

**K2 ENERGY LIMITED**  
**ABN 99 106 609 143**  
**ASX Preliminary final report – 30 June 2008**

**Lodged with the ASX under Listing Rule 4.3A**

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**K2 Energy Limited**  
**Year ended 30 June 2008**  
**Results for Announcement to the Market**

				\$
<b>Revenue</b> from ordinary activities	Down	27.1%	to	<b>890,167</b>
<b>Loss</b> from ordinary activities after tax attributable to members	Down	85.5%	to	<b>(4,058,417)</b>
<b>Net Loss</b> for the period attributable to members	Down	85.5%	to	<b>(4,058,417)</b>

**Additional dividend/distribution information**

Details of dividends/distributions declared or paid during or subsequent to the year ended 30 June 2008 are as follows:

<b>Dividends/distributions</b>	Amount per security	Franked amount per security
Final dividend	Nil	Nil
Interim dividend	Nil	Nil

The Board has resolved that no dividend will be paid for the year ended 30 June 2008.

**Record date** for determining entitlements to the dividend

N/A
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**K2 Energy Limited**  
**Preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

**Brief explanation of figures**

The company changed direction during the year, with the main focus now being its 5,800 net acreage position in the Caney and Woodford shales in Oklahoma, USA. As a result, during 2008 K2 Energy discontinued expenditure outside the Bad Creek AMI (Oklahoma), and has recorded a loss of \$4.06m for the year. The operating loss includes a write-down of \$1.047m for impairment of existing oil and gas assets, amortisation and depreciation of \$0.9m, workover expenses written off of \$0.18m and \$0.5m of foreign exchange losses attributable to the significant weakening of the US dollar during the year.

Revenue from Oil and Gas production has declined due to diminishing production rates from existing wells, and delays in new wells being drilled. Delays in processing pooling applications with the Oklahoma Corporate Commission (“OCC”) resulted in only 3 new wells being drilled in Bad Creek during the year. It is anticipated that further drilling locations will be approved in the first half of the 2008/2009 year from the 12 applications for pooling currently before the OCC.

A water disposal well (Priegel #1-10) has come on line in August 2008 and will begin receiving water produced from the Priegel #3, Patriot #1 and Patriot #3 wells in September which should see an increase in oil and gas production from these wells. The Priegel #3 and Patriot #3 wells have been shut in pending approval of the conversion of the Priegel #1 well to a water disposal well.

The company continued to evaluate the potential of the unconventional gas potential of the Caney and Woodford Shales during the year and has resolved to focus attention on proving up the potential Caney and Woodford contingent resource in place assessed by independent consultants Netherland Sewell and Associates at up to 81 BCF of gas net to K2 Energy. The first horizontal Woodford evaluation well in the Bad Creek project has been drilled and production testing is expected by mid September 2008. The Company is confident that its Woodford and Caney shale gas assets, with its significant associated acreage will prove to be a valuable asset for the Company.

The company’s focus in 2009 is to increase the value of the company’s Bad Creek acreage by drilling as many Caney and Woodford test wells as possible in the Bad Creek 3D seismic area to prove up the potential of the company’s Bad Creek acreage totalling in excess of 5,800 net acres. Several additional drilling locations are expected to be pooled and drilling units established in the fourth quarter of 2008.

**K2 Energy Limited**  
**Preliminary consolidated income statement**  
**For the year ended 30 June 2008**

	<b>2008</b>	<b>2007</b>
	\$	\$
<b>Revenue from oil &amp; gas</b>	<b>669,522</b>	<b>1,173,342</b>
Lease operating expenses	(472,895)	(786,855)
Amortisation and depreciation	(917,219)	(3,349,641)
Other Revenue	220,645	48,643
Administrative, land management and corporate expenses	(1,308,574)	(1,029,549)
Workover expenditure written off	(182,522)	-
Employee benefits and directors' fees	(345,824)	(267,591)
Foreign exchange gains/(losses)	(527,786)	(2,874,536)
Provisions	-	9,539
Interest paid	(24)	(87)
Impairment of oil and gas assets	(1,047,230)	(13,518,087)
Goodwill written off	(148,578)	(7,446,180)
Operating (Loss) before income tax	<b>(4,060,485)</b>	<b>(28,041,002)</b>
Income tax expense/(benefit)	2,068	-
<b>Net Loss</b>	<b>(4,058,417)</b>	<b>(28,041,002)</b>
Basic earnings per share (cents per share)	(3.41)	(35.5)

**K2 Energy Limited**  
**Preliminary consolidated balance sheet**  
**As at 30 June 2008**

	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	4,722,827	6,388,436
Trade and other receivables	17,714	83,039
<b>TOTAL CURRENT ASSETS</b>	<u>4,740,541</u>	<u>6,471,475</u>
<b>NON-CURRENT ASSETS</b>		
Property plant & equipment	25,269	16,176
Deferred exploration, evaluation and development costs	5,699,570	5,886,051
<b>TOTAL NON-CURRENT ASSETS</b>	<u>5,724,839</u>	<u>5,902,227</u>
<b>TOTAL ASSETS</b>	<u>10,465,380</u>	<u>12,373,702</u>
<b>CURRENT LIABILITIES</b>		
Trade and other payables	477,988	285,587
Provisions	-	-
<b>TOTAL CURRENT LIABILITIES</b>	<u>477,988</u>	<u>285,587</u>
<b>TOTAL LIABILITIES</b>	<u>477,988</u>	<u>285,587</u>
<b>NET ASSETS</b>	<u><b>9,987,392</b></u>	<u><b>12,088,115</b></u>
<b>EQUITY</b>		
Issued capital	42,934,768	40,883,347
Foreign currency translation reserve	1,524,466	1,285,250
Option reserve	2,489,100	2,489,100
Accumulated losses	(36,960,942)	(32,902,525)
Equity attributable to equity holders of the parent	<u>9,987,392</u>	<u>11,755,172</u>
Minority Interest	-	332,943
<b>TOTAL EQUITY</b>	<u><b>9,987,392</b></u>	<u><b>12,088,115</b></u>

**K2 Energy Limited**  
**Preliminary consolidated Statement of changes in Equity**  
**For the year ended 30 June 2008**

	Minority Interest	Foreign Currency Translation Reserve	Share Based Payment	Issued Capital	Accumulated Losses	Total
	\$	\$	\$	\$	\$	\$
<b>Balance at 30 June 2006</b>	-	(7,500)	2,183,300	30,634,433	(4,861,523)	27,948,710
Equity settled transactions		-	305,800	-	-	305,800
Foreign translation gain		1,292,750	-	-	-	1,292,750
Shares cancelled during the year		-	-	(5,400,000)		(5,400,000)
Loss attributable to members		-	-	-	(28,041,002)	(28,041,002)
Shares issued during the year		-	-	15,648,914	-	15,648,914
Minority interest	332,943	-	-	-	-	332,943
Capital raising costs	-	-	-	-	-	-
<b>Balance at 30 June 2007</b>	<b>332,943</b>	<b>1,285,250</b>	<b>2,489,100</b>	<b>40,883,347</b>	<b>(32,902,525)</b>	<b>12,088,115</b>
Loss attributable to members	-	-	-	-	(4,058,417)	(4,058,417)
Foreign translation gain	-	239,216	-	-	-	239,216
Shares issued during the year	-	-	-	2,134,021	-	2,134,021
Minority interest acquired during the year	(332,943)	-	-	-	-	(332,943)
Capital raising costs	-	-	-	(82,600)	-	(82,600)
<b>Balance at 30 June 2008</b>	<b>-</b>	<b>1,524,466</b>	<b>2,489,100</b>	<b>42,934,768</b>	<b>(36,960,942)</b>	<b>9,987,392</b>

**K2 Energy Limited**  
**Preliminary consolidated cash flow statement**  
**For the year ended 30 June 2008**

	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
<b>Cashflows from operating activities</b>		
Receipts from customers	644,197	1,090,303
Payments for operations and employees	(2,552,506)	(1,781,423)
Interest received	220,645	48,643
<b>Net cash inflow/(outflow) from operating activities</b>	<b>(1,687,664)</b>	<b>(642,477)</b>
<b>Cashflows from investing activities</b>		
Payments for exploration expenditure	(1,547,845)	(1,655,036)
Cash acquired on acquisition of subsidiaries	-	6,765,346
Payments relating to acquisition of subsidiaries	-	(328,295)
<b>Net Cashflows used in investing activities</b>	<b>(1,547,845)</b>	<b>4,782,015</b>
<b>Cashflows from financing activities</b>		
Proceeds from issue of shares and options	1,652,500	-
Transaction costs of the issue of shares	(82,600)	-
<b>Net Cashflows used in investing activities</b>	<b>1,569,900</b>	<b>-</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>(1,665,609)</b>	<b>4,139,538</b>
Cash and cash equivalents at the beginning of the financial year	6,388,436	2,248,898
Net foreign exchange differences	-	-
<b>Cash and cash equivalents at the end of the financial year</b>	<b>4,722,827</b>	<b>6,388,436</b>
The cash balances at 30 June 2007 and 30 June 2008 are represented by cash at bank and money market securities.		
RECONCILIATION OF OPERATING (LOSS) AFTER INCOME TAX TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES		
Net loss	(4,058,417)	(28,041,002)
<b>Non cash items</b>		
Unrealised foreign currency (gains)/losses	-	1,505,205
Goodwill on acquisition of minority interest	148,578	-
Amortisation	917,219	3,349,641
Impairment	1,047,230	-
Share based payments	-	305,800
<b>Changes in assets and liabilities</b>		
(Increases)/decrease in receivables	65,325	257,975
(Increases)/decrease in payables and accruals	192,401	1,025,176
Increase in provisions	-	(9,539)
<b>Net cashflows (used in)/ from operating activities</b>	<b>(1,687,664)</b>	<b>(642,477)</b>
<b>Reconciliation of cash:</b>		
Cash balances comprises		
- cash in bank	2,991,645	3,565,739
-US Dollar accounts	1,731,182	2,822,697
	<b>4,722,827</b>	<b>6,388,436</b>

**K2 Energy Limited**  
**Notes to the preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

**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 2008 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 judgements 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, Employee benefits 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.



**KZ Energy Limited**  
**Notes to the preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

**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.

**KZ Energy Limited**  
**Notes to the preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

*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
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**KZ Energy Limited**  
**Notes to the preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

**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)).

**K2 Energy Limited**  
**Notes to the preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

**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 2008, but have not been applied in preparing this financial report:

AASB 3 Business Combinations;

AASB 8 Operating Segments;

**KZ Energy Limited**  
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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;

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.

**KZ Energy Limited**  
**Notes to the preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

**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. Regional management are responsible for identifying high risk customers and placing restrictions on future trading, including suspending future shipments and administering dispatches on a prepayment 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.

**K2 Energy Limited**  
**Notes to the preliminary consolidated financial statements**  
**For the year ended 30 June 2008**

*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 is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of the controlled entities, primarily Australian dollars (AUD), but also United States dollars (USD), The currencies in which these transactions primarily are denominated are AUD and 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 Australia.

*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.

**K2 Energy Limited**  
**Notes to the preliminary consolidated financial statements (continued)**  
**For the year ended 30 June 2008**

**5. Segment Operations**

**(a) Primary Segment - Geographical Segments**

The Economic 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.

**Secondary Reporting – Geographical Segments**

	Segment Revenues from External Customers	Carrying Amount of Segment Assets	Segment Result
	<b>2007</b>	<b>2007</b>	<b>2007</b>
Geographical location:	\$	\$	\$
Australia	48,643	4,667,172	(8,257,804)
USA	1,173,342	7,706,530	(19,783,198)
	<u>1,221,985</u>	<u>12,373,702</u>	<u>(28,041,002)</u>
Geographical location:	<b>2008</b>	<b>2008</b>	<b>2008</b>
	\$	\$	\$
Australia	201,346	3,865,005	(1,163,062)
USA	688,821	6,600,375	(2,895,355)
	<u>890,167</u>	<u>10,465,380</u>	<u>(4,058,417)</u>

The result in Australia includes an impairment of goodwill on consolidation relating to the remaining interest acquired in the minority of \$148,578 (2007-\$7,446,180)

**(b) Secondary Segment - Business Segments**

**Oil and Gas Exploration**

The Economic Entity operates solely in the Oil and Gas Exploration and Production, with interests in oil and gas in the USA states of Oklahoma and Texas.

**6. Associates and Joint Venture entities**

Nil

**7. Entities acquired**

No entities were acquired during the period

**8. Foreign Accounting standards**

N/A



**K2 Energy Limited**  
**Notes to the preliminary consolidated financial statements (continued)**  
**For the year ended 30 June 2008**

**9. Contingent liabilities**

At 30<sup>th</sup> June 2008 no contingent liabilities existed, other than as reported previously, by a consultancy agreement, the Company will, subject to satisfaction of production milestones below, be required to grant Carpinteria (or its permitted nominee) the following Technical Consultant Options, pursuant to shareholder's approval obtained on 28 March 2006:

- 3,285,000 Technical Consultant Options, but only if net production attributable to the Company from the Prospect Area exceeds 1.0 million cubic feet of gas per day or the equivalent in liquids; and

- 2,000,000 Technical Consultant Options, but only if net production attributable to the Company from the Prospect Area exceeds 5.0 million cubic feet of gas per day or the equivalent in liquids.

**10. NTA Backing**

	<b>2008</b>	<b>2007</b>
Net tangible asset backing per ordinary share	7.64 cents	10.3 cents

**11. Other significant information**

N/A

**12. Loss Per Share**

The following reflects the loss and share data used in the calculations of basic and diluted loss per share.

	<b>2008</b>	<b>2007</b>
Net loss used in calculating basic and diluted earnings per share	(\$4,058,417)	(\$28,041,002)
Basic and diluted (loss) per share (cents per share)	(3.41)	(35.5)
Weighted average number of shares used in the calculation of basic and diluted loss per share	118,992,920	78,849,339
Shares on issue at year end	130,654,903	116,926,322
Number of options on issue at year end – each option is exercisable at between 20 cents and 70 cents per share and converts to one ordinary share	44,795,500	44,312,792

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.

**Audit**

This report is based on accounts, which are in the process of being audited.

Description of likely dispute or qualification if the accounts have not yet been audited or subject to review or are in the process of being audited or subjected to review. -Nil

Description of dispute or qualification if the accounts have been audited or subjected to review -Nil



Sign here: .....  
 (Director)

Date: 29th August 2008

Print name: P Moore