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EUROPEAN GAS LIMITED ABN 75 075 760 655 ANNUAL REPORT 2007



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Corporate Directory



DIRECTORS

Anthony John McClure
BSc (Managing Director)

Alan John Flavelle
BSc FAusIMM MAIG MSPE (Executive Director)

Terence Vincent Willstead
BE(MIN)Hons BA FAusIMM MSME
(Non-Executive Director)

SECRETARY

Craig John Ferrier BBus CPA

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AUSTRALIA

BANKERS

Australian & New Zealand Banking Group Limited
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Chairpersons' Report



It gives me great pleasure to present this Annual Report for the year ending 30 June 2007.

This is the second Annual Report for the company as European Gas Limited and I am pleased to report that the year has been another highly successful one for the company.

We have seen the continued expansion of exploration and development activities, particularly with our Lorraine Project in France where we have returned highly encouraging results throughout the year. This progress is extremely significant as we move closer to pilot production and commercial development.

The consolidation of our acreage position in Europe has continued with the granting of Lorraine Sud permit adjoining the Lorraine Project in north eastern France and the more recent granting of the large Lons Le Saunier permit in eastern France.

In addition, we have continued to expand our technical and management team. I would like to thank all our staff and employees for their outstanding contributions throughout the year.

With our continued work programs and our expansion objectives, we very much look forward to a particularly interesting period in the company's future development.

A handwritten signature in black ink, appearing to read 'A. McClure', located below the text.

Anthony J McClure – Managing Director

Dated at Perth, Western Australia this 28 day of September 2007

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Directors' Report



Your directors present their report on the company and its controlled entities for the financial year ended 30 June 2007.

1. DIRECTORS

The names of directors in office at any time during or since the end of the financial year:

Name and qualification	Experience
Mr. Anthony J McClure BSc Managing Director	Geologist with 20 years technical, management and financial experience in the resources sector. Mr. McClure is also a director of Planet Gas Limited (since August 2003) and a director of Bolnisi Gold NL (since November 2003).
Mr. Alan J Flavelle BSc FAIMM MAIG, MSPE Executive Director	Geophysicist with over 40 years experience in the minerals, oil exploration and production industries. Knowledge and experience covers both international and domestic projects from grass roots to full production projects. Mr. Flavelle is a director of Greenpower Energy Ltd (since July 2005) and HDR Ltd (since November 2004).
Mr. Terence V Willstead BE(MIN) Hons BA FAusIMM MSME Non-executive Director	A consulting mining engineer with over 40 years experience in the mining, exploration, coal and oil shale industries in Australia and overseas. He has held senior line operational and engineering positions with Zinc Corporation, Mt Isa Mines and Consolidated Goldfields Ltd. Mr. Willstead also holds directorships with Goldsearch NL (since July 2004), International Ferro Metals Limited (since August 2005) and Citigold Corporation Ltd (since October 2006).

Directors have been in office since the start of the financial year to the date of this report unless otherwise stated. The following person held the position of company secretary at the end of the financial year:

Name and qualification	Experience
Mr. Craig J Ferrier BBUS CPA Company Secretary	A corporate specialist with over 19 years experience as a chief financial officer and company secretary. He has worked within a broad range of sectors including mining and exploration, venture capital, manufacturing and technology. Mr. Ferrier is a current director of pieNETWORKS Ltd (since September 2003).

2. PRINCIPAL ACTIVITIES

The principal activities of the economic entity during the course of the financial year were:

- Exploration for commercial coal bed and coal mine methane deposits in Europe; and
- Investigate other potential coal bed and coal mine methane opportunities.

There were no significant changes in the nature of the economic entity's principal activities during the financial year.

3. OPERATING RESULTS

The consolidated loss of the economic entity after providing for income tax amounted to \$1,950,156 (2006: \$689,299).

4. DIVIDENDS

No dividend has been paid by the company during the financial year ended 30 June 2007, nor have the directors recommended that any dividends be paid.



5. REVIEW OF OPERATIONS

5.1 SUMMARY

France

The company has a 100% interest in four projects in France:

- Lorraine, north eastern France; two permits;
- Lons Le Saunier, eastern France; one permit;
- Gardanne, southern France; one permit; and
- Saint Etienne, central France ; one permit.

The principal activities during the 2007 financial year in Lorraine centred on two core holes; one each at the two sites selected for pilot production drilling. Previous work by the company has established a Gas in Place (GIP) volume at these two sites of 28.1 billion cubic metres (991.2 billion cubic feet) over an area of 68 square kilometres.

In the areas Gardanne and Saint Etienne detailed reservoir studies have been completed.

During the year, the Lorraine Sud application adjoining the Lorraine Project was granted and subsequent to the year end, the Lons Le Saunier application, in eastern France was granted.

Investigation of other potential methane deposits for acquisition has continued throughout the year.

Italy

The company has been offered three permits in southern Tuscany subject to the approval of submitted environmental management plans.

Australia

The company maintains its royalty interests covering 30,171 square kilometres in the Canning Basin, Western Australia and is in the process of divesting its exploration permits EP425 and EP447 in the Perth Basin also in Western Australia.

Offer for Heritage Petroleum Plc

During the year, the company completed the acquisition of Heritage Petroleum Plc, consolidating the company's European interests.





5.2 HYDROCARBON PROJECTS, EUROPE

The following table summarises the areas granted and applied for in Europe as at 30 September 2007:

LOCATION	GRANTING DATE	AREA SQUARE KILOMETRES	PARENT ENTITY BENEFICIAL INTEREST %
FRANCE			
Lorraine, north eastern France	24 November 2004	460	100
Lorraine Sud, north eastern France	23 November 2006	528	100
Gardanne, southern France	10 November 2004	730	100
Saint Etienne, central France	10 November 2004	563	100
Lons le Saunier, eastern France	2 July 2007	3,740	100
Sub Total		6,021	
ITALY			
Siena – southern Tuscany	Conditional grant	478	100
Belfore – southern Tuscany	Conditional grant	511	100
Cinigiano – southern Tuscany	Conditional grant	564	100
Sub Total		1,553	
Total		7,574	

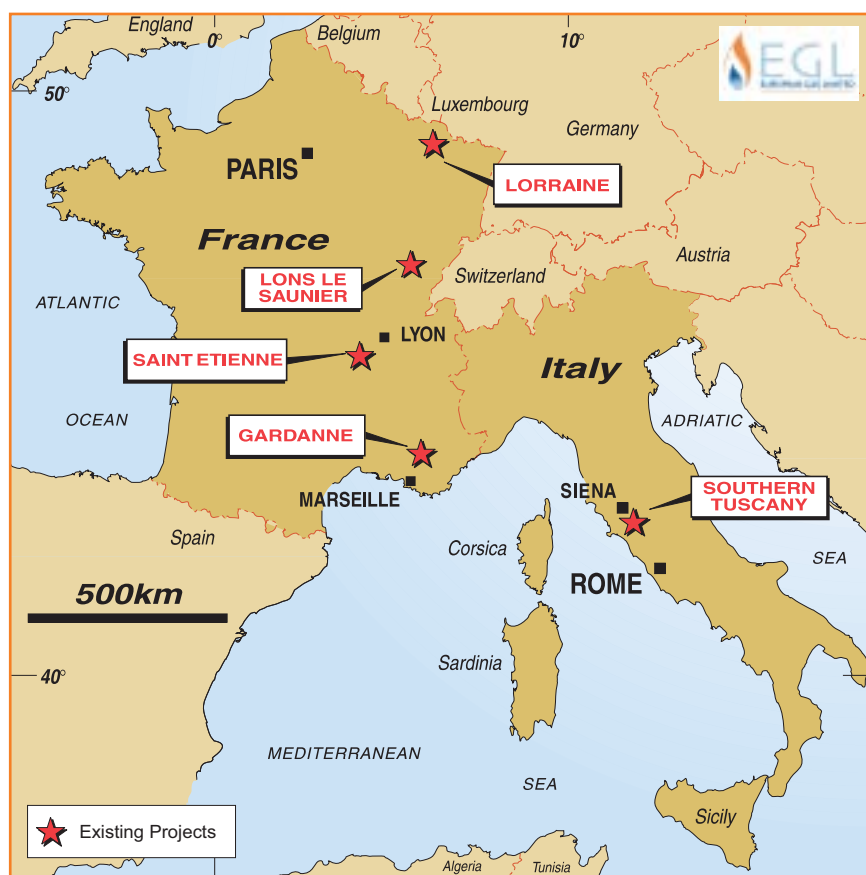


Figure 1. European Gas Limited Permit Areas

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FRANCE

LORRAINE, NORTH EASTERN FRANCE (100%)

The Lorraine and Lorraine Sud permits were granted in November 2004 and July 2007 respectively. The permits cover a total of 988 square kilometres with the principal target of coal bed methane (CBM). The permits encompass a significant part of the Lorraine Basin which has historical coal production in excess of 850 million tonnes. The coal seams within the Lorraine Basin are of Carboniferous age and are characterised as black, gassy high ranking coals. Cumulative seam thicknesses commonly total 20 to 30 metres over 200 metre intervals and in places exceed 40 metres.

Two core holes were completed in the 2007 financial year; one at Folschviller and the second at Diebling. In both cases the program met its principal objectives and good core recovery was achieved. At each site the coal thicknesses encountered were significantly greater than initially estimated with gas content values equal to or better than those reported previously by the French State coal mining company, Charbonnages de France (CdF). As a consequence the company is confident that the GIP volumes calculated in November 2005 are conservative.

Research on the CBM potential of the permits continues to be greatly aided by the drill hole database and geological database of CdF. Over 600 stratigraphic wells have been drilled in the basin with many of the coal intercepts being tested for the methane content. While the western portion of the basin has many stratigraphic wells, the eastern and southern parts of the basin encompass a small number of exploration wells drilled for ESSO-REP and Enron Exploration France ('Enron'). During the period the company began, and has largely completed, its own geotechnical data base which is based partly on the CdF information.

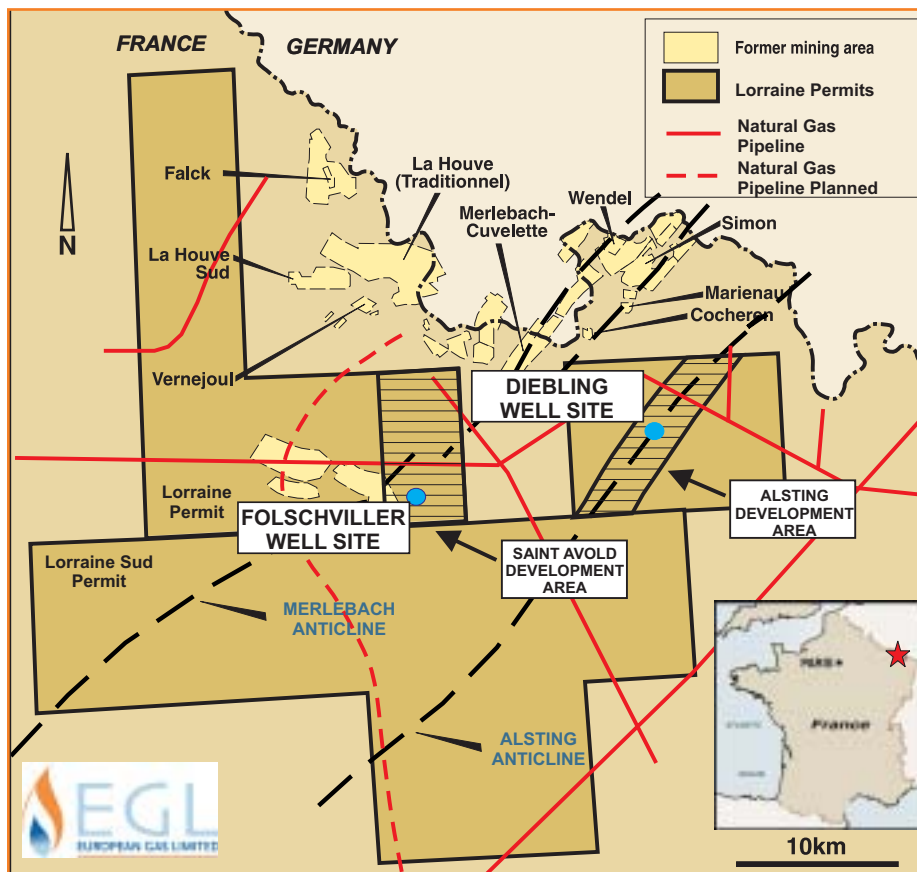


Figure 2. Lorraine Project Development Areas

Gas in Place Calculations

During the 2006 financial year, the company completed a Gas in Place (GIP) CBM inventory assessment for two major areas within the Lorraine Permit. The results of the assessment are;



Lorraine Project Gas in Place (as at November 2005)

	Billions of cubic Metres (Bm ³)	Billions of cubic Feet (Bcf)	Petajoules (PJ)
Saint Avold	11.8	414.9	410.0
Alsting	16.3	576.3	569.4
Total	28.1	991.2	979.4

The GIP calculations are based on definitive polygonal resource estimation techniques over the extensive drill core and petrophysical database. Due to the high level of reliability of the GIP calculations, it is expected that over 50% of the resource will be able to be categorised at higher levels of confidence according to the Petroleum Reserves Definitions of the Society of Petroleum Engineers.

GIP estimates have been calculated over coals shallower than 1,500 metres and are based on the extensive data base of CdF. The CdF data is detailed and has enabled the company to identify areas which have a high CBM content per unit area. In the greater Lorraine Basin, CdF drilled in excess of 600 fully cored holes to support their coal mining activities. For over 30% of these holes detailed gas content measurements have been made. Evaluation of the data base covering additional potential resource areas is continuing.

Resource Expansion

The GIP resource is based on an area comprising 68 square kilometres in total or approximately 7% of the entire Lorraine Project areas totalling 988 square kilometres. Significant increases to GIP calculations are likely.

Folschviller St1 Well

Drilling operations in the Westphalien coal measures began at the Folschviller St1 well in September 2006. Coring was commenced from 743 metres subsurface and continued through to Total Depth (TD) of 1,306 metres. The well will be converted to an observation well for the purpose of monitoring reservoir pressures during future production operations.

The coals are generally black with a brilliant lustre, display regular sub vertical cleating and the ubiquitous presence of minor pyrite and ankerite. The cleating pattern has been affected by regional stress fields.

Total net coal intercepts for the Folschviller St1 well were 62.4 metres within six packets of coal. Four major packets of coal returned over 10 metres of net coal intercepts each ranging from 10.5 metres to 14.9 metres.

Test work on 90 core samples was completed for gas desorption testing and 16 core samples of coal and interseam sediments for porosity and permeability test work. Coal intercepts and desorbable gas content results are shown in the following table:

Seam	Depth From (metres)	Net Coal Intercept (metres)	Average Desorbable Gas content (m ³ /t*)	Average Desorbable Gas content (Scf/t**)
Veines 5-6-7	767.6	4.5	7.3	258
Veines 8-9	803.4	13.5	9.6	338
Veines Ida-Ignace-Isidore	985.3	6.9	9.2	325
Veines Z-Z'-Y	1,092.8	12.2	10.1	358
Veines Alpa-Alpha'-Beta-Gamma	1,150.3	14.9	9.4	333
Veines Marie-Maurice-Noirel	1,251.1	10.5	9.9	350

* cubic metres per tonne

** standard cubic feet per tonne

The weighted average desorbable gas content for the six coal packets is 9.4 cubic metres per tonne (333 cubic feet per tonne).

Gas indications from the mud log readings show that methane is present within the inter seam sediments over virtually the entire Westphalien section penetrated by this well. The company is investigating appropriate methodology to enable quantification of this resource as it is of a view that the Gas in Place in the sediments when measured will enable a considerable up grading of the current resource.

In addition, the mud/gas log showed that the ethane content of the gas increased with depth. Near the top of the sequence at 776 metres depth ethane content was low (less than 1%) while at TD at 1,306 metres it was in the 15-20% range. Laboratory analysis on three coal samples returned an average ethane content of 13.2%.

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Diebling St1 Well

Coring at Diebling St1 was commenced from 946 metres subsurface and continued through to TD of 1,423 metres.

Total net coal intercepts for the Diebling St1 well were 41.1 metres within nine packets of coal. Four major packets of coal returned 31.9 metres of net coal intercepts ranging from 4.2 metres to 13.7 metres.

Coal intercepts and desorbable gas content results are shown in the following table:

Seam	Depth From (metres)	Net Coal Intercept (metres)	Average Desorbable Gas content (m ³ /t*)	Average Desorbable Gas content (Scf/t**)
Veine Frieda 5	964.1	4.2	13.4	473
Veine Frieda 4-3	993.7	1.7	12.9	456
Veine Erna 2	1,031.0	1.9	13.6	480
Veine Erna 1	1,051.0	1.2	13.0	459
Veine Dora-Cecile	1,073.2	5.4	12.7	448
Veine Alyssa	1,176.6	2.7	14.2	501
Veine X,Y	1,226.5	8.6	13.2	466
Veine V2/V2a/V3	1,295.9	13.7	11.8	417
Veine V4	1,333.3	1.7	n/a	n/a

* cubic metres per tonne

** standard cubic feet per tonne

The two principal targets for the Diebling St1 well are Veine X,Y and composite Veine V2/V2a/V3. Veine X,Y had poor core recovery and the net coal intercept of 8.6 metres was determined from analysis of wireline logs. For composite Veine V2/V2a/V3, with a net coal intercept of 13.7 metres, close to 100% core recovery was achieved.

A total of 27 valid gas content values have been returned which are derived from coals in the depth range 964.1 to 1,315.6 metres. The mean desorbable gas content value is 12.7 cubic metres per tonne (448 cubic feet per tonne). This result is 27% higher than the mean desorbable gas content values used in the initial GIP resource calculations for this area (Alsting Block).

Coring operations at Diebling St1 were hampered by total mud loss caused by pervasive fracturing below 930 metres. At depth the fracture intensity decreased as evidenced from the cores and from 1,030 metres it appears to be typical for the Lorraine Basin.

The well will be converted to an observation well for the purpose of monitoring reservoir pressures during future production operations.

The company is particularly encouraged by the positive data which has emerged from the drilling, coring and analytical operations. The presence of substantial coal packets is confirmed in addition to several minor seams not associated with the major packets. Visual inspection of the core shows a significant amount of fracture derived macro scale permeability.

Importantly, initial "oriented" permeability test work carried out on multiple samples has shown that permeability can be very significantly enhanced according to face cleat and butt cleat direction.

Initial fluid sensitivity tests has highlighted the need to limit formation damage related to the use of conventional drilling fluids and the company is continuing to assess the effects of non invasive drilling fluids on the coals as well as its relationship to drill penetration rates and formation damage. Bore hole stability analysis will contribute in the definition of the lateral drain orientation, mud weights and annulus pressure to aid in well stability.

Further structural modelling of the two resource areas at Saint Avold and Alsting will be undertaken with the incorporation of the results of high definition 2D seismic surveys to be undertaken.

The planning for a two well production test program is advanced and the program will be completed in the 2008 financial year. In addition, the company has been investigating the local environmental and easement issues in preparation for designing of a low pressure reticulation network required for a multi well trial production test and future development programs.

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Lorraine Sud

Analysis has indicated that strong CBM potential exists in the Lorraine Sud permit area. The new extension area contains several anticlinal axes which in places are at depths suitable for CBM development. Analysis of the structure as exhibited on the seismic data shows that there is strong horst/graben development which in turn should result in improved permeabilities in the coals and more importantly in the sediments. The area should have excellent tight gas potential.

GARDANNE, SOUTH EASTERN FRANCE (100%)

The Gardanne permit, which was granted in November 2004, covers an area of 730 square kilometres and encompasses the coal basin and old workings of the L'Arc Basin, north east of Marseille. For the production of gas, the region has both CBM and CMM potential. Historical coal production from the Basin is approximately 80 million tonnes of sub bituminous coal.

The coal-bearing sequence is up to 300 metres thick and contains up to 20 seams. The coal seams are Late Cretaceous in age and are interbedded with limestone layers which commonly display porosity and permeability, enhancing the reservoir potential of the coal-bearing sequence. Available data has highlighted a considerable amount of methane within the coal mining complex; whereas coal seams in the shallower mine workings to the east contain water and significantly lower gas content. It is highly possible that the hydrocarbon gas present in the basin or at least a major part is being sourced from the underlying rocks. This is supported by low maturity of the coal and the migration of higher gas contents in the Grande Mine vein along the tectonic north south faults. This strongly indicates that the faults are acting as an inflow conduit of gas from rocks at depth.

The mining records show that in some areas gas relief ahead of mining was undertaken successfully by drilling vertical holes from the surface. This shows that conventional vertically drilled CBM wells should be successful in the areas where gas is known. In 2008, it is planned to drill at least one vertical appraisal well which if successful will be followed by at least two additional wells to form a pilot production pattern.

After completion of the first period of data research and of a reservoir report, the company decided to complete a 3D block model of the basin so that the methane volume and distribution could be accurately estimated and mapped.

Analysis of the model and of the CdF geological data shows that:

- The gas content of the coals is strongly associated with proximity to underlying fault systems which may have acted as migration pathways for the gas which is now in the coal;
- There is good CBM potential in a localised zone southwest of the old mine workings;
- There is no reliable permeability data but the young age of the coal and its low rank suggests that permeability should be fair to good; and
- Evidence from nearby mining activity suggests that the coals will be dry.

The company believes that development via vertical holes may be possible and is planning an initial well for the second half of 2008.

SAINT ETIENNE, CENTRAL FRANCE (100%)

The Saint Etienne permit was granted in November 2004 and covers 563 square kilometres which includes the bulk of the Loire Basin, south west of Lyon. The Basin contains coal measures of up to 40 seams of Carboniferous age ranging in thickness from 1 to 15 metres. Historical production is approximately 600 million tonnes of bituminous coal with a long history of explosive methane being encountered during mining. Mine workings in areas of coal deposition are very extensive and comprise numerous shafts, development drives and extraction areas.

The area is mainly prospective for CMM production and to a lesser extent for CBM production due to the extensive nature of previous coal mining activity.

The company has completed a methane survey of sites above abandoned mines. No significant methane emissions were detected. These results are interpreted to show that the mines are either flooded or that there is a perched water table blocking vertical methane migration.

The coal mines of Saint Etienne had variable methane emission rates. This variability could be related to localised physical and geological conditions. From mine records, the gas content of the coal seams appears to be depth related.

Based on the company's reservoir study and using the available information a cavity volume of 58.7 million cubic metres was determined. The further refinement of the cavity volume will be achieved by the incorporation into the geological model of detailed mining plans. CMM production scenarios have been formulated but further geotechnical information will be needed to be recovered to produce a more detailed projection.

The company is carrying out further evaluation of the project's CBM potential in both the mined and non mined areas. Several of the mined areas have low CBM potential as most of the coal seams have been exploited. However many of the areas mined since 1950 only exploited selectively and a considerable tonnage of residual coal is present. This coal is likely to have enhanced permeability due to the proximity of mining activities.

A detailed review of the data base is in process with potential initial drilling in 2008.

LONS LE SAUNIER, EASTERN FRANCE (100%)

The Lons le Saunier applied permit area of 3740 square kilometres, which was granted in July 2007, is centred on the township of Lons le Saunier, situated to the west of the French-Swiss border (See Figure 3).

The Jura Basin is potentially a substantial hydrocarbon province. The permit area covers the central part of the northeast – southwest oriented Basin which is approximately 250 kilometres in length with the width varying between 30 and 60 kilometres.

Within the permit area, historical drilling and seismic work mainly completed from the 1950's through 1980's has demonstrated that the area contains significant hydrocarbon potential split into three target groups; CBM, conventional gas and conventional oil.

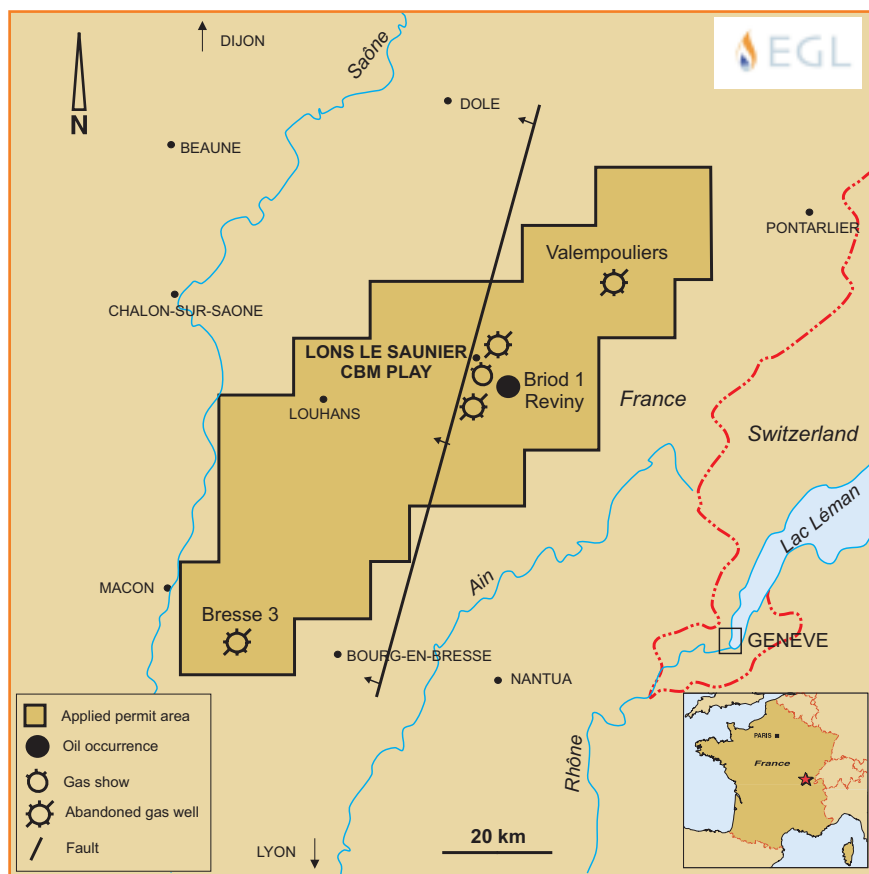


Figure 3. Lons Le Saunier Permit Location

Coal Bed Methane Potential

The Jura Basin overlies a large Carboniferous age sub basin which hosts a substantial tonnage of gassy coal. CdF in association with the Bureau de Recherches Géologiques et Minières ("BRGM") completed 29 wells for approximately 31,000 metres of coal exploration drilling in the vicinity of the town of Lons le Saunier. An in-situ tonnage of 370 million tonnes of coal over a central area of 32 square kilometres was estimated by CdF.

The lateral extent of the coal measures is undefined, however at Bresse some 70 kilometres south west of Lons le Saunier, an oil exploration well intersected what is believed to be the southern extension of the coal measures. The maximum net coal thickness at Lons le Saunier is approximately 29.1 metres while at Bresse, a net coal thickness of 15 metres has been intersected. To the north, the coal measures extent has not been defined, however the basin boundary is approximately 20 kilometres north from Lons le Saunier. The eastern and western limits of the coal basin have not been fully defined.

The coal measures have never been mined as the last evaluation of the coal basin coincided with the decline of the French coal mining industry in the 1980's. In addition, it was noted by CdF that problems associated with potential mining subsidence and the gassy nature of the coals also contributed to the decision not to mine the area.



The coal sequence at Lons Le Saunier has 18 identifiable Stephanien aged coal seams with measured thicknesses of over five metres with maximum net coal thickness of 29.1 metres. Within the permit area the Stephanien coal depths varying from 470 metres at Lons le Saunier to over 1,350 metres at Bresse.

No gas content measurements are available, however, file descriptions contain references to gas desorbing from the coal matrix when brought to the surface.

The coal seams within the permit area show strong potential for CBM development. The coals are at moderate depths along with the presence of a structural high between Lons le Saunier and Bresse. This structural setting may indicate zones of enhanced CBM attributes.

Conventional Gas Potential

The Stephanien coal measures are considered as one of the principal source rocks of the migrated hydrocarbons found in the overlying Middle Triassic sediments.

In addition to the coal exploration wells, the coal measures and the overlying sedimentary sequence have been identified by conventional oil and gas exploration wells as far south as the town of Bresse.

The largest conventional gas field within the permit is located approximately 30 kilometres north east of the township of Lons le Saunier. Five wells were completed at Valempoulières with the Valempoulières-3 well, producing 83.7 million cubic metres (Mm³) or 2.96 billion cubic feet (Bcf) of gas from with initial production of 100,000m³ per day (3.5 million cubic feet). The reservoir was from 860 metres depth and hosted in a five metre thick dolomite unit. The area is considered highly prospective for further discoveries with little exploration work having been completed since the initial discovery in 1961.

In addition, various small gas fields to the north and south of Lons Le Saunier have historical cumulative production of 14.6 Mm³ or 0.52 Bcf of gas between 1957 and 1970.

The Lettenkohle (Triassic) sediments of the Jura Basin within the permit have hosted five historical producing gas fields and during drilling have had numerous strong shows of gas.

Conventional Oil Potential

The presence of oil within the permit area was first encountered in the Lettenkohle and Muschelkalk sediments in the stratigraphic well Reviny in 1943, when core delivered from the Muschelkalk from 427 metres recovered oil. A further oil occurrence was encountered by the CdF stratigraphic well Briod 1 in 1954-55 when formation testing produced 270 barrels of oil. A further appraisal well was completed in 1982 which produced 359 barrels of oil under test. The Briod oil zone is between 25 metres and 30 metres thick and located within the fractured dolomite units of the Lettenkohle formation. This is a high priority target for development activities.

Program

The initial work program will comprise data assembly and analysis. This work will be directed towards establishing sites for CBM stratigraphic core drilling to obtain accurate information about the coals including gas content, permeability, hydrogeologic regime, etc. Extensive seismic coverage exists across the basin and a program of recovery will be put in place to review and possibly re-process the bands. The stratigraphic well logs and reports will also be re-analysed. For this initial period the information recovery program will be centre on the Lons Le Saunier as it has a significant potential CBM resource and an estimation of the gas in place will be undertaken.

In addition, a concurrent program will be undertaken to address each of the conventional oil and gas target areas with a priority for the Briod oil occurrence

ITALY

TUSCANY (100%)

Three permit areas covering 1,553 square kilometres in Southern Tuscany, Italy were granted during the 2007 financial year and are subject to the submission of preliminary environmental impact studies. The permits are each for a period of six years and give the holder exclusive rights for the exploration for and production of hydrocarbons. All three areas are prospective for CBM.

Reports on Environmental Impact Study's for the three permit areas have been completed and lodged with the office of the Regione Toscana.



5.3 AUSTRALIA

During the 2007 financial year, European Gas sold its 100% interest in EP371, EP390, EP391, EP428, EP431, EP426, 12% of L98-1 and 8% of EP104 covering 28,701 square kilometres of the Canning Basin, Western Australia. The company maintains a 2% Net Well Head Royalty.

In addition, the company maintains a 3% Net Well Head Royalty in EP129, L6 and L8 covering 1,470 square kilometres also in the Canning Basin, Western Australia.

The following table summarises the Company's current permit holdings in the Perth Basin, Western Australia as at 30 June 2007:

IDENTIFICATION	EXPIRY DATE	AREA, SQUARE KILOMETRES	ECONOMIC ENTITY % INTEREST
WESTERN AUSTRALIA			
Exploration Permits (EP)			
EP447 – Perth Basin	11 April 2012	1,070	100
EP425 – Perth Basin	16 June 2010	879	100
Total		1,949	

The company is in the process of divesting these exploration permits.

5.4 OFFER FOR HERITAGE PETROLEUM PLC

On 15 December 2006, European Gas announced a recommended share and cash offer for the entire issued and to be issued share capital of Heritage Petroleum Plc ('Heritage') ('the Offer'). The Offer Document setting out the full terms of the Offer was posted to Heritage Shareholders on 15 December 2006.

On 2 February 2007, European Gas announced that the Offer had become unconditional in all respects.

On 13 February 2007, valid acceptances had been received in respect approximately 91.6% of the existing issued ordinary share capital of Heritage. Having received valid acceptances in excess of 90% of the ordinary share capital, European Gas exercised its rights to acquire compulsorily the remaining Heritage Shares on the same terms of the Offer.

On 7 May 2007, the total number of European Gas ordinary shares issued as consideration under the Heritage Offer was 31,509,298 representing 100% of the issued capital of Heritage.

The terms and conditions of the Offer were set out or referred to in the Offer Document and in the Form of Acceptance on the following basis:

For each Heritage Share held, 0.55 New European Gas Shares and 1.5 pence in cash.

European Gas also made an offer to the holders of Heritage Warrants. The offer to holders of Heritage Warrants provided a right for the holders of Out-of-the-Money Heritage Warrants to elect to cancel such Out-of-the-Money Heritage Warrants in exchange for a grant of New European Gas Options on the basis of 0.55 New European Gas Options for each Out-of-the-Money Heritage Warrant cancelled.

Each New European Gas Option (now described as "Heritage Options") gives the holder the right to subscribe for one new share in the Company at an exercise price of A\$1.00 each at any time prior to 28 February 2009.

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6. EVENTS SUBSEQUENT TO REPORTING DATE

Subsequent to the balance sheet date, the company reported that;

GAZONOR S.A. Acquisition and Financing

On 14 August 2007, the company announced that it has been successful in the tender to acquire 100% of the issued capital of Gazonor S.A. (a company incorporated in France "Gazonor") and it had entered into a Sale and Purchase Agreement ("SPA") with Filianor S.A. Filianor S.A. is a wholly owned subsidiary of Charbonnages de France.

Completion and settlement of the purchase is expected to occur in November 2007 following completion of the statutory approval process provided for in the SPA including ministerial approval as advised by the Conseil Général des Mines, the supervisory authority with regards to mining matters in France.

The purchase price for the Gazonor shares is 26.2 million (approximately A\$42.0 million).

Gazonor is the owner of the Nord – Pas de Calais Coal Mine Methane production field and associated infrastructure situated in northern France.

On 2 July 2007, European Gas announced it had entered into a Funding Agreement with a substantial European group ("Group"). This financing is for the acquisition of Gazonor and for working capital purposes.

Under the agreement, the Group will subscribe 36,375,000 (approximately A\$58.4 million) for convertible notes in the Company subject to statutory approvals for the completion of the acquisition of Gazonor and other approvals as detailed in the announcement.

Other than the matters discussed above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the company, to affect significantly the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity, in future financial years.

7. LIKELY DEVELOPMENTS

The economic entity will continue to pursue policies which seek to provide sound opportunities for future development during the next financial year.

Likely developments and expected results of the operations of the economic entity in subsequent years are not discussed further in this report. In the opinion of the directors, further information on those matters could prejudice the interests of the company and the economic entity because these matters are currently under negotiation and premature disclosure could breach commercial confidentiality.

8. REMUNERATION REPORT

The remuneration report is set out on pages 18 to 23 and forms part of the Directors' Report for the financial year ended 30 June 2007.

9. SAFETY

The company carries out its operations under strict industry safety standards and according to its own approved safety manual and safety systems. During the year there were no on site safety concerns or lost time injuries.

10. ENVIRONMENTAL REGULATIONS AND PERFORMANCE

The exploration permits and in France, in which the company has an interest, all carry strict environmental regulations governing activities in the field. To date, as far as the directors are aware, there have been no breaches of the license conditions.



11. MEETINGS OF DIRECTORS

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

	BOARD MEETINGS		AUDIT COMMITTEE MEETINGS	
	A	B	A	B
Anthony J McClure	8	8	2	2
Alan J Flavelle	7	8	2	2
Terence V Willstead	8	8	2	2

A – numbers of meetings attended.

B – number of meetings held during the time the director held office during the year or was a member of the relevant committee.

12. INDEMNIFICATION OF DIRECTORS AND OFFICERS

During or since the end of the financial year the company has given an indemnity or entered into an agreement to indemnify, or paid or agreed to pay insurance premiums for a standard Directors and Officers Liability and Company Reimbursement Policy. The details of the policy remain confidential between the insurer and the company.

13. OPTIONS

At the date of this report, the un-issued ordinary shares of European Gas Limited under option are as follows:

OPTION PLANS	GRANT DATE	NUMBER UNDER OPTION	EXERCISE PRICE	EXPIRY DATE
Employee Options	25 August 2005	1,000,000	\$0.10	25 August 2008
Director Options – Series A	25 November 2006	4,000,000	\$1.00	28 November 2008
– Series B	25 November 2006	4,000,000	\$1.50	28 November 2010
Heritage Options	1 February 2007	1,563,269	\$1.00	28 February 2009
	Total	10,563,269		

Further details concerning the company's share option incentive plans are set out in note 15 to the financial statements accompanying this report.

During the year a total of 8,000,000 director's options were issued pursuant to shareholder approval in general meeting under the terms of the European Gas Limited Employee Share Option Plan. The options were issued in two series and have an exercise price of \$1.00 (Series A) and \$1.50 (Series B) and expire on 28 November 2008 and 28 November 2010 respectively.

Also during or since the end of the year a total of 1,563,269 options were issued under the terms of the agreement to acquire all the issued and unissued securities held by shareholders in Heritage Petroleum plc following acceptance of a merger agreement on 1 February 2007.

No person entitled to exercise the option had or has any right by virtue of the option to participate in any share issue of any other body corporate.

No options lapsed or were forfeited during the year.

A total of 5,135,000 ordinary shares were issued by virtue of the exercise of options during or since the end of the financial year resulting in cash inflows of \$608,250.



14. DIRECTORS INTERESTS

The relevant interest of each director in the shares or options over shares of the company and any other related body corporate, as notified by the directors to the Australian Stock Exchange in accordance with S205G(1) of the Corporations Act 2001, at the date of this report is as follows:

DIRECTOR	ORDINARY SHARES	OPTIONS OVER ORDINARY SHARES
Anthony J McClure	3,220,752	3,750,000
Alan J Flavelle	1,415,040	2,750,000
Terence V Willsted	3,500,000	1,500,000

15. PROCEEDINGS ON BEHALF OF THE COMPANY

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

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

In the opinion of the directors, all significant changes in the state of affairs of the consolidated entity, which occurred during the year under review, are disclosed in this report or the financial statements.

Other than as stated elsewhere in this report, there has not arisen in the interval between the end of the financial year and the date of this report any matter, circumstance or event of a material or unusual nature likely in the opinion of the directors of the company, to affect significantly the operations of the consolidated entity, the results of those operations or the state of affairs of the consolidated entity in subsequent financial years.

16. NON-AUDIT SERVICES

During the year Bentleys MRI Perth Partnership "Bentleys" and PKF, the company auditors, have performed certain other services in addition to their statutory duties.

The board has considered the non-audit services provided during the year by the auditors and has formally resolved that it is satisfied that the provision of those non-audit services during the year by the auditors is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- the other services provided relate to taxation, corporate restructure including merger opportunities, consolidation and accounting advice which is considered not to affect the independence of the company auditors.
- all non-audit services were subject to the corporate governance procedures adopted by the company and have been reviewed by the board to ensure they do not affect the integrity and objectivity of the auditor; and
- the non-audit services provided do not compromise the general principles relating to auditor independence as set out in Code of Conduct *APES 110: Code of Ethics for Professional Accountants* issued by the Accounting Professional and Ethical Standards Board.

Details of the amounts paid to the auditor of the company, Bentleys, PKF and Haines Watts, and their related practices for audit and non-audit services provided during the year are set out in note 20 of the financial statements.

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17. LEAD AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

The lead auditor's independence declaration is set out on page 70 and forms part of the directors' report for the year ended 30 June 2007.

Signed in accordance with a resolution of the Board of Directors

Anthony J McClure – Managing Director

Dated at Perth, Western Australia this 28 day of September 2007

ATTRIBUTION

Aspects of the Directors' Report that relate to oil and gas in place or oil and gas reserves are based on information compiled by persons who are Fellows or Members of the Australian Institute of Mining and Metallurgy and/or the Australian Institute of Geoscientists, and are full-time employees of the company (unless otherwise noted), and have sufficient relevant experience of the activity undertaken and of the hydrocarbon style of deposit described. They qualify as Competent Persons as defined in the 1999 edition of the "Australasian Code for the Reporting of Resources and Reserves" (JORC Code).

A list of the names of the Competent Persons is available upon request. The above statement fairly reflects the reports prepared by these Competent Persons and has been prepared by Mr. Alan Flavelle as the Competent Person for European Gas Limited. Mr. Flavelle has consented to the inclusion in this report of the matters from these reports in the form and context in which it appears.

Remuneration Report



Overview of remuneration policy

This report details the nature and amount of remuneration for each director of European Gas Limited and for the executives receiving the highest remuneration. Remuneration levels for directors, secretaries, senior managers of the company and relevant group executives of the consolidated entity ("the directors and senior executives") are competitively set to attract and retain appropriately qualified and experienced directors and senior executives.

The remuneration structures explained below are designed to attract suitably qualified candidates, reward the achievement of strategic objectives, and achieve the broader outcome of creation of value for shareholders. The remuneration structures take into account:

- the capability and experience of the directors and senior executives;
- the directors and senior executives ability to control the relevant segments performance;
- the consolidated entity's performance including:
- the consolidated entity's operational and financial performance;
- the scale and complexity of operations;
- the growth in share price and returns on shareholder wealth;
- the amount of incentives within each directors and senior executive's remuneration.

Remuneration packages comprise fixed remuneration and long-term performance-based incentives.

Fixed remuneration

Fixed remuneration consists of base remuneration (which is calculated on a total cost basis), as well as employer contributions to superannuation funds.

Remuneration levels are reviewed annually by the Board through a process that considers individual, segment (if applicable) and overall performance of the consolidated entity. The Board has regard to remuneration levels external to the group to ensure the director's and senior executives' remuneration is competitive in the market place. A senior executive's remuneration is also reviewed on promotion.

Performance linked remuneration

Performance linked remuneration is represented by long-term incentives in the form of options and provide a means by which the company can reward and provide performance based incentive to its directors. In the company's early stages of development it is considered appropriate that the company provide incentive options as a cost effective and efficient way of providing incentive to directors and other executives.

During the financial period the company granted directors a total of 8,000,000 Directors Options as the equity based component of a long term incentive structure. Details of outstanding options are provided in note 14 of the director's report. Any grant of options to directors requires prior shareholder approval.

At the Annual General Meeting in November 2006 shareholders "refreshed" the approval of the European Gas Limited Employee Share Option Plan the ("Incentive Plan"). The purpose of the Incentive Plan is to provide selected directors, employees and consultants of the company (and its subsidiaries) with the means of receiving options to subscribe for shares in the company. The intention is to give these people the opportunity to share in the future growth and profitability of the company by aligning their interests with those of shareholders. This is expected to motivate them to have a greater involvement with and commitment to the company, and to focus on the longer term goals of the company.



Consequence of performance on shareholder wealth

In considering the consolidated entity's performance and benefits for shareholders wealth the board has regard to the following indices in respect of the current financial year and the previous financial period.

Indices	2007	2006	2005	2004	2003
Net profit (loss) \$'000	(1,950)	(689)	(180)	(555)	(2,015)
Earnings/(loss) per share (cents per share)	(1.10)	(0.53)	(0.34)	(0.50)	(2.06)
Dividends paid (cents per share)	Nil	Nil	Nil	Nil	Nil
Change in share price – increase/(decrease) (cents per share)	61.0	33.5	(2.2)	5.5	(5.3)
Return of capital	Nil	Nil	Nil	Nil	Nil
Net cash from/(used in operations) \$'000	(2,170)	(1,620)	(239)	(613)	(817)
Market capitalisation (undiluted) at 30 June \$'000	196,174	62,181	6,623	7,945	1,702

In establishing performance measures and benchmarks to ensure incentive plans are appropriately structured to align corporate behavior with the long term creation of shareholder wealth, the Board has had regard for the stage of development of the company's business and given consideration to each of the indices outlined above. In view of the nature of the company's activities and the relatively early stage of development the market capitalisation of the company is likely to be the most representative measure of the impact of the company's remuneration policies on shareholder wealth.

Service agreements

In August 2006, the company entered into an agreement for the engagement of Mr. Anthony McClure as Managing Director. The Agreement between the company and Anthina Holdings Pty Ltd, an entity controlled by Mr. McClure, is for an initial term of four years, subject to rights of earlier termination as follows:

- without notice on certain specified grounds without compensation; and
- by the Company on 3 months notice with compensation being the payout of the base remuneration for the remainder of the term plus relocation costs for Mr. McClure and his family.

In March 2003 the company entered into a service agreement with Seinecorp Pty Ltd, a company controlled by the company secretary, Mr. Craig Ferrier. The contract is for no fixed term and fees payable are based on market rates for these types of services and are payable on a monthly basis for the duration of the contract. Either party may terminate the agreement on 1 months notice at any time.

Non-executive directors

Non-executive directors receive fees determined by the Board, but within the aggregate limit of \$300,000 as approved by Shareholders in 2006.

Directors & Executives Disclosures

Remuneration of directors and executives by the consolidated entity

Other than the executive directors, no other person is concerned in, or takes part in, the management of the company and consolidated entity; or has authority and responsibility for planning, directing and controlling the activities of these entities. As such, during the financial year, the company did not have any person, other than the directors, that would meet the definition of "Key Management Personnel" for the purposes of AASB124 or "company executive" or relevant group executive" for the purposes of section 300A of the Corporations Act 2001 ("Act"). Remuneration details of the company secretary are disclosed as section 300A(1B)(a) of the Act which defines a "company executive" to specifically include a secretary of the entity.

Directors and key Management Personnel

Anthony J McClure	Managing Director
Alan J Flavelle	Executive Director
Terence V Willstead	Non-executive Director

Company Executives (as defined by section 300A (1b) (a))

Craig J Ferrier	Company Secretary
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Remuneration Report (continued)



Remuneration of specified directors and specified executives by the consolidated entity

The following table provides details of all directors of the company (also key management personnel) and other company executives the nature and amount of the elements of their remuneration for the year ended 30 June 2007.

	Year	Salary & fees	Super-annuation benefits	Value of options ⁽¹⁾	TOTAL	Proportion of remuneration related ⁽²⁾	Value of options as a proportion of remuneration
		\$	\$	\$	\$	%	%
Directors							
Anthony J McClure	2007	433,197	–	911,250	1,344,447	0%	68%
	2006	139,900	–	–	139,900	0%	0%
Alan J Flavelle	2007	178,170	1,246	668,250	847,666	0%	79%
	2006	125,235	11,188	–	136,423	0%	0%
Terence V Willstead	2007	84,603	1,012	364,500	450,115	0%	81%
	2006	31,653	2,250	–	33,903	0%	0%
Total, all directors	2007	695,970	2,258	1,944,000	2,642,228	0%	74%
	2006	296,788	13,438	–	310,226	0%	0%
Executives							
Craig J Ferrier (Company Secretary)	2007	81,235	–	–	81,235	0%	0%
	2006	28,933	–	10,453	39,386	0%	27%
Total, all company executives	2007	81,235	–	–	81,235	0%	0%
	2006	28,933	–	10,453	39,386	0%	27%

(1) The fair value of the options is calculated at the date of grant using a binomial tree model and allocated to each reporting period evenly over the period from grant date to vesting date. The value disclosed is the portion of the fair value of the options allocated to the relevant reporting period.

(2) As the options granted in the 2007 financial year were not subject to a performance condition, the grant value is not regarded as “performance related” remuneration.

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Options and Rights over Equity Instruments Granted as Compensation

Details of options over ordinary shares in the company that were granted as compensation to each director (key management person) and company executive during the reporting period and details on options that vested during the reporting period are as follows. Options were issued free of charge. Each option entitles the holder to subscribe for one fully paid ordinary share in the equity at the exercise price shown below.

Directors	Vested number	Granted number	Grant date	Terms & Conditions for Each Grant			
				Value per option at grant date (\$)	Exercise price per share (\$)	First exercise date	Last exercise date
Anthony McClure – Series A	1,875,000	1,875,000	28 Nov 2006	0.225	\$1.00	28 Nov 2006	28 Nov 2008
Anthony McClure – Series B	1,875,000	1,875,000	28 Nov 2006	0.261	\$1.50	28 Nov 2006	28 Nov 2010
Alan Flavelle – Series A	1,375,000	1,375,000	28 Nov 2006	0.225	\$1.00	28 Nov 2006	28 Nov 2008
Alan Flavelle – Series B	1,375,000	1,375,000	28 Nov 2006	0.261	\$1.50	28 Nov 2006	28 Nov 2010
Terrence Willsteed – Series A	750,000	750,000	28 Nov 2006	0.225	\$1.00	28 Nov 2006	28 Nov 2008
Terrence Willsteed – Series B	750,000	750,000	28 Nov 2006	0.261	\$1.50	28 Nov 2006	28 Nov 2010
Company Executives							
Craig Ferrier	-	-	-	-	-	-	-
Total	<u>8,000,000</u>	<u>8,000,000</u>					

No options have been granted since the end of the financial year. The options were provided at no cost to the recipients.

All options issued in the current year were Director Options (Series A and Series B) and are fully vested and may be exercised by the holder at any time during the life of the option. Unless determined otherwise by the Board, options lapse on the day that is 20 days after the termination of the eligible participant's engagement. The period of 20 days is extended to a period of up to 6 months in the event of death or 90 days if termination is a consequence of total and permanent disablement or redundancy.

For options granted in the current year, the earliest exercise date was 28 November 2006.

The following factors and assumptions were used in determining the fair value of options on grant date for options issued during the year:

Director options	Grant date	Expiry date	Fair value per option*	Exercise price	Price of shares on date of grant	Estimated volatility	Risk free rate of return	Dividend yield
Series A	28 Nov 2006	28 Nov 2008	\$0.225	\$1.00	\$0.80	60.0%	5.59%	Nil
Series B	28 Nov 2006	28 Nov 2010	\$0.261	\$1.50	\$0.80	60.0%	5.59%	Nil

* The fair value per option was assessed using a Binomial Tree model.

Modification of terms of equity share-based payment transactions

No terms of equity-settled share-based payment transactions (including options and rights granted as compensation to a key management person) have been altered or modified by the issuing entity during the reporting period.

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Remuneration Report (continued)



Equity instruments

Analysis of share-based payments granted as remuneration

Details of vesting profile of the options granted as remuneration to Directors and Company Executives during the financial year is detailed below:

Directors	Number	Date	Options Granted		Financial years in which grant vests	Value yet to vest	
			% vested in year	% Forfeited in year		Min	Max
Anthony McClure – Series A	1,875,000	28 Nov 2006	100	–	2007	–	–
Anthony McClure – Series B	1,875,000	28 Nov 2006	100	–	2007	–	–
Alan Flavelle – Series A	1,375,000	28 Nov 2006	100	–	2007	–	–
Alan Flavelle – Series B	1,375,000	28 Nov 2006	100	–	2007	–	–
Terence Willstead – Series A	750,000	28 Nov 2006	100	–	2007	–	–
Terence Willstead – Series B	750,000	28 Nov 2006	100	–	2007	–	–
Company Executives							
Craig Ferrier	–	–	–	–	–	–	–

(1) The vesting of the director options were not conditional upon the satisfaction of a performance condition as they were issued substantially “out of the money” and are unlisted and not transferable.

(2) There were no options forfeited during the financial period.

Analysis of movements in options

The movement during the reporting period, by value, of options over ordinary shares in European Gas Limited held by each company director is detailed below:

Directors	Granted in year \$	Value of Options		Total option value in year
		Exercised in year \$	Forfeited in year ⁽¹⁾ \$	
Anthony McClure ²	911,250	1,605,000	–	2,516,250
Alan Flavelle	668,250	–	–	668,250
Terence Willstead ²	364,500	858,750	–	1,223,250
Company Executives				
Craig Ferrier	–	–	–	–
	1,944,000	2,463,750	–	4,407,750

- There were no options forfeited during the financial period.
- The options exercised during the year related to a grant of options to directors approved by shareholders in general meeting in November 2003. The options have been valued as at the date of exercise in accordance with the requirements of the Corporations Act.
- The fair value of the options is calculated at the date of grant using a binomial tree model and allocated to each reporting period evenly over the period from grant date to vesting date. The value disclosed is the portion of the fair value of the options allocated to the relevant reporting period.
- The value of options exercised during the year is calculated as the market price of shares of the company on the Australian Stock Exchange as at close of trading on the date the options were exercised after deducting the price paid to exercise the option.



Exercise of options granted as remuneration

Shares issued on exercise of remuneration options

	Shares issued Number	Paid per share \$	Unpaid per share \$
<hr/>			
Directors			
Anthony McClure	3,000,000	0.1250	–
Alan Flavelle	–	–	–
Terence Willstead	1,500,000	0.0875	–
Company Executives			
Craig Ferrier	–	–	–
Total	4,500,000		

1. The amount paid per share is the weighted average price paid upon the exercise of the options held by the respective director or executive.

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Corporate Governance Statement



INTRODUCTION

The directors are focused on fulfilling their responsibilities individually, and as a board, for the benefit of all the company's stakeholders. That involves recognition of, and a need to adopt, principles of good corporate governance. The board supports the guidelines on the "Principles of Good Corporate Governance and Best Practice Recommendations" established by the ASX Corporate Governance Council.

Given the size and structure of the company, the nature of its business activities, the stage of its development and the cost of strict and detailed compliance with all of the recommendations, the board have adopted a range of modified systems, procedures and practices which it considers will enable it to meet the principles of good corporate governance.

The company's practices are broadly consistent with those of the guidelines and where they do not correlate with the recommendations in the guidelines the company considers that its adopted practices are appropriate to it. At the end of this statement a table is included detailing the recommendations with which the company's practices do not strictly comply.

The following section addresses the company's practices in complying with the principles.

Principle 1: Laying Solid Foundations for Management and Oversight

Role and Responsibilities of the Board

The board exists to lead and oversee the management and direction of the company.

After appropriate consultation with executive management the board:

- defines and sets its business objectives and subsequently monitors performance and achievements of those objectives;
- it oversees the reporting on matters of compliance with corporate policies and laws, takes responsibility for risk management processes and the review of executive management of the company;
- monitors and approves financial performance and budgets; and
- reports to shareholders.

Principle 2: Structuring the Board to Add Value

Composition of the Board

The names of the directors of the company and their qualifications are set out in the section headed Directors' Report in this Annual Report.

The composition of the board is determined so as to provide the company with a broad base of industry, business, technical, administrative, financial and corporate skills and experience considered necessary to represent shareholders and fulfill the business objectives of the company.

The best practice recommendations are that a majority of the directors and in particular the chairperson should be independent. An independent director is one who:

- does not hold an executive position;
- is not a substantial shareholder of the company or an officer or otherwise associated directly or indirectly with a substantial shareholder of the company;
- has not within the last 3 years been employed in an executive capacity by the company or another group member or been a director after ceasing to hold such employment;
- is not a principal of a professional adviser to the company or another group member;
- is not a significant supplier or customer of the company or another group member, or an officer of, or otherwise associated directly or indirectly with a significant supplier or customer;
- has no significant contractual relationship with the company or any other group member other than as a director of the company; and
- 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.

One of the three board members meets these criteria. The board does not currently have a permanently designated chairperson.

Nomination of Other Board Members

The board at least annually reviews its composition to determine if additional core strengths are required to be added to the board in light of the nature of the company's businesses and its objectives. The board will continue to assess its size and composition relative to the company's current and proposed business activities. It is likely that the size of the board will increase as the company's level of activities in Europe advance.

Independent Advice

Each of the directors is entitled to seek independent advice at the company's expense to assist them to carry out their responsibilities.



Principle 3: Promotion of Ethical and Responsible Decision-Making

Directors, officers, employees and consultants to the company are required to observe high standards of behavior and business ethics in conducting business on behalf of the company and they are required to maintain a reputation of integrity on the part of both the company and themselves. The company does not contract with or otherwise engage any person or party where it considers integrity may be compromised.

Directors are required to disclose to the board actual or potential conflicts of interest that may or might reasonably be thought to exist between the interests of the director or the interests of any other party in so far as it affects the activities of the company and to act in accordance with the Corporations Act if conflict cannot be removed or if it persists. That involves taking no part in the decision making process or discussions where that conflict does arise.

Directors are required to make disclosure of any share trading. The company policy in relation to share trading is that officers are prohibited to trade whilst in possession of unpublished price sensitive information concerning the company. That is information which a reasonable person would expect to have a material affect on the price or value of the company's shares. It is recommended that an officer discuss any proposal to acquire or sell shares with the directors or the company secretary prior to doing so to ensure that there is no price sensitive information of which that officer might not be aware. The undertaking of any trading in shares must be notified to the company secretary who makes disclosure to Australian Stock Exchange (ASX).

Principle 4: Safeguarding Integrity in Financial Reporting

In August 2006, the board established an Audit & Compliance Committee ("A&CC"). The role of the A&CC is set out in a charter and its responsibilities include reviewing all published accounts of the group; reviewing the scope and independence of external audits; monitoring and assessing the systems for internal compliance and control, legal compliance and risk management; and advising on the appointment, performance and remuneration of the external auditors. In view of the relative size of the company, the committee comprises all members of the current board. The A&CC is chaired by Mr. Terence Willsteed, an independent non-executive director.

Each board member has access to the external auditors and the auditor has access to each board member, as required. In addition, prior to signoff of the company's financial reports, the board's non-executive director meets with or contacts the external auditors to discuss the conduct of the audit and any issues arising.

Consistent with the requirements of the Corporations Act and best practice recommendations, the person or persons fulfilling the functions of chief executive officer and chief financial officer are required to make a statement 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.

Principle 5: Making Timely and Balanced Disclosure

A continuous disclosure regime operates within the company. Board policies require that matters that a person could reasonably expect to have a material effect on the share price are announced to the ASX in a timely manner. Where a decision is made not to notify the ASX of a particular event or development, the reasons for non-notification are determined by the board.

The company secretary, in consultation with the executive directors, is the person responsible for overseeing and co-ordination disclosure of information to the ASX as well as communicating with the ASX.

Principle 6: Respecting the Rights of Shareholders

The board's fundamental responsibility to shareholders is to work towards meeting the company's objectives so as to add value for them.

The board seeks to inform shareholders of all major developments affecting the company by:

- preparing half yearly and yearly financial reports;
- preparing quarterly cash flow reports and reports as to activities;
- making announcement in accordance with the listing rules and the continuous disclosure obligations;
- hosting all of the above on the company's website;
- annually, and more regularly if required, holding a general meeting of shareholders and forwarding to them the annual report together with notice of meeting and proxy form; and
- voluntarily releasing other information which it believes is in the interest of shareholders.

The Annual General Meeting enables shareholders to receive the reports and participate in the meeting by attendance or by written communication. The board seeks to notify all shareholders so they can be fully informed annually for the voting on the appointment of directors and so as to enable them to have discussion at the Annual General Meeting with the directors and/or the auditor of the company who is invited to the Annual General Meeting.



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Principle 7: Recognising and Managing Risk

The board examines and considers areas of significant business risk and implements policy to minimize exposure to these risks. It is intended that the Audit and Compliance Committee will assist the Board in monitoring this role.

Areas of risk which are considered at board meetings include, assets, operations, project management, occupational health and safety, environmental, insurance, commodity price and foreign exchange, amongst others. The company has adopted procedures by which it identifies and manages those risks on a case by case basis. As an ordinary part of the company's business involves holding assets in a country where sovereign risk is considered higher than in Australia, the directors are sensitive to the need for risk management.

The board is collectively responsible for development of appropriate risk management systems and ensuring that such systems are maintained and complied with.

Principle 8: Encouraging Enhanced Performance

The board regularly discusses and reviews its performance. The board also discusses with each director their requirements, performances and aspects of involvement in the company.

Principle 9: Remunerate Fairly and Responsibly

There is no formal remuneration committee. A commentary on remuneration policy and practices is set out in the remuneration report contained within the Directors' Report in this Annual Report.

One third of the directors retires annually in accordance with the Constitution and is free to seek re-election by shareholders.

Each member of the board has committed to spending sufficient time to enable them to carry out their duties as a director of the company.

The maximum amount of remuneration for non-executive directors is fixed by shareholders in general meeting and can be varied in that same manner. In determining the allocation the board takes account of the time demands made on the directors together with such factors as fees paid to other corporate directors and to the responsibilities undertaken by them.

Principle 10: Recognising the Legitimate Interests of Stakeholders

The company recognises its responsibilities extend beyond its shareholders to clients, customers, consumers and regulators. The company is committed to providing an adequate level of detail for the benefit of all stakeholders, the accuracy in that detail, and to meeting principles of equity and fairness in all of its dealings.



Table of Departures and Explanations (from the Recommendations of the ASX Corporate Governance Council)

"Recommendation" Ref ("Principle No" Ref followed by Recommendation Ref)	Departure	Explanation
1.1	There was no formalisation and disclosure of separate functions between the board and management during the reporting period.	Throughout the reporting period the board consisted of two executive and one non-executive director. The executive directors were involved in the overall management of the company. The practices followed were compatible with the Principle.
2.1	One of the directors satisfies the test of independence. The other two directors are fulfilling executive roles.	Given the nature and size of the company, its business interests and the stage of development, the board is of the view that there is an adequate and broad mix of skills required and that given their experience each of the directors are aware of and capable of acting in an independent manner and in the best interests of the shareholders.
2.2	The Board does not have a permanent chairperson.	The board elects a chairperson before each meeting. All directors are capable and have the requisite experience to fulfill the role. Any potential conflicts are resolved during the election process.
2.4	A separate Nomination Committee has not been formed.	The board comprises three members each of who have valuable contributions to make in fulfilling the role of a nomination committee member. A director will excuse himself where there is a personal interest or conflict.
3.1	No formal code of conduct has been established as to practices necessary to maintain confidence in the company's integrity or as to reporting and investigating unethical practices.	The board and management consist of the three directors. It is not considered that a code of conduct or reporting guide is yet necessary. The principles are followed. Board Charter drafted
3.2	No written policy concerning trading in the company securities by directors, officers or employees has been disclosed.	Section 3 outlines the policy adopted by the board and management. Detailed procedures will be implemented relative to the size of the organization.
4.2 and, 4.3	The audit and compliance committee was established in August 2006. However it does not comprise a majority of independent directors and non-executive directors.	Given the size and composition of the board it is not possible to have an audit committee comprising only non-executive directors. A formal charter has been adopted by the committee. The composition of the committee will continue to be monitored relative to the structure of the board.
5.1	No written policy and procedure exists to ensure compliance with ASX Listing Rules disclosure requirements are met at senior management level.	Two executives of the company are also directors and the board does not consider that a written policy is required at this time. This situation will be reviewed and amended to meet the company's increased activities and growth.
6.1	The company has a formal communication strategy in place for the benefit of its shareholders.	The board is very conscious of the need to continually keep shareholders and markets advised. The development and regular update of the company's web-page provides a continuous communication channel which ensures shareholders and the markets are adequately informed about its activities results.



"Recommendation" Ref ("Principle No" Ref followed by Recommendation Ref)	Departure	Explanation
7.1 and 7.2	There has been no written implementation of policy on risk oversight and management or for senior management to make statements to the board concerning those matters.	Given the nature and size of the company, its business interests and the active involvement of all directors, it is not considered necessary to establish this practice at this time. The directors continually monitor, review and discuss performance and implement changes as necessary.
8.1	There has been no formal disclosure of the process for performance evaluation of the board, committees, individual directors and key executives.	Given the size of the company and the involvement of all three directors a policy has not been required to date. The directors continually monitor, review and discuss performance and implement changes as necessary.
9.1	The company has not disclosed remuneration policies.	The company has disclosed its remuneration policy in the remuneration report of the Directors Report as required by law and accounting standards.
9.2	No formal remuneration committee has been established.	Given the size and involvement of the board in the company's management, the formation of a separate remuneration committee is not warranted.
9.3	Non-executive directors are eligible to participate in the company's Employee Share Option Plan (Incentive plan).	In order to preserve funds (associated with the payment of directors fees), and to attract and retain directors of sufficient caliber and standing, all directors are eligible to participate in the company's incentive plan, subject to prior shareholder approval to any grant made in accordance with the incentive plan.
10.1	There has been no disclosure of a code of conduct to deal with compliance for legal or other obligations to legitimate stakeholders.	The business practices adopted by the board recognise this principle but no formal code has been drawn-up or approved.

Income Statement for the year ended 30 June 2007



	NOTE	ECONOMIC ENTITY		PARENT ENTITY	
		2007	2006	2007	2006
		\$	\$	\$	\$
Continuing operations					
– Sales revenue		–	67,762	–	271,048
– Cost of sales		–	(67,762)	–	(271,048)
Gross profit		–	–	–	–
Other revenue from ordinary operations:					
– Ordinary activities	2	614,830	286,976	2,016,941	807,399
– Profit on sale of subsidiary		430,747	–	571,498	–
– Profit on sale of fixed assets		1,836,178	–	1,620,447	–
– Writeback doubtful debts provision		–	–	500,000	–
		2,881,755	286,976	4,708,886	807,399
Other expenses from ordinary operations:					
– Doubtful debts	3	–	–	212	(500,000)
– Audit Fees and other services		(75,939)	–	(75,939)	–
– Depreciation and amortization expenses	3	(25,558)	(11,374)	(25,558)	(11,374)
– Exploration write-off		(166,647)	–	–	–
– Occupancy expenses		(241,740)	(47,765)	(241,740)	(47,765)
– Legal fees		(267,389)	–	(591,700)	–
– Consultancy		(920,750)	–	(1,140,216)	–
– Administrative expenses		(796,402)	(731,984)	(836,728)	(720,000)
– Borrowing costs expense	3	(12,343)	(16,652)	(11,825)	(16,652)
– Insurance		(41,771)	–	(40,570)	–
– Loss on sale of fixed assets		–	(3,872)	–	(3,872)
– Option valuations		(1,944,000)	–	(1,944,000)	–
– Loss – foreign exchange	3	(103,378)	–	(6,318)	–
– Share registry fees		(48,100)	–	(21,467)	–
– Other expenses from ordinary activities		(187,894)	(235,565)	(189,280)	(210,314)
Loss from ordinary activities before income tax expense		(1,950,156)	(760,236)	(416,243)	(702,578)
Income tax expense relating to ordinary activities	4	–	–	–	–
Net loss attributable to members of the parent entity		(1,950,156)	(760,236)	(416,243)	(702,578)
Profit/(Loss) after tax from discontinued operations	1D	–	70,937	–	1,717,493
Net loss for the period		(1,950,156)	(689,299)	(416,243)	1,014,915
Basic earnings/(loss) per share (cents per share)					
– continuing operations	25	(1.10)	(0.53)	–	–
Diluted earnings/(loss) per share (cents per share)					
– continuing operations	25	(1.10)	(0.53)	–	–
Basic earnings/(loss) per share (cents per share)					
– discontinuing operations	25	–	(0.05)	–	–

The accompanying notes form part of these financial statements.

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Balance Sheet as at 30 June 2007



	NOTE	ECONOMIC ENTITY		PARENT ENTITY	
		2007	2006	2007	2006
		\$	\$	\$	\$
CURRENT ASSETS					
Cash assets	5	5,071,019	13,507,090	667,617	13,489,325
Receivables	6	481,178	303,543	292,662	493,762
Other	7	18,000	176,434	18,000	50,354
		5,570,197	13,987,067	978,279	14,033,441
Assets classified as held for sale	D	54,447	5,193,026	54,447	2,784,843
TOTAL CURRENT ASSETS		5,624,644	19,180,093	1,032,726	16,818,284
NON-CURRENT ASSETS					
Receivables	6	–	275,286	16,588,240	1,543,119
Available for sale financial assets	8	2,618,370	–	2,618,370	–
Investment – subsidiary company		–	–	24,355,792	–
Property, plant and equipment	10	326,047	21,086	326,047	21,086
Exploration & development expenditure	11	33,543,416	1,460,134	–	–
TOTAL NON-CURRENT ASSETS		36,487,833	1,756,506	43,888,449	1,564,205
TOTAL ASSETS		42,112,477	20,936,599	44,921,175	18,382,489
CURRENT LIABILITIES					
Payables and Accruals	13	3,109,943	755,686	3,109,945	480,421
		–	755,686	–	480,421
Liabilities directly associated with assets classified as held for sale	D	–	2,267,432	–	–
TOTAL CURRENT LIABILITIES		3,109,943	3,023,118	3,109,945	480,421
TOTAL LIABILITIES		3,109,943	3,023,118	3,109,945	480,421
NET ASSETS		39,002,534	17,913,481	41,811,230	17,902,068
EQUITY					
Contributed equity	14	47,825,666	25,160,908	47,825,666	25,160,908
Reserves	16	400,583	1,776,132	1,686,779	26,132
Accumulated losses	17	(9,223,715)	(9,023,559)	(7,701,215)	(7,284,972)
TOTAL EQUITY		39,002,534	17,913,481	41,811,230	17,902,068

The accompanying notes form part of these financial statements.

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Statement of Cash Flows for the year ended 30 June 2007



	NOTE	ECONOMIC ENTITY		PARENT ENTITY	
		2007	2006	2007	2006
		\$	\$	\$	\$
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from customers		231,843	1,272,822	237,695	173,198
Payments to suppliers and employees		(2,951,895)	(2,074,101)	(470,919)	(1,381,741)
Borrowing costs		(12,329)	(24,795)	(11,811)	–
Interest received		562,067	258,660	436,543	258,660
NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES	18(b)	(2,170,314)	(567,414)	191,508	(949,883)
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of plant & equipment		(330,519)	(66,963)	(330,519)	(16,471)
Expenditure on exploration		(7,664,046)	(1,052,616)	(58,426)	(145,519)
Proceeds on sale of property & equipment		2,300,000	–	2,300,000	–
Acquisition of subsidiary – net of cash acquired on acquisition		(1,549,142)	–	(2,299,284)	–
Sale of subsidiary – net of cash disposed off		(4,312)	–	–	–
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES		(7,248,019)	(1,119,579)	(388,229)	(161,990)
CASH FLOWS FROM FINANCING ACTIVITIES					
Loans made to controlled entity		–	–	(13,233,237)	(594,957)
Proceeds from issue of shares		608,250	13,245,500	608,250	13,245,500
Proceeds from Blue Loraine Joint venture partner		275,285	–	–	–
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES		883,535	13,245,500	(12,624,987)	12,650,543
NET INCREASE/(DECREASE) IN CASH HELD		(8,534,798)	11,558,507	(12,821,708)	11,538,670
Effect of translation of foreign currency		94,415	–	–	–
Cash at 1 July 2006		13,511,402	1,952,895	13,489,325	1,950,655
Cash at 30 June 2007	18(a)	5,071,019	13,511,402	667,617	13,489,325

The accompanying notes form part of these financial statements.

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Statement of Changes in Equity for the year ended 30 June 2007



CONSOLIDATED	Attributable to equity holders of the parent			
	Issued capital \$	Retained earnings \$	Other reserves \$	Total \$
At 1 July 2005	11,915,408	(8,334,260)	1,750,000	5,331,148
Loss for the period	–	(689,299)	–	(689,299)
Issued shares	13,245,500	–	–	13,245,500
Cost of option valuation	–	–	26,132	26,132
At 30 June 2006	25,160,908	(9,023,559)	1,776,132	17,913,481

CONSOLIDATED	Attributable to equity holders of the parent			
	Issued capital \$	Retained earnings \$	Other reserves \$	Total \$
At 1 July 2006	25,160,908	(9,023,559)	1,776,132	17,913,481
Loss for the period	–	(1,950,156)	–	(1,950,156)
Issued shares	22,664,758	–	–	22,664,758
Cost of option valuation	–	–	1,938,775	1,938,775
Asset revaluation reserve transferred to retained earnings	–	1,750,000	(1,750,000)	–
Movement in Foreign Currency Translation Reserve	–	–	(1,286,196)	(1,286,196)
Movement in Available for sale reserve	–	–	(278,128)	(278,128)
At 30 June 2007	47,825,666	(9,223,715)	400,583	39,002,534

PARENT	Attributable to equity holders of the parent			
	Issued capital \$	Retained earnings \$	Other reserves \$	Total \$
At 1 July 2005	11,915,408	(8,299,887)	–	3,615,521
Profit for the period	–	1,014,915	–	1,014,915
Issued shares	13,245,500	–	–	13,245,500
Cost of options valuation	–	–	26,132	26,132
At 30 June 2006	25,160,908	(7,284,972)	26,132	17,902,068

PARENT	Attributable to equity holders of the parent			
	Issued capital \$	Retained earnings \$	Other reserves \$	Total \$
At 1 July 2006	25,160,908	(7,284,972)	26,132	17,902,068
Loss for the period	–	(416,243)	–	(416,243)
Issued shares	22,664,758	–	–	22,664,758
Cost of option valuation	–	–	1,938,775	1,938,775
Movement in Available for sale reserve	–	–	(278,128)	(278,128)
At 30 June 2007	47,825,666	(7,701,215)	1,686,779	41,811,230

The accompanying notes form part of this financial report.

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1 NOTES TO FINANCIAL STATEMENTS

A REPORTING ENTITY

European Gas Limited (the 'company') is a company domiciled in Australia. The address of the company's registered office is Suite 4, 4 Ventnor Avenue, West Perth Western Australia 6005, Australia. The consolidated financial statements of the company as at and for the year ended 30 June 2007 comprise the company and its subsidiaries (together referred to as the 'Group') and the Group's interest in associates and jointly controlled entities. The Group is primarily involved in the exploration for commercial coal bed and coal mine methane deposits in Europe.

The financial report was authorised for issue by the Directors on 27 September 2007.

B BASIS OF PREPARATION

Statement of Compliance

The financial report is a general purpose report which has been prepared in accordance with Australian Accounting Standards (AASBs) (including Australian Interpretations) adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The consolidated financial report of the Group also complies with the IFRSs and interpretations adopted by the International Accounting Standards Board.

Basis of Preparation

The financial report has been prepared on an accruals basis and is based on historical costs modified by the revaluation of selected non-current assets, financial assets and financial liabilities for which the fair value basis of accounting has been applied.

C SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(i) Principles of Consolidation

A controlled entity is any entity European Gas Limited has the power to control the financial and operating policies of so as to obtain benefits from its activities.

A list of controlled entities is contained in Note 9 to the financial statements. All controlled entities have a June financial year-end.

All inter-company balances and transactions between entities in the economic entity, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistencies with those policies applied by the parent entity.

Where controlled entities have entered or left the economic entity during the year, their operating results have been included/excluded from the date control was obtained or until the date control ceased.

Minority equity interests in the equity and results of the entities that are controlled are shown as a separate item in the consolidated financial report.

(ii) Interest in joint venture operation

The Group's interest in its joint venture operation is accounted for by recognising the Group's assets and liabilities from the joint venture, as well as expenses incurred by the Group and the Group's share of income earned from the joint venture, in the consolidated financial statements.

(iii) Foreign currency transaction

Both the functional and presentation currency of European Gas Limited and all its subsidiaries is Australian dollars (A\$), except for one subsidiary (Heritage Petroleum PLC) whose functional currency is Euro.

Transactions in foreign currencies are initially recorded in the functional currency at the exchange rates ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

All differences in the consolidated financial report are taken to the income statement with the exception of differences on foreign currency borrowings that provide a hedge against a net investment in a foreign entity. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in the income statement.

Tax charges and credits attributable to exchange differences on those borrowings are also recognised in equity.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction.

Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Consolidation of Heritage Petroleum PLC

As at the reporting date the assets and liabilities of these overseas subsidiaries are translated into the presentation currency of European Gas limited at the rate of exchange ruling at the balance sheet date and the income statements are translated at the weighted exchange rates for the period.

The exchange differences arising on the retranslation are taken directly to a separate component of equity ("Foreign Currency Translation Reserve").

On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

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C SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(iv) Property, plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any impairment in value.

Impairment

The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

For an asset that does not generate largely independent cashflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Land and buildings are measured at fair value less accumulated depreciation.

Depreciation is calculated on a straight-line basis over the estimated useful life of the assets as follows:

Buildings – over 20 years

Plant and equipment – over 3 to 20 years

If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount.

The recoverable amount of plant and equipment is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cashflows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

(v) Revaluations

Fair value is determined by reference to market-based evidence, which is the amount for which the assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction as at the valuation date.

Any revaluation surplus is credited to the asset revaluation reserve included in the equity section of the balance sheet unless it reverses the revaluation decrease of the same asset previously recognised in the income statement.

Any revaluation deficit is recognised in the income statement unless it directly offsets a previous surplus of the same asset in the asset revaluation reserve.

An annual transfer from the asset revaluation reserve is made to retain earnings for the depreciation relating to the revaluation surplus.

In addition, any accumulated depreciation as at revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.

Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Independent valuations are performed with sufficient regularity to ensure that the carrying amount does not differ materially from the asset's fair value at the balance sheet date.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognised.

(vi) Exploration and Development Expenditure

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

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

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

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

Costs of site restoration are provided over the life of the facility from when exploration commences and are included in the costs of that stage. Site restoration costs include the dismantling and removal of mining plant, equipment and building structures, waste removal, and rehabilitation of the site in accordance with clauses of the mining permits. Such costs have been determined using estimates of future costs, current legal requirements and technology on an undiscounted basis.

Any changes in the estimates for the costs are accounted on a prospective basis. In determining the costs of site restoration, there is uncertainty regarding the nature and extent of the restoration due to community expectations and future legislation. Accordingly the costs have been determined on the basis that the restoration will be completed within one year of abandoning the site.



(vii) Borrowing costs

Borrowing costs are recognised as an expense when incurred.

(viii) Goodwill

Goodwill on acquisition is initially measured at cost being the excess of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is not amortised.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

As at acquisition date, any goodwill acquired is allocated to each of the cash-generating units expected to benefit from the combination synergies.

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

Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation.

Goodwill disposed of in the circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

(ix) Recoverable amount of assets

At each reporting date, the Group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of recoverable amount. Where the carrying value of an asset exceeds its recoverable amount the asset is considered impaired and is written down to its recoverable amount.

Recoverable amount is the greater of fair value less costs to sell and value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cashflows that are largely independent of those other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

In assessing value in use, the estimated future cashflows are discounted to their present value of money and the risks specific to the asset.

(x) Investments

All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

After initial recognition, investments, which are classified as available for sale, are measured at fair value.

Gains or losses on available-for-sale investments are recognised as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which point the cumulative gain or loss previously reported in equity is included in the income statement.

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.

Other long-term investments that are intended to be held-to-maturity, such as bonds, are subsequently measured at amortised cost using the effective interest method.

Amortised cost is calculated by taking into account any discount or premium on acquisition, over the period of maturity.

For investments carried at amortisation cost, gains and losses are recognised in income when the investments are derecognised or impaired, as well as through the amortisation process.

For investments that are actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the balance sheet date.

For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is subsequently the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

Purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place are recognised on the trade date i.e. the date that the Group commits to purchase the asset.

Parent's investments in the subsidiaries are accounted at "cost" per AASB 127. The management assess the carrying amount of such investments at each balance date, and any impairment therein is provided for.

C SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(xi) Inventories

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

Costs incurred in bringing each product to its present location and condition is accounted for as follows:

Raw materials – purchase cost on a first-in, first-out basis;

Finished goods and work-in-progress – cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

(xii) Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.

An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

(xiii) Cash and cash equivalents

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

For the purpose of cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(xiv) Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Gains and losses are recognised in the income statement when the liabilities are derecognised and as well as through the amortisation process.

(xv) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision in the income statement is net of any reimbursement.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of the money and, where appropriate, the risks specific to the liability.

When discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

(xvi) Share based payment transactions

The Group provides benefits to employees (including directors) of the Group in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ('equity-settled transactions').

The Company operates an Employee Share Option Plan (ESOP), which provides benefits to directors, senior executives, consultants and contractors.

The cost of these equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using the Binomial Tree and Black – Scholes models, taking into account the terms and conditions upon which options were granted.

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of European Gas Limited ('market conditions').

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('vesting date').

The cumulative expense recognised for equity-settled transactions at each reporting date until vesting date reflects (i) the extent to which the vesting period has expired and (ii) the number of awards that, in the opinion of the directors of the Group, will ultimately vest. This opinion is formed based on the best available information at balance date. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition.

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Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new award are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect, if any, of outstanding options is reflected as additional share dilution in the computation of earnings per share.

(xvii) Leases

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to the ownership of the leased items, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments.

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Lease where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and amortized over the lease term on the same bases as the lease income.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

(xviii) Revenue

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

Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and can be measured reliably. Risks and rewards are considered passed to the buyer at the time of delivery of the goods to the customer.

Stage of completion is measured by reference to labour hours incurred to date as a percentage of total estimated labour hours for each contract.

Where the contract cannot be measured reliably, revenue is recognised only to the extent of the expenses recognised that are recoverable.

Interest

Revenue is recognised as the interest accrues (using the effective interest method, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument) to the net amount of the financial asset.

Dividends

Revenue is recognised when the shareholders' right to receive the payment is established.

Rental income

Rental income arising on investment properties is accounted for on a straight-line basis over the lease term. Contingent rental income is recognised as income in the period in which it is earned.

(xix) Income tax

Deferred income tax is provided on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

- Except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction affects neither the accounting profit nor taxable profit or loss; and
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets and unused tax losses can be utilised:

- Except where the deferred income tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects the accounting profit nor taxable profit or loss; and
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which temporary differences can be utilised.

C SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

(xx) Other taxes

Income taxes relating to items recognised directly in equity are recognised in equity and not in the income statement.

Revenues, expenses and assets are recognised net of the amount of GST except:

- Where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Cash flows are included in the Cash Flow Statement on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows.

Commitments and contingencies are discussed net of the amount of GST recoverable from, or payable to, the taxation authority.

• AASB 1 Transitional exemptions

The Group has made its election in relation to the transitional exemptions allowed by AASB 1 'First-time Adoption of Australian Equivalents to International Financial Reporting Standards' as follows:

Business combinations

AASB 3 'Business Combinations' was not applied retrospectively of past business combinations (i.e. business combinations that occurred before the date of transition to AIFRS).

• Designation of previously amortized financial instruments

Financial instruments were designated as financial assets or liabilities at fair value through profit or loss or as available-for-sale at the date of transition to AIFRS.

Share-based payment transactions

AASB 2 'Share-Based Payments' is applied only to equity instruments granted after 7 November 2002 that had not vested on or before 1 January 2005.



Exemption from requirement to restate comparative information for AASB 132 and AASB 139.

D DISCONTINUED OPERATIONS

During 2007 the company continued negotiations for the sale of its Perth Basin exploration asset which requires satisfaction of conditions precedent. The company has agreed to an extension of time and the intending purchaser has accepted responsibility to meet all expenditure commitments until settlement of the sale which is likely to be completed in third quarter of 2007.

During 2007 the company completed the sale of the remainder of its Canning Basin exploration assets located in Western Australia.

The results of the discontinued operations for the year until disposal are presented below:

	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
Revenue				
– Sales – Crude oil	–	1,336,177	–	–
– Other income	–	103,505	–	44,564
– Interest revenue	–	–	–	211,650
– Rent	–	–	–	60,000
– Doubtful debts provision	–	–	–	2,208,115
– Write back of provision for investment	–	–	–	80,000
Total	–	1,439,682	–	2,604,329
Expenditure				
– Cost of sales	–	1,067,873	–	–
– Depreciation	–	197,456	–	–
– Amortisation	–	76,428	–	–
– Other	–	26,988	–	–
– Forgiveness of debt	–	–	–	886,836
Total	–	1,368,745	–	886,836
Profit/(loss) before tax from discontinued operations	–	70,937	–	1,717,493
Income tax:				
– Related to pre-tax profit/(loss)	–	–	–	–
Profit/(loss) for the year from discontinued operations	–	70,937	–	1,717,493

Notes to the Financial Statements for the year ended 30 June 2007 (continued)

D DISCONTINUED OPERATIONS (CONTINUED)

	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
ASSETS				
Intangible	-	208,000	-	-
Property, plant & equipment	-	1,823,360	-	1,505,500
Receivables	-	119,316	-	-
Other	-	36,287	-	-
Exploration, Evaluation & Development	54,447	2,866,447	54,447	1,279,343
Inventory	-	135,304	-	-
Cash & short term deposits	-	4,312	-	-
Assets classified as held for sale	54,447	5,193,026	54,447	2,784,843
LIABILITIES				
Trade creditors & accruals	-	140,798	-	-
Secured & unsecured loans	-	426,130	-	-
Deferred tax liability	-	750,000	-	-
Provisions	-	950,504	-	-
Liabilities directly associated with assets classified as held for sale	-	2,267,432	-	-
Net assets attributable to discontinued operations	54,447	2,925,594	54,447	2,784,843
Net cash inflow on disposal				
Operating activities	-	-	-	-
Investment activities	-	-	-	-
Financing activities	-	-	-	-
Net cash inflow/(outflow)	-	-	-	-



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
2 REVENUE				
Operating Activities				
– Interest received	562,067	258,660	1,061,665	361,530
– Administration and management fees [#]	18,000	24,000	920,493	168,000
– Other revenue	16,669	4,316	16,689	277,869
– Royalties	12,869	–	12,869	–
– Options reserve write-back	5,225	–	5,225	–
Total	614,830	286,976	2,016,941	807,399
*The parent entity provides management, geological, accounting, clerical and administrative services to the controlled entities.				
Discontinuing Activities				
– Sales revenue	–	1,336,177	–	–
– Other revenue	–	103,505	–	316,214
– Doubtful debts provision written back	–	–	–	2,208,115
– Investment provision	–	–	–	80,000
Total	–	1,439,682	–	2,604,329

Notes to the Financial Statements for the year ended 30 June 2007 (continued)



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
3 LOSS FROM ORDINARY ACTIVITIES				
Loss from ordinary activities before income tax has been determined after:				
EXPENSES				
Bad and doubtful debts				
– Wholly-owned subsidiaries	–	–	212	500,000
Total bad and doubtful debts	–	–	212	500,000
Borrowing costs:				
– Interest paid to banks	12,343	16,652	11,825	16,652
Total borrowing costs	12,343	16,652	11,825	16,652
Depreciation of non-current assets				
– Plant and equipment	25,558	11,374	25,558	11,374
Total depreciation	25,558	11,374	25,558	11,374
Foreign currency transaction losses	103,378	–	6,318	–
Total foreign currency transaction losses	103,378	–	6,318	–



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
4 INCOME TAX EXPENSE				
Major components of income tax expense for the years ended 30 June 2007 and 2006 are:				
Income statement				
Current income				
Current income tax charge	-	-	-	-
Deferred income tax				
Relating to origination and reversal of temporary differences	-	-	-	-
Benefit from previously unrecognised tax loss used to reduce deferred tax expense	-	-	-	-
Tax losses applied against subsidiaries taxable income				
Income tax expense (benefit) reported in income statement	-	-	-	-
Statement of changes in equity				
Current income tax				
Capital Raising Costs	-	-	-	-
Reversal of previously recognised deferred tax liability (Asset Revaluations)	(750,000)	750,000	-	-
Income tax expense reported in equity	(750,000)	750,000	-	-

Notes to the Financial Statements for the year ended 30 June 2007 (continued)

4 INCOME TAX EXPENSE (continued)

A reconciliation of income tax expense (benefit) applicable to accounting profit before income tax at the statutory income tax rate to income tax expense at the company's effective income tax rate for the years ended 30 June 2007 and 2006 is as follows:

	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
Accounting profit (loss) before tax from continuing operations	(1,950,156)	(760,236)	(416,243)	(702,578)
Profit before tax from discontinued operations	–	70,937	–	1,717,493
Accounting profit (loss) before income tax	(1,950,156)	(689,299)	(416,243)	1,014,915
At the statutory income tax rate of 30% (2006: 30%)	(585,047)	(206,790)	(124,873)	304,475
Temporary difference not brought to account as a DTA	229,294	–	229,294	–
Non-deductible expenses	632,799	13,791	632,799	13,790
Amounts charged to equity	–	–	–	–
Deferred tax assets relating to losses not brought to account for the Australian Consolidated Group	(277,046)	192,999	(737,220)	(318,265)
Income tax expense	–	–	–	–
Income tax expense reported in income statement	–	–	–	–
Income tax attributable to discontinued operations	–	–	–	–
Effective income tax rate	0%	0%	0%	0%

Tax consolidation

The Company and its 100% owned controlled entities have formed a tax consolidated group. Members of the Consolidated Entity have entered into a tax sharing arrangement in order to allocate income tax expense to the wholly owned controlled entities on a pro-rata basis. The agreement provides for the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. At balance date, the possibility of default is remote. The head entity of the tax consolidated group is European Gas Ltd.

Tax effect accounting by members of the tax consolidated group

Members of the tax consolidated group have entered into a tax funding agreement. The tax funding agreement provides for the allocation of current taxes to members of the tax consolidated group. Deferred taxes are allocated to members of the tax consolidated group in accordance with a group allocation approach which is consistent with the principles of AASB 112 Income Taxes.

The allocation of taxes under the tax funding agreement is recognised as an increase/decrease in the member entities' inter-company accounts with the tax consolidated group head company, European Gas Ltd. In this regard the Company has assumed the benefit of tax losses from the member entities as of the balance date. The nature of the tax funding agreement is such that no tax consolidation contributions by or distributions to equity participants are required.



Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

CONSOLIDATED	Assets		Liabilities		Net	
	2007 \$	2006 \$	2007 \$	2006 \$	2007 \$	2006 \$
Exploration	-	-	16,334	383,803	16,334	383,803
Interest receivable	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	-	-
Accrued superannuation	(2,776)	(3,462)	-	-	(2,776)	(3,462)
Accrued audit fees	(7,500)	(3,600)	-	-	(7,500)	(3,600)
Employee Entitlements	(6,058)	(9,000)	-	-	(6,058)	(9,000)
Provision – annual report	-	(4,500)	-	-	-	(4,500)
Tax losses	-	(363,241)	-	-	-	(363,241)
Tax (assets) liabilities	(16,334)	(383,803)	16,334	383,803	-	-
Set off of tax	-	-	-	-	-	-
Net tax (assets) liabilities	(16,334)	(383,803)	16,334	383,803	-	-

Deferred income tax

Deferred income tax at 30 June relates to the following:

CONSOLIDATED

Movement in temporary differences during the year	Balance 1 July 2005 \$	Recognised in income \$	Recognised in equity \$	Balance 30 June 2006 \$
Capitalised expenditure deductible for tax purposes	317,352	66,451	-	383,803
Employee benefit provisions	(6,668)	(2,332)	-	(9,000)
Accrued superannuation	(3,304)	(158)	-	(3,462)
Accrued audit fees	(4,200)	600	-	(3,600)
Provision for annual report	(3,900)	(600)	-	(4,500)
Provision for site restoration	(22,928)	22,928	-	-
Tax losses	(276,352)	(86,889)	-	(363,241)
	-	-	-	-
Movement in temporary differences during the year	Balance 1 July 2006 \$	Recognised in income \$	Recognised in equity \$	Balance 30 June 2007 \$
Capitalised expenditure deductible for tax purposes	383,803	(367,469)	-	16,334
Employee benefit provisions	(9,000)	2,942	-	(6,058)
Accrued superannuation	(3,462)	686	-	(2,776)
Accrued audit fees	(3,600)	(3,900)	-	(7,500)
Provision for annual report	(4,500)	4,500	-	-
Tax losses	(363,241)	363,241	-	-
	-	-	-	-

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Notes to the Financial Statements for the year ended 30 June 2007 (continued)

4 INCOME TAX EXPENSE (continued)

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

PARENT	Assets		Liabilities		Net	
	2007 \$	2006 \$	2007 \$	2006 \$	2007 \$	2006 \$
Exploration	-	-	16,334	383,803	16,334	383,803
Interest receivable	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	-	-
Accrued superannuation	(2,776)	(3,462)	-	-	(2,776)	(3,462)
Accrued audit fees	(7,500)	(3,600)	-	-	(7,500)	(3,600)
Employee entitlements	(6,058)	(9,000)	-	-	(6,058)	(9,000)
Provision – annual report	-	(4,500)	-	-	-	(4,500)
Tax losses	-	(363,241)	-	-	-	(363,241)
Tax (assets) liabilities	(16,334)	(383,803)	16,334	383,803	-	-
Set off of tax	-	-	-	-	-	-
Net tax (assets) liabilities	(16,334)	(383,803)	16,334	383,803	-	-

Deferred income tax

Deferred income tax at 30 June relates to the following:

PARENT

Movement in temporary differences during the year	Balance 1 July 2006 \$	Recognised in income \$	Recognised in equity \$	Balance 30 June 2007 \$
Capitalised expenditure deductible for tax purposes	329,783	54,020	-	383,803
Employee benefit provisions	(6,668)	(2,332)	-	(9,000)
Accrued superannuation	(3,304)	(158)	-	(3,462)
Accrued audit fees	(4,200)	600	-	(3,600)
Provision for annual report	(3,900)	(600)	-	(4,500)
Provision for site restoration	(22,928)	22,928	-	-
Tax losses	(288,783)	(74,458)	-	(363,241)
	-	-	-	-
Movement in temporary differences during the year	Balance 1 July 2006 \$	Recognised in income \$	Recognised in equity \$	Balance 30 June 2007 \$
Capitalised expenditure deductible for tax purposes	383,803	(367,469)	-	16,334
Employee benefit provisions	(9,000)	2,942	-	(6,058)
Accrued superannuation	(3,462)	686	-	(2,776)
Accrued audit fees	(3,600)	(3,900)	-	(7,500)
Provision for annual report	(4,500)	4,500	-	-
Tax losses	(363,241)	363,241	-	-
	-	-	-	-



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
Unrecognised Deferred Tax Balances				
International exploration costs*	(10,063,025)	–	(10,063,025)	–
Unrecognised deferred tax asset losses				
– Domestic Tax losses	651,862	258,455	245,633	238,655
– International Tax losses**	10,063,025	–	10,063,025	–
– Capital losses	338,143	–	338,143	–
Unrecognised deferred tax asset other	–	17,100	60,416	17,100
Unrecognised deferred tax liabilities	–	(1,450,262)	–	–
	990,005	(1,174,707)	644,192	255,755

The tax losses do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available against which the company can utilise benefits.

* Overseas capitalised exploration has not yet been verified if it is able to be claimed as a tax deduction.

** The ability of international tax losses to be deducted against future taxable profits of international subsidiaries have not yet been verified.

	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
5 CASH ASSETS				
Cash at bank and deposit	5,071,019	13,507,090	667,617	13,489,325
Total Cash	5,071,019	13,507,090	667,617	13,489,325
6 RECEIVABLES				
Current				
– Trade receivables	481,178	303,543	292,662	493,762
Total Current Receivables	481,178	303,543	292,662	493,762
Non-Current				
– Owing from controlled entities*	–	275,286	16,588,240	2,043,331
– Provision for doubtful debts	–	–	–	(500,212)
Total Non-Current Receivables	–	275,286	16,588,240	1,543,119

* Recovery of the amount is dependent upon successful exploitation of mining interests within the subsidiaries.

Notes to the Financial Statements for the year ended 30 June 2007 (continued)



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
7 OTHER ASSETS				
CURRENT				
Prepayments	18,000	176,434	18,000	50,354
	18,000	176,434	18,000	50,354

8 AVAILABLE FOR SALE FINANCIAL ASSETS				
NON-CURRENT				
Investments in listed shares, at fair value	2,618,370	–	2,618,370	–
	2,618,370	–	2,618,370	–

	COUNTRY OF INCORPORATION	PERCENTAGE OWNED (%)	
		2007	2006
9 CONTROLLED ENTITIES			
(a) Controlled entities and their contribution to consolidated loss			
Parent Entity:			
– European Gas Limited	Australia		
Subsidiaries of European Gas Limited:			
– Otto Oil Pty Ltd	Australia	100	100
– Terratek Drilling Tools Pty Ltd	Australia	–	100
– Kimberley Oil Remediation Pty Ltd	Australia	–	100
– European Gas Limited (UK)	United Kingdom	100	100
– Heritage Petroleum plc	United Kingdom	100	–

Note: European Gas Limited (UK) was incorporated in the United Kingdom on 1/1/2005 to hold and manage the company's European exploration and development operations. A branch of the company is also registered in France.

On the 1 February 2007 the company acquired Heritage Petroleum plc for a consideration of fully paid shares, options and cash. Heritage Petroleum holds a 25% equity in the three French licences and currently 100% of the three Tuscany applications.



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	ECONOMIC ENTITY \$	PARENT ENTITY \$
The following consideration was paid:		
Cash (£0.015 per share and options/warrants in the money)	2,299,283	2,299,283
Shares in European Gas Limited (31,509,298 valued @ \$0.70 each)	22,056,509	22,056,509
Options in European Gas Limited (1,546,769 exercisable @ \$1 each anytime prior to 28/02/2009)	-	-
	24,355,792	24,355,792

HERITAGE PETROLEUM PLC
\$

The financial assets and liabilities of Heritage Petroleum plc at the date of acquisition were:

Cash	1,344,302
Receivables	49,435
Payables	(206,864)
Net financial assets	1,186,873

The consideration in excess of the above net financial assets represented the Group's cost for acquiring Heritage Petroleum's interests in the exploration assets.

	ECONOMIC ENTITY \$	PARENT ENTITY \$
The Group's interest in Terratek Drilling Tools Pty Ltd Kimberley Oil Remediation Pty Ltd were disposed off during the year for the following consideration:		
- 8 million shares in Golden Dynasty Resources (GDR), a Canadian company listed on the Toronto Stock Exchange.	571,498	571,498
	571,498	571,498

Notes to the Financial Statements for the year ended 30 June 2007 (continued)



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
10 PROPERTY, PLANT AND EQUIPMENT				
Land & Buildings				
– At cost	169,698	–	169,698	–
	169,698	–	169,698	–
– Accumulated depreciation	–	–	–	–
Total land and buildings	169,698	–	169,698	–
Plant and equipment				
– At cost	378,487	126,566	378,487	47,968
– Broome facilities – At written down valuation	–	1,505,500	–	1,505,500
– Production assets – At directors valuation	–	500,000	–	–
	378,487	2,132,066	378,487	1,553,468
– Accumulated depreciation	(52,440)	(287,620)	(52,440)	(26,882)
Total property, plant and equipment	326,047	1,844,446	326,047	1,526,586
Continuing operations	326,047	21,086	326,047	21,086
Discontinued operations	–	1,823,360	–	1,505,500
Total property, plant and equipment	326,047	1,844,446	326,047	1,526,586

(a) MOVEMENTS IN CARRYING AMOUNTS

Movement in the carrying amounts for plant and equipment between the beginning and end of current financial years.

	PROPERTY, PLANT AND EQUIPMENT	TOTAL
Economic entity		
– Balance at the beginning of the year	1,844,446	1,844,446
– Additions	330,519	330,519
– Depreciation	(25,558)	(25,558)
– Disposals	(1,823,360)	(1,823,360)
Carrying amount at the end of the year	326,047	326,047
Parent entity:		
– Balance at the beginning of the year	1,526,586	1,526,586
– Additions and transfer from subsidiary	330,519	330,519
– Depreciation	(25,558)	(25,558)
– Disposals	(1,505,500)	(1,505,500)
Carrying amount at the end of the year	326,047	326,047



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ECONOMIC ENTITY		PARENT ENTITY	
2007	2006	2007	2006
\$	\$	\$	\$

11. EXPLORATION AND DEVELOPMENT EXPENDITURE

Exploration expenditure costs carried forward in respect of areas of interest in:

– Pre-Production:

– Exploration and evaluation phases – at cost

Balance at the beginning of the year	4,326,581	3,549,251	1,279,344	1,133,824
Expenditure incurred	11,095,109	777,330	58,426	1,451,002
Disposals	(2,819,958)	–	(1,283,323)	–
Transfers to subsidiaries – refer note below	–	–	–	(1,305,482)
Acquisitions – refer note below	21,162,778	–	–	–
Write-offs	(166,647)	–	–	–
Balance at the end of the year	33,597,863	4,326,581	54,447	1,279,344

– Production:

– Development expenditure – at cost

Balance at the beginning of the year	–	1,811,085	–	–
Balance at the end of the year	–	1,811,085	–	–

– Accumulated Amortisation

– Development expenditure – at cost

Balance at the beginning of the year	–	(1,811,085)	–	–
Balance at the end of the year	–	(1,811,085)	–	–
Net Development & Production Costs	–	4,326,581	–	1,279,344

Continuing operations	33,543,416	1,460,134	–	–
Discontinued operations	54,447	2,866,447	54,447	1,279,344
Balance at the end of the year	33,597,863	4,326,581	54,447	1,279,344

Ultimate recoupment of costs carried forward for exploration and evaluation phases is dependent on successful development & commercial exploitation or sale of the respective exploration areas.

11. EXPLORATION AND DEVELOPMENT EXPENDITURE (continued)

In order to maintain an interest in the mining and exploration tenements in which the consolidated entity is involved, the consolidated entity is committed to meeting the conditions under which the permits are granted and the obligations of any joint venture agreements. The timing and amount of exploration expenditure commitments and obligations of the consolidated entity are subject to the minimum expenditure commitments required by the relevant country and state Authorities, and may vary significantly from the forecasts based upon the results of the work performed which will determine the prospectivity of the relevant areas of interest.

a) Exploration work

The company has certain obligations to perform minimum exploration work and expend minimum amounts of money on its coal mine and coal methane and petroleum permits. Programs for the next 12 months in Europe and Australia are expected to amount to \$13,638,798 (2006: \$6,647,454). No estimate has been given beyond 12 months as this is dependent on the director's ongoing assessment of operations.

b) The company has future commitments with various suppliers for the provision of office and accommodation facilities.

	ECONOMIC ENTITY	
	2007	2006
	\$	\$

12 ESTIMATED EXPEDITURE COMMITMENTS

Europe and Australia

– 0-1 year	2,974,382	1,534,541
– 1-5 years	4,665,598	5,112,913
– > 5 years	370,495	–
Total	8,010,475	6,647,454

The company has entered into agreements to dispose of all its exploration permits in Australia subsequent to the end of the financial year. The conditions of the sale require the purchaser to assume responsibility for all outstanding work commitments.

	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$

13 PAYABLES AND ACCRUALS

Trade creditors and accrued expenses	3,109,943	755,686	3,109,945	480,421
Total Payables	3,109,943	755,686	3,109,945	480,421



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
14 CONTRIBUTED EQUITY				
198,155,662 (2006: 161,511,364) fully paid ordinary shares				
(a) Ordinary shares	47,825,666	25,160,908	47,825,666	25,160,908

Effective 1 July 1998, the Company Law Review Act abolished the concept of par value shares and the concept of authorised capital.

Accordingly, the company does not have authorised capital or par value in respect of its issued shares.

	2007	PARENT ENTITY		2006
	\$	2006	2007	2006
	\$	\$	No.	No.
(a) Ordinary shares				
At the beginning of the reporting period	25,160,908	11,915,408	161,511,364	137,996,364
Shares issued during the year				
– Shares issued for cash	–	13,650,000	–	21,000,000
– Shares issued on conversion of options	608,250	278,000	5,135,000	2,515,000
– Shares issued in consideration for 100% of issued capital of Heritage Petroleum plc	22,056,508	–	31,509,298	–
– Cost of issue	–	(682,500)	–	–
At reporting date	47,825,666	25,160,908	198,155,662	161,511,364

Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held.

At the shareholders meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

14 CONTRIBUTED EQUITY (continued)

b) Options

The following options to issue ordinary shares were on issue as at 30 June 2007 (see Note (15) for details on share based payments and employee share option plan. All options outstanding are over unissued shares in European Gas Limited.

		2007		2006	
		Number	Exercise Price	Number	Exercise Price
Economic Entity and parent Entity					
Shares issued during year	Number	Exercise price			
Unlisted options					
– 23 May 2006	–	\$0.200	1,385,000	\$0.20	
– 25 August 2008	1,000,000	\$0.200	1,250,000	\$0.20	
– 28 November 2006	–	\$0.075	1,750,000	\$0.20	
– 28 November 2008	–	\$0.100	1,750,000	\$0.10	
– 28 November 2008	4,000,000	\$1.000	–	–	
– 28 November 2010	4,000,000	\$1.500	–	–	
– 28 February 2009	1,546,769	\$1.000	–	–	
	10,546,769		6,135,000		

i. For information relating to the European Gas Limited employee options plans, including details of options issued, exercised and lapsed during the financial year and options outstanding at year-end refer to Note (15) Share-based Payments.

ii. For information relating to share options issued to key management personnel during the financial year, refer to the remuneration report.

15. SHARE BASED PAYMENTS

The following share-based payments arrangements existed at 30 June 2007:

The company established the European Gas Limited (formerly Kimberley Oil NL) Share Option Incentive Plan in 2000 (Plan). The board in its absolute discretion may invite eligible participants to join the Plan based on its assessment of the prospective participant's contribution to the performance of the group. The total number of Shares to issue upon exercise of Options subject to the Plan at any time, together with any other shares which may be issued under, or which are the subject of, any other of the company's employees share or option incentive schemes, shall not represent more than 10% of the number of the shares on issue in the company at the time of the issue of the options under the Plan. The terms and conditions applicable to options granted will be as determined from time to time by the board in its absolute discretion at the time of the grant of the option's and options may be granted upon different terms and conditions to those applicable to any other options granted.

In general meeting in November 2006 the company approved the renewal and upgrade of the Employee Share Option Plan ("Incentive Plan") to ensure it complied with listing rule 7.2 of the Australian Stock Exchange and to ensure the Incentive Plan continued to meet the future objectives of the company. The grant of options is designed to encourage the recipients to have a greater involvement in the achievement of the company's objectives and to provide an incentive to directors by participating in the future growth and prosperity of the company through share ownership.

In May 2002 a grant of options exercisable at \$0.20 on or before 23 May 2007 was made to directors and employees pursuant to the terms of the Plan and shareholder approval. In addition, in August 2005 the board approved a grant of 1,250,000 plan options to senior personnel exercisable at \$0.10 (representing a premium of approximately 30% to the prevailing market price on ASX as at the date of grant) on or before 25 August 2008. A total of 635,000 (2006: 2,000,000) Plan options were exercised during the current financial year at a weighted average price of \$0.16 (2006: \$0.20). There were no options of this series outstanding at balance date.



Pursuant to shareholder approval in general meeting in November 2003 the company approved the grant of 5,500,000 Director Options (Series A and B). The exercise price of the options is 10 cents and 7.5 cents each for Series A and Series B Director Options respectively. The Series A Director Options are exercisable at any time on or prior to the date which is 5 years after the date of the meeting to approve the grant of the options. The Series B Director Options are exercisable at any time on or prior to the date which is 3 years after the date of the meeting to approve the grant of the options. During the current financial period a total of 3,500,000 (2006: 2,000,000) Director Options were exercised at a weighted average price of \$0.0875 (2006: \$0.0875).

Pursuant to shareholder approval in general meeting in November 2006 the Company approved the grant of a second series of Director Options (Series A and B). A total of 8,000,000 Director Options were approved. The exercise price of the options is \$1.00 and \$1.50 each for Series A and Series B Director Options respectively. The Series A Director Options are exercisable at any time on or prior to the date which is 2 years after the date of the meeting to approve the grant of the options. The Series B Director Options are exercisable at any time on or prior to the date which is 4 years after the date of the meeting to approve the grant of the options.

Except in prescribed circumstances, all options lapse on the day that is 20 business days after the termination of employment or office of the option holder. The options in each of the abovementioned series were fully vested from the date of grant, are un-listed and contain restrictions on transfer.

All options granted to directors in European Gas Limited, which confer a right of one ordinary share for every option held.

	Economic Entity and parent Entity			
	2007		2006	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Outstanding at the beginning of the year	6,135,000	0.115	7,400,000	0.116
Granted	8,000,000	1.250	1,250,000	0.100
Forfeited	–	–	–	–
Exercised	5,135,000	0.119	2,515,000	0.110
Expired	–	–	–	–
Outstanding at year-end	9,000,000	1.122	6,135,000	0.115
Exercisable at year-end	9,000,000	1.122	6,135,000	0.115

A total of 5,135,000 were exercised during the year ended 30 June 2007 (2006: 2,515,000).

The options outstanding at 30 June 2007 had a weighted average exercise price of \$1.122 and a weighted average remaining contractual life of 2.2 years. Exercise prices range from \$0.10 to \$1.50 in respect of options outstanding at 30 June 2007.

The weighted average fair value of the options granted during the year was \$0.243.

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15. SHARE BASED PAYMENTS (continued)

This price was calculated by using a Binomial tree option pricing model applying the following inputs:

Weighted average exercise price	\$1.250
Estimated term of the options	3 years
Underlying share price	\$0.80
Expected share price volatility	60.0%
Risk free interest rate	5.59%

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options) adjusted for any unexpected changes to future volatility due to publicly available information.

Included under employee benefits expense in the income statement is \$1,944,000 (2006: \$26,132), and relates, in full, to equity-settled share-based payment transactions.

16. RESERVES

Economic entity For the year ending 30 June 2007	Option valuation reserve \$	Asset revaluation reserve \$	Foreign currency translation reserve \$	Available for sale investments reserve \$	Total \$
Balance at the beginning of the year	26,132	1,750,000	–	–	1,776,132
Options granted during the year	1,944,000	–	–	–	1,944,000
Options exercised during the year	(5,225)	–	–	–	(5,225)
Transfer to retained earnings upon disposal of the asset	–	(1,750,000)	–	–	(1,750,000)
Movement in fair value of available for sale investments	–	–	–	(278,128)	(278,128)
Effect of translation of functional currency to presentation currency of subsidiary.	–	–	(1,286,196)	–	(1,286,196)
Tax on movements in reserves	–	–	–	–	–
Balance at the end of the year	1,964,907	–	(1,286,196)	(278,128)	400,583
For the year ending 30 June 2006					
Balance at the beginning of the year	–	1,750,000	–	–	1,750,000
Options granted during the year	26,132	–	–	–	26,132
Balance at the end of the year	26,132	1,750,000	–	–	1,776,132



Parent entity For the year ending 30 June 2007	Option valuation reserve \$	Available for sale invesments reserve \$	Total \$
Balance at the beginning of the year	26,132	–	26,132
Options granted during the year	1,944,000	–	1,944,000
Options exercised during the year	(5,225)	–	(5,225)
Movement in fair value of available for sale investments	–	(278,128)	(278,128)
Tax on movements in reserves	–	–	–
Balance at the end of the year	1,964,907	(278,128)	1,686,779
For the year ending 30 June 2006			
Balance at the beginning of the year	–	–	–
Options granted during the year	26,132	–	26,132
Balance at the end of the year	26,132	–	26,132

	ECONOMIC ENTITY 2007 \$	2006 \$	PARENT ENTITY 2007 \$	2006 \$
17. ACCUMULATED LOSSES				
Accumulated losses at the beginning of the financial year	(9,023,559)	(8,334,260)	(7,284,972)	(8,299,887)
Transfer from asset revaluation reserve	1,750,000	–	–	–
– Net loss attributable to the members of the parent entity	(1,950,156)	(689,299)	(416,243)	1,014,915
Accumulated losses at the end of the financial year	(9,223,715)	(9,023,559)	(7,701,215)	(7,284,972)

Notes to the Financial Statements for the year ended 30 June 2007 (continued)



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	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
18. CASH FLOW INFORMATION				
(a) RECONCILIATION OF CASH				
Cash at the end of the financial year as shown in the statement of cash flows is reconciled to items in the statement of financial position as follows:				
Cash at Bank	5,071,019	13,511,402	667,617	13,489,325
(b) RECONCILIATION OF CASH FLOW FROM OPERATIONS WITH LOSS FROM ORDINARY ACTIVITIES AFTER INCOME TAX				
Loss from ordinary activities after income tax	(1,950,156)	(689,299)	(416,243)	1,014,915
Non-cash flows in loss from ordinary activities				
Depreciation of non-current assets	25,558	208,830	25,558	11,374
Amortisation of non-current assets	–	26,000	–	–
Provision for restoration	–	76,428	–	–
Staff options valuation	1,938,775	26,132	1,938,775	26,132
Profit on sale of fixed assets	(1,836,178)	–	(1,620,447)	–
Profit on sale of subsidiary	(430,747)	–	(571,498)	–
Loss on sale of fixed assets	–	4,409	–	3,872
Interest & management fees (charged / undercharged to subsidiaries)	–	–	(1,527,615)	291,038
Write-off exploration expenditure	166,647	–	–	–
Changes in assets and liabilities				
(Increase)/decrease in trade receivables	(74,407)	(335,677)	190,137	(452,025)
Increase/(decrease) in trade and other creditors	–	175,292	2,681,487	(10,855)
(Increase)/decrease in other current assets/prepayments	–	(41,222)	(8,646)	(39,993)
(Increase)/decrease in inventory	–	13,919	–	–
Increase/(decrease) in provisions	(9,806)	(32,226)	(500,000)	(1,794,341)
Cash Flows From /(Used in) Operations	(2,170,314)	(567,414)	191,508	(949,883)
(c) NON-CASH FINANCING AND INVESTING ACTIVITIES				
There are no known commitments outstanding as at 30 June 2007.				
(d) CREDIT STANDBY ARRANGEMENTS WITH BANKS				
Credit facility – bank overdraft	250,000	250,000	250,000	250,000
amount utilised	–	–	–	–
Unused and available credit facility	250,000	250,000	250,000	250,000

Bank Overdraft

The bank overdraft facility is arranged with an Australian bank with general terms and conditions being set and reviewed annually. Interest rates are variable and subject to review and adjustment.



19. CONTINGENT LIABILITIES

The parent entity has provided guarantees to third parties in relation to the performance and obligations of controlled entities in respect to banking services and operating facilities. The guarantees are for the term of the facilities.

- A bank has provided a performance guarantee to the landlord of a rental property to the value of \$95,133 to secure future commitments. The guarantee is secured by a fixed term deposit for an equivalent amount.

20. AUDITORS REMUNERATION

	ECONOMIC ENTITY		PARENT ENTITY	
	2007	2006	2007	2006
	\$	\$	\$	\$
Audit services:				
– auditing services				
a) Bentleys	30,000	17,800	30,000	17,800
b) PKF	25,000	–	25,000	–
c) Haines Watts	1,065	11,984	–	–
	56,065	29,784	55,000	17,800
– other services				
a) Bentleys	32,939	23,955	32,939	23,955
b) PKF	64,610	–	64,610	–
c) Haines Watts	3,975	–	–	–
	101,524	23,955	97,549	23,955
Total Auditors Remuneration	157,589	53,739	152,549	41,755

Notes to the Financial Statements for the year ended 30 June 2007 (continued)

21. SEGMENT REPORTING

In presenting information on the basis of geological segments, segment revenue is based on the geological location of customers. Segment assets are based on the geographical location of the assets.

The consolidated entity's business segments operate geographically as follows:

Europe	Coal bed and coal mine methane exploration activities in Europe.
Australia	Management, financial, accounting and secretarial services.

GEOGRAPHICAL SEGMENTS	EUROPE		AUSTRALIA		DISCONTINUED OPERATIONS		TOTAL OPERATIONS	
	2007	2006	2007	2006	2007	2006	2007	2006
	\$	\$	\$	\$	\$	\$	\$	\$
REVENUE								
From external customers	–	–	47,538	28,316	–	103,505	47,538	131,821
<i>Unallocated income:</i>								
- Interest income							562,067	258,660
- Profit on sale of assets							1,836,178	–
- Profit on sale of subsidiary							430,747	–
- Other unallocated income							5,225	–
Total revenue							2,881,755	390,481
RESULTS								
Segment results	(1,787,218)	(323,245)	47,538	24,736	–	70,937	(1,739,680)	(227,572)
<i>Unallocated expenditure:</i>								
- Option valuations							(1,944,000)	(26,132)
- Other unallocated expenses							(1,100,694)	(694,255)
Profit (loss) before income tax							(1,950,156)	(689,299)
- Income tax expense							–	–
Net profit/(loss) for the year							(1,950,156)	(689,299)
ASSETS								
Segment assets	38,620,410	15,283,510	–	460,063	54,447	5,193,026	38,674,857	20,936,599
Unallocated assets							3,437,620	–
Total assets	38,620,410	15,283,510	–	460,063	54,447	5,193,026	42,112,477	20,936,599
LIABILITIES								
Segment liabilities	3,064,749	700,352	–	13,334	–	1,517,432	3,064,749	2,231,118
Unallocated liabilities							45,194	792,000
Total liabilities	3,064,749	700,352	–	13,334	–	1,517,432	3,109,943	3,023,118
OTHER SEGMENT INFORMATION								
- Depreciation	25,558	–	–	–	–	197,456	25,558	197,456
- Amortisation	–	–	–	–	–	76,428	–	76,428
Capital additions during the year	32,562,847	1,218,511	–	53,782	–	–	32,562,847	1,272,293

Accounting policies relating to segment reporting are contained within the notes to the Financial Statements.



22. SUPERANNUATION COMMITMENTS (LEVY)

European Gas Limited has an arrangement, with Optimum Corporate Tyndall Superannuation Ltd (Trustee) as a participating employer under the Trust Deed whereby it nominates employees for whom superannuation is to be provided. The fund is registered as the Optimum Superannuation Master Plan and is a complying superannuation fund.

Eligible employees are invited to join the Fund and are entitled to varying benefits on retirement, disability or death. The end benefit is determined by the members' accumulation of contributions and earnings of the fund. The economic entity makes contributions to the fund currently at the rate of 9% of gross salaries and wages for those employees who have joined the fund. The company has no other liability to the Trustee other than the remittance of the superannuation contributions.

The economic entity also makes contributions to other unrelated funds on behalf of other employees who by their own choice have nominated alternative funds to receive the superannuation contributions.

These contributions are legally enforceable in Australia.

23. DIRECTOR AND EXECUTIVE DISCLOSURES FOR DISCLOSING ENTITIES

Disclosures of remuneration policies, service contracts and details of remuneration are included in the Remuneration Report on pages 18 to 23.

Other transactions with the Company or its controlled entities

There were no other transactions with specified directors or their personally related entities.

24 RELATED PARTY TRANSACTIONS

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

Transactions with related parties:

- i. European Gas Limited makes periodic unsecured advances, repayable on demand, to its wholly owned subsidiaries:
- ii. European Gas Limited charged administration fees and management fees of \$920,493 (2006: \$168,000) to controlled entities for the provision of management, geological, administrative, accounting and clerical services.
- iii. European Gas Limited charged interest of \$499,598 (2006: \$158,520) to controlled entities at commercial rates on the average monthly balances outstanding on unsecured loans.
- iv. European Gas Limited charged a 15% overhead cost against exploration expenditure excluding cash payments.

Other key management disclosures are contained within the Remuneration Report and Note (27).

European Gas Limited is the parent entity of the economic entity.

25. EARNINGS PER SHARE

The calculation of basic loss per share at 30 June 2007 was based on the loss attributable to ordinary shareholders of \$1,950,156 (2006: \$689,299) and a weighted average number of ordinary shares outstanding during the financial year ended 30 June 2007 of 177,713,564 (2006: 144,658,350), calculated as follows:

	ECONOMIC ENTITY	
	2007	2006
	\$	\$
a. Loss attributable to ordinary shareholders		
Loss used in the calculation of basic and dilutive EPS	1,950,156	689,299
b. Reconciliation of earnings to profit or loss from continuing operations		
Earnings used in the calculation of basic and dilutive EPS from continuing operations	1,950,156	760,236
c. Reconciliation of earnings to profit or loss from discontinuing operations		
Earnings used to calculate basic EPS from discontinuing operations	–	70,937
	No.	No.
d. Weighted average number of ordinary shares outstanding during the year used in calculating basic EPS	177,713,564	144,658,350
Weighted average number of dilutive options outstanding	2,276,151	7,492,124
Weighted average number of ordinary shares outstanding during the year used in calculating dilutive EPS	179,989,715	152,150,474
e. Diluted earnings per share is not reflected for discontinuing operations as the result is anti-dilutive in nature	–	–



26. FINANCIAL INSTRUMENTS

(a) TERMS, CONDITIONS, AND ACCOUNTING POLICIES

The economic entity's accounting policies, including the terms and conditions of each class of financial asset, financial liability and equity instrument, both recognised and unrecognised at the balance date, are as follows:

RECOGNISED FINANCIAL INSTRUMENTS	STATEMENT OF FINANCIAL POSITION NOTES	ACCOUNTING POLICIES	TERMS & CONDITIONS
<i>(i) Financial Assets</i>			
Cash	5	Cash represents cash on hand and at bank with financial institutions. All cash is carried at nominal amounts.	
Receivables – Current and Non-Current	6	Trade receivables are carried at nominal amounts due less any provision for doubtful debts. A provision	Credit sales are normally on 30 day terms.
<i>(ii) Financial Liabilities</i>			
Payables and Accruals	14	Liabilities are recognised for amounts to be paid in the future for goods and services received, whether or not billed to the consolidated entity.	Trade liabilities are normally settled on 45 day terms.
<i>(iii) Equity</i>			
Ordinary Shares	16	Ordinary share capital is recognised at the amount paid-up	Details of shares issued are set out in note 14.

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Notes to the Financial Statements for the year ended 30 June 2007 (continued)

26. FINANCIAL INSTRUMENTS (continued)

2007

FINANCIAL INSTRUMENT	FLOATING INTEREST RATE	FIXED INTEREST RATE 0-1 YEAR	NON-INTEREST BEARING 0-1 YEAR	TOTAL	WEIGHTED AVERAGE EFFECTIVE INTEREST RATE 0-1 YEAR
(i) Financial Assets					
Cash	5,071,019	–	–	5,071,019	6.00%
Receivables	–	–	481,178	481,178	N/A
Total Financial Assets	5,071,019	–	481,178	5,552,197	
(ii) Financial Liabilities					
Trade creditors & accruals	–	–	3,109,943	3,109,943	N/A
Interest bearing liabilities	–	–	–	–	N/A
Total Financial Liabilities	–	–	3,109,943	3,109,943	

2006

FINANCIAL INSTRUMENT	FLOATING INTEREST RATE	FIXED INTEREST RATE 0-1 YEAR	NON-INTEREST BEARING 0-1 YEAR	TOTAL	WEIGHTED AVERAGE EFFECTIVE INTEREST RATE 0-1 YEAR
(i) Financial Assets					
Cash	13,507,09	–	–	13,507,090	5.50%
Receivables	–	–	303,543	303,543	N/A
Total Financial Assets	13,507,090	–	303,543	13,810,633	
(ii) Financial Liabilities					
Trade creditors & accruals	–	–	755,686	755,686	N/A
Interest bearing liabilities	–	–	–	–	N/A
Total Financial Liabilities	–	–	755,686	755,686	

(b) NET FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The aggregate net fair values of financial assets and financial liabilities, at the balance date, are approximated by their carrying value as represented on the Balance Sheet.

(c) CREDIT RISK EXPOSURES

This economic entity's maximum exposure to credit risk at balance date in relation to each class of recognised financial asset is the carrying amount, net of any provision for doubtful debts, of those assets as indicated in the Balance Sheet.

27. KEY MANAGEMENT PERSONNEL DISCLOSURES

Names and positions held of economic and parent entity key management personnel in office at any time during the financial year are:

Key Management Person	Position
Anthony McClure	Managing Director
Alan Flavelle	Executive Director
Terence Willstead	Non-executive Director



Individual directors and executives compensation disclosures

Information regarding individual directors and executives compensation is provided in the Remuneration Report section of the Directors' report on pages 18 to 23.

Apart from the details disclosed in this note and page 19 of the remuneration report, no director has entered into a material contract with the Company or the consolidated entity since the end of the previous financial year and there were no material contracts involving directors' interests existing at year-end.

There were no loans outstanding at the reporting date and no loans made during the reporting period to key management personnel.

Options and rights over equity instruments granted as compensation

The movement during the reporting period in the number of options over ordinary shares in European Gas Limited held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

Directors	Held at 1 July 2006	Granted as compensation	Exercised	Other changes*	Held at 30 June 2007
Anthony McClure	3,000,000	3,750,000	3,000,000	–	3,750,000
Alan Flavelle	–	2,750,000	–	–	2,750,000
Terence Willstead	1,500,000	1,500,000	1,500,000	–	1,500,000
Total	4,500,000	8,000,000	4,500,000	–	8,000,000

* Other changes represent options that expired or were forfeited during the year.

No options held by key management personnel are vested but not exercisable. All options on issue had vested fully in prior years. All options outstanding as at 30 June 2007 are fully vested and exercisable.

Movements in shares

The movement during the reporting period in the number of ordinary shares in European Gas Limited held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

Directors	Held at 1 July 2006	Purchased	Received on Exercise of Options	Sold	Held at 30 June 2007
Anthony McClure	220,752	–	3,000,000	–	3,220,752
Alan Flavelle ⁽¹⁾	950,000	465,040	–	–	1,415,040
Terence Willstead	2,000,000	–	1,500,000	–	3,500,000
Total	3,170,752	465,040	4,500,000	–	8,135,792

1. Shares purchased represent shares issued as consideration pursuant to offer to shareholders in Heritage Petroleum plc. The shares issued were in consideration for acceptances relating to 845,528 ordinary shares in Heritage Petroleum plc held by Alan Flavelle. In addition Mr Flavelle received a cash consideration of \$31,707 on acceptance of the Offer for of his Heritage shares pursuant to the terms of the Offer.

COMPANY DETAILS

The registered office of the company is:

European Gas Limited

Suite 4, 4 Ventnor Avenue

West Perth Western Australia 6005

AUSTRALIA

Telephone: +61 8 9226 0320

Fax: +61 8 9226 0309

E-mail: info@europeangas.com.au

Website: www.europeangas.com.au

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Directors' Declaration



The directors of the company declare that:

1. The financial statements and notes, as set out on pages 29 to 66 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 2007 and of the performance for the year ended on that date of the company and economic entity.
2. The Chief Executive Officer and Chief Finance Officer 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.

On behalf of the Board

Anthony J McClure – Managing Director

Dated at Perth, Western Australia this 28 day of September 2007

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INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF EUROPEAN GAS LIMITED

Report on the Financial Report and AASB 124 remuneration disclosures contained in the directors' report

We have audited the accompanying financial report of European Gas Limited, which comprises the balance sheet as at 30 June 2007, 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 for both European Gas Limited and the consolidated entity. The consolidated entity comprises European Gas Limited and the entities it controlled at the year's end or from time to time during the financial year.

We have also audited the remuneration disclosures contained in the directors' report. As permitted by the Corporations Regulations 2001, the company has disclosed information about remuneration of directors and executives ('remuneration disclosures') required by accounting standard AASB 124 Related Party Disclosures under the heading "remuneration report" in pages 18 to 23 of the directors' report and not in the financial report.

Directors' Responsibility for the Financial Report and the AASB 124 remuneration disclosures contained in the directors' report.

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

The directors of the company are also responsible for the remuneration disclosures contained in the directors' report.

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. Our responsibility is to also express an opinion on the remuneration disclosures contained in the directors' report based on our audit.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report and the remuneration disclosures contained in the directors' report. The procedures

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Chartered Accountants
& Business Advisers

selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report and in the remuneration disclosures contained in the director's 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 and the remuneration disclosures in the directors' 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.

Auditor's Opinion

In our opinion the financial report of European Gas Limited is in accordance with the Corporations Act 2001, including:

- (a) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2007 and of their performance for the year ended on that date; and
- (b) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001.

Auditor's opinion on the AASB 124 remuneration disclosures contained in the directors' report

In our opinion the remuneration disclosures that are contained in pages 18 to 23 of the directors' report comply with Accounting Standard AASB 124.

PKF
Chartered Accountants

Ian Olson
Partner

Dated at Perth, Western Australia this 28 day of September 2007

Auditor's Independence Declaration



AUDITOR'S INDEPENDENCE DECLARATION

As lead engagement partner for the audit of European Gas Limited for the year ended 30 June 2007, I declare that, to the best of my knowledge and belief, there have been:

- (i) no contraventions of the independence requirements of 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.

A handwritten version of the PKF logo in black ink.

PKF
Chartered Accountants

A handwritten signature in black ink, appearing to read 'Ian Olson'.

Ian Olson
Partner

Dated at Perth, Western Australia this 28 day of September 2007

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Additional Information for listed Public Companies



As at 21 September 2007

1. Shareholding

	No.
a. Total number of fully paid shares on issue	198,155,662
b. Number of shareholders	
Total registered	1,789
Holding less than a marketable parcel	56
c. Distribution schedule and number of equity securities	

Range of Units	1-1,000	1,001-5,000	5,001-10,000	10,001-100,000	100,001-max	Total
Fully paid ordinary shares	141	433	393	666	156	1,789
Unlisted options	2	-	-	3	4	9

d. Twenty largest holders of equity securities – ordinary shares

Shareholder	Number of Fully Paid Ordinary Shares	%
1 HSBC Custody Nominees (Australia) Limited	29,840,138	15.06
2 ANZ Nominees Limited (Cash Income Account)	21,774,120	10.99
3 HSBC Custody Nominees (Australia) Limited – A/C 2	13,930,625	7.03
4 Citicorp Nominees Pty Limited	10,065,355	5.08
5 HSBC Custody Nominees (Australia) Limited – GSI ECSA	8,891,396	4.49
6 Merrill Lynch (Australia) Nominees Pty Limited (Berndale A/C)	8,092,893	4.08
7 NEFCO Nominees Pty Ltd	7,299,000	3.68
8 HSBC Custody Nominees (Australia) Limited – A/C 3	7,020,331	3.54
9 National Nominees Limited	4,473,986	2.26
10 Patermat Pty Ltd	3,500,000	1.77
11 Mr. Anthony John McClure	3,000,000	1.51
12 Travelly Pty Ltd	2,000,000	1.01
13 ECG Securities Limited	1,923,287	0.97
14 Heritage Petroleum Trustee for Dissident/Untraceable shareholders	1,820,214	0.92
15 Mr. Shane Bach	1,533,423	0.77
16 PYNC Pty Ltd (Connnat Investment Fund A/C)	1,500,000	0.76
17 Mrs. Rhoda Joy Harris & Mr. Philip Russell Harris (Harris Super Fund A/C)	1,400,000	0.71
18 SOFISCO Nominees Limited	1,124,089	0.57
19 Odessey Pty Limited	1,045,708	0.53
20 Fitel Nominees Limited	1,000,000	0.50
	131,234,565	66.23

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Additional Information for listed Public Companies (continued)

e Substantial shareholder

Those shareholders who have lodged with the company a notice under the Corporations Act 2001 advising of substantial shareholding in the company are as follows:

Shareholder	Number of Fully Paid Ordinary Shares	%
1 Fidelity International Limited FMR Corp & FMR Co	12,555,170	6.34
2 Anglo Pacific Group plc	10,050,877	5.07

f. Voting Rights

The voting rights attaching to each class of securities are set out below.

Fully paid ordinary shares:

Each shareholder is entitled to vote in person or by proxy, attorney or representative.

On a show of hands, every person present, who is a shareholder or a proxy, attorney or representative of a shareholder shall, in respect of each fully paid share held by him, or in respect of which he is appointed a proxy, attorney or representative, have one vote per share.

2. Unquoted Securities

a Unquoted securities on issue as at 21 September 2007:

Unquoted Securities	Number on issue	Exercise Price	Expiry Date
Employee Options	1,000,000	\$0.10	25 August 2008
Director Options – Series A	4,000,000	\$1.00	28 November 2008
– Series B	4,000,000	\$1.50	28 November 2010
Heritage Options	1,563,269	\$1.00	28 February 2009

b Names of persons holding more than 20% of a given class of unquoted securities (other than employee options):

Securities	Name	Number of Securities
Director Options	Anthony McClure	3,750,000
	Noce Pty Ltd	2,750,000
Heritage Options	HSBC Custody Nominees (Australia) Limited	1,480,769

Optionholders have no voting rights.

3. Restricted securities

There are no restricted securities on issue.

4. On-Market Buy Back

There is currently no On-Market Buy-Back in operation by European Gas Limited.

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