

CARNARVON PETROLEUM LIMITED

ABN 60 002 688 851

AND ITS CONTROLLED ENTITIES

ANNUAL FINANCIAL REPORT

30 JUNE 2007

CORPORATE DIRECTORY

Directors

PJ Leonhardt (Chairman)
EP Jacobson (Chief Executive Officer)
NC Fearis (Non-Executive Director)
KP Judge (Non-Executive Director)

Company Secretary

RA Anderson

Auditors

WHK Horwath Perth Audit Partnership

Bankers

Australia and New Zealand Banking Group Limited

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Share Registry

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Investor Enquiries: 1300 557 010 (within Australia)
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Stock Exchange Listing

Securities of Carnarvon Petroleum Limited are listed on ASX Limited.

ASX Code: CVN - ordinary shares

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CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
CHAIRMAN'S REVIEW

At this time last year I expressed confidence that Carnarvon's new management team and the revitalisation of our Phetchabun Basin Joint Venture in Thailand had established a strong platform for future growth. This year the pace of activity has accelerated and there have been significant achievements.

Under Ted Jacobson's excellent leadership we have continued to build our small but high quality technical team and significantly improve our understanding of the Thai assets, as well as provide the capability to pursue new ventures with confidence.

The Company's productive working relationship with its joint venture partner in Thailand, Pan Orient Energy Inc., a Canadian TSX listed oil and gas company, is borne out by the extensive programme delivered in a relatively short time frame and success in the field.

A two phase exploration, evaluation, and development drilling programme commenced in July 2006 based on reprocessed 2D and a new 245 km² 3D seismic programme. This resulted in 12 wells being drilled by year end of which 7 are currently producing oil. The scale of the success can be measured by a Joint Venture production rate under 80 bopd in July 2006 now having increased to over 2500 bopd at the date of this report.

One of the highlights of the year was the successful POE 9 discovery of a fractured volcanic play. Fractured volcanic prospects have been identified in a number of discovered and potential structures and these will be targeted with comprehensive drilling in the coming year.

The Phase 2 programme will continue into 2008 and comprise up to 37 wells, some of which will be positioned on the basis of a new 100 km² 3D seismic survey that has just been completed over the Bo Rang gas field. Significant new contingent resources have been identified and data from the 3D seismic surveys and drilled wells will enable Carnarvon to update reserves for its Phetchabun Basin interests having regard for the new information.

The Company has actively pursued new ventures and was successful in its bid for a 50% interest in a new permit in the Carnarvon Basin. In onshore Thailand, Carnarvon has a 50% interest and, in conjunction with its joint venture partner, sole bidder status in an application for concession rights for Block L20/50 to the west of its existing permits.

The achievements of the new management team in meeting development milestones have provided support in the market to raise almost \$16 million of equity for Phase 2 and new ventures by way of placements to both new and existing shareholders, including \$1 million from an oversubscribed Share Purchase Plan. At the same time we have strengthened our institutional shareholder base.

It is particularly pleasing to report a significant increase in the Company's market capitalisation and share price which reflects the progress made during the year.

On behalf of shareholders I thank Ted and his team for their outstanding contributions during the year which are reflected in Carnarvon now being recognised for its success in the field and as a desirable participant in new ventures. It is with much anticipation that I and my fellow directors look forward to another exciting year of growth in 2008.



Peter Leonhardt
Chairman

CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
CHIEF EXECUTIVE'S REVIEW

The last 2 years has seen considerable growth in the Carnarvon share price from around 3 cents to the current 32 cents, a 10 fold increase. This has resulted from the establishment of a new operator, Pan Orient Energy, and an improved joint venture in our Thailand assets, as well as the recruitment of highly experienced technical managers and staff by both Pan Orient and Carnarvon.

During this period our Phetchabun Basin Joint Venture has recorded a total of 365 km² of 3D seismic and drilled a total of 17 wells, bringing the Wichian Buri oilfield back to life. It has also resulted in the discovery of new oil fields at Na Sanun East and at Na Sanun within a new reservoir of fractured volcanic rocks, previously not on production in the permits.

Total production during these two years has gone from less than 100 barrels of oil per day to over 2,500 barrels of oil per day, a 25 fold increase. At this new flow rate Carnarvon can now fully fund, without going back to the market, continuous drilling with the two contracted rigs and one workover rig and release some funds for new venture opportunities. This is an important milestone for the Company.

Our two exploration permits in Thailand are large (8,000 sq kms), covering almost the entire Phetchabun Basin. It is management's view that these permits have a lot more to deliver, with 28 more wells planned or underway for 2007/2008.

Carnarvon management is carefully looking at additional ways to grow in other areas both within and outside Thailand. Our company has applied for a new, large (4,000 sq kms) permit onshore Phitsanulok Basin west of Carnarvon's existing permits in Thailand. This is an interesting area with similar geology to that of our Phetchabun Basin permits, and located 40 kms south of the very large Sirikit Oil Field. We will know the success of this application in the next few months.

The Carnarvon technical team has significant experience in the various Australian basins and in particular the Australian North West Shelf. With this knowledge Carnarvon, as operator, applied for and was awarded a new offshore permit in the Carnarvon Basin of Western Australia (WA 399-P), 35 kms southeast and downdip of the large Pyrenees/Macydon oil and gas fields. Carnarvon has identified a prospect in this permit with the potential to contain approximately 50 mmbbls of recoverable oil. Seismic data are currently being reprocessed with a view to drilling as soon as possible.

Carnarvon is reviewing a number of other international opportunities and is currently in two separate study groups. On completion of these studies in the next few months Carnarvon has the right to enter into production sharing agreements with the respective Governments. Expenditure on these projects is minimal upfront, so that they will provide Carnarvon with the means to expand at the right time as funds become available from existing production.

Carnarvon has managed to attract some highly experienced scientists and managers to its team, due to the quality of our assets and a supportive and innovative work environment. Our people are our greatest asset. They provide the means to grow our company and I thank them for their hard work and enthusiasm. I also thank shareholders and my co-directors for their support.

As a shareholder of the company I am very pleased at our past progress and I firmly believe we have the right fundamentals for growing the company substantially again over the next 12 months.



Ted Jacobson
Chief Executive Officer

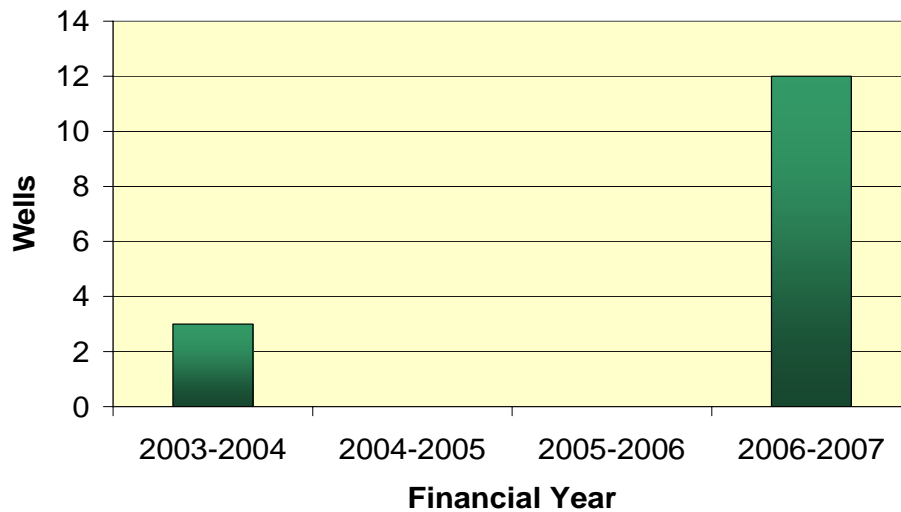
COMPANY PERFORMANCE

Key Performance Indicators

Carnarvon tracks several key performance indicators to provide a relative measure of the Company's growth, as shown below.

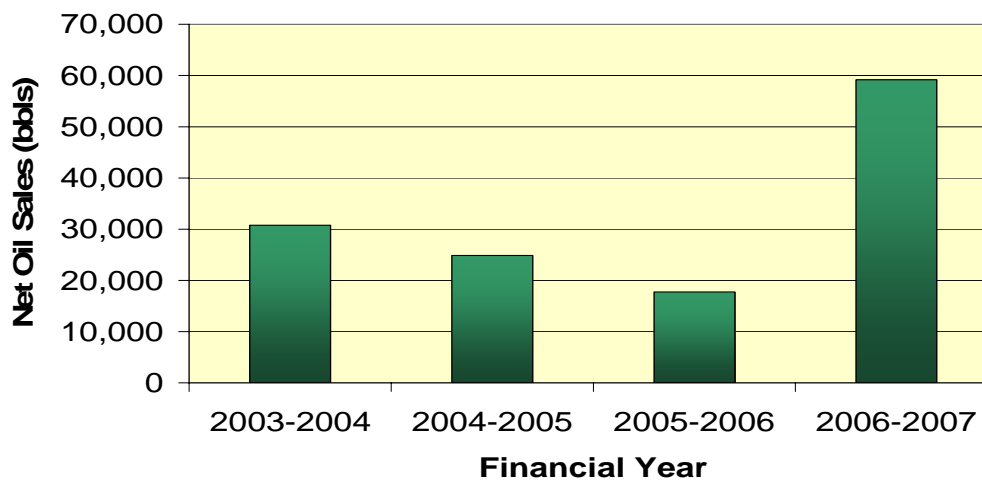
Wells Drilled

Period: 1 July 2006 – 30 June 2007
Measure: 12 Wells
Period Change: N/A



Annual Net Oil Sales

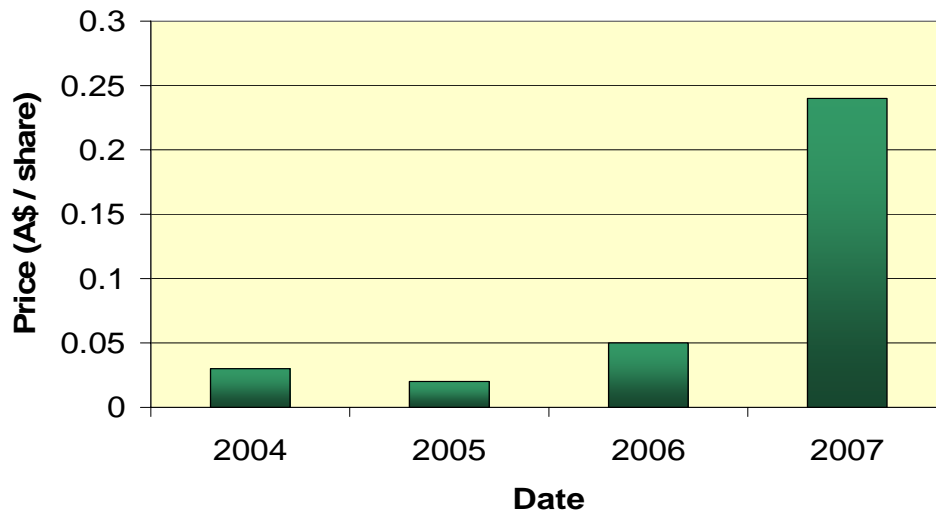
Period: 1 July 2006 – 30 June 2007
Measure: 59,161 Bbls
Period Change: + 300%



CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
OPERATING AND FINANCIAL REVIEW

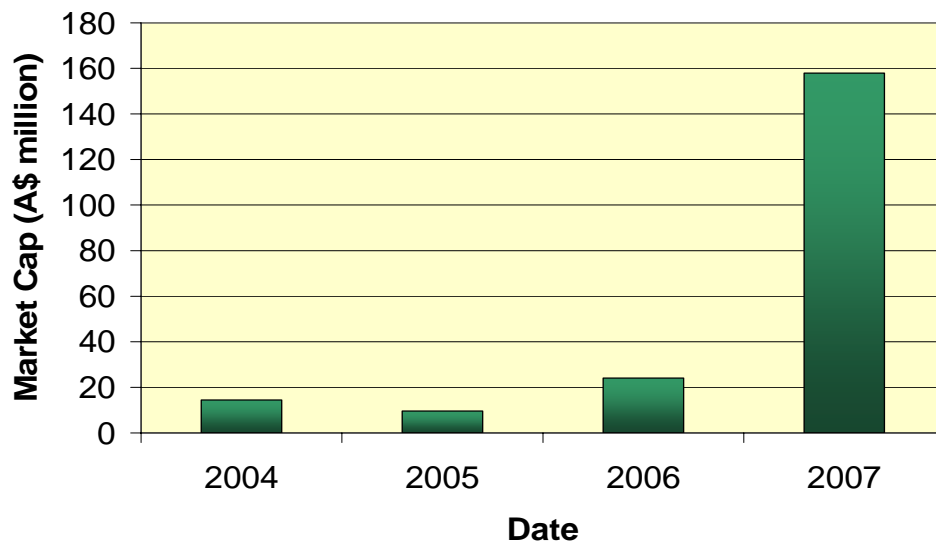
Share Price

Period: 30 June 2007
Measure: A\$0.24
Period Change: + 362%



Market Capitalisation

Period: 30 June 2007
Measure: A\$158 million
Period Change: + 550%



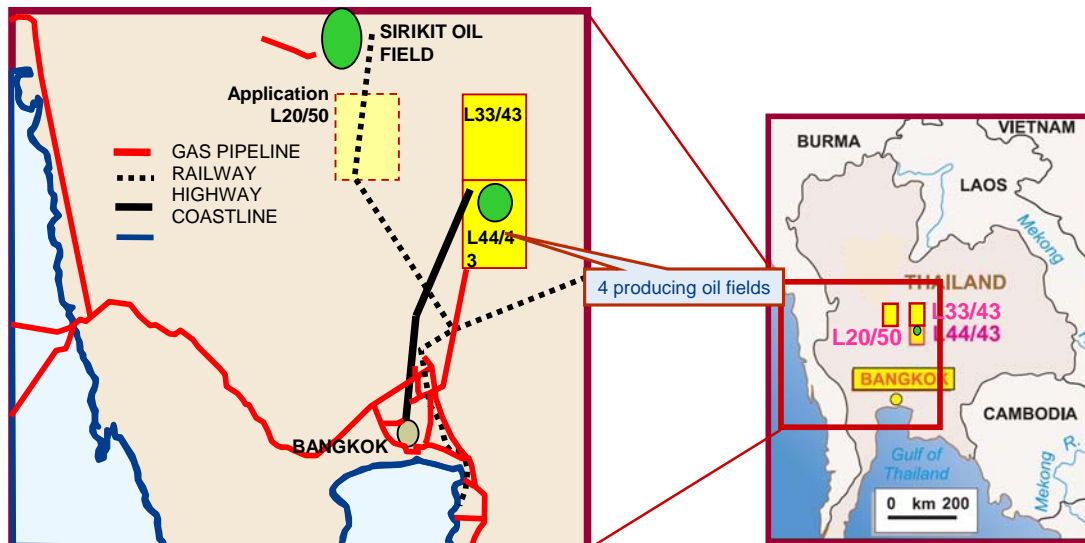
FINANCIAL SUMMARY

The consolidated entity's loss after income tax for the year ended 30 June 2007 was \$1,542,210, (2006: \$758,150 loss), however its share of the cash operating profit of the Phetchabun Basin Joint Venture in Thailand increased to \$881,616 (2006: \$343,151) as a result of significantly improved production.

Corporate and administration costs for the year were \$966,343 excluding share-based payments (2006: \$920,418). The increase primarily reflects staff and consultant costs associated with increasing the Company's technical capability to extract full value from both its current assets and new ventures.

PHETCHABUN BASIN JOINT VENTURE, THAILAND
(Carnarvon Petroleum Ltd 40%; Pan Orient Energy Corp. 60%)

Carnarvon has a 40% interest in the Phetchabun Basin Joint Venture ("Joint Venture"), which includes the Wichian Buri Oilfield, Si Thep Oilfield, Na Sanun Oilfield and exploration blocks L44/43 and L33/43.



Thailand Permits – Location Map

Production and financial summary

The consolidated entity's revenue from continuing operations for the year ended 30 June 2007, being its share of the Joint Venture operations in Thailand, was \$3,673,595 (2006: \$1,090,213).

The higher A\$ oil revenue resulted from higher Joint Venture oil sales of 147,904 bbls (2006: 42,554 bbls) complemented by an improvement in the achieved oil sale price to US\$50.24 per bbl (2006: US\$47.73). These factors were offset by an appreciation in the A\$ to the US\$ from 73 cents to 85 cents over the reporting period.

The increase in oil sales resulted from new production from the Phase 1 and initial part of the Phase 2 drilling programmes, as well as improved production resulting from the workover programme applied to some of the older wells.

The high start up costs associated with the new drilling programme incurred in the first half of the year restricted the full year cash profit per bbl sold to US\$15.65 (2006: \$20.36). However, increased production in the final quarter meant a US\$26.92 cash profit per bbl sold for the 3 months to June 2007.

At financial year end the Joint Venture had produced at a gross rate of 1,080 bopd (432 bopd net to Carnarvon). This rate had been choked back from around 1,400 bopd gross earlier in the year due to changes in the ongoing well testing programme.

Currently the Joint Venture is producing at a gross rate in excess of 2,500 bopd. A significant portion of this production is from well testing operations. It is anticipated that production will vary significantly over the coming months as individual wells are varied to determine optimum flow rates, further exploration and appraisal wells are drilled and a development plan for the Na Sanun East oil field is approved. Full field development of the Na Sanun East field is not anticipated until 2008.

Operations

In 2006 the Joint Venture embarked on a 2 phase work programme incorporating an intensive exploration, appraisal and development programme for 2006 through 2008.

In the first half of 2006 the Joint Venture reprocessed previously recorded 2D seismic data within the L33/43 and L44/43 concessions. Based on these new data, a Phase 1 drilling programme of 6 wells was designed to substantially increase oil production from the existing Wichian Buri Oil Field.

Also in 2006 a 245 km² 3D seismic survey was acquired over the Wichian Buri, Si Thep and Na Sanun fields, and surrounding areas. Initial results from the processing of this new seismic data became available during the drilling programme which was then extended to drill 8 wells in total. The Phase 1 drilling programme ultimately comprised 6 appraisal / development wells (including 1 redrill and 2 wells free-carried for Carnarvon by Pan Orient up to a total of US\$350,000 each on a dry hole basis), and 2 exploration wells, entirely within the existing production licences. At the Wichian Buri Oil Field, the drilling resulted in improved oil production from the new wells, the successful appraisal of a new fault compartment with additional oil reserves and the successful completion and production of new oil reserves from the "G" and "H" reservoir intervals as well as the "F" reservoir interval. In addition, the last well in the programme, POE-9, resulted in a significant oil flow from a new exploration concept within fractured volcanics. The drilling was completed over a six month period from July through to December 2006.

Production testing of the Phase 1 drilling programme commenced in October 2006. Of the eight wells drilled during Phase 1, seven were successfully completed after indications of oil and gas shows during drilling. Five wells are currently undergoing extended production testing at rates between 30 and 300 bopd each; two of the wells are shut-in post initial well testing with sub-commercial flow rates and one well did not encounter a hydrocarbon column.

Based on the results of the Phase 1 drilling and the newly acquired 3D seismic survey, a 37 well Phase 2 programme and a further 120 km² 3D seismic survey was approved by the joint venture to be carried out during 2007 and 2008. Drilling commenced in March 2007 and drilling capacity was increased with the contracting of an additional drilling rig.

There are currently two drilling rigs operating simultaneously for the joint venture, with a further workover rig available for testing and completions, allowing continuous drilling and testing operations. It is anticipated that at least 10 wells from the Phase 2 drilling campaign will be completed and tested by the end of 2007 and the additional wells of the Phase 2 37 well programme will be completed and tested in 2008.

Drilling so far in Phase 2 has focused on appraising the Na Sanun and Na Sanun East oil fields. The remainder of the programme will comprise wells over the Bo Rang and Si Thep structural complexes and several newly mapped structures elsewhere in the L33/43 and L44/43 concessions, as well as further appraisal and development wells on the Na Sanun East structure.

In the third quarter of 2007 the 120 km² 3D seismic survey was completed over the Bo Rang structure and over the northern extent of the Na Sanun East structure.

Development Update

Na Sanun Oil Field

The Na Sanun Oil Field was discovered in 1994 with the drilling of NS-1 and was appraised in 2007 with the successful NS-4 well and with unsuccessful NS-3 and NS-1RD wells. Production from Na Sanun is currently limited to well testing of the upper volcanic of NS-4.

Na Sanun East Oil Field

The Na Sanun East Oil Field was discovered in 2006 with the drilling of POE-9, and appraised with the successful NS3-D1 and L44H wells. Production from this field is limited to the upper volcanics and is subject to ongoing well testing.

Na Sanun East consists of three main fault blocks comprising the south, central and north compartments.

The southern block has been appraised by the two successful wells POE-9 and NS3-D1, with a sustained production history of over 6 months.

The central block has been appraised by L44-H.

The northern block, mapped only on sparse 2D seismic data, has been penetrated by L44G and L44G-D1 which are being prepared for testing at the time of writing this report. The recently acquired 3D over the Bo Rang gas discovery encompasses this area and processed data will be available by year end to assist in further evaluating this area.

The Na Sanun East Oil Field will be the focus of significant appraisal and development drilling through to the end of 2007 and into 2008.

Wichian Buri Oil Field

The Wichian Buri Oil Field has been in production since 1995 and is currently producing around 350 bopd from 8 wells, including both original wells and the POE appraisal wells drilled in 2006. These wells all produce from sandstone reservoirs. Upcoming wells will appraise the northern extent of the Wichian Buri Oil Field as well as the potential for production from the volcanic zones identified in this area by previous drilling.

Si Thep Oil Field

Si Thep is producing from one well, Si Thep-1, within a single sandstone reservoir at a modest rate of 10-15 bopd. Appraisal of this area in the Phase 2 drilling programme will include the examination of different reservoirs within the sandstone, as well as potential production from several volcanic zones intersected in Si Thep-1.

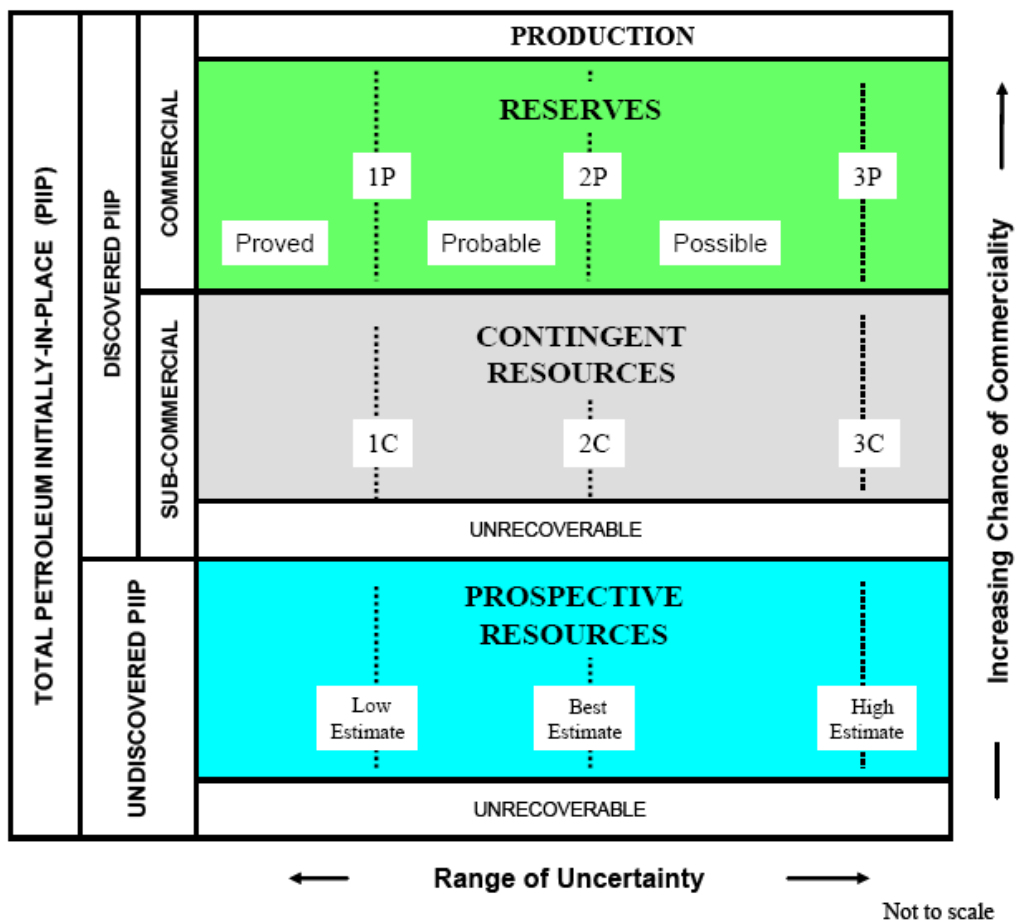
Bo Rang Gas Discovery

Bo Rang was discovered in 1990 and was suspended as a gas discovery in fractured volcanic reservoir, after successful production testing. Appraisal of this area will confirm the extent of the gas discovery and also the oil shows and lost circulation in deeper volcanic zones. Discussions concerning development options for commercialising the gas discovery are ongoing within the Joint Venture.

Reserve assessment

Petroleum Resource Classification, Categorisation and Definitions

Carnarvon is in the process of adopting the SPE/WPC/AAPG/SPEE (Note 1 below) Petroleum Resource Management System (“SPE-PRMS”). The SPE-PRMS uses the SPE/WPC reserves categorisation systems that have been developed over many years. The system categorises reserves according to the reserves commerciality (or maturity) and uncertainty and is shown thus:



Reserves / Resources classification framework

Note 1: Society of Petroleum Engineers (“SPE”); World Petroleum Council (“WPC”); American Association of Petroleum Geologist (“AAPG”) & Society of Petroleum Evaluation Engineers (“SPEE”)

Reserves are defined as “those quantities of hydrocarbons which are anticipated to be commercially recovered from known accumulations from a given date forward” (Note 2 below).

Resources are defined as hydrocarbon volumes that have been discovered but have development approval pending, development unclarified or on hold or are not economically viable under current conditions, and hence cannot be booked as reserves.

Reserve estimates are necessary to determine appropriate development strategies and for accounting purposes. Resource estimates are used in appraisal and early development planning.

Carnarvon undertakes probabilistic and deterministic reserves assessments in order to provide an estimate of the uncertainty in reserves.

Carnarvon generally communicates and uses reserves at the Proved and Probable (2P) confidence level. The use of 2P confidence levels gives a balanced view to the stated reserves as it generally indicates that the actual production volume is expected to have a 50% probability of being either equal to or greater than the stated reserves estimate. Carnarvon may also report the uncertainty range if it is required to demonstrate the uncertainty in an evaluation – this is especially relevant for exploration prospects and leads, which are classed as Prospective Resources.

Reserves/Resource Certification and Regulation

Currently all of Carnarvon's reserves are from the Thailand operations. According to Thai government regulations, an annual independent end of year reserve certificate is required. A 31 December 2006 assessment of reserves for the L33/43 and L44/43 permits was prepared for the operator by Gaffney, Cline and Associates (“GCA”), an independent petroleum consulting company based in Singapore who follow the SPE/WPC classifications and definitions for the reporting of Petroleum Reserves and Resources.

As the current certificate was issued as of 31 December 2006, it does not take into account successful drilling and well testing since that date, particularly in the Na Sanun and Na Sanun East structures.

The next Reserves Certificate will include the current drilling and testing, however it is not anticipated this will be released until Q1 2008.

Carnarvon reports reserves in accordance with ASX listing rules, using calculations based on SPE/WPC classification and definitions.

Reserves

All reserves attributable to Carnarvon are predominantly the Wichian Buri and Si Thep sandstone reservoirs, which have been producing since 1995 and were further appraised / developed with the 2006 drilling programme encompassing the POE wells.

Note 2: “SPE / WPC Petroleum Resources Definition”, (1997)

CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
OPERATING AND FINANCIAL REVIEW (CONTINUED)

Reserve Estimates

The following tables detail Carnarvon's reserve estimates at 31 December 2006. All reserves are Carnarvon share.

| Net Carnarvon Reserves | | |
|-------------------------------|--------------------------|-------------------------------------|
| Proved | Proved + Probable | Proved + Probable + Possible |
| 1P | 2P | 3P |
| (million bbls) | (million bbls) | (million bbls) |

| | | | |
|----------------------------|------|------|----------|
| GCA 31 Dec 2006 (i) | 0.34 | 2.83 | 30.4(ii) |
|----------------------------|------|------|----------|

(i) 31 December 2006 assessment of reserves for the L33/43 and L44/43 permits, prepared for the operator by GCA and as previously reported, does not take into account drilling and testing activities post that date.

(ii) Although not addressed in their 31 December 2006 report, based on previous work by GCA, proven, probable and possible oil reserves are in excess of 30 million bbls net to CVN.

Contingent Resources

Contingent resources describe hydrocarbon volumes that have been discovered but are not yet economic or do not yet have an approved field development plan, and hence cannot be booked as reserves.

For Carnarvon's Thai assets this includes the majority of the Na Sanun East oil field, the Na Sanun Oil field and the Bo Rang gas discovery. Carnarvon has no Contingent Resources outside of Thailand.

The Na Sanun East oil field was discovered with POE-9, and has to date been successfully appraised with the NS-3D1, L44-G, L44G-D1 and L44-H wells. These wells were all drilled post the Dec 2006 GCA reserves assessment, and are currently undergoing production testing as of September 2007. It is anticipated that final well test results will be available at year end. At that time an updated reserves assessment will be carried out by GCA, which will in turn be used to formulate a field development plan. As several exploration / appraisal wells are anticipated to be drilled in the vicinity within the next 12 months, Carnarvon is still evaluating the extent of the resource and methods of commercialisation.

The next Reserves Certificate will include the current drilling and testing results, however this is not anticipated to be released until Q1 2008.

Contingent Resource Estimates

Based on the results of drilling and testing to date, the following net to Carnarvon contingent resource estimates are provided.

| Net Carnarvon Contingent Resource | | |
|--|--------------------------|-------------------------------------|
| Proved | Proved + Probable | Proved + Probable + Possible |
| 1C | 2C | 3C |
| (million bbls) | (million bbls) | (million bbls) |

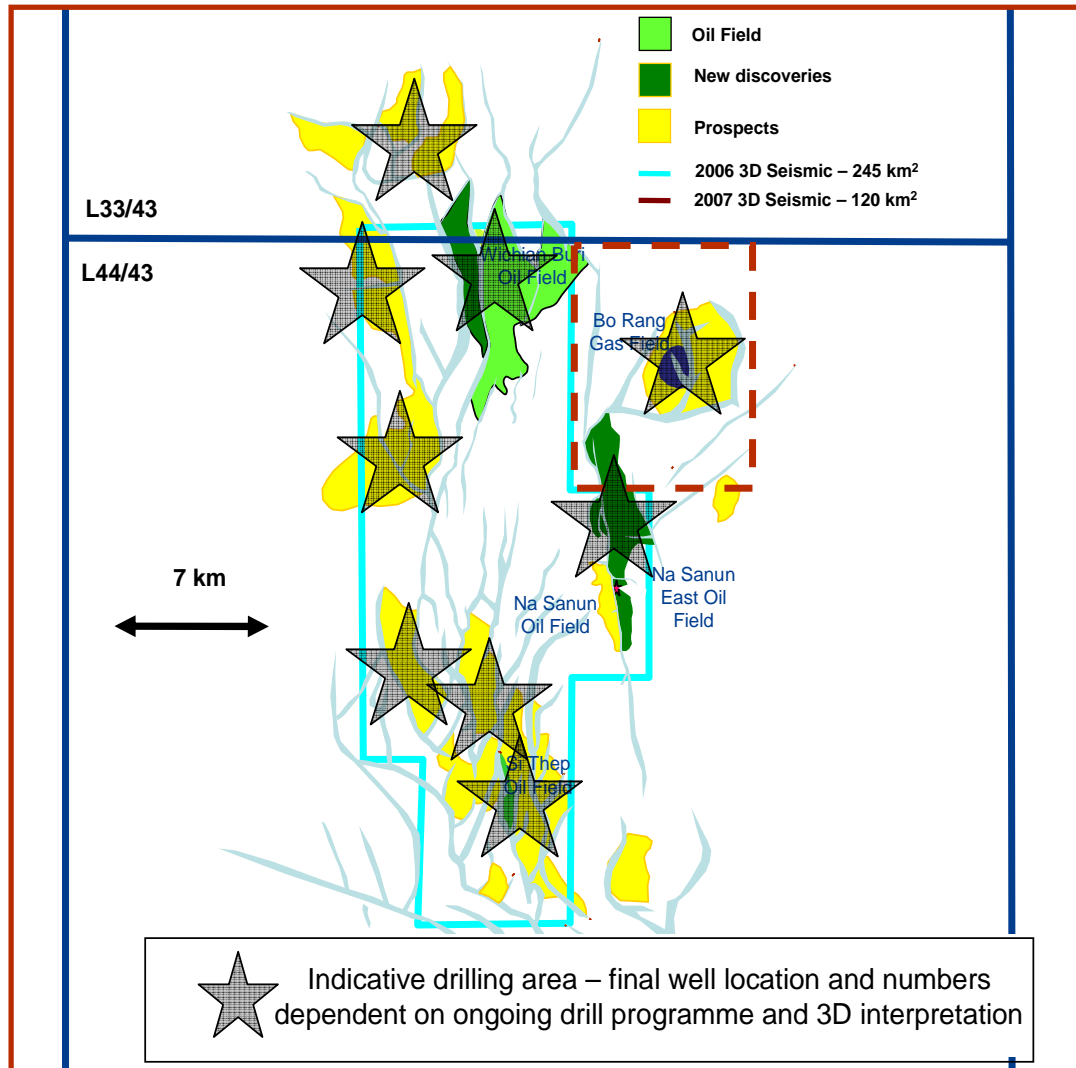
| | | | |
|------------------------------------|------|-------|-------|
| Carnarvon 30 June 2007(iii) | 8.12 | 11.68 | 16.12 |
|------------------------------------|------|-------|-------|

(iii) This report is based on information which has been compiled by the Company's Principal Petroleum Engineer, Mr Philip Huizenga (BE, M.PetEng.), who is a full-time employee of the Company and a person competent to report on reserves according to ASX requirements.

Prospective Resource Estimates

Prospective resources describe hydrocarbon volumes that may be produced in the event that they are discovered by an exploration well. Carnarvon has a significant and increasing international leads and prospects portfolio.

For Carnarvon's Thailand assets, the estimated prospective resource in this portfolio exceeds approximately 50 million barrels of oil net to Carnarvon on an unrisks basis at a 2P confidence level. There are multiple leads and prospects in this portfolio that will be tested in the 2007 / 2008 drilling programme.



Carnarvon's Thailand exploration and appraisal drilling prospects

CARNARVON BASIN (WESTERN AUSTRALIA)
EP 110 AND EP 424

(Carnarvon Petroleum 35% / Strike Oil 40% / Pancontinental Oil & Gas 25%)

Carnarvon has a 35% interest in the permits EP 110 and EP 424 in the Carnarvon Basin, offshore northwest of Western Australia. Strike Oil is the operator of both permits.

Seismic attribute analysis, to determine hydrocarbon potential of the Baniyas prospect within EP 424, has been undertaken and results are expected soon.

The Department of Industry and Resources (DOIR) has agreed to a variation in the work programme, whereby the drilling of a well has been delayed until the permit year commencing April 2008. This will give sufficient time to evaluate the AVO analysis and prepare Baniyas for drilling.

The Baniyas prospect lays 6 km to the southeast and updip of the Chevron-operated Saladin Oil Field. Success at Baniyas could be rapidly tied into existing infrastructure.

CARNARVON BASIN (WESTERN AUSTRALIA)
WA-399-P

(Carnarvon Petroleum 50% / Rialto Energy Limited 50%)

During the reporting period Carnarvon was awarded a 50% interest in, and operatorship of, a new exploration permit (WA-399-P) in the Carnarvon Basin offshore Western Australia.

The Permit covers an area of 50 km² and is located midway between the Pyrenees and Macedon oil and gas fields, 25 kilometres to the north-west, and the Leatherback oil accumulation, 30 kilometres to the south-east.

On 3 July 2007, BHP Billiton announced approval of the Pyrenees/Macedon oil and gas development project. This has significantly improved the economics of developing a discovery within WA-399-P which could be readily tied back to this close-by development.

One significant prospect ("Black Tom Prospect") has been identified on existing seismic with the potential to contain more than 50 million bbls of recoverable oil at the prospective upper Barrow geological level. As operator, Carnarvon has commenced the reprocessing of all available seismic in the Permit to help plan the forward programme.

The joint venture has committed to a minimum work programme in the first 3 years of the Permit term of geological and geophysical studies and the acquisition of 315 km of 2D seismic. Following interpretation of the seismic data in year 3, the joint venture has indicated it may elect to drill an exploration well in each of years 4 and 5 of the permit. However, if the current seismic reprocessing is encouraging, it is likely the drilling of a well would be brought forward.

GROWTH AND NEW VENTURES STRATEGY

Carnarvon has achieved significant growth from continued exploration and development success in the previously undervalued and underexplored concessions L33/43 and L44/43 in Thailand. The new Carnarvon management recognised the potential in these areas which have been the primary focus of the Company's activities. Following the successful exploration programme over the last 18 months Carnarvon is confident that the concessions have all the ingredients to deliver further significant growth for shareholders. For this reason Carnarvon and its operating partner Pan Orient have committed to an extensive work programme going forward.

Carnarvon is currently on the threshold of achieving sustainable production from these Thailand concessions at a level where the operations and the 2 drilling rigs currently contracted are fully funded out of cash flow. Further growth in production would enable Carnarvon to more actively pursue other opportunities with similar high exploration potential to grow the company.

Finding and negotiating new venture opportunities generally involves long lead times. Accordingly Carnarvon has maintained an active new ventures programme seeking out both exploration and appraisal/production opportunities. One new permit in onshore Thailand has been applied for, one new exploration permit has been acquired in Australia, and two more opportunities have been progressed to an advanced stage

Carnarvon's New Venture Strategy is to concentrate on potential exploration and/or appraisal blocks which have the following characteristics:

- On trend with commercial oil discoveries
- Ability to acquire 3D seismic at nominal cost
- Necessary infrastructure in place or readily available
- Oil and/or gas markets defined and accessible

Carnarvon places emphasis on producing fields with potential upside, from either infill drilling, near field exploration or workover. In this respect the Company is reviewing several prospective opportunities to increase overall shareholder value with minimal initial capital outlay.

Technical Capability

Carnarvon operates with a small but highly experienced technical team, encompassing all facets of the oil and gas exploration and production disciplines.

Through ongoing education and training and investment in the latest technical innovations, Carnarvon is able to provide in-depth technical analysis and assessment across a range of geological and geographical areas.

Carnarvon's technical expertise includes, but is not limited to:

- Geophysical acquisition
- Geophysical interpretation
- Geological interpretation
- Reservoir engineering
- Drilling
- Development and production

Carnarvon staff have been involved in projects in all oil production continents and in numerous sedimentary basins worldwide.

CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
DIRECTORS' REPORT

The directors present their report together with the financial report of Carnarvon Petroleum Limited ("Company") and of the Group, being the Company, its subsidiaries, and the Group's interest in jointly controlled entities and operations for the financial year ended 30 June 2007, and the auditor's report thereon.

Carnarvon Petroleum Limited is a listed public company incorporated and domiciled in Australia.

Directors

The names and details of the Company's directors in office at any time during or since the end of the financial year are as follows. Directors were in office for this entire period unless otherwise stated.

Peter J Leonhardt
Chairman

FCA, FAICD (Life)
Age 60. Appointed as a director on 17 March 2005 and appointed Chairman in April 2005.

Mr Leonhardt is an independent company director and adviser with extensive business, financial and corporate experience. He is a Chartered Accountant and a former Senior Partner with PricewaterhouseCoopers and Managing Partner of Coopers & Lybrand in Western Australia.

During the past three years Mr Leonhardt has served as a director of the following listed companies: Centrepoint Alliance Limited (from May 2002); CTI Logistics Limited (from August 1999); Voyager Energy Limited (from March 2001 to September 2005); Titan Resources Limited (from June 2005 to June 2006). He is also a director of the Western Australian Institute for Medical Research and a member of the Advisory Board of the Perth International Arts Festival.

Mr Leonhardt is Chairman of the Audit Committee.

Edward (Ted) P Jacobson
Chief Executive Officer

B.Sc (Hons Geology)
Age 58. Appointed as a director on 5 December 2005.

Mr Jacobson is a petroleum geophysicist with 38 years' experience in petroleum exploration principally in the European North Sea, South East Asia, South America and Australia. Within Australia he has been responsible for initiating a number of petroleum discoveries within the Cooper Basin, Barrow Sub Basin and Timor Sea. Prior to joining Carnarvon, Ted was co-founder of Discovery Petroleum NL and more recently since 1996 co-founder and technical director of Tap Oil Ltd which grew to a market capitalisation of over \$400 million under his technical leadership. Ted is a member of the Australian Institute of Geoscientists.

During the past three years Mr Jacobson has served as director of the following listed companies: Rialto Energy Limited (from July 2006); Tap Oil Ltd (from 1996 to September 2005). Mr Jacobson is also a director of Smart Rich Energy Finance (Holdings) Ltd (from 2006), listed on the Hong Kong Stock Exchange.

Neil C Fearis
Non-Executive Director

LL.B (Hons), MAICD, F Fin
Age 56. Appointed as a director on 30 November 1999.

Mr Fearis has 30 years' experience as a commercial lawyer in the UK and Australia.

During the past three years Mr Fearis has served as a director of the following listed companies: Kresta Holdings Limited (from 1997); Perseus Mining Limited (from 2004); Liberty Resources NL (from 25 June 2007). Mr Fearis is also a member of several professional bodies associated with commerce and law.

Mr Fearis is a member of the Audit Committee.

Directors (continued)

*Kenneth P Judge
Non-Executive Director*

B.Com, LL.B
Age 52. Appointed as a director on 1 April 2005.

Mr. Judge has extensive legal and business management experience having held a number of public company directorships and has been engaged in the establishment or corporate restructure of technology, mining, and oil and gas companies in Australia, United Kingdom, USA, Brazil, Argentina, Mexico and the Philippines.

Mr. Judge is a director and Chairman of Brazilian Diamonds Limited (from February 2001), which is listed on both the Toronto Stock Exchange and the AIM market of the London Stock Exchange Plc.

He is a director of Block Shield Corporation (from February 2004), director and Chairman of Hidefield Gold Plc (from October 2003) and a director of Gulf Sands Petroleum Plc. (from October 2006), all of which are listed on AIM.

He is also a director and Chairman of Alto Ventures Ltd (from April 2004), Columbus Gold Corporation (from September 2004) and Empire Mining Ltd (from January 2005), all of which are listed on the TSX Venture Exchange.

Company Secretary

Mr Robert Anderson was appointed Company Secretary in November 2005. Mr Anderson is a Chartered Accountant who has previously held company secretarial positions in both ASX-listed companies and private entities.

Directors' meetings

The number of directors' meetings and the number of meetings attended by each of the directors of the Company during the financial year are as follows:

| | (a) | (b) |
|-----------------|-----|-----|
| Peter Leonhardt | 7 | 7 |
| Ted Jacobson | 7 | 7 |
| Neil Fearis | 7 | 7 |
| Ken Judge | 7 | 7 |

- (a) Number of meetings held during period of office
- (b) Number of meetings attended

Audit Committee

Names and qualifications of Audit Committee members

The Committee is to include at least 2 members. Current members of the committee are Mr Peter Leonhardt and Mr Neil Fearis. Qualifications of Audit Committee members are provided in the Directors section of this directors' report.

Audit Committee meetings

The number of Audit Committee meetings and the number attended by each of the members during the reporting period were as follows:

| | (a) | (b) |
|-----------------|-----|-----|
| Peter Leonhardt | 4 | 4 |
| Neil Fearis | 4 | 4 |

- (a) Number of meetings held during period of office
- (b) Number of meetings attended

Remuneration Committee

The Board considers that the Company is not currently of a size to justify the existence of a Remuneration Committee and therefore there were no Remuneration Committee meetings during the reporting period.

The Board as a whole is responsible for the remuneration arrangements for directors and executives of the Company. If the Company's activities increase in size, scope and/or nature the formation of a Remuneration Committee will be reviewed by the Board and implemented if appropriate.

The Board considers remuneration packages and policies applicable to the executive directors, senior executives, and non-executive directors. It is also responsible for share option schemes, the Employee Share Plan, incentive performance packages, and retirement and termination entitlements.

Principal activities

During the course of the 2007 financial year the consolidated entity's principal activities continued to be directed towards oil and gas exploration, development and production.

Remuneration report

The Board determines remuneration policies and practices, evaluates the performance of senior management, and considers remuneration for those senior managers. The Board assesses the appropriateness of the nature and amount of remuneration on an annual basis by reference to industry and market conditions, and with regard to the Company's financial and operational performance.

Total non-executive directors' fees are approved by shareholders and the Board is responsible for the allocation of those fees amongst the individual members of the Board.

The value of remuneration is determined on the basis of cost to the Company and consolidated entity.

Principles of compensation (audited)

Remuneration of directors and executives is referred to as compensation, as defined in AASB 124.

Compensation levels for key management personnel of the Company and consolidated entity are competitively set to attract and retain appropriately qualified and experienced directors and senior executives. The directors obtain, when required, independent advice on the appropriateness of remuneration packages, given trends in comparative companies both locally and internationally.

Compensation arrangements include a mix of fixed and performance based compensation. A component of share-based compensation is awarded at the discretion of the Board, subject to shareholder approval when required.

Compensation structures take into account the overall level of compensation for each director and executive, the capability and experience of the directors and senior executives, the executive's ability to control the financial performance of the relative business segment, the consolidated entity's performance (including earnings and the growth in share price), and the amount of any incentives within each executive's remuneration.

Remuneration report (continued)

Principles of compensation (audited) continued

In considering the consolidated entity's performance and benefits for shareholder wealth, the Board have had regard to the following indices in respect of the current financial year and the previous three years. No dividends have been paid or declared during this period.

| | 30 June 2004 | 30 June 2005 | 30 June 2006 | 30 June 2007 |
|--|---------------|---------------|---------------|---------------|
| Share price | \$0.015 | \$0.018 | \$0.052 | \$0.24 |
| Consolidated net (loss) from continuing operations | (\$1,417,044) | (\$1,007,325) | (\$1,246,332) | (\$1,542,210) |

The directors believe the increase in share price since June 2004 reflects a number of corporate changes, including the appointment of Ted Jacobson as Chief Executive Officer in February 2006. The development of the consolidated entity's oil and gas interests in Thailand since his appointment has resulted in a substantial increase in operational revenues, from which improved profitability should flow to the Phetchabun Basin Joint Venture in the 2008 year.

Fixed compensation (audited)

Fixed compensation consists of base compensation as well as employer contributions to superannuation funds. Base compensation may be supplemented by an element of share-based compensation.

There was no share-based compensation in the period under review, other than that set out in the Employee Share Plan section of this Remuneration report.

Non-executive directors (audited)

Total remuneration for all non-executive directors, last voted upon by shareholders at a General Meeting in November 2005, is not to exceed \$200,000 per annum.

A non-executive director's base fee is currently \$45,000 per annum. The Chairman receives \$75,000 per annum. Non-executive directors do not receive any performance related remuneration. Directors' fees cover all main Board activities and membership of Board committees. The Company does not have any terms or schemes relating to retirement benefits for non-executive directors.

Service contracts (audited)

The contract duration, period of notice, and termination conditions for key management personnel are as follows:

- (i) Ted Jacobson, Chief Executive Officer, is engaged through a rolling 12 month Consultancy Agreement. Termination by the Company is with 12 months notice or payment in lieu thereof. Termination by the consultant is with 3 months notice.
- (ii) Robert Anderson, Company Secretary and Chief Financial Officer, is engaged through a rolling 12 month Consultancy Agreement. Termination by the Company is with 6 months notice or payment in lieu thereof. Termination by the consultant is with 3 months notice.

Remuneration report (continued)

Employee Share Plan (audited)

Shares are issued under an Employee Share Plan ("ESP"), which has been approved by shareholders in Annual General Meeting ("AGM").

The purpose of the ESP is to attract, retain and motivate those who have been invited to participate in the ESP and thereby align their interests with those of other shareholders as a means of encouraging them to ensure that Company performance increases shareholder wealth through long term growth. Shares are issued based upon the assessed performance of each person against their job specifications and the recommendations of the Chief Executive Officer, and in the case of directors, with the approval of shareholders.

The following ESP shares were issued to directors and key management personnel during the period under review:

| Directors | Number of shares issued | Issue date | Issue price per share(\$) | Loan(\$) |
|--------------|-------------------------|---------------|---------------------------|-----------|
| EP Jacobson | 6,000,000 | 30 April 2007 | \$0.09 | \$540,000 |
| PJ Leonhardt | 3,000,000 | 30 April 2007 | \$0.09 | \$270,000 |

These issues were not subject to a performance condition. The issue price was calculated based on the 5 day weighted average closing price prior to the date of offer. The purchases were funded by interest-free loans with a limited recourse security over the plan shares and subject to the detailed rules of the ESP.

Mr Leonhardt's share issue, approved by shareholders on 30 April 2007, recognised his active day-to-day role in the management of the Company in support of Ted Jacobson in his role as Chief Executive Officer, over and above the normal role of non-executive Chairman on which his cash remuneration is based.

Mr Jacobson's share issue, approved by shareholders on 30 April 2007, provides an incentive to him in the role of Chief Executive Officer and recognises that his level of cash remuneration is significantly below market levels for an executive in the oil and gas industry with his standing and experience.

Directors' and executive officers' remuneration, Company and consolidated (audited)

Details of the nature and amount of each major element of the remuneration of each director of the Company and each of the named Company executives receiving the highest remuneration are set out on the following page.

The fair value of options, including ESP shares treated in principle as an option over the Company's shares, is calculated at the date of grant using the Black-Scholes Option Pricing Model.

Shares issued under the ESP vest immediately and their fair value recognised as an expense in the current period. The following factors and assumptions were used in determining the fair value of ESP shares at grant date, being the date of shareholder approval:

| Grant date | Assumed Expiry date | Fair value per option | Exercise price | Price of shares at grant date | Expected volatility | Risk free interest rate | Dividend yield |
|---------------|---------------------|-----------------------|----------------|-------------------------------|---------------------|-------------------------|----------------|
| 30 April 2007 | 30 April 2010 | \$0.074 | \$0.09 | \$0.135 | 55% | 5.5% | 0% |

**CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
DIRECTORS' REPORT (CONTINUED)**

Remuneration report (continued)

Directors' and executive officers' remuneration, Company and consolidated (audited) continued

| Name | Short Term | Post Employment | Termination Benefits (\$) | Share-based payments | | Total (\$) | Proportion of Remuneration Performance Related (%) | Value of Options as a Proportion of Remuneration (%) |
|---|----------------------|-----------------------------------|---------------------------|----------------------|--------------|-------------|--|--|
| | Salary and fees (\$) | Superannuation Contributions (\$) | | Shares (\$) | Options (\$) | | | |
| Directors | | | | | | | | |
| <i>Non-Executive</i> | | | | | | | | |
| Mr PJ Leonhardt (Chairman) | | | | | | | | |
| 2007 | \$60,000 | - | - | - | \$222,263 | \$282,263 | - | 78.74% |
| 2006 | \$45,000 | - | - | \$94,500 | \$101,522 | \$241,022 | - | 42.12% |
| Mr NC Fearis | | | | | | | | |
| 2007 | - | \$37,500 | - | - | - | \$37,500 | - | - |
| 2006 | \$27,750 | \$2,250 | - | - | \$67,681 | \$97,681 | - | 69.29% |
| Mr KP Judge | | | | | | | | |
| 2007 | \$37,500 | - | - | - | - | \$37,500 | - | - |
| 2006 | \$30,000 | - | - | - | \$67,681 | \$97,681 | - | 69.29% |
| <i>Executive</i> | | | | | | | | |
| Mr EP Jacobson (Chief Executive Officer) | | | | | | | | |
| 2007 | \$250,000 | - | - | - | \$444,527 | \$694,527 | - | 64.00% |
| 2006 (Appointed 5 December 2005) | \$76,620 | - | - | \$189,000 | \$135,362 | \$400,982 | - | 33.76% |
| Executive Officers | | | | | | | | |
| Mr RA Anderson (CFO/Company Secretary) | | | | | | | | |
| 2007 | \$149,936 | - | - | - | - | \$149,936 | - | - |
| 2006 (Appointed 28 November 2005) | \$71,880 | - | - | - | \$40,421 | \$112,301 | - | 35.99% |
| Total compensation: key management personnel (Company and Consolidated) | | | | | | | | |
| 2007 | \$497,436 | \$37,500 | - | - | \$666,790 | \$1,201,726 | | |
| 2006 | \$251,250 | \$2,250 | - | \$283,500 | \$412,667 | \$949,667 | | |

Mr Peter Leonhardt, the Chairman, is currently acting in a part time executive capacity to support the Chief Executive Officer. Mr Leonhardt's fulfillment of this role going forward will be monitored relative to the Company's stage of development.

Directors' fees are paid or payable to the director or a director related entity.

Remuneration report (continued)

Equity instruments (audited)

(i) Shares

There were no shares in the Company granted as compensation to key management personnel during the reporting period, other than the ESP shares treated in principle as an option over the Company's shares as described under (ii) below.

(ii) Options

There were no options over shares in the Company granted as compensation during the reporting period. No options have been granted since the end of the financial year.

Share issues under the Company's ESP are treated in principle as an option over the Company's shares and are included in the option tables below. These options are assumed to have a life of 3 years.

Details of options granted and vested to directors and executive officers during the reporting period are as follows. All options were issued for nil cash consideration, vest immediately, and have been recognised as an expense in the current period.

| Directors | Number of options granted | Grant date | Fair value per option at grant date | Exercise price per option | Assumed Expiry date |
|--------------|---------------------------|---------------|-------------------------------------|---------------------------|---------------------|
| EP Jacobson | 6,000,000 | 30 April 2007 | \$0.074 | \$0.09 | 30 April 2010 |
| PJ Leonhardt | 3,000,000 | 30 April 2007 | \$0.074 | \$0.09 | 30 April 2010 |

During the reporting period the following shares were issued on the exercise of options granted as compensation in prior periods:

| Director | Number of shares | Amount paid per share |
|-----------|------------------|-----------------------|
| NC Fearis | 2,000,000 | \$0.07 |

There are no amounts unpaid on shares issued as a result of the exercise of options in the reporting period.

During the reporting period there was no forfeiture or vesting of options granted in previous periods. At the end of the reporting period there were no unvested options on issue. All options expire on the expiry date but do not expire as a result of the termination of the holder's engagement with the Company.

The movement during the reporting period, by value, of options over ordinary shares, including shares issued under the Company's ESP, for each company director and company executive and granted as part of remuneration is detailed below:

| Directors | Granted in year (\$) | Value of Options | | Total option value in year (\$) |
|--------------|----------------------|------------------------|------------------------|---------------------------------|
| | | Exercised in year (\$) | Forfeited in year (\$) | |
| EP Jacobson | 444,527 | - | - | 444,527 |
| PJ Leonhardt | 222,263 | - | - | 222,263 |
| NC Fearis | - | 300,000 | - | 300,000 |

The value of options granted in the year is the fair value of the options at grant date using the Black-Scholes Option Pricing Model.

The value of options exercised during the year is calculated as the market price of shares of the Company on the Australian Securities Exchange as at close of trading on the date the options were exercised, after deducting the price paid to exercise the options.

**CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
DIRECTORS' REPORT (CONTINUED)**

Identification of independent directors

The independent directors are identified in the Corporate Governance Statement section of this Annual Report as set out on pages 60 to 63.

Non-audit services

The auditors have not performed any non-audit services over and above their statutory duties during the current reporting period.

A copy of the auditor's independence declaration as required under Section 307C of the Corporations Act is set out on page 26.

Details of the amounts paid or payable to the auditor of the consolidated entity for audit and non-audit services provided during the year are set out below:

| Audit Services | Consolidated 2007 (\$) |
|----------------|---------------------------|
|----------------|---------------------------|

Auditors of the Company:

| | |
|---------------------------------------|--------|
| Audit and review of financial reports | 48,005 |
|---------------------------------------|--------|

Directors' interests

At the date of this report, the relevant interests of the directors in securities of the Company are as follows:

| Name | Ordinary Shares | Options over ordinary Shares |
|--------------|--------------------|---------------------------------|
| PJ Leonhardt | 11,900,000 | 6,000,000 |
| EP Jacobson | 24,613,793 | 8,000,000 |
| NC Fearis | 6,316,186 | 2,000,000 |
| KP Judge | 15,068,596 | 4,000,000 |

Shares issued under the Company's ESP are included under the heading Ordinary Shares.

Likely developments

The likely developments for the 2008 financial year are contained in the Operating and Financial Review as set out on pages 5 to 15.

The directors are of the opinion that further information as to the likely developments in the operations of the consolidated entity would prejudice the interests of the Company and the consolidated entity and it has accordingly not been included.

Operating and financial review

An operating and financial review of the consolidated entity for the financial year ended 30 June 2007 is set out on pages 5 to 15 and forms part of this report.

Dividends

No dividends were paid during the year and the directors do not recommend payment of a dividend in respect of the current financial year.

Lead auditor's independence declaration

The lead auditor's independence declaration under Section 307C of the Corporations Act is set out on page 26 and forms part of the directors' report for the financial year ended 30 June 2007.

**CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
DIRECTORS' REPORT (CONTINUED)**

Share options

Options granted to directors and officers of the Company

There were no options over shares in the Company granted as compensation to key management personnel during the reporting period. No options have been granted since the end of the financial year.

Share issues under the Company's ESP are treated in principle as an option over the Company's shares and are included in the table below. These options are assumed to have a life of 3 years.

Details of ESP shares issued to directors and executive officers during the reporting period, and treated as options for valuation purposes, are as follows. These shares were issued for nil cash consideration, vest immediately, and have been recognised as an expense in the current period.

| <u>Directors</u> | <u>Number of shares granted</u> | <u>Exercise price per share</u> | <u>Assumed Expiry date</u> |
|------------------|---------------------------------|---------------------------------|----------------------------|
| EP Jacobson | 6,000,000 | \$0.09 | 30 April 2010 |
| PJ Leonhardt | 3,000,000 | \$0.09 | 30 April 2010 |

Shares under option

The following unissued ordinary shares of the Company are under option. These exclude share issues made under the Company's ESP.

| <u>Expiry Date</u> | <u>Exercise price</u> | <u>1 July 2006</u> | <u>Issued</u> | <u>Number Exercised</u> | <u>Expired</u> | <u>30 June 2007</u> |
|--------------------|-----------------------|--------------------|------------------|-------------------------|----------------|---------------------|
| 31/03/2008 | \$0.07 | 11,000,000 | - | 2,000,000 | - | 9,000,000 |
| 31/03/2009 | \$0.10 | 11,000,000 | 5,000,000 | - | - | 16,000,000 |
| | | <u>22,000,000</u> | <u>5,000,000</u> | <u>2,000,000</u> | <u>-</u> | <u>25,000,000</u> |

All options expire on the expiry date but do not expire as a result of the termination of the holder's engagement with the Company. Option holders do not have any right, by virtue of the option, to vote or to participate in any share issue of the Company or any related body corporate.

Hartleys Limited was issued with 5 million options during the year in lieu of part of the capital raising fees associated with a share placement.

During or since the end of the financial year, the following shares were issued as a result of the exercise of options:

| <u>Number of shares</u> | <u>Amount paid per share</u> |
|-------------------------|------------------------------|
| 2,000,000 | \$0.07 |

There are no amounts unpaid on the shares issued as a result of the exercise of options in the reporting period.

During the reporting period there was there no forfeiture or vesting of options granted in previous periods. At the end of the reporting period there were no unvested options on issue. All options expire on the expiry date but do not expire as a result of the termination of the holder's engagement with the Company.

Significant changes in state of affairs

A number of significant events occurred in the year under review:

- On 11 July 2006 development drilling commenced at the first well of a two-phase drilling programme at Carnarvon's 40%-owned Phetchabun Basin Joint Venture in Thailand. Twelve wells were drilled during the year, together with the acquisition of the majority of a new 120 km² 3D seismic survey being shot over the Bo Rang gas field and the northern section of Na Sanun East Oil Field.
- On 2 August 2006 the Company placed 50 million shares at 5 cents per share, raising \$2,500,000, in conjunction with an issue under a Share Purchase Plan of 20 million shares at 5 cents per share to raise \$1,000,000. The Share Purchase Plan closed oversubscribed on 30 August 2006. Funds raised from the issues were applied to accelerate the Phase 1 and Phase 2 drilling programmes, evaluation and assessment of new opportunities, and for working capital purposes.
- On 30 April 2007, pursuant to shareholder approval, the Company completed a two tranche placement of 160 million shares at 7.7 cents per share to raise \$12,320,000, to fund the expanded Phase 2 work programme within the Phetchabun Basin Joint Venture in Thailand, evaluation and assessment of new opportunities, and working capital.

Environmental regulation and performance

The consolidated entity's oil and gas exploration and development activities are concentrated in Thailand and Western Australia. Environmental obligations are regulated under both State and Federal Law in Western Australia and under the Department of Mineral Fuels regulations in Thailand.

No significant environmental breaches have been notified by any government agency during the year ended 30 June 2007.

Indemnification and insurance of directors and officers

During the financial year the Company paid a premium to insure the directors and officers of the Company and its controlled entities. The policy prohibits the disclosure of the nature of the liabilities covered and the amount of the premium paid.

Events subsequent to reporting date

No matter or circumstance has arisen since 30 June 2007 that in the opinion of the directors has significantly affected, or may significantly affect in future financial years:

- (i) the consolidated entity's operations, or
- (ii) the results of those operations, or
- (iii) the consolidated entity's state of affairs

Signed in accordance with a resolution of the directors.



PJ Leonhardt
Director

Perth, 27 September 2007

AUDITOR'S INDEPENDENCE DECLARATION

In accordance with the requirements of section 307C of the Corporations Act 2001, as lead auditor for the audit of Carnarvon Petroleum Limited for the year ended 30 June 2007, I declare that, to the best of my knowledge and belief, there have been:

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

WHK HORWATH PERTH AUDIT PARTNERSHIP



SEAN MCGURK
Principal

Perth, WA

Dated this 27th day of September 2007

INCOME STATEMENTS

For the year ended 30 June 2007

| | Notes | Consolidated | | Company | |
|---|-------|--------------------|--------------------|--------------------|--------------------|
| | | 2007 \$ | 2006 \$ | 2007 \$ | 2006 \$ |
| Sales revenue from continuing operations | | 3,673,595 | 1,090,213 | - | - |
| Other income | 4 | 247,205 | 189,582 | 239,688 | 184,277 |
| Cost of sales | 5 | (3,161,782) | (799,130) | - | - |
| Administrative expenses | | (670,361) | (559,497) | (670,361) | (559,497) |
| Directors' fees | | (156,250) | (235,805) | (156,250) | (235,805) |
| Employee benefits expense | | (101,005) | (74,660) | (101,005) | (74,660) |
| Legal fees | | (18,460) | (36,639) | (18,460) | (36,639) |
| Unrealised foreign exchange (loss) / gain | | 53,636 | 6,935 | (1,415,794) | 166,394 |
| Exploration expenditure written off | | (74,752) | (107,242) | (74,752) | (107,242) |
| New ventures | | (379,950) | (10,507) | (379,950) | (10,507) |
| Share based payments | | (933,819) | (706,272) | (933,819) | (706,272) |
| Finance costs | | (20,267) | (3,310) | (1,388) | (2,357) |
| (Loss) before income tax | | (1,542,210) | (1,246,332) | (3,512,091) | (1,382,308) |
| Income tax expense | 10 | - | - | - | - |
| (Loss) from continuing operations | | (1,542,210) | (1,246,332) | (3,512,091) | (1,382,308) |
| Profit on sale of discontinued operation | 8 | - | 488,182 | - | 488,182 |
| (Loss) attributable to members of the parent entity | | (1,542,210) | (758,150) | (3,512,091) | (894,126) |
| Basic (loss) per share from continuing operations (cents per share) | 9 | (0.3) | (0.4) | | |
| Diluted (loss) per share from continuing operations (cents per share) | 9 | (0.3) | (0.4) | | |
| Basic and diluted profit per share from discontinued operations (cents per share) | 9 | - | 0.1 | | |

The income statements should be read in conjunction with the accompanying notes to the financial statements.

BALANCE SHEETS

As at 30 June 2007

| | Notes | Consolidated | | Company | |
|--------------------------------------|-------|-------------------|------------------|-------------------|------------------|
| | | 2007 \$ | 2006 \$ | 2007 \$ | 2006 \$ |
| Current assets | | | | | |
| Cash and cash equivalents | 19(b) | 8,927,018 | 1,897,846 | 6,520,307 | 1,558,676 |
| Trade and other receivables | 11 | 1,684,019 | 175,482 | 123,516 | 47,118 |
| Inventories | 12 | 1,110,661 | 235,138 | - | - |
| Other assets | 13 | 639,298 | 18,153 | 33,646 | 18,153 |
| Total current assets | | 12,360,996 | 2,326,619 | 6,677,469 | 1,623,947 |
| Non-current assets | | | | | |
| Trade and other receivables | 11 | - | 53,400 | 13,024,341 | 5,403,342 |
| Other financial assets | 14 | - | - | 1,482,962 | 1,482,962 |
| Property, plant and equipment | 15 | 12,233,722 | 6,996,586 | 70,074 | 70,364 |
| Total non-current assets | | 12,233,722 | 7,049,986 | 14,577,377 | 6,956,668 |
| Total assets | | 24,594,718 | 9,376,605 | 21,254,846 | 8,580,615 |
| Current liabilities | | | | | |
| Trade and other payables | 16 | 3,027,539 | 602,640 | 297,228 | 145,131 |
| Employee benefits | 22 | 4,280 | - | 4,280 | - |
| Total current liabilities | | 3,031,819 | 602,640 | 301,508 | 145,131 |
| Non-current liabilities | | | | | |
| Provisions | 17 | 105,440 | 67,675 | - | - |
| Total non-current liabilities | | 105,440 | 67,675 | - | - |
| Total liabilities | | 3,137,259 | 670,315 | 301,508 | 145,131 |
| Net assets | | 21,457,759 | 8,706,290 | 20,953,338 | 8,435,484 |
| Equity | | | | | |
| Issued capital | | 65,040,943 | 50,219,815 | 65,040,943 | 50,219,815 |
| Reserves | | (1,895,658) | (1,367,909) | 1,486,928 | 278,111 |
| Accumulated losses | | (41,687,826) | (40,145,616) | (45,574,533) | (42,062,442) |
| Total equity | | 21,457,459 | 8,706,290 | 20,953,338 | 8,435,484 |

The balance sheets should be read in conjunction with the accompanying notes to the financial statements.

STATEMENTS OF CHANGES IN EQUITY

Consolidated Entity

For the year ended 30 June 2007

| | Issued capital \$ | Accumulated losses \$ | Available- for-sale asset revaluation reserve \$ | Translation reserve \$ | Share based payments reserve \$ | Total \$ |
|---|-------------------------|-----------------------------|---|------------------------------|--|-------------------|
| Balance at 1 July 2005 | 45,438,074 | (39,387,466) | 86,740 | (1,890,975) | (9,811) | 4,236,562 |
| Shares issued, net of transaction costs | 4,781,741 | - | - | - | - | 4,781,741 |
| Exchange differences on translation of foreign operations | - | - | - | 244,955 | - | 244,955 |
| Available-for-sale financial assets | - | - | (86,740) | - | - | (86,740) |
| Share based payments | - | - | - | - | 287,922 | 287,922 |
| Loss attributable to members of parent entity | - | (758,150) | - | - | - | (758,150) |
| Balance at 30 June 2006 | 50,219,815 | (40,145,616) | - | (1,646,020) | 278,111 | 8,706,290 |
| Shares issued, net of transaction costs | 14,777,945 | - | - | - | - | 14,777,945 |
| Exchange differences on translation of foreign operations | - | - | - | (1,736,566) | - | (1,736,566) |
| Available-for-sale financial assets | - | - | - | - | - | - |
| Share based payments | 43,183 | - | - | - | 1,208,817 | 1,252,000 |
| Loss attributable to members of parent entity | - | (1,542,210) | - | - | - | (1,542,210) |
| Balance at 30 June 2007 | 65,040,943 | (41,687,826) | - | (3,382,586) | 1,486,928 | 21,457,459 |

The statements of changes in equity should be read in conjunction with the accompanying notes to the financial statements.

STATEMENTS OF CHANGES IN EQUITY

Parent Entity

For the year ended 30 June 2007

| | Issued capital \$ | Accumulated losses \$ | Available- for-sale asset revaluation reserve \$ | Share based payments reserve \$ | Total \$ |
|--|----------------------------------|--------------------------------------|---|--|---------------------|
| Balance at 1 July 2005 | 45,438,074 | (41,168,316) | 86,740 | (9,811) | 4,346,687 |
| Shares issued, net of transaction costs | 4,781,741 | - | - | - | 4,781,741 |
| Available-for-sale financial assets | - | - | (86,740) | - | (86,740) |
| Share based payments | - | - | - | 287,922 | 287,922 |
| Loss attributable to members of parent entity | - | (894,126) | - | - | (894,126) |
| Balance at 30 June 2006 | 50,219,815 | (42,062,442) | - | 278,111 | 8,435,484 |
| Shares issued, net of transaction costs | 14,777,945 | - | - | - | 14,777,945 |
| Available-for-sale financial assets | - | - | - | - | - |
| Share based payments | 43,183 | - | - | 1,208,817 | 1,252,000 |
| Loss attributable to members of parent entity | - | (3,512,091) | - | - | (3,512,091) |
| Balance at 30 June 2007 | 65,040,943 | (45,574,533) | - | 1,486,928 | 20,953,338 |

The statements of changes in equity should be read in conjunction with the accompanying notes to the financial statements.

STATEMENTS OF CASH FLOWS

For the year ended 30 June 2007

| | Notes | Consolidated | | Company | |
|---|-------|--------------------|--------------------|--------------------|--------------------|
| | | 2007 | 2006 | 2007 | 2006 |
| | | \$ | \$ | \$ | \$ |
| Cash flows from operating activities | | | | | |
| Receipts from customers and GST recovered | | 2,782,458 | 1,133,371 | 139,467 | 77,738 |
| Payments to suppliers and employees | | (3,794,436) | (1,697,075) | (1,345,181) | (1,010,843) |
| Interest received | | 212,742 | 45,345 | 205,707 | 45,345 |
| Interest paid | | (1,388) | (2,357) | (1,388) | (2,357) |
| Net cash flows (used in) operating activities | 19a | <u>(800,624)</u> | <u>(520,716)</u> | <u>(1,001,395)</u> | <u>(890,117)</u> |
| Cash flows from investing activities | | | | | |
| Exploration and development expenditure | | (7,187,965) | (2,747,147) | (333,894) | (159,775) |
| Net proceeds from discontinued operation | | - | 488,182 | - | 488,182 |
| Proceeds from sale of property, plant and equipment | | - | 100 | - | 100 |
| Acquisition of property, plant and equipment | | (86,855) | (120,280) | (25,926) | (72,051) |
| Proceeds from sale of equity investments | | - | 90,759 | - | 90,759 |
| Net (advances to) controlled entities | | - | - | (8,829,294) | (2,437,805) |
| Net cash flows (used in) investing activities | | <u>(7,274,820)</u> | <u>(2,288,386)</u> | <u>(9,189,114)</u> | <u>(2,090,590)</u> |
| Cash flows from financing activities | | | | | |
| Proceeds from issue of share capital | | 15,960,000 | 4,719,077 | 15,960,000 | 4,719,077 |
| Payment of share issue costs | | (880,874) | (320,836) | (880,874) | (320,836) |
| Proceeds from repayment of Employee Share Plan loans | | 77,000 | - | 77,000 | - |
| Net cash flows from financing activities | | <u>15,156,126</u> | <u>4,398,241</u> | <u>15,156,126</u> | <u>4,398,241</u> |
| Net increase in cash and cash equivalents | | | | | |
| Cash and cash equivalents at the beginning of the financial year | | 7,080,682 | 1,589,139 | 4,965,617 | 1,417,534 |
| Effect of exchange rate fluctuations on cash and cash equivalents | | 1,897,846 | 301,454 | 1,558,676 | 134,102 |
| | | (51,510) | 7,253 | (3,986) | 7,040 |
| Cash and cash equivalents at the end of the financial year | 19(b) | <u>8,927,018</u> | <u>1,897,846</u> | <u>6,520,307</u> | <u>1,558,676</u> |

The statements of cash flows should be read in conjunction with the accompanying notes to the financial statements.

1. Reporting entity

The consolidated financial report of the Company for the financial year ended 30 June 2007 comprises the Company and its subsidiaries (the “consolidated entity”) and the consolidated entity’s interest in jointly controlled entities and operations. The financial report was authorised for issue by the directors on 27 September 2007.

2. Basis of preparation of the financial report

Statement of compliance

The financial report is a general purpose financial report prepared in accordance with Australian Accounting Standards (“AASBs”) (including Australian Accounting Interpretations), as adopted by the Australian Accounting Standards Board (“AASB”), and the Corporations Act 2001.

The consolidated financial report is prepared in accordance with International Financial Reporting Standards (“IFRSs”) and interpretations adopted by the International Accounting Standards Board. The Company’s financial report does not comply with IFRS in its entirety as the Company has elected to apply the relief provided to parent entities by AASB 132 *Financial Instruments: Presentation and Disclosure* in respect of certain disclosure requirements.

Basis of measurement

The financial report is prepared on a historical cost basis, except for available-for-sale financial assets which are measured at fair value.

Functional and presentation currency

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

Use of estimates and judgements

The preparation of the financial report requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Key estimate – impairment

The consolidated entity assesses impairment at each reporting date by evaluating conditions specific to the group that may lead to the impairment of assets. Where an impairment trigger exists, the recoverable amount of the asset is determined. Value-in-use calculations performed in assessing recoverable amounts incorporate a number of key estimates. There was not considered to be any impairment trigger over the carrying value of the consolidated entity’s interest in the Phetchabun Basin Joint Venture at the date of this report.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial report. The accounting policies have been applied consistently by all entities in the consolidated entity.

Certain comparative amounts have been reclassified to conform with the current year’s presentation.

3. Significant accounting policies (continued)

(a) Basis of consolidation

Subsidiaries

The consolidated financial report comprises the financial statements of the Company and its controlled entities. A controlled entity is any entity controlled by the Company whereby the Company has the power to control the financial and operating policies of an entity so as to obtain benefits from its activities. 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 consistency with those applied by the parent entity.

Where controlled entities enter or leave the economic entity during the year, their operating results are included or excluded from the date control was obtained or until the date control ceased.

Investments in subsidiaries are carried at cost in the Company's financial statements.

Joint venture operations and assets

The consolidated entity's share of the assets, liabilities, revenue and expenses of joint venture operations are included in the financial statements under the appropriate headings.

(b) Income tax

The charge for current income tax expense is based on the result for the year adjusted for any non-assessable or disallowed items. It is calculated using tax rates that have been enacted or are substantively enacted by balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is recognised in the income statement except where it relates to items recognised directly in equity, in which case it is recognised in equity. Deferred income tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and tax losses. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the company / group intends to settle its current tax assets and liabilities on a net basis.

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law. The carrying amount of deferred tax assets is reviewed at each balance date and only recognised to the extent that sufficient future assessable income is expected to be obtained.

Tax consolidation

Carnarvon Petroleum Limited and its wholly-owned Australian resident subsidiaries formed a tax-consolidated group with effect from 1 July 2003 and are therefore taxed a single entity from that date. Carnarvon Petroleum Limited is the head entity of the tax-consolidated group.

At reporting date the consolidated entity has not recognised any tax assets or tax liabilities in respect of any wholly-owned entity within the consolidated group. In future periods the members of the group will, if required, enter into a tax sharing agreement whereby each company in the group contributes to the income tax payable in proportion to their contribution to the net profit before tax of the tax consolidated group.

3. Significant accounting policies (continued)

(c) Property, plant and equipment

Recognition and measurement

All property, plant and equipment is stated at cost less accumulated depreciation and impairment losses. The cost of an item also includes the initial estimate of the costs of dismantling and removing an item and restoring the site on which it is located.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Mining property and development assets include costs transferred from exploration and evaluation assets once technical feasibility and commercial viability of an area of interest are demonstrable, together with subsequent costs to develop the asset to the production phase. Where the directors decide that specific costs will not be recovered from future development, those costs are charged to the income statement during the financial period in which the decision is made.

Impairment

The carrying amount of property, plant and equipment is reviewed at each balance date to determine whether there are any objective indicators of impairment that may indicate the carrying values may not be recoverable in whole or in part. Impairment testing is carried out in accordance with Note 3(f).

Where an asset does not generate cash flows that are largely independent it is assigned to a cash generating unit and the recoverable amount test applied to the cash generating unit as a whole.

If the carrying value of the asset is determined to be in excess of its recoverable amount, the asset or cash generating unit is written down to its recoverable amount.

Depreciation

Depreciation on plant and equipment is calculated on a straight line basis over expected useful life to the economic entity commencing from the time the asset is held ready for use. The major depreciation rates used for each class of depreciable assets are:

Plant and equipment: 20% to 33%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at least annually.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These gains and losses are included in the income statement.

Depreciation of mining property and development costs is calculated on a unit of production basis so as to write off the costs in proportion to the depletion of the estimated recoverable reserves.

(d) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less any estimated selling costs.

Cost includes those costs incurred in bringing each component of inventory to its present location and condition.

3. Significant accounting policies (continued)

(e) Intangible assets

Exploration and evaluation expenditure

Exploration and evaluation expenditure incurred is accumulated in respect of each identifiable area of interest. These costs are only carried forward to the extent that the consolidated entity's rights of tenure to the area are current and that the costs 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.

Each area of interest is assessed for impairment to determine the appropriateness of continuing to carry forward costs in relation to that area of interest. Impairment testing is carried out in accordance with Note 3(f).

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.

Once the technical feasibility and commercial viability of the extraction of mineral resources in an area of interest are demonstrable, exploration and evaluation assets attributable to that area of interest are first tested for impairment and then reclassified from intangible assets to mining property and development assets within property, plant and equipment.

(f) Recoverable amount of assets and impairment testing

Assets that have an indefinite useful life are not subject to depreciation and are tested annually for impairment by estimating their recoverable amount.

Assets that are subject to depreciation are reviewed annually to determine whether there is any indication of impairment. Where such an indicator exists, a formal assessment of recoverable amount is then made. Where this is in excess of carrying amount, the asset is written down to its recoverable amount.

Recoverable amount is the greater of fair value less costs to sell and value in use. Value in use is the present value of the future cash flows expected to be derived from the asset or cash generating unit. In estimating value in use, a pre-tax discount rate is used which reflects the current market assessments of the time value of money and the risks specific to the asset. Any resulting impairment loss is recognised immediately in the income statement.

(g) Trade receivables

Trade receivables are stated at fair value and subsequently measured at amortised cost, less impairment losses. Impairment testing is carried out in accordance with Note 3(f).

(h) Provisions

Provisions are recognised when the consolidated entity has a legal or constructive obligation, as a result of past events, for which it is probable that an outflow of economic benefits will result and that outflow can be reliably measured. Provisions are determined by discounting the expected future cash flows at a pre-tax discount rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Restoration costs

The amount of the provision for future restoration and rehabilitation costs is capitalised and depreciated in accordance with the policy set out in Note 3(c). The unwinding of the effect of discounting on the provision is recognised as a finance cost.

3. Significant accounting policies (continued)

(i) Investments and other financial assets

The consolidated entity determines the classification of its financial instruments at initial recognition and re-evaluates this designation at each reporting date.

Fair value is the measurement basis, with the exception of held-to-maturity investments and loans and receivables which are measured at amortised cost. Fair value is inclusive of transaction costs. Changes in fair value are either taken to the income statement or to an equity reserve (refer below).

Fair value is determined based on current bid prices for all quoted investments. If there is not an active market for a financial asset fair value is measured using established valuation techniques.

The consolidated entity assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets are impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of a security below its cost is considered in determining whether the security is impaired. If any such evidence exists the cumulative loss is removed from equity and recognised in the income statement.

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

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Realised and unrealised gains and losses arising from changes in the fair value of these assets are included in the income statement in the period in which they arise.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method, less any impairment losses.

(iii) Held-to-maturity investments

These investments have fixed maturities, and it is the group's intention to hold these investments to maturity. Held-to-maturity investments are stated at amortised cost using the effective interest rate method.

(iv) Available-for-sale financial assets

Available for sale financial assets, comprising principally marketable equity securities, are non-derivatives that are either designated in this category or not included in any of the above categories. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity in an available-for-sale investments revaluation reserve. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains and losses from investment securities.

(j) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different to those of other business segments.

A geographical segment is engaged in providing products or services within a particular economic environment and is subject to risks and returns that are different from those of segments that are operating in other economic environments.

3. Significant accounting policies (continued)

(k) Foreign currency

Functional and presentation currency

The functional currency of each of the group's entities is measured using the currency of the primary economic environment in which that entity operates (the "functional" currency). The consolidated financial statements are presented in Australian dollars which is the parent entity's functional and presentation currency.

Transactions and balances

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rate at balance sheet date. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction.

Exchange differences arising on the translation of monetary items are recognised in the income statement, except where deferred in equity as a qualifying cash flow or net investment hedge.

Translation differences arising on non-monetary items, such as equities held at fair value through profit and loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

Foreign operations

The financial performance and position of foreign operations whose functional currency is different from the consolidated entity's presentation currency are translated as follows:

- assets and liabilities are translated at exchange rates prevailing at balance sheet date.
- income and expenses are translated at average exchange rates for the period

Exchange differences arising on translation of foreign operations are transferred directly to the group's foreign currency translation reserve as a separate component of equity. These differences are recognised in the income statement upon disposal of the foreign operation.

(l) Leases

Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and benefits incidental to ownership.

Operating leases

A lease where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments in relation to operating leases are charged to the income statement on a straight-line basis over the period of the lease.

(m) Share capital

Incremental costs directly attributable to an equity transaction are shown as a deduction from equity, net of any recognised income tax benefit.

3. Significant accounting policies (continued)

(n) Employee benefits

Wages and salaries, annual leave

Provision is made for the consolidated entity's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits that are expected to be settled within one year have been measured at the amounts expected to be paid when the liability is settled, plus related on-costs.

Share based payments – shares and share options

The fair value of shares and share options granted is recognised as an expense with a corresponding increase in equity. Fair value is measured at grant date and recognised over the period during which the grantees become unconditionally entitled to the shares or share options.

The fair value of share grants at grant date is determined by the share price at that time.

The fair value of share options at grant date is determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, any vesting and performance criteria, the share price at grant date, the expected price volatility of the underlying share, the expected dividend yield and the risk free rate for the term of the option.

Share based payments – Employee Share Plan

Share based compensation has been provided to eligible persons via the Carnarvon Employee Share Plan ("ESP"), financed by means of interest free limited recourse loans. Under AASB 2 "*Share-based Payment*", the ESP shares are deemed to be equity settled, share based remuneration and treated as an in-substance grant of options.

For limited recourse loans issued to eligible persons on or after 1 January 2005, the consolidated entity is required to recognise within the income statement a remuneration expense measured at the fair value of the "share option" inherent in the issue to the eligible person, with a corresponding increase to a share-based payments reserve in equity. The fair value is measured at grant date and recognised when the eligible person become unconditionally entitled to the shares, effectively on grant. A loan receivable is not be recognised.

The fair value at grant date is determined using a pricing model that factors in the share price at grant date, the expected price volatility of the underlying share, the expected dividend yield, and the risk free rate for the assumed term of the "option".

Upon the exercise of the "option", the balance of the share-based payments reserve relating to the "options" is transferred to share capital.

(o) Earnings per share

The consolidated entity presents basic and diluted earnings per share ("ESP") for its ordinary shares.

Basic EPS is calculated by dividing the profit attributable to equity holders of the Company by the weighted number of shares outstanding during the period.

Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all potential ordinary shares, which comprise share options granted.

3. Significant accounting policies (continued)

(p) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held at call with banks, and other short-term highly liquid investments.

(q) Revenue

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership have been transferred to the buyer.

(r) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax ("GST"), except where the amount of GST incurred is not recoverable from the Australian Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of the expense. Receivables and payables in the balance sheet are shown inclusive of GST.

Cash flows are presented in the cash flow statement on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

(s) Trade and other payables

Trade and other payables are stated at amortised cost. The amounts are unsecured and usually paid within 60 days of recognition.

(t) Finance income and expenses

Interest revenue on funds invested is recognised as it accrues, using the effective interest rate method.

Finance expenses comprise interest expense on borrowings and the unwinding of the discount on provisions.

(u) Comparative figures

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

(v) New standards and interpretations not yet adopted

The AASB has issued a number of AASBs and amendments to AASBs which are available for early adoption.

The Company and consolidated entity have not early adopted any of these accounting standards or amendments as they are not expected to have a material impact on the financial results of the Company or consolidated entity. They may have an effect on the disclosures of the Company and consolidated entity, however a detailed assessment of the potential impact has not been undertaken at the date of this report.

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| Notes | Consolidated | | Company | |
|---|--------------------|------------------|-----------------|-----------------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| 4. Other income | | | | |
| Reversal of provision for non-recovery of Employee Share Plan loans | 6,600 | 134,520 | 6,600 | 134,520 |
| Finance income | 240,123 | 50,258 | 233,088 | 50,258 |
| Net gain on disposal of property, plant and equipment | - | 100 | - | 100 |
| Net (loss) from sale of equity investments | - | (715) | - | (715) |
| Other | 482 | 5,419 | - | 114 |
| | <u>247,205</u> | <u>189,582</u> | <u>239,688</u> | <u>184,277</u> |
| 5. Cost of sales | | | | |
| Production | (1,385,511) | (251,208) | - | - |
| Royalty and excise | (409,693) | (173,593) | - | - |
| Transportation | (168,249) | (47,491) | - | - |
| Depreciation of production assets and development costs | (306,896) | (46,763) | - | - |
| Selling, general and administration | (891,433) | (280,075) | - | - |
| | <u>(3,161,782)</u> | <u>(799,130)</u> | <u>-</u> | <u>-</u> |
| 6. Other expenses | | | | |
| Depreciation – plant & equipment | (28,097) | (5,219) | (28,097) | (5,219) |
| Rental premises – operating lease | (60,319) | (43,442) | (60,319) | (43,442) |
| | <u>(88,416)</u> | <u>(48,661)</u> | <u>(88,416)</u> | <u>(48,661)</u> |
| 7. Auditors' remuneration | | | | |
| <i>Audit services:</i> | | | | |
| Auditors of the Company | 48,005 | 31,983 | 48,005 | 31,983 |
| <i>Other services:</i> | | | | |
| Auditors of the Company: | | | | |
| Taxation services | - | 36,025 | - | 36,025 |
| | <u>48,005</u> | <u>68,008</u> | <u>48,005</u> | <u>68,008</u> |

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8. Discontinued operation

On 28 October 2005 the Company announced that it had accepted a \$500,000 unconditional offer from a third party to acquire the Company's interest in Petroleum Retention Licences ("PRLs") 4 and 5 in Papua New Guinea. Other joint venture partners subsequently exercised their pre-emptive rights in respect of the sale.

The Company and consolidated entity's financial performance and cash flow information for these licences is as follows:

| | 2007 | 2006 |
|---|-------------|-------------|
| | \$ | \$ |
| Revenue | - | - |
| Expenses | - | (11,818) |
| (Loss) before tax | - | (11,818) |
| Income tax expense | - | - |
| (Loss) after tax, but before gain on sale of discontinued operation | - | (11,818) |
| Gain on sale of discontinued operation, net of tax expense | - | 500,000 |
| Profit for the period | - | 488,182 |
| Net cash flows from investing activities | - | 488,182 |
| Net increase in cash from discontinued operation | - | 488,182 |

9. Earnings per share

| | 2007 | 2006 |
|---|-------------|-------------|
| <i>Basic (loss)/ profit per share (cents per share)</i> | | |
| From continuing operations | (0.3) | (0.4) |
| From discontinued operations | - | 0.1 |

| | | |
|--|-------|-------|
| <i>Diluted earnings / (loss) per share (cents per share)</i> | | |
| From continuing operations | (0.3) | (0.4) |
| From discontinued operations | - | 0.1 |

| | Number | |
|--|---------------|-------------|
| Issued ordinary shares at 1 July | 411,787,134 | 272,312,513 |
| Effect of shares issued | 95,027,860 | 67,630,141 |
| Effect of options exercised | 98,630 | 13,108 |
| Weighted average number of ordinary shares 30 June (basic) | 506,913,624 | 339,955,762 |
| Effect of share options on issue | 22,750,685 | 5,183,562 |
| Weighted average number of ordinary shares 30 June (diluted) | 529,664,309 | 345,139,324 |

| | | |
|---|---------------|---------------|
| Loss used in calculating basic and diluted loss per share from continuing operations | (\$1,542,210) | (\$1,246,332) |
| Profit used in the calculation of basic and diluted earnings per share from discontinued operations | - | \$488,182 |

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NOTES TO THE FINANCIAL STATEMENTS

| Notes | Consolidated | | Company | |
|--|--------------|-----------|-----------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| 10. Income tax expense | | | | |
| <i>Numerical reconciliation between pre-tax loss and income tax expense:</i> | | | | |
| Prima facie income tax benefit on pre-tax loss | 462,663 | 227,445 | 1,053,627 | 268,238 |
| Tax effect of: | | | | |
| Foreign sourced income | 166,752 | 88,631 | - | - |
| Exempt gain on sale of discontinued foreign operation | - | 146,455 | - | 146,455 |
| Unrealized foreign exchange gains / (losses) | 16,092 | 2,081 | (424,737) | 49,919 |
| Non-assessable income | 1,980 | 40,356 | 1,980 | 40,356 |
| Non-deductible expenditure | (294,936) | (235,793) | (294,936) | (235,793) |
| Current year tax benefit not brought to account | (352,551) | (269,175) | (335,934) | (269,175) |
| Income tax expense on pre-tax loss | - | - | - | - |

Unrecognised net deferred tax assets

Deferred tax assets have not been recognised in respect of the following items (refer Note 3(b)):

| | | | | |
|----------------------------------|------------------|----------------|------------------|----------------|
| Deductible temporary differences | 287,757 | 16,200 | 1,036,761 | 16,200 |
| Tax losses | 1,070,275 | 824,212 | 1,053,657 | 824,212 |
| | <u>1,358,032</u> | <u>840,412</u> | <u>2,090,418</u> | <u>840,412</u> |

Tax Consolidation

Effective 1 July 2003, for the purposes of Australian income taxation, Carnarvon Petroleum Ltd ("Carnarvon") and its 100% owned subsidiaries formed a tax consolidated group. The head entity of the tax consolidated group is Carnarvon.

The impact of consolidating for tax purposes is that Carnarvon's Australian subsidiaries are treated as divisions of Carnarvon rather than as separate entities for tax purposes. The members of the group will, if required, enter into a tax sharing arrangement in order to allocate group tax related liabilities to contributing members on a reasonable basis. The agreement will provide for the allocation of income tax liabilities between entities should the head entity default on its tax payment obligations.

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NOTES TO THE FINANCIAL STATEMENTS

| | Consolidated | | Company | |
|---|------------------|----------------|-------------------|------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Notes | \$ | \$ | \$ | \$ |
| 11. Trade and other receivables | | | | |
| <i>Current</i> | | | | |
| Trade and other receivables | 1,533,825 | 175,482 | 123,516 | 47,118 |
| Owing by Phetchabun Basin Joint Venture partner | 150,194 | - | - | - |
| | <u>1,684,019</u> | <u>175,482</u> | <u>123,516</u> | <u>47,118</u> |
| <i>Non-Current</i> | | | | |
| Amounts receivable from controlled entities | - | - | 13,717,690 | 6,043,291 |
| Provision for non-recovery | - | - | (693,349) | (693,349) |
| | - | - | <u>13,024,341</u> | <u>5,349,942</u> |
| Employee Share Plan loans | - | 60,000 | - | 60,000 |
| Provision for non-recovery | - | (6,600) | - | (6,600) |
| | - | <u>53,400</u> | - | <u>53,400</u> |
| | - | <u>53,400</u> | <u>13,024,341</u> | <u>5,403,342</u> |
| 12. Inventories | | | | |
| <i>Current</i> | | | | |
| Raw materials and consumables | 1,110,661 | 235,138 | - | - |
| | <u>1,110,661</u> | <u>235,138</u> | - | - |
| 13. Other assets | | | | |
| <i>Current</i> | | | | |
| Deposits and prepayments | 639,928 | 18,153 | 33,646 | 18,153 |
| | <u>639,928</u> | <u>18,153</u> | <u>33,646</u> | <u>18,153</u> |

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| | Consolidated | | Company | |
|--|--------------|------|-----------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| 14. Other financial assets | | | | |
| <i>Non-current</i> | | | | |
| Investments in controlled entities – at cost | - | - | 1,482,962 | 1,482,962 |

The consolidated entity has the following interests in joint venture operations:

| Joint venture | Principal activities | Ownership interest % |
|---|---|----------------------|
| <i>Thailand</i> | | |
| Phetchabun Basin Concession, Exploration Blocks L44/43 and L33/43 | Exploration, development, production and marketing of crude oil | 40% |
| <i>Western Australia</i> | | |
| EP 110 & 424 (Carnarvon Basin) | Exploration for hydrocarbons | 35% |
| <i>Western Australia</i> | | |
| WA-399-P (Carnarvon Basin) | Exploration for hydrocarbons | 50% |

Summary financial information for the Phetchabun Basin Joint Venture is included in the financial statements as follows:

| | Consolidated | |
|-------------------------------|--------------|-----------|
| | 2007 | 2006 |
| | \$ | \$ |
| Current assets | | |
| Cash and cash equivalents | 2,406,711 | 339,170 |
| Trade and other receivables | 1,594,086 | 128,364 |
| Inventories | 1,110,661 | 235,138 |
| Other assets | 572,069 | - |
| Total current assets | 5,683,527 | 702,672 |
| Non-current assets | | |
| Property, plant and equipment | 12,163,648 | 6,926,222 |
| Total non-current assets | 12,163,648 | 6,926,222 |
| Total assets | 17,847,175 | 7,628,894 |
| Current liabilities | | |
| Payables | 2,730,311 | 14,657 |
| Total current liabilities | 2,730,311 | 14,657 |
| Non-current liabilities | | |
| Provisions | 105,440 | 67,675 |
| Total non-current liabilities | 105,440 | 67,675 |
| Total liabilities | 2,835,751 | 82,332 |
| Net assets | 15,011,424 | 7,546,562 |
| Income | 3,681,112 | 1,095,518 |
| Expenses | (3,125,271) | (800,083) |
| Net profit | 555,841 | 295,435 |

Expenditure on joint ventures other than the Phetchabun Basin Joint Venture is expensed as incurred. Expenditure written off in respect of the current reporting period was \$74,752 (2006: \$107,242).

Capital expenditure commitments and contingent liabilities in respect of the joint ventures are disclosed in Notes 20 and 21 respectively.

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| Notes | Consolidated | | Company | |
|--|-------------------|------------------|----------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| 15. Property, plant and equipment | | | | |
| <i>Plant and Equipment</i> | | | | |
| Cost: | | | | |
| Balance at beginning of financial year | 327,279 | 203,658 | 80,641 | 11,316 |
| Additions | 105,740 | 120,280 | 27,807 | 72,051 |
| Disposals | - | (2,726) | - | (2,726) |
| Transfers | (110,807) | - | - | - |
| Effects of movements in foreign exchange | (28,803) | 6,067 | - | - |
| Balance at end of financial year | <u>293,409</u> | <u>327,279</u> | <u>108,448</u> | <u>80,641</u> |
| Depreciation and impairment losses: | | | | |
| Balance at beginning of financial year | 147,933 | 120,114 | 10,277 | 7,784 |
| Disposals | - | (2,726) | - | (2,726) |
| Transfers | (22,161) | - | - | - |
| Depreciation charge for year | 63,246 | 30,545 | 28,097 | 5,219 |
| Balance at end of financial year | <u>189,018</u> | <u>147,933</u> | <u>38,374</u> | <u>10,277</u> |
| Carrying amount | <u>104,391</u> | <u>179,346</u> | <u>70,074</u> | <u>70,364</u> |
| <i>Mining property and development</i> | | | | |
| Cost: | | | | |
| Balance at beginning of financial year | 7,167,531 | 4,279,320 | - | - |
| Additions | 6,676,220 | 2,639,906 | - | - |
| Transfers | 110,807 | - | - | - |
| Effects of movements in foreign exchange | (1,181,028) | 248,305 | - | - |
| Balance at end of financial year | <u>12,773,530</u> | <u>7,167,531</u> | <u>-</u> | <u>-</u> |
| Depreciation and impairment losses: | | | | |
| Balance at beginning of financial year | 350,291 | 328,854 | - | - |
| Transfers | 22,161 | - | - | - |
| Depreciation charge for year | 271,747 | 21,437 | - | - |
| Balance at end of financial year | <u>644,199</u> | <u>350,291</u> | <u>-</u> | <u>-</u> |
| Carrying amount | <u>12,129,331</u> | <u>6,817,240</u> | <u>-</u> | <u>-</u> |
| Total carrying amount | <u>12,233,722</u> | <u>6,996,586</u> | <u>70,074</u> | <u>70,364</u> |

CARNARVON PETROLEUM LTD
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| | Notes | Consolidated | | Company | |
|---|-------|------------------|----------------|----------------|----------------|
| | | 2007 | 2006 | 2007 | 2006 |
| | | \$ | \$ | \$ | \$ |
| 16. Trade and other payables | | | | | |
| <i>Current</i> | | | | | |
| Trade payables | | 954,888 | 43,962 | 205,903 | 29,305 |
| Non-trade payables and accrued expenses | | 2,072,651 | 107,907 | 91,325 | 94,206 |
| Owing to Phetchabun Basin Joint Venture partner | | - | 429,151 | - | - |
| Owing to related parties | | - | 21,620 | - | 21,620 |
| | | <u>3,027,539</u> | <u>602,640</u> | <u>297,228</u> | <u>145,131</u> |

Company trade payables denominated in currencies other than the functional currency comprise \$83,502, denominated in US\$ (2006: \$Nil).

17. Provisions

Non-current

Site restoration:

| | | | | |
|---|----------------|-----------------|----------|----------|
| Balance at beginning of financial year | 67,675 | 77,984 | - | - |
| Provision made / (reversed) during the year | <u>37,765</u> | <u>(10,309)</u> | <u>-</u> | <u>-</u> |
| Balance at end of financial year | <u>105,440</u> | <u>67,675</u> | <u>-</u> | <u>-</u> |

18. Capital and reserves

| | Company and consolidated | |
|--|--------------------------|--------------------|
| | 2007 | 2006 |
| | Number of shares | |
| <i>Issued capital</i> | | |
| Balance at beginning of financial year | 411,787,134 | 272,312,513 |
| Issued for cash | 230,000,000 | 128,733,333 |
| Equity settled compensation | - | 10,000,000 |
| Employee Share Plan issues | 13,750,000 | 715,000 |
| Exercise of options | <u>2,000,000</u> | <u>26,288</u> |
| Balance at end of financial year | <u>657,537,134</u> | <u>411,787,134</u> |

Ordinary shares have the right to one vote per share at meetings of the Company, to receive dividends as declared and, in the event of a winding-up of the Company, to participate in the proceeds from the sale of all surplus assets in proportion to the number of, and amounts paid up on, shares held.

The Company does not have authorised capital or par value in respect of its issued shares.

Translation reserve

Movements in the translation reserve are set out in the Statement in Changes in Equity on page 29.

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity.

Available-for-sale asset revaluation reserve

Movements in the available-for-sale asset revaluation reserve are set out in the Statements of Changes in Equity on pages 29 and 30.

This reserve includes the cumulative net change in the fair value of available-for-sale investments until the investment is derecognised.

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18. Capital and reserves (continued)

Share based payments reserve

Movements in the share based payments reserve are set out in the Statements of Changes in Equity on pages 29 and 30.

This reserve represents the fair value at grant of share options issued, including the value of shares issued under the Company's ESP. This reserve is reversed against share capital when shares are issued on exercise of the options, or, in the case of the shares issued under the ESP, the loan is repaid.

19. Reconciliation of cash flows from operating activities

| | Notes | Consolidated | | Company | |
|--|-------|------------------|------------------|--------------------|------------------|
| | | 2007 \$ | 2006 \$ | 2007 \$ | 2006 \$ |
| (a) Cash flows from operating activities | | | | | |
| Loss for the period | | (1,542,210) | (758,150) | (3,512,091) | (894,126) |
| <i>Adjustments for:</i> | | | | | |
| Equity settled share based payment expense | | 933,819 | 706,272 | 933,819 | 706,272 |
| Reversal of provision for impairment losses | | (6,600) | (134,520) | (6,600) | (134,520) |
| Depreciation | | 334,993 | 51,982 | 28,097 | 5,219 |
| Loss on disposal of property plant & equipment | | - | (100) | - | (100) |
| Finance costs associated with rehabilitation provisions | | 18,879 | - | - | - |
| Exploration expenditure written off | | 74,752 | 107,242 | 74,752 | 107,242 |
| Foreign exchange losses / (gains) | | (53,636) | (6,935) | 1,415,794 | (166,394) |
| Loss on disposal of available-for-sale financial assets | | - | 715 | - | 715 |
| Operating loss before changes in working capital and provisions: | | (240,003) | (33,494) | (1,066,229) | (375,692) |
| Changes in assets and liabilities: | | | | | |
| (Increase) in trade and other receivables | | (1,291,801) | (54,802) | (76,398) | (44,230) |
| (Increase) in inventories | | (908,470) | (156,176) | - | - |
| (Increase) / decrease in other assets | | (682,647) | 8,938 | (15,493) | (5,394) |
| Increase in trade and other payables | | 2,318,017 | 224,899 | 152,445 | 34,971 |
| Increase / (decrease) in provisions and employee benefits | | 4,280 | (21,899) | 4,280 | (11,590) |
| Cash flows from operating activities after changes in working capital and provisions: | | (800,624) | (32,534) | (1,001,395) | (401,935) |
| (Gain) on sale of discontinued operations net of income tax | 8 | - | (488,182) | - | (488,182) |
| Net cash flows (used in) operating activities | | (800,624) | (520,716) | (1,001,395) | (890,117) |
| (b) Reconciliation of cash and cash equivalents | | | | | |
| Cash at bank and at call | | 8,927,018 | 1,897,846 | 6,520,307 | 1,558,676 |

20. Capital and other commitments

| | Consolidated | | Company | |
|---|---------------------|-------------|----------------|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| <i>(a) Joint venture commitments</i> | | | | |
| Share of capital commitments of the joint venture operations: | | | | |
| Within one year | 203,953 | 1,389,531 | - | - |
| Share of capital commitments to the joint venture operations: | | | | |
| Within one year | 1,949,624 | - | 1,949,624 | - |

(b) Exploration expenditure commitments

Due to the nature of the consolidated entity's operations in exploring and evaluating areas of interest, it is difficult to accurately forecast the nature or amount of future expenditure, although it will be necessary to incur expenditure in order to retain the entity's present permit interests. Expenditure commitments on exploration permits can be reduced by selective relinquishment of exploration tenure, by the renegotiation of expenditure commitments, or by farming out portions of the entity's equity.

Exploration expenditure commitments forecast but not provided for in the financial statements are as follows:

| | Consolidated | | Company | |
|----------------------------|---------------------|----------------|----------------|----------------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| Less than one year | 568,553 | 427,006 | 132,553 | 152,985 |
| Between one and five years | 212,500 | - | 212,500 | - |
| | <u>781,053</u> | <u>427,006</u> | <u>345,053</u> | <u>152,985</u> |

(c) Capital expenditure commitments

| | | | | |
|--------------------------|----------------|----------|----------------|----------|
| Data licence commitments | <u>106,785</u> | <u>-</u> | <u>106,785</u> | <u>-</u> |
|--------------------------|----------------|----------|----------------|----------|

21. Contingencies

Contingent liabilities not considered remote

- (a) Under the terms of an Investment Agreement the consolidated entity is required to pay a percentage of sales proceeds from specified zones within the Wichian Buri Production Licences I and II in Thailand to Gemini Oil and Gas Limited, an independent oil and natural gas investment fund. The percentage is 12.5% to a maximum cumulative payment of US\$800,000, after which the percentage falls to 7.5%.

Payments of US\$184,408 (2006: US\$91,073) have been expensed. Cumulative amounts estimated paid and payable at balance date under the terms of this agreement are US\$527,828.

21. Contingencies (continued)

Contingent liabilities considered remote

- (a) In accordance with normal petroleum industry practice, the consolidated entity has entered into joint ventures and farm-in agreements with other parties for the purpose of exploring and developing its petroleum permit interests. If a party to a joint venture defaults and does not contribute its share of joint venture obligations, then the other joint venturers are liable to meet those obligations. In this event, the interest in the permit held by the defaulting party may be redistributed to the remaining joint venturers.
- (b) During the previous year the Company sold its interests in Production Retention Licences ("PRLs") 4 and 5 in Papua New Guinea for \$500,000. Under the terms of the sale, if approval and registration of the Deeds and Transfer Instruments is not obtained within 12 months of the date the documents are lodged for approval and registration, the sale proceeds shall be refunded to the purchasers.

At the date of this report the 12 month period has expired, however, despite the Company's strenuous efforts, approval and registration of the Deeds and Transfer Instruments has not been obtained. The PRL assignees have granted the Company an extension to 30 November 2007 to obtain these approvals.

- (c) The Phetchabun Basin Joint Venture operation, in which the consolidated entity has a 40% interest, has issued bank guarantees for an amount of 40 million Thai Baht as security in lieu of Customs Bonds. The consolidated entity's cash balances include A\$598,600 of restricted cash held by the bank as security for these guarantees.

22. Employee benefits

| | Consolidated | | Company | |
|----------------------------|--------------|------|---------|------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| <i>Current:</i> | | | | |
| Liability for annual leave | 4,280 | - | 4,280 | - |

Share based payments - Employee Share Plan

Under the terms of the Carnarvon Employee Share Plan ("ESP"), as approved by shareholders, the Company may, in its absolute discretion, make an offer of ordinary fully paid shares in Carnarvon Petroleum Limited to any eligible person, to be funded by a limited recourse loan granted by the Company.

The issue price is determined by the directors and is not to be less than the weighted average market price of the Company's shares on the five trading days prior to the date of offer. Eligible persons receive an interest free advance to acquire the shares. The Company is empowered to sell, as agent, any shares held under the ESP by an eligible person upon the cessation of employment, and to apply the net sale proceeds in discharging the eligible person's loan from the Company.

The movements in the ESP during the financial year were as follows:

| | 1 July 2006 | Issued | Repaid | 30 June 2007 |
|-------------------------------|-------------|-------------|-----------|--------------|
| Number of shares | 4,700,000 | 13,750,000 | 2,200,000 | 16,250,000 |
| Loan | \$203,742 | \$1,447,250 | \$77,000 | \$1,573,992 |
| Average issue price per share | \$0.043 | \$0.105 | \$0.035 | \$0.097 |

The ESP shares on issue at 1 July 2006 included 200,000 shares held by a director, Mr Neil Fearis. These shares were all issued prior to 1 July 2004. The corresponding loan was repaid during the current period.

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22. Employee benefits (continued)

In accordance with AASB 2 the issue of shares under the ESP is accounted for as an in principle option.

The fair value of services received in return for options for both the Company and consolidated entity, including shares issued under the ESP and valued as options, is measured by reference to the fair value of share options granted using the Black-Scholes model, as set out below.

| Fair value of share options and related assumptions | Key management personnel 2007 | Key management personnel 2006 | Other employees 2007 | Other employees 2006 |
|---|----------------------------------|----------------------------------|-------------------------|-------------------------|
| Fair value at measurement date (cents) | 7.4 | 1.6 to 2.0 | 5.1 to 6.0 | 2.0 |
| Share price at date of issue (cents) | 13.5 | 5.1 to 6.3 | 12.2 to 14.3 | 5.1 |
| Exercise price (cents) | 9.0 | 5.1 to 10.0 | 12.2 to 14.3 | 5.1 |
| Expected volatility | 55% | 51.5% | 55% | 51.5% |
| Actual / assumed option life | 3 years | 2 to 3 years | 3 years | 3 years |
| Expected dividends | Nil | Nil | Nil | Nil |
| Risk-free interest rate | 5.5% | 5.5% | 5.5% | 5.5% |
| Share based expense recognised | \$666,790 | \$412,667 | \$267,029 | \$10,105 |

Current year volatility is based on prorating the historic volatility over a 100 day period for the Company, the ASX Small Ords Index, and the ASX 300 Resources Index. This methodology is intended to reflect the movement of the Company's share price volatility towards its peers as its oil and gas interests mature.

Further details of shares and options issued to directors are set out in Note 26, and in the Remuneration Report set out on pages 18 to 22.

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23. Related party disclosures

Ultimate parent

Carnarvon Petroleum Limited is the ultimate parent company.

Wholly-owned group transactions

During the reporting period there have been transactions between the Company and its controlled entities. The Company provided accounting and administrative services to its controlled entities for which it did not charge a management fee.

During the financial year ended 30 June 2007 loans to controlled entities totalled \$9,088,435 (2006: \$2,437,805).

The carrying value of loans to controlled entities at 30 June 2007 was \$13,024,341 (2006: \$5,349,942) after provisions of \$693,349 (2006: \$693,349). These loans are unsecured, non-interest bearing, and have no fixed terms of repayment.

Other related party balances

At 30 June 2007 an amount of \$Nil (2006: \$21,620) is included in Company and consolidated trade and other payables for outstanding director fees and expenses.

24. Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

| | Consolidated | | Company | |
|----------------------------|---------------------|----------------|----------------|----------------|
| | 2007 | 2006 | 2007 | 2006 |
| | \$ | \$ | \$ | \$ |
| Less than one year | 232,342 | 86,962 | 119,472 | 86,962 |
| Between one and five years | 148,758 | 77,022 | 63,820 | 77,022 |
| More than five years | - | 44,013 | - | 44,013 |
| | <u>381,100</u> | <u>207,997</u> | <u>183,292</u> | <u>207,997</u> |

During the reporting period \$240,245 was recognised as an expense in the consolidated income statement in respect of operating leases (2006: \$18,022).

25. Segment information

Segment information is presented in respect of the consolidated entity's business and geographical segments. The primary format, geographical segments, is based on the consolidated entity's management and internal reporting structure.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers, and segment assets are based on the geographical location of the assets.

The consolidated entity operated predominantly in oil and gas exploration, development and production in Australia and Thailand during the reporting period.

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25. Segment information (continued)

| <i>Geographical Segments</i> | Australia | | Thailand | | Papua New Guinea (discontinued) | | Consolidated | |
|--|--------------------|------------------|--------------------|------------------|--|------------------|---------------------|------------------|
| | 2007 (\$) | 2006 (\$) | 2007 (\$) | 2006 (\$) | 2007 (\$) | 2006 (\$) | 2007 (\$) | 2006 (\$) |
| Revenue | | | | | | | | |
| Sales | - | - | 3,673,595 | 1,090,213 | - | - | 3,673,595 | 1,090,213 |
| Other | 239,688 | 184,277 | 7,517 | 5,305 | - | - | 247,205 | 189,582 |
| Total revenue | 239,688 | 184,277 | 3,681,112 | 1,095,518 | - | - | 3,920,800 | 1,279,795 |
| Segment result | | | | | | | | |
| Result from continuing operations | (2,098,051) | (1,541,767) | 555,841 | 295,435 | - | - | (1,542,210) | (1,246,332) |
| Discontinued operations | - | - | - | - | - | 488,182 | - | 488,182 |
| Total segment result | (2,098,051) | (1,541,767) | 555,841 | 295,435 | - | 488,182 | (1,542,210) | (758,150) |
| Assets | | | | | | | | |
| Property, plant and equipment | 70,074 | 70,364 | 12,163,648 | 6,926,222 | - | - | 12,233,722 | 6,996,586 |
| Other | 6,677,469 | 1,675,857 | 5,683,527 | 702,672 | - | 1,490 | 12,360,996 | 2,380,019 |
| Total segment assets | 6,747,543 | 1,746,221 | 17,847,175 | 7,628,894 | - | 1,490 | 24,594,718 | 9,376,605 |
| Liabilities | | | | | | | | |
| Total segment liabilities | 301,508 | 145,131 | 2,835,751 | 525,184 | - | - | 3,137,259 | 670,315 |
| Other segment information: | | | | | | | | |
| Acquisition of property, plant and equipment | 285,068 | 72,051 | 6,915,000 | 2,688,135 | - | - | 7,200,068 | 2,760,186 |
| Depreciation | 28,097 | 5,219 | 306,896 | 46,763 | - | - | 334,993 | 51,982 |
| <i>Business Segments</i> | | | | | | | | |
| | Oil and gas | | Unallocated | | Consolidated | | | |
| | 2007 (\$) | 2006 (\$) | 2007 (\$) | 2006 (\$) | 2007 (\$) | 2006 (\$) | | |
| Revenue from external customers | 3,673,595 | 1,090,213 | 247,205 | 189,582 | | | 3,920,800 | 1,279,795 |
| Segment assets | 17,847,175 | 7,628,894 | 6,747,543 | 1,746,221 | | | 24,594,718 | 9,376,605 |
| Acquisition of non-current assets | 7,174,142 | 2,688,135 | 25,926 | 72,051 | | | 7,200,068 | 2,760,186 |

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26. Key management personnel disclosures

(a) Key management personnel

The following were key management personnel of the consolidated entity at any time during the reporting period and, unless otherwise indicated, were key management personnel for the entire period.

Non-executive directors

PJ Leonhardt (Chairman)
 NC Fearis
 KP Judge

Mr Leonhardt is currently acting in a part time executive capacity to support the Chief Executive Officer. Mr Leonhardt's fulfillment of this role going forward will be monitored relative to the Company's stage of development.

Executive directors

EP Jacobson – Chief Executive Officer

Executives

RA Anderson - Chief Financial Officer and Company Secretary

(b) Key management personnel compensation

Key management personnel compensation included in employee benefits expense, directors emoluments, share based payments and administration expenses are as follows:

| | Consolidated | | Company | |
|------------------------------|---------------------|------------------|------------------|------------------|
| | 2007(\$) | 2006(\$) | 2007(\$) | 2006(\$) |
| Short term employee benefits | 534,936 | 423,774 | 534,936 | 423,774 |
| Post-employment benefits | - | 34,488 | - | 34,488 |
| Termination benefits | - | 26,070 | - | 26,070 |
| Share based payments | 666,790 | 696,167 | 666,790 | 696,167 |
| | <u>1,201,726</u> | <u>1,180,499</u> | <u>1,201,726</u> | <u>1,180,499</u> |

Information regarding individual directors and executives compensation is provided in the Remuneration Report section of the directors' report as set out on pages 18 to 22.

Apart from the details disclosed in this note, 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.

(c) Other key management personnel transactions

Amounts payable to key management personnel at reporting date in respect of outstanding fees and expenses are as follows:

| | Consolidated | | Company | |
|--------------------------|---------------------|-----------------|-----------------|-----------------|
| | 2007(\$) | 2006(\$) | 2007(\$) | 2006(\$) |
| <i>Current</i> | | | | |
| Trade and other payables | - | 21,620 | - | 21,620 |

An amount of \$928 was paid or payable during the year to an entity associated with Mr Fearis in respect of office accommodation and outgoings. These charges were calculated on an arms' length basis.

Mr Fearis repaid a \$17,000 loan during the year in respect of 200,000 ESP shares on issue to him at 1 July 2006.

CARNARVON PETROLEUM LTD
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NOTES TO THE FINANCIAL STATEMENTS

26. Key management personnel disclosures (continued)

(d) Movements in shares

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

| Directors | Held at 1 July 2006 | Net acquired/ (sold) | Granted as compensation | Award under Employee Share Plan | Received on exercise of options | Held at 30 June 2007 |
|------------------|--------------------------------|-------------------------------------|------------------------------------|--|--|---------------------------------|
| PJ Leonhardt | 7,510,504 | 1,389,496 | - | 3,000,000 | - | 11,900,000 |
| EP Jacobson | 13,189,307 | 5,124,486 | - | 6,000,000 | - | 24,313,793 |
| NC Fearis | 5,871,400 | (1,555,214) | - | - | 2,000,000 | 6,316,186 |
| KP Judge | 14,168,596 | 900,000 | - | - | - | 15,068,596 |
| | | | | - | | |
| Executive | | | | | | |
| RA Anderson | 3,464,998 | 978,492 | - | - | - | 4,443,490 |

| Directors | Held at 1 July 2005 (or when appointed) | Net acquired/ (sold) | Granted as compensation | Award under Employee Share Plan | Received on exercise of options | Held at 30 June 2006 (or on retirement) |
|------------------|--|-------------------------------------|------------------------------------|--|--|--|
| PJ Leonhardt | 2,010,504 | 4,000,000 | 1,500,000 | - | - | 7,510,504 |
| EP Jacobson | 4,166,555 | 6,022,752 | 3,000,000 | - | - | 13,189,307 |
| NC Fearis | 4,871,400 | 1,000,000 | - | - | - | 5,871,400 |
| KP Judge | 11,168,596 | 3,000,000 | - | - | - | 14,168,596 |
| AG Shelton | 9,208,906 | - | 5,500,000 | - | - | 14,708,906 |
| DJ Orth | 1,569,127 | - | - | - | - | 1,569,127 |
| | | | | | | |
| Executive | | | | | | |
| RA Anderson | - | 1,464,998 | - | 2,000,000 | - | 3,464,998 |

All named directors and the named executive participated in a share placement, as approved by shareholders on 30 April 2007. Their participation was on the same terms as other placees, at an issue price of 7.7 cents per share.

Shares allotted under the ESP were funded by interest-free loans with a limited recourse security over the plan shares and subject to the detailed rules of the ESP.

In accordance with AASB 2 the issue of shares under the ESP is accounted for as an in principle option. The fair value of share options, including ESP shares issued and valued as options, and their valuation assumptions are set out in Note 22.

Information regarding individual directors' and executives' compensation, including company loans used to finance the purchase of the ESP shares, is provided in the Remuneration Report section of the directors' report as set out on pages 18 to 22.

CARNARVON PETROLEUM LTD
FINANCIAL REPORT 30 JUNE 2007
NOTES TO THE FINANCIAL STATEMENTS

26. Key management personnel disclosures (continued)

(e) Options and rights over equity instruments

The movement during the reporting period in the number of options over ordinary shares in Carnarvon Petroleum 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 | Acquired/ (sold) | Exercised | Held at 30 June 2007 |
|------------------|--------------------------------|------------------------------------|-----------------------------|------------------|---------------------------------|
| PJ Leonhardt | 6,000,000 | - | - | - | 6,000,000 |
| EP Jacobson | 8,000,000 | - | - | - | 8,000,000 |
| NC Fearis | 4,000,000 | - | - | (2,000,000) | 2,000,000 |
| KP Judge | 4,000,000 | - | - | - | 4,000,000 |

| Directors | Held at 1 July 2005 (or when appointed) | Granted as compensation | Acquired/ (sold) | Expired | Held at 30 June 2006 (or on retirement) |
|------------------|--|------------------------------------|-----------------------------|----------------|--|
| PJ Leonhardt | 589,128 | 6,000,000 | - | (589,128) | 6,000,000 |
| EP Jacobson | - | 8,000,000 | - | - | 8,000,000 |
| NC Fearis | 3,693,700 | 4,000,000 | (3,693,700) | - | 4,000,000 |
| KP Judge | - | 4,000,000 | - | - | 4,000,000 |
| AG Shelton | 1,600,703 | - | - | (1,600,703) | - |

Options granted as compensation vest immediately. During the financial year there was no forfeiture or vesting of options granted in previous periods. There were no options on issue that were still to vest at the end of the reporting period.

27. Non-key management personnel disclosures

Identity of related parties

The consolidated entity has a related party relationship with its subsidiaries (see Note 28), joint venture operations (see Note 14), and with its key management personnel (see Note 26).

28. Consolidated entities

| Name | Country of Incorporation | Ownership interest | |
|-------------------------|---------------------------------|-------------------------------|-------------|
| | | 2007 | 2006 |
| <i>Parent entity</i> | | | |
| Carnarvon Petroleum Ltd | | | |
| <i>Subsidiaries</i> | | | |
| Carnarvon Thailand Ltd | British Virgin Islands | 100% | 100% |
| Lassoc Pty Ltd | Australia | 100% | 100% |
| SRL Exploration Pty Ltd | Australia | 100% | 100% |

Investments in subsidiaries are measured at cost in the financial statements of the Company

CARNARVON PETROLEUM LTD
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NOTES TO THE FINANCIAL STATEMENTS

29. Financial instruments

(a) Interest rate risk

The consolidated entity's exposure to interest rate risk is considered minimal. The effective interest rates of income-earning financial assets at the reporting date are as follows. There were no interest-bearing financial liabilities.

| | Variable rate instruments at call 2007 (\$) | Weighted average effective interest rate 2007 | Variable rate instruments at call 2006 (\$) | Weighted average effective interest rate 2006 |
|---------------------------|--|---|--|---|
| <i>Financial assets</i> | | | | |
| Cash and cash equivalents | 8,927,018 | 5.16% | 1,897,846 | 4.47% |

(b) Foreign currency risk

The consolidated entity is exposed to foreign currency risk on sales and purchases that are denominated in a currency other than the A\$. The currency primarily giving rise to this risk is the US\$. The consolidated entity considers that US\$ sales and purchases provide a natural hedge and that the net exposure is kept to an acceptable level.

(c) Credit risk

Exposure to credit risk is considered minimal but is monitored on an ongoing basis. At balance date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

(d) Fair values

All financial assets and financial liabilities have been recognised in the balance sheets at balance date at their fair values

| | Carrying amount 2007(\$) | Consolidated Fair Value 2007 (\$) | Carrying amount 2006 (\$) | Fair Value 2006 (\$) |
|-----------------------------|--------------------------------|--|---------------------------------|----------------------------|
| Trade and other receivables | 1,684,019 | 1,684,019 | 228,882 | 228,882 |
| Cash and cash equivalents | 8,927,018 | 8,927,018 | 1,897,846 | 1,897,846 |
| Trade and other payables | (3,027,539) | (3,027,539) | (602,640) | (602,640) |
| | <u>7,583,498</u> | <u>7,583,498</u> | <u>1,524,088</u> | <u>1,524,088</u> |

All trade and other receivables / payables have a life of less than one year, and therefore their notional amount is deemed to reflect their fair value.

**CARNARVON PETROLEUM LTD
FINANCIAL REPORT 30 JUNE 2007
DIRECTORS' DECLARATION**

- (1) In the opinion of the directors of Carnarvon Petroleum Limited:
- (a) the financial statements and notes of the company and of the consolidated entity (including the audited remuneration disclosures contained in the Remuneration Report contained in the Directors' Report) set out on pages 27 to 56 are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2007 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and
 - (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- (2) This declaration has been made after receiving the declarations required to be made to the directors in accordance with section 295A of the Corporations Act 2001 for the financial period ending 30 June 2007.

Signed in accordance with a resolution of the directors.

A handwritten signature in black ink, appearing to read 'PJ Leonhardt', with a large, sweeping flourish at the end.

PJ Leonhardt
Director

Perth, 27th September 2007

INDEPENDENT AUDIT REPORT TO MEMBERS OF CARNARVON PETROLEUM LIMITED

We have audited the accompanying financial report of Carnarvon Petroleum Limited (the company) and Carnarvon Petroleum Limited controlled Entities (the consolidated entity), 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 of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

As permitted by the Corporations Regulations 2001, the company has disclosed information about the 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 22 of the directors' report and not in the financial report.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101: Presentation of Financial Statements, that compliance with the Australian equivalents to International Financial Reporting Standards (IFRS) ensures that the financial report, comprising the financial statements and notes, complies with IFRS.

The directors also are responsible for preparation and presentation of the remuneration disclosures contained in the directors' report in accordance with the Corporations Regulations 2001.

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 and that the remuneration disclosures in the directors' report comply with Accounting Standard AASB 124.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

Independence

In conducting our audit, we have complied with the independence requirements of the Corporations Act 2001. We confirm that the independence declaration required by the Corporations Act 2001, provided to the directors of Carnarvon Petroleum Limited on 27 September 2007 would be in the same terms if provided to the directors as at the date of this auditor's report.

Auditor's Opinion

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

- (a) (i) 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
- (ii) complying with Australian Accounting Standards (including Australian Accounting Interpretations) and the Corporations Regulations 2001.
- (b) the remuneration disclosures that are contained in pages 18 to 22 of the directors' report comply with Accounting Standard AASB 124.
- (c) the financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

WHK HORWATH PERTH AUDIT PARTNERSHIP

A handwritten signature in black ink, appearing to read "Sean MCGURK", is written over a light grey rectangular background.

SEAN MCGURK
Principal

Perth, WA

Dated this 27th day of September 2007

Introduction

Carnarvon Petroleum Limited (“Carnarvon”) is a small company with an uncomplicated corporate structure and relatively simple financial and management control requirements. It adheres to the ten Essential Corporate Governance Principles as published by the ASX Corporate Governance Council and has adopted those of the Best Practice Recommendations which the Board considers to be relevant and essential for the efficient management of the Company and its business whilst safeguarding shareholder assets.

The following additional information about the Company's corporate governance practices is set out on the Company's website at www.carnarvonpetroleum.com:

- Corporate governance disclosures and explanations;
- Statement of Board and management functions;
- Composition of the Board and new appointments;
- Committees of the Board;
- Summary of code of conduct for directors;
- Summary of policy on securities trading;
- Audit Committee Charter;
- Summary of policy and procedure for compliance with ASX Listing Rule disclosure requirements;
- Summary of arrangements regarding communication with and participation of shareholders;
- Summary of Company's risk management policy and internal compliance and control system; and
- Corporate code of conduct.

Skills, experience, expertise and term of office of each director

A profile of each director containing the applicable information is set out in the directors' report.

Statement concerning availability of independent professional advice

If a director considers it necessary to obtain independent professional advice to properly discharge the responsibility of his/her office as a director then, provided the director first obtains approval for incurring such expense from the chairman, the Company will pay the reasonable expenses associated with obtaining such advice.

Number of Audit Committee meetings and names of attendees

The number of Audit Committee meetings and names of attendees is set out in the directors' report.

Names and qualifications of Audit Committee members

The names and qualifications of Audit Committee members are set out in the directors' report.

Explanations for departures from best practice recommendations

From 1 July 2006 to 30 June 2007 (the "Reporting Period") the Company complied with each of the Ten Essential Corporate Governance Principle (Note 1 below) and the corresponding Best Practice Recommendations (Note 2 below) as published by the ASX Corporate Governance Council ("ASX Principles and Recommendations"), other than in relation to the matters specified below:

| Principle Reference | Recommendation Reference | Notification of Departure | Explanation for Departure |
|----------------------------|---------------------------------|--|--|
| 2 | 2.1 | The Board did not comprise a majority of independent directors. The Board currently consists of two independent and two non-independent directors. | Mr Peter Leonhardt, the Chairman, is currently acting in a part time executive capacity as a non-independent director to support the Chief Executive Officer. Mr Leonhardt's fulfilment of this role going forward will be monitored relative to the Company's stage of development. |
| 2 | 2.2 | The Chairman is not an independent director. | Mr Peter Leonhardt, the Chairman, is currently acting in a part time executive capacity as a non-independent director to support the Chief Executive Officer. Mr Leonhardt's fulfilment of this role going forward will be monitored relative to the Company's stage of development. |
| 2 | 2.4 | A separate Nomination Committee has not been formed. | The Board considers that the Company is not currently of a size to justify the formation of a Nomination Committee. The Board as a whole undertakes the process of reviewing the skills base and experience of existing directors to enable identification or attributes required in new directors. Where appropriate independent consultants are engaged to identify possible new candidates for the Board. |

Notes

- (1) A copy of the Ten Essential Corporate Governance Principles are set out on the Company's website under the section entitled "Corporate Governance".
- (2) A copy of the Best Practice Recommendations are set out on the Company's website under the section entitled "Corporate Governance".

CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
CORPORATE GOVERNANCE STATEMENT (CONTINUED)

Explanations for departures from best practice recommendations (continued)

| Principle Reference | Recommendation Reference | Notification of Departure | Explanation for Departure |
|----------------------------|---------------------------------|--|--|
| 4 | 4.3 | Since February 2006 the Audit Committee has comprised two directors, one of whom is non-independent and is the Chairman of the Board. This does not meet the criteria set out in Best Practice Recommendation 4.3. | In accordance with Listing Rule 12.7, the Company is not required to comply with Recommendation 4.3. |
| 8 | 8.1 | A formal performance evaluation of the Board was not carried out during the Reporting Period | A review of the functioning of the Board in general did occur by way of an informal review by the Chairman during the regular Board meetings. |
| 9 | 9.2 | A separate Remuneration Committee has not been formed. | The Board considers that the Company is not currently of a size to justify the formation of a Remuneration Committee. The Board as a whole is responsible for the remuneration arrangements for directors and executives of the Company. If the Company's activities increase in size, scope and/or nature the appointment of a Remuneration Committee will be reviewed by the Board and implemented if appropriate. |
| 9 | 9.3 | The Chairman was allocated shares under the Company's Employee Share Plan, as approved by shareholders, in April 2007. | The issue to the Chairman recognised the executive duties he had undertaken, over and above his normal non-executive role, during the Reporting Period. In addition, the satisfaction of remuneration in part by Employee Share Plan issues results in lower cash compensation and helps maintain the entity's cash reserves. |

Recommendations 1 to 10 state that the Company should make publicly available a number of its corporate governance documents and procedures, ideally by posting it to the Company's website in a clearly marked corporate governance section. This occurred in the first quarter of the Reporting Period.

Existence and terms of any schemes for retirement benefits for non-executive directors

The Company does not have any terms or schemes relating to retirement benefits for non-executive directors.

Company's remuneration policies

The Company's remuneration policies are set out in the Remuneration Report on pages 18 to 22.

The Company has separate remuneration policies for executive and non-executive directors.

Non-executive directors receive a fixed fee and, when appropriate, share options or participation in the Employee Share Scheme.

Executive directors receive a salary or fee and, when appropriate, shares, share options, or participation in the Employee Share Scheme.

Identification of independent directors

The Company's two independent directors are considered to be Mr Neil Fearis and Mr Ken Judge.

Neither of these directors was considered to have a material relationship with the Company or another group member during the Reporting Period as professional advisor, consultant, supplier, customer, or through any other contractual relationship, nor did they have any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the Company.

The Board considers "material" in this context to be where any director related business relationship represents the lesser of at least 5% of the Company's or the director-related business's revenue.

CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2007
ADDITIONAL SHAREHOLDER INFORMATION

Additional information required by the ASX Limited ("ASX") Listing Rules and not disclosed elsewhere in this report is set out below.

a) Shareholdings as at 17 September 2007

Substantial shareholders

There are no substantial shareholder notices lodged with the Company.

Voting Rights

The voting rights attaching to Ordinary Shares are governed by the Constitution. On a show of hands every person present who is a member or representative of a member shall have one vote and on a poll, every member present in person or by proxy or by attorney or duly authorised representative shall have one vote for each share held. No options have any voting rights.

Twenty Largest Shareholders

| Name of Shareholder | Number of Shares | % held |
|--|------------------|--------|
| HSBC Custody Nominees (Australia) Limited | 33,335,438 | 5.07 |
| HSBC Custody Nominees (Australia) Limited | 29,548,050 | 4.49 |
| ANZ Nominees Limited (Cash Income A/C) | 26,632,957 | 4.05 |
| Mr Edward Patrick Jacobson | 14,000,000 | 2.13 |
| Macquarie Bank Limited | 12,000,000 | 1.82 |
| National Nominees Limited | 9,298,666 | 1.41 |
| Macquarie Bank Limited | 9,060,000 | 1.38 |
| Arne Investments Pty Ltd | 8,916,906 | 1.36 |
| Mr Peter James Leonhardt | 8,000,000 | 1.22 |
| Citicorp Nominees Pty Limited (Cwith Bank Off Super A/C) | 7,528,026 | 1.14 |
| Citicorp Nominees Pty Limited | 7,483,735 | 1.14 |
| RBC Dexia Investor Service Australia Nominees Pty Ltd (Bkcust A/C) | 7,200,000 | 1.09 |
| Mr Edward Patrick Jacobson | 6,817,903 | 1.04 |
| Arne Investments Pty Ltd | 6,710,493 | 1.02 |
| Pendomer Investments Pty Ltd (Law Settlements Fund A/C) | 6,316,186 | 0.96 |
| Kaymac Nominees (McMullen Super Fund A/C) | 6,000,000 | 0.91 |
| Mr Gregory John Munyard and Mrs Maria Anne Munyard and Miss Carmen Helene Munyard (Riviera Super Fund A/C) | 5,400,000 | 0.82 |
| Dalkeith Resources Pty Ltd | 5,374,921 | 0.82 |
| Mr Lawrence Addision Brown and Mrs Jill Brown | 5,182,303 | 0.79 |
| Wickham Holdings SA | 4,333,333 | 0.66 |
| | 219,138,917 | 33.32 |

Distribution of equity security holders

| Size of Holding | Number of shareholders | Number of fully paid shares |
|-------------------|------------------------|-----------------------------|
| 1 to 1,000 | 104 | 41,195 |
| 1,001 to 5,000 | 342 | 1,192,430 |
| 5,001 to 10,000 | 626 | 5,503,724 |
| 10,001 to 100,000 | 2,550 | 108,781,160 |
| 100,001 and over | 788 | 542,018,625 |
| | 4,410 | 657,537,134 |

The number of shareholders holding less than a marketable parcel of ordinary shares is 154.

CARNARVON PETROLEUM LIMITED
FINANCIAL REPORT 30 JUNE 2006
ADDITIONAL SHAREHOLDER INFORMATION (CONTINUED)

b) Unlisted option holdings as at 17 September 2007

| | Unlisted 7 cent Options expiring 31 March 2008 | Unlisted 10 cent Options expiring 31 March 2009 |
|---|---|--|
| Number on issue | 9,000,000 | 16,000,000 |
| Number of holders | 3 | 5 |
| Those holding more than 20% of the class: | Number held | Number held |
| EP Jacobson | 4,000,000 | 4,000,000 |
| PJ Leonhardt | 3,000,000 | |
| KP Judge | 2,000,000 | |
| Hartleys Limited | | 5,000,000 |

c) On-market buyback

There is no current on-market buyback.

d) Schedule of permits

| <u>Location</u> | <u>Permit</u> | <u>Equity</u> |
|------------------------------------|---------------|---------------|
| Thailand | L 44/43 | 40% |
| Thailand | L 33/43 | 40% |
| Carnarvon Basin, Western Australia | EP 110 | 35% |
| Carnarvon Basin, Western Australia | EP 424 | 35% |
| Carnarvon Basin, Western Australia | WA-399-P | 50% |