FALCON OIL & GAS AUSTRALIA LIMITED

ABN 53 132 857 008

31 DECEMBER 2011 FINANCIAL REPORT

All amounts are in USD unless otherwise stated

Beetaloo Basin, Northern Territory, Australia

Falcon Oil & Gas Australia Limited (the "Company" or "Falcon Australia") is the registered owner of four exploration permits ("the Permits"), comprising 7,000,000 acres in the Beetaloo Basin, Northern Territory, Australia

The Permits are subject to a government royalty of 10% and non-government royalties of 13%-14%.

Hess Participation Agreement

In June 2011, Falcon Australia and Hess Australia (Beetaloo) Pty Ltd. ("Hess") closed on an Evaluation and Participation Agreement (the "E&P Agreement"). Under the terms of the E&P Agreement, Hess paid $17.5 million to the Company as a participation fee for the exclusive right to conduct operations for the exploration, drilling, development and production of hydrocarbons from three of the four Permits, and excluding an area comprising 100,000 acres surrounding the Shenandoah-1 well (the "Area of Interest").

Initially, Hess shall acquire seismic data, at its sole cost of at least $40.0 million, over the Area of Interest within 18 months of the execution of the E&P Agreement. After acquiring the seismic data, Hess shall have the right to acquire a 62.5% working interest in the Area of Interest. If Hess acquires the working interest, they commit to drill and evaluate five exploration wells at their sole cost, one of which must be a horizontal well. All costs to plug and abandon the five exploration wells will also be borne solely by Hess. The drilling and evaluation of the five exploration wells must meet the minimum work requirements of the work program. Costs to drill wells after the five exploration wells will be borne 62.5% by Hess and 37.5% by Falcon Australia. As of 31 December 2011, Hess had completed approximately $10 million of the seismic program.

Hess has paid $2.0 million for Falcon Australia providing Hess copies of data obtained from the Shenandoah-1 well work program, which was completed in November 2011.

Under existing agreements with two advisors, the Company is obligated to pay a "success fee" in the aggregate amount of 5% for services provided in conjunction with the E&P Agreement with Hess. The success fee is based on the cash or cash-equivalent value of any net amount received directly or indirectly by the Company, including the participation fee and warrants issued by the Canadian parent entity Falcon Oil & Gas Limited ('Falcon"), cost of seismic data commitment and cost of drilling commitment.

Operational Highlights

In November 2011, the full testing program of the Shenandoah 1 well was successfully carried out, with gas being produced from each of the shale intervals tested. Both Velkerri intervals are now considered candidates for future testing, including horizontal drilling with multiple stimulation treatments to establish commerciality, with the other intervals subject to further evaluation.

Shenandoah-1 is a vertical well situated in the deepest part of the basin and natural gas was the expected hydrocarbon at the depths being tested. The well is the first to be tested in these unconventional targets, consequently the objectives of the tests were to determine whether the shale intervals could be fracture-stimulated and whether they could produce hydrocarbons, and to confirm rock, pressure and fluid properties. The operation has succeeded in these objectives and the well has been plugged and abandoned.

The Shenandoah-1 test program was not designed for long-term testing with full clean-up of fluids, but rather to test for hydrocarbon production to surface over a period of four to six days and to gather the maximum information possible before moving on to the next interval according to program. For this reason and because these are shale zones in a vertical well with single stimulation treatments, high flow rates were not expected.

Five intervals were tested in accordance with the program. The gathered information is still to be fully interpreted for planning future appraisal and exploration operations. Preliminary results of the testing program were:

- Three of the five intervals flowed gas while still recovering significant amounts of frac fluid.
- The most positive results came from the Middle Velkerri shales where there was no indication of formation water being produced. The sustained gas rates ranged between 50 and 100 mscfpd (thousand standard cubic feet per day), gas gravities ranged from 0.64 to 0.70 and the lower interval also yielded condensate with an API gravity of 43 degrees. Importantly this showed that that these rocks can be stimulated and are over pressured. Both Velkerri intervals will now be considered candidates for future testing, including horizontal drilling with multiple stimulation treatments to establish commerciality.
- The Lower Kyalla shale also produced gas to surface and will now be considered for further exploratory investigation.
- Two separate intervals were perforated in the Moroak sandstones. They were not stimulated but rather were conventional perforation tests, intended to find out if the rocks were gas-bearing and to provide technical information. Little to no commercial hydrocarbons were present. The test did however provide valuable rock property information as the Moroak is target of interest elsewhere in the Beetaloo Basin as a conventional play.
- The Upper Kyalla shale is oil-bearing in Shenandoah-1 but was not tested due to wellbore configuration.

Further evaluation of the extensive information gathered in this wellbore is now required before considering follow-up vertical and horizontal exploration wells. In order to locate future wells optimally it is likely that some additional seismic lines will need to be acquired in the Shenandoah area.

Future Operations

Under a revised work program approved by the Government of the Northern Territory of Australia, Department of Resources on 6 July 2011, the Company is obligated to complete a minimum work program of $18.2 million in 2012, of which $16.6 million will be borne by Hess as part of the acquisition of seismic under the E&P Agreement.

The Directors have pleasure in submitting their report together with the financial report of the Company and the auditor's report thereon for the year ended 31 December 2011

All amounts referred to in this report and the accompanying Financial Statements are in US dollars, unless stated otherwise.

Directors

The names of directors of the Company holding office at any time during or since the end of the financial period are:

Robert C Macaulay	Chairman appointed 31 July 2010
Martin Oring	Director appointed 31 July 2010
Kym P Livesley	Director appointed 31 July 2010
John W Carroll	Director appointed 31 July 2010
John Craven	Director appointed 10 December 2010
Igor R Akhmerov	Director appointed 15 September 2011
Evan Wasoff	Director resigned 15 September 2011

Robert Macaulay, PEng- Non-Executive Director, Chairman

Mr. Macaulay has 26 years' industry experience in petroleum engineering, field development planning and business development and currently provides consulting services in these areas. He is a director of PetroGlobe Inc. (TSX – PGB), serving on the compensation committee and as chairman of the reserves committee. He held the post of V.P. Engineering and Production at Centurion Energy International Inc., a Canadian company active in Egypt which was sold at over 30,000 boepd in 2007. His past experience includes positions of increasing responsibility at Vermilion Resources (petroleum engineering for France properties and business development in Europe), Shell (reservoir engineering in Canada and the Sultanate of Oman) and PanCanadian Petroleum Ltd.

He holds a BSc (Hons) in Chemical Engineering from Queen's University, Ontario and MBA degrees from Queen's and from Cornell University, New York (with distinction). He is a member of APEGGA and SPE.

Martin B Oring, Non-Executive Director

Mr. Oring has been the Chairman of the Board of Directors of PetroHunter Energy Corporation since April 2009, its President and Chief Executive Officer since May 2009. Mr. Oring is an executive in the financial services and energy industries. Prior to forming his current business in 2001, Wealth Preservation, LLC, he had extensive experience as a member of management in several companies, including Prudential Securities (Managing Director of Executive Services), Chase Manhattan Corporation (Manager of Capital Planning), and Mobil Corporation (Manager, Capital Markets & Investment Banking). He has served as a director of Parallel Petroleum Corporation, located in Midland, Texas, and currently serves as Chairman, CEO and President of Searchlight Minerals Corp., located in Henderson, Nevada. Mr. Oring received a B.S. degree in mechanical engineering from the Carnegie Institute of Technology in 1966 and an M.B.A. degree in production management, finance and marketing from Columbia University in 1968.

Kym Pelham Livesley- Non-Executive Director

Kym Livesley is a corporate lawyer with 32 years' experience. Kym has substantial expertise in mergers and acquisitions, capital markets, takeovers and general corporate and commercial advice. Kym maintains an industry focus in the energy and resources sectors, for listed and private corporates in the Asia-Pacific region.

Kym also has experience in capital raising, IPOs, directors' duties, dual listings (AIM, TSX) and corporate governance.

Kym has a Bachelor of Laws from the University of Adelaide. Among other affiliations, Kym is a former National President of the Australian Mining and Petroleum Law Association (AMPLA), member of the Minerals Council NSW and is a fellow of the Australian Institute of Company Directors (AICD).

John Carroll - Non-Executive Director

Mr Carroll is a private consultant specialising in government relations and major project facilitation and has more than 40 years' experience in a wide cross-section of public sector positions in Canberra, Queensland and the Northern Territory. Mr Carroll was Chief Executive Officer of the NT Department of Industries and Business from March 2000 until November 2001. Following that he was General Manager, Business and Trade Development, and Deputy Chief Executive and General Manager, Minerals and Energy, NT Department of Business Industries and Resource Development. In May 2005 he was appointed Chief Executive, NT Department of Primary Industry, Fisheries and Mines.

Prior to his time in the Northern Territory, Mr Carroll was Deputy Director-General, Business, Innovation and Trade in Queensland's Department of State Development. From 1996 he worked in that State's Department of Economic Development and Trade where he was Director-General until July 1998.

His earlier public sector appointments include managing the Business Regulation Review Unit in Queensland, Administration Manager, Australian National Gallery and a number of years at the Commonwealth Public Service Board, Canberra. Mr Carroll was President of the NT Branch of the Institute of Public Administration from 2001 to 2004 and in 2006/7. In November 2004 the National Council made him a Fellow of the Institute.

John Craven - Non-Executive Director

Mr Craven is the Chief Executive Officer and a director of Cove Energy plc. He is a petroleum geologist with over 35 years' experience in senior technical and commercial roles in upstream oil and gas exploration and production companies. Prior to joining Cove he was the founder and Chief Executive of AIM and IEX quoted African and Mediterranean focussed exploration company Petroceltic International plc. Petroceltic grew under his stewardship to a business with a diversified portfolio of exploration and appraisal projects in Italy, Algeria and Tunisia.

Mr Craven has an MSC in Petroleum Geology from the Royal School of Mines in London and an MBA from Queens University Belfast.

Igor P Akhmerov - Non-Executive Director

Mr. Akhmerov graduated from the Moscow Institute Of Management (1989), Wharton Business School (1995) and Lauder Institute of Business and International Relations (1995). From 1989 through 1993 he worked at the Moscow office of Bain & Company and specialised in privatisation and banking. After graduation from Wharton Business School he worked for the Boston office of Bain & Company. In 1998 he returned to Russia and joined Sputnik Group, the largest Russian private equity investment group, as a partner. In 2001 he moved to TNK as First Vice President for Planning, Budgeting, Investment Governance, Taxes, and Reporting. From 2004 until 2006 he served as Chief Financial Officer of Renova Group. He has served as Chief Executive Officer of Avelar Energy Group since 2007. Mr. Igor Akhmerov is also a Non-Executive Member of the Board of Directors of Kerself SpA, the leading player in the Italian solar market, since September 24, 2008.

Company Secretary

Stephen Peterson – appointed 5 August 2008.

Mr Peterson is currently Chief Financial Officer and Company Secretary. He provides financial and administrative services on a contract basis to a number of companies in the resources industry. He has over 25 years experience in senior financial roles and as company secretary with listed public companies primarily in the resources industry in Australia.

Directors' meetings

The number of directors' meetings held, including meetings held by telephone, and the number of those meetings attended by each of the directors of the Company, while a director, during the financial period are as follows:

	Board meetings	
	Number of meetings held	**Number of meetings attended**
Robert C Macaulay	3	3
Martin Oring	3	3
Kym P Livesley	3	2
John Carroll	3	3
Igor Akhmerov	1	1
John Craven	3	1
Evan Wasoff	3	3

Principal activities

The principal activity of the Company in the course of the period was exploration for oil and gas in the Beetaloo basin of the Northern Territory.

Financial results

The net loss after income tax attributable to members of the Company for the year ended 31 December 2011 was $974,000 (2010: loss of $3,135,000).

Dividends

There were no dividends paid or declared by the Company during the year ended 31 December 2011, (2010: nil).

State of affairs

In June 2011 Falcon Australia and Hess finalised the E&P Agreement. Hess paid $17.5 million to Falcon Australia as a participation fee for the exclusive right to conduct operations for the exploration, drilling, development and production of hydrocarbons from three of the four Permits, and excluding an area comprising 100,000 acres surrounding the Shenandoah-1 well (the “Area of Interest”).

Hess shall acquire seismic data, at is sole cost of at least $40.0 million, over the Area of Interest within 18 months of the execution of the E&P Agreement. After acquiring the seismic data, Hess shall have the right to acquire a 62.5% working interest in the Area of Interest. If Hess acquires the working interest, they commit to drill and evaluate five exploration wells at their sole cost, one of which must be a horizontal well. All costs to plug and abandon the five exploration wells will also be borne solely by Hess. The drilling and evaluation of the five exploration wells must meet the minimum work requirements of a work program. Costs to drill wells after the five exploration wells will be borne 62.5% by Hess and 37.5% by Falcon Australia. In November 2011, the full testing program of the Shenandoah 1 well was successfully carried out, with gas being produced from each of the shale intervals tested. The testing program succeeded in its objectives and the well has been plugged and abandoned.

There were no other significant changes in the state of affairs of the Company that occurred during the year under review.

Operating and financial review

The operating and financial review of the Company during the year is detailed on pages 1 to 2 of this report.

Environmental regulation

The Company's operations are subject to Australian Commonwealth and Northern Territory environmental regulations and legislation. The Board believes the Company has adequate systems in place for the management of its environmental requirements and is not aware of any significant breach of those environmental requirements as they apply to the Company.

Events subsequent to balance date

There were no significant events after balance date.

Likely developments

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

Indemnification of officers and auditors

During or since the end of the financial year, the Company has not indemnified or made a relevant agreement to indemnify an officer or auditor of the Company against a liability incurred by such an officer or auditor.

In addition, the Company has not paid or agreed to pay, a premium in respect of a contract insuring against a liability incurred by an officer or auditor.

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

The lead auditor's independence declaration is set out on page 7 and forms part of the directors' report for the year ended 31 December 2011.

Signed this 20 day of April 2012 in accordance with a resolution of the Board of Directors:

RMacaulay

Robert Macaulay
Director

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of Falcon Oil & Gas Australia Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2011 there have been:

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

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

KPMG

KPMG

Stephen Board
Partner

Brisbane
20 April 2012

KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Liability limited by a scheme approved under Professional Standards Legislation.

FALCON OIL & GAS AUSTRALIA LIMITED

Statement of Comprehensive Income for the year ended 31 December 2011

	Notes	**Year Ended 31 December 2011 US$'000**	Year Ended 31 December 2010 US$'000
Revenue			
Revenue		**-**	-
Expenses			
Accounting & Audit Fees		**126**	102
Consultants Fees		**258**	111
Directors Fees		**41**	30
Management Fees		**-**	-
Legal Expenses		**154**	153
Travel Expenses		**297**	897
Miscellaneous		**162**	58
Joint Venture Marketing		**-**	2,057
Management Fee		**240**	-
Results from operating activities		**(1,278)**	(3,408)
Financial income		**1**	1
Financial expenses			
- Foreign Currency Exchange Gains		**303**	272
Net financing gains		**304**	273
Loss before tax		**(974)**	(3,135)
Income tax		**-**	-
Loss for the period		**(974)**	(3,135)
Other Comprehensive Income		**-**	-
Total Comprehensive Loss for the period		**(974)**	(3,135)

Statement of Financial Position as at 31 December 2011

	Notes	31 December 2011 US$'000	31 December 2010 US$'000
Current assets			
Cash and Cash Equivalents	4	**1,914**	5,421
Receivables	5	**926**	428
Total current assets		**2,840**	5,849
Non-current assets			
Property Plant & Equipment	6	**-**	1,666
Exploration and Evaluation Assets	7	**48,221**	50,592
Other	8	**487**	487
Total non-current assets		**48,708**	52,745
Total assets		**51,548**	58,594
Current liabilities			
Payables and Accruals	9	**2,639**	391
Related Party Loans	10	**7,826**	16,015
Total current liabilities		**10,465**	16,406
Non-current liabilities			
Other	11	**150**	281
Total non-current liabilities		**150**	281
Total liabilities		**10,615**	16,687
Net Assets		**40,933**	41,907
Equity			
Issued Capital	12	**43,559**	43,559
Option Reserve	12	**2,083**	2,083
Retained Losses	12	**(4,709)**	(3,735)
Total equity		**40,933**	41,907

FALCON OIL & GAS AUSTRALIA LIMITED

Statement of Cash Flows
for the year ended 31 December 2011

	Notes	**Year Ended December 2011 US$'000**	Year Ended 31 December 2010 US$'000
Cash flows from operating activities			
Cash payments in the course of operations		**(1,308)**	(3,206)
Interest Received		**1**	1
Realise FX gains		**303**	272
Net cash flows from operating activities	13	**(1,004)**	(2,933)
Cash flows from investing activities			
Proceeds from sale of Property, Plant & Equipment		**618**	-
Exploration & evaluation		**(14,042)**	(1,201)
Proceeds from farm out of project		**19,609**	-
Other non-current assets		**(499)**	1,216
Net cash flows from investing activities		**5,686**	15
Cash flows from financing activities			
Proceeds from share issue		**-**	6,313
Cost of issue of shares		**-**	(671)
Proceeds from related party loans		**-**	2,553
Repayment of related party loans		**(8,189)**	-
Net cash flows from financing activities		**(8,189)**	8,195
Net increase in Cash and Cash Equivalents		**(3,507)**	5,277
Cash and Cash Equivalents at the beginning of the financial period		**5,421**	144
Effect of exchange rate fluctuations on Cash and Cash Equivalents		**-**	-
Cash and Cash Equivalents at the end of the financial period	4	**1,914**	5,421

FALCON OIL & GAS AUSTRALIA LIMITED

Statement of Changes in Equity for the year ended 31 December 2011

	Notes	Issued Capital US$'000	Options Reserve US$'000	Retained Losses US$'000	Total Equity US$'000
Balance 1 January 2011		**43,559**	**2,083**	**(3,735)**	**41,907**
Loss for the year		-	-	**(974)**	**(974)**
Other comprehensive income		-	-	-	-
Total comprehensive income		-	-	**(974)**	**(974)**
Issue of share capital, net of share issue costs		-	-	**-**	**-**
Issue of options		-	-	**-**	**-**
Balance as at 31 December 2011		**43,559**	**2,083**	**(4,709)**	**40,933**

	Notes	Issued Capital US$'000	Options Reserve US$'000	Retained Losses US$'000	Total Equity US$'000
Balance as at 1 January 2010		-	-	(600)	(600)
Loss for the year		-	-	(3,135)	(3,135)
Other comprehensive income		-	-	-	-
Total comprehensive income		-	-	(3,135)	(3,135)
Issue of share capital, net of share issue costs		43,559	-	-	43,559
Issue of options		-	2,083	-	2,083
Balance as at 31 December 2010		43,559	2,083	(3,735)	(41,907)

NOTE 1 - REPORTING ENTITY

Falcon Oil & Gas Australia Limited (the 'Company' or 'Falcon Australia") is a company domiciled in Australia. The Company was incorporated on 21 August 2008.

NOTE 2 - BASIS OF PREPARATION

(a) Statement of compliance

The special purpose financial report has been prepared in accordance with the requirements of the Corporations Act 2001 and the recognition and measurement aspects of all applicable Australian Accounting Standards ("AASBs") adopted by the Australian Accounting Standards Board ("AASB"). The directors have determined that the Company is not a reporting entity.

The financial report does not include the disclosure requirements of all AASBs except for the following minimum requirements:

- AASB 101 Presentation of Financial Statements
- AASB 107 Cash Flow Statements
- AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors
- AASB 1048 Interpretation and Application of Standards.
- AASB 124 Related Party Disclosures.

The financial report was authorised for issue by the directors on 20 April 2012.

(b) Basis of measurement

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

(c) Functional and presentation currency

These financial statements are presented in United States dollars, which is the Company's functional currency. All amounts are rounded to the nearest $'000 unless otherwise stated.

(d) Use of estimates and judgements

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

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

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in the following notes:

- Note 7 – Exploration and Evaluation Assets
- Note 11 – Asset Retirement Obligation
- Note 2(e) – Going Concern

(e) Going Concern

The financial statements as of 31 December 2011 have been prepared on the basis that the Company is a going concern. That is, be able to pay its debts as and when they fall due.

NOTE 2 - BASIS OF PREPARATION (Continued)

The Company is reliant on its shareholders for ongoing financial assistance, in the form of the shareholder loans in order to operate as a going concern.

In the near term, the Company's ability to continue as a going concern is dependent upon the continued financial support from Falcon Oil & Gas Ltd (the 73% shareholder and parent entity of the Company) as detailed in note 10 and its ability to access cash to finance its upcoming capital commitments. Additional capital may be sought from existing shareholders, the issuance of shares to other parties or the disposal of certain or parts of certain assets.

The financial statements of Falcon Oil & Gas Ltd for the year ended 31 December 2011 are expected to disclose that:

> "*......The Company's ability to continue as a going concern in the short term is dependent upon its ability to raise additional capital from the sale of additional common shares or other debt or equity instruments and/or to secure an industry partner for its operations in Hungary and South Africa. . There is no assurance that additional capital will be available to the Company on acceptable terms or at all, or that an industry partner will be secured.*
>
> *In the longer term, the recoverability of the carrying value of the Company's long-lived assets is dependent upon the Company's ability to preserve its interest in the underlying petroleum and natural gas properties, the discovery of economically recoverable reserves, the achievement of profitable operations, and the ability of the Company to obtain financing to support its acquisition, exploration, development and production activities.*"

Accordingly, there is an inherent uncertainty as to whether the parent entity will be able to continue to provide financial support to the Company.

Management is of the view that the Company will be able to access such funds in the near future. However, there is no assurance such additional capital will be available.

In the event that the Company does not obtain additional funding, it may not be able to continue its operations as a going concern and therefore may not be able to realise its assets and extinguish its liabilities in the ordinary course of operations and at the amounts stated in the financial report.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in financial report.

Trade and other receivables
Trade and other receivables are stated at their amortised cost less provision for doubtful debts.

Cash and cash equivalents
Cash and cash equivalents comprise cash balances and call deposits.

Property Plant & Equipment
Items of property, plant and equipment are stated at cost, less accumulated depreciation and accumulated impairment charges.

Exploration and Evaluation Costs
Exploration and evaluation expenditure, including the costs of acquiring licences, are capitalised as intangible exploration and evaluation assets on an area of interest basis, less any impairment losses. Costs incurred before the Company has obtained the legal rights to explore an area are recognised in the comprehensive income statement.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

Exploration and evaluation assets are only recognised if the rights of the area of interest are current and either:

- the expenditures are expected to be recouped through successful development and exploitation of the area of interest; or
- activities in the area of interest have not at the reporting date, reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves and active and significant operations in, or in relation to, the area of interest are continuing.

Exploration and evaluation assets are assessed for impairment if sufficient data exists to determine technical feasibility and commercial viability and facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For the purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units to which the exploration activity relates. The cash generating unit shall not be larger than the area of interest.

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 to developing mine properties.

Impairment

The carrying amounts of the Company's assets, other than deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the statement of comprehensive income, unless an asset has previously been re-valued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through profit or loss.

Calculation of recoverable amount

The recoverable amount of assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Reversals of impairment

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Share capital

Transaction costs

Transaction costs of an equity transaction are accounted for as a deduction from equity, net of any related income tax benefit.

Dividends

Dividends are recognised as a liability in the period in which they are declared.

Interest bearing borrowings

Interest bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the statement of comprehensive income over the period of the borrowings on an effective interest basis.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

Trade and other payables

Trade and other payables are stated at their amortised cost. Trade payables are non-interest bearing and are normally settled on 30-day terms.

Revenue

Sales revenue is recognised in the statement of comprehensive income when the significant risks and rewards of ownership have been transferred to the buyer.

Expenses

Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest method, and interest earned.

Interest revenue is recognised in the statement of comprehensive income as it accrues, using the effective interest method. Dividend income is recognised in the statement of comprehensive income on the date the entity's right to receive payments is established.

Income tax

Income tax on the statement of comprehensive income for the period comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of the previous period.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

Goods and services tax

Revenue, 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 taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the balance sheet.

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

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Trade and other receivables

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

New standards and interpretations not yet adopted

The following standards, amendments to standards and interpretations have been identified as those which may impact the entity in the period of initial application. They are available for early adoption at 31 December 2011, but have not been applied in preparing this financial report:

AASB 1053 Application of Tiers of Australian Standards and AASB 2010-2 Amendments to Australian Standards arising from Reduced Disclosure Requirements apply to entities that prepare special purpose financial statements and will be required to prepare financial statements under either Tier 1 or Tier 2. This standard becomes mandatory for the Company's 31 December 2014 financial statements. The impact on disclosures as a result of the revised standard has not yet been assessed.

AASB 9 Financial Instruments deals with classification and measurement of financial assets. The standard becomes mandatory for the Company's 31 December 2015 financial statements. The impact of the revised standard has not yet been assessed.

AASB 10 Consolidated Financial Statements introduces a new approach to determining which investees should be consolidated. This standard becomes mandatory for the Company's 31 December 2013 financial statements. The impact of the revised standard has not yet been assessed.

AASB 127 Separate Financial Statements carries forward the existing accounting and disclosure requirements for separate financial statements with some minor clarifications. This standard becomes mandatory for the Company's 31 December 2013 financial statements. The impact of this standard is not expected to have a significant impact on the financial statements.

AASB 11 Joint Arrangements introduces a new approach to assessing the obligations and rights to underlying assets and liabilities of a jointly controlled entity. The standard becomes mandatory for the company's 31 December 2013 financial statements. The impact of this standard has not been assessed.

AASB 128 Investments in Associates and Joint ventures has been amended resulting in minor changes to the standard. The standard becomes mandatory for the company's 31 December 2013 financial statements. The impact of this standard has not been assessed.

AASB 12 Disclosures of interests in other entities contains disclosure requirements for entities that have interest in subsidiaries joint arrangements, associates and/or unconsolidated structured entities. The standard becomes mandatory for the company's 31 December 2013 financial statements. The impact of this standard has not been assessed.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

AASB 2011-7 Amends Australian Accounting Standards arising from the consolidated and joint arrangement standards. The standard becomes mandatory for the company's 31 December 2013 financial statements. The impact of this standard has not been assessed.

AASB 13 Fair Value Measurement and AASB 2011-8 further define the measurement of fair value with respect to other AASBs. This standard becomes mandatory for the company's 31 December 2013 financial statements. The impact of this standard is not expected to have significant impact on the financial statements.

AASB 2011-9 Amends Australian Accounting Standards in relation to the presentation of items of comprehensive income. The standard becomes mandatory for the company's 31 December 2013 financial statements. The impact of this standard is not expected to have a significant impact on the financial statements.

	Notes	**Year Ended 31 December 2011 US$'000**	Year Ended 31 December 2010 US$'000
NOTE 4 – CASH & CASH EQUIVALENTS			
Cash at bank		**1,914**	5,421
NOTE 5 – RECEIVABLES			
Current			
Accounts receivables		**679**	254
Prepayments		**13**	12
Other Receivables		**234**	162
		926	428
NOTE 6 – PROPERTY PLANT & EQUIPMENT			
Cost			
Opening balance		**1,666**	1,666
Transferred to Exploration & Evaluation		**(1,048)**	-
Disposals the period		**(618)**	-
Balance as at 31 December 2011		-	1,666
Depreciation			
Opening balance		-	-
Depreciation		-	-
Balance as at 31 December 2011		-	-
Net Book Value at 31 December 2011		-	1,666
NOTE 7 – EXPLORATION & EVALUATION ASSETS			
Cost			
Opening balance		**50,592**	37,648
Acquisition of interests in exploration licences		-	11,718
Expenditure in the period		**16,190**	1,226
Transferred from Property Plant & Equipment		**1,048**	-
Proceeds of farm out		**(19,609)**	-
Balance as at 31 December 2011		**48,221**	50,592
Depletion & Impairment			
Opening balance		-	-
Depletion & Impairment		-	-
Balance as at 31 December 2011		-	-
Net Book Value at 31 December 2011		**48,221**	50,592

NOTE 7 – EXPLORATION & EVALUATION ASSETS (continued)

In June 2011, the Company and Hess Australia (Beetaloo) Pty. Ltd. ("Hess") closed on an Evaluation and Participation Agreement (the "E&P Agreement"). Under the terms of the E&P Agreement, Hess paid $17.5 million to the Company as a participation fee for the exclusive right to conduct operations for the exploration, drilling, development and production of hydrocarbons from three of the four Permits, and excluding an area comprising 100,000 acres surrounding the Shenandoah-1 well (the "Area of Interest").

Initially, Hess shall acquire seismic data, at its sole cost of at least $40.0 million, over the Area of Interest within 18 months of the execution of the E&P Agreement. After acquiring the seismic data, Hess shall have the right to acquire a 62.5% working interest in the Area of Interest. If Hess acquires the working interest, they commit to drill and evaluate five exploration wells at their sole cost, one of which must be a horizontal well. All costs to plug and abandon the five exploration wells will also be borne solely by Hess. The drilling and evaluation of the five exploration wells must meet the minimum work requirements of the work program. Costs to drill wells after the five exploration wells will be borne 62.5% by Hess and 37.5% by Falcon Australia. As of 31 December 2011, Hess had completed approximately $10 million of the seismic program,

Under existing agreements with two advisors, the Company is obligated to pay a "success fee" in the aggregate amount of 5% for services provided in conjunction with the E&P Agreement with Hess. The success fee is based on the cash or cash-equivalent value of any net amount received directly or indirectly by the Company, including the participation fee and warrants issued by the Canadian parent entity Falcon Oil & Gas Limited, cost of seismic data commitment and cost of drilling commitment.

In November 2011, Falcon Australia, in accordance with the work program for Permit EP 98, completed the testing and stimulation of the Shenandoah-1 well at its sole cost, and the well has been plugged and abandoned. Falcon Australia provided Hess with the data obtained from these activities, and Hess paid Falcon Australia $2.0 million.

	Year Ended 31 December 2011 US$'000	Year Ended 31 December 2010 US$'000
NOTE 8 – OTHER NON CURRENT ASSETS		
Security deposits	**487**	487
	487	487
NOTE 9 – PAYABLES & ACCRUALS		
Trade payables	**2,065**	327
Accruals	**574**	64
	2,639	391
NOTE 10 – RELATED PARTY LOANS		
Current		
Mako Energy Corporation	-	487
Falcon Oil & Gas Limited	**7,826**	15,528
	7,826	16,015

NOTE 10 – RELATED PARTY LOANS (continued)

The Company's acquisition and exploration expenditure has been primarily funded by way of loans from its holding company, Falcon Oil & Gas Ltd. These loans have been advanced on an interest free basis, repayable on demand, subject to the financial support of Falcon Oil & Gas Ltd noted below.

The Company is dependent upon the financial support of Falcon Oil & Gas Ltd to support the ongoing operations of the Company . The financial support referred to is for a period of 12 months from the date of these financial statements, has been confirmed in writing by Falcon Oil & Gas Ltd, and includes:

- commitment to assist in meeting liabilities as and when they fall due, but only to the extent that money is not otherwise available to meet such liabilities and only for those liabilities which have been previously approved by Falcon Oil & Gas Ltd;
- commitment that Falcon Oil & Gas Ltd will not seek repayment of any amounts owed from Falcon Australia as of 31 December 2011 for a period of not less than 12 months from the date of this report. Falcon Oil & Gas Ltd reserves the right to (i) convert any or all of the amounts due to Falcon Oil & Gas Ltd from Falcon Australia to shares of common stock in Falcon Australia, (ii) be repaid amounts due to it from any proceeds from a joint venture or any other agreement entered into with an unrelated third party, and (iii) be repaid from the proceeds of an IPO or other financing should Falcon Australia enter into such financing arrangement

NOTE 11 – OTHER LIABILITIES

	Year Ended 31 December 2011 US$'000	Year Ended 31 December 2010 US$'000
Asset retirement obligation	**150**	281
	150	281

The Company makes provision for the rehabilitation of drill sites on a discounted basis. The rehabilitation provision represents the present value of estimated rehabilitation expenditure which would be required to rehabilitate the site at the conclusion of current exploration activities.

NOTE 12 – CAPITAL & RESERVES

	31 December 2011 Number	31 December 2010 Number
Share capital		
Opening balance	**206,363,237**	1
Issued during the year	**-**	206,363,236
Ordinary shares on issue – fully paid	**206,363,237**	206,363,237
Options		
Opening balance	**6,510,598**	**-**
Issued during the year - expiry 4 June 2013	**-**	**5,213,877**
Issued during the year - expiry 15 November 2013	**-**	**1,296,721**
Options on issue	**6,510,598**	**6,510,598**

Options holders are entitled to receive 1 fully paid ordinary share for each option exercised by payment of $1.25 per option at any time up to the expiry date.

Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings. The Company does not have authorised capital or par value in respect of its issued shares.

NOTE 12 – CAPITAL & RESERVES (continued)

In the event of winding up of the Company, ordinary shareholders rank after creditors and are fully entitled to any proceeds of liquidation.

Dividends

There were no dividends paid or declared by the Company during the period ended 31 December 2011.

	Note	Share capital US$'000	Options Reserve US$'000	Retained losses US$'000	Total equity US$'000
Balance at 1 January 2011		**43,559**	**2,083**	**(3,735)**	**41,907**
Shares issued		**-**	**-**	**-**	**-**
Costs of issue of shares		**-**	**-**	**-**	**-**
Issuance of options		**-**	**-**	**-**	**-**
Total recognised income and expense		**-**	**-**	**(974)**	**(974)**
Balance at 31 December 2011		**43,559**	**2,083**	**(4,709)**	**40,933**

	Note	Share capital US$'000	Reserves US$'000	Retained losses US$'000	Total equity US$'000
Balance at 1 January 2010		-	-	(600)	(600)
Shares issued		44,357	-	-	44,357
Costs of issue of shares		(798)	-	-	(798)
Issuance of options		-	2,083	-	2,083
Total recognised income and expense		-	-	(3,135)	(3,135)
Balance at 31 December 2010		43,559	2,083	(3,735)	(41,907)

	Notes	Year Ended 31 December 2011 US$'000	21 August to 31 December 2010 US$'000
NOTE 13 – STATEMENT OF CASH FLOWS			
Reconciliation of loss for the period to net cash from operating activities			
Loss for the period		**(974)**	(3,135)
Non cash costs		**21**	23
Decr/(incr) in receivables		**-**	179
Incr/(decr) in payables		**(51)**	-
Net cash from operating activities		**(1,004)**	(2,933)

NOTE 14 – CAPITAL COMMITMENTS

Under a revised work program approved by the Northern Territory of Australia Government, Department of Resources, on 6 July 2011, the Company is obligated to complete minimum work requirements by expending the following amounts in order to continue to hold the underlying permits in the Beetaloo Basin Project.

	US$'000
Year ended 31 December 2012	18,152
Less acquisition of seismic by Hess under E&P agreement	(16,626)
	1,526

	Notes	**Year Ended 31 December 2011 US$**	Year Ended 31 December 2010 US$
NOTE 15 – AUDITOR REMUNERATION			
Audit of financial report - KPMG		**30,500**	25,000

NOTE 16 – SUBSEQUENT EVENTS

There were no significant events after balance date.

Directors' Declaration

1 In the opinion of the directors of Falcon Oil & Gas Australia Limited:

(a) the Company is not a reporting entity;

(b) the financial statements and notes, set out on pages 8 to 22, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Company as at 31 December 2011 and of its performance, as represented by the results of its operations and its cash flows, for the financial year ended on that date in accordance with the statement of compliance and basis of preparation described in Notes 2 and 3; and

(ii) complying with Australian Accounting Standards and other mandatory professional reporting requirements to the extent described in Notes 2 and 3 and the Corporations Regulations 2001; and

.

(c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable

Signed this 20th day of April 2012 in accordance with a resolution of the Board of Directors:

RMacaulay

Robert Macaulay
Director

Independent Audit Report to thememebers of Falcon Oil & Gas Australia Limited

Report on the financial report

We have audited the accompanying financial report, being a special purpose financial report, of Falcon Oil & Gas Australia Limited (the company), which comprises the statement of financial position as at 31 December 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, notes 1 to 16 comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report and have determined that the basis of preparation described in Notes 2 and 3 to the financial report is appropriate to meet the requirements of the Corporations Act 2001 and is appropriate to meet the needs of the members. The directors' responsibility also includes such internal control as the directors determine necessary to enable the preparation of a financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, 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 of the financial report that gives a true and fair view 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.

These procedures have been undertaken to form an opinion whether, in all material respects, the financial report is presented fairly in accordance with the basis of accounting described in Notes 2 and 3 to the financial statements so as to present a true and fair view which is consistent with our understanding of the company's financial position, and of its performance.

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

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's opinion

In our opinion the financial report of Falcon Oil & Gas Australia Limited is in accordance with the *Corporations Act 2001*, including:

(a) giving a true and fair view of the company's financial position as at 31 December 2010 and of its performance for the year ended on that date in accordance with the accounting policies described in Notes 2 and 3; and

(b) complying with Australian Accounting Standards to the extent described in Notes 2 and 3 and the Corporations Regulations 2001.

KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Liability limited by a scheme approved under Professional Standards Legislation.

Material uncertainty regarding continuation as a going concern

Without modifying our opinion, we draw attention to Note 2(e) to the financial statements which indicates that the Company's ability to continue as a going concern is dependent upon the ongoing financial support of its parent entity, and that the ability of the parent entity to continue as a going concern is dependent upon it raising additional capital. This condition, along with other matters as set forth in Note 2(e), indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern concern and, therefore, whether the Company will realise its assets and settle its liabilities in the normal course of business and at the amounts stated in the financial report.

Basis of Accounting

Without modifying our opinion, we draw attention to Note 2 to the financial report, which describes the basis of accounting. The financial report has been prepared for the purpose of fulfilling the directors' financial reporting responsibilities under the Corporations Act 2001. As a result, the financial report may not be suitable for another purpose.

KPMG

KPMG

S Board

Stephen Board
Partner

Brisbane
20 April 2012