



Alto Energy International Limited

ABN 22 073 653 175

Financial Report

for the financial year ended
30 June 2006

CORPORATE DIRECTORY

DIRECTORS

Mr Anthony Grist
Mr Gregory Channon
Mr Andrew Dimsey
Mr Charles Morgan
Mr James Trimble

COMPANY SECRETARY

Ms Katrina Grose

REGISTERED AND PRINCIPAL OFFICE

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ASX CODE

AOI

ABN

78 009 232 026

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

The Directors of Alto Energy International Limited submit herewith the annual financial report of the Company for the financial year ended 30 June 2006.

DIRECTORS

The names and details of the directors of the Company in office during the financial year and until the date of this report, unless otherwise stated, are:

Mr Anthony Grist

Non-Executive Director and Chairman
Appointed 19 January 2006

After managing the corporate underwriting division of a Corporate Member of the Australian Stock Exchange, Mr Grist formed a private investment group based in Perth, Western Australia, in 1991.

Mr Grist has extensive international experience in the management of public companies. He is Non-Executive Chairman of ASX-listed Amcom Telecommunications Limited (appointed 1997) and a non-executive director of iiNet Limited (appointed July 2006).

Mr Gregory Channon

Managing Director and Chief Executive Officer
Appointed 19 January 2006

Mr Channon has been the Managing Director and CEO of Alto Energy Limited since January 2005 and became the Managing Director and CEO of Alto Energy International Limited on its merger with Alto Energy Limited in January 2006. He has extensive expertise in the oil industry, including technical, financial, and management experience.

Graduating from Adelaide University in 1984 with Honours in Petroleum Geology, Mr Channon has worked with Delhi Petroleum, Santos, Fletcher Challenge, Shell, Swift Energy and Alto Energy. This has provided him with experience across Australia, South-East Asia, the US and New Zealand oil and gas provinces. He has been involved in corporate acquisitions, takeovers and mergers as well as Initial Public Offerings and capital raisings and has a proven track record of hydrocarbon discoveries.

Mr Andrew Dimsey

Director, Business Development
Appointed 15 September 2005

Mr Dimsey has 25 years of financial, commercial and corporate experience gained within the oil and gas and exploration and production industry and until recently was the energy marketing and commercial manager of Origin Energy.

Mr Charles Morgan

Non-Executive Director
Appointed 19 January 2006

Mr Morgan is an experienced oil and gas investor and a listed company director. He founded Golden Triangle Energy Inc, now Alto Energy Inc, a wholly owned subsidiary of the group. Mr Morgan was also a founder of SOCDT (now Nido Petroleum Limited), West Oil NL (ASX listed entity) and Fusion Oil & Gas plc.

Mr Morgan is currently a non-executive Director of Gateway Capital Limited.

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

Mr James Trimble

Non-Executive Director
Appointed 22 February 2006

Mr Trimble is a Registered Professional Engineer, graduating from Mississippi State University where he majored in Petroleum Engineering. Mr Trimble is based in Houston, Texas, USA.

Mr Trimble has nearly 35 years of experience in the oil and gas industry serving initially in operational and engineering roles, and has served in many management roles.

Mr Trimble served as a senior executive of Cabot Oil & Gas Company, directing the company in its exploration efforts and implementing a 3D seismic program that resulted in finding 500 BCF of potential reserves.

Mr Trimble has also served as President and Member of the Board of Elysium Energy LLC, directing the drilling and daily production operations activities. He was also the President and CEO and Chairman of the Board of Tri-Union Development Corporation.

Mr Richard Monti

Executive Director – Operations (Lach Drummond Resources Limited)
Resigned 19 January 2006

Mr Monti has qualifications in geology (Bachelor of Science with Honours from the University of Western Australia) and finance (Graduate Diploma in Applied Finance and Investment from the Securities Institute of Australia). He joined the Board of Lach Drummond Resources Limited (now Alto Energy International Limited) in May 2005 and resigned as a director on 19 January 2006.

Mr Adam Sierakowski

Non-Executive Director (Lach Drummond Resources Limited)
Resigned 19 January 2006

Mr Sierakowski is a Barrister and Solicitor. He joined the Board of Lach Drummond Resources Limited (now Alto Energy International Limited) in May 2005 and resigned as a director on 19 January 2006.

Mrs Nadine Donovan

Executive Director and Company Secretary (Lach Drummond Resources Limited)
Resigned as Director 19 January 2006

Mrs Donovan is a qualified Certified Practising Accountant. She joined the Board of Lach Drummond Resources Limited (now Alto Energy International Limited) in May 2005 and resigned as a director on 19 January 2006.

Mrs Donovan has held board positions with listed biotechnology company pSivi da Limited (January 2003 to July 2004) and biomaterials company Colltech Australia Limited (resigned November 2004). She is the former company secretary for both of these companies.

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

COMPANY SECRETARY

Ms Katrina Grose

Company Secretary
Appointed 12 September 2006

Ms Grose graduated with a Bachelor of Commerce from the University of Western Australia and is a qualified Chartered Accountant.

Ms Grose has over 11 years' experience in the accounting profession, including 8 years' experience with ASX-listed companies. Ms Grose has over 5 years' company secretarial experience in the mining and exploration industry.

Mrs Nadine Donovan

Former Company Secretary
Resigned 12 September 2006

CORPORATE INFORMATION

Corporate Structure

Alto Energy International Limited is a company limited by shares that is incorporated and domiciled in Australia. Alto Energy International Limited has prepared a consolidated financial report incorporating the entities that it controlled during the financial period.

In accordance with AASB 3 "Business Combinations", when Alto Energy International Limited (the legal parent) acquired the Alto Energy Limited group (being Alto Energy Limited and its controlled entity, Alto Energy Inc) (the legal subsidiary) in January 2006, the acquisition was deemed to be a reverse acquisition since the substance of the transaction is that the existing shareholders of Alto Energy Limited have effectively acquired Alto Energy International Limited. Under reverse acquisition accounting, the consolidated financial statements are prepared as if Alto Energy Limited had acquired Alto Energy International Limited and its controlled entities, not vice versa as represented by the legal position.

As a consequence, the Company financial statements presented are those of the legal parent, Alto Energy International Limited (formerly Lach Drummond Resources Limited), and the consolidated financial statements are issued under the name of the legal parent but are a continuation of the financial statements of the deemed acquirer (Alto Energy Limited). Hence the comparative figures in the consolidated financial statements are those of Alto Energy Limited and its controlled subsidiary for the year ended 30 June 2005.

Nature of Operations and Principal Activities

The principal activity of the consolidated entity during the financial year was the exploration and evaluation of oil and gas leases.

There has been no significant change in the nature of these activities during the period.

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

REVIEW AND RESULTS OF OPERATIONS

For the financial year ending 30 June 2006, the loss attributable to members of the consolidated entity is \$9,753,881 (2005: loss \$554,948).

Review of operations of Alto Energy International Limited prior to merger with Alto Energy Limited

On 19 July 2005 the Company announced that it had agreed to acquire Golden Fleece Petroleum Inc, a company holding the right to earn a 50% interest in the Home Run project, located in the Appalachian Basin, in Kentucky in the USA. The acquisition was concluded in September 2005 and consideration was in the form of cash, shares and options.

In September 2005 the Company issued 100 million ordinary shares at a price of 3.5 cents each to raise \$3,322,746, net of issue costs, to fund the acquisition of Golden Fleece Petroleum Inc and initial drilling programme.

Review of operations of Alto Energy International Limited consolidated group

On 21 September 2005 Lach Drummond Resources Limited (now Alto Energy International Limited) announced a proposed merger with Alto Energy Limited. The merger was effected by off-market takeover bids for 100% of the ordinary shares in Alto Energy Limited (13 Lach Drummond shares were offered for each Alto share) and was concluded in January 2006.

On 13 January 2006 the Company changed its name from Lach Drummond Resources Limited to Alto Energy International Limited.

On 19 January 2006 the Company announced the appointment of Gregory Channon, Anthony Grist and Charles Morgan to the Board of Alto Energy International Limited, and the resignation of Nadine Donovan, Adam Sierakowski and Richard Monti as directors. Mrs Donovan remained as Company Secretary.

On 1 March 2006 the Company announced the appointment of James Trimble as a director.

As at 30 June 2006 the consolidated cash position was \$2,422,258 (2005: \$2,703,561).

SUBSEQUENT EVENTS

On 31 July 2006 the Company announced that it intended to accommodate a share buy back facility for shareholders with unmarketable parcels of shares assessed at 28 July 2006. The purchase price of these shares is set at 6.7 cents per share.

On 18 September 2006, the Company announced that it had signed an agreement with Ascent Resources WV Inc, for the sale of its 29% interest in Cornstalk/Bugrun/Green Park shale gas projects in West Virginia. The sale is subject to a final Purchase and Sale Agreement with the closing date set for early November.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

In the opinion of the directors, there were no other matters that significantly affected the state of affairs of the consolidated entity during the financial period, other than those referred to in the review of operations.

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

DIVIDENDS

The directors recommend that no amount be paid by way of dividend. No dividend has been paid or declared since the start of the financial period.

STRATEGY AND FUTURE PERFORMANCE

Information about the business strategies of the consolidated entity and its prospects for the future has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the consolidated entity.

SHARE OPTIONS

As at the date of this report, there were a total of 35,311,218 unissued ordinary shares under option (35,311,218 at balance date). Refer to note 13 of the financial statements for further details of the options outstanding.

Option holders do not have any right, by virtue of an option, to participate in any share issue of the Company or any related body corporate or in the interest issue of any other registered scheme.

During the financial year, the Company issued 3,000,000 options (on a post-reconstruction basis) under the shareholder approved Employee Share Option Plan. Details regarding the issue of share options under this plan are provided in note 28 of the financial statements. The Company issued a further 3,375,000 options (on a post-reconstruction basis) during the year as part of the acquisition of Golden Fleece Petroleum Inc and in January 2006, 22,705,423 options were issued as part of the merger with Alto Energy Limited.

INTERESTS IN THE SHARES AND OPTIONS OF THE COMPANY AND RELATED BODIES CORPORATE

As at the date of this report the interests of the Directors in the shares and options of Alto Energy International Limited were as follows:

	Alto Energy International Limited			
	Ordinary Shares		Options	
	Held Directly	Held Indirectly	Held Directly	Held Indirectly
Mr A Grist	16,250	5,166,250	3,282	909,532
Mr G Channon	152,344	-	3,312,012	-
Mr A Dimsey	-	-	1,500,000	-
Mr C Morgan	9,250,000	6,412,500	9,731,250	-
Mr J Trimble	179,815	-	1,500,000	-

REMUNERATION REPORT

This report outlines the remuneration arrangements in place for directors and executives of Alto Energy International Limited. The report has been set out under the following main headings:

- A. Principles Used to Determine the Nature and Amount of Remuneration (audited)
- B. Service Agreements (audited)
- C. Details of Remuneration (audited)
- D. Share-based Compensation (audited)
- E. Additional Information

A. Principles Used to Determine the Nature and Amount of Remuneration (audited)

The Remuneration Committee of the Board of Directors is responsible for determining and reviewing compensation arrangements for the Directors and Executive Officers. The Remuneration Committee will assess the appropriateness of the nature and amount of emoluments of such officers on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality Board and executive team. Such officers are paid their base emolument in cash only.

To assist in achieving these objectives, the Remuneration Committee will link the nature and amount of executive Directors' and officers' emoluments to the Company's financial and operational performance.

Executive Officers are those directly accountable for the operational management and strategic direction of the Company and the consolidated entity.

Fixed remuneration

Fixed remuneration consists of a base remuneration package, which includes directors' fees (in the case of Directors), salaries, consulting fees and employer contributions to superannuation funds.

Fixed remuneration levels for Directors and executive officers are reviewed annually by the Remuneration Committee through a process that considers the employee's personal development, achievement of key performance objectives for the year, industry benchmarks wherever possible and CPI data. Recommendations for remuneration levels are given by the Remuneration Committee to the Board for approval.

Key performance indicators (KPIs) are individually tailored by the Remuneration Committee for each director and executive officer each year, and reflect an assessment of how that employee can fulfil their particular responsibilities in a way that best contributes to Company performance and shareholder wealth in that year.

Performance-linked remuneration

All employees may receive bonuses and/or share options based on achievement of specific goals related to performance against individual KPIs and to the performance of the Company as a whole as determined by the directors, based on a range of factors. These factors include traditional financial considerations such as operating performance, cash consumption and deals concluded and also industry-specific factors relating to the advancement of the Company's exploration and development activities and relationships with third parties and internal employees.

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

The Remuneration Committee determines the total amount of performance-linked remuneration payable as a percentage of the total annualised salaries for all employees employed as at the end of the financial year (with pro rata reductions to the annualised salary made for any employee not employed for the entire financial year). Once the Remuneration Committee has determined the total performance-linked remuneration payable across the Company, Committee members assess the performance of each individual staff member within their department, relative to that staff member's KPIs and decide how much performance-linked remuneration should be paid to that person.

B. Service Agreements (audited)

Remuneration and other terms of employment for the Managing Director and the other key management personnel are formalised in service agreements. Each of these agreements provide for the provision of performance-related cash bonuses, other benefits including health insurance, car allowances, and participation when eligible, in the Alto Energy International Limited Employee Option Plan. Other major provisions of the agreements relating to remuneration are set out below.

All contracts with executives may be terminated early by either party with three months notice, subject to termination payments as detailed below:

Mr G Channon, Managing Director

- Agreement commenced 1 July 2006
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of \$239,800, to be reviewed annually by the remuneration committee
- Payment of a termination benefit on early termination by the Company, other than for gross misconduct, equal to 3 months' base salary

Mr A Dimsey, Director, Business Development

- Term of agreement – 2 years commencing 15 September 2005
- Base salary, inclusive of superannuation, for the year ended 30 June 2006 of \$196,200, to be reviewed annually by the remuneration committee
- Payment of a termination benefit on early termination by the Company, other than for gross misconduct, equal to 12 months' base salary and immediate vesting of options

Mr P Fry, Director

- Agreement terminated upon resignation on 24 January 2006
- Base salary, inclusive of superannuation, for the period ended 24 January 2006 of \$119,650.

Mrs N Donovan, Director

- Agreement terminated upon resignation on 19 January 2006.
- Base salary, inclusive of superannuation, for the period ended 19 January 2006 of \$14,440.

C. Details of Remuneration (audited)

Details of the remuneration of the directors and the key management personnel (as defined in AASB 124 "Related Party Disclosures") of Alto Energy International Limited and the Alto Energy International Limited consolidated group are set out in the following tables:

The key management personnel of Alto Energy International Limited and the Alto Energy International Limited consolidated group during the year ended 30 June 2006 includes the following directors and executives:

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

Directors:

- Mr A Grist (Chairman) (Appointed 19 January 2006)
- Mr G Channon (Managing Director) (Appointed 19 January 2006)
- Mr A Dimsey (Director, Business Development) (Appointed 15 September 2005)
- Mr C Morgan (Non-Executive Director) (Appointed 19 January 2006)
- Mr J Trimble (Non-Executive Director) (Appointed 22 February 2006)
- Mr P Fry (formerly a director of Alto Energy Limited) (Resigned 24 January 2006)
- Mr R Monti (Resigned 19 January 2006)
- Mr A Sierakowski (Resigned 19 January 2006)
- Mrs N Donovan (also Company Secretary) (Resigned 19 January 2006)

Executives

- Mrs N Donovan (Company Secretary) (Resigned 12 September 2006)
- Mr R Prudnick (US Country Manager) (Resigned 30 June 2006)

The Alto Energy International Limited Group key management personnel disclosures include the remuneration of directors of Alto Energy Limited prior to the reverse acquisition that took place during the year (see note 1(b) for more details on the reverse acquisition) and the post acquisition remuneration of the Alto Energy International Limited directors and executives. The 30 June 2005 remuneration disclosure for the Group relates to the remuneration of key management personnel of Alto Energy Limited.

Remuneration packages contain the following key elements:

- a) Primary benefits – salary / fees and bonuses;
- b) Post-employment benefits – including superannuation;
- c) Equity – share options granted under the Employee Share Option Plan as disclosed in Note 28 to the financial statements; and
- d) Other benefits.

(i) Key Management Personnel of Alto Energy International Limited Group

2006

	Primary		Post-employment Super-annuation	Other benefits	Equity Options	Total
	Salary and fees	Bonus				
	\$	\$	\$	\$	\$	\$
<i>Directors</i>						
Mr A Grist	35,000	-	-	-	-	35,000
Mr G Channon	220,000	-	27,638	3,850	33,716	285,204
Mr A Dimsey	75,000	-	6,019	897	31,669	113,585
Mr C Morgan	80,333	-	-	-	-	80,333
Mr J Trimble	13,559	-	-	-	9,309	22,868
Mr P Fry	118,000	-	-	1,650	19,833	139,483
Total	541,892	-	33,657	6,397	94,527	676,473

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

	Primary Salary and fees	Primary Bonus	Post- employment Super- annuation	Other benefits	Equity Options	Total
	\$	\$	\$	\$	\$	\$
<i>Company Executive</i>						
Mrs N Donovan	27,439	-	-	-	-	27,439
<i>Group Executive</i>						
Mr R Prudnick	180,544	-	6,419	48,145	-	235,108
Total	207,983	-	6,419	48,145	-	262,547
Grand Total	749,875	-	40,076	54,542	94,527	939,020

2005

The following table discloses the remuneration of the directors of the Company during the financial year from Alto Energy Limited and controlled entities within the consolidated entity:

	Primary Salary and fees	Primary Bonus	Post- employment Super- annuation	Other benefits	Equity Options	Total
	\$	\$	\$	\$	\$	\$
<i>Directors</i>						
Mr P Fry	110,666	-	-	-	20,164	130,830
Mr G Channon	98,715	-	8,250	25,000	32,788	164,753
Mr C Morgan	23,333	-	-	-	14,770	38,103
Mr D Whitby	-	-	-	-	10,550	10,550
Mr E Rigg	-	-	-	-	-	-
Mr C Burton	-	-	-	-	-	-
Mr J El-Raghy	-	-	-	-	-	-
Mr G Evans	-	-	-	-	-	-
Total	232,714	-	8,250	25,000	78,272	344,236

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

(ii) Key Management Personnel of Alto Energy International Limited

2006

	Primary		Post-employment Super-annuation	Other benefits	Equity Options	Total
	Salary and fees	Bonus				
	\$	\$	\$	\$	\$	\$
<i>Directors</i>						
Mr A Grist	35,000	-	-	-	-	35,000
Mr G Channon	-	-	-	-	-	-
Mr A Dimsey	143,000	-	12,139	1,224	66,908	223,271
Mr C Morgan	26,667	-	-	-	-	26,667
Mr J Trimble	13,559	-	-	-	9,309	22,868
Mr R Monti	16,872	-	1,349	-	-	18,221
Mr A Sierakowski	-	-	-	-	-	-
Mrs N Donovan	13,248	-	1,192	-	-	14,440
Total	248,346	-	14,680	1,224	76,217	340,467
<i>Company Executive</i>						
Mrs N Donovan	27,439	-	-	-	-	27,439
Total	27,439	-	-	-	-	27,439
Grand Total	275,785	-	14,680	1,224	76,217	367,906

2005

	Primary		Post-employment Super-annuation	Other benefits	Equity Options	Total
	Salary and fees	Bonus				
	\$	\$	\$	\$	\$	\$
<i>Directors</i>						
Mr A Sierakowski	-	-	-	-	-	-
Mr R Monti	1,742	-	157	-	-	1,899
Mrs N Donovan	-	-	-	-	-	-
Total	1,742	-	157	-	-	1,899

D. Share based compensation (audited)

Options

The Alto Energy International Limited Employee Share Option Plan was created during the financial year. Options are granted under the plan to senior level executives of the Company for no consideration.

Options granted under the plan carry no dividend or voting rights and have varied contractual lives.

The terms and conditions of each grant of options affecting remuneration in the previous, this or future reporting periods are as follows:

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

Grant Date	Expiry Date	Exercise Price	Value per option at grant date	Date exercisable
<i>Options issued by Alto Energy Limited</i>				
22 March 2005	30 June 2007	\$0.25	\$0.0211	22 March 2005
22 March 2005	31 October 2008	\$0.25	\$0.0298	22 March 2005
22 March 2005	30 November 2008	\$0.30	\$0.0264	22 March 2006
22 March 2005	31 December 2008	\$0.35	\$0.0237	22 March 2007

Options issued by Alto Energy International Limited (formerly Lach Drummond Resources Limited), on a post-reconstruction basis

29 November 2005	31 December 2008	\$0.32	\$0.0589	29 November 2005
29 November 2005	31 December 2008	\$0.40	\$0.0513	1 July 2006
29 November 2005	31 December 2008	\$0.40	\$0.0638	1 July 2007
11 May 2006	31 December 2008	\$0.25	\$0.0103	1 July 2006
11 May 2006	31 December 2008	\$0.30	\$0.0095	1 January 2007

Value of options issued to directors and executives

The following table discloses the value of options granted, exercised or lapsed during the year:

	Options granted	Options exercised	Options lapsed	Total value of options granted, exercised and lapsed	Value of options included in remuneration for the year
	Value at grant date	Value at exercise date	Value at time of lapse		
	\$	\$	\$	\$	\$
Mr A Grist	-	-	-	-	-
Mr G Channon	-	-	-	-	33,716
Mr A Dimsey	87,017	-	-	87,017	66,908
Mr C Morgan	-	-	-	-	-
Mr J Trimble	14,902	-	-	14,902	9,309
Mr R Monti	-	-	-	-	-
Mr A Sierakowski	-	-	-	-	-
Mr P Fry	-	-	-	-	19,833
Mrs N Donovan	-	-	-	-	-
Mr R Prudnick	-	-	-	-	-
Total	101,919	-	-	101,919	129,766

The assessed fair value at grant date of options granted to the individuals is allocated equally over the period from grant date to vesting date, and the amount is included in the remuneration tables above. Fair values at grant date are determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the impact of dilution, the share price at grant date, the expected price volatility of the underlying share, the expected dividend yield and the risk free interest rate for the term of the option.

The model inputs for options granted during the year ended 30 June 2006 have been included in note 28 of the financial statements.

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

No shares in the Company have been provided as a result of the exercise of remuneration options by key management personnel.

E. Additional Information

Principles used to determine the nature and amount of remuneration: relationship between remuneration and company performance

In considering the Company's performance and its effect on shareholder wealth, the Board have regard to a broad range of factors, some of which are financial and others of which relate to the progress on the Company's projects, results and progress of exploration and development activities, joint venture agreements etc. The Board also gives consideration to the Company's result and cash consumption for the year. It does not utilise earnings per share as a performance measure or contemplate payment of any dividends in the short to medium term given that all efforts are currently being expended to build the business and establish self-sustaining revenue streams.

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

During the financial period, the Company maintained an insurance policy which indemnifies the Directors and Officers of Alto Energy International Limited in respect of any liability incurred in connection with the performance of their duties as Directors or Officers of the Company. The Directors made a personal contribution toward the premium to satisfy Section 199B of the Corporations Act 2001. The Company's insurers have prohibited disclosure of the amount of the premium payable and the level of indemnification under the insurance contract.

DIRECTORS' MEETINGS

The following table sets out the number of directors' meetings (including meetings of committees of directors) held during the financial year and the number of meetings attended by each director (while they were a director or committee member). During the financial year, 25 board meetings, 2 audit committee meetings and no remuneration committee meetings were held.

Alto Energy International Limited

	Board of directors		Audit committee		Remuneration committee	
	Held	Attended	Held	Attended	Held	Attended
Mr A Grist	6	6	1	1	-	-
Mr G Channon	6	6	-	-	-	-
Mr A Dimsey	20	20	-	-	-	-
Mr C Morgan	6	6	1	1	-	-
Mr J Trimble	5	5	-	-	-	-
Mr A Sierkowski	19	19	1	1	-	-
Mr R Monti	19	19	1	1	-	-
Mrs N Donovan	19	19	1	1	-	-

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2006

Alto Energy Limited

	Board of directors		Audit committee	
	Held	Attended	Held	Attended
Mr G Channon	10	10	-	-
Mr P Fry	10	9	-	-
Mr C Morgan	10	8	-	-

NON-AUDIT SERVICES

The following non-audit services were provided by the entity's auditor, Horwath Audit (WA) Pty Ltd or associated entities. The directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act. The directors are satisfied that the provision of non-audit services by the auditor, as set out below, did not compromise the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- All non-audit services have been reviewed by the audit committee to ensure they do not impact the impartiality and objectivity of the auditor;
- None of the services undermine the general principles relating to auditor independence as set out in Professional Statement F1, including reviewing or auditing the auditor's own work, acting in a management or a decision-making capacity for the Company, acting as advocate for the Company or jointly sharing economic risk and rewards.

Horwath received or are due to receive the following amounts for the provision of non-audit services:

	\$
Horwath Securities Services	13,838

AUDITOR'S INDEPENDENCE DECLARATION

The auditor's independence declaration is included on page 25 of the financial report.

Dated at Perth, 27 September 2006, and signed in accordance with a resolution of the Directors.



Mr Gregory Channon
Managing Director

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

Alto Energy International's Board and Corporate Governance

The Board of directors of Alto Energy International Limited is responsible for the corporate governance of the consolidated entity and is committed to applying the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* ("ASX Principles") where practicable. The Board guides and monitors the business and affairs of Alto Energy International Limited on behalf of the shareholders. It is a requirement of the Board that the Company maintains high standards of ethics and integrity at all times.

The ASX Principles are an important regulatory guide for listed companies reporting on their corporate governance practices. Under ASX Listing Rule 4.10.3, listed companies must disclose the extent to which they have followed the ASX Principles, and if any of the recommendations have not been followed then the Company must explain why not.

The requirements under Listing Rule 4.10.3 apply to Alto Energy International for the financial year ended 30 June 2006 and this corporate governance statement sets out and explains any departures by Alto Energy International from the ASX Principles.

The Alto Energy International Corporate Governance Website

Important information relating to Alto Energy International's corporate governance policies and practices are set out on the Company's website at www.altoenergy.com.au. The following documents are summarised on the website and are available in full from the Company:

- Board Charter;
- Code of Conduct;
- Communications Strategy Policy;
- Continuous Disclosure Policy;
- Securities Trading Policy;
- Risk Policy;
- Remuneration Policy;
- Audit Committee Charter; and
- Remuneration Committee Charter.

The corporate governance section of Alto Energy International's website was first made available from 24 May 2005 and the documents referred to above were available from that date. Alto Energy International has undertaken a review of its corporate governance policies and practices since that date and is continuing to update its policies and practices to reflect developing corporate governance requirements and practices.

The Role of the Board and the Board Charter

The Board's Duties

As the Board acts on behalf of and is accountable to the shareholders, the Board seeks to identify the expectations of the shareholders, as well as other regulatory and ethical expectations and obligations and strives to meet those expectations. In addition, the Board is responsible for identifying areas of significant business risk and ensuring arrangements are in place to adequately manage those risks.

The role of the Board is to oversee and guide the management of Alto Energy International with the aim of protecting and enhancing the interests of its shareholders and taking into account the interests of other stakeholders including employees and the wider community.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

The Board has adopted a formal Charter which clearly establishes the relationship between the Board and management and describes their functions and responsibilities. A summary of the Board Charter has been posted on the corporate governance section of the Company's website.

The Board is responsible for setting the strategic direction of the Company, establishing goals for management and monitoring the achievement of those goals. The Managing Director is responsible to the Board for the day to day management of the Company.

Code of Conduct

Directors of the Company are also subject to Alto Energy International's Code of Conduct (see further discussion below). The Code of Conduct is considered by the Board to be an effective way to guide the behaviour of all directors and employees and demonstrates the Company's commitment to ethical and compliant practices.

The Composition of Alto Energy International's Board

The composition of the Board is determined in accordance with the following principles and guidelines:

- the Board should comprise at least 3 directors;
- the Board should comprise directors with an appropriate range of qualifications and expertise; and
- the Board shall meet regularly and follow meeting guidelines set down to ensure all directors are made aware of, and have available all necessary information, to participate in an informed discussion of all agenda items.

As at the date of this report, the Board comprises a non-executive chairperson, two executive directors and a further two non-executive directors. Details of the directors are set out in the Directors' Report.

Independence of Directors

The Board has reviewed the position and associations of each of the five directors in office at the date of this report and considers that two of the directors are independent. In considering whether a director is independent, the Board has regard to the independence criteria in ASX Best Practice Recommendations Principle 2 and other facts, information and circumstances that the Board considers relevant. The Board assesses the independence of new directors upon appointment and reviews their independence, and the independence of other directors, as appropriate.

The Board considers that Mr Grist meets the criteria in Principle 2. He has no material business or contractual relationship with the Company, other than as a director and no conflicts of interest which could interfere with the exercise of independent judgement. Accordingly, he is considered to be independent.

The Board considers that Mr Trimble meets the criteria in Principle 2. He has no material business or contractual relationship with the Company, other than as a director and no conflicts of interest which could interfere with the exercise of independent judgement.

The Board considers that Mr Morgan does not meet the criteria in Principle 2 as he is deemed to be a substantial shareholder of the Company as outlined by the *Corporations Act 2001*.

Mr Channon and Mr Dimsey are employed in an executive capacity by the Company and so are not considered to be independent.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

The Alto Energy International Board did not have a majority of independent directors throughout the entire financial year, and therefore was not in compliance with Best Practice Recommendation 2.1 for the entire period. The Board considered that given the Company's stage of development and resources available that it was not in the best interests of maximising the efficiency of the Board and developing the Company's business to have a majority independent Board.

The directors will continue to monitor the composition of the Board to ensure its structure remains appropriate and consistent with effective management and good governance.

Appointment, Election and Re-Election of Alto Energy International Directors

The Constitution of the Company requires one third of the directors, other than the Managing Director, to retire from office at each Annual General Meeting. Directors who have been appointed by the Board are required to retire from office at the next Annual General Meeting and are not taken into account in determining the number of directors to retire at that Annual General Meeting. Directors cannot hold office for a period in excess of three years or later than the third Annual General Meeting following their appointment without submitting themselves for re-election. Retiring directors are eligible for re-election by shareholders.

Nomination and Appointment of New Directors

Recommendations of candidates for new directors are made by the Board for consideration by the Board of Directors as a whole. If it is necessary to appoint a new director to fill a vacancy on the Board or to complement the existing Board, a wide potential base of possible candidates is considered. If a candidate is recommended, the Board assesses that proposed new director against a range of criteria including background, experience, professional skills, personal qualities, the potential for the candidate's skills to augment the existing Board and the candidate's availability to commit to the Board's activities. If these criteria are met and the Board appoints the candidate as a director, that director must retire at the next following Annual General Meeting and will be eligible for election by shareholders at that Annual General Meeting.

Alto Energy International's Board Meetings

The Board met 25 times between 1 July 2005 and 30 June 2006.

The Board meets formally at least 12 times each year, and from time to time meetings are convened outside the scheduled dates to consider issues of importance.

Directors' attendance at Board and Committee meetings is detailed on page 9 of this annual report.

Performance Review

The Board's policy with respect to performance evaluation is to review its performance and that of its Committees and executive management at least annually. The Chairman discusses with each director, on a one on one basis, their contribution to the Board.

The method of the assessment is to be set by the Board.

Due to the changes to the structure of the Board in January 2006, the new Board has not undertaken a performance evaluation of itself or each director before the date of this annual report. The short time in which the current, expanded Board has been in place has resulted in the Board delaying its performance review until late 2006.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

The performance evaluation to be conducted by the Board will include consideration of the Board's policies in relation to Board and executive evaluation, which to date have not yet been formalised. When the Board formally adopts its evaluation policies, and determines the manner in which evaluation will be conducted, a summary of the relevant processes will be disclosed on the corporate governance section of the Alto Energy International website.

Furthermore, the Board aims to ensure that the shareholders are informed of all information necessary to assess the performance of the directors. Information is communicated to the shareholders through:

- the annual report which is distributed to all shareholders;
- the halfyearly report;
- quarterly mining exploration entity report to ASX;
- the annual general meeting and other meetings to obtain shareholder approval for Board actions as appropriate; and
- continuous disclosure in accordance with ASX Listing Rule 3.1 and the Company's continuous disclosure policy.

Board Members' Rights to Independent Advice

The Board has procedures to allow directors, in the furtherance of their duties as directors or members of a Committee, to seek independent professional advice at the Company's expense, subject to the prior written approval of the Chairman.

Alto Energy International's Board Committees

The Board has established the following committees to advise and support the Board in carrying out its duties:

- Audit and Compliance Committee; and
- Remuneration Committee.

Audit and Compliance Committee

It is the Board's responsibility to ensure that an effective internal control framework exists within the Group, including internal controls to deal with both the effectiveness and efficiency of significant business processes. Effective internal controls include the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as the benchmarking of operational key performance indicators.

The Board has established an Audit and Compliance Committee, which operates under a Charter approved by the Board, and has delegated the responsibility for the establishment and maintenance of a framework of internal control and ethical standards for the management of the consolidated entity to the Audit and Compliance Committee.

The duties and responsibilities of the Audit and Compliance Committee include:

- (a) ensuring appropriate Group accounting policies and procedures are defined, adopted and maintained;
- (b) ensuring that Group operating and management reporting procedures, and the system of internal control, are of a sufficiently high standard to provide timely, accurate and relevant information as a sound basis for management of the Group's business;
- (c) reviewing the Group Financial Statements prior to their approval by the Board;

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

- (d) reviewing the scope of work including approval of strategic and annual audit plans and effectiveness of both the external and internal audit functions across the Group;
- (e) monitoring the proper operation of and issues raised through subsidiary company Audit and Compliance Committees;
- (f) ensure that appropriate processes are in place to ensure compliance with all legal requirements affecting the Group;
- (g) ensure that all internal and industry codes of conduct and standards of corporate behaviour are being complied with;
- (h) appointment of, on recommendation by the Managing Director, a person(s) responsible for Internal Audit functions as specified from time to time by, and in accordance with, the Committee's Terms of Reference;
- (i) responsible for making recommendations to the Board of Directors on the appointment, reappointment or replacement (subject, if applicable, to shareholder ratification), monitoring of effectiveness, and independence of the external auditors.
- (j) actioning any other business processes or functions which may be referred to it by the Board of Directors.

The operation and responsibilities of the Audit and Compliance Committee are generally consistent with ASX Principle 4. The Committee met two times during the financial year ended 30 June 2006. Consistent with ASX Principle 4, a summary of the Committee's role, rights, responsibilities and membership requirements has been posted to the corporate governance section of the Company's website referred to above.

The members of the Audit and Compliance Committee at the date of this report were:

- Mr A Grist; and
- Mr C Morgan;

During the financial year, the following persons were also members of the Audit and Compliance Committee:

- Mr A Sierakowski (resigned 19 January 2006);
- Mr R Monti (resigned 19 January 2006); and
- Mrs N Donovan (resigned 12 September 2006).

Due to the structure of the Board during the financial year, the composition of the Audit and Compliance Committee did not comply with Recommendation 4.3 of the ASX Principles as the Committee did not consist of at least three independent members of the Board for the entire financial year. The Board will continue to monitor the composition of the Audit and Compliance Committee to ensure its structure remains appropriate and consistent with effective management and good governance.

Appointment of External Auditors

The Audit and Compliance Committee is directly responsible for the appointment, reappointment or replacement (subject, if applicable, to shareholder ratification), remuneration, monitoring of effectiveness, and independence of the external auditors, including resolution of disagreements between management and the auditor regarding financial reporting.

The Committee must pre-approve all audit and non-audit services provided by the external auditors and must not engage the external auditors to perform any non-audit/assurance services that may impair or appear to impair the external auditor's judgement or independence in respect of the Company. The Committee may delegate pre-approval authority to a member of the Committee. The decisions of any Audit and Compliance Committee member to whom pre-

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

approval authority is delegated must be presented to the full Committee at its next scheduled meeting.

When reviewing the auditor's independence, the committee will require the rotation of the audit partner at least once every 5 years, in accordance with the *Corporations Act 2001*.

Remuneration Committee

The Board has established a Remuneration Committee to assist the Board in ensuring that appropriate and effective remuneration packages and policies are implemented within Alto Energy International and its subsidiaries for the Managing Director, executive directors and direct reports to the Managing Director. The Committee's role also extends to the review of non-executive directors' fees.

The Remuneration Committee shall comprise at least two members and the members of the Remuneration Committee at the date of this report were:

- Mr A Grist;
- Mr G Channon; and
- Mr C Morgan.

The duties and responsibilities of the Remuneration Committee as set out in its Terms of Reference are:

- To review and recommend to the Board, remuneration policies and packages for the Managing Director, executive directors and direct reports to the Managing Director.
- To recommend to the Board any changes in remuneration policy including superannuation, other benefits and remuneration structure for executives and which is likely to have a material impact on the Group.
- To review and recommend to the Board proposals for employee and non-executive director equity plans.
- To review and recommend to the Board proposals for short and long term incentive programmes for executives.
- To review and recommend to the Board any changes to non-executive directors' fees.
- To ensure there is a proper performance management process in place throughout the organisation and that it is operating effectively.
- To be informed of:
 - current trends in executive remuneration and associated incentive initiatives;
 - legislative issues associated with executive remuneration programmes.

The Committee did not have a separate meeting during the financial year ended 30 June 2006. Any significant remuneration issues affecting the Company were discussed with the whole Board at a meeting of the Board of Directors. Consistent with ASX Principle 9, a summary of the Committee's role, rights, responsibilities and membership requirements has been posted to the corporate governance section of the Company's website referred to above. A copy of the Committee's Terms of Reference is available upon request to the Company.

Remuneration for directors and executives

A brief discussion on the Company's remuneration policies in respect of directors and executives is set out on pages 6 and 7 of this annual report. Detailed disclosure of the remuneration paid to the Company's directors and executives is set out on pages 7 and 8.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

Remuneration paid to the Company's directors and executives is determined with reference to the market level of remuneration for other listed oil and gas companies both in Australia and the USA. This assessment is undertaken with reference to advice and comment provided by various search executive firms operating in the sector.

Bonus levels paid to the Company's directors and executives have been determined and paid on the basis of the Company's performance reflected through increases in the market capitalisation of the Company and upon successful capital raisings.

Stock options are awarded under the Employee Share Option Plan to the Company's directors and executives and are determined on the individuals' performance against milestones, the level of involvement in achieving the corporate milestones and goals and to an extent the relativity between executives.

Total remuneration for non-executive directors is determined by resolution of shareholders. The Remuneration Committee determines actual payments to directors and reviews their remuneration annually, based on independent external advice, relativities and the duties and accountabilities of the directors. The maximum available aggregate remuneration approved for non-executive directors is \$200,000.

Non-executive directors may provide specific consulting advice to the Company upon direction from the Board. Remuneration for this work is made at market rates. During the year Mr J Trimble provided specific consulting advice and received \$22,485.

Non-executive directors do not receive any other retirement benefits other than a superannuation guarantee contribution required by government regulation, which is currently 9% of their fees. Non-executive directors do participate in the Company's Employee Share Option Plan, given the Company's size and stage of development and the necessity to attract the highest calibre of professionals to the role, whilst maintaining the Company's cash reserves.

The equity based executive remuneration is made under the Company's Employee Share Option Plan ("Plan").

Integrity in Financial Reporting

Consistent with ASX Principle 4.1, the Company's financial report preparation and approval process for the financial year ended 30 June 2006 involved both the Managing Director and the Chief Financial Officer providing detailed representations to the Board covering:

- compliance with Alto Energy International's accounting policies and relevant accounting standards;
- the accuracy of the financial statements and that they provide a true and fair view;
- integrity and objectivity of the financial statements; and
- effectiveness of the system of internal control.

Risk Identification and Management

The Alto Energy International Board accepts that taking and managing risk is central to building shareholder value. The Board manages Alto Energy International's level of risk by adhering to a formal Risk Policy statement. The Alto Energy International Risk Policy statement was adopted on 24 May 2005 and is available from the corporate governance section of the Company's website.

The Audit and Compliance Committee has primary responsibility for oversight of the financial risks of the Company, in accordance with the Audit and Compliance Committee Charter and with

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

particular emphasis on Alto Energy International's accounting, financial and internal controls. The Audit and Compliance Committee will receive regular reports from the external auditor on critical policies and practices of the Company and in relation to alternative treatments of financial information. The Audit and Compliance Committee Charter was adopted on 24 May 2005 and is available from the corporate governance section of the Company's website.

The Company employs executives and retains consultants each with the requisite experience and qualifications to enable the Board to manage the risks to the Company. The Board and Audit and Compliance Committee review risks to the Company at regular Board and Audit and Compliance Committee meetings.

Securities Trading by Alto Energy International Directors and Employees

Alto Energy International adopted a Securities Trading Policy on 24 May 2005. The policy summarises the law relating to insider trading and sets out the policy of the Company on directors, officers, employees and consultants dealing in securities of Alto Energy International.

A summary of the Securities Trading Policy has been posted to the corporate governance section of the Company's website. This policy is provided to all directors and employees and compliance with it is reviewed on an ongoing basis in accordance with the Company's risk management systems.

Continuous Disclosure

Alto Energy International has established policies and procedures in order to comply with its continuous and periodic disclosure requirements under the *Corporations Act 2001* (Cth) and the ASX Listing Rules. The Alto Energy International Board has adopted a formal Continuous Disclosure Policy, a summary of which is available from the corporate governance section of the Company's website. The Continuous Disclosure Policy was adopted on 24 May 2005, and is consistent with the informal policies and practices of the Board that were in place prior to the formal adoption of the Continuous Disclosure Policy document.

The Company Secretary has primary responsibility for the disclosure of material information to ASIC and ASX and maintains a procedural methodology for disclosure, as well as for record keeping.

Alto Energy International's Continuous Disclosure Policy requires all management to notify the Managing Director, or the Company Secretary in his absence, of any potentially material information as soon as practicable. The Policy also sets out what renders information material.

The Board reviews the Company's compliance with this policy on an ongoing basis and will update it from time to time, if necessary.

Shareholder Communications

The Board's formal policy on communicating with shareholders, its Communications Strategy Policy, is available from the corporate governance section of the Company's website and supplements Alto Energy International's Continuous Disclosure Policy.

The aim of the Communications Strategy Policy is to make known Alto Energy International's methods for disclosure to shareholders and the general public. The Policy details the steps between disclosure to ASIC and ASX and communication to shareholders, with the Company's website playing an important role in Alto Energy International's communications strategy.

The Board reviews this policy and compliance with it on an ongoing basis.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 30 JUNE 2006

To add further value to Alto Energy International's communications with shareholders, the external auditor will be requested to attend the Company's AGM and be available to answer shareholders' questions about the conduct of the audit and the preparation of the auditor's report.

Conduct and Ethics

The Alto Energy International Code of Conduct was adopted on 24 May 2005. The Code covers a broad range of issues and refers to those practices necessary to maintain confidence in Alto Energy International's integrity, including procedures in relation to:

- compliance with the law;
- financial records;
- contributions to political parties, candidates or campaigns;
- occupational health and safety;
- confidential information;
- conflict of interest;
- efficiency;
- equal opportunity;
- corporate bribery; and
- membership to industry and professional associations.

The Code directs individuals to report any contraventions of the Code to their superior or the Managing Director.

27 September 2006

Private and Confidential

The Board of Directors
Alto Energy International Limited
Level 12, BGC Centre
28 The Esplanade
PERTH WA 6000

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AUDITOR'S INDEPENDENCE DECLARATION

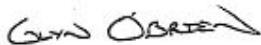
This declaration is made in connection with my audit of the financial report of Alto Energy International Limited for the year ended 30 June 2006 and in accordance with the provisions of the Corporations Act 2001.

As lead auditor I declare that, to the best of my knowledge and belief, there have been:

- No contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to this audit;
- No contraventions of the Code of Professional Conduct of the Institute of Chartered Accountants in Australia in relation to this audit.

Yours sincerely

HORWATH AUDIT (WA) PTY LTD

HORWATH.


GLYN O'BRIEN
DIRECTOR

INCOME STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

	Notes	Consolidated		Company	
		2006	2005	2006	2005
		\$	\$	\$	\$
Revenue from continuing operations	2	175,139	24,686	113,826	7,346
Other income	3	-	-	30,144	-
Corporate office expenses		(411,988)	(103,558)	(613,803)	(9,258)
Employee benefits expense		(708,212)	(322,502)	(93,806)	(6,441)
Impairment of oil and gas capitalised expenditure	10	(11,935,507)	-	-	-
Professional and statutory fees		(595,273)	(87,497)	(237,381)	(13,009)
Provision for diminution of investments	8	-	-	(11,429,162)	-
Other expenses		(17,892)	(66,077)	(291,804)	(214)
Loss before income tax		(13,493,733)	(554,948)	(12,521,986)	(21,576)
Income tax benefit	4	3,742,990	-	-	-
Loss from continuing operations		(9,750,743)	(554,948)	(12,521,986)	(21,576)
Loss from discontinued operations	26	(3,138)	-	-	-
Loss attributable to members of the Company	15	(9,753,881)	(554,948)	(12,521,986)	(21,576)
Loss per share					
Basic (cents)	20	(11.84)	(0.99)		
Diluted (cents)	20	(11.84)	(0.99)		
Loss per share from continuing operations					
Basic (cents)	20	(11.83)	(0.99)		
Diluted (cents)	20	(11.83)	(0.99)		

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

BALANCE SHEETS AS AT 30 JUNE 2006

	Notes	Consolidated		Company	
		2006	2005	2006	2005
		\$	\$	\$	\$
ASSETS					
Current Assets					
Cash and cash equivalents	16(a)	2,422,258	2,703,561	2,257,632	991,823
Trade and other receivables	6	41,194	215,257	1,362,259	8,248
Other assets	7	8,973	1,911	8,973	550
Total Current Assets		2,472,425	2,920,729	3,628,864	1,000,621
Non-Current Assets					
Trade and other receivables	6	-	-	-	2,651
Other financial assets	8	-	-	4,320,106	-
Property, plant and equipment	9	42,859	24,781	24,810	-
Exploration expenditure	10	4,400,000	2,425,030	-	-
Total Non-Current Assets		4,442,859	2,449,811	4,344,916	2,651
Total Assets		6,915,284	5,370,540	7,973,780	1,003,272
LIABILITIES					
Current Liabilities					
Trade and other payables	11	236,678	244,731	1,239,011	21,368
Provisions	12	28,536	7,048	8,230	-
Total Current Liabilities		265,214	251,779	1,247,241	21,368
Non-Current Liabilities					
Deferred tax liabilities	4	563,054	285,005	-	-
Provisions	12	72,593	23,517	-	-
Total Non-Current Liabilities		635,647	308,522	-	-
Total Liabilities		900,861	560,301	1,247,241	21,368
Net Assets		6,014,423	4,810,239	6,726,539	981,904
EQUITY					
Contributed equity	13	15,993,205	5,178,584	18,098,556	1,883,480
Reserves	14	318,174	174,730	2,051,545	-
Accumulated losses	15	(10,296,956)	(543,075)	(13,423,562)	(901,576)
Total Equity		6,014,423	4,810,239	6,726,539	981,904

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

STATEMENTS OF CHANGES IN EQUITY AS AT 30 JUNE 2006

	Consolidated				
	Issued capital	Foreign currency translation reserve	Option premium reserve	Accumulated losses	Total
	\$	\$	\$	\$	\$
Balance at 1 July 2004	-	-	-	11,873	11,873
Loss attributable to members of the parent entity	-	-	-	(554,948)	(554,948)
Foreign currency translation adjustment	-	5,294	-	-	5,294
Total recognised income and expense	-	5,294	-	(554,948)	(549,654)
Shares issued, net of issue costs	5,178,584	-	-	-	5,178,584
Share options issued	-	-	169,436	-	169,436
Balance at 30 June 2005	5,178,584	5,294	169,436	(543,075)	4,810,239
Balance at 1 July 2005	5,178,584	5,294	169,436	(543,075)	4,810,239
Loss attributable to members of the parent entity	-	-	-	(9,753,881)	(9,753,881)
Foreign currency translation adjustment	-	53,117	-	-	53,117
Total recognised income and expense	-	53,117	-	(9,753,881)	(9,700,764)
Shares issued, net of issue costs	10,814,621	-	-	-	10,814,621
Share options issued	-	-	90,327	-	90,327
Balance at 30 June 2006	15,993,205	58,411	259,763	(10,296,956)	6,014,423

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

STATEMENTS OF CHANGES IN EQUITY AS AT 30 JUNE 2006

	Company				
	Issued capital	Foreign currency translation reserve	Option premium reserve	Accumulated losses	Total
	\$	\$	\$	\$	\$
Balance at 9 May 2005	-	-	-	(880,000)	(880,000)
Loss attributable to members of the parent entity	-	-	-	(21,576)	(21,576)
Total recognised income and expense	-	-	-	(21,576)	(21,576)
Shares issued, net of issue costs	1,883,480	-	-	-	1,883,480
Balance at 30 June 2005	<u>1,883,480</u>	<u>-</u>	<u>-</u>	<u>(901,576)</u>	<u>981,904</u>
Balance at 1 July 2005	1,883,480	-	-	(901,576)	981,904
Loss attributable to members of the parent entity	-	-	-	(12,521,986)	(12,521,986)
Total recognised income and expense	-	-	-	(12,521,986)	(12,521,986)
Shares issued, net of issue costs	16,215,076	-	-	-	16,215,076
Share options issued	-	-	2,051,545	-	2,051,545
Balance at 30 June 2006	<u>18,098,556</u>	<u>-</u>	<u>2,051,545</u>	<u>(13,423,562)</u>	<u>6,726,539</u>

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

CASH FLOW STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

	Notes	Consolidated		Company	
		2006	2005	2006	2005
		\$	\$	\$	\$
Cash flows from operating activities					
Receipts from customers		36,998	-	-	-
Payments to suppliers and employees		(1,574,307)	(426,974)	(868,463)	(16,352)
Payments for exploration and evaluation		(624,683)	(1,079,426)	-	-
Interest received		138,141	13,867	113,826	7,346
Net cash outflow from operating activities	16(b)	(2,023,851)	(1,492,533)	(754,637)	(9,006)
Cash flows from investing activities					
Payments for property, plant and equipment		(20,381)	(8,495)	(26,292)	-
Loans to controlled entity		-	-	(472,147)	(2,651)
Payment for purchase of controlled entity, net of cash acquired	27	1,783,389	(383,746)	(977,628)	-
Net cash (outflow) / inflow from investing activities		1,763,008	(392,241)	(1,476,067)	(2,651)
Cash flows from financing activities					
Proceeds from issue of ordinary shares and other equity securities		-	4,601,280	3,650,000	1,500,000
Capital raising costs		(15,693)	(275,041)	(183,630)	(166,520)
Repayments of borrowings		-	-	-	(330,000)
Net cash (outflow) / inflow from financing activities		(15,693)	4,326,239	3,466,370	1,003,480
Net increase / (decrease) in cash and cash equivalents		(276,536)	2,441,465	1,235,666	991,823
Cash and cash equivalents at the beginning of the financial year		2,703,561	262,096	991,823	-
Effects of exchange rate changes on the balance of cash and cash equivalents in foreign currencies		(4,767)	-	30,143	-
Cash and cash equivalents at the end of the financial year	16(a)	2,422,258	2,703,561	2,257,632	991,823

The above cash flow statements should be read in conjunction with the accompanying notes to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

1. Summary of Significant Accounting Policies

(a) Basis of accounting

This general purpose financial report has been prepared in accordance with Australian equivalents to International Financial Reporting Standards (A-IFRS), other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Interpretations and the *Corporations Act 2001*.

Compliance with IFRS

Australian Accounting Standards include A-IFRS. Compliance with A-IFRS ensures that the consolidated financial statements and notes of the consolidated entity comply with International Financial Reporting Standards (IFRS). The parent entity financial statements and notes also comply with IFRS except that it has elected to apply the relief provided to parent entities in respect of certain disclosure requirements contained in AASB 132 "Financial Instruments: Presentation and Disclosure".

Application of AASB 1 "First-time Adoption of Australian Equivalents to International Financial Reporting Standards"

The financial statements are the first Alto Energy International Limited financial statements to be prepared in accordance with A-IFRS. AASB 1 "First-time Adoption of Australian Equivalents to International Financial Reporting Standards" has been applied in preparing these financial statements.

In prior periods financial statements of the consolidated entity had been prepared in accordance with previous Australian Generally Accepted Accounting Principles (AGAAP). AGAAP differs in certain respects from A-IFRS. When preparing the consolidated entity's 2006 financial statements, management has amended certain accounting, valuation and consolidated methods applied in the AGAAP financial statements to comply with A-IFRS. With the exception of financial instruments, the comparative figures in respect of 2005 were restated to reflect these adjustments. The Group has taken the exemption available under AASB 1 to only apply AASB 132 and AASB 139 from 1 July 2005.

Reconciliations and descriptions of the effect of transition from previous AGAAP to A-IFRS on the Group's balance sheet and income statement are given in Note 25.

Historical Cost Convention

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and liabilities (including derivative instruments) at fair value through profit or loss, certain classes of property, plant and equipment and investment property.

Critical accounting estimates

The preparation of financial statements in conformity with A-IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 1(v).

Australian Accounting Standards that have recently been issued or amended but are not yet effective have not been adopted for the annual reporting period ended 30 June 2006. There are no anticipated changes to Alto's accounting policies in future periods as a result of these changes. Below is a summary of recently amended or issued Accounting Standards relevant to the consolidated entity:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

AASB Amendment	Affected Standard(s)	Nature of Change to Accounting Policy	Application Date of Standard for Alto
2005-1	AASB 139: Financial Instruments: Recognition and Measurement	No change to accounting policy required. Therefore no impact.	1 July 2006
2005-5	AASB 1: First-time adoption of AIFRS, AASB 139: Financial Instruments: Recognition and Measurement	No change to accounting policy required. Therefore no impact.	1 July 2006
2005-6	AASB 3: Business Combinations	No change to accounting policy required. Therefore no impact.	1 July 2006
2005-10	AASB 132: Financial Instruments: Disclosure and Presentation AASB 101: Presentation of Financial Statements AASB 114: Segment Reporting AASB 117: Leases AASB 133: Earnings per Share AASB 139: Financial Instruments: Recognition and Measurement AASB 1: First-time adoption of AIFRS AASB 4: Insurance Contracts AASB 1023: General Insurance Contracts and AASB 1038: Life Insurance Contracts	No change to accounting policy required. Therefore no impact.	1 July 2007
New standard	AASB 7: Financial Instruments: Disclosures	No change to accounting policy required. Therefore no impact.	1 July 2007

(b) Principles of consolidation

The consolidated financial statements comprise the financial statements of Alto Energy International Limited and its subsidiaries at 30 June 2006. The financial statements of subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies. Subsidiaries are consolidated from the date on which control is transferred to the group and cease to be consolidated from the date on which control is transferred out of the group.

In preparing the consolidated financial statements, all inter-company transactions and balances have been eliminated in full.

Reverse Acquisition

In accordance with AASB 3 "Business Combinations", when Alto Energy International Limited (the legal parent) acquired the Alto Energy Limited group (being Alto Energy Limited and its controlled entity, Alto Energy Inc) (the legal subsidiary), the acquisition was deemed to be a reverse acquisition since the substance of the transaction is that the existing shareholders of Alto Energy Limited have effectively acquired Alto Energy International Limited. Under reverse acquisition accounting, the consolidated financial statements are prepared as if Alto Energy Limited had acquired Alto Energy International Limited and its controlled entities, not vice versa as represented by the legal position.

- In reverse acquisition accounting, the cost of the business is deemed to have been incurred by the legal subsidiary (the acquirer for accounting purposes) in the form of equity instruments issued to the owners of the legal parent (the acquiree for accounting purposes). However, due to the fact that the fair value of the equity instruments of the legal subsidiary (Alto Energy Limited) was not clearly evident at

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

the date at which the control was passed, the alternative method was elected (per AASB 3, para B6), where the cost of the business combination was determined as the total fair value of all the issued equity instruments of the legal parent (Alto Energy International Limited) immediately prior to the business combination.

- In the separate financial statements of the legal parent (Alto Energy International Limited), the investment in legal subsidiary (Alto Energy Limited) was accounted for at cost.

As a consequence:

- an exercise is performed to fair value the assets and liabilities of the legal acquirer, Alto Energy International Limited;
- the cost of investment held by the legal parent (Alto Energy International Limited) in the legal subsidiary (Alto Energy Limited) is reversed on consolidation and the cost of reverse acquisition is eliminated on consolidation against the consolidated equity and reserves of Alto Energy International Limited and its consolidated entities at the date when control is passed. The effect of this is to restate the consolidated equity and reserves balances to reflect those of Alto Energy Limited at the date of acquisition;
- the amount recognised as issued equity instruments are determined by adding to the issued equity of the legal subsidiary immediately before the business combination, the cost of the combination; and
- the consolidated financial statements are issued under the name of the legal parent (Alto Energy International Limited) but are a continuation of the financial statements of the deemed acquirer (Alto Energy Limited) under the reverse acquisition rules. Hence the comparative figures on the consolidated financial statements are that of Alto Energy Limited and its controlled subsidiary for the year ended 30 June 2005.

(c) Foreign currencies

Functional and Presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Australian dollars, which is Alto Energy International Limited's functional and presentation currency.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates; and
- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of any net investment in foreign entities, and of borrowings and other financial instruments designated as hedges of such investments, are taken to shareholder's equity. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences are recognised in the income statement, as part of the gain or loss on sale where applicable.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entities and translated at the closing rate.

(d) Cash and cash equivalents

For cash flow statement preparation purposes, cash and cash equivalents includes cash on hand, deposits held on call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

(e) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost, less provision for doubtful debts.

Collectibility of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off. A provision for doubtful receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is recognised in the income statement.

(f) Investments and other financial assets

Non-current investments in subsidiaries are carried at their cost of acquisition in the Company's balance sheet. A provision against investment is made where the Company has assessed the investment as impaired.

(g) Impairment of assets

Goodwill and 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 reviewed 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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

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 each reporting date.

(h) Property, plant and equipment

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

Plant and equipment

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

Increases in the carrying amount arising on revaluation of land and buildings are credited to a revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged against fair value reserves directly in equity; all other decreases are charged to the income statement.

Each year the difference between depreciation based on the revalued carrying amount of the asset charged to the income statement and depreciation based on the asset's original cost is transferred from the revaluation reserve to retained earnings.

Depreciation

The depreciable amount of all fixed assets including building and capitalised lease assets, but excluding freehold land, is depreciated on a straight-line basis over their useful lives to the consolidated entity commencing from the time the asset is held ready for use. Leasehold improvements are depreciated over the shorter of either the unexpired period of the lease or the estimated useful lives of the improvements.

The following estimated useful lives are used in the calculation of depreciation:

Plant and equipment	3-10 years
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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 income statement. When revalued assets are sold, amounts included in the revaluation reserve relating to that asset are transferred to retained earnings.

(i) Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments.

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

(j) Trade and other payables

These amounts represent liabilities for goods and services provided to the Group prior to the end of the financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

(k) Provisions

Provisions are recognised when the consolidated entity has a present obligation, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. The discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability. The increase in the provision due to the passage of time is recognised as interest expense.

(l) Contributed equity

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options for the acquisition of a business are not included in the cost of the acquisition as part of the purchase consideration.

If the entity reacquires its own equity instruments, eg as the result of a share buy-back, those instruments are deducted from equity and the associated shares are cancelled. No gain or loss is recognised in the profit or loss and the consideration paid including any directly attributable incremental costs (net of income taxes) is recognised directly in equity.

(m) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns, trade allowances and amounts collected on behalf of third parties. Revenue is recognised for the major business activities as follows:

Oil and gas revenue

Income is recorded when risks and rewards have passed to the buyer and the amount receivable can be measured reliably.

Interest income

Interest income is recognised as it accrues, taking into account the effective yield on the financial asset.

All revenue is stated net of the amount of goods and services tax (GST).

(n) Taxes

Income tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the national income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the taxation authority. In this case, it is recognised as part of the cost of the acquisition of the asset or as part of the expense.

Receivables and payables are stated inclusive of the amount of GST recoverable or payable. The net amount of GST recoverable from, or payable to, the taxation authority is included with other receivables or payables in the balance sheet.

(o) Employee benefits

Wages and salaries, annual leave and sick leave

Liabilities for wages and salaries, including non-monetary benefits, annual leave and accumulating sick leave expected to be settled within 12 months of the reporting date are recognised in other payables and provisions in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

Superannuation

The Company and other controlled entities contribute to several defined contribution superannuation plans. Contributions are charged against income as they are made.

Share-based payments

The fair value of options granted by the entity to employees is recognised as an employee benefit expense with a corresponding increase in equity. The fair value is measured at grant date and recognised over the period during which the employees become unconditionally entitled to the options.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

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

The fair value of the options granted is adjusted to reflect market vesting conditions, but excludes the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimate of the number of options that are expected to become exercisable. The employee benefit expense recognised each period takes into account the most recent estimate.

Upon the exercise of options, the balance of the share-based payments reserve relating to those options is transferred to share capital and the proceeds received, net of any directly attributable transaction costs, are credited to share capital.

(p) Earnings per share (EPS)

Basic EPS is calculated by dividing the profit attributable to equity holders of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

Diluted EPS adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

(q) Segment reporting

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

(r) Business combinations

The purchase method of accounting is used to account for all business combinations, including business combinations involving entities or businesses under common control, regardless of whether equity instruments or other assets are acquired.

Cost is measured as the fair value of the assets given, shares issued or liabilities incurred or assumed at the date of exchange plus costs directly attributable to the acquisition. Where equity instruments are issued in an acquisition, the fair value of the instruments is their published market price as at the date of exchange, unless in rare circumstances, it can be demonstrated that the published price at the date of exchange is an unreliable indicator of fair value and that other evidence and valuation methods provide a more reliable measure of fair value. Transaction costs arising on the issue of equity instruments are recognised directly in equity.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the Group's share of the fair value of the identifiable net assets of the subsidiary acquired, the difference is recognised directly in the income statement, but only after a reassessment of the identification and measurement of the net assets acquired.

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. The discount rate used is the entity's incremental borrowing rate, being at the rate which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

(s) Interest in joint ventures

The economic entity's share of the assets, liabilities, revenue and expenses of joint venture operations and assets are included in the appropriate items of the consolidated balance sheet and profit or loss.

The economic entity'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.

(t) Exploration and development expenditure

Exploration, evaluation and development expenditure incurred is accumulated in respect of each identifiable area of interest.

Exploration and evaluation costs are carried forward where right of tenure of the area of interest is current and they are expected to be recouped through sale or successful development and exploitation of the area of interest, or, where exploration and evaluation activities in the area of interest have not yet reached a stage that permits reasonable assessment of the existence of economically recoverable reserves.

When an area of interest is abandoned or the directors decide that it is not commercial, any accumulated costs in respect of that area are written off in full against income in the financial period in which the decision 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 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.

(u) Provision for restoration

The Group records the present value of the estimated cost of legal and constructive obligations to restore operating locations in the period in which the obligations arises. The nature of the restoration activities includes the removal of infrastructure, abandonment of wells and restoration of affected areas.

(v) Critical accounting estimates, assumptions and judgements

Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

reasonable under the circumstances. Equally, the Group employs judgment in the application of its accounting policies.

(i) **Critical accounting estimates and assumptions**

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of assets

In determining the recoverable amounts of assets, in the absence of quoted market prices, estimations are made using estimated sale value. For oil and gas properties, the Company is not at a stage to determine reserves or the present value of future cash flows. The carrying value of oil and gas properties is reviewed annually for impairment by the board of directors.

At the end of the financial year, an impairment trigger existed, as the market capitalisation of Alto Energy International Limited Group was lower than its net asset position. As a result, the board has determined that based upon the estimated acreage values in each area of interest, the fair value of oil and gas properties is \$4,400,000. The effect on the financial statements was to increase the impairment provision on capitalised oil and gas properties to \$11,953,455.

Restoration obligations

The Group estimates the present value of the costs of legal and constructive obligations to restore operating locations in the period in which the obligations arises. For more detail on the Company's policy in respect of provision for restoration, refer to Note 1(u).

Shared-based payment transactions

The Group measures the cost of equity settled share based payments at fair value at the grant date using the Black-Scholes model taking into account the exercise price, the term of the option, the impact of dilution, the share price at grant date, the expected volatility of the underlying share, the expected dividend yield and risk free interest rate for the term of the option.

The total expenses in share based transactions for the consolidated entity for the year ended 30 June 2006 was \$90,327 (2005: \$78,272).

(ii) **Critical Judgments in Applying the Group's Accounting Policies**

Exploration and evaluation

The Group's accounting policy for exploration and evaluation is set out in Note 1(t). If, after having capitalised expenditure under this policy, the directors conclude that the consolidated entity is unlikely to recover the expenditure by future exploration or sale, then the relevant capitalised amount will be written off to the Income Statement. During the year, following the decision to withdraw from future drilling in the Koppers North and Carden projects, the consolidated entity has written off exploration and evaluation costs amounting to \$926,713 to the income statement.

(w) **Comparative information**

Where necessary, comparatives have been reclassified and repositioned for consistency with current year disclosures.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

2. Revenue from ordinary activities

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Revenues from ordinary activities				
Interest	138,141	24,686	113,826	7,346
Sale of oil and gas	36,998	-	-	-
Total revenues from ordinary activities	175,139	24,686	113,826	7,346

3. Loss from operations

(a) Other income

Foreign exchange gains (net)	-	-	30,144	-
	-	-	30,144	-

(b) Expenses

Loss before income tax includes the following specific expenses:

<i>Depreciation</i>				
Plant and equipment	7,329	906	1,481	-
Total depreciation	7,329	906	1,481	-
Net loss on disposal of property, plant and equipment	261	-	-	-
<i>Rental expense relating to operating leases</i>				
Minimum lease payments	77,992	19,253	83,018	8,710
Total rental expense relating to operating leases	77,992	19,253	83,018	8,710
Defined contribution superannuation expense	34,818	8,250	16,796	532
<i>Foreign exchange gains and losses</i>				
Net foreign exchange losses	326	-	-	-
	326	-	-	-

4. Income tax

(a) Income tax benefit

Current tax	-	-	-	-
Deferred tax Under (over) provided in prior years	(3,742,990)	-	-	-
	-	-	-	-
	(3,742,990)	-	-	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

4. Income tax (continued)

(b) Reconciliation of income tax benefit to prima facie tax payable

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Loss from ordinary activities before income tax expense	(13,493,733)	(554,948)	(12,521,986)	(21,576)
Prima facie tax benefit on loss from ordinary activities at 30% (2005: 30%)	(4,048,120)	(166,484)	(3,756,596)	(6,473)
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:				
Share based payments	27,098	23,482	22,865	-
Impairment expense	3,302,638	-	-	-
Other	-	1,245	-	-
	(718,384)	(141,757)	(3,733,731)	(6,473)
Movements in deferred taxes in relation to temporary differences	(256,789)	(330,192)	3,497,229	(21,153)
Reversal of deferred tax liability in relation to capitalised oil and gas asset (note 4(d))	(3,742,990)	-	-	-
Difference in overseas tax rates	(83,326)	(49,607)	-	-
Tax effect of current year tax losses for which no deferred tax asset has been recognised	1,058,499	521,556	236,502	27,626
Income tax expense / (benefit)	(3,742,990)	-	-	-

(c) Unrecognised temporary differences

Deferred tax assets

Tax losses at 30%	455,709	104,543	521,588	285,086
Temporary differences at 30%	105,015	103,234	3,539,560	39,852
Tax losses – foreign subsidiaries (34%)	1,129,935	421,661	-	-

Deferred tax liabilities

Temporary differences at 30%	(688,398)	(392,955)	-	-
Net deferred tax asset not recognised	1,002,261	236,483	4,061,148	324,938

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

4. Income tax (continued)

(d) Deferred tax liabilities

The balance comprises temporary differences attributable to:

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Amounts recognised in loss:				
Capitalised oil and gas asset on acquisition of subsidiary written off	(3,742,990)	-	-	-
	(3,742,990)	-	-	-
Amounts recognised directly in equity				
	-	-	-	-
	(3,742,990)	-	-	-
<i>Movements:</i>				
Opening balance at 1 July	285,005	-	-	-
Credited / (charged) to loss	(3,742,990)	-	-	-
Credited / (charged) to equity	-	-	-	-
Acquisition of subsidiary	4,021,039	285,005	-	-
Closing balance at 30 June	563,054	285,005	-	-

Net deferred tax assets have not been brought to account as it is not probable within the immediate future that tax profits will be available against which deductible temporary differences and tax losses can be utilised.

5. Dividends paid or provided for on ordinary shares

No dividend has been declared or paid during the current financial year or the prior financial year.

The consolidated entity does not have any franking credits available for current or future years as the consolidated entity is not in a tax paying position.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

6. Receivables

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Current				
Other debtors (i)	41,194	215,257	16,354	8,248
Amounts receivable from controlled entities(ii)	-	-	1,588,379	-
Provision for doubtful debts (iii)	-	-	(242,474)	-
	41,194	215,257	1,362,259	8,248
Non-Current				
Other debtors	-	-	-	2,651
	-	-	-	2,651

(i) Other debtors include amounts outstanding for goods & services tax (GST) These amounts are non-interest bearing and have repayment terms applicable under the relevant government authorities.

(ii) Amounts receivable from controlled entities are unsecured, non-interest bearing and are repayable on demand.

(iii) A provision for doubtful debts was recognised on the amount receivable from a related entity, Alto Energy Inc, based on its net asset position at 30 June 2006.

7. Other assets

Current				
Prepayments	8,973	1,911	8,973	550

8. Other financial assets

Non-current				
Shares in controlled entities (i)	-	-	15,749,268	-
Less Provision for diminution	-	-	(11,429,162)	-
	-	-	4,320,106	-

(i) These financial assets are carried at cost.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

8. Other financial assets (continued)

(a) Investments in controlled entities

The consolidated entity financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in note 1(b).

Investments in controlled entities held by Alto Energy International Limited

	Country of incorporation	2006	2005	2006	2005
		%	%	\$	\$
Golden Fleece Petroleum Inc	USA	100	-	5,479	-
Alto Energy Limited	Australia	100	-	4,314,627	-
LDR Operations Limited	Australia	-	100	-	-
				<u>4,320,106</u>	<u>-</u>

Investments in controlled entities held by Alto Energy Limited

	Country of incorporation	2006	2005	2006	2005
		%	%	\$	\$
Alto Energy Inc	USA	100	100	764,907	764,907
				<u>764,907</u>	<u>764,907</u>

9. Property, plant and equipment

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Plant and equipment				
At cost	50,705	25,687	26,292	-
Accumulated amortisation	(7,846)	(906)	(1,482)	-
	<u>42,859</u>	<u>24,781</u>	<u>24,810</u>	<u>-</u>

(a) Reconciliations

Reconciliations of the carrying amounts for each class of property, plant and equipment are set out below:

Plant and equipment				
Carrying amount at beginning of year	24,781	-	-	-
Additions	26,577	25,687	26,292	-
Disposals	(1,170)	-	-	-
Depreciation	(7,329)	(906)	(1,482)	-
Carrying amount at end of year	<u>42,859</u>	<u>24,781</u>	<u>24,810</u>	<u>-</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

10. Exploration expenditure

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Capitalised oil and gas expenditure	16,353,455	2,425,030	-	-
Provision for impairment	(11,953,455)	-	-	-
	<u>4,400,000</u>	<u>2,425,030</u>	-	-
Capitalised oil and gas expenditure				
Carrying amount at beginning of year	2,425,030	-	-	-
Amounts acquired under business combinations	27 13,193,362	884,031	-	-
Expenditure during the year	680,649	1,698,706	-	-
Disposals	-	(157,707)	-	-
Impairment provision	(11,008,794)	-	-	-
Write off of capitalised expenditure	(926,713)			
Net foreign currency movements	36,446	-	-	-
Carrying amount at end of year	<u>4,400,000</u>	<u>2,425,030</u>	-	-

The ultimate recoupment of costs carried forward for capitalised expenditure is dependent on the successful development and commercial exploitation of lease acreage. In accordance with Note 1(t), amortisation will be calculated over the life of the area according to the rate of depletion of economically recoverable reserves, at the time when production commences.

11. Payables

Current

Trade creditors (i)	95,831	92,270	4,575	2,968
Other creditors (i)	140,848	100,061	68,300	18,400
Amounts payable to directors and director-related entities	-	52,400	-	-
Amounts payable to controlled entities	-	-	1,161,834	-
	<u>236,679</u>	<u>244,731</u>	<u>1,234,709</u>	<u>21,368</u>

- (i) Trade and other creditor amounts represent liabilities for goods and services provided to the consolidated entity prior to the end of the financial year and which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

12. Provisions

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Current				
Provision for employee entitlements	28,536	7,048	8,230	-
Non-Current				
Provision for future restoration	72,593	23,517	-	-

(a) Reconciliations

Provision for future restoration				
Carrying amount at beginning of year	23,517	-	-	-
Additional provisions recognised	49,076	23,517	-	-
Carrying amount at end of year	72,593	23,517	-	-

13. Contributed equity

(a) Issued capital

Ordinary shares, fully paid	15,993,205	5,178,584	18,098,556	1,883,480
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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

13. Contributed equity (continued)

(b) Movements in share capital

Consolidated

	2006	2005	2006	2005
	Number	Number	\$	\$
Balance at beginning of period	36,996,504	11,684,004	5,178,584	275,506
Changes during the year				
Cash call on partly paid shares	-	-	-	802,080
Issue of shares for 18.46 cents per share	-	20,312,500	-	3,750,000
Issue of shares on acquisition of Alto Energy Inc (formerly Golden Triangle Energy Inc) (i)	-	5,000,000	-	640,000
Balances at date of merger	36,996,504	N/A	5,178,584	N/A
Reversal of Alto Energy Limited shares	(36,996,504)	-	-	-
Balance immediately prior to business combination *	433,191,569	-	-	-
Consolidation of shares on 1:8 basis	(379,042,623)	-	-	-
Issue of shares on acquisition of Alto Energy Limited (ii)	60,119,333		10,830,313	
Share placement at 23 cents per share	2,000	-	460	-
Share issue costs	-		(16,152)	(289,002)
Balance at end of year	<u>114,270,279</u>	<u>36,996,504</u>	<u>15,993,205</u>	<u>5,178,584</u>

* Based on the reverse acquisition that was undertaken during the financial year (refer to accounting policy in note 1(b)), the capital structure of the consolidated entity is that of the legal parent (Alto Energy International Limited) whilst the value of the shares are that of the legal subsidiary (Alto Energy Limited) immediately prior to the reverse acquisition. The total amount recognised in issued equity is determined by adding the issued capital of the legal subsidiary immediately before the business combination to the cost of acquisition of Alto Energy Limited.

(i) The issue of shares relates to the fair value of shares issued for the consideration of Alto Energy Inc (formerly Golden Triangle Energy Inc) in March 2005.

(ii) In February 2006, the parent entity (Alto Energy International Limited) issued shares for the consideration of the merger with Alto Energy Limited. For more information on the business combination, refer to note 27 of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

13. Contributed equity (continued)

(b) Movements in share capital (continued)

Company

	2006	2005	2006	2005
	Number	Number	\$	\$
Balance at beginning of period	300,191,569	42,403,760	1,883,480	27,210,978
Changes during the year				
Share placement at 3.5 cents per share	100,000,000	-	3,500,000	-
Issue of shares on acquisition of Golden Fleece Petroleum, Inc	18,000,000	-	756,000	-
Reduction of capital	-	-	-	(27,210,978)
Share placement at 1 cent per share	15,000,000	10,000,000	150,000	100,000
Consolidation of shares on 1:8 basis (2005: 10:21 basis)	(379,042,623)	(22,212,191)	-	-
Share placement at 20 cents per share	2,000	-	460	-
Issue of shares on acquisition of Alto Energy Limited	60,119,333	-	12,023,866	-
Issue of shares at 0.375 cents per share	-	120,000,000	-	450,000
Issue of shares at 1 cent each pursuant to Prospectus	-	150,000,000	-	1,500,000
Share issue costs	-	-	(215,250)	(166,520)
Balance at end of year	<u>114,270,279</u>	<u>300,191,569</u>	<u>18,098,556</u>	<u>1,883,480</u>

(c) Share options

	Exer- cise price	Expiry date	Balance at beginning of year Number #	Issued during the year Number #	Exercised during the year Number #	Cancelled during the year Number #	Balance at end of year Number #
Listed options	\$3.36	31/12/06	1,230,575	-	-	-	1,230,575
Unlisted options	\$0.08	31/12/08	5,000,000	1,500,000	-	-	6,500,000
Unlisted options	\$0.20	31/12/08	-	1,875,000	-	-	1,875,000
Unlisted options *	\$0.32	31/12/08	-	500,000	-	-	500,000
Unlisted options *	\$0.40	31/12/08	-	1,000,000	-	-	1,000,000
Unlisted options	\$0.20	31/1/08	-	17,455,643	-	-	17,455,643
Unlisted options	\$0.20	31/10/08	-	1,706,250	-	-	1,706,250
Unlisted options	\$0.24	30/11/08	-	1,771,875	-	-	1,771,875
Unlisted options	\$0.28	31/12/08	-	1,771,875	-	-	1,771,875
Unlisted options *	\$0.25	31/12/08	-	750,000	-	-	750,000
Unlisted options *	\$0.30	31/12/08	-	750,000	-	-	750,000
			<u>6,230,575</u>	<u>29,080,643</u>	<u>-</u>	<u>-</u>	<u>35,311,218</u>

* Options issued pursuant to the Company's Employee Share Option Plan (ESOP). Refer Note 28 for details.

Number of options is on a post-reconstruction basis

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

13. Contributed equity (continued)

(d) Terms and conditions of contributed equity

Ordinary shares

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

Ordinary shares entitle their holder to one vote, either in person or by proxy, at a meeting of the Company.

14. Reserves

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Foreign currency translation	58,411	5,294	-	-
Option premium	259,763	169,436	2,051,545	-
	<u>318,174</u>	<u>174,730</u>	<u>2,051,545</u>	<u>-</u>

(a) Foreign currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of self-sustaining foreign operations.

Balance at beginning of year	5,294	-	-	-
Gain / (loss) on translation of foreign controlled entities	53,117	5,294	-	-
Balance at end of year	<u>58,411</u>	<u>5,294</u>	<u>-</u>	<u>-</u>

(b) Option premium reserve

The option premium reserve is used to recognise the value of options issued of a capital nature.

Balance at beginning of year	169,436	-	-	-
Increase on issue of options (i), (ii)	90,327	169,436	2,051,545	-
Balance at end of year	<u>259,763</u>	<u>169,436</u>	<u>2,051,545</u>	<u>-</u>

(i) During the year the consolidated entity recognised \$90,327 as employee and directors' options expense. For more details, refer to note 28 of the financial statements.

(ii) During the year, the parent entity recognised \$76,218 as employee options expense. An amount of \$732,066 was recognised in respect of the Golden Fleece Petroleum Inc acquisition and \$1,243,261 was recognised in respect of options issued as part of the Alto Energy Limited merger. For more information on these transactions, refer to notes 27 and 28 to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

15. Accumulated losses

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Balance at beginning of year	(543,075)	11,873	(901,576)	(880,000)
Net loss attributable to members of the Company	(9,753,881)	(554,948)	(12,521,986)	(21,576)
Balance at end of year	<u>(10,296,956)</u>	<u>(543,075)</u>	<u>(13,423,562)</u>	<u>(901,576)</u>

16. Notes to the statement of cash flows

(a) Reconciliation of cash

For the purposes of the statement of cash flows, cash includes cash on hand and in banks and investments in money market instruments. Cash at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:

Cash on hand	2,422,258	2,703,561	2,257,632	991,823
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(b) Reconciliation of loss after related income tax to net cash outflows from operating activities

Loss for the year	(9,753,881)	(554,948)	(12,521,986)	(21,419)
Depreciation	7,329	906	1,481	-
Impairment and write-offs of oil and gas assets	11,935,507	-	-	-
Write offs of intercompany loans and investments	-	-	11,719,889	-
Share based payments	90,327	78,272	76,217	-
Income tax benefit	(3,742,990)	-	-	-
Loss on disposal of property, plant and equipment	261	-	-	-
Exchange rate adjustments on balance of cash held in foreign currencies	326	-	(30,143)	-
Changes in net assets and liabilities				
(Increase) / decrease in assets:				
Trade and other receivables	342,072	(52,580)	(8,106)	(8,248)
Prepayments	18,044	(1,911)	(8,423)	(550)
Capitalised Expenditure	(624,683)	(1,079,426)		
Increase / (decrease) in liabilities:				
Trade and other creditors	(317,652)	110,106	16,434	21,211
Provisions	21,488	7,048		-
Net cash outflows from operating activities	<u>(2,023,851)</u>	<u>(1,492,533)</u>	<u>(754,637)</u>	<u>(9,006)</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

17. Expenditure commitments

(a) Capital commitments

Capital expenditure contracted for at the reporting date but not recognised as liabilities is as follows:

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Exploration and lease rentals commitments				
Not later than one year	1,417,360	2,361,941	-	417,000
Later than one year and not later than five years	-	175,222	-	-
Later than five years	-	-	-	-
	<u>1,417,360</u>	<u>2,537,163</u>	<u>-</u>	<u>417,000</u>

The above commitments relate to exploration expenditure on US joint venture projects as well as lease rentals on specific acreage held in the US.

(b) Lease commitments

Operating leases (non-cancellable)				
Not later than one year	24,561	159,038	24,561	-
Later than one year and not later than five years	-	128,037	-	-
Later than five years	-	-	-	-
	<u>24,561</u>	<u>287,075</u>	<u>24,561</u>	<u>-</u>

The above commitments relate to the sub-lease of premises held by the consolidated entity.

(c) Remuneration commitments

Commitments for the payment of salaries and other remuneration under long term employment contracts in existence at the reporting date but not recognised as liabilities, payable:

Not later than one year	258,110	247,638	258,110	-
Later than one year and not later than five years	-	-	-	-
Later than five years	-	-	-	-
	<u>258,110</u>	<u>247,638</u>	<u>258,110</u>	<u>-</u>

Amounts disclosed as remuneration commitments include commitments arising from the service contracts of key management personnel referred to in section C of the remuneration report in the Directors report that are not recognised as liabilities and are not included in the key management personnel compensation.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

18. Contingent liabilities

The consolidated entity had no contingent liabilities as at 30 June 2006.

19. Subsequent events

On 31 July 2006 the Company announced that it intended to accommodate a share buy back facility for shareholders with unmarketable parcels of shares assessed at 28 July 2006. The purchase price of these shares is set at 6.7 cents per share.

On 18 September 2006, the Company announced that it had signed an agreement with Ascent Resources WV Inc, for the sale of its 29% interest in Cornstalk/Bugrun/Green Park shale gas projects in West Virginia. The sale is subject to a final Purchase and Sales Agreement with the closing date set for early November.

20. Earnings per share

The following reflects the income and share data used in the calculation of basic and diluted earnings per share:

	Consolidated	
	2006	2005
	\$	\$
Net loss	(9,753,881)	(554,948)
Adjustments:	-	-
Losses used in calculating basic earnings per share	(9,753,881)	(554,948)
	Number	Number
Weighted average number of ordinary shares used in calculating basic earnings per share	82,373,402	56,131,947
Effect of dilutive securities		
Share options	-	-
Adjusted weighted average number of ordinary shares used in calculating basic and diluted earnings per share	82,373,402	56,131,947

There have been no conversions to, calls of, or subscriptions for ordinary shares or issues of potential ordinary shares since the reporting date and before the completion of this annual report.

21. Key management personnel disclosures

(a) Directors

The directors of the Alto Energy International Limited consolidated group and Alto Energy International Limited during the financial year have been disclosed in section C of the remuneration report in the Directors report.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

21. Key management personnel disclosures (continued)

(b) Other key management personnel

The executives of the Alto Energy International Limited consolidated group and Alto Energy International Limited during the financial year have been disclosed in section C of the remuneration report in the Directors report.

(c) Key management personnel compensation

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Short-term employee benefits	804,417	257,714	277,009	1,742
Post-employment benefits	40,096	8,250	14,680	157
Share-based payments	94,527	78,272	76,217	-
	<u>939,020</u>	<u>344,236</u>	<u>367,906</u>	<u>1,899</u>

The Company has taken advantage of the relief provided by ASIC Class Order 06/50 and has transferred the detailed remuneration disclosures to the directors' report. The relevant information can be found in sections a) to c) of the remuneration report in the Directors report.

(d) Equity instrument disclosures relating to key management personnel

(i) Options provided as remuneration and shares issued on the exercise of such options

Details of options provided as remuneration and shares issued on the exercise of such options, together with terms and conditions of the options, can be found in section D of the remuneration report in the Directors report.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

21. Key management personnel disclosures (continued)

(d) Equity instrument disclosures relating to key management personnel (continued)

(ii) Option holdings

The number of options over ordinary shares in the Company held during the financial year by each director of Alto Energy International Limited and other key management personnel of the group, including their personally related parties, are set out below.

Alto Energy International Limited Group 2006

Options held in Alto Energy Limited

The following table details options held by directors in Alto Energy Limited to the time of the merger with Alto Energy International Limited:

Name	Balance at start of the period	Granted during the period	Exercised during the period	Other changes during the period	Balance at time of merger	Remuneration options Vested and Exercisable at time of merger
	Number	Number	Number	Number	Number	Number
Directors						
Mr C Morgan	5,700,000	-	-	-	5,700,000	-
Mr G Channon	2,535,937	-	-	-	2,535,937	1,700,000
Mr P Fry#	1,554,687	-	-	-	1,554,687	1,000,000
Total	9,790,624	-	-	-	9,790,624	2,700,000

Closing balance at date of resignation

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

21. Key management personnel disclosures (continued)

(d) Equity instrument disclosures relating to key management personnel (continued)

(ii) Option holdings (continued)

Alto Energy International Limited Group 2005

Options held in Alto Energy Limited

Name	Balance at start of the year	Granted during the year as remuneration	Exercised during the year	Other changes during the year	Balance at end of the year	Remuneration on Options Vested and exercisable at end of the year
	Number	Number	Number	Number	Number	Number
Directors						
Mr C Morgan	-	700,000	-	5,000,000	5,700,000	700,000
Mr G Channon	-	2,500,000	-	35,937	2,535,937	800,000
Mr P Fry	-	1,500,000	-	54,687	1,554,687	500,000
Mr E Rigg #	10,250	-	-	-	10,250	-
Mr C Burton #	10,000	-	-	-	10,000	-
Mr J El-Raghy #	211,500	-	-	-	211,500	-
Mr G Evans #	7,500	-	-	-	7,500	-
Mr D Whitby #	-	500,000	-	-	500,000	500,000
Total	239,250	5,200,000	-	5,090,624	10,529,874	2,500,000

Closing balance at date of resignation

Alto Energy International Limited 2006

Name	Balance at start of the year	Granted during the year as remuneration	Exercised during the year	Other changes during the year	Balance at end of the year	Remuneration on Options Vested and exercisable at end of the year
	Number	Number	Number	Number	Number	Number
Directors						
Mr A Grist *	912,814	-	-	-	912,814	-
Mr C Morgan	9,731,250	-	-	-	9,731,250	-
Mr G Channon	3,312,012	-	-	-	3,312,012	-
Mr A Dimsey *	-	1,500,000	-	-	1,500,000	500,000
Mr J Trimble *	-	1,500,000	-	-	1,500,000	-
Mr R Monti #	125,000	-	-	-	125,000	-
Mr A Sierakowski #	250,000	-	-	73,829	323,829	-
Mrs N Donovan	250,000	-	-	-	250,000	-
Executives						
Mr R Prudnick *	-	-	-	-	-	-
Total	14,581,076	3,000,000	-	73,829	17,654,905	500,000

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

21. Key management personnel disclosures (continued)

(d) Equity instrument disclosures relating to key management personnel (continued)

(ii) Option holdings (continued)

The above holdings are stated on a post 1:8 reconstruction basis

* Opening balance at date of appointment

Closing balance at date of resignation

Alto Energy International Limited 2005

Name	Balance at start of the period	Granted during the period as remuneration	Exercised during the period	Other changes during the period	Balance at end of the period
	Number	Number	Number	Number	Number
Directors					
Mr R Monti	-	-	-	1,000,000	1,000,000
Mr A Sierakowski	-	-	-	2,000,000	2,000,000
Mrs N Donovan	-	-	-	2,000,000	2,000,000
Total	-	-	-	5,000,000	5,000,000

The above holdings are stated on a pre 1:8 reconstruction basis

(iii) Share Holdings

The number of shares in the Company held during the financial year by each of the director of Alto Energy International Limited and other key management personnel of the Group, including their personally related parties, is set out below. There were no shares granted during the reporting period as compensation.

Alto Energy International Limited Group 2006

Shares held in Alto Energy Limited

The following table details shares held by directors in Alto Energy Limited to the time of the merger with Alto Energy International Limited:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

21. Key management personnel disclosures(continued)

(d) Equity instrument disclosures relating to key management personnel (continued)

(iii) Share Holdings (continued)

Name	Balance at start of the period	Received during the period on exercise of options	Other changes during the period	Balance at date of acquisition
	Number	Number	Number	Number
Directors				
Mr C Morgan	5,000,000	-	-	5,000,000
Mr G Channon	143,750	-	-	143,750
Mr P Fry	218,750	-	-	218,750
Total	5,362,500	-	-	5,362,500

Alto Energy International Limited Group 2005

Shares held in Alto Energy Limited

Name	Balance at start of the year	Received during the year on exercise of options	Other changes during the year	Balance at end of the year
	Number	Number	Number	Number
Directors				
Mr C Morgan	-	-	5,000,000	5,000,000
Mr G Channon	-	-	143,750	143,750
Mr P Fry	-	-	218,750	218,750
Mr E Rigg #	1,445,001	-	-	1,445,001
Mr C Burton #	940,001	-	-	940,001
Mr J El-Raghy#	1,756,001	-	-	1,756,001
Mr G Evans #	830,001	-	75,000	905,001
Mr D Whitby #	-	-	-	-
Total	4,971,004	-	5,437,500	10,408,504

Closing balance at date of resignation

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

21. Key management personnel disclosures (continued)

(d) Equity instrument disclosures relating to key management personnel (continued)

(iii) Share Holdings (continued)

Alto Energy International Limited 2006

Shares held in Alto Energy International Limited

Name	Balance at start of the year	Received during the year on exercise of options	Other changes during the year	Balance at end of the year
	Number	Number	Number	Number
Directors				
Mr A Grist *	4,282,500	-	900,000	5,182,500
Mr C Morgan * ^	10,062,500	-	5,600,000	15,662,500
Mr G Channon *^	296,094	-	-	296,094
Mr A Dimsey *	-	-	-	-
Mr J Trimble *	-	-	100,000	100,000
Mr R Monti #	125,000	-	-	125,000
Mr A Sierakowski #	875,000	-	365,625	1,240,625
Mrs N Donovan #	375,000	-	-	375,000
Executive				
Mr R Prudnick *	-	-	-	-
Total	16,016,094	-	6,965,625	22,981,719

The above holdings are stated on a post 1:8 reconstruction basis

* Opening balance at date of appointment

Closing balance at date of resignation

^ Mr Morgan and Mr Channon were shareholders of both Lach Drummond Resources and Alto Energy Limited at the time of the merger.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

21. Key management personnel disclosures (continued)

(d) Equity instrument disclosures relating to key management personnel (continued)

(iii) Share Holdings (continued)

Alto Energy International Limited 2005

Name	Balance at start of the period (9 May 2005)	Received during the period on exercise of options	Other changes during the period	Balance at end of the period
	Number	Number	Number	Number
Directors				
Mr R Monti	-	-	1,000,000	1,000,000
Mr A Sierakowski	-	-	7,000,000	7,000,000
Mrs N Donovan	-	-	3,000,000	3,000,000
Total	-	-	11,000,000	11,000,000

The above holdings are stated on a pre 1:8 reconstruction basis

(e) Other transactions with key management personnel

All transactions with related parties are made on normal commercial terms and conditions except where indicated.

An amount of \$34,974 (2005: \$19,253) was paid to Seaspin Pty Limited, of which Mr C Morgan is a director, for lease of office space and other consulting services for the Group.

During the 2006 financial year, the Group incurred costs of \$9,865 (2005: \$5,042) for communication services from Purple Communications, a company related to Mr C Morgan's spouse.

An amount of \$45,015 (2005: nil) was paid to Albion Capital Partners, of which Mr A Grist is a partner, for sublease of BGC Centre office space (in the period subsequent to Mr Grist being appointed as a director). A further amount of \$8,603 (2005: nil) was paid to Albion Capital Partners for financial analyst services (in the period subsequent to Mr Grist being appointed as a director).

An amount of \$95,548 (2005: \$62,168) was paid to Price Sierakowski, of which Mr A Sierakowski is a partner, for legal services during the period.

Siafu Securities Pty Ltd, a company associated with Mr Burton, Mr El-Raghy and Mr Rigg, all directors of the Group during 2005, entered into a management agreement with the Group whereby Siafu Securities Pty Ltd received a monthly management fee of \$2,000 plus GST from February 2004 to March 2005. The amounts paid under this agreement during the 2005 financial year totalled \$14,000.

Amounts owing to directors, director-related parties and other related parties at 30 June 2006 were nil (2005: nil).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

22. Auditor's remuneration

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
<i>Auditor of the parent entity</i> Audit or review of the financial report	54,055	15,000	26,617	5,024
Other services	1,545	900	-	-
	<u>55,600</u>	<u>15,900</u>	<u>26,617</u>	<u>5,024</u>

The auditor of Alto Energy International Limited is Horwath Audit (WA) Ltd.

23. Segment information

Geographic segment – primary segment

The consolidated entity operates in only one geographic segment, being North America.

24. Financial instruments

(a) Interest rate risk

The consolidated entity is exposed to movements in market interest rates on short term deposits. The policy is to monitor the interest rate yield curve to ensure a balance is maintained between the liquidity of cash assets and the interest rate return. The consolidated entity's exposure to interest rate risks and the effective interest rates of financial assets and financial liabilities, both recognised and unrecognised at the reporting date, are as follows:

	Notes	Floating interest rate	Consolidated Fixed interest rate			Non-interest bearing	Total	Weighted average interest rate
			1 year or less	Over 1 to 5 years	More than 5 years			
			\$	\$	\$			
2006								
<i>Financial assets</i>								
Cash	16(a)	169,109	2,252,949	-	-	200	2,422,258	5.2
Trade and other receivables	6	-	-	-	-	41,194	41,194	-
		<u>169,109</u>	<u>2,252,949</u>	<u>-</u>	<u>-</u>	<u>41,394</u>	<u>2,463,452</u>	
<i>Financial liabilities</i>								
Trade creditors and accruals	11	-	-	-	-	236,679	236,679	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

24. Financial instruments (continued)

(a) Interest rate risk (continued)

2005

Financial assets

Cash	16(a)	2,703,561	-	-	-	-	2,703,561	2.5
Trade and other receivables	6	-	-	-	-	215,247	215,247	-
		<u>2,703,561</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>215,247</u>	<u>2,918,808</u>	

Financial liabilities

Trade creditors and accruals	11	-	-	-	-	244,731	244,731	-
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Notes	Floating interest rate	Company Fixed interest rate			Non-interest bearing	Total	Weighted average interest rate
		1 year or less	Over 1 to 5 years	More than 5 years			
	\$	\$	\$	\$	\$	%	

2006

Financial assets

Cash	16(a)	4,483	2,252,949	-	-	200	2,257,632	5.5
Trade and other receivables	6	-	-	-	-	1,362,259	1,362,259	-
		<u>4,483</u>	<u>2,252,949</u>	<u>-</u>	<u>-</u>	<u>1,362,459</u>	<u>3,619,891</u>	

Financial liabilities

Trade creditors and accruals	11	-	-	-	-	1,234,709	1,234,709	
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2005

Financial assets

Cash	16(a)	991,823	-	-	-	-	991,823	3.9
Trade and other receivables	6	-	-	-	-	8,248	8,248	-
		<u>991,823</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,248</u>	<u>1,000,071</u>	

Financial liabilities

Trade creditors and accruals	11	-	-	-	-	21,368	21,368	-
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24. Financial instruments (continued)

b) Net fair values

The net fair values of the financial assets and liabilities at balance date approximate the carrying amounts in the financial statements, except where specifically stated.

(c) Credit risk exposure

The consolidated entity's maximum exposure to credit risk to each class of recognised financial asset is the carrying amount, net of any provisions for doubtful debts, of those assets as indicated in the balance sheet. As the group does not currently have any significant debtors, lending, stock levels or any other credit risk, a formal credit risk management policy is not maintained.

(d) Foreign currency risk

The Group is exposed to fluctuations in foreign currencies arising from the sale and purchase of goods and services in currencies other than the group's measurement currency. The Group operates internationally and is exposed to foreign exchange risk arising from currency exposures to the United States Dollar, being the functional currency of its operations in the United States. The Group has not formalised a foreign currency risk management policy, however it monitors its potential risk in light of exchange rate movements.

25. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards

The consolidated entity changed its accounting policies on 1 July 2005 to comply with Australian equivalents to International Financial Reporting Standards (A-IFRS). The transition to A-IFRS is accounted for in accordance with Accounting Standard AASB 1 First-time Adoption of Australian Equivalents to International Financial Reporting Standards, with 1 July 2004 as the date of transition, except for financial instruments, where the date of transition is 1 July 2005 (refer Note 1).

An explanation of how the transition from superseded policies to A-IFRS has affected the consolidated entity and Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

Effect of A-IFRS on the balance sheet as at 1 July 2004

The Company's review has determined that the transition to A-IFRS will not have a material effect on the Company's opening balance sheet as at 1 July 2004.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

25. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (continued)

Effect of A-IFRS on the income statement for the financial year ended 30 June 2005

	Note	Previous AGAAP	Effect of transition to A-IFRS	A-IFRS
		\$	\$	\$
Revenue from ordinary activities				
Interest and other		24,686		24,686
		<u>24,686</u>		<u>24,686</u>
Expenses				
Director and personnel expenses	c	244,230	78,272	322,502
Depreciation of plant and equipment		906	-	906
Professional and consulting fees		67,497	-	67,497
Rent		19,253	-	19,253
Travel and accommodation		54,444	-	54,444
Net foreign exchange loss		11,893	-	11,893
Oil and gas lease rentals		10,310	-	10,310
Corporate advisory fees		20,000	-	20,000
Management fees		14,000	-	14,000
Share registry		4,645	-	4,645
Other expenses from ordinary activities		54,184	-	54,184
		<u>501,362</u>	<u>78,272</u>	<u>579,634</u>
Loss from ordinary activities before income tax		<u>476,676</u>	<u>78,272</u>	<u>554,948</u>
Income tax		-	-	-
Net loss		<u><u>476,676</u></u>	<u><u>78,272</u></u>	<u><u>554,948</u></u>

- Reported financial results under previous Australian GAAP.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

25. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (continued)

Effect of A-IFRS on the balance sheet as at 30 June 2005

	Notes	Previous AGAAP \$	Consolidated Effect of transition to A-IFRS \$	A-IFRS \$
Current assets				
Cash and cash equivalents		2,703,561	-	2,703,561
Trade and other receivables		215,257	-	215,257
Other		1,911	-	1,911
Total current assets		2,920,729	-	2,920,729
Non-current assets				
Property, plant and equipment		24,781	-	24,781
Capitalised oil and gas expenditure	a, b, d	2,088,273	336,757	2,425,030
Other intangible assets		-	-	-
Total non-current assets		2,113,054	336,757	2,449,811
Total assets		5,033,783	336,757	5,370,540
Current liabilities				
Trade and other payables		244,731	-	244,731
Provisions		7,048	-	7,048
Total current liabilities		251,779	-	251,779
Non-current liabilities				
Provisions	b	-	23,517	23,517
Deferred tax liabilities	a	-	285,005	285,005
Total non-current liabilities		-	308,522	308,522
Total liabilities		251,779	308,522	560,301
Net assets		4,782,004	28,235	4,810,239
Equity				
Issued capital		5,178,584	-	5,178,584
Reserves	c, d	91,164	83,566	174,730
Accumulated losses		(487,744)	(55,331)	(543,075)
Total equity		4,782,004	28,235	4,810,129

* Reported financial position under previous Australian GAAP.

Effect of A-IFRS on the cash flow statement

There are no material differences between the cash flow statement presented under A-IFRS and the cash flow statement presented under the superseded policies.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

25. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (continued)

Notes to the reconciliations of the income statement and balance sheet

- a) Under A-IFRS, the fair value of oil and gas assets acquired as part of the Golden Triangle acquisition in March 2005 were adjusted to take into account the associated tax liability relating to those assets. The effect at 30 June 2005 is to increase exploration and evaluation expenditures by \$285,005 and increase the deferred tax liability by \$285,005.
- b) Under A-IFRS the liability for future restoration costs reflects the present value of the total expected restoration costs, and is capitalised as a component of and exploration and evaluation expenditures. Under previous GAAP the cost of restoration was provided for over the life of the property.

The effect at 30 June 2005 is to increase exploration and evaluation expenditures by \$23,517 and provisions by \$23,517.

- c) Under A-IFRS the cost of employee remuneration provided in the form of equity-based remuneration (including shares and options) will be measured based on the fair value of those instruments and amortised to the profit and loss over the vesting period.

The effect at 30 June 2005 is to increase accumulated losses by \$78,272 and increase the option premium reserve by \$78,272.

- d) The functional currency of Alto's US subsidiary is US dollars. The subsidiaries' net assets are translated from their US dollar functional currency to Australian dollars at each balance date with differences due to exchange movements reflected in the foreign currency translation reserve.

The effect at 30 June 2005 is to increase oil and gas exploration expenditures by \$28,235, decrease accumulated losses by \$22,941 and increase the foreign currency translation reserve by \$5,294.

26. Discontinued Operations

(a) Description

On 15 March 2006, the Board of Directors announced their intention to dispose of LDR Operations, a company that carried out gold and mineral exploration activities. The division was disposed of on the 15 March 2006, and the entity disposed of is reported in this financial report as a discontinued operation.

Financial information relating to the discontinued operation for the period to the date of disposal is set out below.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

26. Discontinued Operations (continued)

(b) Financial performance and cash flow information

The financial performance and cash flow information presented are for the period ending 15 March 2006 (2006 column) and the year ended 30 June 2005:

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Revenue	-	-	-	-
Expenses	(3,138)	-	-	-
Loss before tax	(3,138)	-	-	-
Income tax expense	-	-	-	-
Loss after income tax of discontinued operations	(3,138)	-	-	-
Net cash outflow from operating activities	-	-	-	-
Net cash outflow from investing activities	-	-	-	-
Net cash inflow from financing activities	4,341	-	-	-
Net increase in cash generated by the entity	4,341	-	-	-

(c) Carrying amounts of assets and liabilities

The carrying amounts of assets and liabilities as at 15 March 2006 (2006 column) and 30 June 2005 are:

Capitalised Expenditure	-	142,400	-	-
Total Assets	-	142,400	-	-
Payables*	(48,253)	(2,650)	-	-
Total Liabilities	(48,253)	(2,650)	-	-
Net assets	(48,253)	139,750	-	-

* The payables held by LDR Operations were in the form of an inter-company loan with its parent entity, Alto Energy International (formerly Lach Drummond Resources). As a result, this amount is eliminated on consolidation for income statement purposes.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

27. Business Combinations

Acquisition of Alto Energy Limited

On 24 January 2006, Alto Energy International Limited acquired 100% of the issued capital of Alto Energy Limited. In accordance with AASB 3 Business Combinations, when Alto Energy International Limited (the legal parent) acquired the Alto Energy Limited group (being Alto Energy Limited and its controlled entity, Alto Energy Inc) (the legal subsidiary), the acquisition was deemed to be a reverse acquisition since the substance of the transaction is that the existing shareholders of Alto Energy Limited have, effectively acquired Alto Energy International Limited.

The basis of the merger was that Alto shareholders would receive 13 Lach Drummond Resources Ltd shares for every 1 Alto share. Options in the Lach Drummond were issued in consideration for Alto options held on a 10.5 LDR options per Alto option basis.

The acquired business (Alto Energy International Limited) contributed revenues of \$47,931 and net loss of \$523,508 to the Group for the period from 1 February to 30 June 2006 (effective date of acquisition was 31 January 2006). If the acquisition had occurred on 1 July 2005, consolidated revenue and consolidated loss for the year ended 30 June 2006 would have been \$271,490 and \$10,080,723 respectively.

The fair value of the identifiable assets and liabilities of Alto Energy International Limited as at the date of acquisition are as follows:

	Recognised on Acquisition	Carrying Value per Alto Energy International Limited
	\$	\$
Property, Plant and Equipment	5,287	5,287
Cash and cash equivalents	1,910,351	1,910,351
Trade Receivables	30,473	30,473
Capitalised Oil and Gas expenditure	13,193,362	4,802,241
	<u>15,139,473</u>	<u>6,748,352</u>
Trade and other payables	161,159	161,359
Deferred Income tax liability	4,021,038	990,342
	<u>4,182,197</u>	<u>1,151,701</u>
Fair value of net assets	10,957,276	
Goodwill arising on acquisition	<u>-</u>	
	<u>10,957,276</u>	

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

27. Business Combinations (continued)

	Recognised on Acquisition \$	Carrying Value per Alto Energy International Limited \$
Consideration		
Fair value of issued equity instruments of acquiree before business combination	10,830,314	
Direct costs relating to the acquisition	<u>126,962</u>	
Total consideration	<u>10,957,276</u>	
The cash outflow on acquisition is as follows:		
Net cash acquired with subsidiary	1,910,351	
Acquisition costs	<u>(126,962)</u>	
Net cash inflow	<u>1,783,389</u>	

Acquisition of Golden Fleece Petroleum Inc

On 15 September 2005, the parent entity acquired 100% of Golden Fleece Petroleum Inc, a Texas based oil and gas company, which holds the right to farm-in to a 50% working interest in the Home Run project. Due to the reverse acquisition of the Alto Energy Limited Group discussed above, and the accounting policy for basis of preparation under reverse acquisition accounting (refer to note 1(b)), the net assets of Golden Fleece Petroleum Inc were included as part of the net assets of Alto Energy International Limited consolidated entity above.

The following details outline the purchase of Golden Fleece Petroleum Inc:

- 18 million ordinary shares at an issue price of \$0.035 cents each;
- 12 million unlisted options exercisable at \$0.01 cents each;
- 15 million unlisted options exercisable at \$0.025 cents each;
- \$215,000 cash consideration; and
- \$224,860 paid for direct acquisition costs.

The issue was based on the market price at the date of purchase.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

27. Business Combinations (continued)

The purchase price allocation is outlined below:

Purchase Consideration	\$
Cash consideration	215,000
Direct costs relating to the acquisition	224,860
Fair value of shares issued (as described above)	756,000
Fair value of options issued (as described above)	732,065
Total purchase consideration:	<u>1,927,925</u>

Assets and liabilities arising at acquisition date:

	\$
Cash	5,497
Capitalised oil and gas expenditure	2,912,771
Deferred tax liability	(990,342)
Net identifiable assets acquired	<u>1,927,926</u>

The assets arising from the acquisition are recognised at fair value which are equal to their carrying value at acquisition date.

Outflow of cash to acquire subsidiaries, net of cash acquired:

	\$
Cash	439,860
Less: Balances acquired	(5,497)
Net outflow of cash	<u>434,363</u>

28. Share Based Payments

(a) Employee Option Plan

The Alto Energy International Limited Employee Option Plan was created during the financial year. Options are granted under the plan to senior level executives of the Company for no consideration.

Options granted under the plan carry no dividend or voting rights and have varied contractual lives.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

28. Share Based Payments (continued)

(a) Employee Option Plan (continued)

The options granted under the plan are set out below:

Alto Energy International Limited– 2006

Grant date	Expiry date	Exercise price	Balance at start of the year Number	Granted during the year Number	Exercised during the year Number	Balance at end of the year Number	Exercisable at end of the year Number
29 Nov 05	31 Dec 08	\$0.32	-	500,000	-	500,000	500,000
29 Nov 05	31 Dec 08	\$0.40	-	500,000	-	500,000	-
29 Nov 05	31 Dec 08	\$0.40	-	500,000	-	500,000	-
11 May 06	31 Dec 08	\$0.25	-	750,000	-	750,000	-
11 May 06	31 Dec 08	\$0.30	-	750,000	-	750,000	-
Total			-	3,000,000	-	3,000,000	500,000

The above options have been disclosed on a post 1:8 reconstruction basis.

Alto Energy International Limited– 2005

No options were granted to employees of Alto Energy International Limited during the 2005 period.

(b) Options Granted to Directors

Prior to the creation of the Employee Share Option plan for Alto Energy International Limited, share options were granted to directors of Alto Energy Limited, which were transferred to options in Alto Energy International Limited upon the merger in January 2006. These options had been granted for no consideration.

Options granted under the plan carry no dividend or voting rights and have varied contractual lives.

Alto Energy Limited – 2006

Grant date	Expiry date	Exercise price	Balance at start of the year Number	Granted during the year Number	Exercised during the year Number	Transferred during the year* Number	Balance at end of the year Number
22 Mar 05	31 Oct 08	\$0.25	1,300,000	-	-	1,300,000	-
22 Mar 05	30 Nov 08	\$0.30	1,350,000	-	-	1,350,000	-
22 Mar 05	31 Dec 08	\$0.35	1,350,000	-	-	1,350,000	-
22 Mar 05	30 Jun 07	\$0.25	1,200,000	-	-	1,200,000	-
Total			5,200,000	-	-	5,200,000	-

* Options transferred during the year to Alto Energy International Limited were vested immediately upon transfer. The related option expense has been taken up in the key management personnel disclosures outlined in part C of the remuneration report in the Directors report.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

28. Share Based Payments (continued)

(b) Options Granted to Directors (continued)

Alto Energy Limited – 2005

Grant date	Expiry date	Exercise price	Balance at start of the year Number	Granted during the year Number	Exercised during the year Number	Balance at end of the year Number	Exercisable at end of the year Number
22 Mar 05	31 Oct 08	\$0.25	-	1,300,000	-	1,300,000	1,300,000
22 Mar 05	30 Nov 08	\$0.30	-	1,350,000	-	1,350,000	-
22 Mar 05	31 Dec 08	\$0.35	-	1,350,000	-	1,350,000	-
22 Mar 05	30 Jun 07	\$0.25	-	1,200,000	-	1,200,000	-
Total			-	5,200,000	-	5,200,000	1,300,000

No options were exercised or forfeited during the periods covered by the above tables.

The weighted average remaining contractual life of share options outstanding at the end of the period was 2.5 years (2005: 3.34 years)

(c) Fair value of options granted

The assessed fair value at grant date of options granted during the year ended 30 June 2006 was 3.4 cents per option (2005: 2.5 cents). The fair value at grant date is determined using a Black-Scholes option pricing model which takes into account the exercise price, the term of the option, the impact of dilution, the share price at grant date and expected price volatility of the underlying share, and the risk free interest rate for the term of the option.

The weighted average model inputs used for options granted during the year ended 30 June 2006 included:

- (a) share price at grant date: \$0.20 (2005: \$0.16)
- (b) expected price volatility of the company's shares: 65% (2005: 60%)
- (c) expected dividend yield: Nil (2005: Nil)
- (d) risk free interest rate: 5.17% (2005: 5.6%)

The expected price volatility is based on the historic volatility (based on the remaining life of the options), adjusted for any expected changes to future volatility due to publicly available information.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

28. Share Based Payments (continued)

(d) Expenses arising from share-based payment transactions

Total expenses arising from share based payment transactions recognised during the period as part of employee benefit expense were as follows:

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Options issued under employee option plan	36,778	-	76,217	-
Options issued to directors	53,549	78,272	-	-
	<u>90,327</u>	<u>78,272</u>	<u>76,217</u>	<u>-</u>

29. Related Party Transactions

(a) Parent entity

The ultimate parent entity within the group is Alto Energy International Limited (the legal parent). For discussion of the reverse acquisition accounting transaction and its effect upon the basis of preparation of the financial statements for the consolidated group, please refer to note 1(b).

(b) Subsidiaries

Interests in subsidiaries are set out in note 8.

(c) Key management personnel

Disclosures relating to key management personnel are set out in note 21.

(d) Loans to / from related parties

Alto Energy International Limited has provided an unsecured, interest free and repayable on demand loan to its wholly owned subsidiary Alto Energy Incorporated (formerly Golden Triangle Energy Incorporated), totalling \$242,474 at balance date. There were no repayments made during the year. This amount has been fully provided for at balance date.

Alto Energy International Limited has provided an unsecured, interest free and repayable on demand loan to its wholly owned subsidiary Golden Fleece Petroleum Incorporated, totalling \$1,345,905 at balance date. There were no repayments made during the year.

Alto Energy Limited has provided an unsecured, interest free and repayable on demand loan to its parent Alto Energy International Limited, totalling \$1,161,834 at balance date.

Alto Energy Limited has provided an unsecured, interest free and repayable on demand loan to its wholly owned subsidiary Alto Energy Inc (formerly Golden Triangle Energy Inc), totalling \$2,036,939 at balance date. There were no repayments made during the year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

29. Related Party Transactions (continued)

(d) Loans to / from related parties (continued)

Alto Energy Inc (formerly Golden Triangle Energy Inc) has provided an unsecured, interest free and repayable on demand loan to a related group entity, Golden Fleece Petroleum, totalling \$102,886 at balance date. There were no repayments made during the year.

30. Interests in joint ventures

Included in the assets of the Company and the consolidated entity are the following items which represent the Company and the consolidated entity's interest in the assets and liabilities in joint ventures recorded in accordance with the accounting policy described in note 1(s).

	Consolidated		Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Current Assets				
Receivables	18,230	178,417	-	-
Total Current Assets	18,230	178,417	-	-
Non-Current Assets				
Capitalised oil and gas expenditure	2,699,597	2,088,273	-	-
Total Non-Current Assets	2,699,597	2,088,273	-	-
Total Assets	2,717,828	2,266,690	-	-
Current Liabilities				
Payables	38,839	40,713	-	-
Total Current Liabilities	38,839	40,713	-	-
Total Liabilities	38,839	40,713	-	-

The principal activity of all the joint venture operations is oil and gas exploration and production.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

30. Interests in joint ventures (continued)

Listed below is the name of each of the areas of joint venture operations and the percentage interest held in the joint venture by the consolidated entity assuming farm-in and farm-out commitments in respect of leases are met.

	Working Interest	
	2006	2005
Kentucky leased acreage	30% - 50%*	27.0%
West Virginia leased acreage	29% - 90.0%	29.0%
Tennessee leased acreage	37.5% - 50.0%	37.5% - 50.0%

* Subject to completing farm in commitment.

31. Non-cash investing and financing activities

Options issued to employees under the Alto Energy International Limited Employee Share Option Plan for no cash consideration are shown in note 28. Shares issued as a result of business combination have been disclosed in note 27.

DIRECTORS' DECLARATION

The directors declare that:

- (a) in the directors' opinion, there are reasonable grounds to believe that the Company will be able to pay its debts as and when they fall due and payable;
- (b) 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 Company and the consolidated entity;
- (c) the audited remuneration disclosures set out on pages 8 to 15 of the director's report comply with Accounting Standards AASB 124 Related Party Disclosures and the Corporations Regulations 2001; and
- (d) the directors have been given the declarations required by s 295A of the Corporations Act 2001.

Signed in accordance with a resolution of the directors made pursuant to s 295(5) of the Corporations Act 2001.

On behalf of the directors



Mr Gregory Channon
Managing Director

Perth, 27 September 2006

Independent audit report on the financial report to members of Alto Energy International Limited

We have audited the accompanying financial report of Alto Energy International Limited (the company) and the consolidated entity for the year ended 30 June 2006. The financial report comprises the balance sheet at 30 June 2006, and the income statement, statement of changes in equity, cash flow statement, summary of significant accounting policies and other explanatory notes, and the directors' declaration for the year then ended.

We have also audited the information about the remuneration of directors and executives ("remuneration disclosures"), the company has disclosed in accordance with Accounting Standard AASB 124 Related Party Disclosures, under the heading "remuneration report" on pages 8 to 14 of the directors' report, as permitted by the Corporations Regulations 2001.

Directors' Responsibility for the Financial Report and the AASB 124 Remuneration Disclosures Contained in the Directors' Report

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

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

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report and the remuneration disclosure based on our audit. We conducted our audit in accordance with Auditing Standards in Australia. 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. Our responsibility is also to express an opinion on the remuneration disclosures contained in the directors' report based on our audit.

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



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

Independence

We are independent of the company and the group, and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001. We have given to the directors of the company a written Auditors' Independence Declaration, a copy of which is included in the Directors' Report. In addition to our audit of the financial statements, we were engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

Auditor's Opinion on the Financial Report

In our opinion:

The financial reports of Alto Energy International Limited and the consolidated entity are in accordance with the Corporations Act 2001, including:

- (a) giving a true and fair view of the company's and the group's financial position as at 30 June 2006 and of its performance for the year ended on that date; and
- (b) complying with Accounting Standards in Australia including the Australian Accounting Interpretations and the Corporations Regulations 2001.

Auditor's Opinion on the AASB 124 Remuneration Disclosures Contained in the Directors' Report

In our opinion the remuneration disclosures that are contained in pages 8 to 14 of the directors' report comply with Accounting Standard AASB 124.

Dated the 27th day of September 2006.

HORWATH AUDIT (WA) PTY LTD

HORWATH.
Glyn O'Brien

GLYN O'BRIEN
DIRECTOR