2010 **2011**

CARBON **ENERGY** ANNUAL **REPORT**

A world leader in advanced coal technology

carbon**energy**
resource. technology. markets.

CARBON ENERGY **IS A WORLD LEADER IN** ADVANCED COAL TECHNOLOGY

In three short years we have turned our proprietary **key**seam® technology into a commercial reality and delivered an Australian first in power generation by syngas.

We have built a portfolio of coal assets ready to supply markets desperate for new fuel sources and partnered with world leading organisations across Australia, Chile, Turkey and the United States.

We have established a strong foundation. Now we are ready to power a new generation in advanced coal technology.

SUNSET AT BLOODWOOD CREEK PROJECT SITE


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CARBON ENERGY **IS A WORLD LEADER IN** ADVANCED COAL TECHNOLOGY

Our business is transforming previously stranded coal resources into high-value fuels with lower emissions to meet the increasing global demand for new, low cost, alternative energy sources.

RESOURCE

STRANDED COAL RESOURCES

Build a targeted international portfolio of coal assets suitable for Underground Coal Gasification (UCG)

STRATEGIC OBJECTIVES

TECHNOLOGY

TRANSFORMED INTO SYNGAS

Be a leader in advanced coal technology that delivers a lower cost, lower emission fuel source.

keyseam®

MARKETS

DOWNSTREAM PRODUCT MARKETS

Supply UCG Syngas to high-value downstream markets.

2011 CONTENTS

RESOURCE

"The World Energy Council estimates UCG could potentially increase recoverable global coal reserves by as much as 600 billion tonnes."*

* 2007 Survey of Energy Resources

We transform stranded coal resources into valuable product gas

Core to what we do is transform otherwise stranded coal resources into high value fuels. Identification and selection of resources suitable for our keyseam technology is essential to our strategy. We are building a targeted international portfolio of coal assets that meet our key resource assessment criteria.

Our current resource targets

Project	Commercial Target[1] (Million Tonnes)	Jorc Resource[2] (Million Tonnes)	Recoverable Gas[3] (Pj)
Queensland, Australia		668	6,680
Mulpun, Chile[4]		103	1,100
Wyoming, United States	500	By Dec 12	5,000
TOTAL	500	771	12,780

Notes

1 Carbon Energy target
2 JORC compliant – Competent Person: Dr C. Mallett
3 Carbon Energy calculation based on estimated energy content of the coal and 50% recovery (that takes into account pillars, losses and a gasification efficiency of 80%)
4 Carbon Energy has the right to a 30% contributing interest in the Chile deposit upon completion of agreed milestones

Our key assessment criteria for selecting resource projects

Criteria	Description
Coal resource	Suitable for keyseam.
Location	Close to routes to markets.
Market	Market demand for UCG Syngas products (e.g. power, chemicals, liquid fuels) at attractive prices. Revenues and profits can be repatriated to Australia.
Regulation	A regulatory pathway for UCG projects.
Counterparty	A strong counterparty that brings additional capability to projects (e.g. coal resources, capital, access to markets).
Sovereign Risk	Clear legal framework to protect commercial interests. Ability to repatriate profits to Australia. Strong environment and safety standards.

TECHNOLOGY

keyseam creates a low-cost, low-emission and low-impact pathway for delivering a new generation of commercial scale energy projects. Its more efficient, cleaner utilisation of deep coal resources unlocks a previously inaccessible energy source with minimal environmental footprint.

keyseam

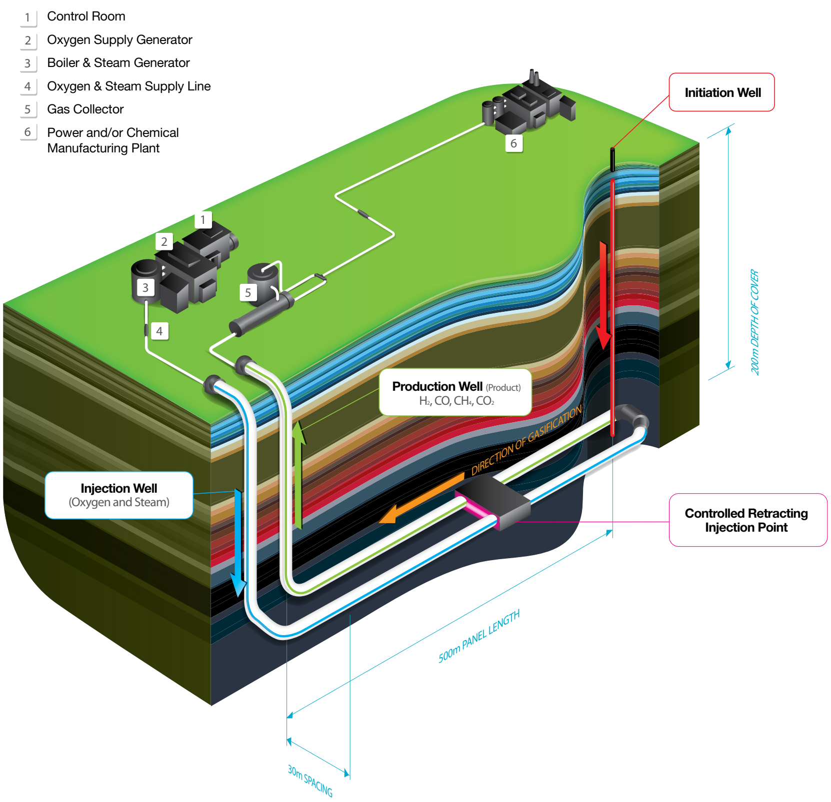
Carbon Energy's competitive advantage lies in its intellectual property and proprietary technology, keyseam, which transforms in-situ coal into gas underground and optimises the amount of energy extracted from otherwise stranded coal resources.

keyseam is an innovation in underground coal gasification (UCG), incorporating a unique criteria for site selection and advanced geological modelling. It also maximises resource efficiency, extracting up to 20 times more energy than the coal seam gas (coal bed methane) process from a given resource, whilst minimising surface disturbance and preserving groundwater.

keyseam's advantage comes from Carbon Energy's long association with Australia's premier research agency, the Commonwealth Scientific Industrial Research Organisation (CSIRO), which includes world-class geotechnical, hydrological and gasification modelling capabilities.

Six significant environmental advantages of **key**seam

1. Maximises resource efficiency by extracting up to 20 times more energy from the same resource when compared to coal seam gas (coal bed methane) production.
2. Minimises surface disturbance by extracting the energy from coal through a series of boreholes rather than mechanical excavation used in conventional mining methods.
3. Preserves groundwater by operating the gasification process below the hydrostatic pressure and not pumping groundwater to the surface.
4. Leaves rock and ash, originally mixed with the coal, underground in the coal seam.
5. Cuts carbon emissions by producing syngas-fuelled electricity with 10-20% less CO_2 emissions than traditional coal-fired power plants.
6. Does not involve fraccing.



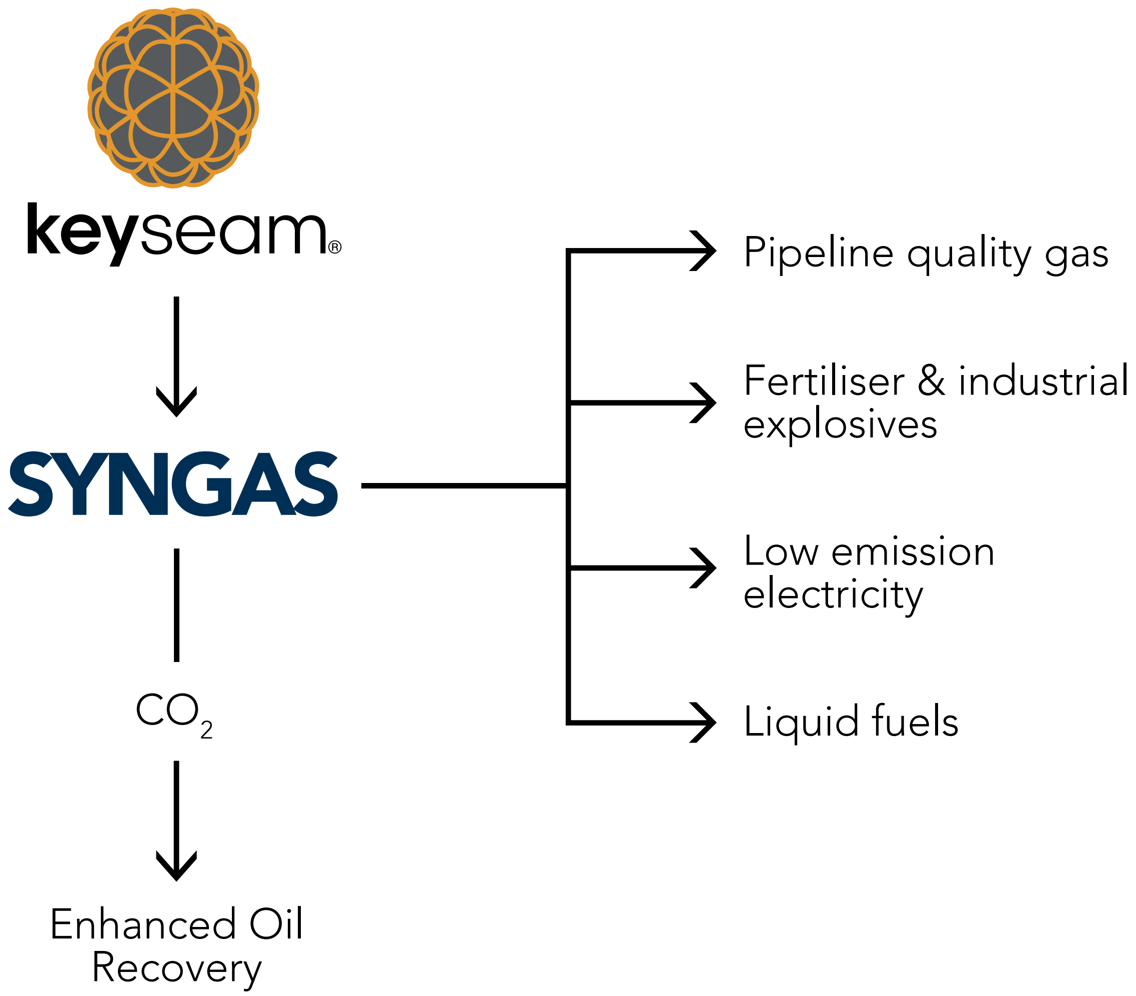
MARKETS

"UCG has scale and cost base to be 10% of global energy supply."*

* AUSTOCK Securities, Sustainable Energy – Tangible Solutions will prevail over International Regulatory Uncertainty, July 2011

Our valuable product gas syngas can be used in the production of high value commodities such as electricity, pipeline quality gas, fertilisers, and liquid fuels. We have the flexibility to deploy our technology and supply syngas to a range of downstream industrial customers depending on local market requirements wherever we are in the world.

An additional revenue stream can also be generated by separating the by-product carbon dioxide (CO_2) from our syngas for use downstream in Enhanced Oil Recovery, a technique used to increase the productive life of mature oil fields which has been demonstrated at a commercial scale for more than 30 years in the USA.



CHAIRMAN'S **REPORT**

It's with great pleasure that I present my first report to you as Chairman.

I have watched Carbon Energy for some time, as the Company has demonstrated its ability to progressively de-risk the technology and environmental issues, associated with Underground Coal Gasification (UCG). Since my appointment we continue to focus on delivering on our technology, which will bring long term value to shareholders.

While the global economic outlook remains uncertain, the Board is confident our strategy is growing even more relevant in the current climate. This strategy is clear:

We have rights to and will continue to acquire unique energy assets suitable for keyseam. We will transform these into high value fuels using our proprietary technology and monetise the energy we create to supply global energy markets and return long term shareholder value.

Execution of this strategy requires our continued focus on:

Resource:

the acquisition of targeted coal resources, with criteria suitable for keyseam, in markets that require our energy service delivery

Technology:

the development and implementation of the keyseam as the world leading advanced UCG technology, that delivers a low cost, lower emission energy source

Markets:

the implementation of keyseam to supply energy to high-value downstream markets and maximise shareholder return

Governments are demanding more renewable energy sources. The reality is that renewables alone will be unable to meet the demand required at reasonable prices, in the short to medium term. Markets are turning to non-conventional energy fuels such as shale gas, coal seam gas and syngas which capitalise on previously inaccessible or stranded fuel resources and at the same time offer lower emissions. These non-traditional fuel reserves also provide lower cost alternatives that can alleviate some of the environmental constraints, currently being applied to conventional energy sources.

keyseam has been developed with over 10 years research with Australia's CSIRO and has completed three years of in-field trials in readiness for commercialisation. keyseam extracts 80% of the energy recoverable from coal in-situ. In a world hungry for energy, resource efficiency is becoming a higher priority.

Carbon Energy's Australian developed, keyseam technology has the potential to unlock energy contained in otherwise stranded coal resources.

The future for Carbon Energy remains exciting. We have delivered an Australian first in generating electricity from syngas. We expect to start taking our first revenues from the supply of syngas derived electricity into the local grid in Queensland before Christmas 2011 and at our Bloodwood Creek site, further UCG panels will demonstrate the scalability of syngas production.

Carbon Energy's global expansion continues with the construction and commissioning of our first UCG panel in Chile, in conjunction with joint venture partners Antofagasta Minerals. Together we are working to accelerate feasibility studies and gain approvals required to build a commercial power project in Mulpun, approximately 800km south of Santiago.

We are also about to launch into an UCG project in Wyoming in the United States. A dedicated drilling program to fast track the establishment of resources is planned for next year. Exploration, permit approvals and environmental baseline monitoring will be the focus of effort across the projects in Wyoming and the Montana/North Dakota border regions throughout 2012.

I joined the Board in July 2011. Kim Robinson has stepped down as Chair but remains as a Non-Executive Board Member. Dr Cliff Mallet has left the Board, but remains an Executive as our Technical Director to assist the development of UCG opportunities globally.

On behalf of the Board I would like to acknowledge our appreciation to Kim for his tenure as Chairman and also to Cliff for his contribution as a founding Director. Fortunately we have retained the benefit of Kim's and Cliff's expertise through their ongoing services.

The strategy of a company is only as good as the people who execute it. One thing that has impressed me in the short time I've been a part of Carbon Energy is the enthusiasm and knowledge of our dedicated management team. The past year has provided many challenges and distractions and despite this the team has continued to achieve milestones as well as work on future projects beyond the commercialisation of Bloodwood Creek. The Board and I thank the Executive team and all staff for their tremendous efforts.

Finally, since becoming Chairman I have had the privilege of meeting several institutional and individual investors. This has been a very valuable experience in understanding the demands of our shareholders. I thank you for your continued support in what has been a very challenging period in our development and I look forward to meeting many more of you as we deliver further progress over the years ahead.

Chris Rawlings
Chairman

CEO & MANAGING DIRECTOR'S **MESSAGE**

The financial year of 2011 was defined for Carbon Energy as commencing with technical challenges and regulatory delays and finishing with our ground breaking achievement; an Australian first in the innovation of Underground Coal Gasification (UCG), which we pioneered.

I am immensely proud of our team who over the last 12 months have weathered adverse circumstances and have now emerged as world leaders in our industry.

Queensland is experiencing unprecedented growth in energy projects including traditional coal mining, coal seam gas to LNG and the developing UCG industry. This is creating competition for coal resource tenure in some places between competing energy proponents as well as competition for surface land rights between energy developers and farmers. These competing issues have created challenges for all stakeholders, including regulators and Government in balancing the benefits to the State and ensuring equity amongst participants. This will remain a challenge for all energy players in the years to come.

In July 2010 the Department of Environmental & Resource Management requested we conduct an Environmental evaluation of a release of process water in 2009. We conducted a thorough investigation of the issue and our resulting report demonstrated no ongoing environmental harm. The Department accepted our report in October 2010 and the Government subsequently confirmed our findings. While there was no ongoing harm from this incident we have implemented changes in process design and procedures to ensure that this type of event will not re-occur. This approach to continuous improvement in our environmental performance is enshrined in the values of our Company.

In February 2011 we obtained amended environmental authorities and commenced commissioning of UCG Panel 2. Outstanding achievements followed in the successful operation of our unique panel design and an Australian first in the production of electricity from UCG syngas.

UCG Panel 2 was initiated in March 2011 and has achieved six months of continuous syngas production. In August 2011 we achieved an Australian first in generating electricity using syngas produced from our proprietary Underground Coal Gasification (UCG) technology. We have successfully completed testing of power station load circuits and up to 1 MW of electricity has been generated and transmitted into a load bank which replicates the continuous supply of electricity into the grid. This facility confirms Carbon Energy as a world leader in UCG technology development and expertise that will deliver lower emission energy from coal. As we continue to progress amendments to our existing environmental approvals to increase production to 5 MW of electricity, we remain focused on beginning to turn our resources into revenue before the end of 2011.

Bloodwood Creek's site selection has been important in meeting our commitment to environmental and social responsibility. The site is ideal for the type of commercial developments we have planned. It is close to key infrastructure as well as being located away from good quality aquifers and prime agricultural land. Our site is also located outside Strategic Cropping Land so does not infringe on the region's agricultural production.

What we have learned and the improvements we continue to gain at Bloodwood Creek cannot be underestimated. The developments of keyseam have become the cutting edge of UCG technology. It not only enables us to utilise deep coal resources otherwise inaccessible through traditional coal mining methods but also delivers a high quality, low cost energy source that has a lower impact on the environment. Every day we are expanding the skills and knowledge developed here in Australia and it is our knowledge and intellectual property (IP) that can be exported to markets looking for new sources of energy.

Our technology delivers access to previously inaccessible coal assets, with a lower impact on the environment, protection of groundwater reserves, as well as maximising energy recovery, up to 20 times more than coal seam gas (coal bed methane).

Our strategy of developing our assets and technology and supplying high-value fuels to markets has kept the team focused on delivering long term shareholder value. This approach has underpinned the key decisions we have made across acquisitions and global expansion in 2011 financial year, helping to develop a strong foundation for growth.

In February 2011 we executed an agreement for the acquisition of USA based Clean Coal Inc and UK based Clean Coal Amasra Limited. This acquisition launched Carbon Energy into both the North American and European markets and underpinned our transformation into a truly international energy business. In line with our strategic direction the purchase also provided access to coal resources suitable for keyseam. The main commercial criterion for these projects is a target resource of 1000Mt JORC Inferred Resource in the United States projects of Wyoming, Montana/North Dakota border and 500Mt in Amasra, Turkey.

The contracts to our North American rights to coal resources include off-take agreements providing access to an additional revenue stream for the sale of carbon dioxide (CO_2) for use in Enhanced Oil Recovery (EOR). The separation and sale of CO_2 for use in EOR also has the added benefit of further reducing UCG carbon emissions to below that of Natural Gas.

In June 2011 year we announced our Maiden Resource Statement for the Mulpun project coal deposits in Chile. The JORC Resource estimate totals 103 million tonnes. This is a very significant energy resource for the Chilean market being sufficient to run as much as 300 MW power station for 55 years.

We appreciate the continued support we receive from our partners Antofagasta Minerals. I am continually impressed by their professionalism, enthusiasm and experience to progress developments at Mulpun. As a project team we have worked well to develop the first UCG panel with construction of the site and environmental monitoring underway. Front End Engineering and Design (FEED) is progressing well as we enter into the detailed Engineering, Procurement and Construction (EPC) phase.

Chile has always been an attractive market for energy due to the country's reliance on imported fuel and growing energy demand of 8% pa. When we began looking into this project in 2009 spot energy prices were US$120 per MWh. However recent reports have indicated spot prices have increased to US$220 per MWh making these some of the highest energy prices in the world.

We are lucky in a company as young as ours to have built a team of dedicated and talented people. As our knowledge and experience grows we are developing innovators in our specialised field that can deliver long term growth for shareholders.

This year has given us more challenges than we expected and I'd like to thank you, our shareholders, for your support over the last year. I'd also like to thank my Executive leadership team and all our staff for their commitment to our Australian activities as well as their efforts in driving our expansion globally. All of which have set a very good foundation for a very positive year ahead.

I would also add my welcome to our new Chairman Chris Rawlings, who brings a wealth of experience in both energy and new technology companies.

I look forward to working with him and the Board to continue to develop and grow our company for the benefit of all shareholders.

Andrew Dash
Managing Director

Our current resource targets

Project	Commercial Target[1] (Million Tonnes)	Jorc Resource[2] (Million Tonnes)	Recoverable Gas[3] (Pj)
Queensland, Australia		668	6,680
Mulpun, Chile[4]		103	1,100
Wyoming, United States	500	By Dec 12	5,000
TOTAL	500	771	12,780

Notes: see page 5.

HIGHLIGHTS **FY 2011**

FY11 a year of domestic achievements and global expansion across 4 continents

Bloodwood Creek UCG Panel 2 has achieved over 5 months continuous gas flow

Bloodwood Creek 5MW Power Station is generating electricity

Major international acquisitions delivering project opportunities in Wyoming, Montana & Turkey

Establishment of US headquarters

MoU with Adani Group to participate in tender processes with Coal India Limited

Investing in talented people, to expand knowledge and transfer skills

Advancement of project in Chile with partner Antofagasta Minerals

Progression of keyseam innovation through experience with constructing Panel 2 & 3, commissioning of Panel 2 and decommissioning of Panel 1 at Bloodwood Creek

AUSTRALIA
BLOODWOOD CREEK, QUEENSLAND

Project milestones:

August 2011
First electricity generated at Bloodwood Creek

February 2011
First gas produced from UCG Panel 2

August 2010
Construction of UCG Panel 2 and 3 commences

July 2009
5MW Power Station construction commences

February 2009
Successful commercial trials completed

Phase 1 power generation: 5MW power station

In August 2011 our pilot-scale 5MW Power Station located at Bloodwood Creek in Queensland achieved an Australian first in power generation from UCG syngas.

The latter half of 2010 and early 2011 was a challenging period as the Queensland Department of Environment and Resource Management (DERM) temporarily restricted operations to investigate a release of process water from surface containment on site from 2009. Following a thorough investigation of the matter, DERM accepted our report and agreed with our findings that there was no ongoing environmental harm. We are committed to upholding the strong environmental credentials which Carbon Energy was founded upon. While we experienced delays during this period, we have been able to successfully demonstrate the value of our keyseam technology.

UCG Panel 2 has been producing syngas continuously since March 2011 and in the month that followed we achieved our optimal operating configuration with syngas produced from the Product Well in accordance with our unique UCG panel design.

Product gas heating values rapidly reached the target range of 5-6 MJ/m^3 with sustained gas production periods achieving heating values in excess of 6MJ/m^3. During the second quarter of 2011 controlled changes to operating parameters were made to optimise gasifier performance. The effectiveness of improvements implemented from the learnings of Panel 1 was confirmed.

Syngas was introduced to the 5MW Power Station in May 2011 allowing the testing of each engine to commence. Initial testing of the engines was completed successfully by the end of June 2011. The July milestone of testing power station load circuits was achieved. Additionally, the first engine successfully delivered electricity to the load bank and testing to 1MW was completed during August as scheduled.

Completion of the construction of electricity lines from the site to the local network and connection work by the network operator is progressing and targeted for completion in October 2011. In addition, the required amendment to our existing Environmental Authorities which would allow for an increase in the volume of gas consumed to enable operation of the 5MW Power Station at full load is being progressed with the Queensland Department of Environment and Resource Management (DERM). Subject to gaining these approvals we are on-track to export 5MW of electricity to the local electricity grid in October 2011 and look forward to generating our first revenue from an off-take agreement signed with Queensland Government-owned Ergon Energy. This is an important step in demonstrating the ability of Carbon Energy's advanced coal technology, keyseam, to deliver low-cost energy to Queenslanders.

In addition, this project has the dual benefit of stimulating economic growth in regional Queensland whilst significantly reducing the environmental impact of producing energy from coal when compared to traditional mining, surface gasification and coal seam gas production.

Drilling of UCG Panel 3 was also completed during 2010. When it is commissioned in 2012, Panel 3 will prove our ability to demonstrate a multi-panel operation that will enable consistent higher volume power generation to support larger developments. Learnings from the decommissioning of Panel 1 and re-design involved in the construction of Panel 2, including sophisticated directional drilling, have been applied to Panel 3 as well as the design of subsequent panels to optimise production in our expansion from pilot phase to commercial-scale operations.

The controlled decommissioning of UCG Panel 1 is continuing as planned. Results from the decommissioning process will be used to demonstrate the environmentally safe operations of a full life cycle of a UCG Panel in support of applications for long term gas production licences.

Phase 2 power generation: 25MW power station development

Our Queensland based Phase 2 and Phase 3 power station developments took a major step forward with the signing of a Power Station Development Agreement with Arcadia Energy Trading (Arcadia) in September 2010. Arcadia Energy Trading is affiliated with UK-based Arcadia Petroleum and is part of the Farahead Holdings group of companies that have a market capitalisation in excess of US$11 billion.

AUSTRALIA
BLOODWOOD CREEK, QUEENSLAND

The Power Station Development Agreement provides a framework for Carbon Energy and Arcadia to progressively develop the Power Generation Phase 2: 25MW Power Station and Power Generation Phase 3: 300MW Power Station based on UCG syngas from Bloodwood Creek's coal resource in Queensland.

The key terms of the announced agreement include:

- Arcadia will, upon Carbon Energy obtaining a Mining Lease for Bloodwood Creek, purchase the 25MW Power Station from Carbon Energy and enter into a long term Gas Supply Agreement, subject to certain conditions being met; and
- Carbon Energy and Arcadia will partner in the development of Carbon Energy's 300MW Power Station at the Company's proposed Blue Gum Energy Park, located close to the Bloodwood Creek coal resource.

Additionally this agreement presents the opportunity to work with an experienced and successful energy trading company providing complementary market knowledge and financial capability, which will assist in the successful progression of our development plans.

Connection arrangements for the 5MW Power Station are being designed to allow, as much as possible for the export of a further 25MW. Final commitments to the 25MW Power Station will be made once there is greater certainty on the Queensland Government's UCG policy such that the necessary financial investment is not subject to tenure risk.

Power generation phase 3: 300 MW power station and Blue Gum Energy Park

Plans for a 300MW Power Station fuelled by syngas and developed with our power station development partner, Arcadia Energy Trading, will be further developed in the future. It is anticipated that Federal Government's plan to implement policy for the reduction of carbon emissions will positively change the economics of our planned project. This is expected as the carbon intensity of the syngas-fuelled power station (CO_2/MWh of electricity generated) will be lower than the average intensity of coal fired electricity generation. In addition co-firing of coal and syngas could enable an existing power station using both fuels to be a net beneficiary of the pass through of lower carbon costs into electricity prices.

In December 2010 Carbon Energy finalised a concept study undertaken in conjunction with significant shareholder Incitec Pivot Limited which concluded that Carbon Energy's UCG syngas is suitable for commercial production of both ammonia and synthetic natural gas (SNG). The joint study was undertaken by international ammonia experts Ammonia Casale and confirms that Carbon Energy will be able to produce high value added products from syngas. The study assessed the feasibility of a standalone an ammonia plant, a combination of an ammonia plant and a 300MW power station and an independent synthetic natural gas plant. Each option assessed produced positive results confirming there are a range of alternatives for Carbon Energy to successfully bring UCG syngas to market at a commercial scale.

Power station at Bloodwood Creek

Tim Kurtz, Process Operator

Directional sign at Bloodwood Creek

Ray Thomas, Site Supervisor & Bob Foster, Project Engineer, at a daily staff briefing.

Resource highlights

JORC Resource Assessment

Location	Coal Thickness Cut-Off (m)	Indicated (Mt)	Inferred (Mt)	TOTAL (Mt)
Bloodwood Creek, Australia	2 5[1]	218 158	280 57	498 215
Kogan, Australia	2 5[1]		170 149	170 149

Notes: 1. Optimal target for Underground Coal Gasification

Competent Person Statement – Coal

The information in this table that relates to resources is based on information compiled by Dr C.W. Mallett, Technical Director Carbon Energy Limited who is a member of the Australian Institute of Mining and Metallurgy. Dr Mallett has sufficient experience which is relevant to the style of mineralisation and type of deposit under consideration and to the activity which he is undertaking to qualify as a Competent Person as defined in the 2004 Edition of the "Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves". Dr Mallett consents to the inclusion in the release of the matters based on his information in the form and context in which it appears.

Tenement Status at end June 2011

Tenement	Status	Sub-Blocks as at March 2011	Sub-Blocks as at June 2011	Area Sq km
MLA 50253	Application	1342 ha	1342 ha	15
MDL 374	Granted	2687 ha	2687 ha	32
867	Granted	191	191	670
869	Granted	64	64	213
868	Granted	177	177	605
1132	Granted	23	23	78
1109	Granted	65	65	224
			Total	1,837

EARLY MORNING AT BLOODWOOD CREEK

SOUTH **AMERICA**

MULPUN, CHILE

Since we entered into our first international energy project in South America with global mining giant, Antofagasta Minerals S.A., significant progress has been made. The agreement was signed at the end of 2009 to jointly assess and develop Antofagasta's deep coal deposit adjacent to the town of Mulpun in Chile using keyseam. Antofagasta Minerals has formed a new energy division called Mulpun Energy which has day to day carriage of the project located in southern central Chile, 800 kilometres south of Santiago.

Chile continues to provide an attractive market for energy projects due to the nation's reliance on imported fuel and rapidly growing energy demand of 8% p.a. When Carbon Energy initially considered the Mulpun Project in late 2009, electricity spot prices were US$120 per MWh. Recently, reports have indicated that spot prices have increased to US$220 per MWh making these some of the highest power prices in the world.

The first major project milestone was achieved in August 2010 when Mulpun Energy obtained Environmental Approval for the parties' first stage joint UCG project in Mulpun. This has paved the way for the development of the project and allows us to construct and operate a pilot project that includes our first UCG panel and on-site facilities. The purpose of the pilot project is to confirm the gas quality produced from the Mulpun coal deposit to enable detailed design work and equipment installation to be undertaken for a major power generation project at that site.

Seismic studies have been assessed to confirm the location and configuration of the initial UCG panel. The drilling of site characterisation wells was completed in the first quarter of 2011 and groundwater monitoring began during the second quarter of 2011.

At the beginning of June 2011, a major development milestone was achieved with sign-off by both Carbon Energy and Antofagasta of the achievement of key Phase 1 deliverables. These deliverables include: design plan, work plan and budget development; hydrological model development; site selection for the pilot project; land acquisition; environmental approval for the pilot project; and a preliminary market study for the commercial application of UCG syngas for the production of power and synthetic natural gas. Completion of Phase 1 enables the project to move forward with the formalisation of the Joint Venture Company.

Also in June 2011 we completed our maiden JORC Resource Assessment for the Mulpun coal deposit in Chile. The JORC Resources estimate totals 103 million tonnes at 2 metre coal seam thickness cut-off (Measured: 26 million tonnes, Indicated: 37 million tonnes, Inferred: 40 million tonnes). This was our first international JORC Resource Assessment and upon completion of agreed milestones we have the rights to a contributing 30% interest in the Mulpun deposit.

This 103 million tonne coal resource could produce approximately 1,100 petajoules (PJ) of syngas[1] based on conservative assumptions.

Energy output of this scale would be sufficient to operate a 300MW power station for over 55 years making this a significant energy resource in the Chilean market.

Activities with Antofagasta have been increasing in Chile. The work program is progressing well with the following activities being undertaken during the second quarter 2011:

- Tender submissions for the first panel drilling contract have been received and are under evaluation.
- Drilling of the water monitoring wells has commenced and completion is targeted for October 2011 with baseline environmental monitoring underway.
- Dispatch of long lead items such as well heads and related materials, supplied from Australia has been completed.
- Preliminary site civil works have commenced with the construction of roadways and drilling pads substantially completed and targeted for full completion in October 2011.

Front End Engineering and Design (FEED) is well progressed with Antofagasta Minerals and ourselves now finalising FEED documentation prior to entering the detailed Engineering, Procurement and Construction (EPC) phase. The project schedule is progressing as planned and first gas production is targeted for March 2012.

Both parties have also agreed to accelerate feasibility studies and approvals required for a commercial scale power project based on the application of our proprietary keyseam technology.

Note 1: 103 million tonnes of coal at an energy content of 21.67 GJ per tonne has 2,232 PJ energy in place. Using a conservative UCG recovery figure of 50% (that takes into account coal left as pillars, losses and a gasification efficiency of 80%) the estimated recoverable energy is approximately 1,100 PJ should a resource of this size proceed to production. 1 petajoule (PJ) is equivalent to 1,000,000 gigajoules (GJ).

Resource highlights

JORC Resource Assessment

Location	Coal Thickness Cut-Off (m)	Measured (Mt)	Indicated (Mt)	Inferred (Mt)	TOTAL (Mt)
Mulpun, Chile[1]	2	26.4	36.7	40.1	103.2
	5[2]	25.3	19	39.3	83.6

Notes:

1. Carbon Energy has the right to a 30% contributing interest in the Chile deposit upon completion of agreed milestones

2. Optimal target for Underground Coal Gasification

Competent Person Statement – Coal

The information in this table relates to resources is based on information compiled by Dr C.W. Mallett, Technical Director Carbon Energy Limited who is a member of the Australian Institute of Mining and Metallurgy. Dr Mallett has sufficient experience which is relevant to the style of mineralisation and type of deposit under consideration and to the activity which he is undertaking to qualify as a Competent Person as defined in the 2004 Edition of the "Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves". Dr Mallett consents to the inclusion in the release of the matters based on his information in the form and context in which it appears.

PLANT PREPARATION AND EARTHWORKS AT MULPUN

INTERNATIONAL **EXPANSION**

Our launch into both the North American and European markets underpinned our transformation into a truly international energy business.

The International Energy Agency forecast in its World Energy Outlook 2010 that coal will maintain its position as the leading source of power generation globally for at least the next 25 years. In addition, the World Energy Council estimates UCG could potentially increase global coal reserves by as much as 600 billion tonnes; approximately a 70% increase in proven coal reserves worldwide.

We are now recognised internationally as one of the few companies with the advanced coal technology capable of converting otherwise stranded coal resources into a commercial reality.

In line with our strategy, we executed a Share Sale Agreement in February 2011 to acquire Clean Coal Incorporated and Clean Coal Amasra Limited. This transaction delivers energy project opportunities in North America and Europe. The acquisitions have the potential to increase Carbon Energy's coal resources by almost three fold to in excess of 2 billion tonnes of additional coal resource in highly attractive energy markets.

A summary of each project follows:

- Wyoming Project, USA: includes rights to explore and lease coal tenements with Anadarko Land Corporation over 113 km^2.
- Montana - North Dakota Project, USA: includes rights to explore and lease coal tenements with Great Northern Properties (subsidiary of the Quintana Capital Group) in an area over 276km^2.
- Amasra Project, Turkey: Carbon Energy will establish a 50/50 Joint Venture Agreement with Hema Endustri (subsidiary of the diversified Hattat Group) to develop UCG projects in Hema's coal tenements in Amasra northern Turkey. Carbon Energy is responsible for initial pilot costs, while the joint venture company is responsible for production royalties to state-owned mining company, Turkish Hard Coal Enterprise ("TTK").

Our key commercial criterion for these projects is a resource of 500 million tonnes of Inferred coal resources and 100 million tonnes of Indicated coal resources at each of the three locations. Each of these projects will enable us to establish relationships with strategic partners in key energy markets and also diversifies regulatory and market risk.

Project site, Wyoming, United States

Establishment of access road, Mulpun, Chile

Proposed site, Amasra, Turkey

Dr Cliff Mallett (right) with Hema geologists, at Amasra, Turkey

NORTH **AMERICA**

WYOMING, UNITED STATES

The strategic acquisition of coal rights in southern Wyoming strongly meets our criteria for UCG projects, namely: suitable coal resources, access to attractive markets for syngas, and a regulatory pathway for the application of underground coal gasification technology.

As a result of this acquisition we are the sole beneficiary of an Exploration License with Option to Lease agreement with Anadarko Land Corporation covering 44 square miles in southern Wyoming. Anadarko has a significant portfolio of coal resources and connected surface rights in Wyoming. This agreement gives us the rights to explore over 113km^2 (44 square miles) of land owned by Anadarko and subsequently exercise an option to enter into an exclusive long term coal lease (20 years+) for all or a portion of the property with Anadarko to extract the energy from coal via underground coal gasification in exchange for a production royalty.

The contract also includes an Off-Take Agreement for carbon dioxide (CO_2). Carbon dioxide produced by industry in Wyoming is often sold as an additional revenue stream because it can be injected into depleted oil fields to increase the productive life of mature oil reservoirs, a technique known as Enhanced Oil Recovery (EOR) which has been demonstrated at a commercial-scale for more than 30 years in the United States.

Due to the supply shortfall of pipeline CO_2 for EOR in Wyoming, the current market outlook for separating CO_2 from syngas and selling it to nearby EOR operators presents a lucrative additional revenue stream

The Wyoming Project is in an ideal location. The most attractive coal resources for keyseam are located within close proximity to existing gas, electricity, transportation and CO_2 pipeline infrastructure; facilitating ready-access to gas trading hubs and electricity networks servicing the growing demand for power generation in neighbouring states with planning underway to supply the highly populated west coast of the United States.

We are currently assessing the following commercialisation options for our product gas, syngas:

- Power Generation, supplemented by the sale of industrial carbon dioxide (CO_2) for use in Enhanced Oil Recovery (EOR) projects.
- Synthetic Natural Gas (SNG) production to supply the local gas pipeline network.

Our commercial target of 500 million tonnes of JORC Inferred coal resource in each US project location could support gas production of 5,000PJ which can generate $550M each year for 50 years at USD $5.50 per gigajoule (GJ)[4].

Note 4 - Sources: NYMEX and Carbon Energy analysis

NORTH **AMERICA**
MONTANA - NORTH DAKOTA, UNITED STATES

As part of our US acquisition we have exploration rights to coal resources owned by Great Northern Properties (GNP) that straddle the Montana-North Dakota border. GNP is the largest private coal owner in the United States with over 20 billion tonnes of proven coal reserves throughout the country.

The contract also includes an Option to Lease for coal resource development and an Off-Take Agreement for the sale of industrial carbon dioxide (CO_2). Separating and selling pipeline CO_2 for use in Enhanced Oil Recovery (EOR) has been a commercial reality in the United States for over three decades.

Currently in North Dakota a conventional surface coal gasification facility supplies industrial CO_2 into a 320km pipeline for an EOR operation in Canada which is also the world's largest carbon capture and storage project. keyseam is more economically favourable than mining followed by surface gasification and also has a smaller environmental footprint than surface mines and surface gasification.

Combining UCG with the sale of CO_2 for Enhanced Oil Recovery will deliver the production of clean energy from coal with a low environmental footprint.

EUROPE
AMASRA, TURKEY

As part of our Clean Coal acquisition we now have a 50/50 Joint Venture arrangement with private company, Hema Endustri, for the Amasra project located on the coast of the Black Sea in northern Turkey approximately 435km from Istanbul and 300km from Ankara.

Hema Endustri is a subsidiary of the diversified Hattat Group, one of Turkey's leading companies with interests in construction, mining and transport. Hema has mining and coal seam gas (coal bed methane) rights over the Amasra project area. Consequently, there are no conflicts of access rights to the coal and gas resources in the target area which is located close to existing infrastructure.

Turkey is one of the fastest growing economies in Europe importing about 70% of its energy needs. With attractive power and gas prices[5] of around USD$70 per megawatt hour (MWh) and USD $7.30 per GJ significant market opportunity currently exists for low-emission power generation and the production of synthetic natural gas (SNG).

With a prominent local partner such as Hema, regulatory approvals in place for the pilot project, and strong demand for low-cost domestic energy supplies – the Amasra Project presents an attractive commercial opportunity for Carbon Energy.

Note 5 - Sources: TETAS and BOTAS

EXECUTIVE **MANAGEMENT**

In the past year we have continued to focus on the investment in people who bring additional experience and capability to our growing operations.

In January this year we welcomed Julian Hoskin to the executive team, in the role of Chief Operating Officer. Julian's strong results driven approach and broad experience in both underground and surface mining are a significant advantage for the business.

Peter Swaddle who has been our General Manager Commercial for over 3 years has relocated to the USA to head up our new office and drive the Wyoming project development.

Andrew Dash

Chief Executive Officer and Managing Director BE (Chem), MCom

Andrew joined Carbon Energy in 2008. In his role, Andrew is responsible for the day to day management of all Company operations as well as defining the strategic direction and managing the rapid expansion plans of the business. Andrew has established Carbon Energy as one of the world leading UCG innovators and brings over 20 years experience in large scale operations with a focus on commercial development of gas operations and associated infrastructure.

Andrew has a degree in Chemical Engineering from the University of Sydney and a Masters Degree in Commerce from University of New South Wales.

John Bidwell

General Manager Commercial & Project Development

John has the overall responsibility for the successful planning and delivery of Carbon Energy's projects. This including the finalisation of the our 5MW power station at Bloodwood Creek along with the 2nd and 3rd phases of power plant construction. John is also responsible for the Project Delivery Team at our Mulpun Energy project in Chile where we partner with Antofagasta Minerals SA.

John is highly respected as an energy and infrastructure industry leader in project management and commercial viability. His experience stretches across the globe including Australia, New Zealand and South America.

Back row - Prem Nair; John Bidwell; Julian Hoskin

Front row - Andrew Dash; Dr Cliff Mallett

Julian Hoskin

Chief Operating Officer BSc (Eng) (Hons), MAppSc, MBA, FAusIMM

Julian started with Carbon Energy in January 2011 following an extensive career in coal mining. His role is responsible for Carbon Energy's operations management and technical implementation of our technology. Julian is a professional mining engineer with over 30 years industry experience in Australia and the UK. He has a BSc(Eng) (with First Class Honours) in mining engineering from the Royal School of Mines, and Masters degrees in Applied Science (Mining Geomechanics) and Business Administration. He has held senior management roles with Vale, AMCI, Xstrata/MIM and Arco with responsibility for exploration, project development, technical support and operational management of mines.

Dr Cliff Mallett

Technical Director - UCG MSc, PhD

Cliff is one of Australia's most highly regarded UCG experts with over 30 years coal mining research experience including over 15 years dedicated to advancing the development of UCG process technology. His role is responsible for the ongoing development of Carbon Energy's UCG technology. Additionally, Cliff undertakes assessment of potential coal deposits and their suitability for keyseam and our expanding portfolio of projects both in Australia and around the world. Cliff is also heavily involved with the evaluation of emerging carbon capture and storage opportunities and has degrees in Geology from the University of Queensland and the University of Melbourne.

Prem Nair

Chief Financial Officer and Company Secretary

BBus (Acctg), MBA, FCA, FCIS, FTIA, MAICD

Prem has an expansive role within the organisation with responsibility for financial management including all financial and corporate regulatory compliance and reporting. Additionally Prem and his team provide Human Resource management and Information Technology support for the business. Prem has over 30 years experience in the accounting and commercial business. His experience includes leading finance teams in publicly listed entities covering exploration, resources, technology and construction industries. He also has over 20 years experience in corporate governance and company secretarial roles.

Peter Swaddle

Senior Vice President - Strategy and Business Development

In June this year Peter relocated to New York to establish our US headquarters and develop the Wyoming and North Dakota-Montana projects. With his focus firmly across North America Peter's role covers business development with current and potential partners, project opportunity assessment, and government.

Peter is a senior commercial and marketing executive with over 16 years experience with two of Australia's major national brand leaders. Peter has a proven track record in commercial development and strategic brand management with extensive experience in both product development and project management.

Peter Swaddle in the New York office

DIRECTORS' **REPORT**
BOARD INFORMATION

Your Directors present their report on Carbon Energy and its controlled entities for the financial year ended 30 June 2011.

Directors

Directors in office at the date of this report.

C. Rawlings (appointed 1 July 2011) - Chairman

K. Robinson - Non-Executive Director

A.M. Dash - Managing Director

M.D.J. Cozijn - Non-Executive Director

H. M. Garnett (appointed 6 September 2010) - Non-Executive Director

P.N. Hogan - Non-Executive Director

L.I. Rozman - Non-Executive Director

Company Secretary

Mr P Nair was appointed the Company Secretary on 1 January 2009. Details of Mr Nair's experience and qualifications are set out in the information on Directors and Company Secretary in the Directors' Report.

Principal activities

The principal activities of the Consolidated Group during the financial year were:

- to successfully construct and commission its Underground Coal Gasification (UCG) project in Queensland, applying its world leading UCG technology, keyseam; and
- to build a portfolio of coal resource assets.

Operating results

The consolidated loss of the Consolidated Group after providing for income tax amounted to $15,840,856 (2010: loss $10,820,487).

Dividends paid or recommended

No dividend was paid or declared during the year and the Directors do not recommend the payment of a dividend.

Review of operations

A review of the Consolidated Group's operations during the year and the results of those operations are contained in pages 10 to 21 of this Annual Report.

Financial position

The net assets of the Consolidated Group have increased by $21,378,970 to $175,936,838 during the financial year. The net increase is largely due to the acquisition of Clean Coal Exploration assets and options to coal leases located in Wyoming and Montana (USA) and joint venture rights in Amasra (Turkey) as well as the capital raising announced in December 2010.

The Directors are of the opinion the Group will require to undertake a capital raising to maintain a strong and stable financial position to progress its objectives and strategy.

Impact of proposed carbon tax

The Federal Government introduced the Clean Energy Bill in July 2011 which proposes a fixed carbon price of $23/tonne from 1 July 2012, moving to a market price three years later. The proposal is intended to replace older technologies with higher emissions to newer and cleaner technologies. As a result Carbon Energy's lower emission use of coal in its UCG process is likely to be a beneficiary of carbon pricing should the legislation be passed through Parliament. Our ability to separate carbon dioxide from syngas prior to combustion means we are likely to have an advantage compared to the higher cost of capturing CO_2 from coal after combustion.

Significant changes in state of affairs

The following significant changes in the state of affairs of the Parent entity occurred during the financial year:

(i) Dr Helen Garnett was appointed as a Non-Executive Director to the Board on 6 September 2010. Dr Garnett is an accomplished Company Director with over 16 years experience. Additionally, Dr Garnett took the role of Chair for the Company's Audit Committee.

(ii) On 9 December 2010 Carbon Energy completed a share placement of approximately 61 million shares at $0.33 to raise $20 million, before costs. Approximately $10 million (gross) received from the first tranche of capital raising in December 2010 with the remainder of funds from the second tranche ($10 million gross) received January 2011.

(iii) Mr Ian Walker resigned on 31 December 2010 as a Non-Executive Director to assist the Company in restructuring the Board as Carbon Energy evolves as an international energy company. The Board and Management wish to record our sincere appreciation for the significant contribution Ian has made in the advancement of Carbon Energy, and we wish Ian every success in his future endeavours.

(iv) On 6 April 2011 Carbon Energy acquired exploration assets and options to coal leases located in Wyoming and Montana (USA) and joint venture rights in Amasra (Turkey) for a total consideration of $US 19 million (including deferred consideration of US $9 million) Consideration of 27,645,208 Carbon Energy shares has been issued (US$10 million of shares based on 60 day Volume Weighted Average Price (VWAP) preceding the date of execution of the agreement of 23 February 2011). Two further tranches of US$4.5 million of shares each (based on 30 day VWAP at time of milestone achievement) will be issued subject to meeting key development milestones including the delineation of JORC compliant coal resources in excess of 500Mt at two of the three locations.

(v) Dr Cliff Mallett stepped down from the Board on 30 June 2011 but has remained as an Executive of Carbon Energy.

After balance date events

On 1st July 2011, Dr Christopher Rawlings joined the Board as a Non-Executive Director (and Chairman) of Carbon Energy Limited and was appointed Chairman from 26 July 2011.

DIRECTORS' **REPORT**
BOARD INFORMATION

On 12th July 2011 Department of Environment and Resource Management advised the Company of charges in relation to spillage of process water in 2009. Proceedings have been adjourned to 20 September 2011.

No other matters of substance have arisen since the end of the financial year, which significantly affected or may significantly affect the operations of the Consolidated Group, the results of those operations and the state of affairs of the Consolidated Group in subsequent financial years.

Future developments

Future developments in the operations of the Consolidated Group are referred to in the Chairman's Report on page 8 – 9 of this Annual Report. Further information regarding likely developments in the operations of the Consolidated Group and likely results of those operations would, in the opinion of the Directors, be speculative and not in the best interests of the Consolidated Group.

Environmental issues

The Consolidated Group's operations are subject to significant environmental regulation under the Laws of the Commonwealth and State. On 20 August 2010, Carbon Energy submitted an Environmental Evaluation of its Bloodwood Creek site as requested by Queensland Department of Environment and Resource Management (DERM). The evaluation relates to an incident that occurred during 2009 at the Bloodwood Creek site which involved the release of UCG process water onto the ground with an amount running into a pond at Bloodwood Creek. An immediate spill response was initiated with the water being pumped out and affected soils removed. Water sampling results have concluded that no ongoing environmental harm has occurred as a result. In November 2010 DERM accepted Carbon Energy's environmental report as addressing the requirements of the Environmental Evaluation notice issued on 21 July 2010 and additional information notice issued on 21 September 2010. Subsequently in February 2011, DERM approved the initiation of UCG Panel 2 enabling Carbon Energy to continue its Queensland operations at Bloodwood Creek. On 12 July 2011 DERM advised Carbon Energy of charges laid against the Company. Proceedings have been adjourned to 20 September 2011.

Mineral exploration

In Queensland, the Company has lodged financial assurance bonds for Environmental Authority Permits and associated security bonds of $55,640.

Coal exploration and UCG

Carbon Energy prides itself on the Company's environmental track record which, apart from the one isolated and rectified incident mentioned above, has remained untarnished. The Carbon Energy UCG project at Bloodwood Creek has complied with the conditions of the Environmental Authority Number MIN200647007 which was issued by the Environmental Protection Authority on December 2007. The Environmental Authority regulates the environmental aspects of all UCG activities authorised to be conducted on Mineral Development Licence 374. In addition, on 13 April 2010 Petroleum Facility Licence No. 6 was granted to Carbon Energy together with Environmental Authority PEN200236408. This is for the processing of syngas on the Mining Development Lease area which requires a separate tenure and approval under the Petroleum and Gas Act (Production and Safety) 2004. Both Environmental Authorities were amended on the 11th of February 2011.

Carbon Energy has obtained all regulatory approvals, including environmental approvals, to enable the UCG pilot project and associated activities to be conducted on MDL 374, based on the submission and approval of the Environmental Management Plan. The growth and activities on-site requires an update of the Environmental Management Plan. The increasing scale of activities on site requires the existing Level 2 Environmental Authorities to be upgraded to Level 1 Environmental Authorities. Applications for these amendments have been lodged with the Department of Environment and Resource Management and are being assessed. The government agencies involved in permitting the pilot project have included the Department of Employment, Economic Development and Innovation, the Department of Environment and Resource Management, and the Department of Infrastructure and Planning.

DIRECTORS' **REPORT**

INFORMATION ON DIRECTORS AND COMPANY SECRETARY

THE NAMES OF DIRECTORS IN OFFICE AT ANY TIME DURING OR SINCE THE END OF THE YEAR.

Dr Chris Rawlings - Director (Non-Executive) - Chairman (Appointed 1 July 2011, elected as Chairman 26 July 2011)

BSc (Hons), PhD, FAICD

Dr Chris Rawlings graduated from the University of Newcastle in 1976 with a Bachelor of Science (Honours) in Geology, he then went on to complete a PhD in Structural Geology and Rock Mechanics in 1983. Dr Chris Rawlings has extensive experience running mining operations and his experience in this sector is very attractive to the Board. His strong industry knowledge backed by a pragmatic, results driven approach will be a great advantage to the Company. Dr Rawlings is a Fellow of the Australasian Institute of Mining and Metallurgy, the Geological Society of Australia and the Institute of Company Directors.

Dr Rawlings is a member of the Remuneration committee.

During the past three years, Dr Rawlings has held the following other listed company Directorships:

- Northern Energy Corporation Limited (February 2005 to February 2011) Non-Executive Director

  Dr Rawlings is also a Director of Uniquest, Director of JK Tech, Chairman of Queensland Energy Resources and Chairman of Diversified Mining Services.

Mr Kim Robinson – Director (Non-Executive)

BSc (Geol)

Mr Robinson graduated from the University of Western Australia in 1973 with a Degree in Geology. Mr Robinson has subsequently amassed over 36 years involvement in the mineral exploration and mining industries, including the last 10 years as the Executive Chairman of Kagara Limited. He has been closely involved in the discovery, financing and development of numerous gold, base metal and nickel mines including Cosmos, Lounge Lizard and Emily Ann nickel mines, the Bounty and Mt McClure gold mines and the Mt Garnet, Balcooma, Mungana and Dry River South polymetallic mines.

Mr Robinson is a member of both the Audit and Remuneration Committees.

During the past three years Mr Robinson has held the following other listed company Directorships

- Kagara Limited (from September 1981) Executive Chairman
- Apex Minerals NL (from April 2006) Non-Executive Chairman

Mr Andrew M. Dash – Chief Executive Officer & Managing Director

BE (Chem), MCom

Mr Dash was appointed to the Board on 30 June 2008.

Mr Dash was initially appointed to the position of Chief Operating Officer, The Board appointed Andrew in January 2009 to his current role as Chief Executive Officer and Managing Director. Andrew has a Degree in Chemical Engineering from the University of Sydney and a Masters Degree in Commerce from the University of New South Wales. He has extensive experience in the energy sector, with particular experience in the commercial development of gas operations and associated infrastructure. He had previously held executive management roles with the leading energy transmission business APA Group.

During the past three years Mr Dash has held no other listed company Directorships.

Mr Max D.J. Cozijn – Director (Non-Executive)

BCom, CPA, MAICD

Mr Cozijn has a Bachelor of Commerce Degree from the University of Western Australia, having graduated in 1972, and is a member of CPA Australia and is a member of the Australian Institute of Company Directors. Mr Cozijn has over 30 years experience in the administration of listed mining and industrial companies, as well as various private operating companies.

Mr Cozijn was the Company's Finance Director between 1993 and 2008, and is now a Non-Executive Director.

During the past three years Mr Cozijn has held the following other listed company Directorships:

- Oilex Ltd (from September 1997) Non-Executive Chairman
- Magma Metals Ltd (from June 2005) Non-Executive Chairman
- Malagasy Minerals Limited (from September 2006) Executive Chairman
- Energia Minerals Limited (from May 1997) Non-Executive Director

DIRECTORS' **REPORT**
INFORMATION ON DIRECTORS AND COMPANY SECRETARY

Dr Helen M. Garnett – Director (Non-Executive) Appointed 6 September 2010

PSM, BSc (Hons), PhD, FTSE, FAICD

Dr Helen Garnett is an Emeritus Professor of the University of Wollongong and of Charles Darwin University, a Fellow of the Academy of Technological Sciences and Engineering and a Fellow of the Australian Institute of Company Directors.

Dr Garnett has over 25 years experience in transforming technical innovation into practical commercial outcomes. She has 15 years experience as a Chief Executive and over 16 years as a Non-Executive Director having been closely associated with the resource and energy sectors throughout this time.

Dr Garnett is the Chairman of the Audit Committee.

During the past three years Dr Garnett has held the following other listed company Directorships:

- Energy Resources of Australia Limited (from Jan 2005) Non-Executive Director

Dr Garnett is also a Director of Australian Centre for Plant Functional Genomics, Director of National Centre for Vocational Education Research and Director of Museum and Art Galleries NT Foundation.

Mr Peter N. Hogan – Director (Non-Executive)

BBus, ACA

Appointed to the Board on 29 August 2008, Mr Hogan is a Chartered Accountant, and is currently a Strategy and Development Executive with Incitec Pivot Ltd. Prior to joining Incitec Pivot in early 2008; Mr Hogan worked with PricewaterhouseCoopers for 23 years, including 17 years as Partner. He has extensive experience in providing business advisory services to Australian and overseas listed public companies and large private companies. He has particular experience with companies in the consumer and industrial product sectors and the mining sector.

Mr Hogan is a member of both the Audit and Remuneration Committees.

During the past three years Mr Hogan has held the following other listed company Directorships:

- Fabchem China Ltd (Singapore Stock Exchange listed) (from July 2008) Non-Executive Director

Mr Louis I. Rozman – Director (Non-Executive)

BEng, MGeos, FAusIMM CP (Man), MAICD

Mr Rozman holds degrees in mining engineering and mineral economics and has 30 years' experience in mining operations, joint ventures and corporate management in Australasia and Africa. He was previously Chief Operating Officer of major gold producer, Aurion Gold and Chief Executive Officer of coal seam gas producer, CH4 Gas Limited. Mr Rozman is a Fellow and Chartered Professional of the Australasian Institute of Mining and Metallurgy and a Member of the Australian Institute of Company Directors.

During the past three years Mr Rozman has held the following other listed company Directorships:

- TSXV listed Timmins Gold Corp; (from Nov 08) Non-Executive Director
- ASX listed Pacific Energy Limited; (from May 09) Non-Executive Director.

M Rozman is also a Director of Pacific Road Capital, private equity mining investment fund and he holds a number of other non listed directorships.

Mr Ian W. Walker – Director (Non-Executive) Resigned 31 December 2010

BSc (Geol) (Hons)

Mr Walker is a geologist with over 35 years experience in multi-commodity exploration within Australia and overseas, having graduated from the University of Western Australia in 1974 with an Honours Degree in Geology.

Mr Walker is a Member of the Australian Institute of Geoscientists.

During the past three years Mr Walker has held the following other listed company Directorships:

- Energia Minerals Limited (from May 1997) Non-Executive Director

Mr Walker was Managing Director of the Company between 1993 and 2008 and resigned as a Non-Executive Director on 31 December 2010. He is also a Director of subsidiary companies Metex Resources NL, and Nickelex Pty Ltd.

Dr Clifford W. Mallett – Technical Director (Executive) Resigned 30 June 2011

MSc, PhD, FAIE

Dr Cliff Mallett was appointed to the Board on 14 February 2008. Dr Mallett has been associated for more than 10 years in advancing the development of the Underground Coal Gas ("UCG") process technology. He has received degrees in Geology from the Universities of Queensland and Melbourne and held academic appointments at the Universities of Newcastle and Melbourne from 1966 to 1978.

He has almost 30 years experience in mining research at CSIRO, culminating in acting as Chief of the CSIRO Exploration and Mining Division.

During the past three years Dr Mallett has held no other listed company Directorships.

Dr Mallett is also Interim Director of the Centre for Low Emission Technology, and Executive Manager for the Queensland Centre of Advanced Technologies.

Mr Prem K. Nair – CFO & Company Secretary

BBus (Acctg), MBA, FCA, FCIS, FTIA, MAICD

Mr Nair has over ten years experience with Australian professional accounting firms in various areas including business assurance and tax services and has over 20 years experience in start up companies, resource and constructing industries, holding senior executive finance roles with both publicly listed and unlisted entities. Mr Nair is the Chief Financial Officer and Company Secretary of the Company.

Directors' Interests

As at the date of this report, the interests of the Directors in shares and unlisted options of the Company are:

	NO. OF SHARES HELD		UNLISTED OPTIONS	
	Direct	Indirect	Direct	Indirect
C.D. Rawlings	-	-	-	-
K. Robinson	2,000,000	-	-	-
M.D.J. Cozijn	12,544	3,015,796	-	-
H.M. Garnett	-	27,101	-	-
P.N. Hogan	-	250,000	-	-
A.M. Dash	-	-	24,400,000	
TOTAL	2,012,544	3,292,897	24,400,000	-

DIRECTORS' **REPORT**
REMUNERATION REPORT (AUDITED)

This report details the nature and amount of remuneration for each Director of Carbon Energy Limited and for the Executives receiving the highest remuneration.

Remuneration policy

The remuneration policy, which sets the terms and conditions for the Managing Director and other Senior Executives, was developed by the Remuneration Committee after seeking professional advice from independent consultants and was approved by the Board. All Executives receive a base salary, superannuation, fringe benefits and performance incentives. The remuneration committee reviews Executive packages annually by reference to group performance, Executive performance, comparable information from industry sectors and other listed companies and independent advice. The performance of Executives is reviewed bi-annually, in February and August, by the Managing Director and his performance is reviewed by the remuneration committee, with revised remuneration packages generally taking effect from the 1st of July of the new financial year.

Executives are also entitled to participate in the employee option arrangement from time to time, as determined by the Board. Key performance indicators are established for each executive and relate to specific outcomes agreed between the Executive and the Company for the period involved. Furthermore, the Executive needs to be in the employment of the Consolidated Group for the period to successfully meet the performance criterion for the granted options to vest. The amount of remuneration for all specified Directors and the specified Executives including all monetary and non-monetary components are detailed below. All remuneration paid to Executives is valued at the cost to the Company and expensed. Any options that are issued are valued using the Black-Scholes methodology.

An election has been provided to existing Executives to forfeit the Options under the Executive Service Agreement and to participate in a new scheme to receive Short Term Incentives (STI) and Long Term Incentives (LTI). The STI and LTI components paid to Executive Managers range between 15% and 20% of their fixed annual remuneration package and involve providing shares in Carbon Energy Limited. All new executives will participate in this new scheme.

The scheme involves establishing a maximum STI value and LTI value for each financial year, subject to satisfactorily meeting Key Performance Indicators. These would be allocated as follows:

- At the end of each financial year, the executive would be allocated a number of shares equivalent to the cash value of the STI, based on the 90 day VWAP prior to 30 June of that year, which are redeemable immediately;
- At the end of each financial year the executive will be allocated a number of shares equivalent to the cash value of the LTI, based on the 90 day VWAP prior to 30 June of that year, which would be redeemable in 2 equal trances. The first tranche is redeemable after 12 months from 1 July, the second after 24 months from 1 July, provided the executive remained employed with the Company at that time; and
- If the Company terminates the Executive's employment, other than for cause, the LTI tranches that have been allocated but not yet redeemed will be issued to the executive.

The Board expects that the remuneration structure implemented will result in the Company being able to attract and retain the best Executives to run the Consolidated Group. It will also provide Executives with the necessary incentives to work to grow long-term shareholder value.

The payment of bonuses, stock options and other incentive payments are reviewed by the remuneration committee annually as part of the review of Executive remuneration and a recommendation is put to the Board for approval. All bonuses, options and incentives must be linked to predetermined performance criteria. The Board can exercise its discretion in relation to approving incentives, bonuses and options and can recommend changes to the Committee's recommendations. Any changes must be justified by reference to measurable performance criteria.

The Company's Remuneration Committee Charter is set out on the Company's website www.carbonenergy.com.au.

Details of remuneration for year ended 30 June 2011

The remuneration for each Director of the Consolidated Group during the year is noted as follows:

PARENT ENTITY DIRECTORS

2011	Salary $	Directors Fee $	Other $	Super Contributions $	Sub-total $	Share-based Payments Expense (iii) $	Total Excluding Forfeited Options $	Performance related %	Forfeited options $
Mr K. Robinson	-	60,000	-	5,400	65,400	-	65,400	-	-
Mr A.M. Dash	465,502	-	-	25,000	490,502	847,098	1,337,600	63.3%	(1,086,816)
Dr C.W. Mallett (resigned 30 June 2011)	175,000	-	-	15,750	190,750	59,870	250,620	23.9%	(94,834)
Mr M.D.J Cozijn	-	40,000	-	3,600	43,600	-	43,600	-	-
Mr P.N. Hogan (i)	-	40,000	-	-	40,000	-	40,000	-	-
Mr L. Rozman (ii)	-	40,000	-	-	40,000	-	40,000	-	-
Mr I.W. Walker (resigned 31 Dec '10)	-	20,000	-	1,800	21,800	-	21,800	-	-
Dr H.M. Garnett (appointed 6 Sep '10)	-	40,924	-	3,683	44,607	-	44,607	-	-
TOTALS	640,502	240,924	-	55,233	936,659	906,968	1,843,627	-	(1,181,650)

(i) Amounts paid to Incitec Pivot Limited for Mr Hogan's service.
(ii) Amounts paid to Pacific Road Partnership for Mr Rozman's services.
(iii) Options are valued using the Black Scholes Methodology.

PARENT ENTITY DIRECTORS

2010	Salary $	Directors Fee $	Other $	Super Contributions $	Sub-total $	Share-based Payments Expense (iii) $	Total Excluding Forfeited Options $	Performance related %	Forfeited options $
Mr K. Robinson	-	60,000	-	5,400	65,400	-	65,400	-	-
Mr A.M. Dash	299,926	-	1,320	25,000	326,246	1,670,335	1,996,581	83.7%	-
Dr C.W. Mallett	140,750	-	2,640	50,000	193,390	176,411	369,801	47.7%	-
Mr M.D.J Cozijn	-	20,000	-	23,600	43,600	-	43,600	-	-
Mr P.N. Hogan (i)	-	40,000	-	-	40,000	-	40,000	-	-
Mr L. Rozman (ii) (appointed 7 Apr '10)	-	9,341	-	-	9,341	-	9,341	-	-
Mr I.W. Walker	-	-	-	43,600	43,600	-	43,600	-	-
Mr P.T. McIntyre (resigned 12 Feb '10)	-	24,666	-	2,220	26,886	-	26,886	-	-
TOTALS	440,676	154,007	3,960	149,820	748,463	1,846,746	2,595,209	-	-

(i) Amounts paid to Incitec Pivot Limited for Mr Hogan's service.
(ii) Amounts paid to Pacific Road Partnership for Mr Rozman's services.
(iii) Options are valued using the Black Scholes Methodology and calculated at the date of grant. As at the date of this report, the Board has not formally ratified the vesting of these options.

The remuneration for each Executive Office of the Consolidated Group during the year is noted as follows:

PARENT ENTITY EXECUTIVES

2011	Salary $	Termination Costs $	Other Costs $	Super Contribution $	Sub-total $	Share-based Payments (ii) $	Total excluding Forfeited Options $	Performance related %	Forfeited Options $
Mr J Bidwell	329,357	-	-	29,642	358,999	104,640 (i)	463,639	22.6%	-
Mr A Mifflin (resigned 4 Feb '11)	192,469	-	-	16,974	209,443	218,748	428,191	51.1%	(44,400)
Mr P Nair	206,879	-	-	18,619	225,498	67,650 (i)	293,148	23.1%	(135,919)
Mr P Swaddle	224,488	-	-	20,204	244,692	55,056 (i)	299,748	18.4%	(135,919)
Mr J Hoskin (appointed 24 Jan '11)	138,519	-	-	12,467	150,986	45,780 (i)	196,766	23.3%	-
TOTALS	1,091,712	-	-	97,906	1,189,618	491,874	1,681,492		(316,238)

(i) The amounts have been earned but shares have not been issued as at the date of this report each reflecting 50% as STI and 50% as LTI.
(ii) Options are valued using the Black Scholes Methodology.

PARENT ENTITY EXECUTIVES

2010	Salary $	Termination Costs $	Other Costs $	Super Contributions $	Sub-total $	Share-based Payments (i) $	Total excluding Forfeited Options $	Performance related %	Forfeited Options $
Mr J Bidwell (appointed 27 Apr '10)	28,749	-	-	12,501	41,250	-	41,250	-	-
Mr A Mifflin (appointed 18 Jan'10)	99,722	-	605	24,300	124,627	104,332	228,959	45.6%	-
Mr P Nair	148,933	-	20,387	50,000	219,320	122,551	341,871	35.9%	-
Mr P Swaddle	180,000	-	1,320	38,000	219,320	122,551	341,871	35.8%	-
Mr J Wedgwood (resigned 7 May '10) (ii)	160,513	31,559	2,750	25,346	220,168	118,748	338,916	35.0%	(303,964) (ii)
TOTALS	617,917	31,559	25,062	150,147	824,685	468,182	1,292,867	-	(303,964)

(i) Options are valued using the Black Scholes Methodology.
(ii) Upon resignation, $303,964 worth of options were forfeited.

Performance Bonuses were awarded to Executive Directors and Executive Officers on successful achievement of key performance indicators.

Options Granted as part of Remuneration:

2011 – No options over shares were provided to Key Management Personnel.

KEY MANAGEMENT PERSONNEL

2010	Vested No.	Granted No.	Grant Date	Value per option at Grant Date $	Exercise Price $	First Exercise Date	Last Exercise Date
Mr A Mifflin (appointed 18 Jan '10)		1,000,000	22/03/10	$0.28	$0.80	30/06/11	22/03/15
		1,000,000	22/03/10	$0.23	$1.20	30/06/12	22/03/15
		1,000,000	22/03/10	$0.20	$1.60	30/06/13	22/03/15

In 2010, all options issued to Executive Officers were as part of their at-risk remuneration and all options are all performance based. Options were granted for nil consideration.

Shares issued on Exercise of Compensation Options

No options were exercised during the 2011 year that were granted as compensation in prior periods to current Key Management Personnel.

Options exercised during the 2010 year that were granted as compensation in prior periods are as follows:

KEY MANAGEMENT PERSONNEL

2010	No. of ordinary shares issued	Amount paid per share	Amount unpaid per share
Mr I.W. Walker	6,000,000	$0.20	Nil
Mr M.D.J. Cozijn	3,000,000	$0.20	Nil
TOTALS	9,000,000		

Options expensed during the 2011 year that were granted as compensation in current and prior periods are as follows:

2011	Options Expensed (i) $	Total Remuneration Represented by Options %	Options Exercised $	Options Forfeited ($)	Total $
Mr A.M. Dash	847,038	63.3%	-	(1,086,816)	(239,778)
Dr C.W. Mallett	59,870	23.9%	-	(94,834)	(34,964)
Mr A Mifflin	218,748	51.1%	-	(44,400)	174,348
Mr P Nair	-	N/A	-	(135,919)	(135,919)
Mr P Swaddle	-	N/A	-	(135,919)	(135,919)
TOTALS	1,125,656			(1,497,888)	(372,232)

(i) Options are calculated using the Black Scholes Methodology and calculated at the date of grant.

Options expensed during the 2010 year that were granted as compensation in current and prior periods are as follows:

2010	Options Expensed $	Total Remuneration Represented by Options %	Options Exercised $	Options Forfeited ($)	Total $
Mr A.M. Dash	1,670,335	83.7%	-	-	1,670,335
Dr C.W. Mallett	176,411	47.7%	-	-	176,411
Mr A Mifflin	104,332	45.6%	-	-	104,332
Mr P Nair	122,551	35.8%	-	-	122,551
Mr P Swaddle	122,551	35.8%	-	-	122,551
Mr J Wedgwood	118,748	N/A	-	(303,964) #	(185,216)
TOTALS	2,314,928 *		-	(303,964)	2,010,964

Options previously granted forfeited on resignation of employee.
* Options are calculated using the Black Scholes Methodology and calculated at the date of grant.

Service Agreements of Directors and Executives

No new options were issued to Executive Directors during the year.

Mr Dash, Managing Director is employed under a four-year Executive Service Agreement (ESA) which commenced on 30 June 2008 and expires on 30 June 2012.

Dr Mallett, Technical Director is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 1 July 2008 and expires on 30 June 2011, extended for 1 year, until 30 June 2012.

Mr Nair, CFO and Company Secretary is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 1 November 2008 and expires on 31 October 2011.

Mr Swaddle, Senior VP Strategy & Business Development is employed on a permanent basis.

Mr Hoskin, Chief Operating Officer commenced on 24 January 2011 and is employed on a permanent basis.

Mr Bidwell, General Manager Commercial and Project Development agreed to take up the role on a permanent basis from 1 May 2011.

Mr Mifflin, resigned on 4 February 2011.

Required notice periods for executives employed under Executive Service Agreements are three months from either party. A payment for termination benefit on early termination by the employer is payable, other than for gross misconduct, and is equal to base salary and superannuation for 6 months.

The remuneration and terms of employment for the Non-Executive Directors (Messrs Robinson, Walker, Cozijn, Hogan and Dr Garnett) are subject to annual review with no fixed term, with one third of the Director's being subject to re-election at each Annual General Meeting of Shareholders.

The aggregate amount of remuneration payable to all non-executive Directors was set by shareholders at $500,000 per annum. The total amount currently paid inclusive of superannuation is $43,600 per annum to each Non Executive Director and $65,400 per annum to the Chair of the Board. The Chair of the Audit Committee is paid an additional $10,000 per annum plus superannuation. No termination payment provisions are currently in place.

MEETINGS OF DIRECTORS DURING THE YEAR ENDED 2011

Director	BOARD MEETING		AUDIT COMMITTEE MEETING		REMUNERATION COMMITTEE MEETING		NOMINATION COMMITTEE MEETING	
	Number eligible to Attend	Number Attended	Number eligible to attend	Number attended	Number eligible to attend	Number attended	Number eligible to attend	Number attended
K. Robinson	9	8	2	2	1	1	2	2
A. Dash	9	9	NM	NM	NM	NM	2	2
C.W. Mallett	9	9	NM	NM	NM	NM	2	2
M.D.J. Cozijn	9	8	NM	NM	NM	NM	2	2
P.N. Hogan	9	9	2	2	1	1	2	2
L.I. Rozman	8	7	NM	NM	NM	NM	2	2
I.W. Walker (retired 31 Dec '10)	5	4	NM	NM	NM	NM	NM	NM
H. Garnett (appointed 7 Sep '10)	6	6	2	2	NM	NM	1	1

NM – Not a member of the Committee

Share Options

At the date of this report, the total of unissued ordinary shares of Carbon Energy Limited under option is 35,580,000 and is comprised of:

No. of Options	Grant Date	Exercise Price	Vesting Date	Expiry Date
5,000,000	13/11/2008	$0.25	30/06/2009	10/12/2013
8,000,000	13/11/2008	$0.70	30/06/2011	10/12/2013
10,000,000	13/11/2008	$1.00	30/06/2012	10/12/2014
1,400,000	13/11/2008	$0.35	30/06/2010	10/12/2013
1,750,000	13/11/2008	$0.80	30/06/2011	10/12/2013
875,000	13/11/2008	$1.20	30/06/2010	10/12/2013
1,750,000	13/11/2008	$1.60	30/06/2011	10/12/2013
2,500,000	16/09/2008	$0.80	30/06/2009	10/12/2013
1,000,000	16/09/2008	$0.80	30/06/2011	10/12/2013
1,000,000	17/10/2008	$0.80	31/10/2009	10/12/2013
1,000,000	17/10/2008	$0.80	31/10/2009	10/12/2013
205,000	31/03/2009	$0.40	30/06/2010	1/04/2012
100,000	31/03/2009	$0.25	30/06/2010	1/04/2012
1,000,000	22/03/2010	$0.80	30/06/2011	22/03/2015

DIRECTORS' **REPORT**

Unlisted

35,580,000 of these Options are on issue to Directors and employees of Carbon Energy Limited at the date of this report.

Non-audit services

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

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

Fees for non-audit services were paid to the external auditors Deloitte Touche Tohmatsu during the year ended 30 June 2011.

Indemnifying Officers and Auditors

The Company has continued an insurance policy insuring Directors and officers of the Company against any liability arising from a claim brought by a third party against the Company or its Directors and Officers, and against liabilities for costs and expenses incurred by them in defending any legal proceedings arising from their conduct while acting in their capacity as a Director or Officer of the Company, other than conduct involving a wilful breach of duty in relation to the Company.

In accordance with a confidentiality clause under the insurance policy, the amount of the premium paid to insurers has not been disclosed. This is permitted under S300 (9) of the Corporations Act 2001.

Proceedings on behalf of the Company

On 12 July 2011 DERM advised Carbon Energy of charges laid against the Company in relation to a spillage of process water that occurred during 2009. Proceedings have been adjourned to 20 September 2011.

The Company has also commenced proceedings in the Supreme Court of Queensland against Alexware Consulting Pty Ltd trading as Pangea Partners International ("Pangea") and Mr John Wedgwood, a former Carbon Energy employee. Pangea was the contractor originally engaged to build and commission Carbon Energy's 5MW power station. The legal action brought about by Carbon Energy is in relation to serious irregularities in the performance of the contract and accordingly, Carbon Energy will be seeking damages from the partners named above.

Auditor's independence declaration

The lead auditor's independence declaration for the year ended 30 June 2011 has been received and can be found on page 37 of the Annual Report.

Signed in accordance with a resolution of the Board of Directors made pursuant to s298 (2) of the Corporations Act 2001.

On behalf of the Directors

C. Rawlings
Chairman

A.M. Dash
Managing Director

Brisbane, Queensland
15 September 2011

Deloitte.

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Board of Directors
Carbon Energy Limited
Level 12
301 Coronation Drive
Milton QLD 4064

15 September 2011

Dear Board Members,

Carbon Energy Limited

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Carbon Energy Limited.

As lead audit partner for the audit of the financial statements of Carbon Energy Limited for the financial year ended 30 June 2011, I declare that to the best of my knowledge and belief, there have been no contraventions of:

(i) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and

(ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

M. Sheerin

M G Sheerin
Partner
Chartered Accountants

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

CORPORATE GOVERNANCE **STATEMENT**

Statement

Carbon Energy Limited (**"Company"**) has adopted systems of control and accountability as the basis for the administration of corporate governance. Some of these policies and procedures are summarised in this statement. Commensurate with the spirit of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations 2nd edition (**"Principles & Recommendations"**), the Company has followed each recommendation where the Board has considered the recommendation to be an appropriate benchmark for its corporate governance practices. Where the Company's corporate governance practices follow a recommendation, the Board has made appropriate statements reporting on the adoption of the recommendation. In compliance with the "if not, why not" regime, where, after due consideration, the Company's corporate governance practices depart from a recommendation, the Board has offered full disclosure and an explanation for the adoption of its own practice.

The Company reports below on how it has followed (or otherwise departed from) each of the Principles & Recommendations during the 2010/2011 financial year (**"Reporting Period"**). The Principles & Recommendations were amended in 2010 and these amendments apply to the Company's first financial year commencing on or after 1 January 2011. However, as encouraged by the ASX Corporate Governance Council, the Company has made an early transition to the amended Principles & Recommendations. Accordingly, the report below is made against the Principles & Recommendations as amended in 2010.

Board

Roles and responsibilities of the Board and Senior Executives

Principle 1 – Lay solid foundations for management and oversight

Recommendation 1.1:

Companies should establish the functions reserved to the Board and those delegated to senior executives and disclose those functions.

Disclosure:

The Company has established the functions reserved for the Board, and those delegated to senior executives and has set out these functions in its Board Charter. The Board is collectively responsible for promoting the success of the Company through its key functions of overseeing the management of the Company, providing overall corporate governance of the Company, monitoring the financial performance of the Company, engaging appropriate management commensurate with the Company's structure and objectives, involvement in the development of corporate strategy and performance objectives, and reviewing, ratifying and monitoring systems of risk management and internal control, codes of conduct and legal compliance.

Senior executives are responsible for reporting all matters which fall within the Company's materiality thresholds at first instance to the Managing Director or, if the matter concerns the Managing Director, then directly to the Chair or the lead independent director, as appropriate.

The Company's Board Charter is available on the Company's website.

Recommendation 1.2:

Companies should disclose the process for evaluating the performance of senior executives.

Disclosure:

The Nomination Committee (or its equivalent) is responsible for evaluating the Managing Director. Other senior executives are evaluated by the Managing Director. The performance of senior executives is reviewed individually and compared to key performance indicators which have been endorsed by the Board.

Recommendation 1.3:

Companies should provide the information indicated in the Guide to reporting on Principle 1.

Disclosure:

During the Reporting Period an evaluation of senior executives took place in accordance with the process disclosed.

Principle 2 – Structure the Board to add value

Recommendation 2.1:

A majority of the Board should be independent Directors.

Notification of Departure:

The Board was not comprised of a majority of independent Directors.

Explanation for Departure:

The Board does not have a majority of directors who are independent. In February 2010, the Company began an evaluation of the Board to review the strength and skill base of the directors, and consider where, if possible, it could be enhanced. The Board also undertook internal discussions in an open forum to discuss its composition. This Board evaluation was a lengthy process, but resulted in the appointment of two independent Non-Executive Directors - Helen Garnett appointed on 6 September 2010 and Chris Rawlings appointed on 1 July 2011.

The independent Directors of the Company during the Reporting Period were Kim Robinson and Helen Garnett (appointed 6 September 2010). These Directors are independent as they are Non-Executive Directors who are not members of management and who are free of any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgment.

Recommendation 2.2:

The Chair should be an independent Director.

Disclosure:

The independent Chair of the Board was Kim Robinson up to 26 July 2011 (he stepped down to remain a Non-Executive Director) and subsequently Chris Rawlings was elected the independent chairman of the Board.

Recommendation 2.3:

The roles of the Chair and Chief Executive Officer should not be exercised by the same individual.

Disclosure:

The Managing Director is Andrew Dash who is not Chair of the Board.

Recommendation 2.4:

The Board should establish a Nomination Committee.

Notification of Departure:

The Company has not established a separate Nomination Committee.

Explanation for Departure:

The full Board considers those matters and issues that would usually fall to a Nomination Committee. The Board considers that no efficiencies or other benefits would be gained by establishing a separate Nomination Committee at this present time. Accordingly, the Board performs the role of Nomination Committee. Nomination Committee meetings are held separate from Board meetings.

When the Board convenes as the Nomination Committee it carries out those functions which are delegated to the Company's Nomination Committee in its Charter. The Board deals with any conflicts of interest that may occur when convening in the capacity of the Nomination Committee by ensuring the director with conflicting interests is not party to the relevant discussions.

Recommendation 2.5:

Companies should disclose the process for evaluating the performance of the Board, its committees and individual directors.

Disclosure:

The Chair is responsible for the evaluation of the Board and, when deemed appropriate, Board committees and individual directors.

The process for evaluating the performance of the Board, individual directors and any Board committees is:

- questionnaires are prepared by the Company Secretary and circulated to each Director for completion;
- the Company Secretary then summaries and collates the responses to the questionnaires and reports back to the Board; and
- the Chair and directors then review and discuss the report and address any issues as required.

Recommendation 2.6:

Companies should provide the information indicated in the Guide to reporting on Principle 2.

Disclosure:

Skills, Experience, Expertise and term of office of each Director

A profile of each director containing their skills, experience and expertise is set out in the Directors' Report.

Identification of independent Directors

The independent Directors of the Company during the Reporting Period were Kim Robinson and Helen Garnett (appointed 6 September 2010). Subsequent to year end, Chris Rawlings was appointed a Non-Executive Director and is regarded as an independent Director. These Directors are independent as they are Non-Executive Directors who are not members of management and who are free of any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgment. At the date of this Report there are 3 independent Directors and 4 non-independent Directors. One of the non-independent Directors will be categorised as independent on 1 January 2012 when his period as a former executive exceeds 3 years and at that time the majority of the Board would be deemed independent.

The Board evaluates the independence of directors having regard to the relationships listed in Box 2.1 of the Principles & Recommendations and the Company's materiality thresholds. The Board has agreed on, and as set out in the Company's Board Charter, the following guidelines for assessing the materiality of matters.

CORPORATE GOVERNANCE **STATEMENT**

Company's materiality thresholds

The Board has agreed on the following guidelines for assessing the materiality of matters, as set out in the Company's Board Charter:

- Balance sheet items are material if they have a value of more than 10% of the net assets.
- Profit and loss items are material if they will have an impact on the current year operating costs of 10% or more.
- Items are also material if they impact on the reputation of the Company, involve a breach of legislation, are outside the ordinary course of business, they could affect the Company's rights to its assets, if accumulated they would trigger the quantitative tests, involve a contingent liability that would have a probable effect of 10% or more on balance sheet or profit and loss items, or they will have an effect on operations which is likely to result in an increase or decrease in net income or dividend distribution of more than 10%.
- Contracts will be considered material if they are outside the ordinary course of business, contain exceptionally onerous provisions in the opinion of the Board, impact on income or distribution in excess of the quantitative tests, there is a likelihood that either party will default, and the default may trigger any of the quantitative or qualitative tests, are essential to the activities of the Company and cannot be replaced, or cannot be replaced without an increase in cost of such a quantum, triggering any of the quantitative tests, contain or trigger change of control provisions, they are between or for the benefit of related parties, or otherwise trigger the quantitative tests.

Statement concerning availability of independent professional advice

To assist directors with independent judgement, it is the Board's policy that if a Director considers it necessary to obtain independent professional advice to properly discharge the responsibility of their office as a Director then, provided the Director first obtains approval from the Chair for incurring such expense, the Company will pay the reasonable expenses associated with obtaining such advice.

Nomination matters

The full Board held two meetings in its capacity as the Nomination Committee during the Reporting Period. Details of Directors' attendance at these meetings are set out in the Directors' Report. To assist the Board to fulfil its function as the Nomination Committee, it has adopted a Nomination Committee Charter.

The Company's Nomination Committee Charter is available on the Company's website.

The explanation for departure set out under Recommendation 2.4 above explains how the functions of the Nomination Committee are performed.

Performance evaluation

During the Reporting Period an evaluation of the Board, its committees, and individual Directors took place in accordance with the process disclosed.

Selection and (re) appointment of Directors

In determining candidates for the Board, the Nomination Committee (which consists of all directors) follows a prescribed procedure whereby it considers the balance of independent directors on the Board as well as the skills and qualifications of potential candidates that will best enhance the Board's effectiveness. Potential candidates are identified and, if relevant, the Nomination Committee (as part of the Board) recommends an appropriate candidate for appointment to the Board. Any appointment made by the Board is subject to ratification by shareholders at the next general meeting.

The Board recognises the impact of Board tenure on succession planning and considers that Board renewal is critical to the Company's performance. Each Director other than the Managing Director, must not hold office (without re-election) past the third annual general meeting of the Company following the Director's appointment or three years following that Director's last election or appointment (whichever is the longer). However, a Director appointed to fill a casual vacancy or as an addition to the Board must not hold office (without re-election) past the next annual general meeting of the Company. At each annual general meeting a minimum of one Director or a third of the total number of directors must retire. A Director who retires at an annual general meeting is eligible for re-election at that meeting and the re-appointment of Directors is not automatic.

The Company's Policy and Procedure for the Selection and (Re) Appointment of Directors is available on the Company's website.

Principle 3 – Promote ethical and responsible decision-making

Recommendation 3.1:

Companies should establish a Code of Conduct and disclose the code or a summary of the code as to the practices necessary to maintain confidence in the Company's integrity, the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders and the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Disclosure:

The Company has established a Code of Conduct as to the practices necessary to maintain confidence in the Company's integrity, the practices necessary to take into account its legal obligations and the reasonable expectations of its stakeholders, and the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Recommendation 3.2:

Companies should establish a policy concerning trading in company securities by Directors, senior executives and employees, and disclose the policy or a summary of that policy.

Disclosure:

The Company has established a policy concerning trading in the Company's securities by Directors, senior executives and employees.

Recommendation 3.3:

Companies should provide the information indicated in the Guide to reporting on Principle 3.

Disclosure:

A summary of the Company's Code of Conduct is available on the Company website.

Recommendation 3.4:

Companies should disclose in each annual report the proportion of women employees in the whole organisation, women in senior executive positions and women on the Board.

Disclosure:

The proportion of women employees in the whole organisation, women in senior executive positions and women on the Board, as at the end of the Reporting Period, are set out in the following table:

	Proportion of women
Whole organisation	15 out of 42 (35.7%)
Senior executive positions (including management)	0 out of 6 (0%)
Board	1 out of 7 (14.3%)

Recommendation 3.5:

Companies should provide the information indicated in the Guide to reporting on Principle 3.

Disclosure:

The Company has established a Diversity Policy. However, the Company's Diversity Policy does not require the Board to establish measurable objectives for achieving gender diversity or for the Board to assess annually both the objectives and progress towards achieving them.

The Company's Diversity Policy is available on the Company's website at www.carbonenergy.com.au.

The Board has not yet set measurable objectives for achieving gender diversity. The Directors are in the process of collecting information to enable them to set meaningful measurable objectives which are appropriate to the size of the Company.

Principle 4 – Safeguard integrity in financial reporting

Recommendation 4.1:

The Board should establish an Audit Committee.

Disclosure:

The Company has established an Audit Committee.

Recommendation 4.2:

The Audit Committee should be structured so that it:

- consists only of Non-Executive Directors
- consists of a majority of independent Directors
- is chaired by an independent Chair, who is not Chair of the Board
- has at least three members.

Notification of Departure:

For the majority of the Reporting Period (since 6 September 2010), the Audit Committee was structured in accordance with Recommendation 4.2. The Audit Committee comprises Helen Garnett (independent Non-Executive Chair), Kim Robinson (independent Non-Executive) and Peter Hogan (non-independent Non-Executive). For the period 1 July 2010 to 5 September 2010, the Audit Committee only comprised Messrs Robinson and Hogan.

Recommendation 4.3:

The Audit Committee should have a formal charter.

Disclosure:

The Board has adopted an Audit Committee Charter which describes the role, composition, functions and responsibilities of the Audit Committee.

CORPORATE GOVERNANCE **STATEMENT**

Recommendation 4.4:

Companies should provide the information indicated in the Guide to reporting on Principle 4.

Disclosure:

The Audit Committee held two meetings during the Reporting Period. Details of the Directors' attendance at the Audit Committee meetings are set out in the Directors' Report.

Details of each of the Director's qualifications are set out in the Directors' Report. Mr Hogan is a Chartered Accountant who was a partner of PricewaterhouseCoopers for 17 years. All members of the Audit Committee have the requisite financial and/or industry knowledge to participate on and contribute to the Audit Committee. Furthermore the Company's Chief Financial Officer and Company Secretary, Prem Nair, is available to attend Audit Committee meetings by invitation and the Audit Committee has the opportunity to meet with the external auditor, if necessary.

The Company has established procedures for the selection, appointment and rotation of its external auditor. The Board is responsible for the initial appointment of the external auditor and the appointment of a new external auditor when any vacancy arises, as recommended by the Audit Committee. Candidates for the position of external auditor must demonstrate complete independence from the Company through the engagement period. The Board may otherwise select an external auditor based on criteria relevant to the Company's business and circumstances. The performance of the external auditor is reviewed on an annual basis by the Audit Committee and any recommendations are made to the Board.

The Company's Audit Committee Charter and the Company's Procedure for Selection, Appointment and Rotation of External Auditor are available on the Company's website.

Principle 5 – Make timely and balanced disclosure

Recommendation 5.1:

Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.

Disclosure:

The Company has established written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and accountability at a senior executive level for that compliance.

Recommendation 5.2:

Companies should provide the information indicated in the Guide to reporting on Principle 5.

Disclosure:

Summaries of the Company's Policy on ASX Listing Rule Compliance and of the Compliance Procedures are available on the Company's website.

Principle 6 – Respect the rights of shareholders

Recommendation 6.1:

Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.

Disclosure:

The Company has designed a communications policy for promoting effective communication with shareholders and encouraging shareholder participation at general meetings.

Recommendation 6.2:

Companies should provide the information indicated in the Guide to reporting on Principle 6.

Disclosure:

The Company's Shareholder Communication Policy is available on the Company's website.

Principle 7 – Recognise and manage risk

Recommendation 7.1:

Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.

Disclosure:

The Board has adopted a Risk Management Policy, which sets out the Company's risk profile. Under the policy, the Board is responsible for approving the Company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control.

Under the policy, the Board delegates day-to-day management of risk to the Managing Director, who is responsible for identifying, assessing, monitoring and managing risks. The Managing Director is also responsible for updating the Company's material business risks to reflect any material changes, with the approval of the Board. As part of the Company's risk management system, the Managing Director reports regularly to the Board on the management of material business risks and provides assurances to the Board, on behalf of management, that the Company's management of its material business risks are effective.

In fulfilling the duties of risk management, the Managing Director has unrestricted access to Company employees, contractors and records, and may obtain independent expert advice on any matter he believes appropriate, with the prior approval of the Board.

The Board has established a separate Audit Committee to monitor and review the integrity of financial reporting and the Company's internal financial control systems. The Board is presented with monthly financial reports which include analysis on variances and any explanations. In addition, the following risk management measures have been adopted by the Board to manage the Company's material business risks:

- the Board has established authority limits for management, which, if proposed to be exceeded, require prior Board approval;
- the Board has adopted a compliance procedure for the purpose of ensuring compliance with the Company's continuous disclosure obligations; and
- the Board has adopted a corporate governance manual which contains other policies to assist the Company to establish and maintain its governance practices.

The Company has established systems for managing its material business risks, these systems among other things comprise a detailed risk matrix showing the Company's business risks and their materiality based on scales of likelihood and consequences to the Company should they eventuate. The matrix also details controls put in place by the Company to manage material business risks. The material business risks of the Company are reviewed at each fortnightly management meeting. Management prepares a monthly report on risk management which is then tabled at each Board meeting. Risk management is a standing Board meeting agenda item.

The categories of risk reported on include: operations, environmental, human capital, technology, commercial, political and financial reporting, legal and compliance.

Deloitte Touche Tohmatsu facilitated a forum to assist management in conducting the following:

- create a risk map through organisational research (interviews and documentation reviews);
- identify the areas of highest risk through a high level risk analysis;
- create a risk dashboard to manage these risks; and
- assign management actions plans to critical risks.

Recommendation 7.2:

The Board should require management to design and implement the risk management and internal control system to manage the Company's material business risks and report to it on whether those risks are being managed effectively. The Board should disclose that management has reported to it as to the effectiveness of the Company's management of its material business risks.

Disclosure:

The Board has required management to design, implement and maintain risk management and internal control systems to manage the Company's material business risks. The Board also requires management to report to it confirming that those risks are being managed effectively. The Board received a report from management as to the effectiveness of the Company's management of its material business risks during the Reporting Period.

Recommendation 7.3:

The Board should disclose whether it has received assurance from the Chief Executive Officer (or equivalent) and the Chief Financial Officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.

Disclosure:

The Managing Director and the Chief Financial Officer have provided a declaration to the Board in accordance with section 295A of the Corporations Act and have assured the Board that such declaration is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risk.

Recommendation 7.4:

Companies should provide the information indicated in the Guide to reporting on Principle 7.

CORPORATE GOVERNANCE **STATEMENT**

Disclosure:

A summary of the Company's Risk Management Policy is available on the Company's website.

Principle 8 – Remunerate fairly and responsibly

Recommendation 8.1:

The Board should establish a Remuneration Committee.

Disclosure:

The Company has established a Remuneration Committee.

Due to the composition of the Board, the Remuneration Committee was not structured in accordance with Recommendation 8.2 during the Reporting Period. The Remuneration Committee comprised Kim Robinson and Peter Hogan, both of whom are Non-Executive Directors, however only Kim Robinson is considered to be independent. The composition of the Remuneration Committee changed on 26 July 2011 to comply with Recommendation 8.2 and ASX Listing Rule 12.8. At the date of this Report, the Remuneration Committee is comprised of Kim Robinson as independent Chair, Chris Rawlings independent and Peter Hogan as non independent member.

Recommendation 8.2:

Companies should clearly distinguish the structure of Non-Executive Directors' remuneration from that of Executive Directors and senior executives.

Disclosure:

Non-Executive Directors are remunerated at a fixed fee for time, commitment and responsibilities. Remuneration for non-executive directors is not linked to individual performance.

Pay and rewards for executive directors and senior executives consists of a base salary and performance incentives. Long term performance incentives may include options granted at the discretion of the Board and subject to obtaining the relevant approvals. Executives are offered a competitive level of base pay at market rates and are reviewed annually to ensure market competitiveness.

Recommendation 8.3:

Companies should provide the information indicated in the Guide to reporting on Principle 8.

Disclosure:

To assist the Remuneration Committee to fulfil its function the Board has adopted a Remuneration Committee Charter.

Details of remuneration, including the Company's policy on remuneration, are contained in the "Remuneration Report" which forms of part of the Directors' Report.

The Remuneration Committee held one meeting during the Reporting Period. Details of the Directors' attendance at the Remuneration Committee meeting are set out in the Directors' Report.

There are no termination or retirement benefits for Non-Executive Directors (other than for superannuation).

The Company's Remuneration Committee Charter includes a statement of the Company's policy on prohibiting transactions in associated products which limit the risk of participating in unvested entitlements under any equity based remuneration schemes.

The Company's Remuneration Committee Charter is available on the Company's website.

FINANCIAL **REPORT**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2011

		CONSOLIDATED GROUP	
	Notes	2011 $	2010 $
Other income	3	772,632	6,897,961
Employee benefits expense		(5,515,772)	(3,867,203)
Depreciation expense	4 (a)	(142,975)	(130,392)
Administration and other costs		(3,920,964)	(3,303,211)
Consultancy costs		(1,639,397)	(2,266,629)
Finance costs		(19,778)	(15,190)
Tenement holding costs		(150,839)	(271,412)
Share-based payments income / (expense)		98,421	(2,074,912)
Bloodwood Creek costs		(4,042,666)	(4,713,935)
Net loss from equity accounted investment in associate	10	(1,279,518)	(1,075,564)
Loss before income tax expense		(15,840,856)	(10,820,487)
Income Tax Expense	6	-	-
Loss for the Year		(15,840,856)	(10,820,487)
Other comprehensive income for the year (net of tax)		-	-
Total comprehensive income for the year		(15,840,856)	(10,820,487)
LOSS ATTRIBUTABLE TO OWNERS OF THE PARENT		(15,840,856)	(10,820,487)
Total comprehensive income attributable to owners of the parent		(15,840,856)	(10,820,487)
OVERALL OPERATIONS			
Basic loss per share	5	(2.45)	(1.83)
• cents per share			
Diluted loss per share		(2.45)	(1.83)
• cents per share			

The above consolidated statement of comprehensive income should be read in conjunction with the following notes.

FINANCIAL **REPORT**
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2011

		CONSOLIDATED GROUP	
	Notes	2011 $	2010 $
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	8	9,798,985	18,874,230
Trade and other receivables	9	520,813	128,149
TOTAL CURRENT ASSETS		10,319,798	19,002,379
NON-CURRENT ASSETS			
Trade and other receivables	9	1,396,569	1,408,403
Investment in Associate	10	3,044,920	4,324,438
Construction Work In Progress	11	12,370,001	14,825,380
UCG Panel assets	12	10,616,055	-
Property, plant & equipment	13	8,756,618	10,672,036
Other non-current asset	14	1,100,473	-
Mine development	17	-	16,468,042
Deferred exploration and evaluation costs	16	107,964,187	89,714,658
Intangible assets	15	24,218,525	2,499,999
TOTAL NON-CURRENT ASSETS		169,467,348	139,912,956
TOTAL ASSETS		179,787,146	158,915,335
LIABILITIES			
CURRENT LIABILITIES			
Trade and other payables	19	1,437,700	4,125,198
Provisions	20	237,332	191,919
TOTAL CURRENT LIABILITIES		1,675,032	4,317,117
NON CURRENT LIABILITIES			
Provisions	20	2,175,276	40,350
TOTAL NON CURRENT LIABILITIES		2,175,276	40,350
TOTAL LIABILITIES		3,850,308	4,357,467
NET ASSETS		175,936,838	154,557,868
EQUITY			
Issued capital	21	218,256,942	188,759,462
Reserves	22	14,149,360	6,427,014
Accumulated losses	23	(56,469,464)	(40,628,608)
TOTAL EQUITY		175,936,838	154,557,868

The above consolidated statement of financial position should be read in conjunction with the following notes.

FINANCIAL **REPORT**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2011

CONSOLIDATED GROUP

	Notes	Ordinary Issued Capital $	Accumulated Losses $	Option Reserve $	Total $
BALANCE AT 1 JULY 2009		172,265,745	(29,808,121)	4,664,569	147,122,193
Shares issued during the year	21	16,706,250	-	-	16,706,250
Transaction Costs		(525,000)	-	-	(525,000)
Movement in share option reserve on recognition of share based payments		-	-	2,074,912	2,074,912
Exercise of options		312,467	-	(312,467)	-
Loss attributable to members of parent entity		-	(10,820,487)	-	(10,820,487)
BALANCE AT 30 JUNE 2010		188,759,462	(40,628,608)	6,427,014	154,557,868
BALANCE AT 1 JULY 2010					
Shares issued during the year	21	30,184,920	-	-	30,184,920
Transaction Costs		(692,725)	-	-	(692,725)
Shares to be issued arising from Clean Coal transaction (refer note 18)		-	-	7,826,052	7,826,052
Movement in share option reserve on recognition of share based payments		-	-	(98,421)	(98,421)
Exercise of options		5,285	-	(5,285)	-
Loss attributable to members of parent entity		-	(15,840,856)	-	(15,840,856)
BALANCE AT 30 JUNE 2011		218,256,942	(56,469,464)	14,149,360	175,936,838

The above consolidated statement of changes in equity should be read in conjunction with the following notes.

FINANCIAL **REPORT**
CASH FLOW STATEMENT
FOR THE YEAR ENDED 30 JUNE 2011

	Notes	CONSOLIDATED GROUP 2011 $	2010 $
CASH FLOWS FROM OPERATING ACTIVITIES			
Payments to suppliers and employees (including GST)		(19,240,144)	(13,600,303)
Interest received		724,094	325,263
Other receipts (including GST)		1,037,358	204,477
NET CASH (USED IN) OPERATING ACTIVITIES	29	(17,478,692)	(12,467,563)
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for property, plant and equipment		(128,810)	(380,523)
Proceeds from sale of property, plant and equipment		-	42,138
Payment for Exploration & Evaluation Expenditure		(443,558)	(163,269)
Payments for Construction in progress		(9,434,822)	(12,622,827)
Payment for Intangible Assets		(18,000)	-
Payment for Chile project		(1,100,472)	-
Proceeds from sale of Laverton Gold tenements		-	2,500,000
Proceeds from return of security bonds		16,834	251,000
Payment to Energia Minerals Limited for seed capital		-	(400,000)
Proceeds from Constellation Energy		-	800,000
Proceeds from sale of investments - Magma Metals	4 (b)	-	6,464,250
NET CASH (USED IN) INVESTING ACTIVITIES		(11,108,828)	(3,509,231)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issues of shares		20,205,000	14,703,792
Capital raising costs		(692,726)	(1,600,000)
Proceeds from new HP financing		-	-
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES		19,512,274	13,103,792
Net decrease in cash and cash equivalents held		(9,075,245)	(2,873,002)
Cash and cash equivalents at the beginning of the financial year		18,874,230	21,747,232
Cash and cash equivalents at the end of the financial year	8	9,798,985	18,874,230

The above consolidated cash flow statement should be read in conjunction with the following notes.

FINANCIAL **REPORT**
NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011

Note 1 – Statement of Significant Accounting Policies

The financial report covers the Consolidated Group of Carbon Energy Limited and its controlled entities. Carbon Energy Limited is a listed public company, incorporated and domiciled in Australia.

Basis of Preparation

The financial report has been prepared on a historical cost basis modified, where applicable, by the measurement at fair value of selected non-current assets, financial assets and financial liabilities. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars unless otherwise stated.

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, Australian Accounting Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board ("AASB"), and the Corporations Act 2001 and other requirements of the law. The financial statements were authorised for issue by the directors on 15 September 2011.

Australian Accounting Standards set out accounting policies that the AASB has concluded would result in a financial report containing relevant and reliable information about transactions, events and conditions to which they apply. Compliance with Australian Accounting Standards ensures that the financial statements and notes also comply with International Financial Reporting Standards. Material accounting policies adopted in the preparation of this financial report are presented below. They have been consistently applied unless otherwise stated.

The following is a summary of the material accounting policies adopted by the Consolidated Group in the preparation of the financial report. The accounting policies have been consistently applied, unless otherwise stated.

(a) Going Concern

The financial report has been prepared on the going concern basis, which assumes the continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

For the year ended 30 June 2011 the Consolidated Group incurred a loss of $15,840,856 (2010: $10,820,487) and recorded a net cash outflow from operating and investing activities of $28,587,520 (2010: $15,976,794). Further, for the year ended 30 June 2011 the Company incurred a loss of $1,189,211 (2010: profit of $2,839,029).

In concluding that the going concern basis is appropriate, the Directors considered many factors, including a cash flow forecast for twelve months from the signing of this financial report which included management's estimates of cash inflows and outflows for that period. The ability of the Company and the Consolidated Group to continue as going concerns is dependent upon additional capital being raised to finance continued development of the Bloodwood Creek and offshore projects and fund the operations of the Consolidated Group. The ability of the Company and the Consolidated Group to raise additional funds will be dependent upon a number of factors including market sentiment and the progress of current development activities. The Directors are confident of the Consolidated Group's ability to undertake such a capital raising based on past demand for previous capital raisings.

As a result of the above matters, there is material uncertainty as to whether the Company and the Consolidated Group will be able to continue as going concerns and, therefore, whether they will realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report.

The financial report does not include adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company and Consolidated Group not continue as going concerns.

(b) Principles of Consolidation

A controlled entity is any entity over which Carbon Energy Limited has the power to govern the financial and operating policies so as to obtain benefits from its activities. In assessing the power to govern, the existence and effect of holdings of actual and potential voting rights are considered.

A list of controlled entities is contained in Note 32 to the financial statements.

As at reporting date, the assets and liabilities of all controlled entities have been incorporated into the consolidated financial statements as well as their results for the year then ended. Where controlled entities have entered (left) the Consolidated Group during the year, their operating results have been included (excluded) from the date control was obtained (ceased).

All inter-group balances and transactions between entities in the Consolidated Group, 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 adopted by the parent entity.

Business combinations

The acquisition method of accounting is used to account for all business combinations, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred also includes the fair value of any asset or liability resulting from a contingent consideration arrangement and the fair value of any pre-existing equity interest in the subsidiary. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are, with limited exceptions, measured initially at their fair values at the acquisition date.

The excess of the consideration transferred, the amount of any non-controlling interest in the subsidiary acquired 'acquiree' and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the subsidiary acquired and the measurement of all amounts has been reviewed, the difference is recognised directly in profit or loss as a bargain purchase.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange.

(c) Income tax

The charge for current income tax expenses is based on the profit for the year adjusted for any non-assessable or disallowed items. It is calculated using tax rates that have been enacted or are substantially enacted by the 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 credited in the Statement of Comprehensive Income except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred income tax assets relating to temporary differences and unused tax losses are recognised only to the extent that it is probable that future tax profits will be available against which the benefits of the deferred tax asset can be utilised.

Where temporary differences exist in relation to investments in subsidiaries and joint ventures, deferred tax assets and liabilities are not recognised where the timing of the reversal of the temporary difference can be controlled and it is not probable that the reversal will occur in the foreseeable future.

Current tax assets and liabilities are offset where a legally enforceable right of set-off exists and it is intended that net settlement or simultaneous realisation and settlement of the respective asset and liability will occur. Deferred tax assets and liabilities are offset where a legally enforceable right of set-off exists, the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where it is intended that net settlement or simultaneous realisation and settlement of the respective asset and liability will occur in future periods in which significant amounts of deferred tax assets or liabilities are expected to be recovered or settled.

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 Consolidated Group will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

(d) Property, plant and equipment

Each class of property, plant and equipment is carried at cost less, where applicable, any accumulated depreciation and impairment losses.

Plant and equipment

Plant and equipment are measured on the cost basis less depreciation and impairment losses.

The cost of plant and equipment constructed within the Consolidated Group includes the cost of materials, direct labour, borrowing costs and an appropriate proportion of fixed and variable overheads.

The carrying amount of plant and equipment is reviewed annually by Directors to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows which will be received from the assets employment and subsequent disposal. The expected net cash flows have been discounted to their present values in determining recoverable amounts.

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 Consolidated Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the Statement of Comprehensive Income during the financial period in which they are incurred.

Depreciation

The cost of all plant and equipment is depreciated on a reducing balance basis commencing from the time the asset is held ready for use as intended by management. Computers are depreciated on a straight line basis over their useful lives to the Consolidated Group commencing from the time the asset is held ready for use.

The depreciation rates used for each class of depreciable assets are:

Class of fixed asset and depreciation rate

Motor Vehicles 22.5%

Plant and Equipment 7.5-50%

Water Monitoring assets 4%

Site Infrastructure 4%

Bloodwood Creek Trial Plant and Equipment assets 4%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

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 profit and loss component of the statement of comprehensive income.

(e) UCG panel assets

UCG Panel Assets include costs transferred from Construction Work-in-progress once technical feasibility and commercial viability for a particular Panel can be demonstrated. When production commences, the accumulated costs for the relevant area of interest (for each panel) are amortised over the life of the area according to the rate of coal depletion.

(f) Exploration and evaluation expenditure

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

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

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

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

Restoration, rehabilitation and environmental costs necessitated by exploration and evaluation activities are expensed as incurred and treated as exploration and evaluation expenditure.

(g) Mine development costs

Mine development costs represent development expenditure in respect of areas of interest in which mining for UCG has commenced or likely to commence shortly. It is only carried forward when future economic benefits can be established. After the Consolidated Group moves into the commercial phase of the project, assets classified as mine developments costs will be moved to a producing asset category and amortised over the life of the asset.

The net carrying value of the area of interest is reviewed annually for impairment. In the event that the carrying value of an area exceeds its recoverable amount the asset will be written down to its recoverable amount.

(h) Leases

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses and accounted for on a straight line basis in the periods in which they are incurred. There are no finance leases.

(i) Financial instruments

Recognition and Initial measurement

Trade date accounting is adopted for financial assets that are delivered within timeframes established by marketplace convention.

Financial instruments, incorporating financial assets and liabilities are recognised when the entity becomes a party to the contractual provisions of the instrument. Financial instruments are initially measured at fair value plus transactions costs where the instrument is not classified as at fair value through profit or loss. Transaction costs related to instruments classified as at fair value through profit or loss are expensed to profit or loss immediately. Financial instruments are classified and measured as set out below.

De-recognition

Financial assets are derecognised where the contractual rights to receipt of cash flows expires or the asset is transferred to another party whereby the entity no longer has any significant continuing involvement in the risks and benefits associated with the asset. Financial liabilities are derecognised where the related obligations are either discharged, cancelled or expire. The difference between the carrying value of the financial liability extinguished or transferred to another party and the fair value of consideration paid, including the transfer of non-cash assets or liabilities assumed, is recognised in profit or loss.

Financial instruments incorporating financial assets and financial liabilities, are recognised when the entity becomes a party to the contractual provisions of the instrument.

Classification and subsequent measurement

(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 and within the requirements of AASB 139: Recognition and Measurement of Financial Instruments. Derivatives are also categorised as held for trading unless they are designated as hedges. Realised and unrealised gains and losses arising from changes in the fair value of these assets are included in the profit and loss component of the statement of comprehensive income 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.

(iii) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are either designated as such or that are not classified in any of the other categories. They comprise investments in the equity of other entities where there is neither a fixed maturity nor fixed or determinable payments. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to Comprehensive Income.

(iv) Financial liabilities

Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

(v) Fair value

Fair value is determined based on current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arms length transactions, reference to similar instruments and option pricing models.

(vi) Impairment

At each reporting date, the Group assess whether there is objective evidence that a financial instrument has been impaired. In the case of available-for sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether impairment has arisen. Impairment losses are recognised in the profit and loss component of the statement of comprehensive income.

(j) Impairment of tangible and intangible assets other than goodwill

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(k) Investments in associates

Investments in associate companies are recognised in the financial statements by applying the equity method of accounting. The equity method of accounting recognises the Group's share of post acquisition reserves of its associates. Significant influence is defined as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. Such investments are tested for impairment in accordance with the policy stated in Note 1 (j).

(l) Interest in joint ventures

The Consolidated Group's share of the assets, liabilities, revenue and expenses of joint venture operations are included in the appropriate items of the consolidated financial statements.

The Consolidated Group's interests in joint venture entities are brought to account using the equity method of accounting in the consolidated financial statements.

The parent entity's interests in joint venture entities are brought to account using the cost method.

(m) Intangibles

Underground Coal Gasification (UCG) intangible assets - arising from development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development (or from the development phase of an internal project) is recognised if, and only if, all of the following have been demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognised for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognised, development expenditure is recognised in profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible assets are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

The UCG Intangible asset UCG 'know how' recognised by the Company has an indefinite life and is not amortised. Each period, the useful life of the asset is reviewed to determine whether events and circumstances continue to support an indefinite useful life assessment for the asset. Such assets are tested for impairment in accordance with the policy stated in note 1 (j).

Trademarks and licences

Trademarks and licences have a finite useful life and are carried at cost less accumulated amortisation and impairment losses. Amortisation is calculated using the straight-line method to allocate the cost of trademarks and licences over their estimated useful lives, which vary from 3 to 5 years.

De-recognition of intangible assets

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from de-recognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset are recognised in profit or loss when the asset is derecognised.

(n) Employee benefits

Provision is made for the entity's liability for employee benefits arising from services rendered by employees to the balance date. Short term employee benefits have been measured at the amounts expected to be paid when the liability is settled, plus related on costs. Other long term employee benefits have been measured at the present value of the estimated future cash outflows to be made for those benefits. The fair value of equity granted is measured at grant date based on the fair value of services received.

Contributions are made by the Consolidated Group to employee superannuation funds and are charged as expenses when incurred.

Equity settled compensation

The Group operates equity-settled share-based payment employee share and option schemes. The fair value of the equity to which employees become entitled is measured at grant date and recognised as an expense over the vesting period, with a corresponding increase to an equity account. The fair value of shares is ascertained as the market bid price. The fair value of options is ascertained using a Black–Scholes pricing model which incorporates all market vesting conditions. The number of shares and options expected to vest is reviewed and adjusted at each reporting date such that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. The Group also enters into equity-settled share-based payment arrangements with major suppliers whereby the Company (supplier) receives shares in Carbon Energy Limited as payment for services provided by the supplier. The equity granted is recognised based on the fair value of services provided.

(o) Provisions

Provisions are recognised when the Group 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. The amount recognised as a provision represents the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation.

Provision for restoration and rehabilitation

Site rehabilitation

A provision for restoration and rehabilitation is recognised when there is a present obligation as a result of exploration and development activities undertaken, it is probable that an outflow of benefits will be required to settle the obligation and the provision can be measured reliably. The estimated future obligations will include (but are not limited to) the costs of site restoration, investigative bore holes, cavity process water clean-up and removal/transfer of surface infrastructure (if applicable).

The provision for future restoration is the best estimate of the present value of the expenditure required to settle the restoration obligation at the reporting date. Future restoration costs will be reviewed annually and any changes in the estimate are reflected in the present value of the restoration provision at each reporting date.

The initial estimate of restoration and rehabilitation relating to the construction or installation of site assets is capitalised into the cost of the related asset and amortised on the same basis as the related asset.

Changes in the estimate of the provision for restoration and rehabilitation are treated in the same way, except that the unwinding of the effect of discounting on the provision is recognised as a finance cost rather than being capitalised into the cost of the related asset.

Panel rehabilitation

The amount recognised as a provision will be the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. The provision will be measured using the cashflows estimated to settle the present obligation, therefore the carrying amount will be the present value of those cashflows. Essentially management will take the present value of the estimated panel rehabilitation costs, calculated over the estimated life of the panel and recognise the rehabilitation expense based on the percentage of coal utilisation for the period.

(p) Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

(q) Revenue and other income

Interest revenue is recognised on a monthly basis taking into account the interest rates applicable to the financial assets. Gain from sale of investments is recognised on the date of the contract for sale note. All revenue is stated net of the amount of goods and services tax (GST).

(r) Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount of 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 an item of the expense. Receivables and payables in the Statement of Financial Position 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) Contributed equity

Issued and paid up capital is recognised at the fair value of the consideration received by the Company. Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received.

(t) Critical accounting estimates and judgments

The Directors evaluate estimates and judgments incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the Group.

Key Estimates – Impairment

The Group assess impairment at each reporting date by evaluating conditions specific to the Group that may lead to 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.

An impairment review is completed annually on carried forward exploration costs resulting from relinquishments, transfers and ongoing exploration prospectivity and commercial value.

Key Estimates – Construction work in progress

The construction work in progress comprises of various assets located at the Bloodwood Creek site, namely 5MW Power Station Plant, Panel 3 and design costs for the 20MW Power Station. These assets when completed and ready for use will be allocated to the appropriate asset category. After the Consolidated Group moves into the commercial phase of the project, these assets will be depreciated /amortised over the life of the respective assets.

Key Estimates – Provision for rehabilitation

The provision for rehabilitation is based on the present obligations of the estimates of the future sacrifice of economic benefits required to rehabilitate the Bloodwood Creek site at Kogan. The Group has considered the provision for rehabilitation for its exploration and tenements at Bloodwood Creek based on valuations provided by independent consultants. The Consolidated Group has taken the future value of the estimated rehabilitation liability provided by the external consultants and used an appropriate discount rate to calculate the present value of the provision for rehabilitation.

Key Estimates – Estimate of useful lives of assets

The estimation of the useful lives of assets has been based on historical experience. In addition, the condition of the assets is assessed at least once per year and considered against the remaining useful life. Details of the useful lives of property, plant and equipment are set out in note 1(d).

Note 2 – Application of new and revised Accounting Standards

2.1 Standards and Interpretations affecting amounts reported in the current period (and/or prior periods)

The following new and revised Standards and Interpretations have been adopted in the current period and have affected the amounts reported in these financial statements. Details of other Standards and Interpretations adopted in these financial statements but that have had no effect on the amounts reported are set out in section 2.2.

Standards affecting presentation and disclosure

Amendments to AASB 101 'Presentation of Financial Statements' (adopted in advance of effective date of 1 January 2011)	The amendments (part of AASB 2010-4 'Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project') clarify that an entity may choose to present the required analysis of items of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements.
Amendments to AASB 107 'Statement of Cash Flows'	The amendments (part of AASB 2009-5 'Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project') specify that only expenditures that result in a recognised asset in the statement of financial position can be classified as investing activities in the statement of cash flows. Consequently, cash flows in respect of development costs that do not meet the criteria in AASB 138 'Intangible Assets' for capitalisation as part of an internally generated intangible asset (and, therefore, are recognised in profit or loss as incurred) have been reclassified from investing to operating activities in the statement of cash flows.

Standards and Interpretations affecting the reported results or financial position

There are no new and revised Standards and Interpretations adopted in these financial statements affecting the reporting results or financial position.

2.2 Standards and Interpretations adopted with no effect on financial statements

The following new and revised Standards and Interpretations have also been adopted in these financial statements. Their adoption has not had any significant impact on the amounts reported in these financial statements but may affect the accounting for future transactions or arrangements.

AASB 2009-5 'Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project'	Except for the amendments to AASB 5 and AASB 107 described earlier this section, the application of AASB 2009-5 has not had any material effect on amounts reported in the financial statements.

2.2 Standards and Interpretations adopted with no effect on financial statements continued

AASB 2009-8 'Amendments to Australian Accounting Standards – Group Cash-Settled Sharebased Payment Transactions'	The application of AASB 2009-8 makes amendments to AASB 2 'Share-based Payment' to clarify the scope of AASB 2, as well as the accounting for group cash-settled share-based payment transactions in the separate (or individual) financial statements of an entity receiving the goods or services when another group entity or shareholder has the obligation to settle the award.
AASB 2009-10 'Amendments to Australian Accounting Standards – Classification of Rights Issues'	The application of AASB 2009-10 makes amendments to AASB 132 'Financial Instruments: Presentation' to address the classification of certain rights issues denominated in a foreign currency as either an equity instrument or as a financial liability. To date, the Group has not entered into any arrangements that would fall within the scope of the amendments.
AASB 2010-3 'Amendments to Australian Accounting Standards arising from the Annual Improvements Project	The application of AASB 2010-3 makes amendments to AASB 3(2008) 'Business Combinations' to clarify that the measurement choice regarding non-controlling interests at the date of acquisition is only available in respect of noncontrolling interests that are present ownership interests and that entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. All other types of noncontrolling interests are measured at their acquisition-date fair value, unless another measurement basis is required by other Standards. In addition, the application of AASB 2010-3 makes amendments to AASB 3(2008) to give more guidance regarding the accounting for share-based payment awards held by the acquiree's employees. Specifically, the amendments specify that share-based payment transactions of the acquiree that are not replaced should be measured in accordance with AASB 2 'Share-based Payment' at the acquisition date ('market-based measure').
AASB 2010-4 'Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project'	Except for the amendments to AASB 7 and AASB 101 described earlier this section, the application of AASB 2010-4 has not had any material effect on amounts reported in the financial statements.
Interpretation 19 'Extinguishing Financial Liabilities with Equity Instruments	This Interpretation provides guidance regarding the accounting for the extinguishment of a financial liability by the issue of equity instruments. In particular, the equity instruments issued under such arrangements will be measured at their fair value, and any difference between the carrying amount of the financial liability extinguished and the fair value of equity instruments issued will be recognised in profit or loss. To date, the Group has not entered into transactions of this nature.

Note 2 – Application of new and revised Accounting Standards continued

2.3 Standards and Interpretations in issue not yet adopted

At the date of authorisation of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective.

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
AASB 124 'Related Party Disclosures' (revised December 2009), AASB 2009-12 'Amendments to Australian Accounting Standards'	1 January 2011	30 June 2012
AASB 9 'Financial Instruments', AASB 2009¬11 'Amendments to Australian Accounting Standards arising from AASB 9' and AASB 2010-7 'Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)'	1 January 2013	30 June 2014
AASB 2009-14 'Amendments to Australian Interpretation – Prepayments of a Minimum Funding Requirement'	1 January 2011	30 June 2012
AASB 2010-5 'Amendments to Australian Accounting Standards'	1 January 2011	30 June 2012
AASB 2010-6 'Amendments to Australian Accounting Standards – Disclosures on Transfers of Financial Assets'	1 July 2011	30 June 2012
AASB 2010-8 'Amendments to Australian Accounting Standards – Deferred Tax: Recovery of Underlying Assets'	1 January 2012	30 June 2013

At the date of authorisation of the financial statements, the following IASB Standards and IFRIC Interpretations were also in issue but not yet effective, although Australian equivalent Standards and Interpretations have not yet been issued.

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
AASB 10 Consolidated Financial Statements	1 January 2013	30 June 2014
AASB 11 Joint Arrangements	1 January 2013	30 June 2014
AASB 12 Disclosure of Interests in Other Entities	1 January 2013	30 June 2014
AASB 127 Separate Financial Statements	1 January 2013	30 June 2014
AASB 128 Investments in Associates and Joint Ventures	1 January 2013	30 June 2014
AASB 2011-7 Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards.	1 January 2013	30 June 2014

Note 3 – Other income

	Note	CONSOLIDATED GROUP 2011 $	CONSOLIDATED GROUP 2010 $
Operating Activities			
• Interest received		699,965	965,519
		699,965	965,519
Non-operating activities			
• Fair value adjustment on Energia Minerals Investment	4 (b)	-	3,946,749
• Other Income		72,667	354,433
• Gain/loss on disposal of assets	4 (b)	-	1,631,250
		72,667	5,932,442
TOTAL OTHER INCOME		772,632	6,897,961

Note 4 – Loss from ordinary activities

	CONSOLIDATED GROUP 2011 $	CONSOLIDATED GROUP 2010 $
Loss from ordinary activities before income tax has been determined after:		
(a) Expenses		
Depreciation of Non-current assets		
• Motor Vehicles	18,549	8,311
• Plant & Equipment	124,426	122,081
Total Depreciation	142,975	130,392
Rental expenses on operating leases		
• Minimum lease payments	256,847	278,223
Loss on disposal of assets	-	42,563
(b) Significant Transactions		
Gain on divestment of Uranium Assets		
During the year ended 30 June 2010, Carbon Energy Limited disposed of its Uranium interests and acquired a 42% interest in Energia Minerals Limited, a company incorporated in Australia and engaged in uranium exploration and mining via an Initial Public Offering. In exchange for seed capital of $400,000 and uranium interests carried at $1,053,254, Carbon Energy Minerals Limited received 4 million shares at $0.10 and 25 million shares at $0.20. A gain of $3,946,746 was recognised representing the difference between the Group carrying value disposed of and fair value of consideration received by way of investment in Energia Minerals Limited.	-	3,946,746
Gain/loss investments		
• Net proceeds from the sale of Magma Metals Limited shares were received on 21 October 2009 and amounted to $6,464,250. The carrying value of the investment at the date of disposal was $4,508,000 resulting in a realised gain of $1,956,250. In 2009 the investment was impaired by $1,177,535 to reflect the fair value at that date.	-	1,956,250
• Loss on disposal of Laverton Gold Assets	-	(325,000)
Share based payments		
This relates to accounting for share options provided to employees in accordance with the Australian Accounting Standards and are based on a theoretical cost using a 70% volatility factor. The negative expense for the 2011 financial year relates to the forfeiture of a number of options during the period.	98,421	(2,074,912)
TOTAL	98,421	3,503,084

Note 5 – Earnings per share (EPS)

	CONSOLIDATED GROUP	
	2011 $	2010 $
Net Loss for the year attributable to members of the parent entity	(15,840,856)	(10,820,487)
Basic loss per share	(2.45)	(1.83)
• cents per share		
Diluted loss per share	(2.45)	(1.83)
• cents per share		
(a) Weighted average number of ordinary shares outstanding during the year used in calculation of basic and diluted EPS	647,689,993	592,675,611

Options outstanding at 30 June 2011, totalling 39,955,000 are not considered potential ordinary shares as the effect is anti-dilutive.

Note 6 – Income tax expense

	CONSOLIDATED GROUP	
	2011 $	2010 $
(a) The components of tax expense comprise		
Current year tax	-	-
Deferred tax	-	-
Recoupment of prior years tax losses	-	-
R&D tax concession	-	-
(b) The prima facie tax/(benefit) on Profit/(Loss)		
from ordinary activities is reconciled to the income tax expense as follows:		
Prima facie tax/(benefit) on Profit/(Loss) from ordinary		
activities before income tax at 30%	(15,840,856)	(10,820,487)
2011:30% (2010: 30%)	(4,752,257)	(3,246,146)
Add tax effect of:		
Non-deductible items	(26,713)	1,195,065
Other deductible items	(235,481)	(780,792)
Revaluation and gain on disposals of investments		
not subject to income tax	(383,855)	763,855
Deferred tax assets not brought to account	5,398,306	2,068,018
Income tax attributable to entity	-	-
(c) Deferred tax assets		
An income tax Consolidated Group was formed from 1 July 2008.	32,244,449	30,240,000
Taking into account deductions from acquisition of exploration assets and loss to 30 June 2011 amount to: Adjustment to prior year carry forward losses to incorporate claim for Research and Development upon completion and lodgement of tax return	16,249,433	-
Deferred tax assets not brought to account, the benefits of which will only be realised if the conditions for deductibility set out in Note 1(b) occur		
Temporary differences	(676,678)	(63,569)
Tax losses (after income tax at 30%)	5,398,306	2,068,018
TOTAL DEFERRED TAX ASSETS NOT BROUGHT TO ACCOUNT	53,215,510	32,244,449

Note 7 – Key Management Personnel compensation

(a) Names and positions held of the consolidated and parent entity Key Management Personnel in office during the financial year are:

Executive / Non-Executive Directors

Mr K. Robinson
Non-Executive Director (Non-Executive Chairman)

Mr A.M. Dash
Chief Executive Officer & Managing Director (Executive Director)

Dr C.W. Mallet
Technical Director (Executive Director) (retired 30 June 2011)

Mr M.D.J. Cozijn
Non-Executive Director

Mr P.N. Hogan
Non-Executive Director

Mr L.I. Rozman
Non-Executive Director

Dr H.M. Garnett
Non-Executive Director (appointed 6 September 2010)

Mr I.W. Walker
Non-Executive Director (retired 31 December 2010)

Other Key Management Personnel

Mr J Bidwell
General Manager Project Development

Mr J Hoskin
Chief Operating Officer (appointed 24 January 2011)

Dr C Mallett
Technical Director

Mr A Mifflin
Chief Operating Officer (resigned 4 February 2011)

Mr P Nair
CFO & Company Secretary

Mr P Swaddle
General Manager Commercial

Note 7 – Key Management Personnel compensation continued

	2011 $	2010 $
Short-term employee benefits	1,973,138	1,241,622
Post-employment benefits	153,139	331,526
Share-based payments	1,398,842	2,314,928
TOTAL	3,525,119	3,888,076

Detailed remuneration disclosures are provided in the remuneration report.

(b) Option Holdings held directly and indirectly by Key Management Personnel:

2011 Directors	Balance at 01 Jul 10	Granted as Remuneration	Options Exercised	Net Change Other	Balance at 30 Jun 11	Total Vested 30 Jun 11	Total Exercisable 30 Jun 11	Total Unexercisable 30 Jun 11
Mr K. Robinson	-	-	-	-	-	-	-	-
Mr I.W. Walker (retired 31 December 2010)	-	-	-	-	-	-	-	-
Mr M.D.J. Cozijn	-	-	-	-	-	-	-	-
Dr C.W. Mallett (Retired 30 June 2011)	5,250,000	-	-	(875,000)	4,375,000	4,375,000	4,375,000	-
Mr A.M. Dash	30,000,000	-	-	(5,600,000)	24,400,000	14,400,000	14,400,000	10,000,000
Mr P.N. Hogan	-	-	-	-	-	-	-	-
Mr L. I. Rozman	-	-	-	-	-	-	-	-
Dr H.M Garnett	-	-	-	-	-	-	-	-
TOTAL	35,250,000	-	-	(6,475,000)	28,775,000	18,775,000	18,775,000	10,000,000

2010 Directors	Balance at 01 Jul 09	Granted as Remuneration	Options Exercised	Net Change Other	Balance at 30 Jun 10	Total Vested 30 Jun 10	Total Exercisable 30 Jun 10	Total Unexercisable 30 Jun 10
Mr K. Robinson	2,000,000	-	2,000,000	-	-	-	-	-
Mr I.W. Walker	6,000,000	-	6,000,000	-	-	-	-	-
Mr M.D.J. Cozijn	3,000,000	-	3,000,000	-	-	-	-	-
Mr P.T. McIntyre (Retired 12 February 2010)	1,000,000	-	1,000,000	-	-	-	-	-
Dr C.W. Mallett	5,250,000	-	-	-	5,250,000	3,500,000	3,500,000	1,750,000
Mr A.M. Dash	30,000,000	-	-	-	30,000,000	12,000,000	12,000,000	18,000,000
Mr P.N. Hogan	-	-	-	-	-	-	-	-
Mr L. I. Rozman (Appointed 7 April 2010)	-	-	-	-	-	-	-	-
Dr J.G. Linley	-	-	-	-	-	-	-	-
TOTAL	47,250,000	-	12,000,000	-	35,250,000	15,500,000	15,500,000	19,750,000

2011 Executives	Balance at 01 Jul 10	Granted as Remuneration	Options Exercised	Net Change Other (i)	Balance at 30 Jun 11	Total Vested 30 Jun 11	Total Exercisable 30 Jun 11	Total Unexercisable 30 Jun 11
Mr P Nair	3,000,000	-	-	(2,000,000)	1,000,000	1,000,000	1,000,000	-
Mr P Swaddle	3,000,000	-	-	(2,000,000)	1,000,000	1,000,000	1,000,000	-
Mr A. Mifflin	3,000,000	-	-	(2,000,000)	1,000,000	1,000,000	1,000,000	-
Mr J. Bidwell	-	-	-	-	-	-	-	-
Mr J. Hoskin	-	-	-	-	-	-	-	-
TOTAL	9,000,000	-	-	(6,000,000)	3,000,000	3,000,000	3,000,000	-

(i) These options were forfeited during the 2011 financial year.

2010 Executives	Balance at 01 Jul 09	Granted as Remuneration	Options Exercised	Net Change Other (i)	Balance at 30 Jun 10	Total Vested 30 Jun 10	Total Exercisable 30 Jun 10	Total Unexercisable 30 Jun 10
Mr R Mark	7,500,000	-	-	(7,500,000)	-	-	-	-
Mr J Wedgwood	3,000,000	-	-	(3,000.000)	-	-	-	-
Mr P Nair	3,000,000	-	-	-	3,000,000	1,000,000	1,000,000	2,000,000
Mr P Swaddle	3,000,000	-	-	-	3,000,000	1,000,000	1,000,000	2,000,000
Mr G. Scott	1,250,000	-	-	(1,250,000)	-	-	-	-
Mr A. Mifflin	-	3,000,000	-	-	3,000,000	-	-	3,000,000
TOTAL	17,750,000	3,000,000	-	(11,750,000)	9,000,000	2,000,000	2,000,000	7,000,000

(i) These options lapsed prior to vesting on cessation of employment.

Note 7 – Key Management Personnel compensation continued

(c) Share Holdings held directly and indirectly by Key Management Personnel:

2011 Directors	Balance at 01 Jul 10	Options Exercised	Net change Other	Balance at 30 Jun 11
Parent Entity Directors				
Mr K. Robinson	2,000,000	-	-	2,000,000
Mr A.M. Dash	-	-	-	-
Dr C.W. Mallett (retired 30 June 2011)	11,766,952	-	-	11,766,952
Mr M.D.J. Cozijn	3,628,340	-	(600,000)	3,028,340
Mr P. Hogan	200,000	-	50,000	250,000
Mr L. I. Rozman	-	-	-	-
Mr I.W. Walker (retired 31 December 2010)	8,576,603	-	(8,576,603) (i)	-
Dr H.M Garnett	-	-	27,101	27,101
TOTAL	26,171,895	-	(9,099,502)	17,072,393

2010 Directors	Balance at 01 Jul 09	Options Exercised	Net change Other	Balance at 30 Jun 10
Parent Entity Directors				
Mr K. Robinson	-	2,000,000	-	2,000,000
Mr A.M. Dash	-	-	-	-
Dr C.W. Mallett	9,437,322	-	2,329,630	11,766,952
Mr M.D.J. Cozijn	2,128,340	3,000,000	(1,500,000)	3,628,340
Mr P.N. Hogan	100,000	-	100,000	200,000
Mr L. I. Rozman (appointed 7 Apr 2010)	-	-	-	-
Mr I.W. Walker	6,326,603	6,000,000	(3,750,000)	8,576,603
Mr P.T. McIntyre (retired 12 Feb 2010)	50,000	1,000,000	(1,050,000)	-
TOTAL	18,042,265	12,000,000	(3,870,370)	26,171,895

(i) Ian Walker resigned as a Director during the 2011 financial year, accordingly his shareholding is shown as nil at 30 June 2011.

2011 Key Management Personnel	Balance at 01 Jul 10	Options Exercised	Net change Other	Balance at 30 Jun 11
Executives				
Mr A Mifflin	-	-	-	-
Mr P. Nair	-	-	-	-
Mr P. Swaddle	-	-	-	-
Mr J Bidwell	-	-	-	-
Mr J.Hoskin	-	-	-	-
TOTAL	-	-	-	-

2010 Key Management Personnel	Balance at 01 Jul 09	Options Exercised	Net change Other	Balance at 30 Jun 10
Executives				
Mr A Mifflin	-	-	-	-
Mr P. Nair	-	-	-	-
Mr P. Swaddle	-	-	-	-
Mr J Bidwell	-	-	-	-
Mr R. Mark	2,252,778	-	(2,252,778)	-
Mr J. Wedgwood	-	-	-	-
TOTAL	2,252,778	-	(2,252,778)	-

Note 8 – Cash and cash equivalents

	CONSOLIDATED GROUP	
	2011 $	2010 $
Cash on hand	750	750
Cash at bank	3,289,235	12,873,480
Short term deposits	6,500,000	6,000,000
TOTAL CASH AND CASH EQUIVALENTS	9,798,985	18,874,230

Note 9 – Trade and other receivables

	CONSOLIDATED GROUP	
	2011 $	2010 $
CURRENT		
Trade Receivables	-	9,073
Other Receivables *	520,813	119,076
TOTAL CURRENT TRADE & OTHER RECEIVABLES	520,813	128,149
NON CURRENT		
Deposits	221,569	233,403
Receivable from Crescent Gold Limited	1,175,000	1,175,000
TOTAL NON CURRENT TRADE & OTHER RECEIVABLES	1,396,569	1,408,403

* Balance at 30 June 2011 includes $296,640 relating to costs incurred by Carbon Energy on the Chile project that will be re-charged to Antofagasta Minerals (refer note 14)

Note 10 – Investment in associate

In the 2010 financial year Carbon Energy Limited disposed of its Uranium interests and acquired a 42% interest in Energia Minerals Limited. During the 2011 financial year Energia Minerals Limited completed a number of capital raisings resulting in a dilution of Carbon Energy's holding in Energia Mineral Limited. The resulting 26% interest in Energia Minerals Limited at 30 June 2011 has been accounted for as an associate on the basis that Carbon Energy Limited exerts significant influence over the entity.

The equity accounted loss for the year ended 30 June 2011 amounted to $1,279,518 resulting in a carrying value of the investment as at 30 June 2011 of $3,044,920.

	CONSOLIDATED GROUP	
	2011 $	2010 $
(a) Carrying amount of investment in associate:		
Balance at the beginning of the financial year	4,324,438	-
Investments made during the period	-	5,400,002
Share of associate's loss after income tax	(1,279,518)	(1,075,564)
BALANCE AT 30 JUNE 2011	3,044,920	4,324,438

Note 11 – Construction work-in-progress

	CONSOLIDATED GROUP	
	2011 $	2010 $
(a) Carrying amount of Construction Work-in-progress		
Balance at the beginning of the financial year	14,825,380	-
Additions during the year	9,380,891	14,825,380
Transfer to UCG Panel Assets (refer note 12)	(8,916,055)	-
Transfer to Property, Plant and Equipment assets (refer note 13)	(606,657)	-
Transfer to Water Monitoring assets (refer note 13)	(1,514,768)	-
Transfer to UCG intangible asset (refer note 15)	(798,790)	-
BALANCE AT 30 JUNE 2011	12,370,001	14,825,380

The 2011 Work in progress balance relates to the construction of the 5MW power plant, Panel 3 and design costs for the 20MW power station at Bloodwood Creek in Queensland. Commissioning of the 5MW power plant is expected towards the end of the 2011 calendar year.

Note 12 – UCG panel assets

	CONSOLIDATED GROUP	
	2011 $	2010 $
(a) Carrying amount of UCG Panel Assets:	-	-
Balance at the beginning of the financial year	-	-
Transfer from Construction Work-in-progress	8,916,055	-
Additions	1,700,000	-
BALANCE AT 30 JUNE 2011	10,616,055	-

The above costs relate to the construction of Panel 2 commissioned during the 2011 financial year. As additional Panels are constructed and commissioned they will be transferred into this asset category.

Note 13 – Property, plant and equipment

	CONSOLIDATED GROUP	
	2011 $	2010 $
Freehold Land	408,016	408,016
Motor Vehicles – cost	87,287	40,348
Less accumulated depreciation	(26,860)	(8,311)
	60,427	32,037
Site Infrastructure – cost	764,000	-
Less accumulated depreciation	-	-
	764,000	-
Plant and equipment – cost	1,307,760	574,938
Less accumulated depreciation	(298,763)	(174,337)
	1,008,997	400,601
Water Monitoring Assets – cost	2,714,768	-
Less accumulated depreciation	-	-
	2,714,768	-
Bloodwood Creek UCG Trial Construction – cost	3,800,410	9,831,382
Less accumulated depreciation	-	-
	3,800,410	9,831,382
TOTAL PROPERTY, PLANT & EQUIPMENT	8,756,618	10,672,036

Note 13 – Property, plant and equipment continued

(a) Movements in carrying amounts

Movement in the carrying amounts for each class of property, plant and equipment between the beginning and the end of the current financial year.

	Land $	Motor Vehicles $	Site Infrastructure $	Property, Plant & Equipment $	Water Monitoring Assets $	Laverton Project Property Plant & Equipment $	Bloodwood Creek Trial Plant $	Total $
Carrying amount at 1 July 2009	408,016	1,514	-	224,534	-	41,159	9,831,382	10,506,605
Additions	-	40,348	-	340,176	-	-	-	380,523
Disposals	-	(1,514)	-	(42,028)	-	(41,159)	-	(84,701)
Depreciation expense	-	(8,311)	-	(122,081)	-	-	-	(130,392)
Carrying amount at 30 June 2010	408,016	32,037	-	400,601	-	-	9,831,382	10,672,036
Carrying amount at 1 July 2010	408,016	32,037	-	400,601	-	-	9,831,382	10,672,036
Additions	-	46,939	-	126,165	-	-	397,000	570,104
Transfer from Mine Development costs (refer note 17)	-	-	550,000	-	1,200,000	-	-	1,750,000
Transfer from Construction in progress (refer note 11)	-	-	-	606,657	1,514,768	-	-	2,121,425
Transfer to Site Infrastructure assets	-	-	214,000	-	-	-	(214,000)	-
Transfers to Intangible asset (refer note 15)	-	-	-	-	-		(6,183,694)	(6,183,694)
Disposals	-	-	-	-	-	-	(30,278)	(30,278)
Depreciation expense	-	(18,549)	-	(124,426)	-	-	-	(142,975)
Carrying amount at 30 June 2011	408,016	60,427	764,000	1,008,997	2,714,768	-	3,800,410	8,756,618

Note 14 – Other non-current asset (Chile project)

	CONSOLIDATED GROUP	
	2011 $	2010 $
(a) Carrying amount of non-current asset (Chile project):		
Balance at the beginning of the financial year	-	-
Additions	1,100,473	-
BALANCE AT 30 JUNE 2011	1,100,473	-

Carbon Energy has executed an Agreement with Antofagasta Minerals S.A (AMSA) to jointly assess and develop a coal deposit in Mulpun, Chile using Carbon Energy's Underground Coal Gasification technology. Under the Agreement both entities have commenced work to finalise a work plan, schedule and budget for an initial trial at the Mulpun location. This represents phase one of the project, which has been structured in four phases, with Carbon Energy's contribution during phase one being management time and travel costs. Antofagasta will conduct drilling and hydrological testing at its cost during this phase.

Note 15 – Intangible assets

	Note	CONSOLIDATED GROUP 2011 $	2010 $
UCG intangible asset		21,700,526	-
Trademarks		18,000	-
Acquired on acquisition			
Licences and Intellectual property		2,499,999	2,499,999
Total Intangible Assets		24,218,525	2,499,999
(a) Reconciled as follows:			
Opening Balance		2,499,999	2,499,999
Additions arising from legal fees in relation to facilitation of Trademark applications lodged in Australia and international jurisdictions		18,000	-
Additions arising from recognition of UCG intangible asset (refer Notes 11, 13a & 17)		21,700,526	-
Cost carried forward in respect of areas of Interest in Exploration and Evaluation phases		24,218,525	2,499,999

UCG intangible asset

UCG 'know how' intangible asset recognised by the Company has an indefinite life. A new intangible asset amounting to $21,700,526 has been recognised in the 2011 financial year and relates to transfers from Mine Development costs and Property, Plant and Equipment from the Bloodwood Creek trial. This balance also includes design and engineering costs in relation to the modification of carburettors and other associated work to enable the engines to run on syngas.

Trademarks and licences

Trademarks and licences have a finite useful life and are carried at cost less accumulated amortisation and impairment losses.

COSFLOW licence and Intellectual Property

The licence relates to the use of COSFLOW, a modelling system which predicts the geotechnical hydrological effects and impacts on subsidence gas, and water flows of large scale coal removal. Intellectual property relates to modelling tools developed for site selection characterisation and gasifier design and gas production prediction specific to the application of UCG. In addition the intangible assets include research support agreements from CSIRO which the Consolidated Group can draw upon and have rights to geological data base in the Surat Basin. This intangible asset has an indefinite life and is not amortised.

Note 16 – Deferred exploration and evaluation costs

		CONSOLIDATED GROUP	
	Note	2011 $	2010 $
Exploration Expenditure			
Exploration expenditure – cost		107,964,187	89,714,658
Total capitalised exploration and evaluation expenditure		107,964,187	89,714,658
(a) Reconciled as follows:			
Opening Balance		89,714,658	101,451,222
Additions arising from Clean Coal transaction (refer note 18)		18,249,529	-
Transfer to mine development costs		-	(10,846,579)
Expenditure capitalised during year		-	163,269
Disposals	4 (b)	-	(1,053,254)
Cost carried forward in respect of areas of Interest in Exploration and Evaluation phases		107,964,187	89,714,658

Note 17 – Mine development costs

	CONSOLIDATED GROUP	
	2011 $	2010 $
Opening balance	16,468,042	3,621,463
Additions	-	2,000,000
Transfer from deferred exploration and evaluation costs	-	10,846,579
Transfers to Water Monitoring assets (refer note 13a)	(1,200,000)	-
Transfers to Site Infrastructure assets (refer note 13a)	(550,000)	-
Less transfers to Intangible asset (refer note 15a)	(14,718,042)	-
Total Mine Development Costs	-	16,468,042

Note 18 – Acquisition of Clean Coal exploration assets

On 6th April 2011, Carbon Energy acquired exploration assets and options to lease located in Wyoming and Montana (USA) and joint venture rights in Amasra (Turkey) for a total consideration of $US 19,000,000 (including deferred consideration of US $9,000,000). As part of this transaction Carbon Energy Limited acquired 100% of USA-based Clean Coal Inc. and UK-based Clean Coal Amasra Limited and accordingly Carbon Energy Limited issued 27,645,208 shares on 7 April 2011 (US $10,000,000 of shares based on 60 day VWAP preceding the date of execution of the agreement of 23 February 2011).

Two further tranches of deferred consideration US $4,500,000 of shares each (based on 30 day VWAP at time of milestone achievement) may be issued subject to meeting key development milestones including the delineation of JORC compliant coal resources in excess of 500Mt at two of the three project locations ie. Wyoming, Montana and Turkey.

The transaction has resulted in an increase in exploration costs of $18,249,529 at 30 June 2011. In accordance with the Share Sale Agreement, Tranches 1, 2 and 3 comprising 27,645,208 shares were issued on 7 April 2011 and have increased share capital in Carbon Energy Limited by $9,979,920. Under the Share Sale Agreement the remaining shares to be issued have been recognised in the share-based payments reserve amounting to $7,826,052.

Note 19 – Trade and other payables

	CONSOLIDATED GROUP	
	2011 $	2010 $
Trade payables	33,800	1,674,576
Sundry creditors and accrued expenses	1,403,900	2,450,622
TOTAL TRADE AND OTHER PAYABLES	1,437,700	4,125,198

Note 20 – Provisions

	CONSOLIDATED GROUP	
	2011 $	2010 $
CURRENT		
PROVISION FOR ANNUAL LEAVE		
Opening balance	191,919	93,808
Increase in provisions	225,010	249,391
Benefits paid	(179,597)	(151,280)
CLOSING BALANCE	237,332	191,919
NON CURRENT		
PROVISION FOR LONG SERVICE LEAVE		
Opening balance	40,350	-
Increase in provisions	37,926	40,350
Benefits paid	-	-
CLOSING BALANCE	78,276	40,350
TOTAL EMPLOYEE BENEFITS	315,608	232,269

A provision has been recognised for employee entitlements relating to annual leave and long service leave entitlements accrued at the balance date. The measurement and recognition criterion relating to employee benefits has been included in Note 1 (n) to this report.

PROVISION FOR REHABILITATION (NON CURRENT)		
Opening balance	-	-
Increase in provisions *	2,097,000	-
CLOSING BALANCE	2,097,000	-
TOTAL NON CURRENT PROVISIONS	2,175,276	40,350

* This balance represents the present value of the estimated rehabilitation costs for the Bloodwood Creek site and includes both panel rehabilitation work and removal of aboveground infrastructure. The measurement and recognition criterion relating to rehabilitation costs has been included in Note 1 (o) to this report.

Note 21 – Issued capital

	CONSOLIDATED GROUP	
	2011 $	2010 $
698,517,858 (2010: 609,497,650) Fully paid ordinary shares	218,256,942	188,759,462

	2011 No.	2010 No.
Ordinary Shares at the beginning of the reporting period	609,497,650	547,296,637
Shares issued during the year:		
• 23 July 2009 placement @ 43c per share	-	24,418,605
• 23 July 2009 exercise of 2nd Tranche Options on CEPL Acquisition 79c per share	-	7,407,408
• 17 August 2009 exercise of Directors options @ 15c per share	-	1,000,000
• 16 September 2009 exercise of employee options @ 60c per share	-	1,000,000
• 2 October 2009 exercise of employee options @ 15c per share	-	250,000
• 10 November 2009 exercise of employee options @ 20c per share	-	500,000
• 15 December 2009 exercise of Directors options @ 15c per share	-	1,000,000
• 17 December 2009 exercise of Directors options @15c per share	-	3,125,000
• 16 March 2010 exercise of Directors options @ 20c per share	-	4,000,000
• 22 March 2010 exercise of Directors options @ 20c per share	-	2,500,000
• 31 March 2010 exercise of Directors options @ 20c per share	-	2,000,000
• 28 May 2010 issue of shares to Constellation Energy Pty Ltd @ 20c per share	-	15,000,000
• 19 October 2010 exercise of employee options @ 20 cents per share	250,000	-
• 16 December 2010 placement @ 33 cents per share	30,696,970	-
• 30 December 2010 exercise of employee options @ 20 cents per share	125,000	-
• Jan 2011 placement @ 0.33 per share	30,303,030	-
• 7 April 2011 issued 27,645,208 @ 0.361 per share to Summa Resource Holdings LLC	27,645,208	-
At reporting date	698,517,858	609,497,650

The Company has no maximum authorised share capital. Ordinary shares are of no par value.

	No. Shares	$
BALANCE AT 1 JULY 2009	547,296,637	166,450,930
30 June 2009 Deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd – future issues	7,407,408	5,814,815
Ordinary shares on issue including deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd	554,704,045	172,265,745
Balance at 1 July 2009 (excluding deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd	547,296,637	166,450,930
Share Placements	24,418,605	10,500,000
Issue of shares on exercise of 2nd Tranche Options on CEPL Acquisition	7,407,408	5,814,815
Issue of shares under employee share option plan	1,750,000	737,500
Issue of shares under Directors share option plan	13,625,000	2,468,750
Issue of shares to Constellation Energy	15,000,000	3,000,000
Release from Option Reserve	-	312,467
Share Issue costs	-	(525,000)
BALANCE AT 30 JUNE 2010	609,497,650	188,759,462
BALANCE AT 1 JULY 2010	609,497,650	188,759,462
19 October 2010 exercise of employee options @ 20 cents per share	250,000	50,000
16 December 2010 placement @ 33 cents per share	30,696,970	10,130,000
30 December 2010 exercise of employee options @ 20 cents per share	125,000	25,000
Jan 2011 placement @ 0.33 per share	30,303,030	10,000,000
7 April 2011 issued 27,645,208 @ 0.361 per share to Summa Resource Holdings LLC (refer note 18)	27,645,208	9,979,920
Release from Option Reserve	-	5,285
Share Issue costs	-	(692,725)
BALANCE AT 30 JUNE 2011	698,517,858	218,256,942

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

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

Capital risk management

When managing capital, management's objective is to ensure the entity continues as a going concern as well as to maintain optimal returns to shareholders and benefits for other stakeholders. Management also aims to maintain a capital structure that ensures the lowest cost of capital available to the entity.

In order to maintain or adjust the capital structure, the entity may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, enter into joint ventures or sell assets.

The entity does not have a defined share buy-back plan.

No dividends were paid in 2011 (2010: Nil) and no dividends are expected to be paid in 2012.

Stock exchange listing

Quotation has been granted for 698,517,858 of the Company's ordinary shares on all Member exchanges of the Australian Stock Exchange Limited ("ASX").

Quotation of the Company's ordinary shares on the Berlin Stock Exchange commenced in July 1997.

Note 21 – Issued capital continued

Options

As at the year end the Company has on issue 39,955,000 unlisted options of which 27,080,000 have vested and are exercisable. Exercise prices for unlisted options range from $0.25 to $1.60.

For information relating to share options issued to Key Management Personnel during the financial year refer to Note 34, Share based payments.

Note 22 – Reserves

Option reserve

The Option reserve records items recognised as expenses on valuation of employee share options together with shares to be issued arising from the Clean Coal transaction as disclosed in note 18.

	CONSOLIDATED GROUP	
	2011 $	2010 $
Balance at beginning of the year	6,427,014	4,664,569
Movement in share option reserve on recognition of share based payments	(98,421)	2,074,912
Exercise of options	(5,285)	(312,467)
Shares to be issued arising from Clean Coal transaction (refer note 18)	7,826,052	-
BALANCE AT END OF THE YEAR	14,149,360	6,427,014

Note 23 – Accumulated losses

	CONSOLIDATED GROUP	
	2011 $	2010 $
Balance at beginning of the year	(40,628,608)	(29,808,121)
Loss attributable to the Group	(15,840,856)	(10,820,487)
BALANCE AT END OF THE YEAR	(56,469,464)	(40,628,608)

Note 24 – Interests in joint ventures

Since the disposal of Laverton gold assets during the 2010 financial year, the Consolidated Group no longer participates in any joint venture arrangements. The Consolidated Group settled all previous Joint Venture arrangements during the previous financial year as disclosed in the 2010 annual report.

Note 25 – Statement of operations by segment

The Consolidated Group operates in one segment, being to produce clean energy and chemicals feedstock from Underground Coal Gasification (UCG) Syngas and reports to the chief operating decision-maker on this basis. As such one reportable segment has been identified and this basis is consistent with the current reporting structure.

Note 26 – Parent entity disclosures

	PARENT ENTITY	
	2011 $	2010 $
Financial Position		
Assets		
Current assets	9,959,155	18,291,152
Non-current assets	200,858,791	156,457,131
TOTAL ASSETS	210,817,946	174,748,283
Liabilities		
Current liabilities	39,048	16,639
Non-current liabilities	-	-
TOTAL LIABILITIES	39,048	16,639
Equity		
Issued capital	218,256,942	188,759,462
Accumulated losses	(21,627,404)	(20,438,193)
Reserves		
Share based payments reserve	14,149,360	6,427,014
TOTAL EQUITY	210,778,898	174,748,283

Financial performance	2011 $	2010 $
Profit/(loss) for the year	(1,189,211)	2,839,029
Other comprehensive	-	-
TOTAL COMPREHENSIVE INCOME	(1,189,211)	2,839,029

Carbon Energy Limited had nil contingent liabilities at 30 June 2011 (2010: nil).

(a) Operating lease commitment

	PARENT ENTITY	
	2011 $	2010 $
Non-cancellable operating leases contracted for but not capitalised in the financial statements		
• not later than one year	267,121	256,847
• later than one year but not later than five years	231,504	498,625
TOTAL OPERATING LEASE COMMITMENTS	498,625	755,472

These relate to property leases as follows:

Brisbane office lease commenced 1 November 2008 and expires 25 April 2013 with 5 year option. Rent increases are set at a 4% increase per annum.

Note 27 – Financial risk management

The Consolidated Group's principal financial instruments comprise cash and short-term deposits. The main purpose of these financial instruments is to finance the Consolidated Group's operations. The Consolidated Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. Cash flow interest rate risk is the main risk arising from the Consolidated Group's financial instruments. Other minor risks are either summarised below or disclosed at Note 21 in the case of capital risk management. The Managing Director and Executive Team review and agree policies for managing each of these risks.

(a) Cash flow interest rate risk

The Consolidated Group's exposure to the risks of changes in market interest rates relates primarily to the Consolidated Group's cash deposits with a floating interest rate and its short term deposits and bonds with fixed interest rates (these are predominantly 30 day revolving term deposits). These financial assets expose the Consolidated Group to cash flow interest rate risk. All other financial assets and liabilities in the form of receivables and payables are non-interest bearing. The Consolidated Group does not engage in any hedging or derivative transactions to manage interest rate risk. The following tables set out the carrying amount by maturity of the parent entity and Consolidated Group's exposure to interest rate risk and the effective weighted average interest rate for each class of these financial instruments. Also included is the effect on profit and equity after tax if interest rates at that date had been 10% higher or lower with all other variables held constant as a sensitivity analysis. The Consolidated Group has not entered into any hedging activities to cover interest rate risk. In regard to its interest rate risk, the Consolidated Group continuously analyses its exposure. Within this analysis consideration is given to potential renewals of existing positions, alternative investments and the mix of fixed and variable interest rates.

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	Weighted Ave		Floating Interest		Fixed Interest Rate		Non-interest		Total	
	2011 %	2010 %	2011 $	2010 $	2011 $	2010 $	2011 $	2010 $	2011 $	2010 $
FINANCIAL ASSETS										
Cash	5.41	4.77	3,298,232	12,873,480	6,500,000	6,000,000	753	750	9,798,985	18,874,230
Receivables	5.86	5.00	-	-	186,569	203,403	1,730,813	1,333,149	1,917,382	1,536,552
TOTAL FINANCIAL ASSETS			3,298,232	12,873,480	6,686,569	6,203,403	1,731,566	1,333,899	11,716,367	20,410,782
FINANCIAL LIABILITIES										
Payables			-	-	-	-	(1,437,700)	(4,125,198)	(1,437,700)	(4,125,198)
TOTAL FINANCIAL LIABILITIES			-	-	-	-	(1,437,700)	(4,125,198)	(1,437,700)	(4,125,198)
NET FINANCIAL ASSETS (LIABILITIES)			3,298,232	12,873,480	6,686,569	6,203,403	293,866	(2,791,299)	10,278,667	16,285,584

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	Interest Rate Risk Sensitivity 2011		Interest Rate Risk Sensitivity 2010	
	+10% Profit $	-10% Profit $	+10% Profit $	-10% Profit $
FINANCIAL ASSETS				
Cash	53,053	(53,053)	90,026	(90,026)
Receivables	1,093	(1,093)	1,017	(1,017)
TOTAL FINANCIAL ASSETS	54,146	(54,146)	91,043	(91,043)
FINANCIAL LIABILITIES				
Payables	-	-	-	-
TOTAL FINANCIAL LIABILITIES	-	-	-	-
NET FINANCIAL ASSETS (LIABILITIES)	54,146	(54,146)	91,043	(91,043)

A sensitivity of 10% has been selected as this is considered reasonable given the current level of both short term and long term Australian dollar interest rates. A 10% sensitivity would increase/(decrease) short term interest rates at 30 June 2011 by approximately 50 basis points. This would represent approximately two RBA interest rate increases/(decreases) which is reasonably possible in the current environment particularly due to the volatile markets activities.

Based on the sensitivity analysis only interest revenue from cash deposits, short term, term deposits and bank and cash balances are impacted resulting in a decrease or increase in overall income.

(b) Price risk

The Consolidated Group has not been exposed to equity securities price risk since the sale of Magma Metals Ltd shares during the 2009 financial year.

(c) Credit risk

The Consolidated Group is exposed to credit risk primarily from financial institutions. Receivables primarily include interest and amounts on deposit.

The maximum exposure to credit risk at balance date to recognised financial assets, is the carrying amount, net of any provisions for impairment of those assets, as disclosed in the Statement of Financial Position and notes to the financial statements.

The credit risk for counterparties in trade and other receivables at 30 June 2011 are not credit rated by the Company. Their maturities are detailed below:

	CONSOLIDATED GROUP	
	2011 $	2010 $
Contracted maturities of receivable year ended 30 June 2011		
RECEIVABLE		
• Less than 6 months	-	128,149
• 6 to 12 months	-	-
• 1 to 5 years	186,569	233,403
• Later than 5 years	-	-
TOTAL	186,569	361,552

(d) Liquidity risk

The Consolidated Group manages liquidity risk by maintaining sufficient cash reserves and marketable securities, and through the continuous monitoring of budgeted and actual cash flows.

	CONSOLIDATED GROUP	
	2011 $	2010 $
Contracted maturities of payables year ended 30 June 2011		
PAYABLE		
• Less than 6 months	1,437,700	4,125,198
• 6 to 12 months	-	-
• 1 to 5 years	-	-
• Later than 5 years	-	-
TOTAL	1,437,700	4,125,198

Note 27 – Financial risk management continued

(e) Commodity price risk

The Consolidated Group is exposed to commodity price risk. This risk arises from its activities directed at exploration and development of mineral commodities. If commodity prices fall, the market for companies exploring for these commodities is affected. The Consolidated Group does not hedge its exposures.

(f) Foreign exchange risk

Foreign exchange risk arises when future commercial transactions and recognised assets and liabilities are denominated in a currency that is not the entity's functional currency. To date the Consolidated Group's foreign transactions have not been material however this will be monitored going forward to ensure foreign currency risk is managed effectively.

(g) Net fair values

For financial assets and liabilities, the net fair value approximates their carrying value. No financial assets and financial liabilities are readily traded on organised markets in standardised form, other than listed investments. The Company's investment in Energia Minerals Limited will rise and fall depending on market volatility. At 30 June 2011 there were no changes noted in the underlying operations of Energia Minerals Limited and no price sensitive announcements made during the year that would suggest an impairment in the carrying value of the investment.

The Consolidated Group's payables at balance date are detailed in note 19 and comprise trade payables, sundry creditors and accrued expenses.

The Consolidated Group's receivables at balance date are detailed in Note 9 and comprise Bonds and GST input tax credits refundable by the ATO. The balance also includes consideration due from Crescent Gold and rechargeable costs incurred on the Chile project that will be on-charged to Antofagasta Minerals.

Note 28 – Contingent liabilities and commitments

(a) Exploration commitments

Ongoing annual exploration expenditure is required to maintain title to the Consolidated Group's mineral exploration tenements and to earn an interest in various joint venture mining prospects. No provision has been made in the financial statements for these amounts as the amounts are expected to be fulfilled in the normal course of the operations of the Consolidated Group. The Consolidated Group has certain statutory obligations to perform minimum exploration work on its tenements.

	CONSOLIDATED GROUP	
	2011 $	2010 $
These obligations which are not provided for in the financial statements and are payable:		
• not later than one year	230,000	230,000
• 2 to 5 years	1,775,000	1,775,000
TOTAL EXPLORATION COMMITMENTS	2,005,000	2,005,000

The above summary of statutory exploration commitments has currently been deferred and waiting on the 2012 decision from the Department of Employment & Economic Development. The Statutory expenditure requirement may be renegotiated with the relevant state department of Minerals and Energy, and expenditure commitments may be varied between tenements, or reduced subject to reduction of exploration area and/or relinquishment of non-prospective tenements.

(b) Operating lease commitment

	CONSOLIDATED GROUP	
	2011 $	2010 $
Non-cancellable operating leases contracted for but not capitalised in the financial statements		
• not later than one year	267,121	256,847
• later than one year but not later than five years	231,504	498,625
TOTAL OPERATING LEASE COMMITMENTS	498,625	755,472

These relate to property leases as follows:

Brisbane office lease commenced 1 November 2008 and expires 25 April 2013 with 5 year option. Rent increases are set at a 4% increase per annum.

(c) Claims of native title and cultural heritage

Mineral exploration

The Company is aware of native title claims made in accordance with the Native Title Act 1993 (NTA) that was enacted to accommodate the decision of the High Court in Mabo v Queensland (No2) (1992) 175 CLR 1, which recognised the rights and interests of the Aboriginal and Torres Strait Islanders as a form of common law native title.

The main objectives of the NTA are to:

1. provide for the recognition and protection of native title;
2. establish ways in which future dealings affecting native title may proceed and to set standards for those dealings; and
3. establish a mechanism for determining claims to native title; and provide for, or permit, the validation of past acts invalidated because of the existence of native title.

Coal exploration and UCG

A Cultural Heritage Management Plan (CHMP) has been developed in partnership with the Aboriginal traditional owners of the lands the subject of the UCG demonstration trial. The CHMP is registered under the provisions of the Aboriginal Cultural Heritage Act and ensures that there is minimal impact or damage caused to Aboriginal cultural heritage items, materials or values during the exploration and UCG activities on mining and petroleum tenements owned by Carbon Energy.

(d) Bank guarantees

	CONSOLIDATED GROUP	
	2011 $	2010 $
Standby arrangements with banks to provide funds and support facilities for bank guarantees relating to rehabilitation bonds.		
These facilities are secured by fixed term cash deposits of (2010: $32,500)		
Credit Facility - Deposit (Note 9)	32,500	32,500
Amount Utilised	(32,500)	(32,500)
Unused Credit Facility	-	-
Interest rates on these credit facilities are variable		
and subject to adjustment.		
Bank Guarantee in relation to Environmental bonds	21,783	21,783
Bank Guarantee in relation to the entity's share		
of guarantee for Lease of office premises	132,286	132,286
Bank Guarantee in relation to Ergon contract	470,800	-

Note 29 – Cashflow information

	CONSOLIDATED GROUP	
	2011 $	2010 $
(a) Reconciliation of cash flow from operations with loss after income tax		
Loss after income tax	(15,840,856)	(10,820,487)
Non-cash flows in loss		
Depreciation	142,975	130,392
Fair value adjustment on acquisition Energia investment	-	(3,946,747)
Share Options expensed	(98,421)	2,074,912
Equity accounted loss in associate	1,279,518	1,075,564
Loss/(Gain) on disposal of Plant & Equipment	-	42,563
Realised gain on sale on investments	-	(1,956,250)
Changes in assets and liabilities		
(Increase)/Decrease in receivables	(380,829)	(1,257,533)
(Increase)/Decrease in property plant and equipment	-	(380,523)
(Increase)/Decrease in exploration costs	-	1,053,254
(Increase)/Decrease in financial assets	-	(1,053,254)
Increase/(Decrease) in trade creditors and accruals	(2,664,418)	2,432,085
Increase/(Decrease) in provisions	83,339	138,461
Cash flow (used in) operations	(17,478,692)	(12,467,563)

Non-cash transactions

During the current year, Carbon Energy acquired exploration assets and options to coal leases located in Wyoming and Montana (USA) and joint venture rights in Amasra (Turkey) for a total consideration of $US 19 million (including deferred consideration of US $9 million). Consideration of 27,645,208 Carbon Energy shares has been issued (US$10 million of shares based on 60 day VWAP preceding the date of execution of the agreement of 23 February 2011). Two further tranches of US$4.5 million of shares each (based on 30 day VWAP at time of milestone achievement) will be issued subject to meeting key development milestones including the delineation of JORC compliant coal resources in excess of 500Mt at two of the three locations (refer note 18).

Note 30 – Related party transactions

	CONSOLIDATED GROUP	
	2011 $	2010 $
Transactions between related parties are on usual commercial terms and conditions no more favourable than those available to other parties unless otherwise stated.		
(a) Directors' Share Transactions:		
Directors and Director related entities hold directly, indirectly or beneficially as at the reporting date the following equity interests in the Company.		
Ordinary Shares	5,305,441	26,171,895
25 cent vested unlisted options expiring 10/12/13	5,000,000	5,000,000
35 cent vested unlisted options expiring 10/12/13	1,400,000	7,000,000
10 cent vested unlisted options expiring 10/12/13	8,000,000,	-
80 cent vested unlisted options expiring 10/12/13	1,750,000	1,750,000
$1.20 vested unlisted options expiring 10/12/13	875,000	1,750,000
$1.60 vested unlisted options expiring 10/12/13	1,750,000	-

Directors and their related entities did not change their share holdings of (2010: net increase of 8,129,630) ordinary shares through the exercise of employee share options, market transfers during the course of the year.

	2011 $	2010 $
(b) Director – Related Entities:		
Other service fees charged to Carbon Energy Limited of which Mr I.W. Walker is a Director amounted to:	39,820	51,120

Parent entity with significant influence over associated entity where Mr M.D.J. Cozijn is a Director:

Carbon Energy Ltd was the ultimate parent entity of the Energia Minerals Limited ("Energia Group") until 18 December 2009. Post this date Carbon Energy Ltd ("Carbon Energy") remains an entity with significant influence over the Energia Group. As at 30 June 2011 Carbon Energy Ltd owns 26.48% of the Energia Group.

Transactions with related parties

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

Note 31 – Events subsequent to balance date

No matters of circumstance have arisen since the end of the financial year, which significantly affected or may significantly affect the operations of the Consolidated Group, the results of those operations and the state of affairs of the Consolidated Group in subsequent financial years, other than:

On 1st July 2011, Dr Christopher Rawlings joined the Board as a Non-Executive Director (and Chairman) of Carbon Energy Limited.

On 12th July 2011 Department of Environment and Resource Management advised the Company of charges in relation to spillage of process water in 2009. Proceedings have been adjourned to 20 September 2011.

The Federal Government introduced the Clean Energy Bill in July 2011 which proposes a fixed carbon price of $23/tonne from 1 July 2012, moving to a market price three years later. The proposal is intended to replace older technologies with higher emissions to newer and cleaner technologies. As a result Carbon Energy's lower emission use of coal in its UCG process is likely to be a beneficiary of carbon pricing should the legislation be passed through Federal Parliament. To date no assessment of its impact has been made.

Note 32 – Controlled entities

(a) Controlled entities

	COUNTRY OF INCORPORATION	PRINCIPAL ACTIVITY	PERCENTAGE OWNED	
			2011 %	2010 %
Parent Entity:				
Carbon Energy Ltd (CEL)	Australia	Parent entity of Carbon Energy group	-	-
Carbon Energy (Holdings) Pty Ltd (CEH)	Australia	Holding company for Carbon Energy Operations	100	100
Carbon Energy (Operations) Pty Ltd (CEOPL)	Australia	Facilitate the construction and commissioning of the Underground Coal Gasification project in Queensland.	100	100
Coronation Drive (Energy) Pty Ltd	Australia	Holding company for the investment in Clean Coal Inc.	100	-
Carbon Energy (Galilee) Pty Ltd	Australia	Holding company for the investment in Clean Coal Amasra Limited	100	-
Carbon Energy USA Inc (previously Clean Coal Inc)*	USA	Company has the right to explore and lease coal tenements in Wyoming, USA and Montana / North Dakota, USA.	100	-
Clean Coal Amasra Limited *	UK	To establish a 50/50 joint venture with Hema Endustri to develop UCG projects in Hema's coal tenements in Amasra.	100	-
Carbon Energy Chile Limitada	Chile	To jointly assess and develop an Underground Coal Gasification project at Mulpun, Chile	100	-

The subsidiaries noted above are all controlled entities and are in the early stage of establishment and are dependent on the parent entity for financial support. At year end, total loans to these subsidiaries amount to $85,839,886 (2010: $58,498,711).

* Carbon Energy USA Inc (previously Clean Coal Inc) and Clean Coal Amasra Limited were acquired on 6 April 2011 as part of the acquisition of Clean Coal exploration assets (refer note 18)

Note 33 - Remuneration of auditors

	CONSOLIDATED GROUP	
	2011 $	2010 $
Auditor of the parent entity:		
• auditing or reviewing the financial report	143,900*	52,500
• other non audit services – advisory services	59,536	189,298
	203,436	241,798
Other auditors		
• auditing or reviewing the financial report	-	-
• corporate advisory services	-	-
	-	-

* Balance includes $43,000 of outside scope audit fees relating to the 30 June 2010 audit period.

Note 34 – Share-based payments

The acquisition of Clean Coal exploration assets (refer note 18) was the only share-based payment arrangement undertaken by the Company during the 2011 financial year.

No. of Shares	Issue Date	Deemed Value
27,645,208	7/04/2011	$0.361

The following share-based payment arrangements were issued during the 2010 financial year.

No. of Options	Grant Date	Exercise Price	Vesting Date	Expiry Date
1,000,000	22/03/2010	$0.80	30/06/2011	22/03/2015
1,000,000	22/03/2010	$1.20	30/06/2012	22/03/2015
1,000,000	22/03/2010	$1.60	30/06/2013	22/03/2015

All Options granted to Key Management Personnel and employees are ordinary shares in Carbon Energy Limited, which confer a right of one ordinary share for every Option held.

None of the Options hold voting or dividend rights. If the Option holder ceases to be in the employment of the Company prior to vesting, the Options will lapse.

No. of Shares	Issue Date	Deemed Value
15,000,000	26/05/2010	$0.20

The Company issued 15,000,000 fully paid shares (Securities) to Constellation Energy Pty Ltd in consideration for the supply of drilling services of $3,000,000 by Constellation for the Bloodwood Creek Trial. The shares issued were in satisfaction of an obligation in an Heads of Agreement announced on 5 May 2008.

The total Options exercisable at 30 June 2011 is 27,080,000 and is comprised of:

No. of Options	Grant Date	Exercise Price	Vesting Date	Expiry Date
500,000	14/11/2007	$0.30	30/06/2008	30/06/2011 *
1,000,000	15/05/2008	$0.60	3/07/2008	30/06/2011 *
2,500,000	16/09/2008	$0.80	30/06/2009	10/12/2013
1,000,000	16/09/2008	$0.80	30/06/2011	10/12/2013
1,000,000	17/10/2008	$0.80	31/10/2009	10/12/2013
1,000,000	17/10/2008	$0.80	31/10/2009	10/12/2013
1,400,000	13/11/2008	$0.35	30/06/2010	10/12/2013
875,000	13/11/2008	$1.20	30/06/2010	10/12/2013
8,000,000	13/11/2008	$0.70	30/06/2011	10/12/2013
1,750,000	13/11/2008	$0.80	30/06/2011	10/12/2013
1,750,000	13/11/2008	$1.60	30/06/2011	10/12/2013
5,000,000	10/12/2008	$0.25	30/06/2009	10/12/2013
205,000	31/03/2009	$0.40	30/06/2010	1/04/2012
100,000	31/03/2009	$0.25	30/06/2010	1/04/2012
1,000,000	21/03/2010	$0.80	30/06/2011	22/03/2015

* Options expired post year end

Note 34 – Share-based payments continued

	CONSOLIDATED GROUP			
	2011		2010	
Summary of Option Movements	No. of Options	Weighted Average Exercise Price	No. of Options	Weighted Average Exercise Price
Outstanding at the beginning of the year	49,930,000	$0.80	69,451,000	$0.71
Granted - 22 March 2010	-		3,000,000	$1.20
Exercised	(375,000)		(15,375,000)	$0.21
Forfeited	(9,600,000)		(7,146,000)	$1.38
Outstanding at year end	39,955,000		49,930,000	$0.80
Exercisable at year end	27,080,000		21,430,000	$0.49

There were 375,000 (2010: 15,375,000) options exercised during the year. These Options had a weighted average share price of $0.20 (2010: $0.208) at exercise date.

The Options outstanding at 30 June 2011 had a weighted average exercise price of $0.64 and a weighted average remaining contractual life of 2.08 years. Exercise prices range from $0.25 to $1.60 in respect of options outstanding at 30 June 2011.

The weighted average fair value of the options granted during the 2010 financial year was $1.20.

This price was calculated using a Black Scholes option pricing model applying the following inputs:

Weighted average exercise price	$1.20
Weighted average life of option	4.73 years
Underlying share price	$0.58
Expected share price volatility	70%
Risk free interest rate	5.25%

Historical volatility has been the basis for determining expected share price volatility as it is assumed that this is indicative of future trend, which may not eventuate. Included under Share-based payment expense in the Statement of Comprehensive Income is a negative expense of $98,421, (2010: expense of $2,074,912) and relates, in full, to equity-settle share - based payment transactions. The negative expense of $98,421 for the 2011 financial year relates to the forfeiture of a number of options during the year.

Note 35 - Company details

The Registered & Principal Office of the Company is:

Carbon Energy Limited
Level 12, 301 Coronation Drive
Milton, QLD 4064

FINANCIAL **REPORT**
DIRECTORS' DECLARATION

The Directors of the Company declare that:

1. The financial statements and notes, as set out on pages 45 to 84, are in accordance with the Corporations Act 2001 and:

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

   (b) the attached financial statements are in compliance with International Financial Reporting Standards, as stated in note 1 to the financial statements

   (c) in the Directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the Consolidated Group

   (d) the Directors have been given the declarations required by s.295A of the Corporations Act 2001.

2. The Managing Director and Finance Director have each declared that:

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

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

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

This declaration is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the Directors by:

C. Rawlings
Chairman

A.M. Dash
Managing Director

Brisbane, Queensland
15 September 2011

Deloitte.

Deloitte Touche Tohmatsu
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Independent Auditor's Report to the Members of Carbon Energy Limited

Report on the Financial Report

We have audited the accompanying financial report of Carbon Energy Limited, which comprises the statement of financial position as at 30 June 2011, the statement of comprehensive income, the statement of cash flows and the statement of changes in equity for the year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, 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 set out on pages 45 to 85.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

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. Those 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.

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

Auditor's Independence Declaration

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*, which has been given to the directors of Carbon Energy Limited, would be in the same terms if given to the directors as at the time of this auditor's report.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

Deloitte.

Opinion

In our opinion:

(a) the financial report of Carbon Energy Limited is in accordance with the *Corporations Act 2001*, including:
  (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2011 and of its performance for the year ended on that date; and
  (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
(b) the financial statements also comply with International Financial Reporting Standards as disclosed in Note 1.

Material Uncertainty Regarding Continuation as a Going Concern

Without qualifying our opinion, we draw attention to Note 1(a) in the financial report which indicates that, for the year ended 30 June 2011 the Consolidated Entity incurred a loss of $15,840,856, recorded a net cash outflow from operating and investing activities of $28,587,520 and the Company incurred a loss of $1,189,211. Further the Company and the Consolidated Entity are reliant on future capital raisings in order to be able to fund and continue the development of the Company's and the Consolidated Entity's operations. These conditions, as set out in Note 1(a), indicate the existence of material uncertainty that may cast significant doubt about the Company's and Consolidated Entity's ability to continue as going concerns and therefore, the Company and Consolidated Entity may be unable to realise their assets and discharge their liabilities in the normal course of business.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 30 to 35 of the directors' report for the year ended 30 June 211. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Opinion

In our opinion the Remuneration Report of Carbon Energy Limited for the year ended 30 June 2011, complies with section 300A of the *Corporations Act 2001*.

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

M. Sheerin

M G Sheerin
Partner
Chartered Accountants
Brisbane, 15 September 2011

TENEMENT **SCHEDULE**

As at 30 June 2011

Tenement Number	Grant Date	Expiry Date	Holder	% of interest held	Sub-blocks as at June 2011
EPC 867	18/02/2005	17/02/2015	Carbon Energy (Operations Pty Ltd)	100%	191
EPC 868	18/02/2005	17/02/2015	Carbon Energy (Operations Pty Ltd)	100%	177
EPC 869	14/10/2004	13/10/2014	Carbon Energy (Operations Pty Ltd)	100%	64
EPC 1109	14/02/2007	13/02/2012	Carbon Energy (Operations Pty Ltd)	100%	65
EPC 1132	21/06/2007	20/06/2012	Carbon Energy (Operations Pty Ltd)	100%	23
EPC 1741 Kogan West	Application	-	Carbon Energy (Operations Pty Ltd)	100%	35
MLA50253	Application	-	Carbon Energy (Operations Pty Ltd)	100%	1342 ha
MDL374	01/02/08	31/01/2013	Carbon Energy (Operations Pty Ltd)	100%	2687 ha

In accordance with Society of Petroleum Engineers (SPE) guidelines, the reserves in there properties are:

Area	Category	Gross Gas Volumes (PJ)
Bloodwood Creek EPC 867 (including MDL 374)	1P Reserve (Proven)	11
	2P Reserve (Proven + Probable)	743
	3P Reserve (Proven + Probable + Possible)	1,042

The reserve estimates used in this document were compiled by Mr Timothy Hower of MHA Petroleum Consultants, Colorado, USA, a qualified person under ASX Listing Rule 5.11. Mr Hower has consented to the use of the reserve information contained within this document in the form and context in which it appears.

Coal resource summary

As at 30 June 2011

Location	Seam Thickness Cut-off	Indicated (Mt)	Inferred (Mt)	TOTAL (Mt)
Bloodwood Creek	2 5[1]	218 158	280 57	498 215
Kogan	2 5[1]		170 149	170 149
Mulpun, Chile [2]	2 5[1]	36.7 19	40.1 39.3	76.8 58.3
TOTAL RESOURCE	2 5[1]	254.7 177	490.1 245.3	744.8 422.3

Notes:
1. Optimal target for Underground Coal Gasification
2. Carbon Energy has the right to a 30% contributing interest in the Chile deposit upon completion of agreed milestones

Competent person's statement

Coal Tenements

The information in this table relates to resources is based on information compiled by Dr C.W. Mallett, Technical Director Carbon Energy Limited who is a member of the Australian Institute of Mining and Metallurgy. Dr Mallett has sufficient experience which is relevant to the style of mineralisation and type of deposit under consideration and to the activity which he is undertaking to qualify as a Competent Person as defined in the 2004 Edition of the "Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves". Dr Mallett consents to the inclusion in the table of the matters based on his information in the form and context in which it appears.

SHAREHOLDER **INFORMATION**

The shareholder information set out below was applicable as at 2 September 2011.

(a) Distribution of share and option holdings as at 2 September 2011.

Size of Holding and Option Holdings	Number of Shareholders	Shares	% of issued Capital
1 - 1,000	409	241,927	0.03
1,001 - 5,000	1,506	4,677,034	0.67
5,001 - 10,000	1,122	9,498,588	1.36
10,001 - 100,000	2,239	79,536,962	11.39
100,001 and over	471	604,563,347	86.55
Total Shareholders	5,747	698,517,858	100.00

(b) Of the above total 952 Ordinary Shareholders hold less than a marketable parcel.

(c) Shareholders in excess of 5% holding

- Incitec Pivot Limited holds 67,160,924 ordinary shares
- Pacific Road holds 48,398,878 ordinary shares
- HSBC holds 45,154,185 ordinary shares

(d) Voting rights

The voting rights attached to the ordinary shares are governed by the Constitution. On a show of hand 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. None of the options have any voting rights.

1. The name of the Company Secretary is Mr Prem Nair.
2. The address of the principal registered office in Australia is Level 12, 301 Coronation Drive, Milton, Brisbane, Queensland 4064, Telephone +61 7 3337 9944.
3. The register of securities is held at; Security Transfer Registrars Pty Ltd, 770 Canning Highway, Applecross WA 6153, Telephone +61 8 9315 2333.
4. Stock Exchange Listing Quotation has been granted for all the ordinary share of the Company on all Member Exchanges of the Australian Stock Exchange Limited, and trade under the symbol CNX.
5. Quotation has also been granted for all the ordinary shares of the Company on the Berlin and Frankfurt Stock Exchange (Third Market).
6. Detailed schedules of exploration and mining tenements held are included in the tenement schedule.
7. Directors' interest in share capital are disclosed in the Directors' Report.
8. Unquoted Securities – Details of the 35.58 million unlisted options on issue are detailed in the Directors' Report on page 35.
9. Mr A.M. Dash (Managing Director) holds options over 24.4 million ordinary shares representing 68.5% of the unlisted options on issue.

SHAREHOLDER **INFORMATION**

Twenty largest shareholders

As at 2 September 2011

Shareholders (Fully Paid Ordinary)	Number of Shares	%
Incitec Pivot Ltd	67,160,924	9.61%
NV Pacific Road Carbon Energy	48,398,878	6.93%
HSBC Custody Nom Aust. Ltd	45,154,185	6.46%
Lujeta PL	33,550,000	4.80%
Citicorp Nom PL	31,279,546	4.48%
Commonwealth Scientific & Industrial Research	28,346,389	4.06%
Summa Resource Hldgs LLC	24,327,783	3.48%
J P Morgan Nom Aust Ltd	17,149,713	2.46%
Stanley Ross Francis	17,000,000	2.43%
Lomacott PL	15,500,000	2.22%
Constellation Energy PL	15,000,000	2.15%
PRCM Nom PL	11,994,032	1.72%
Mallet CW & WJ	11,766,952	1.68%
Bridgelane Cap PL	11,000,000	1.57%
Harman Nom PL	9,300,000	1.33%
JP Morgan Nom Aust Ltd	6,402,773	0.92%
Twynam Agricultural Group	6,120,000	0.88%
National Nom Ltd	5,980,185	0.86%
Equity Ttees Ltd	5,716,424	0.82%
Elizabethan Super PL	5,355,224	0.77%
Top 20 Shareholders	416,503,008	59.63%
TOTAL ISSUED SHARES as at 2 September 2011	698,517,858	100%

CORPORATE **INFORMATION**

CARBON ENERGY LIMITED ABN 56 057 552 137 AND CONTROLLED ENTITIES
NINETEENTH ANNUAL REPORT AND 2011 FINANCIAL STATEMENTS

Current Directors:
C. Rawlings Bsc (Hons), PhD, FAICD (appointed 1 July 2011) – Non-Executive Chairman
A.M. Dash BEng (Chem), MCom – Chief Executive Officer & Managing Director
M.D.J. Cozijn BCom, CPA, MAICD – Non-Executive Director
H.G. Garnett PSM, BSc (Hons), PhD, FTSE, FAICD (appointed 6 September 2010) – Non-Executive Director
P.N. Hogan BBus, ACA – Non-Executive Director
K. Robinson BSc (Geol) – Non-Executive Director
L.I. Rozman BEng, MGeos, FAusIMM CP(Man), MAICD – Non-Executive Director

Secretary:
P.K. Nair BBus, MBA, FCA, FCIS, FTIA, MAICD

Management team:
A Dash – Chief Executive Officer & Managing Director
C Mallett – Technical Director
J Bidwell – General Manager Commercial & Project Development
J Hoskin – Chief Operating Officer
P Nair – Chief Financial Officer & Company Secretary
P Swaddle – Senior Vice President – Strategy and Business Development

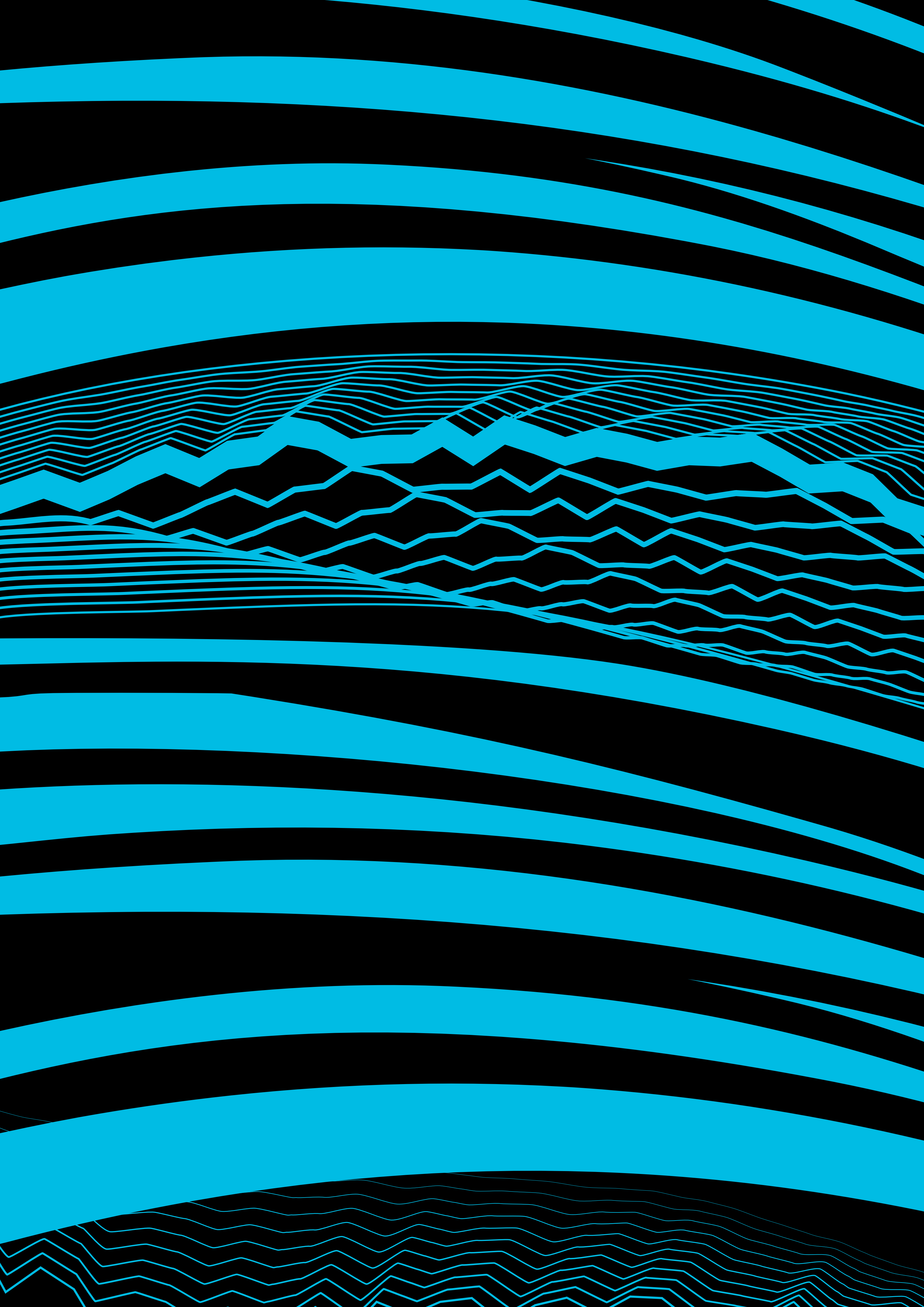
Registered and principal office:
Level 12, 301 Coronation Drive
MILTON QLD 4064
Telephone: + 617 3337 9944, Facsimile: +617 3337 9945
Email: askus@carbonenergy.com.au

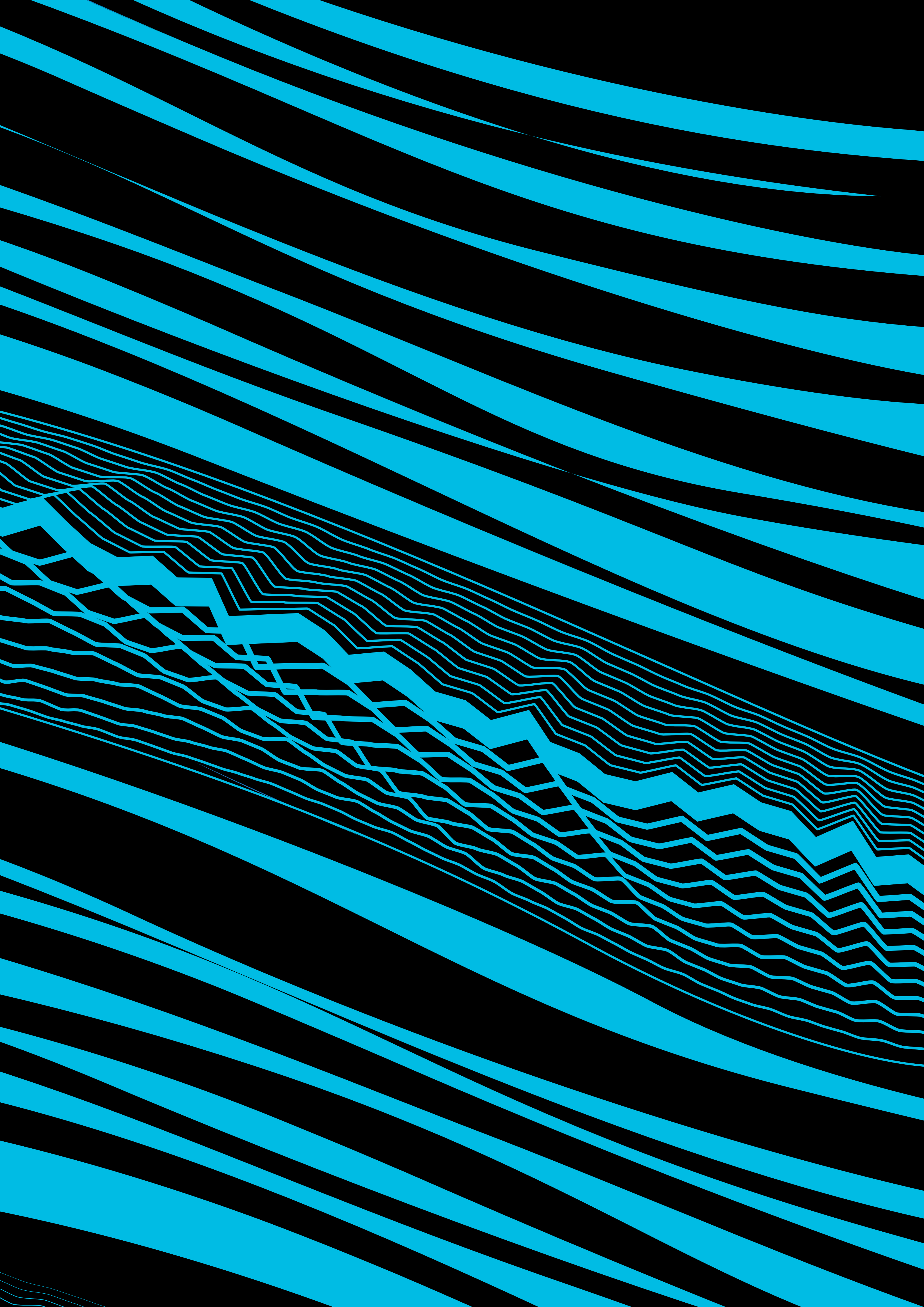
Postal address:
PO Box 2118
TOOWONG DC QLD 4066

Share registry:
Security Transfer Registrars Pty Ltd
770 Canning Highway
APPLECROSS WA 6153

Solicitors:
Gadens Lawyers
240 Queen Street
BRISBANE QLD 4001

Annual General Meeting:
The Annual General Meeting is anticipated to be held on Thursday 24 November 2011





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