

AQUILA RESOURCES LIMITED

(ACN: 092 002 769)

and its Controlled Entities

Condensed Consolidated
Interim Financial Report
31 December 2005

AQUILA RESOURCES LIMITED
and its Controlled Entities

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AQUILA RESOURCES LIMITED
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DIRECTORS' REPORT

The Directors of Aquila Resources Limited (“*Aquila*” or the “*Company*”) present their report together with the consolidated financial report for the half-year ended 31 December 2005 and the auditors’ review report thereon.

1. DIRECTORS

The Directors of the Company at any time during or since the end of the half-year are:

Anthony Poli (47)

Executive Chairman

Mr Poli, a qualified accountant, has been a member of the Board since the incorporation of the Company on 14 March 2000 and is responsible for the operations of the Company.

Charles Bennett Bass (56)

Non-Executive Director

Mr Bass is a qualified geologist and mining engineer with 30 years experience in mineral exploration, development and production in Australia, Canada and the United States and has been a member of the Board of the Company since it was incorporated on 14 March 2000.

Derek Thomas Cowlan (72)

Non-Executive Director

Mr Cowlan is a businessman with a wealth of experience in financial and business management and has been a member of the Board of the Company since it was incorporated on 14 March 2000.

He currently presides as the Chairman of the Ross North Group, a large home building company operating in Western Australia.

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DIRECTORS' REPORT

2. LEAD AUDITOR'S INDEPENDENCE DECLARATION

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

The Lead Auditor's Independence Declaration is set out on page 10 and forms part of the Directors' Report for the half-year ended 31 December 2005.

3. REVIEW OF OPERATIONS

3.1 COAL

ISAAC PLAINS COAL PROJECT

(Aquila Resources Limited 50%)

Mine Development

The grant of the mining lease on 1 December 2005 permitted the key infrastructure contractors to commence construction of the Isaac Plains Coal Project.

Roche Mining (JR) Pty Ltd has been awarded the contract for the construction of the coal handling and preparation plant (CHPP) and Leightons Contractors Pty Ltd has been awarded the civil engineering contract.

By the end of the reporting period, the raw water dam had been excavated, the CHPP run of mine ("ROM") and product coal stockpile pads had been built, the construction of the access roads had commenced and the cut and fill for the 4.9 km rail loop was underway.

In addition, Ergon Energy has been contracted to supply power to the project and construction of the substation had commenced. Arrangements have also been entered into to access water from a local bore field and two SunWater dams.

Reserves and Resources

Reserve

An initial reserve statement for the Isaac Plains Coal Project was stated during the reporting period. The Isaac Plains Coal Project resource contains total ROM reserves of 19.7 Mt on the assumption that current prices for coal revert to long-term averages and is also based on a truck and shovel operation.

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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

Summary of Reserves – Isaac Plains Coal Project

Seam	ROM Reserves Proven Tonnes (t)	ROM Probable Tonnes (t)	Total ROM Reserves Tonnes (t)
Leichhardt			
- Open Cut	16.8	0.1	16.9
- High Wall	2.4	0.2	2.6
Sub-Total	19.2	0.3	19.5
Lower Leichhardt			
- Open Cut	-	0.2	0.2
- High wall	-	-	-
Sub-Total	-	0.2	0.2
Total	19.2	0.5	19.7

Based on this reserve estimate, the project has a mine life of approximately 10 years at a processing rate of 2 million ROM tonnes per annum. The CHPP facility is scheduled to commence operating at a rate of 1 million ROM tonnes per annum from mid 2006, increasing to 2 million ROM tonnes per annum thereafter. There is sufficient design capacity to treat an additional 1.6 million ROM tonnes per annum to accommodate coal from the Isaac Plains South Coal Project.

The resource appears amenable to being developed as a dragline operation, which could be expected to increase the reserves. A conceptual dragline mine plan is currently being developed and a consultant has been engaged to identify a suitable dragline.

Coal resources at the Isaac Plains South Coal Project are not included in the above reserve statement.

An initial reserve statement and feasibility statement for the Isaac Plains South Coal Project will be completed in the June quarter.

Resources

The Isaac Plains Coal Project has a JORC compliant resource totalling 135.3 million tonnes comprising:

Measured	32.3 million tonnes
Indicated	61.6 million tonnes
Inferred	<u>41.4 million tonnes</u>
	<u>135.3 million tonnes</u>

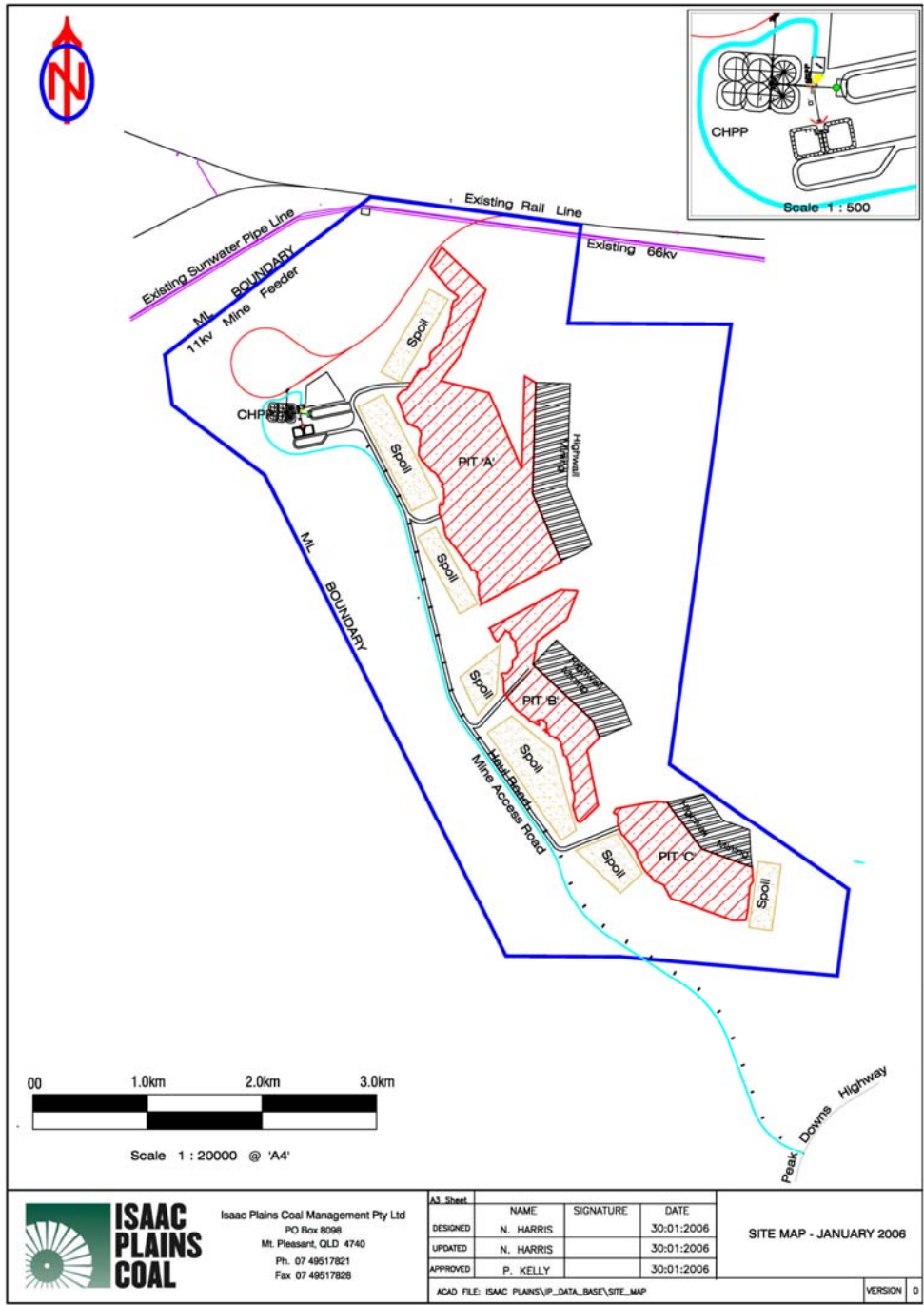
This resource statement includes the Isaac Plains South Coal project area which lies 10 km south of the Isaac Plains Coal Project.

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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

Isaac Plains Coal Project – Site Plan



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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

BELVEDERE COAL UNDERGROUND PROJECT

(Aquila Resources Limited 50%)

During the reporting period the Joint Venture partners entered into an agreement with a wholly owned subsidiary of Companhia Vale do Rio Doce ("CVRD"), whereby CVRD will undertake an Exploration Study ("Study") on the Belvedere Coal Underground Project.

The project has an estimated 2.7 billion tonne hard coking coal resource.

A project team has been appointed and a comprehensive exploration programme has commenced, that is centred on seismic surveys and diamond drilling. An approved twelve month budget of \$15 million has been allocated to the programme.

Some 60,000 metres of drilling is planned and drill contracts for the first 44,000 metres have been let. The first hole reached a depth of 290 metres before stopping for Christmas and by late January three rigs were in operation.

At the completion of the Study, CVRD may exercise an option to acquire approximately half of the Company's interest in the project by paying US\$45 million to Aquila. CVRD then has further options to increase its interest to 100% by acquiring the remaining interests of the Joint Venture partners at fair market value, determined at the time of exercising each option.

CVRD is Brazil's largest mining company and is the world's largest producer of iron ore. Its investment in the Belvedere Coal Underground Project forms part of a global strategy to secure projects with the potential to become world class coking coal mining operations.

PEAK DOWNS EAST UNDERGROUND COAL PROJECT

(Aquila Resources Limited 50%)

A new phase of exploration drilling commenced on the Peak Downs East Underground Coal Project, which is situated south of the Isaac Plains Coal Project.

The full sequence of the 6-8 seams forming the Moranbah Coal Measures has been intersected by drilling. The principal target seam is the Harrow Creek (Lower) Seam, which is the equivalent to the Goonyella Middle Seam. The seam has been intersected in four of the holes over a depth range of 332.3 to 410.1 metres with an average thickness of 8.34 metres.

A comprehensive programme of grid drilling on 2 km hole spacing is planned to commence in the March 2006 quarter. Holes will be RC drilled to the base of the Fort Cooper Coal Measures then diamond cored through the Moranbah Coal Measures.

Drilling on this grid together with geophysical logging should enable the Company to report a resource statement by calendar year end.

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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

MOÇAMBIQUE COAL PROJECT

(Aquila Resources Limited 100%)

Programmes of geological mapping and diamond drilling were conducted on two of the Company's coal licences in the Tete Province of Moçambique during the period. These licences cover significant portions of the Moatize sub-basin, where, on an adjoining tenement, CVRD is conducting a bankable feasibility study into developing a large coking coal mining operation. Results of the Company's programmes have been encouraging and show potential for near surface coal to occur on its licences.

Four out of five of the holes drilled on the first licence intersected the most prospective of the coal horizons – the Chipanga Seam demonstrating continuity of this coal horizon over a large area. The intersected thickness ranged from 12.2 to 31.2 metres. Three of the holes intersected the lowest coal horizon – the Sousa Pinto Seam before drilling through to basal conglomerate and glacial sediments.

The Company is awaiting coal quality results which will then determine the focus of exploration in the coming year and establish the economic significance of these encouraging results.

3.2 IRON ORE

AUSTRALIAN PREMIUM IRON JOINT VENTURE

(Aquila Resources Limited 50%)

The Australian Premium Iron Joint Venture ("API") was formed to explore for iron ore in Western Australia in partnership with AMCI Holdings Australia Pty Ltd ("AMCI"). Under the terms of the joint venture, the Company and AMCI each hold a 50% participating interest, with AMCI sole funding the first \$10 million of exploration expenditure.

The Joint Venture is focussing its exploration on channel iron deposits ("CIDs") in the highly prospective West Pilbara region of Western Australia. It has assembled strategic exploration portfolios by taking up new tenements and by concluding a series of farm-in arrangements with other companies.

WEST PILBARA – MT STUART IRON ORE PROJECT

(API earning 70%)

Geological mapping and RC drilling programmes were completed over the Catho Well and Cardo Bore prospects during the reporting period.

As part of the mapping programme, selective rock chip sampling was conducted, on traverses not less than 500 metres apart. Iron grades varied between 54.0% and 56.4% at Cardo Bore and 53.3% and 57.1% at Catho Well. Iron grades are relatively consistent across a wide area with grades for both prospects averaging around 55% Fe.

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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

By the end of the reporting period a total 197 RC holes (CWRC004 – 200) for 4,456 metres had been completed at Catho Well and 38 holes (CBRC001-021, 023-037, 051-052) for 1,169 metres at Cardo Bore.

Results from 79 holes (CWRC004 to CWRC082) have been returned from Catho Well to date. Encouraging results include:

- 15.0 metres at 55.05% Fe, 3.81% Al₂O₃, 7.11% SiO₂, 0.04% Mn, 0.05% P and 0.03% S from surface in CWRC061:
- 15.0 metres at 56.70% Fe, 2.54% Al₂O₃, 5.20% SiO₂, 0.07% Mn, 0.05% P and 0.01% S from 7m in CWRC063:
- 17.0 metres at 56.42% Fe, 2.86% Al₂O₃, 5.86% SiO₂, 0.08% Mn, 0.04% P and 0.02% S from 1m in CWRC069:
- 15.0 metres at 55.05% Fe, 3.08% Al₂O₃, 7.78% SiO₂, 0.05% Mn, 0.04% P and 0.01% S from surface in CWRC071: and
- 17.0 metres at 54.69% Fe, 2.49% Al₂O₃, 9.07% SiO₂, 0.07% Mn, 0.04% P and 0.01% S from surface in CWRC074.

No results have been returned for the Cardo Bore drilling.

Metallurgical samples have been collected from RC drill residues for the Catho Well prospect and submitted to a laboratory for beneficiation testwork. Beneficiation tests to be completed include screening, scrub/screen and density separation.

Results were received at quarter end for the screen testwork and indicate a 0.5% to 1.5% upgrade in iron between size fractions; however grade improvement is variable between size fractions. A larger in-situ sample is required to produce a sample that will provide representative sizing following crushing.

WEST PILBARA – RED HILL IRON ORE PROJECT

(API earning 80%)

Geological mapping has been completed over both the Cardo Bore East and Catho Well North prospects. During mapping, selective rock chip sampling was conducted, on traverses not less than 500 metres apart. Iron grades varied between 48.8% and 57.6% at Cardo Bore and 53.5% and 58.3% at Catho Well and are consistent with grades returned from sampling elsewhere in the area.

During the reporting period a total of 14 RC drill holes (CBRC022, 038 to 050) for 534 metres were completed at the Cardo Bore Prospect.

Drill holes were spaced nominally at 200 metre intervals on access tracks established along the central axis of the mesa.

No assay results have been returned from the RC drilling by the end of the reporting period.

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3. REVIEW OF OPERATIONS (CONT'D)

WEST PILBARA – YALLEEN IRON ORE PROJECT

(API earning 70%)

GPX Airborne Pty Ltd conducted a Hoist EM/magnetics survey over the Yalleen Valley centred on the Robe River/Kumina Creek area.

A number of potential targets have been identified from the geophysical responses. Emphasis was placed on the types of geophysical response that potentially reflect the presence of a pisolitic iron deposit buried under Quaternary cover.

3.3 EVENTS SUBSEQUENT TO REPORTING DATE

WEST PILBARA – DE BEERS TENEMENT PORTFOLIO

(API 100%)

Subsequent to the reporting period API entered into an agreement with De Beers Australia Exploration Limited (“De Beers”) to acquire all rights to iron ore on De Beers’ tenements in the West Pilbara region of Western Australia.

The tenement holdings cover a large area, in excess of 4,500 sq km, of the Hamersley Basin in the West Pilbara. The area was identified by the Company as having potential for Channel Iron Deposits (“CIDs”) to occur in the paleodrainage systems, that are developed in that part of the Basin. In addition to the CID potential, the area has potential for Bedded Iron Deposits, supergene-enriched hematite and hematite-goethite mineralisation, to occur in the Marra Mamba and Brockman Iron Formations of the Hamersley Group. The Brockman Iron Formation, the thickest and most economically important iron formation unit in the Hamersley Group, forms prominent strike ridges through the core of the tenements, while there is a 100 km strike extent of Marra Mamba Iron Formation within the northern sector.

The Joint Venture plans to commence programmes of detailed mapping and sampling on the project area in the March 2006 quarter with drilling to be conducted once prioritised target settings have been identified.

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DIRECTORS' REPORT

Dated at Perth this 15th day of March 2006.

Signed in accordance with a resolution of the Directors.



Anthony Poli
Executive Chairman



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

To: the directors of Aquila Resources Ltd

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2005 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

D P McComish
Partner

Perth
15 March 2006

AQUILA RESOURCES LIMITED

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INCOME STATEMENT For the half-year ended 31 December 2005

	<i>Note</i>	<i>Consolidated</i> <i>31 Dec 2005</i> \$	<i>Consolidated</i> <i>31 Dec 2004</i> \$
Revenue	3	3,490,318	232,532
Other income	4	1,254,698	2,300
Depreciation expense		(8,054)	(9,276)
Directors' fees		(36,000)	(27,250)
Exploration and evaluation expenses		(1,011,996)	(509,018)
Employee benefits expense		(256,708)	(170,666)
Financing costs		(75,000)	-
Foreign exchange losses		(72,881)	-
Management fees		(138,000)	(117,524)
Mine evaluation costs		(1,022,923)	-
Share based payment expense	10	(6,264,757)	(109,940)
Other expenses		(494,847)	(401,978)
Profit (loss) before income tax		(4,636,150)	(1,110,820)
Income tax (expense) benefit		170,644	-
Profit (loss) for the period		(4,465,506)	(1,110,820)
Profit (loss) attributable to minority interest		-	-
Profit (loss) attributable to members of the parent entity		(4,465,506)	(1,110,820)
Basic earnings per share		(\$0.088)	(\$0.025)

Potential ordinary shares are not considered dilutive and accordingly diluted earnings per share is the same as basic earnings per share.

Dividends per share

-

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The Income Statement is to be read in conjunction with the Notes to the Interim Financial Report set out on pages 15 to 40.

AQUILA RESOURCES LIMITED

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BALANCE SHEET

as at 31 December 2005

	<i>Note</i>	<i>Consolidated</i> 31 Dec 2005 \$	<i>Consolidated</i> 30 June 2005 \$
CURRENT ASSETS			
Cash and cash equivalents		8,182,039	4,349,176
Trade and other receivables		283,209	234,584
Other financial assets		3,359,427	1,441,148
Other current assets		73,910	62,118
Total Current Assets		11,898,585	6,087,026
NON-CURRENT ASSETS			
Receivables		40,000	25,000
Property, plant and equipment	5	6,937,057	37,717
Mineral properties		80,000	80,000
Other financial assets		4	254,324
Total Non-current Assets		7,057,061	397,041
TOTAL ASSETS		18,955,646	6,484,067
CURRENT LIABILITIES			
Trade and other payables		3,207,945	512,038
Provisions		37,996	24,889
Total Current Liabilities		3,245,941	536,927
NON-CURRENT LIABILITIES			
Deferred tax liabilities		190,624	-
Total Non-current Liabilities		190,624	-
TOTAL LIABILITIES		3,436,565	536,927
NET ASSETS		15,519,081	5,947,140
EQUITY			
Issued capital	6	19,350,341	12,692,091
Reserves		7,656,537	277,340
Accumulated (losses)	7	(11,487,797)	(7,022,291)
Total equity attributable to equity holders of the parent		15,519,081	5,947,140
Minority interest		-	-
TOTAL EQUITY	8	15,519,081	5,947,140

The Balance Sheet is to be read in conjunction with the Notes to the Interim Financial Report set out on pages 15 to 40.

AQUILA RESOURCES LIMITED
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STATEMENT OF CHANGES IN EQUITY
For the half-year ended 31 December 2005

	<i>Note</i>	<i>Consolidated</i> 31 Dec 2005 \$	<i>Consolidated</i> 31 Dec 2004 \$
Total equity at the beginning of the period		5,947,140	8,642,535
Gain on revaluation of available-for-sale financial assets net of deferred tax		1,302,690	-
Increase in share based payment reserve		6,264,757	109,940
Amounts recognised directly in equity		7,567,447	109,940
Profit (loss) for the period		(4,465,506)	(1,110,820)
Total recognised income and expense for the period		3,101,941	(1,000,880)
Transactions with equity holders in their capacity as equity holders:			
Exercise of options	6	6,470,000	20,000
Total equity at the end of the period	8	15,519,081	7,661,655
Total recognised income and expense for the period attributable to equity holders of the parent		3,101,941	(1,000,880)

The Statement of Changes in Equity is to be read in conjunction with the Notes to the Interim Financial Report set out on pages 15 to 40.

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CASH FLOW STATEMENT

For the half-year ended 31 December 2005

	<i>Consolidated</i> 31 Dec 2005 \$	<i>Consolidated</i> 31 Dec 2004 \$
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash payments in the course of operations	(2,822,703)	(1,180,677)
Cash receipts in the course of operations	3,250,703	6,000
Interest received	163,321	120,437
Net cash provided by (used in) operating activities	591,321	(1,054,240)
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for property, plant and equipment	(3,383,212)	(11,821)
Proceeds from sale of mineral properties	-	600,000
Proceeds from farm-out of mineral properties	154,754	-
Proceeds from sale of equity investments	-	264,637
Net cash provided by (used in) investing activities	(3,228,458)	852,816
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issue of shares	6,470,000	20,000
Net cash provided by financing activities	6,470,000	20,000
Net increase (decrease) in cash and cash equivalents	3,832,863	(181,424)
Cash and cash equivalents at the beginning of the financial period	4,349,176	5,238,993
Cash and cash equivalents at the end of the financial period	8,182,039	5,057,569

The Cash Flow Statement is to be read in conjunction with the Notes to the Interim Financial Report set out on pages 15 to 40.

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies

Aquila Resources Limited (“the Company”) is a company domiciled in Australia.

The condensed consolidated interim financial report of the Company for the six months ended 31 December 2005 comprise the Company and its subsidiaries (together referred to as the “consolidated entity”) and the consolidated entity’s interest in jointly controlled operations.

The condensed consolidated interim financial report was authorised for issue by the Directors on 15 March 2006.

(a) Statement of compliance

The condensed consolidated interim financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards, Urgent Issues Group Interpretations adopted by the Australian Accounting Standards Board (“AASB”) and the Corporations Act 2001.

International Financial Reporting Standards (“IFRS”) form the basis of Australian Accounting Standards adopted by the AASB, and for the purpose of this report are called Australian equivalents to IFRS (“AIFRS”), to distinguish from previous Australian GAAP.

This is the consolidated entity’s first AIFRS condensed consolidated interim financial report for part of the period covered by the first AIFRS annual financial report and AASB 1 *First time adoption of Australian equivalents to International Financial Reporting Standards*. The condensed consolidated interim financial report does not include all of the information required for a full annual financial report.

The interim financial report is to be read in conjunction with the most recent annual financial report, however, the basis of their preparation is different to that of the most recent annual financial report due to the first time adoption of AIFRSs. This report must also be read in conjunction with any public announcements made by Aquila Resources Limited during the half-year in accordance with continuous disclosure obligations arising under the Corporations Act 2001.

An explanation of how the transition to AIFRSs has affected the reported financial position, financial performance and cash flows of the consolidated entity is provided in Note 13. This note includes reconciliations of equity and profit or loss for comparative periods reported under Australian GAAP (previous GAAP) to those reported for those periods under AIFRSs.

(b) Basis of preparation

The financial report is presented in Australian dollars. It has been prepared on the historical cost basis, except for other financial assets, which are recorded at fair value.

AQUILA RESOURCES LIMITED

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NOTES TO THE FINANCIAL STATEMENTS

For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

The preparation of an interim financial report in conformity with AASB 134 *Interim Financial Reporting* requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

This condensed consolidated interim financial report has been prepared on the basis of AIFRSs in issue that are effective at the consolidated entity's first AIFRS annual reporting date, 30 June 2006. Based on these AIFRSs, the Board of Directors have made assumptions about the accounting policies expected to be adopted when the first AIFRS annual financial report is prepared for the year-ended 30 June 2006.

The consolidated entity has elected to early adopt AASB 2005-4 *Amendments to Australian Accounting Standards (June 2005)* amending AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 132 *Financial Instruments: Disclosure and Presentation* and AASB 1.

The Australian Accounting Standards and UIG Interpretations that will be effective or available for voluntary early adoption in the annual financial statements for the period ended 30 June 2006 are still subject to change and therefore cannot be determined with certainty. Accordingly, the accounting policies for that annual period that are relevant to this interim financial information will be determined only when the first AIFRS financial statements are prepared at 30 June 2006.

The preparation of the condensed consolidated interim financial report in accordance with AASB 134 resulted in changes to the accounting policies as compared with the most recent annual financial statements prepared under previous GAAP. Except for the change in accounting policy relating to the classification and measurement of financial instruments, the accounting policies set out below have been applied consistently to all periods presented in these condensed consolidated interim financial statements. They also have been applied in preparing an opening AIFRS balance sheet at 1 July 2004 for the purposes of the transition to Australian Accounting Standards – AIFRSs, as required by AASB 1. The impact of the transition from previous GAAP to AIFRSs is explained in Note 13. Where relevant, the accounting policies applied to the comparative period have been disclosed if they differ from the current period policy.

The accounting policies have been applied consistently throughout the consolidated entity for purposes of this condensed consolidated interim financial report.

(c) Principles of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

Subsidiaries (cont'd)

In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the condensed consolidated interim financial report from the date that control commences until the date that control ceases.

Associates

Associates are those entities for which the consolidated entity has significant influence, but not control, over the financial and operating policies. The condensed consolidated interim financial statements include the consolidated entity's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases.

When the consolidated entity's share of losses exceeds its interest in an associate, the consolidated entity's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the consolidated entity has incurred legal or constructive obligations or made payments on behalf of an associate.

Joint ventures

Joint ventures are those entities over whose activities the consolidated entity has joint control, established by contractual agreement.

Jointly controlled entities

In the condensed consolidated interim financial report, investments in jointly controlled entities, including partnerships, are accounted for using equity accounting principles. Investments in joint venture entities are carried at the lower of the equity accounted amount and recoverable amount.

The consolidated entity's share of the jointly controlled entity's net profit or loss is recognised in the condensed consolidated interim income statement from the date joint control commenced until the date joint control ceases. Other movements in reserves are recognised directly in consolidated reserves.

Jointly controlled operations and assets

The interest of the consolidated entity in unincorporated joint ventures and jointly controlled assets are brought to account by recognising in its financial statements the assets it controls and the liabilities that it incurs, and the expenses it incurs and its share of income that it earns from the sale of goods or services by the joint venture.

Transactions eliminated on consolidation

Intragroup balances, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the condensed consolidated interim financial statements.

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

(d) Revenue recognition

Revenue is measured at the fair value of consideration received or receivable, net of the amount of goods and services tax.

Interest revenue

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

Sale of non-current assets

Sales of non-current assets are recognised at the date control of the assets passes to the buyer, usually when an unconditional contract of sale is signed.

The gain or loss on disposal is calculated as the difference between the carrying amount of the asset at the time of disposal and the net proceeds on disposal.

(e) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

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

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

(f) Foreign currency

Transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair value was determined.

AQUILA RESOURCES LIMITED

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NOTES TO THE FINANCIAL STATEMENTS

For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

(g) Income tax

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

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

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

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

Tax consolidation

The Company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 1 July 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Aquila Resources Limited.

Current tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'stand alone taxpayer' approach by reference to the carrying amounts in the separate financial statements of each entity and the tax values applying under tax consolidation.

Current tax liabilities and assets and deferred tax assets arising from unused tax losses and tax credits of the members of the tax-consolidated group are recognised by the Company (as head entity in the tax-consolidated group). Deferred tax assets and deferred tax liabilities are measured by reference to the carrying amounts of the assets and liabilities in the Company's balance sheet and their tax values applying under tax consolidation.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses assumed by the head entity from the subsidiaries in the tax-consolidated group are recognised as amounts receivable or payable to other entities in the tax-consolidated group in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Company as an equity contribution to or distribution from the subsidiary. Distributions firstly reduce the carrying amount of the investment in the subsidiary and are then recognised as revenue.

AQUILA RESOURCES LIMITED

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NOTES TO THE FINANCIAL STATEMENTS

For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

Tax consolidation (cont'd)

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses assumed from subsidiaries are recognised by the head entity only.

Tax funding and sharing agreements

The members of the tax-consolidated group are in the process of entering into a funding arrangement that sets out the funding obligations of members of the tax-consolidated group in respect of tax amounts. The tax funding arrangements require payments to/from the head entity equal to the current tax liability (asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity, resulting in the head entity recognising an inter-entity receivable (payable) in the separate financial statements of the members of the tax-consolidated group equal in amount to the tax liability (asset) assumed. The inter-entity receivables (payables) are at call.

The head entity recognises the assumed current tax amounts as current tax liabilities (assets), adding to its own current tax amounts, since they are also due to or from the same taxation authority. The current tax liabilities (assets) are equivalent to the tax balances generated by external transactions entered into by the tax-consolidated group. Contributions to fund the current tax liabilities are payable as per the tax funding arrangement and reflect the timing of the head entity's obligation to make payments for tax liabilities to the relevant tax authorities.

The members of the tax-consolidated group are also entering into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement as payment of any amounts under the tax sharing agreement is considered remote.

(h) Earnings per share

Basic earnings per share

Basic earnings per share 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 half-year, adjusted for bonus shares issued during the half-year.

Diluted earnings per share

Diluted earnings per share is calculated by dividing basic earnings per share (adjusted by the after tax effect of financing costs associated with dilutive potential ordinary shares and the effect of revenues and expenses associated with the conversion to ordinary shares of dilutive potential ordinary shares) by the weighted average number of ordinary shares and dilutive potential ordinary shares, adjusted for bonus shares issued during the half-year.

AQUILA RESOURCES LIMITED

and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS

For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

(i) Cash and cash equivalents

Cash and cash equivalents comprise of cash balances and call deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the consolidated entity's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(j) Acquisition of assets

The purchase method of accounting is used to account for all acquisitions of assets 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, together with costs directly attributable to the acquisition.

Where equity instruments are issued in an acquisition, the value of the instruments is their published market price as at the date of exchange, unless it can be demonstrated that 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.

Where settlement of any part of the 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 consolidated entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

(k) Property, plant and equipment

Owned assets

Items of property, plant and equipment are stated at cost or deemed cost less accumulated depreciation (see below) and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour, and an appropriate proportion of production overheads. The cost of self-constructed assets and acquired assets includes (i) the initial estimate at the time of installation and during the period of use, when relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and (ii) changes in the measurement of existing liabilities recognised for these costs resulting from changes in the timing or outflow of resources required to settle the obligation or from changes in the discount rate.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leased assets

Leases in terms of which the consolidated entity assumes substantially all of the risks and rewards of ownership are classified as finance leases. Assets under finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation (see below) and impairment losses.

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

Subsequent costs

The consolidated entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied within the item will flow to the consolidated entity and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives in the current and comparative periods are as follows:

- plant and equipment 2-5 years

The residual value, if not insignificant, is reassessed annually.

Development expenditure

Once a development decision has been taken, all capitalised exploration and evaluation expenditure, together with development costs, are carried forward to the extent that it is reasonably assured that they will be recouped from revenue to be derived from the sale of production of minerals from the relevant area of interest. No depreciation or amortisation is provided for in relation to development expenditure until the commencement of production.

The carrying value of capitalised development costs associated with each area of interest is reviewed each reporting period.

Joint venture assets

Expenditure on property, plant and equipment comprising part of unincorporated joint ventures in which the consolidated entity has an interest are accounted for in accordance with the policy detailed above.

(1) Mineral properties

Exploration and evaluation expenditure

Exploration and evaluation costs are only carried forward as an asset where rights to tenure are current and the costs:

- (i) relate to acquisitions and activities have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves; or
- (ii) are expected to be recouped through successful development and exploitation of the area of interest or by its sale.

Expenditure on exploration and evaluation activities in relation to areas of interest which have not yet reached a stage which permits reasonable assessment of the existence or otherwise of economically recoverable reserves are expensed as incurred.

Identifiable exploration assets acquired are accounted for in accordance with the consolidated entity's policy on acquisition of assets.

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

Exploration and evaluation expenditure (cont'd)

Where an area of interest has been relinquished, abandoned or sold or the Directors decide that it is not commercial, all carrying costs in respect of that project area are written off in the year the decision is made.

Exploration and evaluation assets will be assessed annually for impairment in accordance with AASB 6 *Exploration for and Evaluation of Mineral Resources* and the Company's policy in relation to impairment.

(m) Other financial assets

Classification

Other financial assets are classified into the following categories:

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

This category includes financial assets held for trading and those designated at fair value through profit and loss on initial recognition. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or, if so designated, where there exists the possibility it will be sold in the short term and the financial asset is subject to frequent changes in fair value. Derivatives are categorised as held for trading unless they are designated as hedges.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that are intended and able to be held-to-maturity.

(d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets, such as marketable equity securities, that are either designated in this category or are not classified in any of the other categories.

Recognition

Financial assets classified as held for trading or available-for-sale are recognised/derecognised by the consolidated entity on the date it commits to purchase/sell the investments. Held-to-maturity investments are recognised/derecognised on the day they are transferred to/by the consolidated entity.

AQUILA RESOURCES LIMITED

and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS

For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

Measurement

Financial assets are initially recognised at fair value plus, in the case of items not carried at fair value through profit and loss, transaction costs directly attributable to the acquisition.

Subsequent to initial recognition, financial assets at fair value through profit and loss and available-for-sale financial assets are carried at fair value. Loans and receivables and held-to-maturity investments are recorded at amortised cost (using the effective interest method).

Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit and loss are included in the income statement in the period in which they arise.

Unrealised gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in equity in the available-for-sale asset revaluation reserve, until the financial asset is sold or impaired, at which point the cumulative gain or loss is transferred to the income statement.

Where financial assets are interest-bearing, interest calculated using the effective interest method is recognised in the income statement.

Impairment losses arising in relation to financial assets are recognised in the income statement.

The fair value of quoted financial assets is based on their bid price at the balance sheet date, however in the case of financial assets without active markets, fair value is established using relevant valuation techniques.

(n) Impairment

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

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of goodwill (if any) allocated to the cash-generating unit (group of units) and then, to reduce the carrying amount of the other assets in the unit (group of units) on a *pro rata* basis.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in profit or loss even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

Calculation of recoverable amount

The recoverable amount of the consolidated entity's investments in held-to-maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

Impairment of receivables is not recognised until objective evidence is available that a loss event has occurred. Significant receivables are individually assessed for impairment.

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

Reversal of impairment

An impairment loss in respect of a held-to-maturity security or receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available for sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss shall be reversed, with the amount of the reversal recognised in the income statement.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

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

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

(o) Payables

Trade and other payables are stated cost.

(p) Provisions

A provision is recognised in the balance sheet when the consolidated entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, when appropriate, the risks specific to the liability.

(q) Employee benefits

Wages and salaries, annual leave and sick leave

Liabilities for employee benefits for wages, salaries, annual leave and sick leave represent present obligations resulting from employees' services provided to reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that the consolidated entity expects to pay as at reporting date including related on-costs, such as, workers compensation insurance and payroll tax.

Long service leave

The consolidated entity's net obligation in respect of long-term service benefits, other than pension plans, is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using expected future increases in wage and salary rates including related on-costs and expected settlement dates, and is discounted using the rates attached to the Commonwealth Government bonds at the balance sheet date which have maturity dates approximating to the terms of the consolidated entity's obligations.

Retirement benefits

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

(r) Share based payments

Share options granted before 7 November 2002 and/or vested before 1 January 2005

No expense is recognised in respect of these options. The shares are recognised when the options are exercised and the proceeds received allocated to share capital.

Share options granted from 7 November 2002 and vested from 1 January 2005

The fair value of options granted is recognised as an expense with a corresponding increase in equity.

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

1. Statement of significant accounting policies (cont'd)

Share options granted from 7 November 2002 and vested from 1 January 2005 (cont'd)

The fair value is measured at grant date and spread over the period during which the option holders become unconditionally entitled to the options. The fair value of the options granted is measured using an option pricing model, taking into account the exercise price, the term of the option, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option, the share price at the date of grant, the expected 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 includes market performance conditions such as the target price of the underlying share. Non-market vesting conditions such as project generation criteria, are taken into account in assumptions regarding the number of options that are expected to become exercisable. At each reporting date, the consolidated entity revises its estimate of the number of options that are expected to become exercisable.

The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting.

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

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

2. Segment reporting

Segment information is presented in the condensed consolidated interim financial statements in respect of the consolidated entity's business segments, which are the primary basis of segment reporting.

The consolidated entity's business segments are determined on the basis of its mineral interests and reflect its activities in connection with the exploration, evaluation and development of gold, coal and iron ore mineral properties.

Segment revenue and results include items directly attributable to the segment.

Unallocated revenue and expenses comprise the results of corporate activities.

<i>Business segments</i>	<i>Gold</i>		<i>Coal</i>		<i>Iron Ore</i>		<i>Consolidated</i>	
	<i>Dec 2005</i>	<i>Dec 2004</i>	<i>Dec 2005</i>	<i>Dec 2004</i>	<i>Dec 2005</i>	<i>Dec 2004</i>	<i>Dec 2005</i>	<i>Dec 2004</i>
Segment revenue	-	-	3,323,584	100,000	-	-	3,323,584	100,000
Other unallocated revenue	-	-	-	-	-	-	166,734	132,532
Total revenue	-	-	3,323,584	100,000	-	-	3,490,318	232,532
Segment result	(39,780)	(377,199)	2,723,664	64,329	(140,521)	(86,163)	2,543,363	(399,033)
Unallocated revenues and expenses							(7,179,513)	(711,787)
Profit (loss) from ordinary activities before income tax							(4,636,150)	(1,110,820)

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

	<i>Consolidated</i> <i>31 Dec 2005</i> \$	<i>Consolidated</i> <i>31 Dec 2004</i> \$
3. Revenue from ordinary activities		
Proceeds from grant of exploration rights	3,323,584	-
Proceeds from sale of mineral properties	-	100,000
Interest revenue	160,734	126,532
Other revenue	6,000	6,000
Total revenue from ordinary activities	3,490,318	232,532
4. Other income		
Gain on farm-out of mineral properties	1,254,698	-
Gain on sale of shares	-	2,300
Total other income	1,254,698	2,300

Following satisfaction of third party farm-in expenditure obligations in November 2005 relating to the Isaac Plains and Bowen Central Coal joint ventures, the consolidated entity commenced cash contributions towards the operations of the joint ventures and recognised a net gain on the joint venture farm-out transaction, being the disposal of a 50% interest in the mineral properties held by the joint ventures.

The gain represents the net assets acquired within the joint ventures during the period for which the consolidated entity was not required to contribute funding amounts.

5. Property, plant and equipment

Acquisitions

During the half-year ended 31 December 2005, the consolidated entity acquired property, plant and equipment with a cost of \$6,910,308 including the consolidated entity's interest in joint venture assets amounting to \$6,887,542 (work in progress) which primarily relates to expenditure associated with mine development.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

	<i>Consolidated</i>	<i>Consolidated</i>
	<i>31 Dec 2005</i>	<i>30 June 2005</i>
	<u>\$</u>	<u>\$</u>
6. Contributed equity		
Issued and paid-up capital		
Balance at beginning of period:		
48,894,940 ordinary shares (June 2004: 43,900,003)	12,692,091	12,472,091
Ordinary shares issued during the period:		
- 600,000 ordinary shares by means of the exercise of 550,000 options at \$0.40 per share	-	220,000
- 4,394,937 ordinary shares issued at no cost by means of a bonus issue of 1 share for every 10 shares held (19 November 2004)	-	-
- 605,000 ordinary shares by means of the exercise of 550,000 options at \$0.40 per share	220,000	-
- 18,150,000 ordinary shares by means of the exercise of 15,000,000 options at \$0.25 per share	3,750,000	-
- 3,025,000 ordinary shares by means of the exercise of 2,500,000 options at \$1.00 per share	2,500,000	-
- 4,949,927 ordinary shares issued at no cost by means of a bonus issue of 1 share for every 10 shares held (2 December 2005)	-	-
Transfer from share based payment reserve upon exercise of 2,500,000 options at \$1.00 per share above	<u>188,250</u>	<u>-</u>
Balance at end of period:		
75,624,867 ordinary shares (June 2005: 48,894,940)	<u>19,350,341</u>	<u>12,692,091</u>

Options

As at 31 December 2005, the following options remain outstanding:

- 1,120,000 options exercisable at \$1.00 each on or before 31 December 2007.
- 600,000 options exercisable at \$2.50 each on or before 31 December 2008.
- 2,000,000 options exercisable at \$4.00 each on or before 31 December 2008.
- 5,000,000 options exercisable at \$4.00 each on or before 31 December 2010.

AQUILA RESOURCES LIMITED

and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS

For the half-year ended 31 December 2005

	<i>Consolidated</i> 31 Dec 2005 \$	<i>Consolidated</i> 30 June 2005 \$
7. Accumulated losses		
Accumulated losses at beginning of the period	(7,022,291)	(3,866,114)
Net loss for the period	(4,465,506)	(3,156,177)
Accumulated losses at the end of the period	(11,487,797)	(7,022,291)

8. Reconciliation of movements in capital and reserves

Attributable to equity holders of the parent

Consolidated	<i>Note</i>	Share capital	Available- for-sale asset revaluation reserve	Share based payment reserve	Accumulated losses	Total
		\$	\$	\$	\$	\$
Balance 1 July 2005		12,692,091	-	277,340	(7,022,291)	5,947,140
Total recognised income and expense		-	1,302,690	6,264,757	(4,465,506)	3,101,941
Shares issued	6	6,470,000	-	-	-	6,470,000
Transfer on exercise of share options	6	188,250	-	(188,250)	-	-
Balance 31 December 2005		19,350,341	1,302,690	6,353,847	(11,487,797)	15,519,081

9. Acquisition of controlled entities

Name	Date acquired	Consolidated entity interest	Consideration	Contribution to consolidated net loss
Acquisitions			\$	\$
2005				
Aquila Steel (SA) Pty Ltd	13 Aug 2005	100%	2	(1,817)
Aquila Steel (S Africa) (Proprietary) Limited	12 Oct 2005	100%	816	(3,817)
2004				
Aquila Coal (Africa) Pty Ltd <i>(formerly Aquila Gold Pty Ltd)</i>	14 Jul 2004	100%	2	16,425

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

10. Share based payments

Share options are granted from time to time to certain personnel as part of incentivisation and retention strategies for executives, employees and contractors.

Share options are also issued to organisations as part of normal commercial transactions. Options are granted for no consideration and do not carry voting or dividend entitlements.

The exercise price of the options is determined after taking into account the underlying share price performance during the period leading up to the date of grant and any applicable performance conditions attached to the share options. Subject to vesting conditions, each option is convertible into one ordinary share.

Options issued prior to 7 November 2002 and/or vested before 1 January 2005 are accounted for when exercised via recognition of the proceeds received in share capital.

Options issued from 7 November 2002 and vesting from 1 January 2005 are expensed over the period of expected vesting, taking into account the value of option at the date of grant and its related performance conditions.

Set out below are summaries of share options outstanding during the relevant reporting periods.

Grant date	Expiry date	Exercise price	No. at start of period	No. granted during period	No. exercised during period	No. expired during period	No. at end of period	No. exercisable at end of period
Consolidated and parent entity – 30 June 2005								
28 Jan 04	31 Mar 06	\$1.00	2,500,000	-	-	-	2,500,000	2,500,000
1 Nov 04	31 Dec 07	\$1.00	1,340,000	-	-	220,000	1,120,000	-
1 Jun 05	31 Dec 08	\$2.50	-	150,000	-	-	150,000	-
1 Jun 05	31 Dec 08	\$2.50	-	450,000	-	-	450,000	-
1 Jun 05	31 Dec 08	\$4.00	-	1,000,000	-	-	1,000,000	-
1 Jun 05	31 Dec 08	\$4.00	-	1,000,000	-	-	1,000,000	-
			<u>3,840,000</u>	<u>2,600,000</u>	<u>-</u>	<u>220,000</u>	<u>6,220,000</u>	<u>2,500,000</u>
Consolidated and parent entity – 31 December 2005								
28 Jan 04	31 Mar 06	\$1.00	2,500,000	-	2,500,000	-	-	-
1 Nov 04	31 Dec 07	\$1.00	1,120,000	-	-	-	1,120,000	373,333
1 Jun 05	31 Dec 08	\$2.50	150,000	-	-	-	150,000	-
1 Jun 05	31 Dec 08	\$2.50	450,000	-	-	-	450,000	-
1 Jun 05	31 Dec 08	\$4.00	1,000,000	-	-	-	1,000,000	-
1 Jun 05	31 Dec 08	\$4.00	1,000,000	-	-	-	1,000,000	-
23 Nov 05	31 Dec 10	\$4.00	-	2,500,000	-	-	2,500,000	2,500,000
23 Nov 05	31 Dec 10	\$4.00	-	2,500,000	-	-	2,500,000	-
			<u>6,220,000</u>	<u>5,000,000</u>	<u>2,500,000</u>	<u>-</u>	<u>8,720,000</u>	<u>2,873,333</u>

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

10. Share based payments (cont'd)

Vesting conditions attaching to the share options are as follows:

Grant date	No. of share options	Vesting conditions
28 Jan 04	2,500,000	Share price to be above \$1.50 for five consecutive trading days.
1 Nov 04	1,120,000	One third of options vest on each anniversary.
1 Jun 05	150,000	Identification of an approved development project.
1 Jun 05	450,000	One third of options vest on each anniversary.
1 Jun 05	1,000,000	Identification of an approved development project.
1 Jun 05	1,000,000	Identification of an approved acquisition opportunity, or entitlement to 500,000 share options, one third of which vest on each anniversary.
23 Nov 05	2,500,000	Share price to be at/above \$5.00 for five consecutive trading days and receipt of shareholder approval at the 2005 Annual General Meeting.
23 Nov 05	2,500,000	Share price to be at/above \$5.00 for five consecutive trading days, approval to proceed with a feasibility study on a third project of significant value and receipt of shareholder approval at the 2005 Annual General Meeting.

Fair value of options granted

The assessed fair value at grant date of the options is determined using binomial, or where market performance conditions exist, trinomial, option pricing models which incorporate the following inputs:

	<i>Consolidated</i> 31 Dec 2005	<i>Consolidated</i> 30 June 2005
Term	5 years	3 - 3.6 years
Exercise price	\$4.00	\$1.00 - \$4.00
Underlying share price at the date of grant, being the date of agreement to issue the options, or, where applicable, the date of shareholder approval	\$4.86	\$0.99 - \$2.00
Expected share price volatility over the term of the options	40%	50%
Risk-free rate for the term of the options (based on the Government bond rate)	5.30%	5.10%

In addition, the determination of fair value takes into account the non-tradeable nature of the options and their non-participation in any future dividends.

The assessed fair value of the share options issued during the current reporting period was \$2.44 each and between \$0.22 and \$0.72 for those share options issued for the year ended 30 June 2005.

AQUILA RESOURCES LIMITED

and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS

For the half-year ended 31 December 2005

10. Share based payments (cont'd)

The fair value of the share options issued during the current period, compares to a range of \$0.29 to \$0.57 each contained in the Explanatory Statement provided to shareholders in relation to the approval of the issue of these options at the 2005 Annual General Meeting.

The difference between the assessed fair values is due to the escalation in the underlying share price between the date of Board approval to issue the share options (8 September 2005) and the subsequent shareholder approval at the Annual General Meeting (23 November 2005), with the latter date being the deemed date of grant for the purpose of determining the share based payment expense.

During the six months ended 31 December 2005, the consolidated entity recognised share based payments expenses of \$6,264,757.

11. Related parties

Transactions with key executives

Key executives received management fees and share option based compensation during the period in accordance with arrangements detailed in the 2005 Annual Report and Note 10 above.

The total amount of fees and compensation (including share based payments expenses) referable to key executives during the period was \$6,268,661 (31 Dec 2004: \$117,524).

12. Change in accounting policy

In the current financial year the consolidated entity has adopted AASB 132 *Financial Instruments: Disclosure and Presentation* and AASB 139 *Financial Instruments: Recognition and Measurement*. This change in accounting policy has been adopted in accordance with the transition rules contained in AASB 1 *First time adoption of Australian equivalents to International Financial Reporting Standards*, which does not require the restatement of comparative information for financial instruments within the scope of AASB 132 and AASB 139.

The adoption of AASB 139 has resulted in the consolidated entity recognising available-for-sale investments at fair value. Previously equity investments were recorded at the lower of cost or recoverable amount, with gains and losses recognised in the income statement.

There is no financial impact of this change in policy at 1 July 2005.

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS

As stated in Note 1, these are the consolidated entity's first condensed consolidated interim financial statements for part of the period covered by the first AIFRS annual consolidated financial statements prepared in accordance with Australian Accounting Standards - AIFRSs.

The accounting policies in Note 1 have been applied in preparing the condensed consolidated interim financial statements for the six months ended 31 December 2005, the comparative information for the six months ended 31 December 2004, the financial statements for the year ended 30 June 2005 and the preparation of an opening AIFRS balance sheet at 1 July 2004 (the consolidated entity's date of transition).

In preparing its opening AIFRS balance sheet, comparative information for the six months ended 31 December 2004 and financial statements for the year ended 30 June 2005, the consolidated entity has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting (previous GAAP).

An explanation of how the transition from previous GAAP to AIFRSs has affected the consolidated entity's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS (cont'd)

Reconciliation of equity	Previous GAAP	Effect of transition to AIFRS	AIFRS	Previous GAAP	Effect of transition to AIFRS	AIFRS	Previous GAAP	Effect of transition to AIFRS	AIFRS
	1 July 2004			31 December 2004			30 June 2005		
<i>Note</i>	\$	\$	\$	\$	\$	\$	\$	\$	\$
ASSETS									
Cash and cash equivalents	5,238,993	-	5,238,993	5,057,569	-	5,057,569	4,349,176	-	4,349,176
Trade and other receivables	782,205	-	782,205	511,593	-	511,593	234,584	-	234,584
Other financial assets	1,447,698	-	1,447,698	1,508,640	-	1,508,640	1,441,148	-	1,441,148
Other current assets	-	-	-	33,854	-	33,854	62,118	-	62,118
Total Current Assets	7,468,896	-	7,468,896	7,111,656	-	7,111,656	6,087,026	-	6,087,026
Receivables	41,250	-	41,250	15,000	-	15,000	25,000	-	25,000
Property, plant and equipment	39,512	-	39,512	42,057	-	42,057	37,717	-	37,717
Mineral properties	494,830	-	494,830	494,830	-	494,830	80,000	-	80,000
Other financial assets	969,840	-	969,840	646,560	-	646,560	254,324	-	254,324
Total Non-current Assets	1,545,432	-	1,545,432	1,198,447	-	1,198,447	397,041	-	397,041
TOTAL ASSETS	9,014,328	-	9,014,328	8,310,103	-	8,310,103	6,484,067	-	6,484,067

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS (cont'd)

Reconciliation of equity	Previous GAAP	Effect of transition to AIFRS	AIFRS	Previous GAAP	Effect of transition to AIFRS	AIFRS	Previous GAAP	Effect of transition to AIFRS	AIFRS
	1 July 2004			31 December 2004			30 June 2005		
<i>Note</i>	\$	\$	\$	\$	\$	\$	\$	\$	\$
LIABILITIES									
Trade and other payables	346,678	-	346,678	624,843	-	624,843	512,038	-	512,038
Provisions	25,115	-	25,115	23,605	-	23,605	24,889	-	24,889
Total Current Liabilities	371,793	-	371,793	648,448	-	648,448	536,927	-	536,927
NET ASSETS	8,642,535	-	8,642,535	7,661,655	-	7,661,655	5,947,140	-	5,947,140
EQUITY									
Issued capital	12,472,091	-	12,472,091	12,492,091	-	12,492,091	12,692,091	-	12,692,091
Reserves	<i>13(a)</i> -	36,558	36,558	-	146,498	146,498	-	277,340	277,340
Accumulated (losses)	<i>13(a)</i> (3,829,556)	(36,558)	(3,866,114)	(4,830,436)	(146,498)	(4,976,934)	(6,744,951)	(277,340)	(7,022,291)
Total equity attributable to equity holders of the parent	8,642,535	-	8,642,535	7,661,655	-	7,661,655	5,947,140	-	5,947,140
Minority interest	-	-	-	-	-	-	-	-	-
TOTAL EQUITY	8,642,535	-	8,642,535	7,661,655	-	7,661,655	5,947,140	-	5,947,140

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS (cont'd)

Reconciliation of profit (loss)		Previous GAAP	Effect of transition to AIFRS	AIFRS	Previous GAAP	Effect of transition to AIFRS	AIFRS
		<i>Note</i> For six months ended 31 December 2004			For year ended 30 June 2005		
		\$	\$	\$	\$	\$	\$
Revenue	<i>13(b)</i>	498,532	(266,000)	232,532	635,348	(266,000)	369,348
Other income	<i>13(b)</i>	-	2,300	2,300	-	2,300	2,300
Cost of shares sold	<i>13(b)</i>	(263,700)	263,700	-	(263,700)	263,700	-
Depreciation expense		(9,276)	-	(9,276)	(21,182)	-	(21,182)
Directors' fees		(27,250)	-	(27,250)	(60,333)	-	(60,333)
Diminution in investments		-	-	-	(459,732)	-	(459,732)
Exploration and evaluation expenses	<i>13(c)</i>	(509,018)	-	(509,018)	(895,230)	-	(895,230)
Employee benefits expense		(170,666)	-	(170,666)	(272,511)	-	(272,511)
Management fees		(117,524)	-	(117,524)	(243,719)	-	(243,719)
Share based payment expense	<i>13(a)</i>	-	(109,940)	(109,940)	-	(240,782)	(240,782)
Write-down in value of mineral property		-	-	-	(414,830)	-	(414,830)
Other expenses	<i>(13(c)</i>	(401,978)	-	(401,978)	(919,506)	-	(919,506)
Profit (loss) before income tax		(1,000,880)	(109,940)	(1,110,820)	(2,915,395)	(240,782)	(3,156,177)

AQUILA RESOURCES LIMITED
and its Controlled Entities
NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS (cont'd)

Reconciliation of profit (loss)	Previous GAAP	Effect of transition to AIFRS	AIFRS	Previous GAAP	Effect of transition to AIFRS	AIFRS
	<i>Note</i> For six months ended 31 December 2004			For year ended 30 June 2005		
	\$	\$	\$	\$	\$	\$
Profit (loss) before income tax (cont'd)	(1,000,880)	(109,940)	(1,110,820)	(2,915,395)	(240,782)	(3,156,177)
Income tax (expense) benefit	-	-	-	-	-	-
Profit (loss) for the period	(1,000,880)	(109,940)	(1,110,820)	(2,915,395)	(240,782)	(3,156,177)
Profit (loss) attributable to minority interest	-	-	-	-	-	-
Profit (loss) attributable to members of the parent entity	(1,000,880)	(109,940)	(1,110,820)	(2,915,395)	(240,782)	(3,156,177)

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS (cont'd)

Notes to the reconciliation of equity and reconciliation of profit (loss)

(a) Share based payments

The consolidated entity applied AASB 2 to its active share based payment arrangements at 1 January 2005 except for equity settled share based payment arrangements granted before 7 November 2002. The consolidated entity granted equity settled share based payments in 2004 and 2005.

Under previous GAAP, the consolidated entity did not account for equity settled share based payments.

The effect in the consolidated entity of accounting for equity settled share based payment transactions at fair value is to increase expenses by \$109,940 for the six months ended 31 December 2004 and by \$240,782 for the year ended 30 June 2005, with a corresponding increase in the share based payments reserve. The adoption of AASB 2 is equity neutral for equity settled transactions.

(b) Gain on sale of shares

The consolidated entity has applied AASB 101 *Presentation of Financial Statements*, resulting in a change to the presentation of the gain on sale of shares in the income statement. Under AASB 101, the gain is disclosed as other income (\$2,300) and no separate disclosure is provided of the proceeds received (\$266,000) and the cost of shares sold (\$263,700).

(c) Classification of expenses

In order to improve the presentation of items in the income statement, project evaluation costs (31 Dec 2004: \$64,908; 30 June 2005: \$245,698) have been included in exploration and evaluation expenses and insurance costs (31 Dec 2004: \$17,908; 30 June 2005: \$36,293) and professional and consulting fees (31 Dec 2004: \$264,196; 30 June 2005: \$593,895) have been included within other expenses.

14. Events subsequent to reporting date

On 17 February 2006, the Australian Premium Iron Joint Venture, in which the consolidated entity holds a 50% interest, entered into an agreement with De Beers Australia Exploration Limited ("De Beers") to acquire all rights to iron ore on De Beers' tenements in the West Pilbara region of Western Australia.

AQUILA RESOURCES LIMITED

and its Controlled Entities

DIRECTORS' DECLARATION

For the half-year ended 31 December 2005

In the opinion of the Directors of Aquila Resources Limited:

1. the financial statements and notes set out on pages 11 to 40 are in accordance with the Corporations Act 2001, including:
 - (a) giving a true and fair view of the financial position of the Consolidated Entity as at 31 December 2005 and of its performance, as represented by the results of its operations and cash flows for the half-year ended on that date; and
 - (b) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Act 2001, and
2. there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Dated at Perth this 15th day of March 2006.

Signed in accordance with a resolution of the Directors:



Anthony Poli
Executive Chairman



Independent review report to the members of Aquila Resources Ltd

Scope

The financial report and directors' responsibility

The financial report comprises the condensed consolidated interim income statement, balance sheet, statement of changes in equity, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for the Aquila Resources Ltd Consolidated Entity ("the Consolidated Entity"), for the half-year ended 31 December 2005. The Consolidated Entity comprises Aquila Resources Ltd ("the Company") and the entities it controlled during that half-year.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for preparing the relevant reconciling information regarding adjustments required under the Australian Accounting Standard AASB 1 *First-Time Adoption of Australian equivalents to International Financial Reporting Standards*

Review approach

We conducted an independent review in order for the Company to lodge the financial report with the Australian Securities and Investments Commission. Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements.

We performed procedures in order to state whether on the basis of the procedures described anything has come to our attention that would indicate the financial report does not present fairly, in accordance with the Corporations Act 2001, Australian Accounting Standard AASB 134 *Interim Financial Reporting* and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Consolidated Entity's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our statement on the basis of the review procedures performed, which were limited primarily to:

- enquiries of company personnel; and
- analytical procedures applied to the financial data.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

The procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

A review cannot guarantee that all material misstatements have been detected.



Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe the half-year financial report of Aquila Resources Ltd is not in accordance with:

- a) the Corporations Act 2001, including:
 - i. giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2005 and of its performance for the half-year ended on that date; and
 - ii. complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
- b) other mandatory financial reporting requirements in Australia.

KPMG

Denise P McComish
Partner

Perth
15 March 2006