505,719
Trade Payables (note 13)	(176,245)	(412,772)	-	-
	5,217,654	7,057,418	-	1,505,719

* Investment in and funds advanced to the USA subsidiary has been impaired hence there is no currency risk

The following significant exchange rates applied to the Company and the Consolidated Entity during the year:

	Average Rate		Reporting date spot rate	
AUD = 1	2009	2008	2009	2008
USD	0.7585	0.8999	0.8064	0.9586

Interest Rate Risk

Profile

At the reporting date, the interest rate profile of the Company's and the Consolidated Entity's interest bearing financial instruments was:

	CONSOLIDATED ENTITY		THE COMPANY	
Carrying amount	**30 June 2009**	**30 June 2008**	**30 June 2009**	**30 June 2008**
	$	**$**	**$**	**$**
Variable rate instruments				
Financial assets	1,555,461	4,271,287	325,000	1,500,000
Financial liabilities	-	-	-	-

30. FINANCIAL INSTRUMENTS (Continued)

Liquidity Risk

The following are the contractual maturities of the Consolidated Entity's financial assets and liabilities including estimated interest payments.

2009	Effective interest rate p.a.	Carrying amount $	Less than 1 year	1-5 years	More than 5 years
Cash and cash equivalents	3.17%	3,503,179	3,503,179	-	-
Receivables		26,857	26,857	-	-
Payables		(200,618)	(200,618)	-	-
Total		3,329,418	3,329,418	-	-

2008	Effective interest rate p.a.	Carrying amount $	Less than 1 year	1-5 years	More than 5 years
Cash and cash equivalents	3.97%	4,722,827	4,722,827	-	-
Receivables	-	17,714	17,714	-	-
Payables	-	(477,988)	(477,988)	-	-
Total		4,262,553	4,262,553	-	-

The following are the contractual maturities of the Company's financial assets and liabilities including estimated interest payments.

2009	Effective interest rate p.a.	Carrying amount $	Less than 1 year	1-5 years	More than 5 years
Cash and cash equivalents	3.67%	1,720,596	1,720,596	-	-
Payables		(807,213)	(807,213)	-	-
Other financial assets		7,093,692	-	-	7,093,692
Total		8,007,075	913,383	-	7,093,692

2008	Effective interest rate p.a.	Carrying amount $	Less than 1 year	1-5 years	More than 5 years
Cash and cash equivalents	4.47%	1,581,626	1,581,626	-	-
Payables	-	(626,991)	(626,991)	-	-
Other financial assets	-	9,032,757	-	1,505,719	7,527,038
Total		9,987,392	954,635	1,505,719	7,527,038

30. FINANCIAL INSTRUMENTS (Continued)

Sensitivity Analysis

In managing interest rate and currency risks, the Consolidated Entity aims to reduce the impact of short-term fluctuations on the Consolidated Entity's earnings. Over the longer term however, permanent changes in foreign exchange and interest rates will have an impact on the result.

For the year ended 30 June 2009, it is estimated that a general increase of one percent in interest rates would have decreased the Consolidated Entity's loss after income tax and equity by approximately $46,000 (2008: $56,000). A one percent decrease in interest rates would have had the equal but opposite effect on the Consolidated Entity's loss and equity.

It is estimated that a general increase of ten percent in the value of the AUD against the USD would have decreased the Consolidated Entity's loss for the year ended 30 June 2009, and increase the Consolidated Entity's equity by $0.1 million (2008: decrease $0.1 million). A ten percent decrease in the value of the AUD against the USD would have the equal but opposite effect on the Consolidated Entity's loss and equity.

Fair Values

The fair values of financial assets and liabilities, together with carrying amounts shown in the balance sheet are as follows:

	CONSOLIDATED ENTITY			
	30 June 2009		30 June 2008	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and equivalents	3,503,179	3,503,179	4,722,827	4,722,827
Trade and other receivables – current	26,857	26,857	17,714	17,714
Trade and other payables	(200,618)	(200,618)	(477,988)	(477,988)
Total	3,329,418	3,329,418	4,262,553	4,262,553

	THE COMPANY			
	30 June 2009		30 June 2008	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and equivalents	1,720,596	1,720,596	1,581,626	1,581,626
Trade and other receivables – current	-	-	-	-
Trade and other payables	(807,213)	(807,213)	(626,991)	(626,991)
Other financial assets	7,093,692	7,093,692	9,032,757	9,032,757
Total	8,007,075	8,007,075	9,987,392	9,987,392

Basis for determining fair values

The following summarises the significant methods and assumptions used in estimating the fair values of financial instruments reflected in the table above.

Non-derivative financial assets and liabilities

The fair value of cash, receivables, payables and short-term borrowings is considered to approximate their carrying amount because of their short maturity. Other assets are based on the assets carrying values as per the subsidiary company's accounts, which approximates fair value.

DIRECTORS' DECLARATION

The directors of the Company declare that:

1. the financial statements and notes, as set out on pages 15 to 44, 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 2009 and of the performance for the year ended on that date of the Company and Consolidated Entity; and

2. the Managing Director and Company Secretary have each declared that:

    (a) the financial records of the Company for the financial year have been properly maintained in accordance with section 286 of the *Corporations Act 2001*;

    (b) the financial statements and notes for the financial year comply with the Accounting Standards; and

    (c) the financial statements and notes for the financial year give a true and fair view.

3. 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.

Mr Sam Gazal
Chairman

30 September 2009

STIRLING INTERNATIONAL

CHARTERED ACCOUNTANTS

INDEPENDENT AUDIT REPORT TO THE MEMBERS OF K2 ENERGY LIMITED

Report on the Financial Report

We have audited the accompanying financial report of K2 Energy Limited (the company) and the consolidated entity, which comprises the balance sheet as at 30 June 2009, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies and other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation 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 control 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 Accounting Standard AASB 101: Presentation of Financial Statements, that compliance with the Australian equivalents to International Financial Reporting Standards (IFRS) ensures that the financial report, comprising the financial statements and notes, complies with IFRS.

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 judgment, 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 entity'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 entity'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.

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

Independence

In conducting our audit, we have complied with the independence requirements of the Corporations Act 2001. We confirm that the independence declaration required by the *Corporations Act 2001*, provided to the directors of K2 Energy Limited, would be in the same terms if provided to the directors as at the date of this auditor's report.

INDEPENDENT AUDIT REPORT TO THE MEMBERS OF K2 ENERGY LIMITED

Auditor's Opinion

In our opinion:

a. the financial report of K2 Energy Limited is in accordance with 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 2009 and of their performance for the year ended on that date; and

   ii. complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001;

b. the financial report also complies with International Financial Reporting Standards as disclosed in Note 1; and

Report on the Remuneration Report

We have audited the Remuneration Report included in the report of the directors for the year ended 30 June 2009. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with s 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 the Australian Auditing Standards.

Auditor's Opinion

In our opinion the Remuneration Report of K2 Energy Limited for the year ended 30 June 2009, complies with s 300A of the corporations Act 2001.

Stirling International

Chartered Accountants

Keanu Arya

St James Centre 111 Elizabeth St Sydney 2000

30 September 2009

AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001 TO THE DIRECTORS OF K2 ENERGY LIMITED

I declare that, to the best of my knowledge and belief, during the year ended 30 June 2009 there have been:

i. no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and

ii. no contraventions of any applicable code of professional conduct in relation to the audit.

Stirling International

Chartered Accountants

Keanu Arya

30 September 2009

St James Centre 111 Elizabeth St Sydney 2000

ADDITIONAL SHAREHOLDER INFORMATION

Shareholding

The distribution of members and their holdings of equity securities in the company as at 21 September 2009 was as follows:

	Class of Equity Securities	
Number Held	**Fully Paid Ordinary Shares**	**Options expiring 30th September 2009**
1-1,000	94,653	0
1,001 - 5,000	720,001	491,375
5,001 – 10,000	3,083,923	455,000
10,001 - 100,000	25,439,926	3,772,954
100,001 and over	101,316,400	25,278,171
TOTALS	**130,654,903**	**29,997,500**

	Class of Equity Securities	
No of Holders	**Fully Paid Ordinary Shares**	**Options expiring 30th September 2009**
1-1,000	245	0
1,001 - 5,000	219	173
5,001 – 10,000	404	69
10,001 - 100,000	671	73
100,001 and over	184	34
TOTALS	**1,723**	**349**

Holders of less than a marketable parcel – fully paid shares: 605

Substantial Shareholders

The names of the substantial shareholders listed in the Company's register as at 21 September 2009

Shareholder	**Number**
Golden Words Pty Limited	14,401,703
Edwards Meadows Pty Limited <Moore Investment A/C>	11,100,000

Voting Rights

Ordinary Shares

In accordance with the Company's Constitution, on a show of hands every member present in person or by proxy or attorney or duly authorised representative has one vote. On a poll every member present in person or by proxy or attorney or duly authorised representative has one vote for every fully paid ordinary share held.

ADDITIONAL SHAREHOLDER INFORMATION (CONT.)

Twenty Largest Shareholders

The names of the twenty largest ordinary fully paid shareholders as at 21 September 2009 are as follows:

NAME	Number of Ordinary Fully Paid Shares Held	% Held of Issued Ordinary Capital
GOLDEN WORDS PTY LIMITED	12,401,703	9.492
EDWARDS MEADOWS PTY LIMITED <MOORE INVESTMENT A/C>	11,100,000	8.496
FORTIS CLEARING NOMINEES P/L <SETTLEMENT A/C>	4,188,177	3.206
METRO ENERGY GROUP INC	3,800,000	2.908
MR ROBERT KENNETH GAUNT	2,662,037	2.037
ANZ NOMINEES LIMITED <CASH INCOME A/C>	2,435,550	1.864
MR TREVOR KENNEDY & MRS CHRISTINA KENNEDY & MR DANIEL KENNEDY <GOLDEN EGGS SUPER FUND A/C>	2,000,000	1.531
ASPEN ENERGY PTY LIMITED	1,800,000	1.378
BALANDER PTY LIMITED <SUPER FUND A/C>	1,770,000	1.355
MERRILL LYNCH (AUSTRALIA) NOMINEES PTY LIMITED	1,550,973	1.187
TOWERTUN PTY LTD	1,550,000	1.186
HEENALU PTY LTD	1,500,000	1.148
RAVENHILL INVESTMENTS PTY LTD <HOUSE OF EQUITY A/C>	1,460,000	1.117
MR PETER TSU & MR SONNY BERGLUND <TSU SUPERANNUATION FUND A/C>	1,400,000	1.072
MR MARIO TRAVIATI	1,400,000	1.072
TARA SHORE PTY LTD <JOHN TAYLOR FAMILY A/C>	1,268,211	0.971
MR RONALD ROSS MARTIN & MRS VERNA RUTH MARTIN	1,200,000	0.918
TIMBINA PTY LIMITED <SUPER FUND A/C>	1,100,000	0.842
MR PETER WROBEL	1,010,000	0.773
BEDEL & SOWA CORP PTY LTD	1,000,000	0.765
	56,596,651	43.318

Twenty Largest Optionholders

The names of the twenty largest 20 cent option holders as at 21 September 2009 are as follows:

Name	Number of 30 September 2009 Options Held	% Held of Class of Equities
EDWARDS MEADOWS PTY LIMITED <MOORE INVESTMENT A/C>	9,250,000	30.836
GOLDEN WORDS PTY LIMITED	2,801,875	9.340
ASPEN ENERGY PTY LIMITED	1,500,000	5.000
BLAZZED PTY LIMITED <THE GAUNT MANAGEMENT A/C>	1,187,500	3.959
BALANDER PTY LIMITED <SUPER FUND A/C>	1,050,000	3.500
TIMBINA PTY LTD <SUPER FUND A/C>	1,000,000	3.334
ANZ NOMINEES LIMITED <CASH INCOME A/C>	937,500	3.125
ARKINDALE PTY LTD <B N SINGER NO 2 FAMILY A/C>	625,000	2.084
HEENALU PTY LTD	625,000	2.084
ECHO BEACH PTY LTD	625,000	2.084
TIMBINA PTY LIMITED <SUPER FUND A/C>	625,000	2.084
HAYDALEX PTY LTD <HAYDALEX A/C>	405,864	1.353
MR IAN SCOTT ROBERTSON & MRS DONNA ELIZABETH ROBERTSON	375,000	1.250
PLAN B TRUSTEES LIMITED <LIFETIME INVEST SERVICE A/C>	312,500	1.042
JAYDEN INVESTMENTS PTY LTD	312,500	1.042
NUKARNI PTY LTD <WOODS FAMILY A/C>	312,500	1.042
SMALL ENTERPRISES (AUST) PTY LTD <SMALL MANAGEMENT A/C>	312,500	1.042
TARA SHORE PTY LTD <JOHN TAYLOR FAMILY A/C>	312,500	1.042
TUBBIN INVESTMENTS PTY LTD	312,500	1.042
TODBERN PTY LTD	300,000	1.000
	23,182,739	77.285

SCHEDULE of INTERESTS as at 22 September 2009

Acreage Held by Production (HBP)

Section-Township-Range	*Well Lease*	*Quadrant*	*Drilling Units Acreage HBP*	*Interest held by K2 Energy Limited*
OKLAHOMA				
5-T10N-R11E	Adkins # 1-5	NE, SW, NW	80 Acres	
5-T10N-R12E	Jones # 1-5	SW, SW, SW	243.92 nma's	38.11 % WI (30.49 % NRI)
10-T10N-R12E	Priegel # 1-10	N/2, SE	209.34 Acres	32.7 % WI (25.9 % NRI)
	Priegel # 3-10	NE/4		
13-T10N-R12E	Smith # 1-13	SE, NW, NW	80 Acres	12.5% WI (9.375 % NRI)
15-T10N-R12E	Patriot # 1-15	SW, SW, NE	80.66 Acres	12.6 % WI (9.74 % NRI)
	Patriot # 2-15	SW, SW, NE		
	Patriot # 3-15	SE/4, SW/4		
13-T1ON-R11E	Snell-Heirs # 4 – 13	SE, SW, NE	Wellbore only	50% WI (37.5% NRI)
	Snell-Heirs # 6 - 13	NE/4, NE/4	120 Acres	BP 75% WI (56.25% NRI)
	Snell-Heirs # 7 - 13	SW4, SE4		AP 50% WI (37.5% NRI)
	Snell-Heirs # 8 - 13	SE/4, SW/4		
	Snell-Heirs # 9 - 13 (Accl)	SE/4, SW/4	Wellbore only	50% WI (37.5% NRI)
16-T10N-R12E	Hudson # 1 – 16	SE/4, SW/4	280 Acres	100% WI (71.5% NRI)
17-T10N-R12E	Longview 1 – 17	SE4	160 Acres	100% WI (71.5% NRI)
	Longview 2 – 17	W2 SW4	160 Acres	
	THK Snell # 1 – 17	NE/4, SE/4	160 Acres	100% WI (71.5% NRI)
	THK Snell # 2 - 17 (Accl)	NE/4, SE/4	Wellbore only	
18-T1O-R12E	Snell-Heirs # 4 - 18	NE4	160 Acres	100% WI (71.5% NRI)
	Snell-Heirs # 5 - 18 (Accl)	NE4	Wellbore only	
19-T10N-R12E	Snell-Heirs # 2 – 19	SE4 NW4	40 Acres	BP 75% WI (56.25% NRI)
	Snell-Heirs # 4 - 19 (Accl)	SE4 NW4	Wellbore only	AP 50% WI (37.5% NRI)
	Snell-Heirs # 3 – 19	SE4 NE4	40 Acres	BP 75% WI (56.25% NRI)
	Snell-Heirs # 5 - 19 (Accl)	SE4 NE4	Wellbore only	AP 50% WI (37.5% NRI)
20-T10N-R12E	Snell-Heirs # 1 – 20	NW/4, NW/4	160 Acres	50% WI (37.5% NRI)
	Wise # 1-20	SW, SE	80 Acres	12.5% WI (9.375 % NRI)
22-T10N-R12E	Wise # 1-22	NW, SE, SE	80 Acres	12.5% WI (9.375 % NRI)
24-T10N-R12E	Farrow # 1-24	SW, SW, NE	50 Acres	7.5% WI (5.625% NRI)
27-T10N-R12E	Gator # 1-27	NE, NE, NW	80 Acres	12.5% WI (9.375 % NRI)
	Ross # 3-27V	SE, NE, SW	28 Acres	4.412 % WI (3.31 % NRI)
27-T10N-R9E	Long # 1 – 27	NW/4	160 Acres	100% WI (71.5% NRI)
28-T10N-R9E	Palmer # 1 – 28	NE/4	160 Acres	100% WI (71.5% NRI)
	Wise # 1-29	NW, NE	80 Acres	11.52 %WI (8.625 % NRI)
29-T10N-R12E	Beverly # 1-29H	NE, SW	80 Acres	11.52 % WI (8.625% NRI)
36-T10N-R9E	Martin # 1-36	SE/4	160 Acres	100% WI (71.5% NRI)
		OKLAHOMA TOTAL	3011.92365	
TEXAS				
Brazoria County, Texas	Gayle # 1	A-127	102.59 Gross Acres	9.722% WI BP
				8.479% WI AP
Hidalgo County, Texas	Shary # 1	San Salvador Del Tule, A-290	160 Acres	9.06664 % WI BCP
		TEXAS TOTAL	262.59 Acres	
		ACCUMULATED TOTAL	3274.51 ACRES	
Exploration Acreage				
Project	***State***	***County***	***Net Acres***	***Interest***
Bad Creek	Oklahoma	Okfuskee	2474.93	100%

WI- Working Interest **BP- Before Payout** **BCP- Before Casing Point**
NRI- Net Revenue Interest **AP- After Payout** **ACP- After Casing Point**

CORPORATE DIRECTORY

DIRECTORS
Samuel Gazal
Peter Moore
Ken Gaunt
Mike Reed

COMPANY SECRETARY
Terence Flitcroft

REGISTERED OFFICE
Level 2 Kyle House
27 Macquarie Place
Sydney NSW 2000
Telephone: (02) 9251 2254
Facsimile: (02) 9251 6550

AUDITORS
Stirling International

SHARE REGISTRY
Registries Limited
Sydney NSW 2000
Telephone: (02) 9290 9600
Facsimile: (02) 9279 0664

STOCK EXCHANGE LISTING
Australian Securities Exchange
(Home Exchange: Sydney)
ASX Codes:
Ordinary shares: KTE
Listed Options: KTEOA

BANKERS
Westpac Banking Corporation

WEBSITE
www.k2energy.com.au